

2. THE ACTIVITY OF THE BANK OF ALBANIA

2.1. MONETARY POLICY

According to the Law "On the Bank of Albania", the main objective of the Bank of Albania is to achieve and maintain price stability. In quantitative terms, price stability is defined as maintaining an annual inflation rate, measured by the annual change in the Consumer Price Index, around 3% in the medium term.

The Bank of Albania aims to fulfil this objective through the implementation of an inflation targeting regime and a floating exchange rate regime.

The monetary policy framework, the principles for drafting and the instruments for its implementation are defined and explained in the Monetary Policy Document. In accordance with the principles set out in this Document, the Bank of Albania implements a consistent, balanced, prudent, transparent and forward-looking monetary policy.

For several years now, the Bank of Albania continues to implement an accommodative monetary policy amid undershooting inflation values and in the presence of aggregate demand levels that is still insufficient to ensure full use of productive capacities both in the labour and capital market. The monetary stimulus is transmitted through low policy rates, liquidity supply of the banking sector, and forward guidance on the monetary policy stance. This stimulus has aimed and managed to create favourable financing conditions, to reduce the uncertainty of financial market agents and fluctuations of this market indicators, and to promote expansion of consumption and investment. Through these channels, the monetary policy has helped strengthen the country's economic growth and has created the necessary premises for the return of inflation to target.

2.1.1 MONETARY POLICY THROUGHOUT 2018

The Albanian economy performed positively throughout 2018. Aggregate demand expanded, enabling further growth of output, employment and wages as well enabling to improve the country's main economic and financial balances. In parallel with these developments, domestic inflationary pressures increased, but their effect on inflation increase was offset by exchange rate appreciation.



This dynamics reflected the maintenance and the strengthening of the stimulus of the monetary policy during 2018.

According to INSTAT data, in the first nine months of 2018, the economy grew 4.3%, following the accelerating trend noticed over the previous three years.¹ Economic growth had a broad base; it reflected positive contributions from the expansion of household consumption, business investments, and expansion of exports. Coupled with the above demand-side factors, the rapid expansion of electricity production contributed significantly to growth.

The expansion of aggregate demand contributed to increase in employment and further decline in the unemployment rate. According to the available information, the number of employees recorded 3.5% annual growth during the first nine months of the year, while the unemployment rate fell to 12.2%. Also, survey data suggest that enterprises increased the capacity utilization rate. This trend shows that the Albanian economy is gradually moving towards its potential.

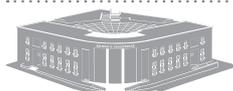
Economic growth contributed to the overall improvement of Albania's economic and financial balances. In particular,

- The country's external position improved, reflected both in the narrowing of the current account deficit and in the improvement of foreign debt sustainability indicators. The current account deficit decreased at an average of 5.2% of GDP during the first nine months of the year, against the 7.5% registered the previous year.
- Budget deficits and public debt continued to show a downward trend, reflecting both the consolidating trend of fiscal policy and the economic growth and the strengthening of the exchange rate.
- The main soundness indicators of the banking sector - in particular liquidity, profitability and capitalization - remained at adequate levels. In particular, significant improvement was noted in the non-performing loans ratio, which decreased to 11.1% at the end of the year.

The improving trend of economic activity was also reflected in the performance of inflation, but its rise towards the target was offset by the exchange rate appreciation. Increase of wages and production costs led to an increase in the inflation of domestic consumer basket items. On the other hand, the appreciation of the lek's exchange rate against the euro led to the reduction of imported inflation. Consequently, annual inflation averaged 2.0%, unchanged from 2017.

The lek exchange rate appreciated rapidly during 2018, following a gradual appreciation trend that had started in 2015. This trend reflects the improvement of the external position of the economy, the reduction of risk premiums in financial

¹ The available indirect data suggests that the fourth quarter will not lead to significant shifts in the annual growth dynamics.



markets, and the increased preference of agents to keep and invest their savings financial instruments denominated in the national currency. Although these trends were present in 2018 as well, the appreciation of the exchange rate during this period was also driven by specific foreign exchange market factors such as the temporary imbalance of supply and demand for foreign currency in the second quarter and the creation of expectations for further appreciation of the rate.² These factors triggered a rapid appreciation of the exchange rate in the second quarter and were accompanied by a disruption of the functioning of the domestic foreign exchange market. The results of our analysis suggest that the exchange rate in 2018 appreciated beyond its medium and long-term trend.

The Supervisory Council of the Bank of Albania deemed that the rapid appreciation of the exchange rate jeopardized the fulfilment of the inflation target in the medium term. Consequently, in its meeting on 6 June 2018,³ it decided on:

- lowering the policy rate from 1.25% to 1.00%. In parallel, interest rates on deposit and overnight loans were reduced, from 0.25% and 2.25%, to 0.1% and 1.9% respectively. The reduction of the policy rate aimed at further reducing the financing costs in lek and mitigating the appreciation pressures on the exchange rate;
- launching a foreign currency purchase program in the domestic market, with the aim of curbing the exchange rate appreciation and creating the premises for a normal trading activity in the domestic foreign exchange market. The use of the exchange rate as a temporary and extraordinary instrument of monetary policy was necessary, as the room for further reduction of the policy rate was limited.

The intervention of the Bank of Albania curbed the exchange rate appreciation and helped for the return of trading to normality in the foreign exchange market. At the end of the tourist season, the foreign currency demand and supply appeared as balanced, even in the absence of Bank of Albania interventions. Also, the exchange rate risk to meeting the inflation target dropped.

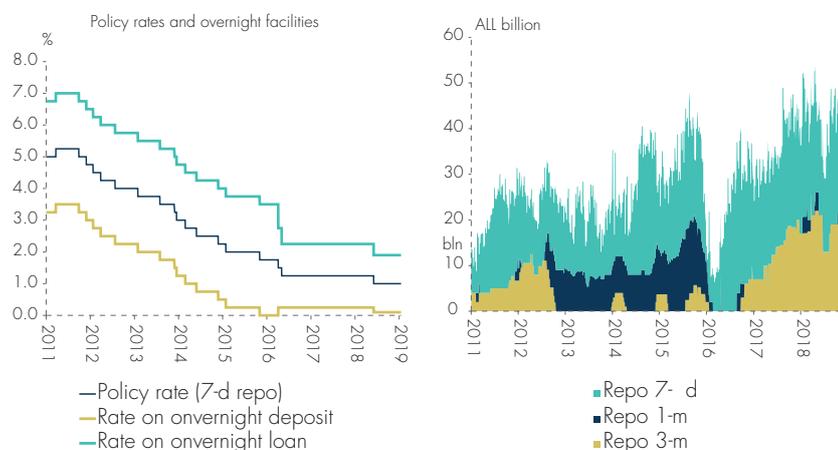
In line with these developments, the Bank of Albania kept the strength and intensity of the monetary stimulus unchanged during the second half of the year. The policy rate remained unchanged at 1.0%, while the financial market was supplied with the necessary liquidity and focused on forward guidance.

² For more information, see Information Box 1 “Lek appreciation in 2018: a synthesis of factors, implications and reaction of the Bank of Albania”.

³ During 2018, there were 8 meetings on monetary policy decisions; In 7 of them, the policy rate and overnight loan interest rates were kept unchanged.



Chart 1 Key interest rates in lek and liquidity injections



Source: Bank of Albania.

BOX 1: LEK APPRECIATION IN 2018: FACTORS, IMPLICATIONS AND BANK OF ALBANIA'S REACTION

The lek's exchange rate against the euro followed a gradual appreciation trend until the end of 2017. This trend accelerated significantly in 2018 and the appreciation rate reached 4.9% from 2% a year compared to the previous years.

The appreciation of the exchange rate in 2018 was largely analysed by the Bank of Albania. In accordance with the free exchange rate regime applied in Albania, its level is neither an explicit nor an implicit objective of the Bank of Albania. However, significant and prolonged deviations of the exchange rate from levels dictated by fundamental factors have implications for the performance of the economy and inflation and, consequently, for the monetary policy stance. Based on these considerations, our analyses have continuously aimed at determining the factors of this appreciation and assessing its impact on the economy, in order to inform the Bank of Albania's response.

Box 1 briefly summarizes the conclusions of our analysis, which are communicated on a continuous basis in the periodic reports of the monetary policy.

(i) Factors explaining exchange rate appreciation

The determinants of the exchange rate performance are studied through empirical models and studies, which are consistent with economic theory and best practices.¹ These studies enable the identification of the medium and long-term exchange rate trends and the impact of the various shocks that affect it.

Based on these results, the medium and long-term exchange rate appreciation trend is explained by the improvement of the external position of the Albanian economy and the increase of the interest to invest in financial instruments in lek². These tendencies are described in greater detail below.

- The current account deficit narrowed from 8.6% of GDP in 2015 to 5.2% of GDP for the first nine months of 2018. This development was, to a large extent, a result of export growth.
- FDI inflows have increased, standing at 8.0% of GDP. The balance of



payments resulted in surplus, implying that foreign currency inflows in the country were higher than outflows.

- Interest rates on lek financial instruments, albeit low, provide positive yields, when the interest rates on deposits in euro are close to zero.

Likewise, studies show that the appreciation of the lek against the euro in 2018 went beyond the improvement rate of fundamental factors¹¹. It reflected specific developments in the domestic foreign exchange market. Such as:

- Conversion of the capital of some banks in our system, reflecting of their internal policies;
- Information circulating in the market regarding EBRD loan access for the Albanian Power Cooperation (KESH); and
- Creating one-sided expectations for further appreciation of the exchange rate, which was associated with the change in the behaviour of economic agents and increase of the foreign currency supply in the market.

These factors led to increase in the foreign currency supply and dissipated the foreign exchange market in April and May. The fast acceleration of the exchange rate pushed it out of the levels suggested by the fundamental factors. The timely extension of this phenomenon was estimated to produce negative effects on inflation over the medium term.

(ii) **Response of the Bank of Albania**

The finding that rapid exchange rate appreciation jeopardized the fulfilment of the inflation target led to the reaction of the monetary policy. This reaction consisted of:

- lowering the policy rate in June to 1.00%, from 1.25%;
- launching a temporary programme for foreign currency purchases. This program was intended to monitor the pace of exchange rate appreciation and avoiding risks affecting the fulfilment of the inflation target. Bank of Albania's decision to intervene in the foreign exchange market became necessary in the conditions when there was limited room for lowering the interest rate.

The intervention of the Bank of Albania was more intensive in the summer period, which corresponds to high currency inflows as a result of the tourist season. Moreover, the Bank of Albania was not present in the foreign exchange market in the framework of this program.

(iii) **Impact of the exchange rate appreciation on the Albanian economy**

To evaluate the exchange rate effect on the Albanian economy, structural models were used, which break down its impact according to the following channels:

- **Competition**, which captures the negative impact on the performance of exports and economic growth from the appreciation beyond the fundamentals of the exchange rate. Given the high importing intensity of the Albanian economy, this impact was somewhat mitigated by the increase in the purchasing power of importers and consumers;
- **Financial balance** sheets of financial agents, which captures the positive impact from exchange rate appreciation on balance sheets of foreign currency borrowers' through lower euro loan instalments. This is an important channel in a high euroization-level economy.
- **Interest rate**, which captures the positive impact from the exchange rate appreciation on the reduction of risk premiums for foreign currency loans, reducing financing costs for the economy;

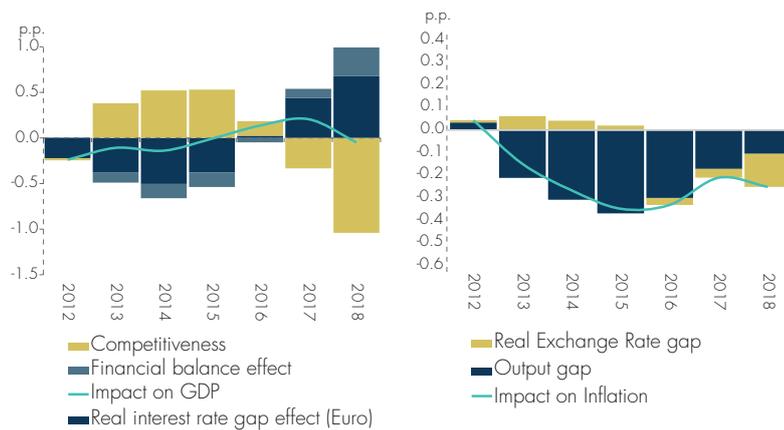


- **Price**, which captures the impact of the exchange rate on inflation. This channel is twofold: the course affects prices directly, through the basket of imported goods, and, indirectly, through aggregate demand (the above channels).

Estimations on the exchange rate effect are shown in the charts below.^{iv} The effect of the exchange rate appreciation beyond the fundamentals on economic growth is marginally negative. This impact reflects the reduction in the competitiveness of Albanian exports; however, it was partially offset by the increase of the purchasing power of creditors in euro and, in part, by the reduction of credit risk premiums in euro.

The exchange rate appreciation reduced inflation by an average of 0.2 percentage point in 2018. This effect increased over the quarters and, in the last quarter, it is estimated at 0.3 percentage point. In line with the time-lag in the transmission of exchange rate fluctuations of prices, this impact is expected to be present even during 2019 H1 and come to a standstill in the following quarters.

Chart 2. Impact of real exchange rate appreciation on economic growth (left) and on inflation (in p.p.)



Source: Bank of Albania.

The estimations of these effects reflect, *inter alia*, the measures taken by the Bank of Albania. The results so far show that Bank of Albania's interventions in the foreign exchange market have met the objectives of this programme^v. The exchange rate appreciation reduced and foreign exchange market activity returned to normal parameters. Also, our forecasts and communications confirm that inflation will return to target in 2020.

ⁱ The results of some of the Bank of Albania studies were published and discussed as materials dedicated to the exchange rate, or as part of the materials that treat the exchange rate as an integral element of modelling.

ⁱⁱ A more detailed analysis is found in the information box "Exchange Rate Appreciation: Determining factors and implications", part of the Bank of Albania's Annual Report for 2017.

ⁱⁱⁱ A more detailed analysis is found in the information box "On the exchange rate performance during 2018 H1", part of the Quarterly Monetary Policy Report 2018 / III.

^{iv} A more detailed analysis is found in the box "Exchange Rate and its impact in the economy", part of the Quarterly Monetary Policy Report 2019 / I.

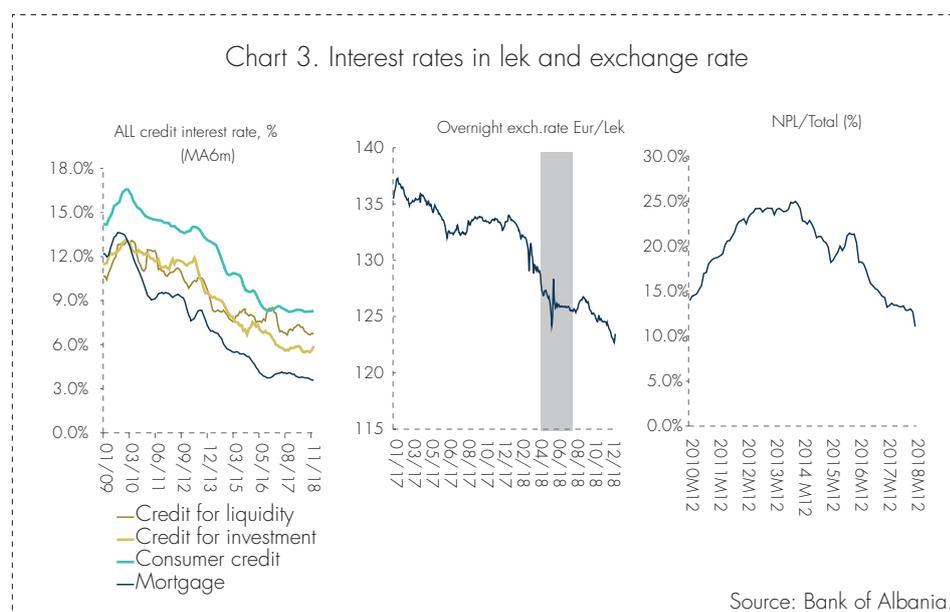
^v A more detailed analysis of the progress of the intervention programme is available in the box: "Effects of interventions in the foreign exchange market", in the Quarterly Monetary Policy Report 2018 IV.



Similar to the previous years, the monetary policy of the Bank of Albania contributed to the positive performance of the economy, its approach to the potential and the build-up of inflationary pressures in the economy. The transmission of the monetary stimulus is noted in several aspects.

First, the accommodative monetary policy generated favourable financing conditions for Albanian households and enterprises. Interest rates continued to stay close to the historical minimum, across all financial instruments in lek. The financial markets are characterized by satisfactory levels of liquidity and low risk premiums. The average liquidity injection by the Bank of Albania was about ALL 39 billion, up from ALL 34 billion injected a year earlier. The forward guidance on the monetary policy stance helped flatten the interest rate curve and it extended its effect over a longer period of time. Also, the implementation of the programme of measures for the reduction of non-performing loans helped to reduce credit risk.

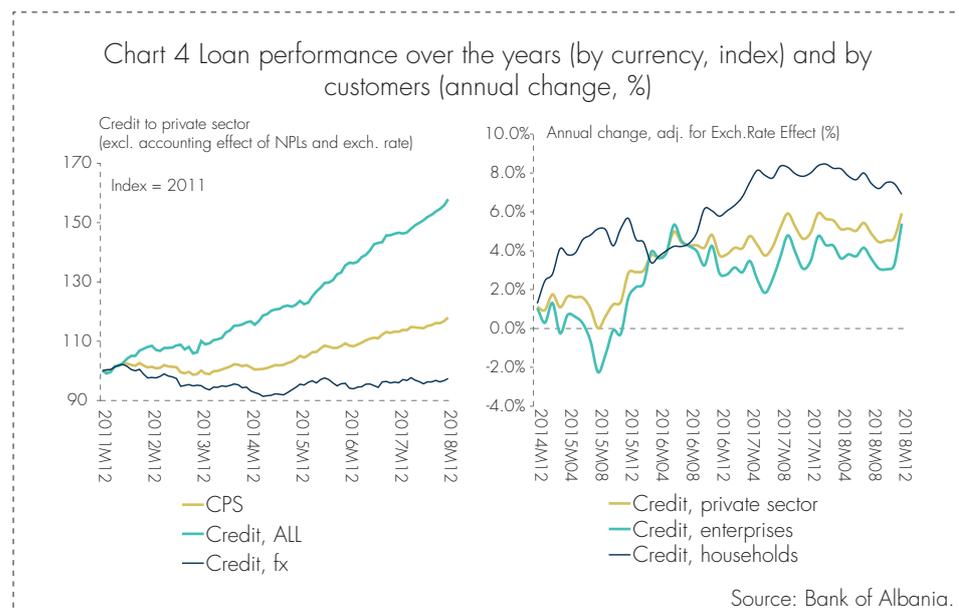
Together, these instruments have dictated the reduction of interest rates on loans, yields of 12-month treasury bills and on deposits in lek, respectively by 1.5, 1.2 and 0.5 percentage points from 2015.



Second, the accommodative monetary policy led to increased financing in lek and lowered the cost of existing debt servicing. Continuous improvements of financing conditions were reflected not only in the fall of interest rates but also in the increase of the volume of credit to the private sector. Thus, credit in lek increased on average by 6.7% in 2018, while the share of this portfolio against total loans grew 47.2%, or 2.5 percentage points higher than in the previous year.

Reducing interest rates lowers the cost of financing with bank loans and the cost of servicing existing loans, thus creating a financial saving that helps increase consumption and investment.



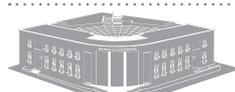


Third, the accommodative monetary policy supported the strengthening of Albania’s financial stability. Low interest rates and favourable financing conditions have helped improve borrowers’ financial position, by lowering debt servicing costs and encouraging restructuring of existing loans. The orientation of lending in the domestic currency increased its share in total lending and reduced the exposure of the financial system to the risks of exchange rate fluctuations.

The monetary policy measures undertaken by the Bank of Albania contributed to the growth of household consumption and business investment, thus supporting economic growth. Our assessments suggest that accommodative monetary policy has contributed positively, on average by 0.5 percentage point, to the economic growth of the last two years.

While boosting aggregate demand, the accommodative monetary policy has contributed to the increase of employment and better utilization of production capacities. In parallel, economic agents’ expectations for inflation have been rising compared to the previous year. In response, wages and core inflation have shown a slight upward trend, creating premises for the return of inflation to target in the medium term.

The Bank of Albania will continue to implement a prudent monetary policy in the future in line with its price stability objective and with a view to supporting the overall economic and financial stability of the country. In parallel, the Bank of Albania deems that the country must continue to continue forward with the structural reforms agenda. These reforms should aim to accelerate the pace of economic growth over the long term, and to increase sustainability and distribute its benefits in wider social groups.



BOX 2: MONETARY POLICY DECISION-MAKING PROCESS

In 2018, the Supervisory Council reviewed and re-evaluated the appropriateness of the monetary policy stance in eight cases. Within these discussions, it approved eight monetary policy reports (four quarterly and four interim reports), as well as one set of periodic analyses.

Monetary policy decisions are based on a contemporary analysis and forecasting framework, which enables the formulation of the monetary policy in view of achieving the inflation target. This framework is filled with all available information, and is based on tested econometric models and on the best practices of central banking.

In 2018, we continued our work:

- **To improve and update the forecasting models and monetary policy analyses, apply contemporary modelling techniques, and update the staff with the latest information.** This work was supported by the technical assistance in the framework of the cooperation agreements with the IMF, the Swiss State Secretariat for Economic Affairs (SECO), and the Geneva Institute.
- **Regarding scientific research and ongoing research of the monetary policy transmission mechanism and its effectiveness.** A particular focus in research in 2018 was drawn by the appreciation of the exchange rate. The objective of our studies was to find the reasons behind the appreciation of the exchange rate, assessing its expected impact, as well as to identify the Bank of Albania's response in accordance with our legal mandate. In parallel, structural factors and cycles of inflation performance were studied, as well as its formation according to the domestic and foreign component. The Bank of Albania continued to monitor developments in the banking system, to assess the strength of the monetary policy transmission mechanism and to identify the effects of monetary policy measures on these indicators.
- **On intensive monetary policy communication to increase its understanding, predictability and effectiveness.** The Bank of Albania continued to use monetary policy forward guidance as a monetary policy instrument. It aims to reduce uncertainty in the market by informing the public on the period when the target is foreseen to be achieved and the future path of the monetary policy. Also, in 2018, the monetary policy communication intensified to explain the Bank of Albania's position on exchange rate developments. For this purpose, monetary policy statements interviews, and articles in the media were used. For informing the general public, periodic reports include specific boxes.
- **Active co-operation with domestic and foreign partners, aiming at increasing the synergies of economic policies in Albania and supporting the European integration process.** The current policy mix, characterized by monetary stimulus and fiscal consolidation, continues to remain a convenient combination. This combination addresses the need for boosting aggregate demand and reduces the vulnerabilities of public finances. The Bank of Albania has continued the dialogue with the International Monetary Fund in the framework of Article IV Consultations and with European partners in terms of: (i) recognition and implementation of relevant directives in the field of monetary policy and financial markets; and (ii) periodic reporting in the integration process.



For the upcoming year, job priorities aim to increase the effectiveness, flexibility and transparency of monetary policy, helping to adapt it to a dynamic and complex financial and economic environment.

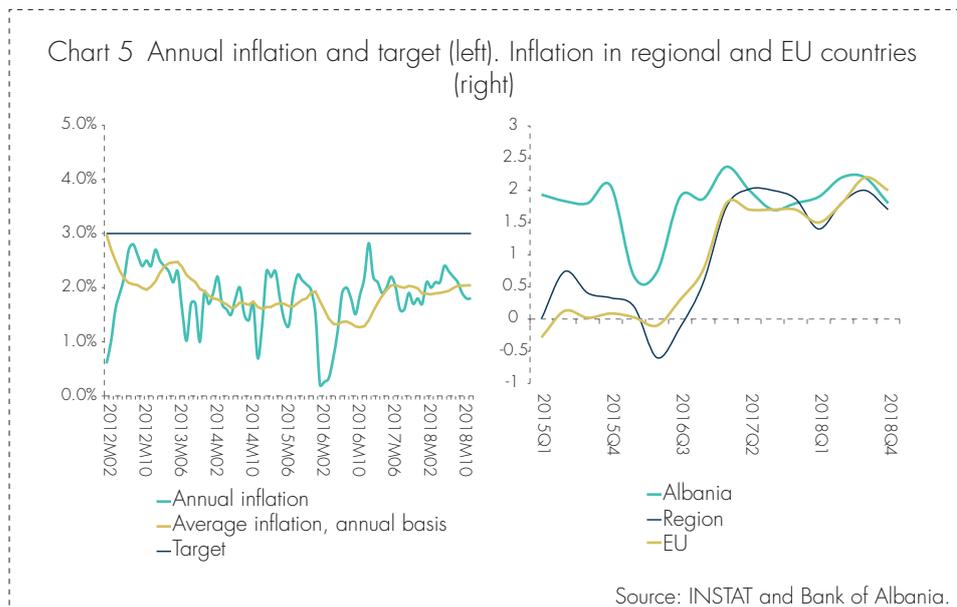
* For more information see:
 Box 1: "Supporting processes of monetary policy decision-making at the Bank of Albania", Annual Report 2015;
 Box 2: "Monetary policy drafting, implementation and communication process", Annual Report 2016.

2.1.2 INFLATION AND ITS DETERMINANTS

Domestic inflationary pressures increased over 2018. The improvement of the cyclical position, expressed in the increase of aggregate demand and in the better utilization of production capacities, has enabled the increase of wages and production costs. On the other hand, the appreciation of the exchange rate led to lower imported inflation, offsetting the improvement of the cyclical position of the economy.

Annual inflation averaged 2.0% in 2018, remaining almost at the same level as in the previous year. By quarter, inflation averaged 1.9% in the first quarter; rose to 2.2% in the second and third quarters; and decreased to 1.8% in the last quarter.

From the macroeconomic point of view, inflation reflected the opposite impact of the two factors: improvement of the cyclical position of the Albanian economy and the rapid appreciation of the exchange rate. The first factor, improvement of the country's cyclical position - in other words, higher utilization of production capacities - is accompanied by increased employment and wages, which led to increased production costs and increased domestic prices. On the other



hand, the appreciation of the exchange rate during 2018 curbed the price rise of imported items, offsetting the effect of the domestic factor. Other effects are generated by transitional factors, including oil price fluctuations and food inflation.

Food items remain the main contributors to the formation of headline inflation

Consumer prices reflected, in 2018, to a large extent, the impact of "Unprocessed Foods". Inflation of this category declined compared to the previous year, mainly as a result of domestic supply growth, but it continued to be the main inflation generator. The prices of "Processed foods" declined during the year, showing a completely different performance compared to the previous year. Prices in this category were driven by the appreciation of the lek and the fall in prices in international markets, especially grain prices.

Other categories increased their contributions to headline inflation

The "Housing-Rent", "Regulated prices" and "Non-Food goods" accounted for 40% of headline inflation, compared to 20% in the previous year. The rental price maintained an upward trend in 2018. Such trend had begun at the end of 2017. The maximum of the "Housing-Rent" contribution was reached in October, with 0.5 percentage point. The category of "Regulated prices" contributed positively to headline inflation (0.2 percentage point), due to the increase of water price. Oil prices fluctuated significantly over the course of the year, trending downward at the end of the year, in comparison with the upward trend during the summer. This performance reflected the fall in oil prices in foreign markets.

