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EDITORIAL

Project on the needs analysis for the Bank of Albania

The Project on the “Needs Analysis for the Bank of Albania” was designed and coordinated by the European Central Bank (ECB), implemented with the support of experts from 11 central banks, members of the European System of Central Banks. This project was implemented within the broader context of ECB’s “Technical cooperation with central banks of Western Balkan countries, to prepare their central banks for membership of the European System of Central Banks (ESCB)”. The beneficiaries were the central banks of EU candidate and potential candidate countries in this region.

The Project was funded through the EU’s Instrument for Pre-Accession Assistance 2013 amounting €500,000 and was implemented simultaneously at the Central Bank of the Republic of Kosovo (CBRK) and the National Bank of the Republic of Macedonia (NBRM). In this regard, Project-related activities were promoted jointly by representatives of the three central banks and of European institutions. At the launching of the programme, in Tirana, on 17 April 2014, Mr Yves Mersch, member of the Executive Board of the ECB, highlighted: “Strong central banks are key for monetary and financial stability in Europe and around the world. With this joint initiative, the central banking community in the EU stands ready to support our colleagues in the Western Balkans in their endeavour to introduce the highest standards, for the benefit of their countries and people.”

For the Bank of Albania, the purpose of this Project was to strengthen its institutional capacities, through the identification of legal and organisational criteria, as well as the needed resources for approximation to the standard institutional and operational framework of the ECB, in view of Albania’s integration in the EU and, consequently, of Bank of Albania’s in the ESCB.

The Project with the ECB and partner central banks was implemented in three stages and focused on 13 functions of the Bank of Albania.

Function	Experts from Central Bank
Finance/Accounting	European Central Bank
Financial Stability	Bulgarian National Bank
European Integration	Oesterreichische Nationalbank (central bank of the Republic of Austria)
Communication	Banque De France; National Bank of Slovakia
Human Resources	European Central Bank; National Bank of Slovakia
Internal audit	Bank of Slovenia
Banknotes	DeNederlandscheBank; Deutsche Bundesbank
Legal	Central Bank of Malta
Monetary operations	Banque De France
Monetary Policy	Czech National Bank
Payment System	Banca d’Italia; Banco de Portugal
Statistics	Oesterreichische Nationalbank (central bank of the Republic of Austria)
Banking supervision	Banca d’Italia
Information technology	European Central Bank

According to the agreement with the European institutions, a resident Coordinator was deployed at the Bank of Albania during the six months of the project implementation. The Coordinator was elected by the ECB and partner banks to manage project activities, on the day-to-day basis, coordinate experts' visits and compile the final report.

In the first stage, operational objectives serving as benchmarks for the next stages were identified, reflecting the standards/minimum requirements that Bank of Albania should meet under the EU accession process. The benchmarks were agreed on a special meeting in Tirana between the international experts and those of the Bank of Albania and were broadly based on the laws, regulations, directives, international standards, guidelines and best practices. The benchmarks, however, do not have the same characteristics. For example, the Regulations of the European Union should be approximated to by the time of Albania's membership in European Union. Best practices of central banks should be adopted in advance, in order to successfully accomplish tasks deriving from a central bank's membership in the ESCB.

In the second stage, after defining and agreeing on the benchmarks, the experts from EU central banks had stock-taking missions at the Bank of Albania, meeting with the experts and managers of each field to assess the actual status of the Bank of Albania in each of the 13 fields of the Project. During the missions, taking place in June and July 2014, together with Bank of Albania's experts, the international experts analysed the core documentation, against the agreed benchmark. This process generated discussions among experts about the way the existing regulations, procedures or guidelines are implemented. At the conclusion of assessment missions, experts prepared reports on the main findings.

During the third and final stage, the gap between the actual framework of the Bank of Albania and the set benchmark operational objectives was assessed. In July 2014, the project experts met in Frankfurt and discussed the main findings and the content of the Project report. The 'Needs Assessment Report' was the final product of the Project, providing recommendations and findings for each function that had been analysed during the project. The proposed recommendations serve as guidelines for the Bank of Albania in its endeavours for approximation to European standards and principles.

In the final report, the experts emphasised that starting from 1992, the Bank of Albania has made considerable progress in implementing its tasks. Overall, their analysis points out that, for the fields subject to the Project analysis, the Bank of Albania is a professional institution, strategically concentrated, transparent and with good technical capacities. Many regulations and practices of the Bank of Albania are in line with European standards. While the report focuses on the regulations and procedures that still need to be approximated to the European Union framework, it highlights that central bank experts commend the achievements of the Bank of Albania related to EU membership. The cooperation between the Bank of Albania and some

banks of the Eurosystem¹ in the previous years and with international financial institutions has contributed to the achieved progress. Once Albania becomes a member in European Union, the Bank of Albania's staff will participate in some of ESCB's committees, actively informing and participating in the inter-related working groups with subcommittees.

Recommendations deriving from the project, on the 13 analysed functions of the Bank of Albania are divided into three categories: recommendations or actions which should be implemented prior to Albania's membership in the European Union, hence of the Bank of Albania in the ESCB; recommendations to be fulfilled by the time of adopting the euro and membership in the Eurosystem; and recommendations that are not obligatory, but are best practices in the European Union.

The final report specifies the category for each identified recommendation. It also provides a timeframe for the implementation of each recommendation. The report focuses primarily on the recommendations that are part of the tasks of a department. Possible interconnections are also identified when inter-departmental cooperation is needed. The realisation of some recommendations requires cooperation with other Albanian institutions and their full implementation does not depend only on the Bank of Albania.