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

	Q1-17	Q2-17	Q3-17	Q4-17	Q1-18	Q2-18	Q3-18	Q4-18
Processed food	0.6	0.5	0.2	0.0	0.1	0.2	0.2	0.1
Bread and grains	0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
Alcohol and tobacco	0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Unprocessed foods	1.3	1.1	1.2	1.3	0.9	1.1	1.0	0.9
Fruits	0.3	0.3	0.5	0.6	0.6	0.1	0.0	-0.1
Vegetables	0.9	0.7	0.7	0.6	0.2	0.9	0.9	0.9
Services	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Goods with regulated prices	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.2
Water supply	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.2
Housing rent	0.0	0.1	0.1	0.2	0.3	0.4	0.4	0.3
Non-food consumer goods	0.3	0.2	0.2	0.2	0.3	0.3	0.3	0.2
Oil	0.0	0.0	0.0	0.0	0.1	0.1	0.2	0.2
Long-term consumer goods	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Annual inflation	2.4	2.0	1.7	1.8	1.9	2.2	2.2	1.8

Source: INSTAT and Bank of Albania.

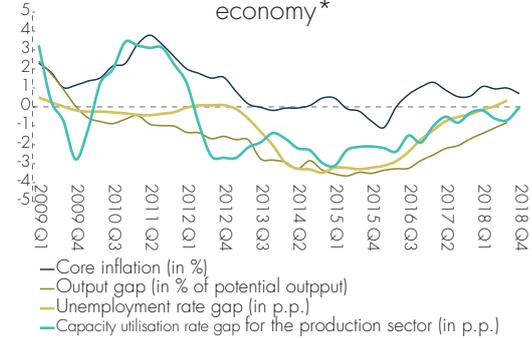
*The table shows some of the main groups of items.

The improvement of the cyclical position of the economy is reflected in the increase of domestic inflationary pressures.

The expansion of aggregate demand in 2018 is reflected in the improvements of the country's cyclical position, observed in the narrowing of the negative



Chart 6 Indicators of the cyclical situation of the economy*



*The output gap is the average of several measurements. The capacity utilisation rate gap is assessed as a deviation of the current value from the relevant historical average, for each of the Business Confidence Survey sectors. After, the gaps of the sectors are weighted as in the economic sentiment indicator, also the method of the four terms moving average is applied. The chart shows the resulted gap for the production sector. Services sectors are excluded due to the presence of many short-term fluctuations. The unemployment rate gap is assessed as an average of unemployment gaps according to three methods, which assess the equilibrium or structural level of unemployment (NAIRU or NAWRU). The unemployment rate gap is stated as the difference of equilibrium unemployment rate to actual unemployment rate and then the method of the four terms moving average is applied.
Source: INSTAT and estimations of the Bank of Albania.

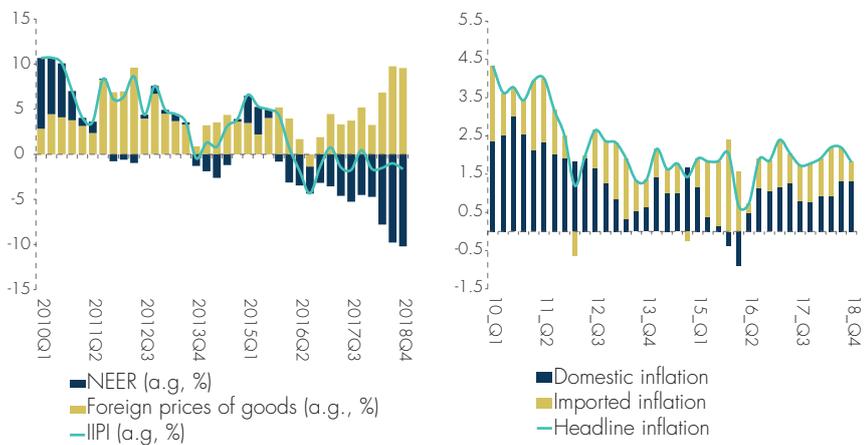
output gap. The labour market was characterized by rising employment and the continued decline in the unemployment rate, which was further reflected in wage growth in the economy. Also, the capacity utilization rate followed a slow upward trend, though it remains below its historical average.

Domestic inflationary pressures increased in 2018. Core inflation and non-tradable net inflation were 0.9% and 1.4%, in annual terms, respectively. Consequently, the contribution of domestic inflation increased by 0.9 percentage point in the first half of the year, and 1.3 percentage point in the second.

Exchange rate appreciation reduced imported inflation

The appreciation of the exchange rate in 2018 prevented the full improvement transmission of the country's cyclical position in inflation. Appreciation by 8.1% of the nominal effective exchange rate (NEER) led to the reduction of foreign inflationary pressures, although "Foreign prices" index increased 7.4% during the year.

Chart 7 IIP1 and its components' contributions (left). Contribution of imported and domestic inflation (right)



Source: INSTAT and Bank of Albania's calculations.

As a result, the Imported Inflationary Pressures Index IIP1⁴ fell by 0.7% in annual average terms. This performance materialized in the reduction of the contribution of imported inflation, from 1.1 percentage points in the first half of the year to 0.7 percentage point in the second.

⁴ IIP1 is calculated as the annual increase in Import Price Index and NEER index for the respective month.



2.1.3 ECONOMIC ACTIVITY

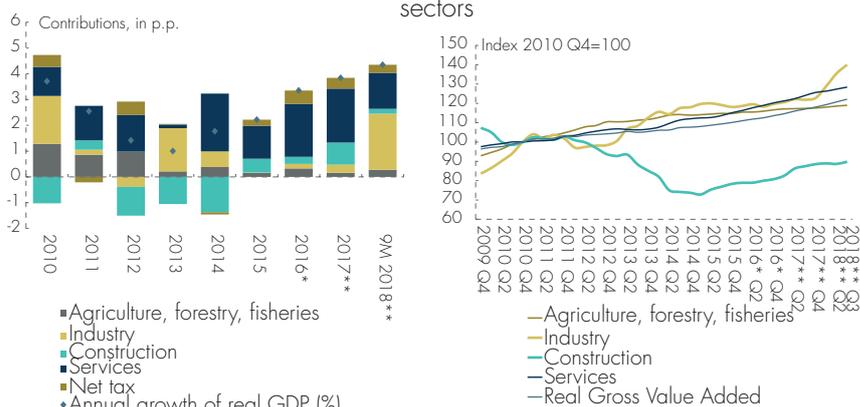
The Albanian economy increased in 2018, reflecting the expansion of consumption, private investments, and exports. Economic growth materialized in the rapid growth of the industry and services sector, while other sectors of the economy marked a slower expansion.

Domestic demand growth created grounds for higher employment and lower unemployment rates, suggesting that the Albanian economy is gradually moving towards its potential. Also, economic growth was associated with the reduction of the current account deficit and helped reduce public debt.

According to INSTAT data, economic growth in the first nine months of the year was 4.3%, accelerating compared to growth rates recorded in the previous year.⁵ These data suggest that growth continued in the fourth quarter as well.

The expansion of GDP reflected mainly the positive performance of the manufacturing sector, which contributed upward by 2.6 percentage points. Developments in the manufacturing sector reflected the increased activity in industry, translated into a contribution of about 2.2 percentage points to annual GDP growth. Activity in industry was mainly driven by increased electricity production. Meanwhile, the agricultural sector contributed by about 0.3 percentage point to economic growth, while contribution from the construction sector fell to 0.2 percentage point.⁶

Chart 8 Annual growth of the real GDP (in %) and contribution of production-side components (in p.p.). Trend of real GVA in the economy and sectors



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.

Source: INSTAT and Bank of Albania.

⁵ Up to 28 December 2018, the data published by INSTAT on the gross domestic production by production and expenditures method cover developments until 2018 Q3. According to the INSTAT publication calendar, data on gross domestic product in the fourth quarter of 2018 will be published on 29 March 2019.

⁶ This dynamic was also influenced to some extent by the comparison with a higher base a year ago, when the construction sector also recorded the highest annual growth by about 9.6% for the period 2010-2017.

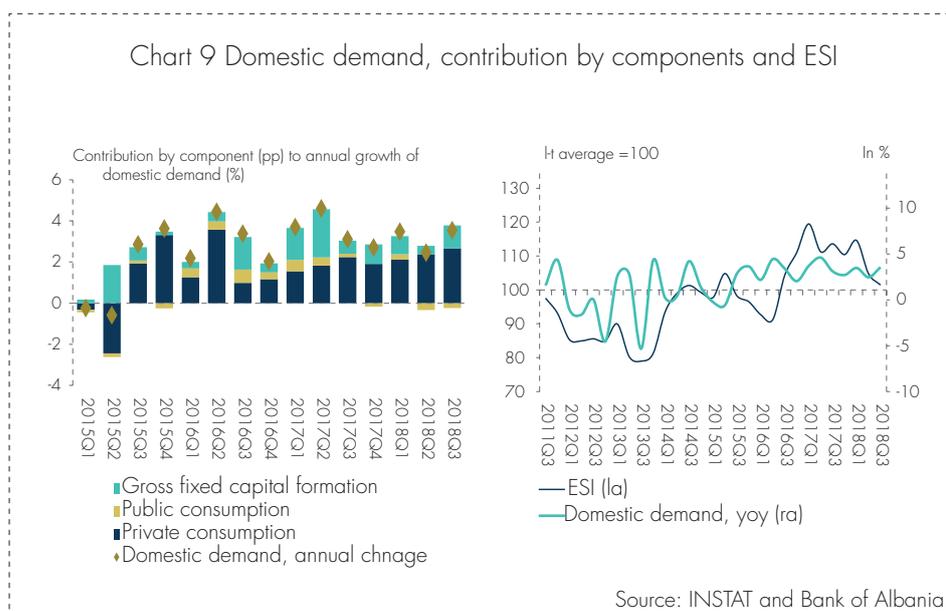


Services sector⁷ contributed positively by 1.4 percentage points to economic growth. Mainly driven by growth of tourism, the “Trade, Transport, Accommodation and Food Service” branch had the highest contribution, by about 0.8 percentage point, to annual GDP growth.

Also, “Professional Activities and Administrative Services” added 0.4 percentage point to its impact on economic growth, while contributions from other service activities are low.

Domestic demand has been the main contributor to economic growth during the first three quarters of 2018, supported by increased consumption and private investments

Domestic demand increased by 3.1% during the first nine months of 2018.⁸ The main contribution came from the consumption of the population, but the positive contribution came also from the growth of private investments. Meanwhile, public expenditures have been declining during the year, in terms of both current and capital spending.



Private consumption was the main contributor to growth in 2018

Gross Domestic Product grew by 3.4% during the first nine months of 2018. This constitutes the highest growth rate since 2008. Growth in consumption was supported by increase of employment and wages, accommodative

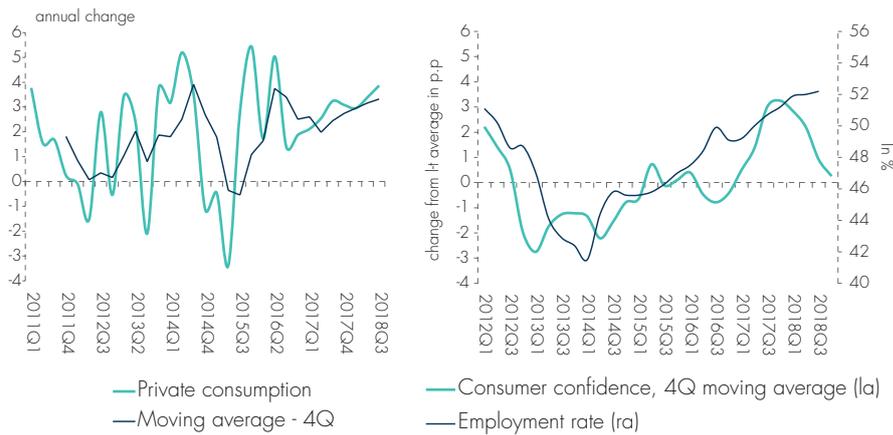
⁷ The main branches of services are: “Trade and transportation, accommodation and food service”, “Information and communication”, “Financial and insurance activities”, “Real estate activities”, “Professional activities and administrative services”, “Public administration, education and health” “Arts, Entertainment and Recreation and other service activities”.

⁸ Domestic demand consists of final consumption 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.



monetary policy, and eased lending conditions. Indirect indicators suggest that, in 2018, private consumption increased mainly in the categories of non-durable consumer goods and less in the category of durable consumer goods and services.⁹

Chart 10 Private consumption (left) and consumer confidence and employment rate (right)



Source: INSTAT and Bank of Albania.

Investment growth continued in 2018, although it showed lower growth rates

Investments increased by 4.2% over the first nine months of 2018, compared to a 6.5% in 2017. According to our estimates, the expansion of private sector investments provided the main contribution to the increase, while the public investment provided significantly lower contribution. Indirect data show that private investments expanded into two main categories: investment in construction and investment in new machinery and equipment.¹⁰ Investment

Chart 11 Investments (left) and capacity utilisation rate (right)



Source: INSTAT and Bank of Albania.

⁹ Based on the disaggregated index of retail trade and GDP by production.

¹⁰ Based on import indicators by items, as well as on GDP measurement by production



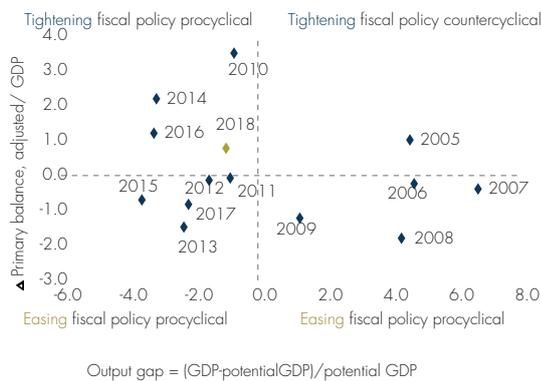
growth reflected the increase in the capacity utilization rate and was supported by favourable financing conditions.

Fiscal policy was consolidating during 2018.

Fiscal policy showed a consolidating trend during 2018, though the budget plan foresaw an almost neutral approach during the year. Thus, the primary surplus was about 0.6 percentage point of GDP higher than in the previous year. Although pro-cyclical, fiscal consolidation is reflected in the reduction of public debt and expanded fiscal space to cope with potential future shocks.

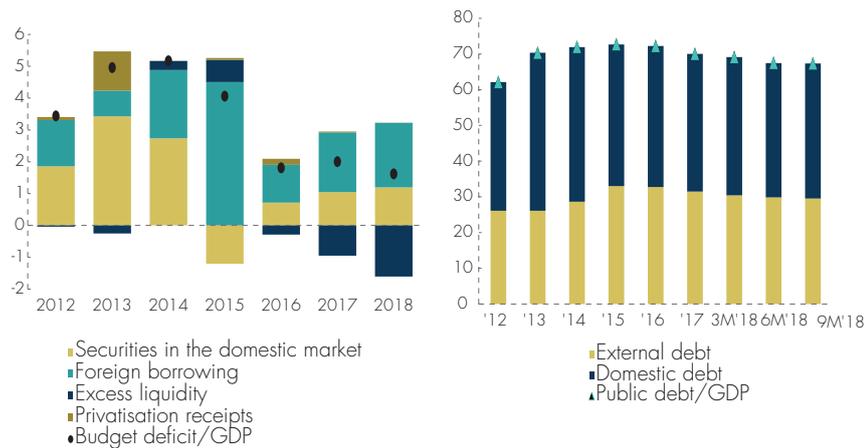
For 2018, **budget deficit** amounted to about ALL 26.5 billion, accounting for about 1.6% of GDP. Similar to the previous three years, deficit was dominantly financed by foreign sources. The main instrument of foreign financing during 2018 was the issuance of the 7-year Eurobond for EUR 500 million. This instrument, in line with the revised government borrowing schedule for 2018, was partially used to reduce the existing foreign debt (about EUR 200 million) and domestic debt (about ALL10 billion)¹¹. The increased borrowing in the domestic market consisted only in long-term debt instruments, which also offset the decrease of short-term issues.

Chart 12 Nature of fiscal policy*



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

Chart 13 Budget deficit and financing (left) and public debt (right) to GDP



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

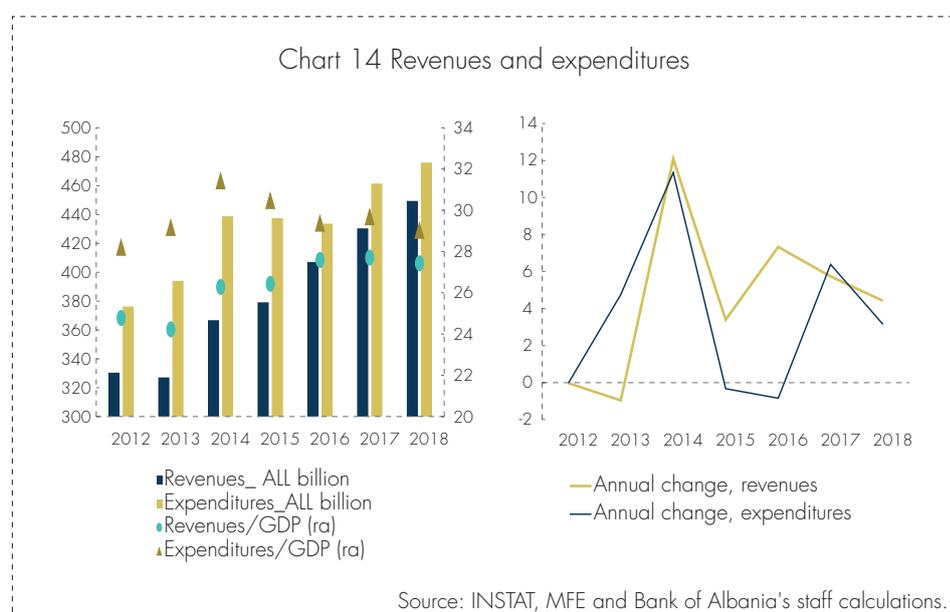
¹¹ At the beginning of the year, the government had planned to increase domestic borrowing by about ALL 30 billion throughout the year, while foreign borrowing would be reduced by ALL 9 billion. However, given the favourable conditions in the international markets, through a normative act, the foreign borrowing plan was revised to ALL 32.6 billion through the issuance of the 7-year Eurobond, and the domestic borrowing plan was reduced to ALL 20 billion.



According to data by the Ministry of Finance and Economy, the public stock is assessed to have decreased at 67.1% of GDP in 2018, from 70.1% in 2017.¹² The decline in debt is attributed to the consolidating nature of fiscal policy, appreciation of domestic currency, and the continuation of economic growth.

Budget expenditures in 2018 resulted around ALL 475.9 billion, or around 3.1% higher in annual terms. Expenditure growth profile was determined by capital expenditures, those for social security, as well as interest payments on existing debt received in previous years. By contrast, the lack of various transfers during 2018 affected them.¹³ The size of the public sector expressed as a ratio of total expenditures to GDP, was estimated at around 29.1%, the lowest of the last five years. In terms of composition, the structure of budget expenditures marked improvement during 2018, increasing the relative weight of investment expenditures against total expenditures.

Budget revenues for 2018 amounted ALL 449.4 billion or around 4.4% higher than in the previous year. Tax revenues were estimated at about 25.6% of GDP, similar to the previous year. Tax policy was almost the same as last year. For this reason, the profile of the increase of tax revenues during 2018 has reflected the pervasiveness of private consumption, increased economic activity as well as the improved dynamics of labour market indicators. On the other hand, the increase in tax revenues this year was curbed by exchange rate appreciation.



¹² The data of debt stock is referred to the publication of MoFE for 2018 Q3.

¹³ In 2017, these transfers were in the form of lending to KESh. During 2018, no such transactions were carried out.



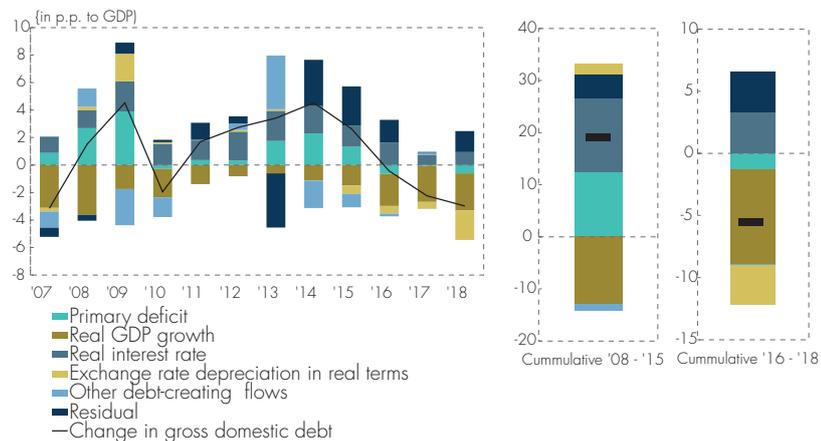
BOX 3 DETERMINANTS OF PUBLIC DEBT DYNAMICS IN ALBANIA

This box aims to present the macroeconomic and fiscal factors that have determined the timely dynamics of public debt.¹ The analysis relies on the approach applied by the International Monetary Fund (2013) to assess the sustainability of public debt for countries that have access to international markets. One of the analysis tools proposed by the IMF is the review of the dynamics of timely public debt, broken down by its determinant factors: primary balance, real economic growth, real interest rate, real exchange rate, other debt-creating flows and one residual component.

According to data from the Ministry of Finance and Economy, public debt in Albania has grown in the post-crisis years, peaking at 72.7% of GDP in 2015. After this period, the debt is positioned on a downward trajectory, falling to 67.1% of GDP by the end of 2018. In greater detail:

- Public debt to GDP ratio increased by 19.1 percentage points in the period 2008-2015 (Chart 15). The main reason for such increase is attributed to real interest rates paid on debt and primary deficits that characterized fiscal policy during this period. On the other hand, economic growth has acted in the opposite direction, leading to the decrease of the public debt to GDP ratio.
- Public debt to GDP ratio fell by about 5.6 percentage points in the period 2016 - 2018. Its fall continued to be supported by economic growth rates, but it was also favoured by exchange rate appreciation and fiscal consolidation, expressed in primary surpluses, undertaken during this period.

Chart 15 Change in public debt, broken down by determining factors, 2007 - 2018



Source: Ministry of Finance and Economy, INSTAT, and Bank of Albania's staff calculations.

Decomposition of the public debt dynamics highlights the importance of economic growth in improving the debt trajectory. As illustrated in Chart 16, the ability of the economy to improve public finances soundness depends on its position in the business cycle. During economic boom periods, when output is above its potential (as in 2007 and 2008), real economic growth has a higher contribution to the decline in the public debt ratio. By contrast, when the output gap is negative towards expansion, the contribution of economic growth to debt reduction is lower. The impact of business cycles on the dynamics of public debt



underlines that systematic follow-up of counter-cyclical fiscal policies helps monitor the debt level and creates fiscal space to cope with potential future shocks.

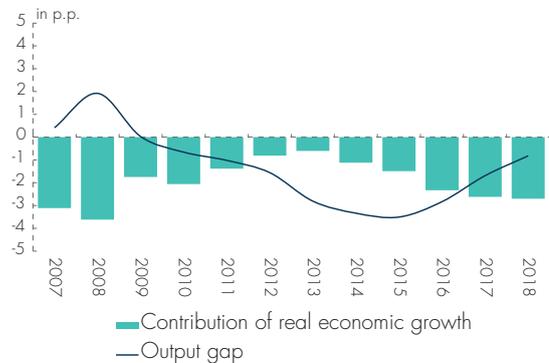
Beyond the level, the profile of its financing structure carries particular importance in the analysis of the sustainability of public debt. The main dimensions of this structure are: (i) maturity; (ii) currency; and, (iii) the holders. An optimal financing structure ought to minimize the overall cost of public debt, while, at the same time, keeping in check the risks arising from the above dimensions.

Regarding the debt financing structure in Albania we can conclude that:

- Public debt maturity has extended in recent years, reducing the risk of its re-financing. (Chart 17, left). This target was achieved through the issuance of Eurobonds (5-year Eurobond in 2015 and 7-year-Eurobond in 2018) and through the increase in the share of long-term instruments in the domestic market.
- Debt structure by currency shows an increase in the share of foreign currency debt, increasing its exposure to exchange rate fluctuations. In 2018, foreign debt accounted for about 49% of total debt, or 32.8% of GDP (Chart 17, right).
- Debt structure according to the holders shows a more diversified base of investors (Chart 18). Measures to promote the development of the primary and secondary markets of government securities - the expansion of the range of debt instruments, or legal arrangements that encourage the participation of individuals and other institutions - has reduced the government's exposure to the banking system, from around 68% of domestic debt in 2008 to 58% in 2018.

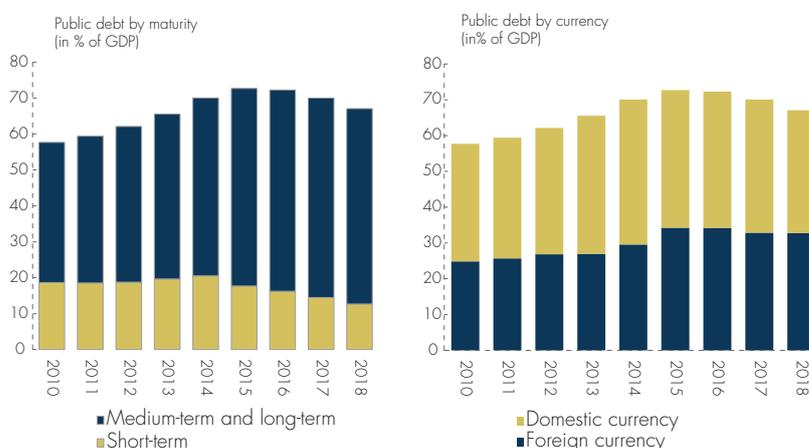
Despite positive trends, further improvement of the public debt sustainability requires further attention to improving its financing structure.

Chart 16. Contribution of real economic growth to public debt dynamics, as well as the output gap in the economy*



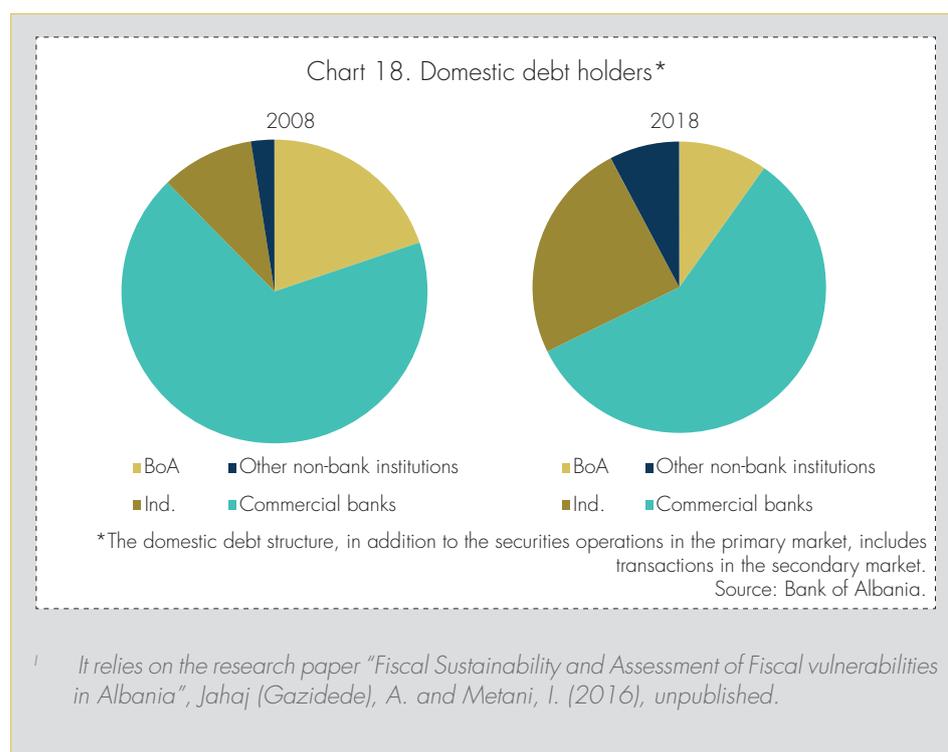
*The output gap is the average of several measurements on which the method of moving average is applied.
Source: Ministry of Finance and Economy, INSTAT, and Bank of Albania's staff calculations.

Chart 17. Public Debt Profile, 2010 - 2018



Source: Ministry of Finance and Economy, INSTAT, and Bank of Albania's staff calculations.





The current account deficit has shown a narrowing trend during the first nine months of 2018

Current account deficit narrowed to 5.2% of GDP during the first nine months of 2018, significantly reducing compared to 7.5% in the previous year. In nominal terms, the deficit narrowed annually by about 11.3%.

The narrowing reflects mainly the increase by 8% of net remittances, as well as the expansion by about 3.0% of the surplus of trade balance in services, including tourism revenues. On the other hand, the trade deficit narrowed by only 0.2% in annual terms over the first three quarters of the year. Growth of exports by about 25.7%, largely driven by the increase in the export of electricity, was offset by an increase of imports by about 5.8%.

The overall trade deficit (in goods and services) narrowed by 1.9% for the first nine months of 2018, mainly as a result of improved balance of trade exchanges.

This narrowing reflects the improvement of the savings-investment gap, particularly as a result of increased public sector savings. At the same time, the private sector's savings-investment gap narrowed, though this narrowing reflects the faster growth of savings in relation to investments in this sector.

Despite the overall volume growth, the structure of Albanian exports remains relatively little diversified, especially in terms of high added value products. On the other hand, the structure of imports is more diverse.

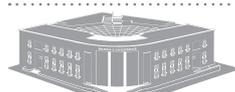
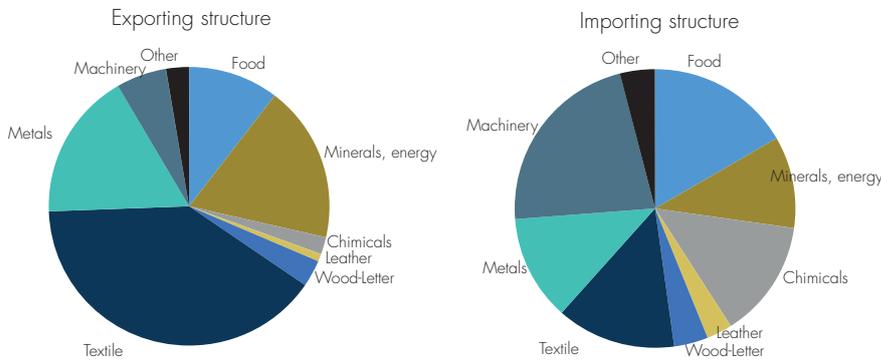


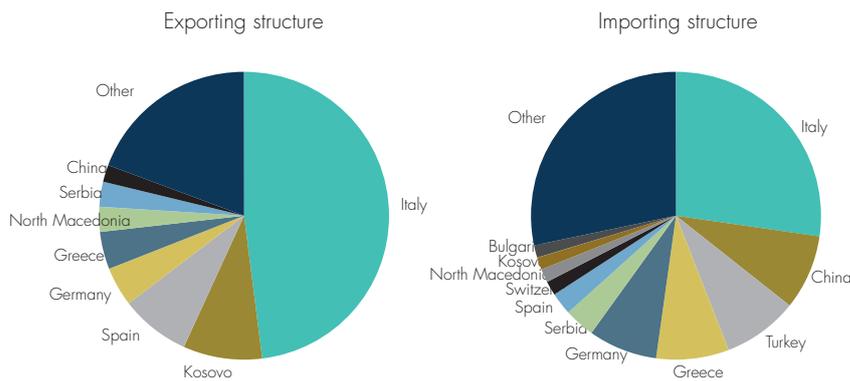
Chart 19. Structure of exports (left) and imports (right) for 2018, goods



Source: INSTAT.

The countries of the European Union, mainly Italy, remain our main trading partners. In 2018, a relative increase was noted in the share of some destination countries, where fuel and electricity are exported, such as Switzerland and Spain. In parallel, an increase in Kosovo's share was noted, mainly as a result of the higher exports of "Construction Materials and Metals" toward this destination. Regarding the countries of origin, Italy remains the main partner with a wide variety of imported products.

Chart 20. Structure of exporting destinations (left) and origins of imported goods in 2018 (%)



Source: INSTAT.

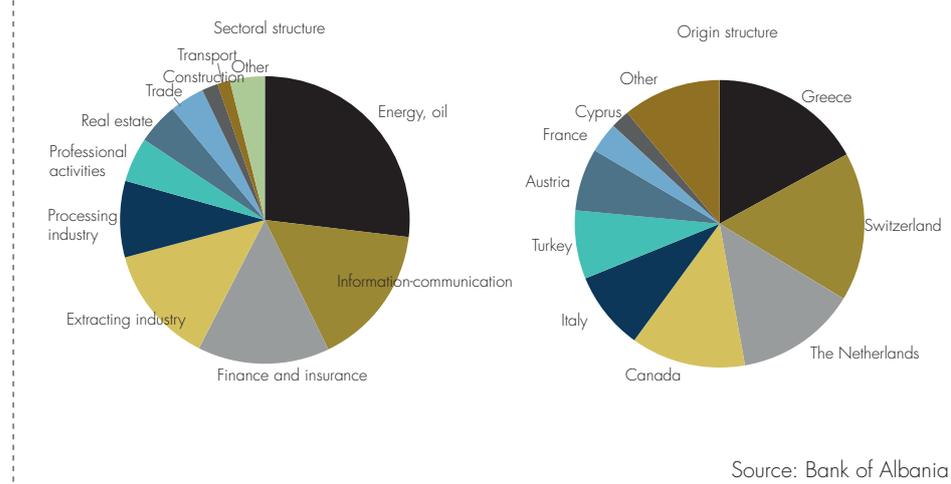
Current account deficit is financed based on non-debt creating flows

Foreign Direct Investment Flows have played the main role in financing the current account deficit. FDI inflows expanded by about 11.6% over the first nine months of the year, with investments in the energy sector as the main



source. Consequently, the energy sector is ranked first in FDI, accounting for about 26.9% of the total at the end of the first nine months of 2018. Also, as a result of these developments, Switzerland is ranked in the second place in terms of countries of origin.

Chart 21. Sector structure (left) and import origin for FDI in 2018 (% of total)



High inflows also generated high rates of current financing deficit financing. Consequently, at the end of 2018, the stock of foreign reserve assets amounted to EUR 3.4 billion. This is sufficient to cover 7.2 months of import in goods and services and 170% of the short-term gross external debt.

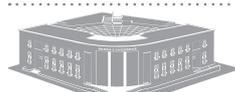
External debt sustainability indicators continued to improve in 2018

Foreign debt sock registered EUR 8.04 billion in 2018 Q3, up by 2.7% compared with the previous year. The stock was assessed at 64.5% of the nominal GDP. In structural terms, government debt dominates with around 43.8% of the total, followed by debt related to commercial banks (17.6%). In maturity terms, long-term debt dominates at around 79.6%. Regarding instruments, loans and currency and deposits investments constitute around 71.7%. The share of portfolio investments is somewhat low.

In terms of stability, the long-term repayment ability indicators improved during 2018. The ratio of debt stock to the exports of goods and services was around 161.3% at the end of 2018 Q3, from 174.0% in the previous year. At the same time, the ratio of debt stock to fiscal revenue marked 237.5%, from 246.3% registered in the previous year.

2.1.4 LABOUR MARKET

Growth in aggregate demand and expansion of production are accompanied by increased employment. Employment increased on average by 3.5%



during the first nine months of 2018.¹⁴ This growth is higher than the 2.9% increase recorded in the same period a year earlier. Employment performance in the economy reflected the increase in the number of employees both in the manufacturing sector and in the services sector. Employment growth was associated with the continuous fall of the unemployment rate, which stood at 12.2% in 2018 Q3, or about 1.4 percentage points lower than in the same quarter a year earlier. Lastly, the fall in the unemployment rate created premises for a 3% increase of the average wage during the first three quarters of 2018.

Table 2. Quantitative labour market figures (%)

	2014	2015	2016	2017	2018		
					Q1	Q2	Q3
Employment (15 years and older, annual changes)	1.6	4.9	6.5	3.3	4.9	3.3	2.3
- In agriculture	-3.4	1.4	3.9	-2.0	1.2	1.2	1.2
- In industry (including construction)	7.4	11.5	11.0	3.4	8.6	7.1	3.9
- In services	5.1	6.2	7.8	8.4	6.7	3.4	2.5
Employment rate (15 - 64 years old)	50.5	52.9	55.9	57.4	59.2	59.2	59.7
Labour Force Participation Rate (15-64 years old)	61.5	64.2	66.2	66.8	68.0	68.0	68.3
Unemployment rate (15 years and older)	17.5	17.1	15.2	13.8	12.5	12.4	12.2
The average monthly wage for an employee (nominal annual changes)		5.2	-0.8	3.0	4.2	2.5	2.4
The average monthly wage in the public sector (nominal annual changes)	1.7	1.8	0.9	9.8	5.7	0.2	-0.3

Source: INSTAT (Labour Force Survey, Data of the General Directorate of Tax) 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.

2.1.5 FINANCIAL MARKETS AND MONETARY INDICATORS

Financial markets were generally calm during 2018, characterized by low interest rates and declining risk premiums. With the exception of the foreign exchange market. In the first half of the year, this market was characterized by shocks, which affected the parameters of its functioning and triggered strong appreciation of the exchange rate. The Bank of Albania's response through the reduction of the policy rate and temporary market interventions calmed down the functioning and contained the pace of exchange rate appreciation.

Credit to the private sector continued to show moderate growth rates in 2018. This performance reflected both the still low demand for loans and the conservative lending policies implemented by the banking sector. In terms of structure, lending shows faster growth rates in the segment of loans granted in lek as well as in the segment of loans granted to households and individuals.

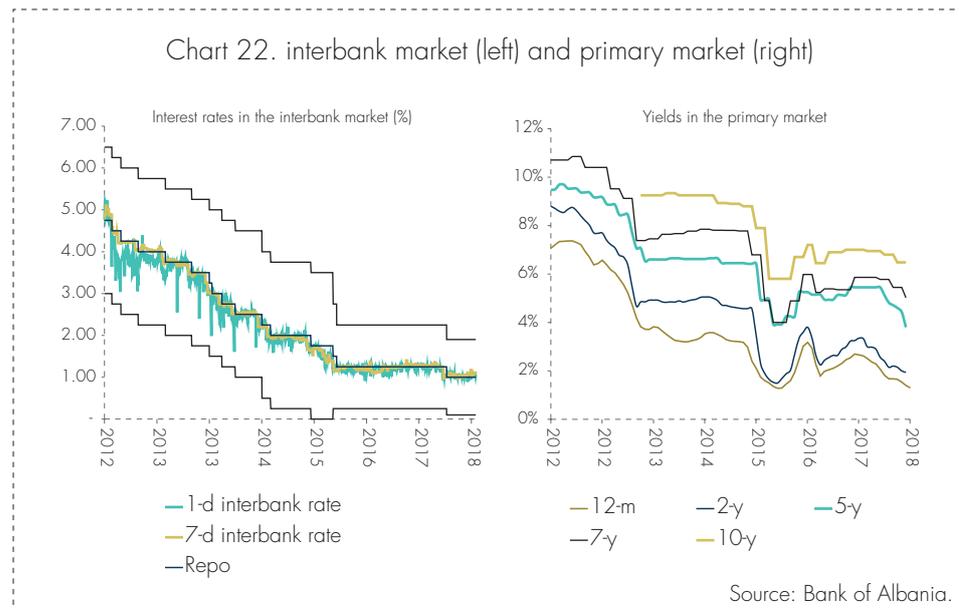
From the perspective of the liability, the savings and investment instruments continue to be characterized by the tendency of shifting towards the extremes of the spectrum: short or long maturities.

¹⁴ 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.



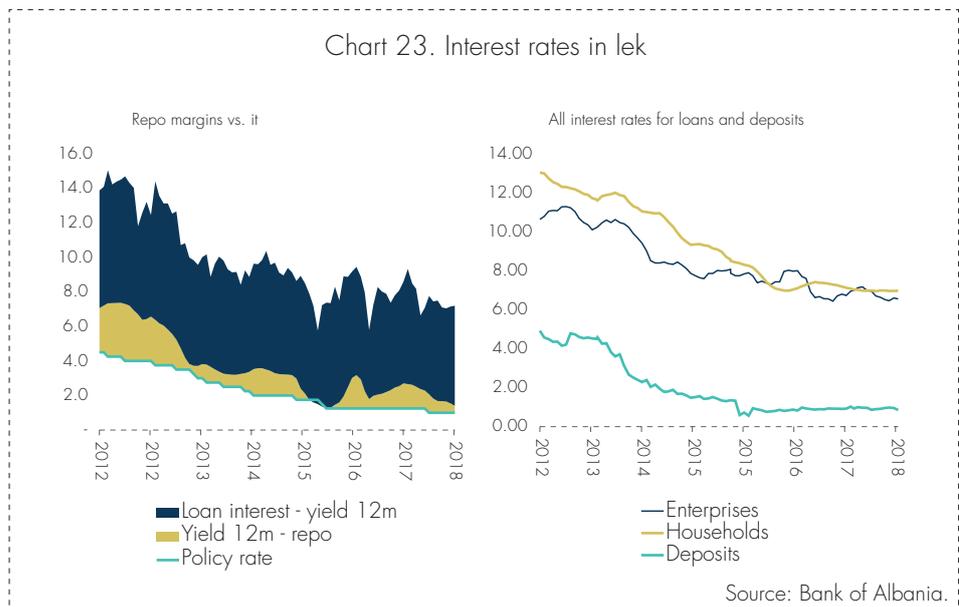
Interbank rates ranged close to the policy rate, in accordance with the operational target of the monetary policy

The Bank of Albania continued to supply liquidity to commercial banks through its main instrument, the one-week repo. The injected liquidity was slightly higher than in the previous year, as a result of higher demand for financing from the banking sector. Interest rates in the interbank market remained close to the policy rate and showed lower fluctuations, while trading volumes remained similar to 2017.



Government securities yields decreased slightly during 2018

Yields on Government securities were downward, driven by both easing monetary policy and reduction of borrowing in the domestic market. After the decrease of marginal rates in the first months of the year, the fall in yields accelerated in the next quarters. Following the issuance of the Eurobond in October, the government's financing demand in the domestic market declined,



reinforcing the downward trend of yields. The 12-month yield resulted 2.0% in average during the year, from 2.4% registered in the previous year. During 2018, the implementation of a pilot project for issuing 5-year benchmark bonds through development banks of the market. Daily trading and quotation of this bond has contributed to the reduction of premiums in long-term maturities and the smoothing of differences between the yields of these maturities. The yield curve at the end of the year is presented with a moderate slope, mainly in the medium and long-term spectrum.

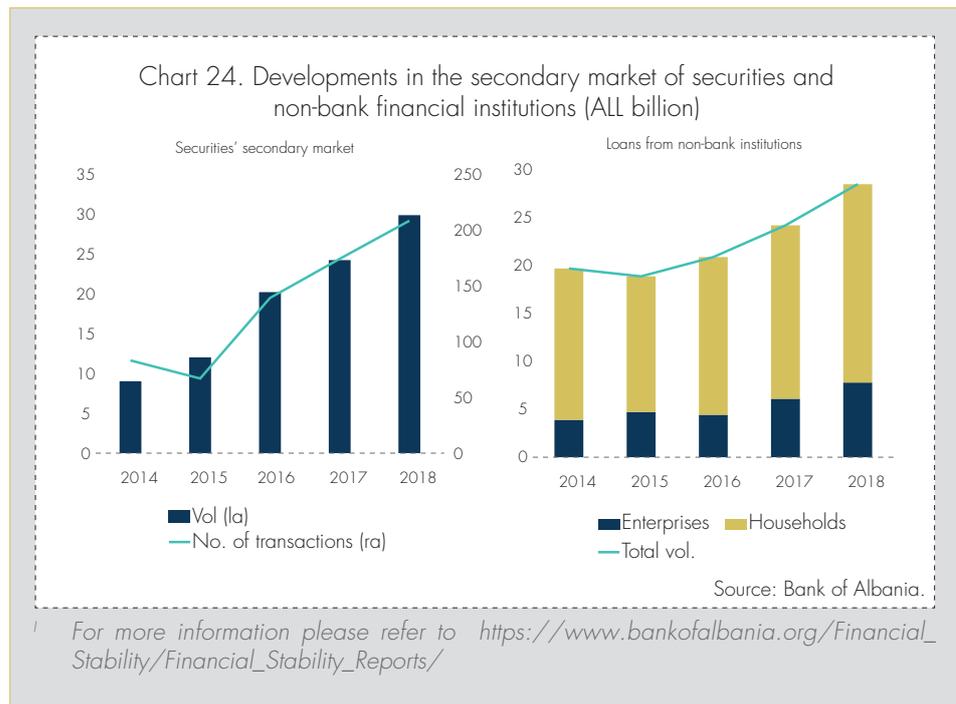
BOX 4 INNOVATIONS IN THE FINANCIAL MARKET DURING 2018

The financial system in Albania is dominated by the banking sector, while non-bank financial institutions have a modest share, albeit with an upward trend in the last five years.¹ The spectrum of saving instruments in the Albanian economy is limited, while the financing needs of businesses are met mainly by banks.

During 2018, the financial market in Albania progressed in some respects.

- *The volume traded on the secondary market of government securities increased (see Chart 24, left). In the framework of the joint initiative of the Government and the Bank of Albania to develop the financial markets, the issue of the 5-year benchmark bond started since July. This bond is continuously quoted, increasing the liquidity of this instrument and establishing a reference rate for the interests of government debt securities and the interests of other financial market products. This practice is also intended to be followed by other maturities in order to add reference points along the yield curve.*
- *Lending by non-bank institutions increased in the last two years, both in terms of the loan portfolio (see Chart 24, right) and in terms of the number of borrowers. The financial records of these institutions show that the loan portfolio increased by ALL 4.3 billion in 2018, or 18% compared to the previous year. (However, the loan portfolio of these institutions accounts for about 6% of the total bank financing for the private sector, indicating their small share in business financing.)*
- *In February 2018, the Albanian Securities Exchange ALSE sh.a. started its activity with the aim of creating an electronic trading platform that would enable the compliance of supply and demand for securities in Albania. This electronic platform aims to complement the lack of an organized stock market, where local businesses can raise funds as an alternative to banking sector financing. In its first year, this platform was used to trade government securities.*
- *A positive development in the capital market is the issuance of bonds from the private business. These issuances started in 2012 but there were mainly issuing financial institutions (banks, funds). In 2018, the first bond was issued by a business in the form of a private offer. Increasing the number of companies that use these instruments increases liquidity in this market. This will bring the development of capital market and its use as an investment opportunity and capital growth from businesses.*





Interest rates on loans and deposits in lek remained low

The average interest rate on new loans in lek was 7.0% in 2018, remaining close to the average rates of the previous year (7.1%). Credit interest rates for households decreased during 2018, while interest rates on loans to enterprises were approximately the same as in the previous year. Reduction of loan interest rates for households fell mainly in the financing of housing purchases¹⁵. Deposit interest rates fluctuate at minimal levels, while maintaining banks' financing costs low.

Lek appreciated further during 2018

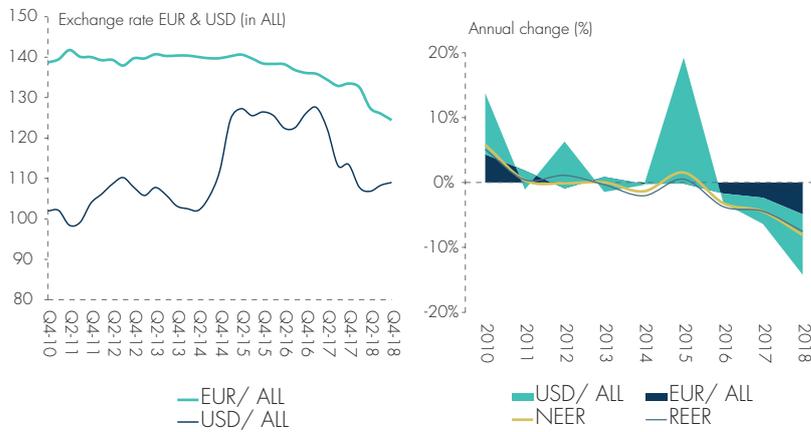
The foreign exchange market is characterized by a strong appreciation of the lek during 2018. Following a gradual appreciation trend during 2016 and 2017, the lek exchange rate against the euro appreciated by about 4.9% this year. The appreciation of the lek peaked in the second quarter, reflecting the shocks this market experienced during this period (for more information, see Box 1).

Bank of Albania's intervention in the foreign exchange market curbed the rapid pace of exchange rate appreciation and restored the activity in the foreign exchange market within normal parameters. This intervention was mainly focused on the third quarter, which is characterized by increased foreign currency inflows due to the tourist season. In the following months, the lek exchange rate continued to appreciate, but at a moderate pace, in line with its seasonal behaviour. Demand and supply for foreign currency was more balanced and daily fluctuations of the exchange rate were bilateral. The appreciation of the lek was also observed against the US dollar. One US dollar was traded at ALL 108 on average, or 9.3% less compared to the previous year.

¹⁵ The average interest rate for households in 2018 decreased to 7% from 7.3% in 2017. The loan interest rate for housing purchase was 3.7% this year from 4.1% in the previous year.



Chart 25. Developments in the exchange rate*



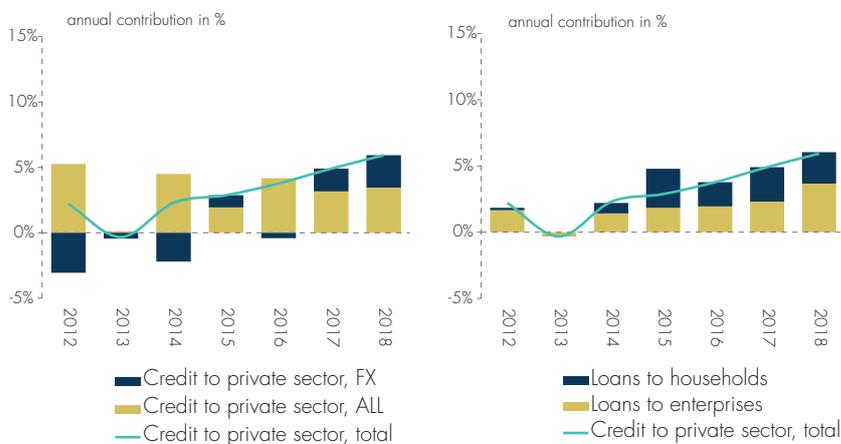
*In the annual change chart, the negative values indicate the appreciation of the lek against foreign currencies. Source: Bank of Albania.

Lending activity appears to be slightly improved, supported by the steady growth of loans in lek

Credit to the private sector grew by 2% on average, reaching 35.2% of GDP¹⁶. The credit growth rate continues to be moderate, driven by the weak demand for loans by the private sector, conservative lending policies applied by banks, and the exchange rate appreciation effect. Excluding the latter effect, the average annual expansion for credit to the private sector stood around 5%.¹⁷

The accommodative monetary policy stance continued to maintain low interest rates and favourable lending conditions. Credit portfolio in lek continued to

Chart 26. Credit to the private sector (annual change in %)



Source: Bank of Albania.

¹⁶ The data of loans are adjusted for written off loans.

¹⁷ The following credit records are also adjusted for this effect.



contribute the most to the expansion of credit to the private sector. The average annual growth rate of this portfolio was at 6.6%. Credit in lek is channelled mainly to the segment of households. This portfolio grew steadily over the year, marking 8% average annual rate. Credit to households expanded, supported by the increase in both mortgage loans, and consumer credit. Sustainable demand and eased lending conditions in the segment of households remain factors with a positive impact on the growth of this portfolio.

Foreign currency loans showed an upward improvement, marking an average annual growth of 4%. The expansion of foreign currency loans mainly supports the financing of enterprises. This portfolio recorded an annual average increase of around 4%, showing greater sustainability in the segment of loans for investments and fluctuating performance in the segment of loans for liquidity purposes. Business credit continues to reflect the still unsustainable demand and relatively tight conditions of the banking offer for this segment.

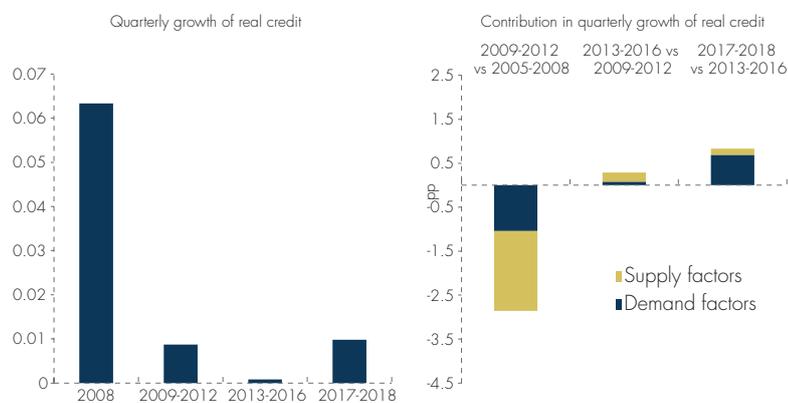
BOX 5 PERFORMANCE OF SUPPLY AND DEMAND FACTORS FOR LOANS

Credit performance is subject to ongoing analysis by the Bank of Albania, for its role in the monetary policy transmission mechanism, economic growth and inflation.

Over the last two years, lending activity has improved moderately, although the credit growth rate has not fully reflected the growth of economic activity and the reduction of risk premiums in the financial markets. Empirical studies¹ suggest that the recovery of lending activity is slow and its recovery lasts longer in time, especially after the financial crises that have originated as a result of rapid credit growth.

In this box, we will reflect the performance of supply and demand factors that have affected lending activity in Albania during 2017 - 2018. In order to evaluate the performance of supply and demand for loans during this period,

Chart 27. Contribution of supply-demand factors on credit growth



Source: Bank of Albania.



we have updated the empirical model of the study on lending determinants in the countries of the region.¹ Based on the relationship found between demand and supply factors and loans, the relative impact of these factors on the real growth of the loan was calculated. The chart below reflects the aggregate performance of demand and supply factors over three time-periods: the first period, immediately after the crisis, refers to the years 2009-2012; the second period refers to the years 2013-2016, and the third period is the one with most recent data, for 2017-2018.

The model results show that supply and demand factors have improved over the last two years. However, the relative improvement in loan demand is far faster than in loan supply.

- The improvement of demand was supported by the recovery of economic activity in the country, which has shown an acceleration of growth rates, contributing positively to the performance of loans.
- On the other hand, the marginal improvement in loan supply reflected the positive impact of the decline in the ratio of non-performing loans to the total as a credit risk proxy.

The analysis of the results of this exercise show that the recovery of credit demand factors is faster than that of supply-side factors. This performance is also confirmed by the results gathered from the bank lending survey. Banks report that they have tightened loan standards for enterprises and have eased standards for households, while credit demand is growing in both segments for the period 2017-2018.

According to banks, the factors that affect the tightening of standards for enterprises are: risk perception for this segment, limitations from the balance sheet, and banks' risk tolerance.² A different situation is observed in the performance of lending standards for households. Lending activity surveys show that since 2012, banks have steadily eased lending standards. Banks claim that almost all of the factors have positively impacted the easing of standards to households.

¹ For example, Antoshin S. et al 2017: "Credit Growth and Economic Recovery in Europe after the Global Financial Crisis" - IMF Working Paper WWP / 17/256.

² This model is estimated for the period 2004-2016 and it explains the growth of credit to the private sector through demand factors (economic growth, banking system intermediation rate) and supply factors (the ratio of non-performing loans, deposits, foreign borrowing of banks, credit interest rate) and the exchange rate. The model is described in the working paper "Determinants of the credit growth in CESEE countries", prepared by E. Suljoti and S. Note Working paper- Bank of Albania 2017

³ This factor was introduced for the first time in June 2018, in the framework of the review of the lending activity survey. For more information, see: https://www.bankofalbania.org/Monetary_Policy/Surveys_11282/Bank_Lending_Survey/

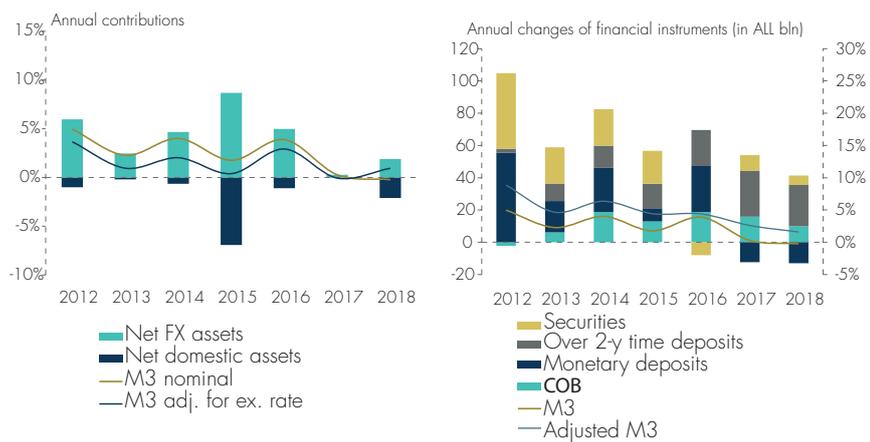


Monetary supply expanded at moderate pace over the year, reflecting the low monetary financing of the economy as well as the structural changes in money holdings

Broad money during 2018 reflected the low level of money creation in the economy, structural changes due to the shift of economic agents' deposits to maturities over two years¹⁸, as well as the effect of exchange rate appreciation. The broad money indicator, the M3 aggregate, recorded an average annual reduction of 0.4% during 2018. Structural changes in money reflect not only the shift towards long-term maturities, but also toward the liquid component, in the form of demand deposits and money outside banks. The latter ratio to the money indicator in lek, M2 aggregate, resulted in an average of about 36.3% over the year, or 1.6 percentage points higher than the previous year.

Deposits stock in the banking system expanded by around 1.1% in annual average terms during the year. At the end of the period, total residents' deposits are assessed at 68.4% of GDP. The largest contribution to deposit growth was given by foreign currency deposits, supported by high foreign exchange rates during the year. Deposits in lek have contributed to a lower extent, since a part of the domestic currency savings are channelled into government securities. In parallel, the shift from deposits with maturity under two years toward demand deposits and time deposits of over two years has continued. These categories account for 44% and 12% respectively of the total stock of deposits. Performance by economic agents confirms both household and enterprises deposit growth.

Chart 28. Monetary supply components and deposits in the banking system



Indicators represent the annual average of net quarterly balances.
Source: Bank Lending Survey - Bank of Albania.

¹⁸ Based on the Monetary Statistics compilation methodology, the broad money indicator includes currency outside banks and deposits (in all currencies) with a maturity of up to two years.



Table 3. Main macroeconomic and financial indicators

	2014	2015	2016	2017	2018*
Inflation (Average)					
Headline inflation (in %)	1.6	1.9	1.3	2.0	2.0
Core inflation (in %)	0.1	-0.2	0.2	0.8	0.9
Economic growth					
Real GDP growth (annual, in %)	1.8	2.2	3.4	3.9	4.3
GDP per capita (EUR)	3,443	3,556	4,043		
Labour Market ¹					
Participation rate in the labour force (15-64 years of age)	61.5	64.2	66.2	66.6	68.1
Unemployment rate (15-64 years of age)	17.5	17.1	15.2	13.9	12.4
Fiscal sector					
Budget Balance (including grants, % of GDP)	-5.2	-4.1	-1.8	-2.0	-1.6
Budget revenues (% of GDP)	26.3	26.4	27.6	27.7	27.4
Budget expenditure (% of GDP)	31.5	30.5	29.4	29.7	29.0
Public debt (% of GDP)	70.0	72.7	72.2	70.0	67.2
External sector					
Current account (excluding official transfers, in % of GDP)	-10.9	-8.7	-8.0	-8.1	-5.7
Imports of goods (fob, as a percentage of GDP)	31.6	29.9	30.9	31.3	29.4
Exports of goods (fob, as a percentage of GDP)	9.3	7.5	6.7	6.9	7.7
Foreign Direct Investments (% of GDP)	8.7	8.7	8.8	7.7	8.0
International reserve (in EUR million, end of period)	2,192	2,880	2,945	2,996	3,399
Monetary and financial sector					
Repo rate (end of period)	2.25	1.75	1.25	1.25	1.00
M3 aggregate (annual growth, end of period)	4.0	1.8	3.9	0.3	-0.2
Credit to the private sector (annual growth, end of period) ²	2.0	2.4	3.1	3.3	2.0
Deposit/GDP ³	73.0	72.6	74.1	71.3	69.0
Credit/GDP ³	37.1	37.0	37.1	36.4	35.2
12-month average yield	3.4	3.3	1.8	2.4	2.0
ALL/USD average exchange rate	105.5	126	126.0	119.1	108.0
ALL/EUR average exchange rate	140.0	139.7	136.1	134.2	127.6
NEER	112.1	113.8	110.2	105.2	96.8
Banking Sector					
Non-performing loans ratio/total loans (%)	22.8	18.2	18.2	13.2	11.1

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

* Data on economic growth for labour market and the external sector are from the first 9 months of 2018.

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

2.2. MONETARY OPERATIONS

Open market operations are used for short and long-term liquidity management in the money market, with the main purpose of meeting the Bank of Albania's operational objective. This objective is defined in the Monetary Policy Document and aims at the orientation of short-term interest rates of the interbank market toward and close to the Bank of Albania's key interest rate and minimizing their fluctuations.

Interbank rates stood close to the key interest rate and showed low volatility during 2018. Overnight and one-week interest rates traded on the interbank market averaged 0.02 percentage points above the key interest rate. In contrast to previous years, the pressure to avoid the upper interest rate target were higher, as a result of the increased liquidity shortage in the banking system.



This deficit reached a maximum of ALL 50 billion in the second quarter and fluctuated ALL 28-46 billion in the third and fourth quarters of the year and was present in a considerable number of banks. Also, the concentration of excess liquidity in 1-2 banks of the system, lowered trading pressures below the key interest rate although this is less noticeable compared to the previous years.

Another feature of 2018 was the tendency for a relative increase of collateralized lending in comparison to non-collateralized lending. Trading in the interbank market for longer-than-one -week maturities are still not common this year.

In response to the banking system's need for liquidity, the Bank of Albania increased the average liquidity injected through open market operations about ALL 39 billion in 2018, from ALL 24 -34 billion over the past two years. In response to the increase of liquidity shortage, the Bank of Albania increased the share of injections up to 46%, from 19.3% and 39.4% in 2016 and 2017, respectively.

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

	2011	2012	2013	2014	2015	2016	2017	2018
Annual average liquidity shortage (in ALL bln)	-14.2	-11.5	-17.3	-23.5	-27.1	-21.0	-32.5	-36.3
Main instrument	74%	55%	60%	64%	55%	80.7%	61.6%	54%
Long-term liquidity	26%	45%	40%	36%	45%	19.3%	39.4%	46%

Source: Bank of Albania.

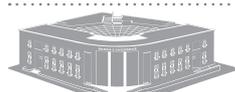
In 2018, the Bank of Albania carried out structural operations by purchasing and selling treasury bills of the Ministry of Finance and Economy, with the aim of reducing the concentration of 6-month issues.

In the activity of the securities portfolio management-through structural operations-and liquidity management of the banking system, the Bank of Albania aimed and managed to increase operations in the secondary market in contrast with operations in the primary market. During the 2018, about ALL 11.5 billion in treasury bills or about 20% of the securities portfolio were purchased in the secondary market. This figure increased, from ALL 9.3 billion in 2017.

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 to define a corridor in which interest rates fluctuate in the interbank market. This corridor narrowed in 2018 to 1.8 percentage points from 2.0 percentage points in 2017. Currently, the overnight deposit rate stands at 0.1% and the overnight loan rate at 1.9%.

The overnight deposit instrument was used every day during the second half of the year, meanwhile the average volume this year was ALL 4.55 billion. The use of overnight loan almost doubled during 2018, in 42 cases versus 20 cases in the previous year. The increase in the number of overnight loans



is mainly related to structural deficiencies in the interbank market, where the liquidity exchange is limited by the trading limits that banks have among each other. Despite the most numerous cases, the average amount used decreased to ALL 450 million compared to an average of ALL 1.1 billion in 2017.

REQUIRED RESERVE

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

Under the de-euroization measures, the Bank of Albania changed the required reserve rate during 2018. The changes aimed at easing the reserve burden for the domestic currency. The reserve ratio for the domestic currency decreased by 10% uniformly for all types of liabilities, to 5.0% for accounts with a maturity of up to 12 months and 7.5% for accounts with a maturity of 12 months to 2 years. For foreign currencies, the rate rose to 12.5% and 20% depending on the exposure level of banks against foreign currency liabilities, applying a higher rate for banks with a higher exposure. The Bank of Albania decided that the additional funds that commercial banks had to block in foreign currency ought to be kept in ALL countervalue until June 2019.

Also, the Bank of Albania increased the daily use rate of the required reserve in lek to 70% by 40%, thus increasing the banks' possibilities to manage Lek liquidity. This new limit has been used on average by 4 banks, since the decision came into force in February 2018.

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 base rate, from 70%.

The remuneration of required reserves in foreign currency and remuneration of bank surpluses at the Bank of Albania has not affected regulatory changes. Starting from September 2016, the banks pay for the required reserve in euro an interest rate equal to the overnight deposit rate of the European Central Bank. This interest rate remained unchanged during 2018, and was negative at -0.40%. 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 has remained 0% during 2018, like in the previous year. On the other hand, the interest rate remuneration of the euro surplus remained at the level set in 2016, at 0.25 percentage point lower than the ECB's deposit interest rate.



2.3. FINANCIAL STABILITY AND MACRO-PRUDENTIAL POLICIES

The Bank of Albania plays a primary role in achieving and maintaining the stability of the financial system in the country. The Bank of Albania fulfils this objective through the parallel execution of three important functions: the supervisory function that includes licensing, regulation and supervision of banks and other non-bank financial institutions¹⁹, the formulation and implementation of the macro-prudential policies, and the resolution in banks.

The supervisory function shall ensure that particular institutions are well-regulated, adequately manage the risk and carry out their activity in accordance with the legislation in force; while the resolution function aims at ensuring the continuity of the critical functions of banks in financial difficulties with the lowest costs for financial stability and public finances.

As the main authority for the implementation of the macro-prudential policy, through the use of macro-prudential instruments, the Bank of Albania tends to prevent systemic risks to the financial system and to increase the banking sector's resilience to these risks. This way, the financial system remains stable and capable of performing its role as a financial intermediary among economic agents, thus supporting the economic growth of the country.

2.3.1. BANK OF ALBANIA ACTIONS IN THE FRAMEWORK OF THE IMPLEMENTATION OF MACRO-PRUDENTIAL POLICY

In August 2017, the Bank of Albania approved the Macro-prudential Policy Strategy, which aims to take actions to prevent and mitigate systemic risk in order to guarantee a stable and efficient financial system. This document sets out the main and intermediate objectives of macro-prudential policy, macro-prudential policy instruments, and the most important indicators that can be used to monitor each of the objectives. The Strategy Document defines the cycle of macro-prudential policy and the role of certain structures of the Bank of Albania for its pursuit. This document recognizes the Bank of Albania as an authority with a primary, but not exclusive, authority in terms of formulating and implementing macro-prudential policy. In view of the implementation of the Strategy, during 2018, the Bank of Albania has focused on: a) the development of macro-prudential policy instruments; b) building early warning systems for systemic risks; and c) improving transparency and communication with the banking industry and the public.

a) *Development of macro-prudential policy instruments*

¹⁹ Pursuant to the definition of Law "On banks in the Republic of Albania".



Package of measures to strengthen the use of the domestic currency

During 2018, the Bank of Albania worked to review the regulatory framework and to implement the institution's obligations under the Memorandum of Understanding with the Ministry of Finance and Economy and the Financial Supervisory Authority (April 2017), to strengthen the use of the domestic currency within the financial system and the Albanian economy (also known as the de-euroization package). A higher use of the domestic currency in the Albanian economy prioritises the effectiveness of the economic policies and reduces the financial risks. In line with these conclusions and in accordance with the policy "On increasing the use of the national currency (ALL) in the activity of banks and financial institutions," approved by the Supervisory Council of the Bank of Albania²⁰, during 2018, the Bank of Albania²¹ approved some regulatory changes. These changes include (i) lowering the required reserve ratio for deposits in lek and increasing the required reserve ratio for foreign currency deposits, (ii) raising the required minimum level of the ratio of liquid assets to short-term foreign currency liabilities, and (iii) setting out requirements to increase transparency on foreign currency loans related to the risks attributed to the borrower. The measures came into force at a differentiated time during 2018 H1. Euroization is present across the entire Albanian economy thus its treatment requires coordinated and multi-dimensional efforts at inter-institutional level.

Macroprudential capital buffers

In formulating and implementing the macro-prudential policy, the Bank of Albania is guided by the best international standards and practices. One of the most important blocks of macro-prudential instruments that has been implemented in many countries, including countries of the European Union and the Balkan region, is the one that creates macro-prudential capital reserves / buffers. These capital buffers aim to mitigate the systemic cyclical and structural risks of banking activity and include the conservative capital buffer, countercyclical capital buffer, capital buffer for systemically important banks, and capital buffer for systemic structural risk. During 2018, the Bank of Albania has prepared a draft regulation for the implementation of macro-prudential capital buffers; it has prepared methodologies that detail the implementation of some of them; it has consulted these documents extensively with the banks and has published them on its website for a wider public opinion. The draft regulation is expected to be reviewed by the Supervisory Council of the Bank of Albania within the first half of 2019.

²⁰ Decision of the Supervisory Council dated 07.02.2018, No. 9, "On the Approval of the Policy" On Expanding the Use of National Currency in the Activities of Banks and Financial Institutions".

²¹ Decisions of the Supervisory Council, dated 07.02.2018 with no.10, no.14 and no.15: "On the approval of some amendments to the regulation" On the minimum required reserve held at the Bank of Albania by banks"; "For an amendment to the regulation" On liquidity risk management "; "On Amendments to the Regulation" On Transparency of Banking and Financial Products" and the Decision dated 04.04.2018, No. 27 "On Amendments to the Regulation on Consumer Credit and Mortgage Lending".



By adopting the regulatory and methodological package for macroprudential capital buffers, the Bank of Albania simultaneously addresses three of the intermediate objectives of the macroprudential policy presented in the Macroprudential Policy Strategy: mitigation and prevention of rapid growth of lending and debt, limitation of direct and indirect concentrations of exposure and the restriction of excessive risk undertaking by systemically important financial institutions.

Table 5. Intermediate objectives and the expected effects from the implementation of macro-prudential capital buffers

Intermediate objective	Instruments	Transmission channels/ Expected effect from the instrument/measure
Mitigation and prevention of fast expansion of lending and borrowing	Establishment of countercyclical capital reserves (countercyclical capital buffers)	Increases the resilience of banks; it may decrease the credit growth rate, because of the higher funding costs;
Limitation of direct and indirect exposure concentrations	Establishment of capital reserves for systemic risk (capital buffers for systemic risk)	Increases banks capability to absorb losses; increases the funding costs and limits concentrations
Limitation of excessive carried on risk by financial institutions with systemic importance.	Establishment of capital reserves for systemic risk (capital buffers for systemic risk)	Decreases the probability and size of the impact of the failure of systemically- important banks ; strengthens the resilience of banks

The simultaneous application of these requirements to banks is expected to result in increased banks' resilience to potential shocks, increased banks' capacity to absorb losses and reduce probability of failure and the size of systemically-important banks. Macroprudential capital buffers represent a fundamental step towards approximation with the relevant European Union standard, such as the Directive 2013/36 / EU "On capital requirements", the relevant technical standards published by the European Banking Authority and the recommendations of the European Systemic Risk Board.

b) Building Early Warning Systems

An important condition for the success of macroprudential policies is the use of early warning systems for systemic risks in the financial system and the banking sector. This process implies building and using a number of significant indicators of macroeconomic and financial activity classified according to the intermediate objectives of the macroprudential policy and the monitoring of the performance of these indicators to critical values, whose exceedance signals accumulation of systemic risks. This analytical package is known as the Macroprudential Map. While the Bank of Albania has consistently used Financial Health Indicators developed according to international methodologies to monitor various aspects of the banking and financial activity and to identify systemic risks, the Macroprudential Map represents an added value for the analysis of financial stability, for identifying systemic risks and for monitoring the



effect of macroprudential measures. The monitoring of macroprudential map indicators started in the first quarter of 2018, while the presentation of the Map and the preliminary analysis model were carried out during the second half of the year. After testing the indicator signalling capacity we will consider the possibility of publishing the Macroprudential Analysis and the accompanying analysis in an adequate form. Building and analysing the Macroprudential Map serves to the first step of the macro-prudential policy cycle: identifying risk and assessing it.

c) Transparency and communication

The Bank of Albania, in compliance with its legal obligations, vision, values and principles aims to provide the highest level of transparency and communication in terms of formulating and implementing macroprudential policy. During 2018, the Bank of Albania worked to improve the communication with the public regarding the methods and instruments used by the Bank of Albania for the evaluation and addressing of systemic risks. One of the information blocks used by the Bank of Albania for the analysis of financial stability and monitoring of systemic risk is the database from the surveys on financial situation and debt burden of households and enterprises. In the Financial Stability Report for 2018 H1, these surveys' analysis and data were published for the first time.

2.3.2. HIGHLIGHTS IN THE BANKING SECTOR AND THE FINANCIAL SYSTEM

The activity of the banking and financial sectors during 2018 was stable and was conducted under favourable macroeconomic conditions. Monetary policy continued its accommodative trend in 2018, supporting the further fall of interest rates on deposits, loans and government securities. Public sector supported by the external borrowing has created conditions for the expansion of credit from domestic banks to the private sector.

At the end of 2018 Q3, due to the faster growth of the economy compared to the growth of financial activity, the share of financial system assets to GDP fell to about 97% from 99.5% at the end of 2017. The aggregate balance of non-bank financial institutions, insurance companies, savings and loan associations and supplementary private pension funds expanded in annual terms; the balance of the banking sector slightly increased, while the balance of investment funds decreased due to the decline in the volume of investments of these funds in government securities. The banking sector, which has over 90% of the financial system's assets, ended 2018, with a positive financial result, with a good capitalization level, with excessive liquidity, at levels higher than those required by the relevant regulation, and with a better credit quality compared to the previous year.

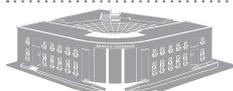


During 2018, domestic banks expanded their activity in security transactions, while customer transactions (credit) and treasury and interbank transactions shrank. Despite slow credit growth, the banking ended 2018, with a positive financial result of about ALL 18 billion, which is somewhat lower compared to the previous year. Net interest income continued to represent the main source (about 70%) of the banking sector's income. These revenues were almost the same as those of 2017, as income and interest expenditures remained at the same level of the previous year. Other sources of income included fees and commissions, as well as reversals of provisions for investments in other financial assets. Profitability indicators dropped slightly, but continue to remain at satisfactory levels.

The banking sector's capital adequacy ratio increased to 18.2%, from 17% in the previous year. The majority of banks' adequacy ratio is higher than 15%. The increase of capitalization came mainly from the decline in the volume of risk-weighted assets as a result of regulatory changes undertaken during the year, while the regulatory capital of banks slightly declined. The liquidity situation of the banking sector continued to be stable and the liquidity ratios in both lek and foreign currency are higher than the minimum set in the regulation. By the end of 2018, the outstanding deposits held by the banking sector was about two times higher than the credit provided by the banking sector to households and to public and private non-financial corporations.

As at end-2018, the overall outstanding loan was about 3% lower than in the previous year. Credit stock fell due to the withdrawal from the balance sheet (as a result of write off and sales) and the repayment of a part of non-performing loans (as a result of the moderate performance of the new loan) and the appreciation of the domestic currency which gave a statistically significant effect on the contraction of the reported value of the foreign currency loan. The latter, fell by 4%, while credit in the original currency euro (which accounts for over 90% of foreign currency credit) grew by about 5%. Excluding the value of write off loans and the exchange rate effect, the annual growth of outstanding loans would be about 2%. The amount of new credit to households during 2018 was comparable to that of the previous year, while the new credit to enterprises was about 5% lower.

Credit risk continues to represent the main risk of banking and financial activity, but this risk decreased during 2018 as a result of the measures taken by banks to write off and restructure the non-performing loans and as a result of stronger risk monitoring for lending to enterprises over the past few years. The coverage of non-performing loans with provisions and capital and the coverage of outstanding loan with collateral remained at adequate levels. By the end of 2018, the ratio of non-performing loans (NPLs) was 11.1% from 13.2% in the previous year, while the non-performing loans ratio reduced by 20%. The greatest improvement in credit quality was recorded for loans in lek, loans to enterprises, long-term loans and loans to the trade sector. Loans to enterprises and foreign currency loans continue to have a weaker quality



compared to loans to households and loans in the domestic currency. The agricultural sector has the lowest level of NPLs, whilst the industry sector has the highest level of NPLs. The weight of unhedged foreign currency credit to foreign currency credit and total credit remained almost unchanged, but the quality of this loan improved considerably during 2018. This improvement was a result of write offs and restructuring, while the strengthening of the domestic currency may have had a positive impact on the solvency of foreign currency borrowers whose revenues are in lek.

The liquidity risk continues to be low and under control. The minimum liquidity rates by currency are regulated by regulatory acts of the Bank of Albania. Moreover, the liquidity ratios by currency, both for the sector and for individual banks, continued to remain significantly above the minimum levels set by the relevant regulation. The liquidity stress test, which is conducted once a year shows that the banking sector and individual banks have sufficient reserves in total and in each of the three major currencies (lek, euro, US dollar) to cope with extreme liquidity shocks over a two-year time horizon. The main source of financing lending activity is public deposits, which are about two times higher than outstanding loans, both in the domestic and in the foreign currency. Over the last two years, the share of demand deposits and current accounts to total deposits increased from 40% to 44%. The weight and volume of time deposits continued to fall, in response to low interest rates. On the one hand, a significant share of current accounts and demand deposits impels banks to maintain high levels of liquid assets and, on the other hand, to encourage long-term or high-risk investments in order to provide higher returns. Data in this regard show that the growth of risk-weighted assets was significant in the period 2008-2016, but decreased over the last two years. On the other hand, although the share of long-term loans to outstanding loans increased by 4 percentage points, to 44%, the residual maturity for the banking sector's financial assets did not show significant changes over the last two years.

Market risks represented by the risk arising from the change in the interest rates and the direct and indirect risk arising from movements in the exchange rate continue to remain low but present. Throughout 2018, the banking sector held more assets than rate-sensitive liabilities. Keeping a positive spread between assets and liabilities with variable interest rates exposes banks to interest rate risk if the rates fall abruptly. When the net position to regulatory capital ratio is low, and has decreased in 2018 H2, and when interest rates continue to remain at low historical levels, exposure to possible shocks from interest rates is estimated to be limited. The direct risk from exchange rate fluctuations in the banking sector's balance sheet remains low, as the ratio of net open foreign exchange position (purchase) to regulatory capital remains low and significantly below the upper regulatory limit of 30% for all currencies and 20% for specific currencies. But, the indirect foreign exchange rate risk is significant. The transmission channel of this risk remains the high presence of foreign currency credit to unhedged borrowers. At the end of 2018, the outstanding loan did not change and remained close to the lowest historical levels, accounting for



24.3% of the total outstanding loans. Maintaining incentives for higher use of the domestic currency in the financial system and the real sector of the economy is necessary to reduce this risk.

Concentration risk by activities and products offered by the banking sector continues to be low. At the end 2018 Q3²², the Bank of Albania approved the merger by absorption of Intesa Sanpaolo Albania sh.a. with Veneto Banka sh.a. and the American Bank of Investments sh.a. with NBG Bank Albania sh.a. Both Veneto Bank and NBG Bank belonged to the group of small banks and accounted for 1.7% and 2.4% of total banking sector assets. Their absorption by a large bank and a medium-sized bank, respectively, consolidates the banking activity and is expected to be accompanied by improved efficiency. The decline in the number of banks from 16 to 14 did not lead to changes in the concentration indicators of the banking sector according to the main balance sheet items and bank activity, as none of the banks involved in the absorption had a dominant position on indicators or specific activities.

BOX 6 MEASURES OF THE BANK OF ALBANIA TO STRENGTHEN THE USE OF DOMESTIC CURRENCY IN BANKING ACTIVITY

In the framework of the Memorandum of Cooperation with the Ministry of Finance and the Financial Supervisory Authority, signed on 18 April 2017, the Bank of Albania undertook a package of concrete measures to stimulate the use of lek. The package of measures, which was adopted by the decision of the Supervisory Council of the Bank of Albania in February 2018, consists of the following main elements: i) the adoption of a policy document on the expansion of the use of the domestic currency in the bank and non-bank activity supervised by the Bank of Albania, ii) the differentiation of the required reserve for foreign currency liabilities; iii) a higher level required for foreign currency liquidity indicators; iv) raising the awareness of borrowers about the risk posed by foreign currency credit.

Thus:

- i. Approval of Policy "On increasing the use of the national currency (ALL) in the activity of banks and non-financial institutions, subject to the Bank of Albania regulation and supervision."*
- ii. In order to increase the share of the use of the domestic currency and, at the same time, extend the maturity in the structure of liabilities of the banking sector, the Bank of Albania decided to differentiate the required reserve rateⁱ, for the categories of liabilities included in the reserve requirement base as follows:*
 - 7.5% (from 10% previously) for liabilities in lek with a maturity not longer than 12 months;*

²² Decisions are published in the Official Bulletin, Volume 20, Issue 5, October 2018. Approved with Decision of the Supervisory Council No. 60, dated 6.09.2018 "The preliminary approval for merger by absorption of the Intesa Sanpaolo Albania sh.a. with Veneto Banka sh.a."; Decision of the Supervisory Council No 61, dated 6.09.2018 "The preliminary approval for merger by absorption of the American Bank of Investments sh.a. with NBG Bank Albania sh.a.".



- 5% (from 10% previously) for ALL liabilities with an initial term of more than 12 months to 2 years;
 - 12.5% (from 10% previously) for foreign currency liabilities when these account for less than 50% of total liabilities;
 - 20% (from 10% previously) for the foreign currency liabilities of over 50% of total liabilities.
- iii. For a more cautious management of liquidity risk, the Bank of Albania decided to increase the minimum regulatory requirement for the ratio of liquid assets in foreign currencyⁱ to short-term foreign currency liabilities at 20%. The minimum required ratio level for lek remained at 15%.
- iv. To raise borrowers' awareness regarding credit risk due to unhedged borrowing in foreign currency, the Bank of Albania required by other commercial banksⁱⁱⁱ to:
- Make a proposal to the borrower, when the client applies for loans in a currency other than that of his income, for an alternative loan in the same currency of his income, and provide him a concrete example on how the loan installment changes in the case of lek depreciation and / or increase of interest rate (with defined values);
 - Include in the new contracts of foreign currency loans (or newly restructured) the option to use mechanisms that mitigate market risk for the borrower when the conditions agreed between the bank and the borrower are met.

The measures entered into force gradually until June 2018. Since that period, in order to assess the impact of the measures, the Bank of Albania has published a special report every six months.

ⁱ Bank of Albania's Supervisory Council Decision No. 13, dated 07.02.2018 "On the approval of the reserve requirements rate held by banks with the Bank of Albania".

ⁱⁱ Bank of Albania's Supervisory Council Decision No. 14, dated 07.02.2018, "On an amendment to the regulation on liquidity risk management".

ⁱⁱⁱ Bank of Albania's Supervisory Council Decision No. 15, dated 07.02.2018, "On amendments to the Regulation "On transparency of banking and financial products and services".

2.4. SUPERVISION

The supervision function remains an important instrument of the Bank of Albania in fulfilling its legal and institutional mission. A main pillar of the institution, this function keeps under control the developments of the financial system and its operators. Safeguarding the financial health of financial institutions - bank and non-bank financial institutions- is of primary importance, taking into account the high share of these actors in the financial stability of the country. This goal is aimed to be achieved by expanding their controlling from licensing to the creation of regulatory infrastructure and on site supervision.

The Bank of Albania remains committed to exercise this function by taking into account all developments at micro and macro level, both domestically and internationally, to assess the impact on the health of domestic stakeholders and timely intervention to address the issues.



2.4.1. MAIN DEVELOPMENTS

The Bank of Albania signed a Memorandum of Understanding with the European Central Bank (ECB) in the field of banking supervision. Its signing enables the Bank of Albania to establish a more structured and formalized cooperation relationship with the most important financial institution of the European Union. It establishes the way the two institutions will cooperate, by providing exchange of information and conducting effective supervision, and paves the way for full participation in the supervisory colleges for relevant European banks in Albania.

In the framework of cooperation with counterpart authorities, the Bank of Albania has participated in three supervisory colleges organized for European banking groups that operate in Albania. Even though the Bank of Albania participated in the collage under the observer status, the estimations regarding the activity of subsidiaries in Albania are considered and conveyed in the framework of risk management at the group level. Also, during 2018, there was a regular flow of information on the assessment of the group recovery plan, as well as on the definition of capital requirements. In the framework of co-ordination of supervisory activities, this year, a joint (targeted) inspection was carried out with the ECB supervisors in one of the banks from EU-based groups.

During 2018, we can mention some developments in the ownership structure in the banking system, related to consolidation in the banking market, bringing the number of banks of the system to 14 and, with the eventual materialization of the changes under way, potentially to 12. In this context, the following events were materialized:

- The process of merging by absorption for two of the banks of the system. More than an internal market need, the process was dictated by developments in the country of origin of two banks. Thus, Intesa SanPaolo Bank sh.a. acquired and merged with Veneto Bank sh.a. in Albania, after Veneto Bank declared bankruptcy and was acquired by Intesa Sanpaolo Bank in Italy.
- The American Bank of Investments acquired and merged with NBG Bank Albania. This event was supported by the banking system restructuring plan in Greece for the reduction of exposure outside Greece, agreed between Greek authorities and international partners as part of Greece's economic crisis bailout package.
- The Union Bank has concluded an agreement to purchase the shares of the International Commercial Bank. This event was determined by the decision of ICB's shareholders to leave the Albanian market as well as from the Union Bank's early ambitions to expand in the domestic market through the absorption of an existing bank.
- Tirana Bank, formerly part of the Piraeus Group, for the same reasons as in the case of NBG Bank, concluded its sale of shares to Balfin Group shpk and Banka Komercijalna A.D. Skopje. This transaction



was approved by the Supervisory Council of the Bank of Albania in February 2019 and will come into force after receiving approval from the Hellenic Financial Stability Fund.

- Societe Generale Albania Bank realized the sale to OTP Bank Nyrt bank from Hungary, as part of Societe Generale parent bank's strategy to withdraw from the Balkan region in general.
- Lastly, the Credit Bank of Albania shareholders have decided on the voluntary liquidation of the bank, a process that is expected to be finalized during the first half of 2019.

The above-mentioned events are the materialization of emerging trends in recent years for the consolidation of the banking market and the majority of expected changes has already taken place. These changes raise the share of domestic capital in the market. This is expected to give an impetus to the banking activity, but, at the same time, it may bring a higher risk, requiring supervisory attention to be focused on safeguarding the quality of risk management and financial health indicators.

Exposure to credit risk, identified as the main risk on the basis of the volume and weight of the activity, the impact on banks' financial position and the dominant capital demand, declined significantly. The main indicator of non-performing loans to total loan portfolio was 11.1% at the end of 2018, thus being approximated to the same period of a decade ago. The indicator decreased by 2.15 percentage points when the non-performing loan portfolio reduced by about ALL 15.2 billion, or about 20%, as a result of events related mostly to the sale of non-performing loan portfolios and their write off from the bank balance sheets. Aside from what the non-performing loans indicator presents, in the last two years, the absolute value of non-performing loans declined significantly. In 2017, non-performing loans decreased by about ALL 30 billion and in 2018 by ALL 15 billion, a total of ALL 45 billion for 2 years or 41.3%.

Another supervisory measure is being considered to be undertaken in 2019, to reduce the regulatory requirement for the forced write off of loss loans, from three years that it is currently to two years. Despite the continued reduction of the risk to this exposure, the Bank of Albania, as part of its approach to address the issues in a stable and inclusive manner, remains committed to fulfilling all its commitments under the Action plan for reducing non-performing loans. For this purpose, it has also compiled a draft-regulation on the out-of-court addressing of borrowers, which the Bank of Albania has been discussing with other banks in several meetings and through written communication. The exchange of opinions and their reflection on the draft regulation has taken time from all parties due to the complex nature of establishing a stable and regulated co-operation form among banks. Meanwhile, in the meetings organized with banks, important issues have been discussed in view of credit risk management, such as the use of borrowers' official financial statements to support their loan application and the study of Deloitte on the financial sustainability of the largest enterprises in the country, funded by the FinSAC project of the World Bank.



An important matter of the national plan of measures for reducing non-performing loans was the use of official financial statements in assessing the credit risk of borrowers. While this matter was addressed for large exposures of banks by the regulation "On the risk management for large exposures of banks", in 2018, this requirement was extended to all types of borrowers. Since banks were already aware of this measure, through written form by the Governor of the Bank of Albania, it was brought to attention this request and its implementation was monitored continuously by our Supervision Department during on-site supervision.

In the framework of the national plan for the reduction of non-performing loans, another task of the Bank of Albania was the improvements in the Credit Registry. In addition to the improvements realized in 2016 within the institution, a working group has been set up to expand the database in order to harmonize credit reporting in accordance with international standards. Meanwhile, the Bank of Albania is part of the discussion process for the establishment of the Credit Bureau, with representatives from the European Bank for Reconstruction and Development and the Albanian Banking Association.

There is still room for review and discussion of the "Internal Capital Adequacy Assessment" document, as well as of the "Recovery Plan", presented by each of the banks. These two documents represent a complete self-evaluation of the capabilities of the bank to monitor and cope with the risks levels that arise during casual activity, and to recover from a difficult financial situation.

- The process of internal capital adequacy assessment is a novelty for both banks and supervisors and as such it requires a long-term commitment. The first assessment of this document pointed out the quantitative effects calculated by banks, compliance with regulatory requirements and some shortcomings for a wider and more qualitative inclusion of risks with potential effects on capital requirements.
- In 2018, recovery plans were subject to enhanced regulatory requirements, whilst their assessment is conducted in close communication with banks, as well as with the World Bank's valuable assistance. Plans drafted by Banks had a qualitative increase, though there are still elements that need to be improved for a better integration with the internal risk management framework, and with strategies and objectives at individual and group level.

In terms of improving supervisory processes, the Bank of Albania remains committed to finalizing two projects assisted by EBRD and WB. More specifically, with the assistance of the European Bank for Reconstruction and Development, an assessment was conducted on the internal supervisory procedures on risk assessment, mainly organizational and credit risk, as well as of the regulatory framework for this purpose, accompanied by concrete proposals for change. A plan was drafted for their implementation based on the assessments on the proposed changes. The other documents is on the communication and



exchange of information and evaluation of external auditors in order to improve the monitoring of banks and auditors. This document is drafted with the assistance of World Bank and Grant Thornton.

During 2018, based on the already known regulatory changes regarding the additional requirements for reporting by financial entities of quantitative and qualitative data, in accordance with international standards and the recommendations by the Moneyval experts' during the fourth round of assessment on Albania, the Bank of Albania continued with an assessment of the entities' exposure to money laundering and terrorism financing risk. The external assessment presents a generally average exposure of the banking system, while for other entities this risk is high. The results of this assessment are taken into consideration for the drafting of supervisory plans for the most exposed entities such as Foreign Exchange Bureaus. During 2018, 23 of such were inspected for PPP / CFT. For seventeen of them, supervisory and administrative measures were taken for the identified shortcomings.

In the first part of the year, the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) completed the fifth round of the assessment of Anti-Money Laundering and Terrorism Financing Measures, a process that was initiated and reported since 2017. The assessment, where the Bank of Albania has played a special supporting role in the position of the supervisory institution for the majority of the financial market, ended in July 2018, with the passing of the evaluation report at Moneyval's plenary meeting. According to this report, financial entities were assessed with a "substantial / significant" level of effectiveness, in particular when banks present a good understanding of the risks of money laundering and terrorism financing and of legal obligations, and have generally taken appropriate measures, in proportion to the estimated level of risk, regarding the prevention of money laundering and terrorism financing. The evaluation process included also a plan of measures aimed at addressing the main problems identified in the report, whose fulfilment will continue during 2019.

Cooperation with General Directorate for the Prevention of Money Laundering during the year continued more intensively. This cooperation materialized in the framework of Moneyval's assessment process, joint inspections as well as contribution towards revising the legal framework for money laundering prevention issues.

Finally, in support of its mission, the Bank of Albania continued its normal activity: monitoring the financial system, mainly banks through on-site inspections and of-site examination, assessment of the level of exposure to individual risks and monitoring their administration as well as reviewing / improving the regulatory framework, licensing of subjects, or additional activities.



2.4.2. ON-SITE INSPECTIONS

Full and partial inspections were conducted during 2018; in 7 banks, 10 non-bank financial entities, and 31 Foreign Exchange Bureaus. The main focus and sources are focused on bank inspections, which play a significant role in the financial market activity. Special attention was paid on banks in purchasing / merging processes, or banks with high growing rates. Meanwhile, the above-mentioned inspections, for 5 banks, for 7 non-bank financial entities and for 8 Foreign Exchange bureaus were conducted in cooperation with the General Directorate for the Prevention of Money Laundering and inspection in a bank was conducted in cooperation with the Financial Supervisory Authority.

Table 6 Number of inspections by entities and topic

Inspections of entities	Strategic risk	Organisational risk	Credit risk	Liquidity risk	Interest rate risk	Market risk	Information and Communication Technology	Operational risk	Reputational risk	Profitability	Capital
2016*	6	7	8	6	7	7	7	7	8	6	8
2017	9	12	13	10	10	9	11	8	11	10	11
2018	8	10	9	8	8	8	9	8	48	9	8

* In 2016, 14 joint inspections were carried out with the Deposit Insurance Agency (ASD) in the Loan and Savings Association, where the Bank of Albania's presence reflected the support towards ASD.

The recommendations from inspections, focused on the following main areas:

- Increase of the importance of the steering council in drafting strategic plans (including planning of needs for capital), as well as the oversight of their implementation.
- Assurance of a proper relationship between dependent and independent members of the Steering Council.
- Adaptation and completion of the organizational structure in accordance with the growth pace of the activity and provision of appropriate incentive and reward systems.
- Strengthening internal audit systems, increasing the quality of work and independence of audit structures.
- Careful implementation of investment policies, by avoiding complex instruments with no known ranking.
- Careful handling of related borrower groups, as well as strengthening eligibility criteria during financial analysis of loans; reclassification of borrowers and creation of additional reserve funds.
- Deepening the analyses related to liquidity risk and interest rate risk.
- Increasing support from Information and Communication Technology,



strengthening the safety programs, regular risk assessment, review of the continuity plan, staff increase, etc.

- Accurate application of regulatory requirements for calculating capital indicators.
- Increase of attention in terms of PPP measures, application of automated monitoring systems, staff training, etc.

Banks generally reacted in due time regarding all recommendations, taking appropriate measures to ensure compliance with regulatory requirements at all times.

With regard to non-bank financial entities, the focus of 2018 has been on entities that are part of banking groups, in order to comprehensively assess these groups. Overall, the results were positive, evidencing a careful management of risks across the group, in line with regulatory restrictions for related parties. Micro-credit and payment services institutions were also at the focus of supervision in this year. Issues identified during the inspections are related to the re-classification of the loan portfolio and their relevant effects in the financial statements, risk management from open foreign exchange positions, improvement of the internal governance framework, internal audit systems, etc. The on-site supervisory process for these subjects is also focused on assessing the level of transparency with customers, where it has been stated that the entities with consolidated experience in the market generally present a higher level of transparency and attention to customer complaints. Newer entities, in spite of respecting the legal and regulatory requirements, still need some improvement regarding their level of transparency. At the end of the inspections, recommendations were left for making necessary improvements.

Part of the supervisory process is also the follow-up of the implementation of the recommendations, as well as the quick reaction in cases of potential risks or violations of indicators reported by bank and non-bank institutions. In 2018, besides on-site inspections, there were frequent correspondence and contacts with all subjects in response to events or developments with potential impact on their financial situation, coupled with specific supervisory measures and requirements. The Bank of Albania has also been attentive to international developments, notably the Turkish Crisis, during the past year, regarding which restrictive and preventive measures were taken for banks with exposures in this country.

2.4.3. REVIEW OF THE LEGAL AND METHODOLOGY FRAMEWORK

Through the review of the supervisory and regulatory framework, during 2018, the Bank of Albania aimed at completing and further improving it, in order to ensure more effective supervision in compliance with the legal requirements. The review of the regulatory framework was based on the approximation of the most recent developments in the legal and regulatory acts of the European



Union (EU) and Basel documents, and by considering the issues identified by supervisors during the oversight of entities and suggestions made by the latter, in the context of an ongoing communication with them.

Below are some of the major regulatory changes during 2018, namely:

- Amendments to the regulation "On consumer credit and mortgage credit" were adopted, in order to further align with the requirements of the EU Directive 2014/17, which aimed at the continuous strengthening of supervisory requirements for consumer protection. The amendments set additional requirements for the existence of the consumer's right, to replace the collateral with another collateral, upon the meeting of certain conditions; for the bank to offer some options / alternatives (if any) to mitigate the exchange rate risk for the consumer; for the provision of the consumer's right to demand conversion of the credit in the currency in which his income is, if the conditions are met, based on the bank's analysis or estimates; for the presentation of an illustrative example for the consumer, as part of the pre-contractual information, to raise awareness of the exchange rate risk, etc.
- In the framework of the Bank of Albania's initiative to increase the use of the national currency and to reduce the use of foreign currencies (de-euroization) in the Albanian financial system, some amendments to the supervisory regulations were adopted:
 - In the regulation "On Liquidity Risk Management", the change consisted in the increase of the minimum required level, for the indicator of liquid assets to short-term foreign currency liabilities, from 15% to 20%, while the minimum level of this indicator remained unchanged, for the national currency (15%) and for the total (20%); and
 - In the regulation "On transparency of banking and financial products and services", the changes consisted in the increase in the demand for the bank to provide an alternative and comparable credit in the currency in which the client generates his income, for the client applying for a loan in a different currency, based on the Bank's assessment of the insufficiency of its capacity to hedge against exchange rate risk, as well as the presentation of an illustrative example for the borrower (at the time of applying for a loan). The latter raises the awareness of the customer on the risk of borrowing in foreign currency.
- Amendments were adopted in the regulation "On the capital adequacy ratio", which relates to the abrogation of the remaining part of the countercyclical package of measures imposed on banks in 2013.
- The Supervision Department, in order to continuously align with the European directive and regulation on the activity of credit institutions and with the standards of the Basel Committee for effective supervision, has completed the drafting of the new draft regulation "On the liquidity coverage ratio", which aims at introducing a new liquidity indicator in



the regulatory framework of the Bank of Albania. The draft regulation was also consulted with the banking system and is expected to be adopted in early 2019.

- In the framework of regulatory initiatives aiming at reducing non-performing loans, a draft regulation was drafted on “Out of court treatment from banks of borrowers in financial difficulties” together with some amendments to the regulation “On Credit Risk Management by banks and foreign bank branches”. These documents were also discussed with the banking industry and the Bank of Albania remains committed to further proceed with their approval in 2019.
- During the year, the Bank of Albania worked toward the approval of the guideline “On Stress Testing in Banks”. The first draft of the document, concluded at the end of 2018, is currently in the consolidation and submission for opinion phase to the banking system within 2019 Q1. This document defines the requirements and methodologies for carrying out stress tests from banks as an important part of the risk management process and in the framework of the internal assessment process of capital adequacy. This guideline is drafted based on the provisions of the European Banking Authority (EBA) guidelines on the preparation of stress tests by banks.
- During 2018, some regulatory changes were made in the regulation “On bank regulatory capital”, which aimed at approximating the requirements of the Bank of Albania with Basel III requirements for capital ratios, which will precede the establishment of the requirements for capital buffers banks, in the future from the authority. In addition, in order to proceed with the fulfilment of the by-laws for early intervention in the implementation of the Law on recovery and resolution in banks, final drafts of regulatory acts which provide for the requirements of the supervisory authority “For the determination of the conditions for granting prior approval for the financial support agreement within the banking group have been finalized” and “On the determination of the conditions when the early intervention measures, the conditions and the way of performing temporary management “are being consulted with the World Bank experts (FINSAC project) , while regulatory requirements for the bridge bank are under review.

2.4.4. LICENSING FRAMEWORK AND APPROVALS

Even during 2018, the Albanian banking sector continued to be dominated by subsidiaries of foreign EU-based banking groups. Compared to 2017, the number of banks was reduced to 14 from 16 banks. This is due to the revocation of the two banks’ licenses as a result of the completion of their merger by absorption from two existing system banks.



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

	2013	2014	2015	2016	2017	2018
Banks in Albania, of which:	16	16	16	16	16	14
Branches of foreign banks	-	-	-	-	-	-
Banks' ownership structure, by capital origin, of which:						
With foreign capital with Majority foreign owned ¹	14	14	13	13	13	11
- From the countries of the European Union	10	10	9	9	9	7 ²
- From Turkey	1	1	1	1	1	1 ³
- by an international financial institution (Saudi Arabia)	1	1	1	1	1	1 ⁴
- from Kuwait	1	1	1	1	1	1 ⁵
- From the Swiss Confederation	1	1	1	1	1	1 ⁶
With private capital with majority of domestic ownership	2	2	3	3	3	3 ⁷

- ¹ "Majority" is in any case the simple majority of 50 percent of the votes plus 1 vote.
- ² Banks with capital originating from EU countries are from: Italy (Intesa Sanpaolo Bank Albania), Austria (Raiffeisen Bank), Germany (Procredit Bank), France (Societe Generale Albania Bank), Greece (Tirana Bank, Alpha Bank Albania), Bulgaria (First Investment Bank, Albania).
- ³ National Commercial Bank.
- ⁴ United Bank of Albania.
- ⁵ Credit Bank of Albania
- ⁶ International Commercial Bank
- ⁷ Banks with domestic capital, as at the end of 2017 are: Union Bank, Credins Bank and American Bank of Investments.

The Bank of Albania issued preliminary approvals for: the transfer of 100 per cent of NBG Albania Bank's ownership of the shares to the American Bank of Investments sh.a.; legal reorganization of the two banks with merger by absorption; the opening of the Credins Bank sha.a subsidiary in Kosovo; increasing the financial activity of a bank, to trade transferable securities for its account; amendments to the statutes of nine banks; appointments of legal auditors of all banks; and the issuance or settlement of the subordinated debt of three banks, etc.

In line with the amendments to the regulation of bank administrators, related inter alia, with the approval of bank administrators, including cases of extending the term in the same position during the year under review, there was an increase in the number of bank applications for approvals by administrators. The Bank of Albania approved 59 bank administrators, specifically; 31 members' part of the steering council, 13 members, part of audit committees and 15 executive directors and managers of the bank's internal audit.

During 2018, 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 within the country (through closure, merger) for 30 branches / agencies within the country, and the transformation into a subsidiary of a branch of the National Commercial Bank. By the end of 2018, banks operated through 447 branches / agencies from 473 branches / agencies that operated at the end of 2017.



Based on the submitted applications, the Bank of Albania licensed an electronic money institution (Financial Union Tirana), revoked the license of two non-bank financial institutions respectively Vodafone M-Pesa at the request of the entity, and the Financial Union of Tirana after the licensing as an Electronic Money Institution and provided preliminary approvals to non-bank financial entities. As at the end of 2018, there are 30 licensed non-bank financial institutions. Meanwhile, some approvals for non-bank financial institutions were preliminary approvals for 10 administrators, approvals for exercising additional financial activities for three institutions and approval for the transfer of qualified holding of a non-bank financial institution.

As at end of 2018, there are 13 savings and loan associations and one union of savings and loan associations.

Licensing of foreign exchange bureaus continued in 2018, during which 58 new licenses were issued, while licences were revoked for 21 foreign exchange bureaus for reasons of their inactive status at the National Business Center, suspending the activity for more than two months and failure to execute reporting requirements at the Bank of Albania, or at the request of the bureaus for termination of activity. As at the end of 2018, 463 foreign exchange bureaus operate in the foreign exchange market.

Table 8. Number of banks, NBFIs, SLAs and foreign exchange bureaus licensed by the Bank of Albania (end of period)

	2013	2014	2015	2016	2017	2018
Banks and Branches of foreign banks	16	16	16	16	16	14
Non-bank financial institutions	21	22	27	28	31	30
Foreign exchange bureaus	333	356	397	428	426	463
Unions of Savings and Loan Associations	2	2	2	2	1	1
Savings and Loan Associations	121	113	111	13	13	13

Source: Bank of Albania.

2.5. RESOLUTION

In accordance with the Law No. 133/2016 "On 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 its capacity as Resolution Authority, during 2018, the Bank of Albania has fulfilled its mandate for this function, achieving the targets defined in accordance with legal requirements. In this regard, the resolution regulatory and procedural framework has been drafted, aiming at the harmonisation with the international technical standards. The first phase of the draft of the resolution plans has started, defining the resolution strategy that allows the continuity of the critical functions of banks and maintaining financial stability. In terms of achieving the operational objectives set as priorities for the functioning of the resolution, the regulatory framework has been supplemented with two



new regulations approved by the Supervisory Council of the Bank of Albania. Also, during 2018 the Resolution Fund was established and the procedures for monitoring its management were built up, thus by enhancing the cooperation relationships with the Deposit Insurance Agency (DIA). The Bank of Albania has also expanded the cooperation relationships with the European institutions by signing a cooperation agreement with the Single Resolution Board (SRB).

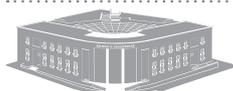
2.5.1. COMPLETION OF THE REGULATORY AND METHODOLOGICAL FRAMEWORK

In compliance with the obligations deriving by the Law No. 133/2016 "On recovery and resolution of banks in the Republic of Albania" during 2018 the following were approved:

- a. Regulation No. 31/2018 "On resolution plans". The Regulation specifies the content of resolution plans drawn up by the Bank of Albania as Resolution Authority, for individual banks or group of banks that operate in Albania. Also, the Regulation identifies the entirety of information and data necessary that banks should submit to the Bank of Albania, for the purposes of resolution planning. In this regard, the Bank of Albania has developed several standardised forms to collect data as well as a detailed guideline to facilitate the process of data collection.
- b. Regulation No. 43/2018 "On the cooperation between the Supervision Department and the Resolution Department". The Bank of Albania is the Resolution Authority as well as the Supervision Authority for banks that exercise their activity in Albania. In this regard, the Bank of Albania exercises the supervision function and the resolution function through two different organisational units within itself, which have separate reporting and dependency lines, ensuring their independence in the respective decision-making. The employees of the organisational units that are responsible for exercising the supervision and the resolution functions cooperate effectively in drafting, planning and implementing the resolution decisions. The cooperation Regulations defines the ways these two units cooperate, the sharing of information; as well the relevant duties and responsibilities in fulfilling the recovery and resolution objectives in banks.
- c. During 2018, the Regulation "On valuation for purposes of resolution" was drafted and is in the consultation process. There are defined the requirements and manner of selection of the independent valuer for resolution purposes as well as the relevant valuation and determination methodologies of the value of liabilities deriving from derivative products.

In the framework of meeting resolution objectives, during 2018 were drafted:

- a. The Guideline "On the identification of critical functions with and main activities of the banking sector". The identification of critical functions



main activities of the bank is very important in the process of recovery and resolution plans' drafting. The recovery plan (drafted by the bank) includes the identification of critical functions and main activities through self-assessment process by the bank, while the resolution plan (drafted by the Bank of Albania) describes how the critical functions and main activities may be separated legally and economically from the other functions, in order to ensure their continuity after the resolution as well. This Guideline aims to specify the criteria defining and identifying the critical functions through self-valuation by banks, as well as the criteria defining the main activities and related services in accordance with the same approach.

- b. "Guidelines on meeting the requirement to collect the necessary information for drafting resolution plans". Requirements to collect information as well as the guidelines addressed in this document are drafted in accordance with the Regulation "On resolution plans". By using forms drafted for this purpose, the aim is to collect information related with the governance and management of the bank, its main activities, the structure of liabilities, the placed collaterals, off balance-sheet items, payment, clearing, and settlement systems used by banks, the information systems, financial and other interconnectedness and dependencies, as well as contractual agreements that may either affect or be affected by the resolution actions.

2.5.2. ESTABLISHMENT AND MONITORING OF THE RESOLUTION FUND

Pursuant to the legal requirement and provisions set out in the Regulation No. 56/2017 "On the Resolution Fund and the procedures for its management", the Bank of Albania calculates the targeted level of the Fund and the annual contribution of each bank, based on the financial statements of 2016.

- The fund's targeted level of the "Resolution Fund" calculated with the audited balance sheet data of the banking sector in December 2016 is ALL 6 billion.
- The annual level of the "Resolution Fund" for the first year of contribution is ALL 632 million and is calculated proportionally according to the share of each bank in the liabilities of the banking sector, defined as the difference between assets and regulatory capital.

The Resolution Fund was established in January 2018 through the transfer of the first part of the annual contribution by the banking sector. In April 2018 was finalized the transfer of the contribution's second instalment as well. The Fund is managed by the Deposit Insurance Agency in accordance with the document "Management Policy of the Resolution Fund". It is monitored on a quarterly basis against the limits established in the above-mentioned document on liquidity, instruments' maturity, issuing agencies and investment currencies to insure the necessary liquidity and security of the Fund in accordance with the legal requirement.



2.5.3. PLANNING THE RESOLUTION

As one of the main pillars of the resolution, the resolution plans aim to facilitate the efficient use of resolution tools by the Bank of Albania. The Bank of Albania has begun the process of drafting the individual resolution plans and defining the resolution strategies for each bank and banking groups that operate in Albania. In this framework, through the identification of the critical functions was realized the first step of resolution planning. The identification of critical functions for each bank is an important obligation/task in the resolution planning process since preserving the continuity of critical function constitutes one of the main objectives of the resolution.

BOX 7 CRITICAL FUNCTIONS

The banks offer a series of economic functions that are important for financial markets and the real economy overall. Here we can mention: accepting deposits; granting loans; payment settlements etc. The identification of the economic functions that are essential to maintain financial stability is one of the main objectives of resolution. According to the definition given in the Law No. 133/2016 " critical functions shall be the activities, services or operations of a bank, the discontinuance of which can bring the disruption of services that are essential to the real economy or disrupt financial stability due to the size and share of market it represents, its internal or external interconnections, complexity or cross-border activities, with particular regard to the inability of substitution of those activities, services or operations in the market."

According to this definition, an economic function is considered critical, if it fulfils the following two elements:

- a. *the function is provided by a bank or a banking group for third parties that are not linked with the bank or the banking group itself;*
- b. *the sudden disruption of the function may have an important impact on the third parties, may create a negative chain effect or may impair the overall confidence of participants in the market due to the systemic importance that the economic function has for the parties that use it or due to the systemic importance that the bank or banking group that provides the function has.*

For the valuation of these two element, the Bank of Albania has developed a methodology for identifying critical functions, which includes two steps:

- 1) *The impact analysis of the sudden disruption of the function aims at assessing the impact on the financial market or the real economy from this event as follows:*
 - a. *Impact on third parties relying on that function: if the disruption of the function has a direct negative impact on a small number of third parties that are not systemic, then the function is not considered critical.*
 - b. *Systemic impacts and interconnection: if the disruption of the function has important negative effects on the real economy and financial markets, in terms of chain effect and impact on market confidence, respectively, then the analysis is oriented as follows:*



- if the disruption of the economic function by the bank impairs the relevant market or other participants that are exposed in that market or interconnected with the bank, the function is critical.
 - if the disruption of the economic function has a broad range and a high number of market participants and the market itself is important for the functioning of another market, the function is critical. In this case it is also important to assess how much the market may be affected by the overall loss of confidence of its participants due to the disruption of the function. Market loss of confidence is more probable in the case of functions that are more “visible” or publicly known by the clients or the public (e.g. payments services for households), increasing in this case the criticality of this function.
- 2) The supply analysis aims to assess if there are similar providers in the market who can substitute the critical function disrupted by the bank. If the economic function and its role may be easily substituted by other market participants (including those that may enter in the market), in comparable size and quality, with acceptable costs and within a reasonable timeline, then it is not considered critical. The basic criteria to assess the “substitutability” are the market structure for the economic function as well as the availability of providers which includes:
- The concentration structure of the market, i.e. how many participant there are in the market (including the market share, the number of competitors or similar participants that are able to undertake providing the critical functions);
 - The valuation if there are other functions and markets that provide an equivalent economic function with the activity or economic function disrupted by the bank.

Based on the business model of the banking sector in Albania, banks provide five economic functions that serve as a starting point for assessing their criticality. These economic functions are:

- a) Acceptance of deposits;
- b) Lending and loan services;
- c) Payments, settlements and custody;
- d) Assets of wholesale funding markets;
- e) Capital markets and investment in public debt instruments

During 2018, the Bank of Albania has identified the critical functions for each bank, thus also defining the resolution strategy, which support the continuity of these critical functions and maintains financial stability.

2.5.4. COOPERATION WITH OTHER INTERNATIONAL INSTITUTIONS

In its capacity as Resolution Authority, the Bank of Albania enters into cooperation agreements with other resolution authorities that are responsible for the resolution of cross-border banking groups that operate in Albania. Considering the important share of European banks in the activities of the Albanian banking sector, in October 2018 was signed the Cooperation Agreement between the Bank of Albania and the Single Resolution Board - SRB. The Single Resolution Board is the Resolution Authority for European Union banks and banking groups.



This agreement provides the exchange of information and cooperation in connection with the Resolution planning and the implementation of such planning with respect to entities with cross-border operations. The Cooperation Agreement will also support drafting coordinated resolution plans for European banks' subsidiaries that operate in Albania.

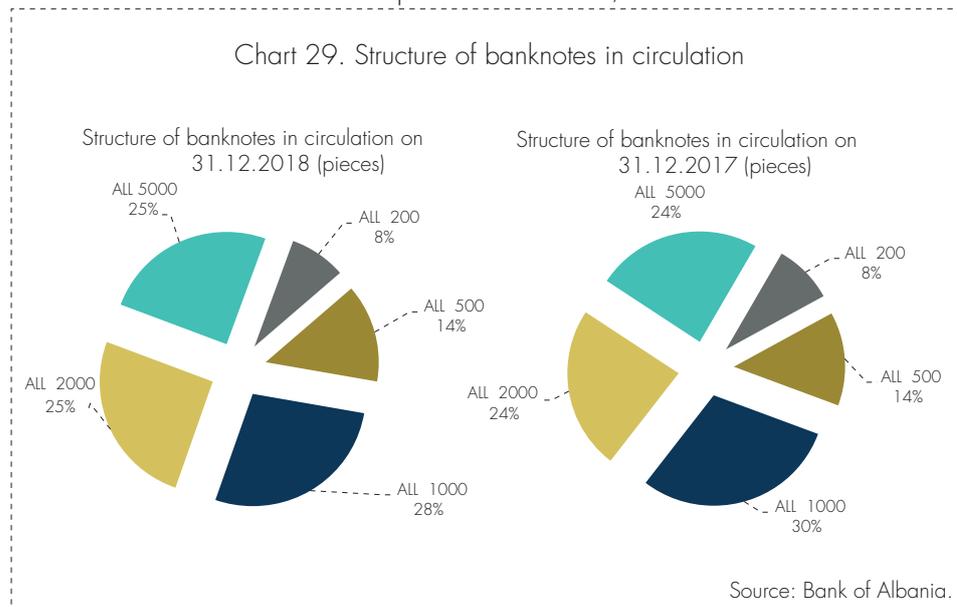
Also, in November, the Bank of Albania, in cooperation with the Financial Sector Advisory Center (FinSAC²³) of the World Bank, organised the Regional Conference on "Recovery and resolution planning". This conference was attended by senior representatives of the supervisory and resolution authorities of the European Union, of the countries in the region and of commercial banks operating in Albania. The issues addressed at the conference focused on recent developments in recovery and resolution planning in the EU, the challenges ahead for their implementation in our region, the experiences of central banks and resolution authorities in the design and evaluation of recovery and resolution plans, on the cooperation and coordination between the responsible authorities.

2.6. CURRENCY ISSUE

The Bank of Albania has the exclusive right for the issue and circulation 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 coins and banknotes for numismatic purposes.

BANKNOTES IN CIRCULATION²⁴

At the end of 2018, there were 136,447,888 banknotes in circulation, worth around ALL 281.3 billion. Compared with 2017, the number of banknotes in



²³ FinSAC - Financial Sector Advisory Center

²⁴ It is the number and value of banknotes put in circulation by the Bank of Albania.

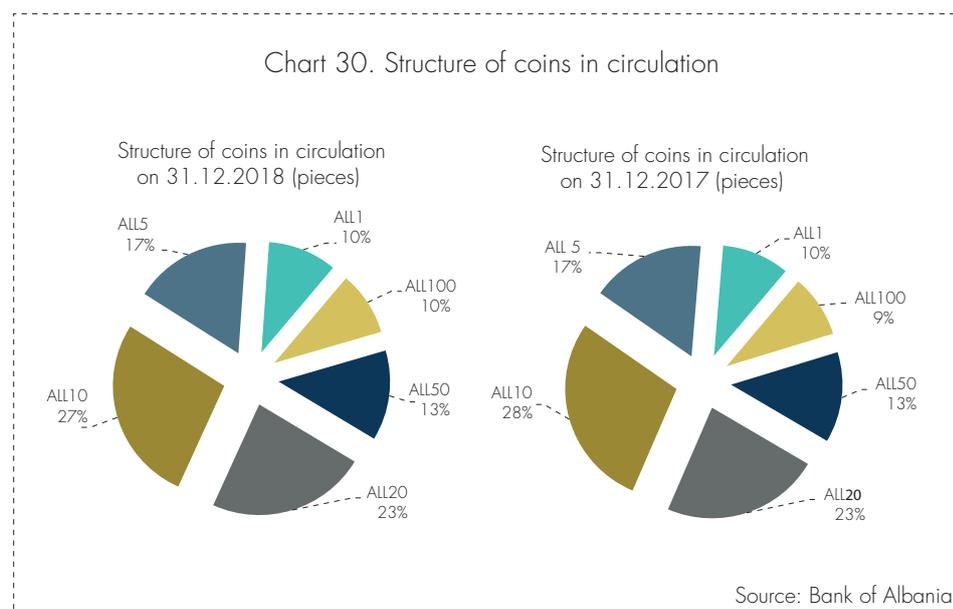


circulation increased by around 1.6%, while their value increased by 4.1%. The change in these indicators is attributable to the continuing change in structure in favour of 5000 lek and 2000 lek banknotes. The average value of a banknote in circulation was ALL 2.062 at end-2018, from ALL 2.012 at end- 2017.

COINS IN CIRCULATION

At end-2018, there were 198,670,092 coins were in circulation, worth ALL 4.8 billion. Compared with 2017, the number of coins increased by 7.9% and their value increased by 8.6%.

Chart 30. Structure of coins in circulation



Indicators of currency in circulation

At the end of 2018, the ratio of currency in circulation to the M2 aggregate was 39,741%²⁵, from 37,173% at end-2017. The circulation coefficient of the currency²⁶ was 0,404 in 2018, from 0,432 in 2017.

Recirculation and quality of banknotes in circulation

In 2018, around 106.9 million banknotes were processed, and were checked for their authenticity and fitness for circulation. From the process, around 25.9 million banknotes resulted unfit for use, and were withdrawn from circulation. The sorting rate²⁷ was 24.3%. Unfit banknotes were replaced with new banknotes fit for circulation.

The banknote circulation coefficient²⁸ for 2018 was 0.80, implying that a banknote is returned to the cash desks of the Bank of Albania, on average less than once a year,. This coefficient is higher for 500 Lekë and 1000 Lekë

²⁵ Note: the value for aggregate M2 used is based on preliminary official data as at end2018.

²⁶ Ratio of the number of banknotes and coins returned to the Bank of Albania cash desks to the average annual number of banknotes and coins in circulation.

²⁷ Ratio of unfit banknotes and coins to the total number of banknotes and coins sorted in a year.

²⁸ Ratio of the number of banknotes returned to the Bank of Albania cash desks to the average annual number of banknotes in circulation.



banknotes (around 1.51 and 1.17, respectively), and lower for 5000 Lekë and 2000 Lekë banknotes (around 0,164 and 0,728, respectively).

Analysing the structure and themes of currency in circulation

Bank of Albania objectives for banknotes and coins relate to improving the quality of banknotes in circulation, higher engagement with regard to protection against counterfeiting, and reviewing themes, design and security features in legal tender series of Albanian banknotes. In 2018, the work to materialize the definition of design and security features of the banknotes continued.

Protecting banknotes and coins against counterfeiting

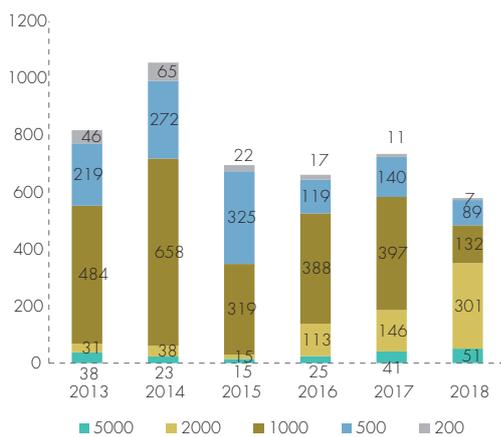
In view of safeguarding the currency from counterfeiting, during 2018 as well, the Bank of Albania has assessed as necessary to further improve and strengthen the technological and administrative capacities of its structure dedicated to implement its functions in this field. In addition, a variety of preventive actions were continuously developed and organized, focused mainly on the continuous training of cash professional staff, inspections, testing and monitoring the process of authenticating and sorting machines/equipment used by the staff, etc.

The quantity of counterfeited banknotes and coins discovered in circulation during 2018 has decreased considerably, compared with 2017, by 21%. The counterfeited amount remains insignificant compared with the amount of genuine banknotes and coins in circulation. By structure the 2000 Lekë denomination has the main share in the total counterfeit banknotes, followed by the 1000 Lekë and the 500 Lekë denominations,

differently from other years. Amongst counterfeit coins, it is identified the 50 Lekë denomination (113 coins), with a falling trend compared with the previous years.

From the technical and/or technological aspect of counterfeiting the 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 the counterfeit banknotes have a low risk to be accepted as true. Imitations of security features of counterfeiting banknotes readable by authenticating/sorting equipment are encountered only in few cases.

Chart 31. Trend of counterfeit banknotes, over the years (pieces)



Source: Bank of Albania.

2.7. PAYMENT SYSTEMS

In fulfilment of its responsibility in the field of payment systems, the Bank of Albania has paid particular attention to guaranteeing the security and efficiency



of the basic infrastructure of payments in lek, both through its role as system operator and through its role as supervisor and catalyst. Beyond consolidation of the oversight role of payment systems and services and the expansion of the oversight processes and securities' settlement systems, during 2018, special efforts have been dedicated to the reformatory role. In this framework, the Bank of Albania through the National Payment System Committee has approved the National Retail Payments Strategy in Albania (2018-2023).

2.7.1. PAYMENT SYSTEM OVERSIGHT

The Bank of Albania, in the framework of the oversight role of payment systems and payment instruments as an integral part of these systems, has undertaken a series of measures to further improve the legal and regulatory framework throughout 2018. In more detail, in order to align with the European practices in the market, the Regulation "On electronic payment instruments" has been revised. This revision aims to accommodate the innovation in the field of card payments and mainly the manner of PIN distribution through electronic means of communication. Moreover, the approval of the Regulation "On oversight policy of payment and settlement systems" aims to implement the European practices on system classification, thus creating spaces for private initiatives and avoiding oversight requirement too strict for systems that do not have a systemic importance for the Albanian market.

Also, in the framework of the developments in the securities' market throughout 2018, the Bank of Albania has drafted and signed a cooperation agreement with the Albanian Financial Supervision Authority (AFTA) for the purposes of licensing, regulating and oversight the infrastructures of clearing and securities' settlements. This agreement has created the preconditions for a draft-regulation "On regulating, licensing and oversight of securities settlement systems", which is expected to be approved within 2019 H1.

In terms of improving the legal framework, as one of the of the objectives pillars of the of the Bank of Albania strategy and the National Retail Payments Strategy (2018-2023), the Bank of Albania has worked on the transposition of the revised EU Directive 2015/2366 in the draft-law "On payment systems" (PSD2). The adoption and implementation of this draft-law is expected to have a direct impact in promoting competition and innovation in the field of retail payments, thus promoting their efficiency and reducing the costs of their use. This draft-law aims to balance the spaces for payment services providing between banks and non-bank financial institutions, by allowing the later to open payment accounts and issue electronic payment instruments. The draft-law is expected to increase the transparency of the services provided by the market and establish a consolidated framework for consumer protection. The Bank of Albania has finalised the drafting of this law and the consultation process with market stakeholders throughout 2018 and now is continuing with the other procedural steps until its approval by the Assembly.



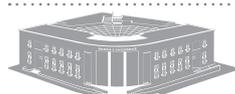
2.7.2. THE REFORMATORY ROLE - THE NATIONAL PAYMENT SYSTEM COMMITTEE

In order to promote the developments in the field of payment systems, the Bank of Albania, during 2018 as well, has played a very active role in the development of activities that promote deepening the knowledge and the actions of the various market stakeholders in this regard. The main activities on this regard are:

1. Project Greenback - the World Bank in cooperation with the Bank of Albania has organised two activities in the framework of the presentation (March 2018) and implementation (December 2018) of the Project Greenback in Berat, financed by the Swiss State Secretariat for Economic Affairs (SECO) as part of the programme for Remittances and Payments.
2. The participation on 4 May 2018 in the Card Forum on “Transforming Cards and Payments toward a Cashless Economy”, organised by the Albanian Association of Banks (AAB). The purpose of this Forum was to orient market stakeholders on the foreseeable developments by the Bank of Albania in this market.
3. The organisation of the Fourth Meeting of the National Payment System Committee on 20 June 2018 (more information available in the following section).
4. The organisation of the Conference on “Modernisation of retail payment systems in Albania” on 21 June 2018 in order to promote the vision and measures of the National Retail Payments Strategy (2018-2023). The participants in this Conference were from relevant institutions, mainly other homologue central banks like the European Central Bank (ECB), the Bank of Italy (BI), the World Bank (WB), the Central Bank of the Republic of Kosovo (CBRK), the Central Bank of Serbia (CBS). Also, in this Conference participated the Ministry of Finance and Economy (MFE), the Albanian Association of Banks (AAB), national companies licensed by the Bank of Albania in the field of payments, as well as other international companies.
5. In cooperation with the World Bank, the organisation of the Workshop “BIS Oversight Principles for the financial markets infrastructure” (June 2018), attended by representatives of the Central Bank of Kosovo as well by the Financial Supervision Authority of Albania and Kosovo.
6. Western Balkans regional workshop on “Promoting the harmonisation of the legal and regulatory framework with EU legislation on retail payments”.

Fourth Meeting of the National Payment Systems Committee

The National Payment Systems Committee was very active throughout 2018. On 20 June 2018, NPSC held the fourth meeting of the National Payment Systems Committee where were finalized and published a range of projects undertaken by this Committee, amongst which:



- The expansion of the participation in the Committee with non-bank financial institutions in the field of payments and payment systems' operators in accordance with the recommendations of the World Bank.
- The Assessment Report "Review of the Market for remittances in Albania" on the basis of the CPMI – World Bank General Principles for International Remittance Services, in order to identify the needs for intervention addressed in the action plan of the strategy's;
- The analysis "Achieving effective financial inclusion in Albania: a payments perspective", clearly identifying the need to increase the percentage of population that has a bank account as well as the need to promote the use of these accounts;
- The study "The Retail Payment Costs and Savings in Albania". Beyond identifying the high costs of using cash in the economic (around 1% of GDP), were also identified the costs borne by each economic stakeholder with a particular interest on costs for payment services providers (banks and non-banks).
- Approval of the National Retail Payments Strategy in Albania (2018-2023).

BOX 8 THE NATIONAL RETAIL PAYMENTS STRATEGY IN ALBANIA (2018-2023)

The Strategy approved by the National Payment Systems Committee in its fourth meeting is the result of several years of work by the Bank of Albania and the institutions member of NPSC with the assistance of the World Bank to identify the needs of the market and the intervention measures.

The strategy sets for the a clear medium-term vision for the retail payments market which consists in "To create a modern and inclusive retail payments market in Albania, supported by safe and efficient payment infrastructures, and a wide range of instruments and services that meet the needs of financially capable payment service users throughout the country."

The Strategy aims to improve the retail payments market by providing Albanian citizens with more choices across more places for conducting their day-to-day transactions in a convenient and cost-effective manner, also supporting the objective of broader financial inclusion. More concretely, the strategy aims to double the population that owns an account (from 38% in 2014, to 70% in 2022) and increase the number of electronic payments per capita from 4.3 in 2016, to 10 in 2022.

The strategy also includes a detailed action plan to reach the objectives, where the main measures consist in the: a) improvement of the applicable legal and regulatory framework; b) development and improvement of financial services infrastructure; c) expansion of a bank account ownership and of the use of their services; d) expansion of access points of these services; e) enhance of financial literacy and awareness; f) increase of the volume of transactions processed in the payment systems; and g) inter-institutional commitment of both private and public sectors, which is very important for the implementation of the recommendations.



It is worth pointing out that the implementation of the strategy and the materialisation of its effects requires a commitment by all market stakeholders. For this purpose, the strategy foresees concrete roles and objectives for each involved institution.

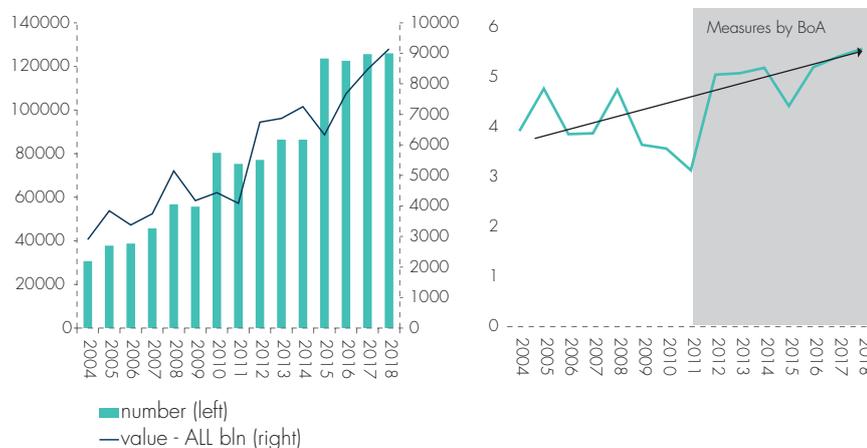
2.7.3. PERFORMANCE OF AIPS AND AECH SYSTEMS

AIPS system, which is considered the core infrastructure for the settlement of payments in the national currency and of financial markets, has functioned securely and efficiently during 2018, reflecting a high availability (over 99.9%)²⁹. In the same line, the AECH system, which accommodates the clearing of interbank transactions by banks' clients (households and enterprises) has also operated in full compliance with the rules of the system, guaranteeing a maximum availability (99.4%) for the market, avoiding incidents and delays. The participation of banks in AIPS and AECH systems resulted in a decrease from 16 banks to 14 banks at end-2018, due to the absorption of two banks by other banks of the system. The implementation of the exit from the AIPS and AECH systems of the two participants was managed successfully, reflecting no problems in the operation of these systems.

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

In 2018, the activity of the AIPS system registered a slight increase by 0.3% in annual terms, reaching a volume of 126.038 transactions. The increase is accompanied by a growth of the processed value (8% in annual terms reaching ALL 9.141 billion), reflecting an increase of the ration of processed transaction

Chart 32. AIPS performance by number and value of transactions processed in AIPS



Source: Bank of Albania.

²⁹ The availability of the system indicates how much the system was functional during the working hours announced in the system functioning regulations.

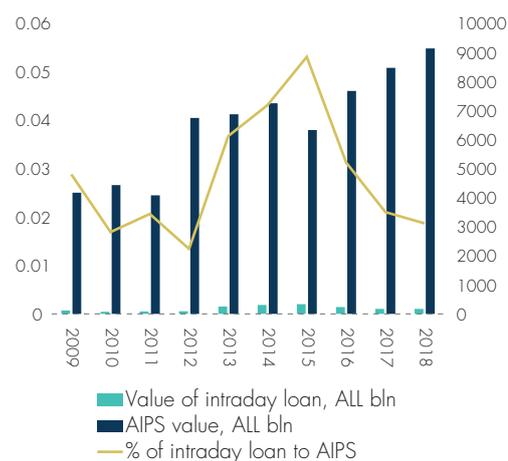


value in AIPS against GDP. This ratio resulted 5.6 times from 5.4 times in 2017 and indicated an ever-increasing use of this system by market stakeholders. The upward trend of use of the AIPS is assessed to multiply with the development and deepening of financial markets in Albania as well as the financial inclusion of the Albanian population, targeting the levels of advanced markets³⁰.

A breakdown of the analysis of the use of this system by different transaction typologies indicates that the item "Payments for Clients (with main share of payments in terms of figures, 55.93%) continues to register increasing rates in both figures and value, by 4.95% and 6.48%, respectively, compared with the previous year. On the other end, the main item in terms of value: "Settlements in the AFISaR system" (41.05%) registered a decrease of almost 3.94% in number of transactions, and an increase in value of 9.74% compared with the previous year.

In 2018, in the AIPS system were disbursed around 17.41% more Intraday Loans Facilities (ILF)³¹. However, the value of IL registered a fall by 3.71% mainly due to the decrease of the average value per transaction. This trend indicates that the exposure of the system to liquidity risk is at very low levels.

Chart 33. Intraday Loan Facility (ILF) ratio to total AIPS in ALL billion



Source: Bank of Albania.

Albanian Electronic Clearing House for retail payments (AECH)

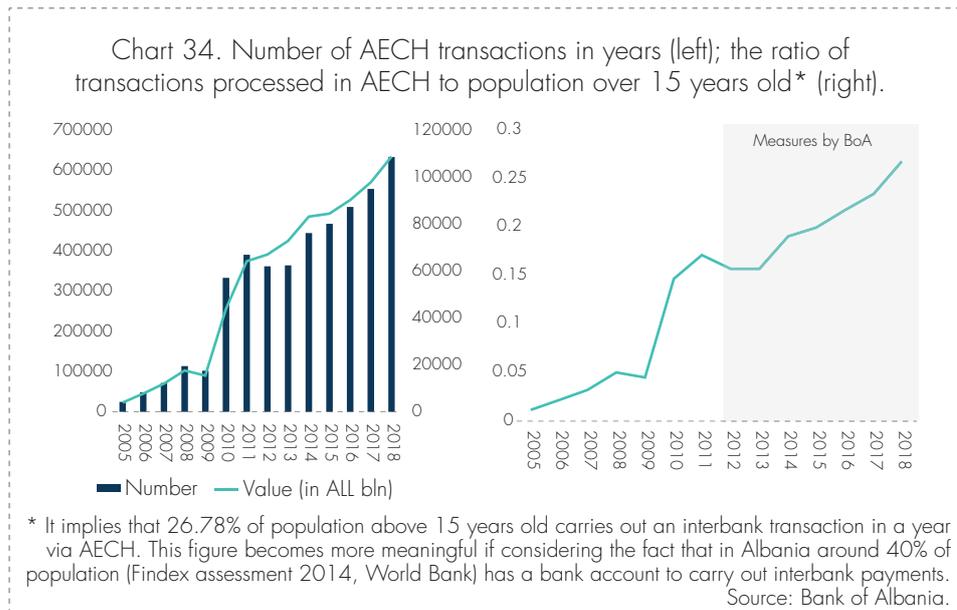
In 2018, AECH has continued to register an increase of figures and values by 14.36% and 11.15%, respectively, in annual terms. In more details, 632.923 payments were processed in AECH, with an average value per transaction around ALL 172.000, in 2018. The increase of the use of AECH indicates the familiarization of the public with payment instruments and their use at the interbank level. Also, this increase confirm the efficiency of the measures taken by the Bank of Albania, since 2011, on commissions applied by banks on the final user in order to expand the use of this system.

In order to expand the use of this system, the Bank of Albania, in medium and long-terms, has foreseen a series of measures from the point of view of infrastructural developments as well as legal and regulatory ones. The implementation of the draft-law "On payment services" is assessed to give a considerable support in this regard, as well as the implementation of the project

³⁰ Target 2 - within a week is settled an equal amount to the GDP of the European Union dictating the importance that this system has for the European markets.

³¹ ILF - the facility granted to a participant of the payments system by the central bank/operator of the system to carry out payments/settlements based on applicable laws and bylaws. The Central Bank provides liquidity within the day (ILF) to banks participating in the system, which is treated in the form of collateralized loan with zero interest. The financial instruments acceptable for granting the intraday loan are defined and monitored by the Monetary Operations Department.





of interbank Direct Debit and the expansion of the participants in the system beyond traditional ones, the commercial banks

In terms of avoiding risks in the system, the allocation of transactions cleared in AECH by sessions, shows a higher concentration in the first clearing session. This development avoids the overload in the payment flows in the last clearing session by minimising the risks from these overloads and promoting the security and efficiency of this system³².

2.7.4. PAYMENT INSTRUMENTS

The Bank of Albania, in cooperation with market stakeholders, is undertaking reforms that aim toward the modernisation of this market to provide citizens and businesses with services as efficient and at a low cost as possible. The promotion of the use of electronic payment instruments aims toward the financial inclusion of the population from the point of view of payments, which serves as a first step in the financial inclusion of the more sophisticated banking and financial products as well. The targeted objectives, the increase of the percentage of population that own an account from 40% in 2017 to 70% in 2022, as well as doubling the use of these accounts (from 4.3 payments per capita to 10 payments per capita) is assessed to materialize through the improvement of the regulatory and legal framework, infrastructural improvement, and through financial education.

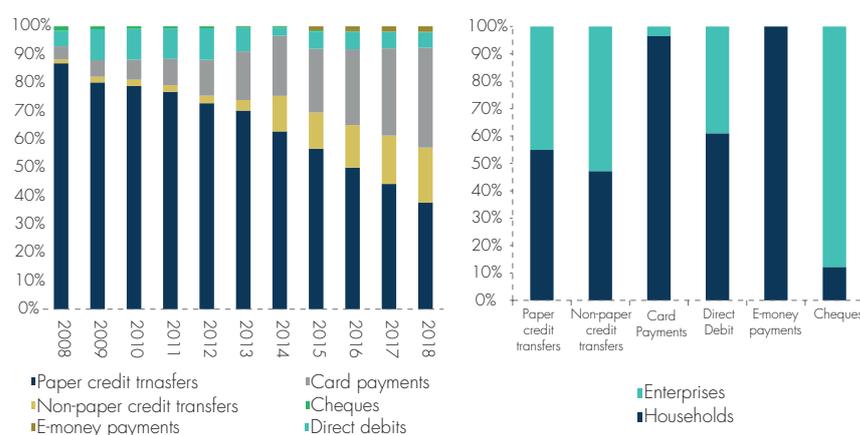
The use of payment instruments in the Albanian economy continued to increase throughout 2018, reflecting an annual growth of the number of payments by 13.23%, reaching around 15 million payments for households and enterprises.

³² This behaviour reflects the measures taken by the Bank of Albania in 2011 to differentiate sessions' tariffs thus favouring the use of the first session.



By instruments used, the payments analysis indicates a continuous expansion of electronic payments, where we may mention bank cards, credit transfers in electronic form (home banking), as well as recently the introduction of 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 2018 accounted for around 38% from around 90% in 2008.

Chart 35. Volume of payment instruments in years (left) and use volume of payment instruments by households and enterprises during 2018 (right)



Source: Bank of Albania.

HOME BANKING

The initiation of credit transfer in electronic form is realized through “home banking”³³ services, which are provided by 12³⁴ of overall 14 banks. These services are both increasingly widespread in the Albanian market, and used to carry out payments, beyond basic information services for the account. More concretely, in 2018 we observe a significant increase of the volume of home banking payments by 28.64% and of the value of these transactions by 61.02%, compared with the previous year. A contribution to the upward trend of home banking is assessed to be the development of infrastructure and the expansion of possibilities to access internet through a smartphone as well. Also, the policies of banks, in the framework of promoting these alternative payment ways, were assessed to have provided a positive role, being reflected in the increase of the remote accessible accounts, from 1% in 2008, to around 12.81% in 2018 against the total accounts. From the point of view of the use of these accounts, despite positive development (around 13 transactions per year per account) the potential for growth remains high.

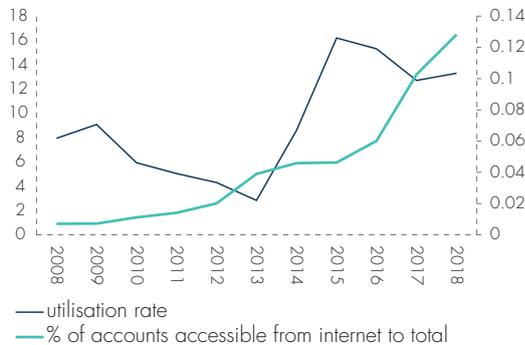
Credit transfers in electronic form are the more efficient instrument and with the lowest cost in the Albanian economy. In these regard, the reforms aimed by

³³ These products provide remote access to the bank account, via on-line, telephone or software that the bank makes available to its clients.

³⁴ At end-2018 there were overall 14 banks in the banking system (from 16 at end-2017).



Chart 36. Trend of online accessible accounts against total accounts and trend of online accessible accounts utilisation ratio*



*The utilisation ratio shows how much on average an account is used on-line to carry out transactions.
Source: Bank of Albania.

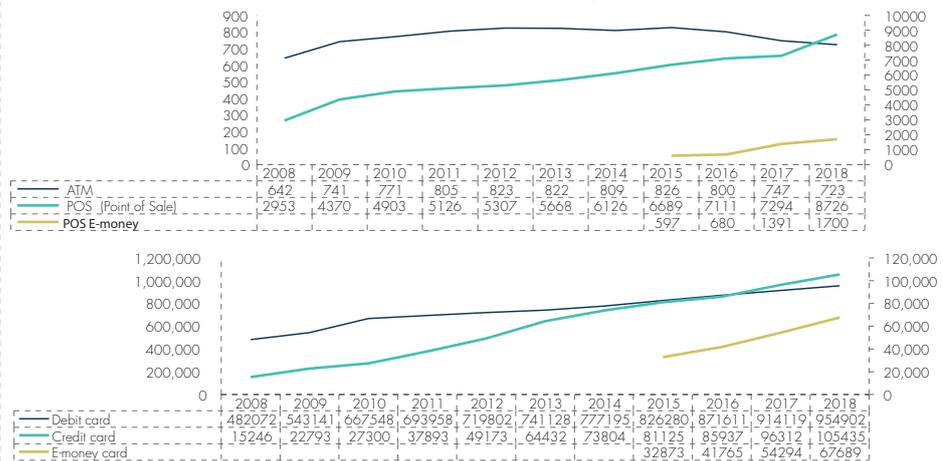
the Bank of Albania through legal (the draft-law “On payment services”) and infrastructural interventions (instant payment) are expected to have a direct impact on the further use of these services to carry out the daily payments from the citizens.

BANK CARDS

At end-2018, thirteen banks were licensed as card issuers in the Republic of Albania, of which seven were also licensed as card accepters. The infrastructure provided by these banks has trended upwards. The number of POS terminals, calculated as the ratio of POS per 1.000.000 citizens was 3.692, from 2.541 in 2017. Despite the positive trend of the increase of the number of POS terminals, their concentration continues to remain high in urban areas and mainly the region of Tirana³⁵ (83.19%).

Meanwhile, the number of ATMs has decreased by 3.21%, compared with 2017³⁶. However, it is worth pointing out that in the Albanian market ATMs are used mainly for cash withdrawal rather than for initiating payments. In these conditions, the existence of ATMs may not be directly related with the expansion of possibilities for carrying out electronic payments.

Chart 37. Developments in ATM and POS terminals left); developments in debit and credit cards (right)



Source: Bank of Albania.

Terminals for the use of electronic money cards also recorded positive developments. They continue to show an upward pace at 22.21% compared with end-2017. The encouragement to use the electronic money instruments is

³⁵ Regions are divided according to the branches of the Bank of Albania.

³⁶ It is also worth mentioning the consolidation of banks from 16 at end-2017 to 14 at end-2018.



assessed to have affected the financial inclusion of the population, by providing access to bank services (opening of an electronic money account and the owning of a pre-paid card) to categories of population who may not access other services, for example they do not take a wage.

During 2018, the issue of debit and credit cards increased by 4.46% and 9.47%, respectively. Also, the functioning of electronic-money cards in the market showed a fast increasing pace during the year, by 24.67%.

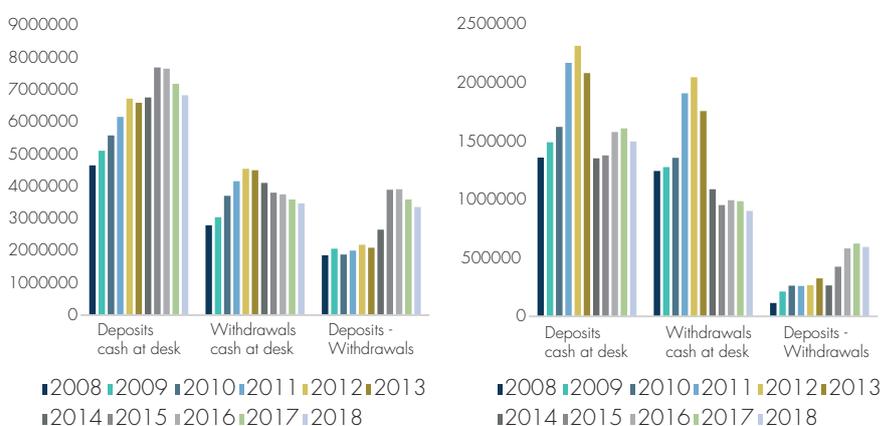
The use of bank cards in ATM and POS terminals shows that cash withdrawals from ATM terminals have the main share in transactions with cards, an indicator of a largely cash-based economy. In 2018, differently from the previous year, the number and value of card payments in physical and virtual POSs increased by 22.40% and 15.82%, respectively. In relative terms, payments carried out with prepaid cards reached up to 5.60% of the payments with debit and credit cards, up 20.57% from the previous year. The low use of cards as a payment instrument in terminals shows the familiarity level of public, the low level financial education, and the limited infrastructure of POS terminals from enterprises.

The 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 operate two electronic money institutions. During March³⁷-December 2018 these institutions together have conducted a volume of around 1.78 million electronic money payments, with a value of ALL 4.578 million.

CASH TRANSACTIONS

Regarding cash transactions conducted by customers at banks' cash desks, in 2018, we observe a decrease of the number compared with the previous

Chart 38. Number (left) and value (right) of cash transactions at banks' cash desks



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

³⁷ Since the second electronic money institution was licensed in February 2018, the aggregate report of these institutions begun in March 2018.



year. This year has registered a slight decrease of cash desk transactions by 5.48% in terms of numbers and a slight increase by 0.82% in terms of value, compared with the previous year.

Notwithstanding the decrease in using cash, from the perspective of withdrawals and deposits at banks' cash desks in 2018, the use of cash in the Albanian economy is dominant and has high costs for the various actors and the overall economy. Hence, the coordination of efforts at market level to encourage the use of efficient instruments at low costs is of special importance and one of the priorities of the Bank of Albania.

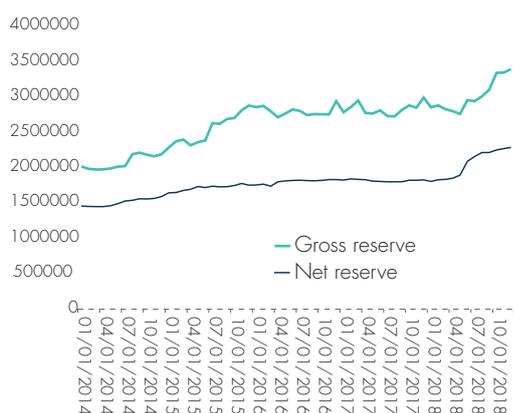
2.8. INTERNATIONAL RESERVE MANAGEMENT

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

reserve management are subject to the approval by the Supervisory Council. The primary objectives of this process are liquidity and security, whereas ensuring returns from reserve funds management represents the 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-.

Chart 39. FX reserve performance at the Bank of Albania (in EUR million)



Note: At end December-2018, the stock of foreign reserve was EUR 3,395.92 million, including the monetary gold, amounting at EUR 56.58 million, 1.7% of the total.
Source: Bank of Albania.

COMPOSITION OF INTERNATIONAL RESERVE PORTFOLIO BY MATURITY

At end-2018, the international reserve managed by the Monetary Operations Department is invested into liquid assets, mainly with maturities of 0-3 months.

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



The share of debt instrument with maturity over 5 years does not exceed 2.1% of the reserve portfolio. The portfolio managed by the external manager (World Bank) is invested against a reference portfolio of 1-3 years, mainly in debt instruments issued by governments or government agencies.

COMPOSITION OF FOREIGN RESERVE PORTFOLIO BY CURRENCY

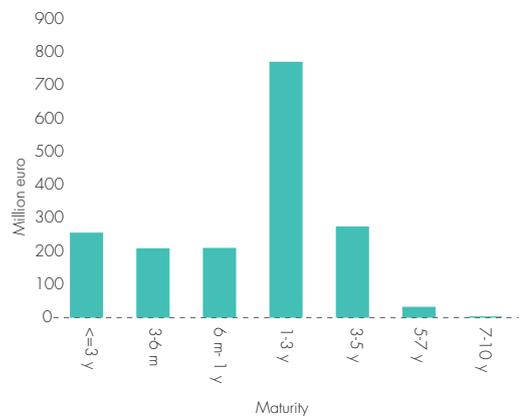
The composition by currency of the gross international reserve at end-2018 is presented in Chart 41.

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

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

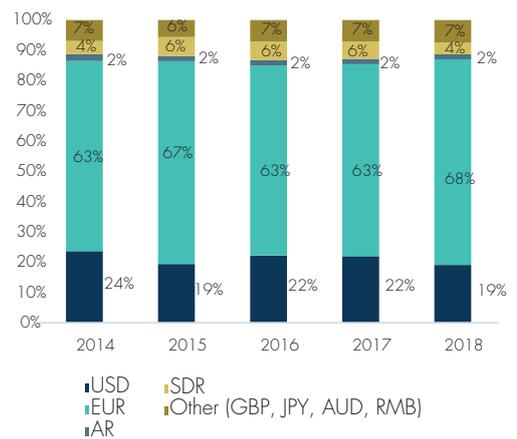
Around 84% of the international reserve portfolio resulted invested in names of high quality rating (class AAA and AA including exposures in current accounts). By type, exposures of issuers/counterparties are represented by governments/central banks (76.3%), followed by multiparty institutions (8.1%), banks/other financial institutions (10.1%), agencies (4.5%),

Chart 40. Reserve allocation by investment maturity



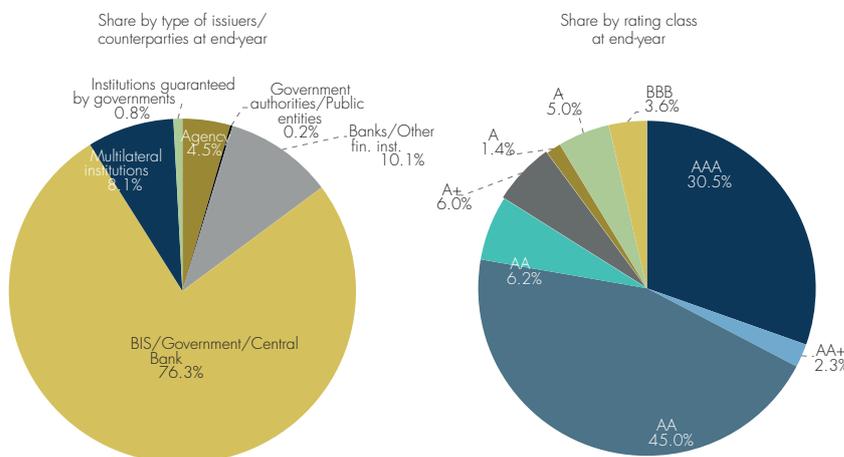
*Excluding funds kept in current accounts. Source: Bank of Albania.

Chart 41. Share of composing currencies of the international reserve in %



Source: Bank of Albania.

Chart 42. Shares by type of issuer/counterparty and rating classes at end-year



Source: Bank of Albania.



government-guaranteed institutions (0.8%) and government authorities/public bodies (0.2%).

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 0.218% in 2018, compared with -0,029% in the previous year. The low return rate reflects the challenging international environment, where the interest rates of treasury issues in euro continue to remain in a negative territory due to monetary policy pursued by the ECB (the ECB deposit rate continues to be -0.40%). Hence, the investment possibilities with a positive return rate for the part of portfolio in euro, maintaining the accepted credit risk level, still continue to be low. This situation was also reflected in the establishment of strategic portfolios in euro where during 2018 the share of cash has increased compared with the previous year. At end-2018, the situation in the current account was around 52% of the total reserve portfolio, reflecting the efforts to minimize investment costs, in the conditions of the continuation of negative interest rate in euro. Investments in securities in the euro denominated portfolio resulted with a negative interest rate that varies from -4 basis point to -69 basis point.

BOX 9 IMPACT OF EXTERNAL ENVIRONMENT IN THE INVESTMENT OF INTERNATIONAL RESERVE

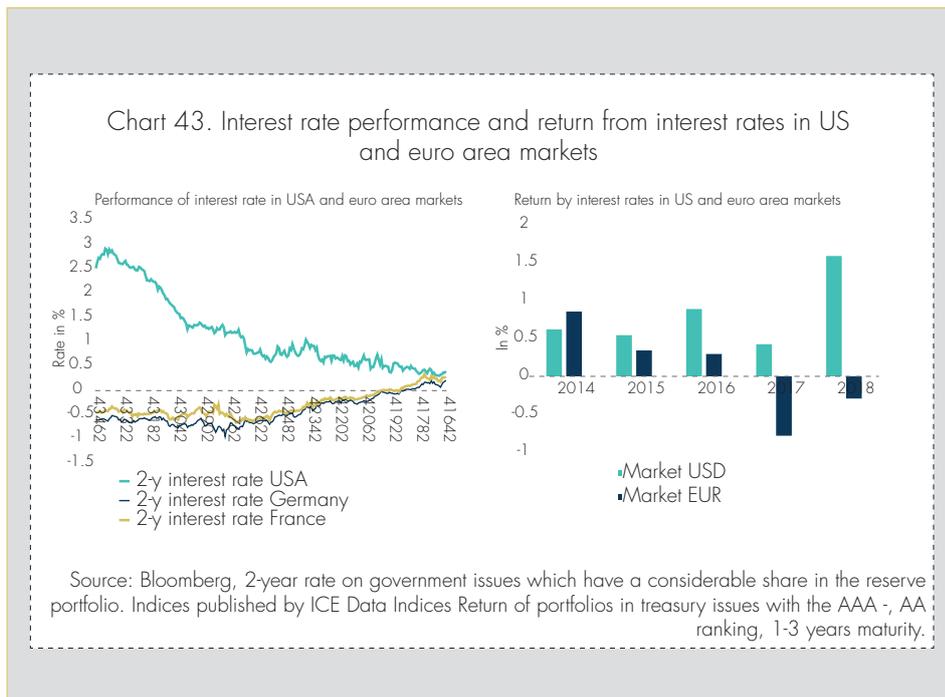
In 2018 were registered divergences in the development of the main economies and an increase of the protectionist attitude. During most of the year, the USA was characterized by a real economic growth above average (around 2.9%), mainly driven by White House fiscal policies, while the euro area, Japan and the United Kingdom had a more moderated growth (1.9%, 0.8% and 1.4%, respectively). Events like the political crisis in Italy, the USA-China trade war as well as the exit of the United Kingdom from the EU dominated the news, bringing volatility and a shift towards more safe investments. Interest rates increased in the USA, slightly increased in the UK, while remained in negative territory and almost at the same levels as the beginning of the year in the euro area and Japan.

The absolute return on the international reserve again at low levels reflects the continuation of an environment with still low interest rates, in the main currencies/markets where the reserve portfolio is invested (left); and the performance of markets in the main two currencies where the international reserve is invested, euro and US dollar (right).

The contribution to the return from of the euro, which shares higher than 60% of reserve portfolio, was negative thus reflecting the negative interest rates in the euro area. The contribution to the return from the US dollar and other currencies of the reserve was positive, due to the higher base of the average interest rates in these currencies during 2018.

The return generated from the active management of the reserve portfolio over 2018 was positive. By currency, the euro had the highest share of the contribution on this return.





OTHER DEVELOPMENTS RELATED TO THE INTERNATIONAL RESERVE MANAGEMENT FUNCTION

Cooperation with the World Bank in the framework of Reserves Advisory Management Program (RAMP) continued in 2018. The World Bank continued to provide specialized training and educational programs. These qualifications aimed at further consolidating and increasing the expertise level of the employees engaged in the process of international reserve management, the staff that supports or monitors the performance of this process and of the Bank's staff in general. Also, the World Bank provided assistance towards the integration of credit risk in the process choosing the strategic portfolio, in order to establish a more consolidated methodology for portfolios that are exposed to credit risk.

Regarding the main developments in the framework of the relationships of enterprises with counterparties, in 2018 was finalized the agreement with the Bank for International Settlements (BIS) for a credit line of EUR 500 million with this institution. The agreement serves to manage the needs for significant amount of foreign currency liquidity, by using as collateral investment securities from the international reserve portfolio. In complete accordance with the purposes of keeping an 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 act in emergency needs for foreign currency liquidity. The existence of this agreement created more flexibility for a more efficient management of the international reserve over time, particularly in the conditions where its main share in euro is invested with negative interest rates.

Within the diversification of the instruments of reserve portfolio investment, we may mention the beginning of the implementation for the first time of investments



in covered bonds as well as the analysis of new potential investment instruments, mortgage backed securities.

BOX 10 FLOWS AFFECTING INTERNATIONAL RESERVE IN 2018.

Gross international reserve, estimated and reported in euro, grew by around EUR 401.64 million, in 2018, standing at EUR 3,395.92 million as at end-December. Year 2018 is characterised again by a high fluctuation of excess reserves of commercial banks at the Bank of Albania.

A. Transactions with the Ministry of Finance and Economy provided a negative impact, estimated at EUR 15.21 million, according to the following items:

- net inflows from extension of various loans, at EUR 123.2 million;*
- inflows from the issue of foreign currency debt in the foreign market, at EUR 268.09 million;*
- Transfers, including debt service, at EUR 406.50 million.*

B. Commercial banks and other entities' transactions provided a negative impact, estimated at EUR 48.82 million, according to the following items:

- deposits by commercial banks in their account at the Bank of Albania, at EUR 1,829.23 million;*
- transfers, at EUR 1,890.10 million;*
- net inflows for the account of other entities (DIA, etc.), at EUR 12.05 million.*

C. Bank of Albania's transactions provided a positive impact, estimated at EUR 454.13 million, according to the following items:

- purchasing foreign currency from Ministry of Finance and Economy, banks and other institutions, at EUR 427.24 million:*
 - from commercial banks, at EUR 307.85 million;*
 - from institutions, at EUR 117.96 million;*
 - from the Ministry of Finance and Economy, at EUR 1.42 million¹⁶.*
- receipts from interests, coupons, etc. (calculated on cash basis) generated from international reserve investments, at around EUR 31.34 million;*
- settlement of the Bank of Albania's dues to the IMF, at EUR 1.32 million;*
- transfers, at around EUR 3.12 million;*

D. Market factors provided a positive impact, estimated at EUR 11.54 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, registering an effect of around EUR 30.70 million;*
- the portfolio revaluation effect, as a result of interest rate volatility, is estimated at a negative value of around EUR 19.16 million.*



2.9. STATISTICS

In accordance with the provisions of the Law “On the Bank of Albania”, the Official Statistics Program and the Law on Official Statistics, the statistics of the Bank of Albania aim 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 compiles and publishes statistics necessary for monetary policy, supervision of the financial market, financial stability and other tasks of the Bank of Albania. These statistics are available to the public in the Statistics section at the official website of the Bank of Albania.

In view of its strategic vision, the Bank of Albania has intensified its work towards fulfilling quantitative standards of international methodologies and EU legislation, related to the content and reporting of statistics to European and international institutions. At the same time, attention has been dedicated to building databases with detailed data so as to enhance the micro-macro consistency of and to provide the establishment of new indicators in response to the evolution of analytical needs. Fostering and deepening the dialogue with data users, to better identify their needs, remains our focus.

The Bank of Albania also complies with the reporting obligations to international institutions, the IMF, the World Bank, Eurostat and the ECB, within the framework of the European integration process of Albania. The Bank of Albania is a member of the General Data Dissemination System (e-GDDS) and various reporting systems ran by the IMF.

Since 1 November 2018, the Bank of Albania was accepted as full institutional member of the Irving Fisher Committee (IFC) on Central Bank Statistics. The IFC promotes the exchange of ideas among economists, statisticians, policy-makers as well as other participants in the discussion of statistical issues related with financial and monetary stability. In particular, the IFC aims to strengthen the relations between statistical compilers, the users’ community and statistical data analysts within and outside the central bank institution.

APPROXIMATION OF METHODOLOGIES WITH INTERNATIONAL STANDARDS

The Bank of Albania intensified its work for aligning the methodology of statistics with the international standards and their harmonization in accordance with the *acquis communautaire*. Concrete efforts have been undertaken to create new indicators, as well as to improve the data processing system in order to meet the obligations arising from the “Action plan on economic, monetary and financial statistics for candidate and potential candidate countries” at the European Union.

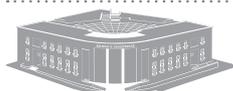


In the field of monetary and financial statistics, in the framework of alignment with international compilation standards (ECB, IMF), and in line with the recommendations of the ECB's experts report, progress has been made in the following aspects:

- The National Financial Accounts³⁹ statistics were published for the first time in December 2018, in compliance with the compilation standards of the European System of National and Regional Accounts (ESA 2010). Financial accounts constitute an important statistical pillar for monetary policy and financial stability analyses.
- Particular attention was dedicated to the series' timeframe, requirements arising from the obligations in the framework of the calculation and reporting of MIP indicators (Macroeconomic imbalances procedure)⁴⁰. The drafting of this new statistical block at the Bank of Albania was supported and assessed by several missions led by IMF and Eurostat experts.
- The government financial statistics project - the Excessive Deficit Procedure (EDP) and government's financial accounts in accordance with the best international methodological standards and practices have been a priority in 2018. The the Excessive Deficit Procedure (EDP) represents an important statistical block for monitoring the soundness of public finances in member and candidate countries towards respecting the two criteria of Maastricht.
- The development and drafting of interest rate statistics in accordance with the Regulation (EU) No. 1072/2013 of ECB, dated 24.9.2013 (ECB/2013/33). Interest rates statistics are the basis of the analysis of the monetary transmission mechanism. They also allow the monitoring of structural developments in the banking and financial systems as well as the analysis of financial stability aspects, such as banks' interest rate margin, their changes in profitability, etc.
- In September 2017, the Supervisory Council of the Bank of Albania approved the Regulation "On interest rate statistics reporting at the Bank of Albania", which fully aligns with the Regulation (EU) No 1072/2013 of ECB.
- Completion of the Financial Soundness Indicators framework. Since end-2017, the Bank of Albania publishes at Albania's web page of IMF (<http://fsi.imf.org>) the Financial Soundness Indicators. FSIs include aggregate data on financial institutions as well as indicators representative of the markets in which these institutions operate.
- In the field of external statistics, the methodological alignment has affected mainly the balance of payments current account. The progress has been supported by cooperation/assistance projects with Eurostat.

³⁹ In accordance with the Official Statistics Programme 2017-2021 and the Statistics Publishing Calendar of the Bank of Albania.

⁴⁰ For Albania, the completion of MIP is a project supported by ECB and Eurostat and coordinated by the Bank of Albania. The majority of the included indicators are compiled by BoA and have to be reported in a 10 year timeframe.



The time of publication and transmission of the indicators of International Investment Position has reduced in accordance with the timeline on data transmitting of Eurostat.

- Under project IPA 2015 MB PP1.2: On International Trade in Services, the aim is to improve and harmonize the statistical methodologies related with international trade in services statistics (ITSS) in order to gradually align with the acquis and improve the transmission of data to Eurostat in accordance with the requirements proposed by BoP Vademecum and the regulations of the European Parliament and the European Council.
- The Bank of Albania has coordinated with success the work on the development of macroeconomic imbalance indicators (MIP indicators) for Albania, in cooperation with INSTAT and with expertise from the European Union. The Macroeconomic Imbalance Procedure (MIP) is a system for monitoring economic policies and duly discovering potential risks in the normal functioning of the European Union economy. The MIP is part of the EU acquis to be adapted by candidate countries by the date of accession.
- During 2018, we worked on the realisation of the objectives of the project “Necessary data sources for calculating the indicator of the Macroeconomic Imbalance Procedure” (September 2017 - August 2019). Each quarter, the latest updates and progress on each of the indicators included in the Macroeconomic Imbalance Procedure are reported to Eurostat. The project is scheduled to be concluded in August 2019 and also includes the preparation and reporting at Eurostat of the Data Quality Report and the project’s Final Report in 2019.
- In 2018 H2, the project “Improving the Credit Registry in order to increase its level of use and harmonization with the ECB methodological standards” was initiated. The Bank of Albania is working on the implementation of the Regulation No 2016/867 of the European Central Bank on the collection of detailed data related with credit and credit risk. This will allow the implementation of the new reporting requirements by the banking system in the framework of the Credit Registry and establishing an harmonized database with detailed information on loans granted to natural and legal persons.

ENHANCING THE QUALITY AND INTEGRITY OF STATISTICS

The fulfilment of the quality criteria of statistics, in accordance with the requirements of the codes of practices and international standards on data quality has been the focus of the statistics function. During 2018, a group of experts from Eurostat conducted an evaluation mission on the Statistical System in Albania (Peer Review). This mission evaluates the compliance with the Principle of the European Statistics Code of Practice (CoP). It assessed that Bank of Albania statistics are in compliance with the principles set forth in the Code.



COOPERATION AT THE INSTITUTIONAL LEVEL

Following the signing of the Memorandum of Cooperation with INSTAT and the Ministry of Finance and Economy in September 2016, the cooperation with these two institutions extended in several aspects, most importantly the establishment of two inter-institutional working groups, respectively focusing on (i) national accounts; monetary and balance of payments statistics; and (ii) excessive deficit procedure (EDP) and government financial accounts.

The Bank of Albania and INSTAT have intensified the cooperation towards the harmonisation of financial accounts statistics with annual national accounts statistics and the international investments position.

The cooperation with the Albanian Financial Supervisory Authority (AFSA) on providing statistical information on the non-bank financial system, under AFSA jurisdiction, has been strengthened. In the framework of increasing the quality of statistics produced for the sub-sectors of insurance companies, investment funds and voluntary pension funds, during 2018 has started the reporting of new forms of pension and investment funds. In December 2018, the insurance companies reported for the first time within the standards necessary to draft the flow data for this sub-sector. The benefits resulting from this cooperation will be used to close and address several gaps in information for policy decision-making and to improve timeframes and coverage with significant information, while enhancing market transparency.

In the international aspect, the Bank of Albania continues to maintain correct and timely reporting of statistics, in accordance with the methodological and transmitting (platforms) standards of the IMF, Eurostat, ECB, and CEFTA. These relationships are expected to intensify through cooperation with several projects, financed by the IPA 2015 programme and the IMF.

2.10. RESEARCH

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

In 2018, research at the Bank of Albania focused mainly on the monetary policy objective, issues related to the preservation of financial stability and banking supervision, and the interaction between these objectives and less on monetary operations or other fields. In line with its medium-term strategy, scientific research continued to support the decision-making process for drafting



and implementing the policies of the Bank of Albania, developing new empirical analysis methodologies and enriching the portfolio of econometric models on which decision-making is based.

In particular, research projects in 2018 were micro data studies covering various aspects of enterprises, households, labour markets and other social sectors.

These and other studies have become the subject of discussion in the activities and conferences organized by the Bank of Albania or other institutions, where comments and observations have been provided for their further improvement before being offered for decision-making at the Bank of Albania. In this context, on 6-7 December 2018, the Bank of Albania organized the 12th SEE Economic Research Workshop. This workshop aimed to provide a discussion forum on innovative research for issues related to central banking and to promote the exchange of views among researchers, academia and policy makers, other research institutions contributing towards deepening economic research as well as to expand knowledge on certain features of economic developments and scientific research methodologies. This year 34 research works were presented by experts from the central banks of Austria, Bulgaria, Greece, Hungary, Italy, Lithuania, Romania, Turkey and the European Central Bank, as well as by academic institutions such as the Agricultural University of Tirana, Luigj Gurakuqi University of Shkodra, Chieti-Pescara University in Italy, Chile University in Germany, Staffordshire University and LSE University in the UK, Halmstad University in Sweden, Poznan University in Poland, Pennsylvania State University and Drexel University in the USA. The topics were related to euroization and its implications for inflation and financial stability; coordination of monetary and macro-prudential policies; implications of financial innovations for the implementation of monetary policy and banking supervision; capital flows, productivity and labour market after the global crisis; risk assessment in the financial sector; and building up macroeconomic models.

A more complete and detailed information on the research papers of the Bank of Albania is found at the official website of the Bank of Albania in the section "Publications/Researches". Other researches are published as articles in the "Economic Review" of the Bank of Albania. The Research Newsletter, published half-yearly, features information of recently concluded and in-progress research papers at the Bank of Albania, researches presented in the "Friday Seminars", or in other activities organized by the Bank of Albania throughout the year.



BOX 11 MAIN TOPICS OF RESEARCH DURING 2018

The performance of the exchange rate of lek was one of the most discussed topics during 2018. The rapid appreciation of lek against euro, particularly in 2018 H1, drove to a number of analyses and research efforts. Their common conclusion was that the exchange rate generally plays the role of “shock absorber” in the economy, stabilising the deviations of indicators from equilibrium, while it does not result to be the main cause of disturbances in the economy.

The government’s commitment to continue budget consolidation in the medium-term stimulated the assessment of the sensitivity of economic growth to the fiscal stimulus. Empirical findings suggest that tax revenues have a higher effect on the economic activity than government spending. They are more relevant in the short-run, while its effects fade out over longer horizons. Consumption and public investments showed similar effects on economic growth, but the impacts of investments remain significant for longer.

The monetary quantitative easing programmes by central banks have been a research object not only for the assessment of the impact in their home countries, but also due to their implications in other countries. The Quantitative Easing (QE) policies of the European Central Bank (ECB) are assessed to have affected significantly the financial conditions in Albania. However, the real sector of the economy does not indicate to have profited significantly by external easing policies. Their positive transmission through the financial channel seems to have been offset by the negative impacts transmitted through the re-balancing portfolio channel. The gap between 1-year maturity interest rate in Albania against rates in the euro area affects investments and economic growth in the country, acting through the re-balancing portfolio channel, remittances and bank lending channel.

Regarding financial stability, empirical assessments support the relationship between prudential banking behaviour and the need for their capitalisation in order to maintain financial stability, focusing more on risk-weighted assets. However, it seems that this relationship is non-linear. So being prudential at a certain level may harm banks’ capitalisation. Finally, the adjustment and capitalisation of banks in accordance with regulatory requirements appears more significant in banks with low capital.

A new alternative method to measure the prudential behaviour of banks by the analysis of the main component indicates the changes of banks’ behaviours have been overall moderated. The more significant changes in their prudential behaviour relate to the confidence (or lack thereof) in the economic environment. During the period before the financial crisis, larger banks have dedicated more attention to issues related with concentration in the system, as well as with net open position liquidity, while small banks appear more focused on credit provisioning, as well as capital concentration reports. After the global financial crisis, the characteristic of this behaviour appear more homogeneous, where banks seem to have dedicated more attention to provision and maturity gap. Finally, banks are more aware of the need to be more cautious after the financial crisis, particularly after the Greek debt crisis.

The survey conducted on the assessment of the financial and borrowing situation of microeconomic enterprises in agriculture indicates the low level of financial inclusion of this sector, where less than 20% of enterprises declare to rely on loans as a source of funding.



A study focusing on changes of households' consumption basket suggests that with the increase of income, households tend to increase the share of spending on entertainment, transport and luxury items, and reduce the share of spending on food and other necessities. Meanwhile, the rise in administered prices does not significantly affect the composition of the household basket.

Another study with micro data from LSMS¹ indicates that the consumption of households is sensitive to the performance of income and wealth measured by housing prices. These conclusions are drawn for four different percentiles of household income. In line with the theoretical microeconomic expectations, assessments show that changes in consumption are more sensitive for lower-income households than those in the fourth-tier percentile of income. Meanwhile, we are working on the realization for the first time of the survey on income, real and financial wealth, credit, employment, consumption and family composition, which will ensure standardization and harmonization of the questionnaire and its methodology with the questionnaire developed by the ECB for European Union countries.

The survey on measuring the level of financial literacy of the population, organised for the second time by the Bank of Albania, suggests for continuous attention and efforts for public financial education. The research analyses 2015 data at country level, as well as compares the data with the results of the 2011 survey, focusing on issues that address financial inclusion, knowledge, behaviours and attitudes of households.

The use of Gini and Rawlsian indices to measure the inequality of Albanian households with LSMS data from 2002 to 2012 concludes that inequality has decreased as a result of the redistributive effect among higher income households, while the magnitude of inequality has remained almost constant.

Higher education employees seem to be paid, on average, better than those with secondary and lower education. Meanwhile, according to the analysis, professions paid below average appear to be skilled workers in agriculture, forestry and fisheries; sales and service employees, as well as those in unskilled occupations.

¹ Living Standard Measurement Survey, published by INSTAT.

2.11. EUROPEAN INTEGRATION

Albania has continued to implement the obligations stemming from the Stabilization and Association Agreement (SAA) as well as from bilateral EU-Albania meetings. In November 2016 the European Commission recommended the conditional opening of negotiations based on developments on the implementation of the justice reform.

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



related to Chapter 4, "Free movement of Capital" and Chapter 17, "Economic and Monetary Policy". In addition, it contributes also to six other chapters of the European Union acquis.

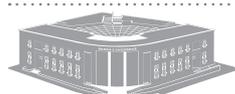
It took part in the Stabilization and Association Committee meeting and in the regular meetings of the subcommittee on the domestic market and competition as well as for economic, financial and statistical issues.

On 17 April 2018, the European Commission published the Progress Report for Albania. This document assesses the progress made during October 2016 - February 2018, with a particular focus towards fulfilling the five key priorities and the other chapters of the acquis.

This report commends the work of the Bank of Albania toward reaching price and financial stability. The report underlines in particular, the progress made in the payment system fields, through the change of regulations and the implementation of the medium-term strategy of the National Payment System Committee. Also, the report underlines the improvement of internal procedures for strengthening banks and non-bank financial institutions, by applying a risk-based supervision policy. The Bank of Albania has continued to further harmonize the banking regulation and the supervision manual with Basel II and Basel III and the relevant EU acquis. In Albania the identification system of systemically-important banks is similar to the EU practice. Regarding monetary policy, the Bank of Albania has continued to align the 1997 Law on the Bank of Albania with the European System of Central Banks (ESCB) in accordance with the requirements of the acquis.

In the statement of common conclusions on the economic and financial dialogue (May 2018), the European Commission recommended the Bank of Albania to increase the transparency of monetary policy, through publishing the series of core inflation and inflationary expectations, continuing the implementation of the national plan measures to decrease non-performing loans and implementing the measures in accordance with the Memorandum of Cooperation for the increase of the use of the national currency in the Albanian financial system and economy.

In compliance with the first recommendation, the Bank of Albania published the policy inflation and inflationary expectation series in its website in January 2019. In fulfilling the inter-institutional plan to decrease non-performing loans, it has worked to draft a regulation for out-of-court addressing of borrowers, the use of official financial statements in the credit risk assessment of borrowers and the improvement of the Credit Registry (for more refer to sub-chapter "Supervision"). Also, it has adopted the package of regulatory measures envisaged in the initiative to increase the use of national currency (sub-chapter "Financial Stability").



2.12. INTERNATIONAL COOPERATION

RELATIONS WITH THE INTERNATIONAL MONETARY FUND

The Republic of Albania continues to have SDR 139.3 million quotas and owns 2,858 votes or 0.06% of the total 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 295.42 million (around EUR 377.3 million).

Albania's relations with the International Monetary Fund continue to focus on the Article IV consultations, which were concluded on 20 November by the IMF Executive Board.

During 2018, the Bank of Albania has been 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

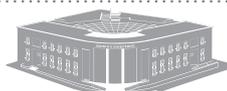
The World Bank Group (WBG) supports Albania through the Partnership Framework covering the period 2015-2019, which aims to support Albania's aspirations for equal growth and integration into the European Union. Over the years, the World Bank Group has provided over USD 2.2 billion in assistance to the country. Currently there are 11 projects amount 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 has continued toward providing technical assistance for the implementation of an integrated credit risk and interest rate model.

Throughout 2018, the Bank of Albania with the assistance of the World Bank has finalised a series of projects, such as the study "On measuring the cost of payment instruments", an analysis of the Albanian market regarding financial inclusion of the population from the point of view of payments, as well as the remittance market analysis. Based on the findings of these studies and analyses, the Bank of Albania supported by the World Bank has drafted and adopted the "National Retail Payments Strategy (2018-2023)" at the fourth National Payments Committee meeting held in May 2018.

Also, cooperation with the World Bank has continued in the areas of remittances and payments including financial awareness and education,



payment systems, securities clearing systems, central securities depositors and central counterparties.

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 the critical functions.

RELATIONS WITH OTHER INTERNATIONAL INSTITUTIONS

Throughout 2018, the Bank of Albania has devoted a special place to the cooperation with the central banks of the European Union. More concretely, this cooperation was channelled through the participation in the Task Force of the European System of Central Banks on the Cooperation of Central Banks. This forum, among other things, is devoted to technical cooperation with the Western Balkan countries, including Albania.

More specifically, the banks of the region were informed on 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 programme 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. In November, the Annual Conference on: "Monetary Policy, Economic Integration and the New Normal" was organized.

The Bank of Albania continued to cooperate with the FSVC. Among others, we may mention the engagement of experts from the Board of Directors of FED in training the Bank of Albania's staff members in order to improve and update the executive skills of the BoA's officials.

Also, in 2018, cooperation in the framework of the support of the Swiss State Secretariat for Economic Affairs (SECO) continued. This cooperation focused on various areas such as the payment system, financial stability, monetary policy and research.

The Bank of Albania continued to maintain contacts with the European Bank for Reconstruction and Development (EBRD). What is worth mentioning is the discussion on potential projects on Central Bank Technical Cooperation in the framework of the new EBRD reforms.



PARTICIPATION IN INTERNATIONAL CONFERENCES, FORUMS AND SEMINARS

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

- On 16-17 January 2018, 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 13 April 2018, the Governor of the Bank of Albania, Mr Gent Sejko participated at the 7th Annual Research Conference organized by the National Bank of the Republic of Macedonia on “Around a Decade After the Crisis: Heading to the New Global Cycle and Monetary Policy Normalization”, in Ohrid, Macedonia.
- On 20-22 April 2018, the Governor of the Bank of Albania, Mr Gent Sejko, and the First Deputy Governor, Ms Elisabeta Gjoni, attended the Spring Meetings of the International Monetary Fund (IMF) and the World Bank Group (WBG) in Washington D.C., USA
- In May 2018, the Governor of the Bank of Albania, Mr Gent Sejko, attended the 39th Meeting of the Central Bank Governors’ Club of the Central Asia, Black Sea Region and Balkan Countries.
- In June 2018, the Governor of the Bank of Albania, Mr Gent Sejko, attended the regional summit on “Region’s Financial and Monetary Stability Ten Years since the Crisis Outbreak”, in Bečići, Montenegro.
- On 20-21 September 2018, the Governor of the Bank of Albania, Mr Gent Sejko, attended the 40th Meeting of the Central Bank Governors’ Club of the Central Asia, Black Sea Region and Balkan Countries. The meeting was held in Bucharest, Romania, and was attended by governors of central banks of Club member countries.
- On 12-14 October 2018, the Governor of the Bank of Albania, Mr Gent Sejko, in the capacity of the Governor of the Republic of Albania at the IMF, attended the Annual Meetings of the International Monetary Fund (IMF) and the World Bank Group (WB), in Bali, Indonesia. These meetings represent a high level forum which brings together the most senior decision-makers of IMF and the WBG, and governors and ministers of finance of the member countries in these international financial institutions, to discuss about the latest developments in the global economy.

MEMORANDUM OF COOPERATION

- Albania and the EBRD signed a memorandum to enhance lending in lek and the development of the capital market. On 26 February 2018, the Governor of the Bank of Albania, Mr Gent Sejko, signed, on behalf of the Bank of Albania, a Memorandum of Understanding on fostering cooperation on the use of the Albanian lek and the development of



the local capital market in Albania, between the European Bank for Reconstruction and Development (EBRD), the Bank of Albania and the Ministry of Finance and Economy.

- Bank of Albania and the People's Bank of China renewed the SWAP agreement. On 3 April 2018, the Governor of the Bank of Albania, Mr Gent Sejko, and the Governor of the People's Bank of China, Mr Yi Gang signed the renewal of the bilateral currency SWAP agreement, for the maximum amount at RMB 2 billion/ALL 34.2 billion. The new agreement, like the previous one, is valid for 3 years, from the date of its signing.
- Second Deputy Governor of the Bank of Albania, Ms Natasha Ahmetaj and the Chair of the Single Resolution Board (SRB), Ms. Elke König, signed a bilateral agreement on the exchange of information and cooperation in the field of drafting Resolution Plans, as well as the implementation of this planning in relation with cross-border banking entities, that exercise their activity in the Republic of Albania and vice versa.
- On 23 November 2018, the Memorandum of Cooperation between the Bank of Albania (BoA) and the European Central Bank (ECB) was signed. On behalf of the ECB the Memorandum was signed by the President of the Supervisory Board, Mr Danièle Nouy and the Deputy President of the Supervisory Board, Ms Sabine Alice Lautenschläger. On behalf of the Bank of Albania the Memorandum was signed by the Governor, Mr Gent Sejko, and by the Head of the Supervision Department, Mr Deniz Deralla. The signing of this Memorandum formalizes the mechanisms of cooperation and information sharing between the ECB and the Bank of Albania. This cooperation is essential to ensure an effective and comprehensive supervision of the entities under the jurisdiction of each of the above authorities.

2.13. TRANSPARENCY AND PUBLIC COMMUNICATION

Public communication is an important aspect in the Bank of Albania's activity, for fulfilling the obligation to provide maximum transparency of its decision-making and effectiveness, as well for achieving the permanent objective of increasing the confidence in it. 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 the legal obligations, the Bank of Albania communicates to the public a variety of information regarding its role and activity, from the decision-making of the Supervisory Council to its daily operational activity. This transparent communication helps to increase the effectiveness of the policies pursued by the Bank of Albania, enabling the public to understand timely and properly the decisions taken by the Bank in order to evaluate them fairly.



The Bank of Albania uses a variety of communication channels, in order to explain the role and its main objective more clearly – to maintain price stability as well as the way of its realisation.

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 2018, during which the Governor has responded to the media interest on various issues related to the Bank of Albania. Press conferences were followed by the publication of the Governor's speeches, and the related Q&A in Albanian and in English.

Also during 2018, 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 6 editions of this publication.

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 the interest, academic level and professional level of targeted groups by the Bank of Albania, among which, media has an important role. In this framework, the media is continuously informed and sensitized on issues related to BoA and on economic and financial performance of Albania. Media communication has continued through press conferences, speeches, presentations and lectures in activities organized by the Bank of Albania or other domestic and foreign institutions, dedicated interviews or participation in TV shows, 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. During 2018, the activity of the Bank of Albania was communicated to the public mainly through 130 public announcements, press releases, speeches, interviews and participations in TV shows. During the year, seven of its periodic reports were presented "off-the-records" to the media. These meetings aim to guide the media for 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 increase interaction with the public, in 2018, we have continued the digital communication through the 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.



BOX 12 ACTIVITIES OF BANK OF ALBANIA'S ADMINISTRATORS

- On 13 February 2018, the Governor of the Bank of Albania, Mr Gent Sejko received the Deputy Managing Director of the International Monetary Fund (IMF), Mr Tao Zhang in an official visit at the Bank of Albania. During the meeting, Governor Sejko highlighted the very good cooperation with the IMF, which has supported Albania's economic and financial reforms. The IMF's DMD Zhang emphasised that the policies undertaken by the Bank of Albania have contributed to maintaining macroeconomic stability and consolidating financial system in Albania.
- On 21 March 2018, at the Bank of Albania, the Project Greenback 2.0 was officially launched for Albania, as recipient country for remittances. This project, which is one of the main components of the SECO-funded Remittances and Payments Program (RPP) in Albania, is a World Bank initiative for promoting accessible channels and cost-effective payment instruments for sending and receiving remittances. The World Bank, in partnership with the Bank of Albania has chosen Berat as a Champion City for the implementation of the Project Greenback 2.0.
- On 20 June 2018, the National Payment Systems Committee (NPSC) held its fourth meeting, chaired by Ms Elisabeta Gjoni, First Deputy Governor of the Bank of Albania, who also chairs this Committee. The purpose of this Committee is to support and contribute to enhancing the security, stability and efficiency of the national payment system in Albania. Beyond the advisory role, the Committee aims to facilitate the implementation of measures of the relevant authorities by fostering cooperation. In this meeting, the Committee approved the "National Retail Payments Strategy" and presented the projects realised in the framework of modernising the retail payment systems.
- On 13-14 June 2018, the Bank of Albania and the European Central Bank (ECB) co-organized the regional statistical seminar. This seminar is organized regularly by the ECB with a central bank and provides an important forum for exchanging views on statistical requirements, formulating policies and discussing most recent developments on central bank statistics-related issues. The purpose is to provide a platform for discussions and exchanging views on statistics, as one of the most challenging and fundamental issues for central bankers and policy-makers in general.
- On 21 June 2018, the Bank of Albania held the conference on "Modernisation of retail payment systems in Albania". This conference was chaired by the First Deputy Governor, Ms Elisabeta Gjoni and was attended by representatives of the World Bank, the European Central Bank, the central banks of the region, the Ministry of Finance and Economy, the Albanian Association of Banks and representatives from the business community. The purpose of this conference was the clear transmission of the objectives pursued in the context of retail system market reform, to all market stakeholders who are partners in achieving these objectives.
- On 10 July 2018, the Bank of Albania organised the Workshop on "Finances for economic growth", in cooperation with the World Bank. The workshop focused on the presentation of the World Bank study "Access



to financing for micro, small and medium enterprises." Based on this, the World Bank has compiled a detailed diagnosis and recommendations report on the economic environment in which micro, small and medium-sized enterprises operate in Albania

- On 1 November 2018, 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 "Monetary Policy, Economic Integration and the "New Normal"". The Conference proceedings were opened by the Governor of the Bank of Albania, Mr Gent Sejko; the Director of the LSE's Institute of Global Affairs (IGA), Mr Erik Berglof; the Minister of Finance and Economy, Mr Arben Ahmetaj; and the Prime Minister of the Republic of Albania, H.E. Mr. Edi Rama. The Closing Panel with the Governors' Roundtable brought together in a discussion panel the governors and deputy governors of the Bank of Albania, Iceland, Kosovo, Bosnia & Herzegovina and Croatia.
- On 15 November 2018, chaired by the Second Deputy Governor, Ms Natasha Ahmetaj, the Bank of Albania in cooperation with the Financial Sector Advisory Centre (FinSAC) of the World Bank, organized the Regional Conference on "Recovery and Resolution Planning", attended by senior representatives of the supervision and resolution authorities of the European Union, the countries of the region and of commercial banks operating in Albania. This Conference culminated the work of the Bank of Albania in the past 18 months for developing a complete framework for bank recovery and resolution.
- On 6-7 December 2016, the Bank of Albania organized the 12th SEE Economic Research Workshop. This workshop aims to provide a discussion forum on innovative research work for issues related to central banking and to promote the exchange of views among researchers of the Bank of Albania, other central banks, academia and other research institutions.
- On 14 December 2018, at the premises of the Bank of Albania the second high-level meeting was held between the Bank of Albania, the Minister of State for the Diaspora, commercial banks and non-bank financial institutions engaged in the field of monetary transfers that operate in Albania. This meeting was held in the framework of the Memorandum of Understanding "On Remittances" signed last year by the Bank of Albania, The Minister of State for the Diaspora and the Ministry of Finance and Economy.
- On 20 December 2018, 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. During the end-of-year event, the three winners of the "Governor's Award for the Best Diploma Thesis 2018" were announced: the first prize was awarded to Ms Migena Musli, a student at the Mediterranean University of Albania; the second prize was awarded to Mr Donald Vullnetari, a student at the University of Tirana; and the third prize was awarded to Mr Klisman Ndoje, a student at the Université Libre de Bruxelles. This annual event is dedicated to Albanian students graduated this year in Albania and abroad, for scientific research on issues related to international monetary economics, price and financial stability, economic integration, etc.



A RESPONSIBLE AND ACCOUNTABLE CENTRAL BANK

The Bank of Albania considers transparency as an obligation and instrument for enhancing independence.

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 May 2018, 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 matters. As every year, the Governor presented in November, in a special hearing to CEF, the Bank of Albania's opinion on the draft state budget for the following year 2019.

2.14. PUBLIC EDUCATION AND THE MUSEUM OF THE BANK OF ALBANIA

Central banks pay special attention and resources to the financial and economic education of the public. This is because an informed public is more likely to understand and accept the complex decisions of the central bank. For nearly a decade, the Bank of Albania has been committed to expand and deepen financial literacy in the country, in particular targeting the younger generation. The programmes, activities and special educational publications prepared by the Bank of Albania focus on two main goals: presenting the central bank, its functions and role to the public; and cultivating and enhancing financial literacy in the society. With a view to increasing financial literacy in Albania, during 2018, educational efforts continued in several aspects:

- **Educational publications.** The distribution of educational textbooks: "Personal finance in your hands" continued during 2018 for six high schools (in total 820 pupils), in addition to the distribution of brochures and educational materials prepared in previous years.
- **Money Week.** On 12 March 2018, at the premises of the Bank of Albania, the Money Week for 2018 was launched under the motto: "Money: You reap what you sow". The Bank of Albania participated for the fifth time in this celebration, in cooperation with the Albanian Association of Banks, and 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 5000 children and young people, representing about 55 middle schools, 14 high schools, 8 universities in 14 cities. Educational activities include: school competitions, lectures at university auditoriums and youth centres, visits to the Museum of the Bank of Albania and to commercial banks.
- **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 the public, mainly the younger generation. During 2018, about 70 posts were published to inform and provide the public with educational materials, numismatic curiosities, activities and publications of the Bank.

- **Analysis of financial literacy in Albania.** During 2018, the Bank of Albania presented the Survey results on "Measuring Financial Literacy: for Albania, 2015" at the 12th South-Eastern European Economic Research Workshop. This overall analysis of the survey results is an important tool in identifying issues that need attention and formulation of the public education strategy and policies.

THE MUSEUM OF THE BANK OF ALBANIA

Since October 2015, the Museum of the Bank of Albania has served as a bridge between the Bank and the public. Its exhibitions and information provide the public with numismatic and historical information and knowledge related to banking and financial education. During 2018, the Museum of the Bank of Albania was visited by 3100 visitors, of which, 1,700 were children and students and 1,400 adults older than 18 years old.

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 2018, the Museum organised a series of activities of historical and educational character, listed below:

- **Temporary exhibition "Gjergj Kastriot Skanderbeg featured in Albanian coins and banknotes", 17 January 2018.** The Museum of the Bank of Albania presented "Gjergj Kastriot Skanderbeg on the Albanian coins and banknotes" a temporary exhibition in memoriam of the 550th anniversary of the death of the National Hero. The Museum of the Bank of Albania dedicated the exhibition to the figure of Skanderbeg, featured in the Albanian coins and banknotes from 1921 to 1996. It also highlights various features in these banknotes and coins. The temporary exhibition was open for the public throughout 2018.
- **"Museum Nights" lectures.** The "Museum nights" lectures co-ordinate and integrate knowledge about the currency with information found in archives, libraries, private collections or exhibited through architecture, sculpture, visual arts and pictures across other museums in the country. Lectures are followed by visits to the Museum. Two lectures were held in 2018. On 17 April, Dr Dorian Koci, Director of the National Historical Museum, held the lecture, on "Ali Pasha Tepelena's financial relations". On 2 March 2018, Prof. Dr. Jovan Basho, a philatelist, delivered a lecture on "Gjergj Kastrioti Scanderbeg on Albanian Stamps".
- **One-week seminar: "Ancient coins from the beginning of the VII cent.**



BC, until the fall of the Roman Empire at the end of the V cent. AD”, **30 April and 2, 3, 4, 7 May 2018**. This lecture was delivered by Dr. Albana Meta, a numismatist at the Institute of Archaeology. Around 30 people attended the seminar, including scholars, collectors and students of the University of Tirana. At the end, participants were certificates of attendance.

- **International Museum Day, 18 May 2018**. On the occasion of the 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.
- **Temporary exhibition “Gjergj Kastriot Skanderbeg featured in Albanian coins and banknotes”, in Prizren, Kosovo**. The Bank of Albania, organized this exhibition in cooperation with the Central Bank of the Republic of Kosovo, in the framework of the pan-national Year of Gjergj Kastrioti Skanderbeg. This exhibition was opened on 10 June 2018 - a date that coincides with the 140th anniversary of the Albanian League of Prizren. It was organized at the House of the League of Prizren, in the city of Prizren in Kosovo, and it remained open until 12 June 2018.
- **The Second Conference of the Museum of the Bank of Albania: on “The Role of Money in Wartime”, 20 September 2018**. The Conference brought together historians, numismatists, archaeologists, scholars of the history of money, experienced and young researchers, to share their findings and discuss on the role of money throughout the centuries in wartime. The conference was organised in sessions starting from antiquity to modern times.
- The temporary exhibition “80th anniversary of the Bank of Albania building”, **30 October 2018**. On 30 October 2018, the temporary exhibition was opened on: “80th anniversary of the Bank of Albania building, 1938-2018” The exhibition presented photographs and building sketches of the central Bank of Albania in Tirana and its former branches in Durrës, Shkodra, Korça, Vlora, Saranda and Elbasan.