Also, the report identifies four recommendations for horizontal issues related to the work of each department: inter-departmental collaboration, operational risk management, business-continuity plan and communication.

It must be noted that the ECB's technical assistance programme envisages continuing the Project in the future through the implementation of the Second Component of the Programme. The Second Component of the Programme, which was implemented in some central banks in the countries in the region, envisages the compilation of a plan for the implementation of the recommendations identified during the First Component.

¹ The report makes special mention of the twining project implemented with the Banca d'Italia in partnership with Banque de France, during 2011-2012.

ADDRESSES AND PRESENTATIONS BY BANK OF ALBANIA'S ADMINISTRATORS

STATEMENT BY MR. ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA,

On the monetary policy decision taken by the
Supervisory Council of the Bank of Albania
on 30 July 2014

Today, on 30 July 2014, the Supervisory Council of the Bank of Albania reviewed and approved the Monetary Policy Statement of the Bank of Albania on the first half of 2014. Based on Albania's latest monetary and economic developments and discussions on their outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 2.50%. The Supervisory Council deems that the inflationary pressures from the real and financial sectors of the economy are weak and will remain so. Under these conditions, the monetary policy will remain stimulating, hence providing the adequate monetary conditions for inflation to return to the target over the medium term.

Let me now proceed with an overview of the economic developments and key issues discussed at today's meeting.

* * *

The Albanian economy improved in the first half of the year. Economic growth stood in positive territory and apparently there are progressive signs of recovery; the country's economic and financial stability remains solid, while the trend of domestic and external financial conditions are on the easing side. Economic activity expanded, due to the increase in private consumption and investments, and was supported by a stimulating macroeconomic policy mix. In the first half of the year, the economy performed, overall, in line with our projections; however, inflation's performance was worse than expected, as a result of disinflationary pressures from the external environment and other supply-side shocks.

The Bank of Albania expects the tendencies noted in the first half to continue in the second half of 2014 and in the next year. Economic growth will continue to maintain positive rates and improve further, contributing to the gradual return of inflation to target within the medium term horizon predicted by the monetary policy transmission mechanism. In our judgment, macroeconomic policies should continue to be stimulating for as long as the Albanian economy continues to operate below its potential capacities and inflation or inflation expectations are not consolidated around Bank of Albania's target. Yet, the landscape of expected developments contains some risks. I would like to list four of them: (i) sources of growth are not stabilised, (ii) our economy is very sensitive to supply-side shocks, (iii) our projections are subject to macroeconomic policies, which should continue and prudently establish a balance between the short-term stimulus and medium and long-term

equilibriums; and (iv) economic performance will depend on the acceleration of structural reforms, both at macro and microeconomic level.

Following, I will dwell in more detail on the issues I mentioned above.

During the first half of the year, inflation was low, standing below our target. Average inflation was 1.6% in the second quarter of 2014, down from the rate recorded in the previous quarter. Annual inflation fell to 1.5% in June. It continues to be determined by the performance of unprocessed food prices, while other groups of the CPI basket provided low contribution to inflation.

On the macroeconomic aspect, the low inflation rate reflected the unutilised capacity rate, low inflation rates in our trading partners, and downward short-term inflation expectations.

According to INSTAT data, the Albanian economy grew by 1.65% during the first quarter of the year. This growth rate was on the upper bound of our projections. Preliminary data suggest that economic growth is expected to be stronger in the second quarter of the year. From the sectorial perspective, both the manufacturing and services sector contributed positively, hence showing a more diversified basis of contributors than in the previous year. From the perspective of aggregate demand components, economic growth was driven mostly by the rise in private consumption and investments, reflecting the improved confidence in the economy, higher foreign direct investments, and more favourable financial conditions. Indirect indicators show that private investments were the main contributor, while the final consumption of households, albeit upward, remains weak. In the meantime, the expansion of the net export deficit and the public sector's demand provided negative contribution.

Net export deficit expanded, as a result of the increase in imports in the first quarter of the year, driven in large part by the intensification of imports of goods for investment purposes. Albanian exports continued to grow, but data on the foreign trade of goods showed a cumulative annual expansion of the trade deficit during January - May 2014, by approximately 6.7%. The capacity of the Albanian economy to horizontally diversify the range of exported products, and to vertically increase the value added of such products will be a primary factor for ensuring long-term economic growth.

Fiscal policy was consolidating over the first half of the year, reflecting in part the strong stimulating bias of the fiscal policy implemented during the first half of the past year. However, it largely reflects the correction of the upward trend of public debt. The consolidating nature of the fiscal policy is materialised in both increasing revenues and declining public expenditures – mainly capital expenditures. The budget deficit in the first half reached ALL 22.2 billion, standing 54.3% lower than in the previous year. As with any consolidating fiscal policy, the direct effect of such developments on aggregate demand has been negative. The Bank of Albania has, however, urged for and supported this fiscal move, being confident that its resultant effect will be positive. In the

medium and long term, a lower public debt level decreases risk premiums and increases the economy's capacity to withstand unforeseen shocks. In the short term, a consolidating fiscal policy contributes to creating better lending conditions for the private sector. Also, it has enabled the Bank of Albania to implement a stronger stimulating monetary policy. On the aspect of public finance, in Bank of Albania's judgement, adopting a fiscal rule that will serve as an instrument for disciplining budget deficit and public debt indicators is indispensable. Public expenditure should have a more linear distribution throughout the year and a better compliance with the planned levels.

Despite the positive pace of economic growth, output gap remains negative and the utilization capacity rate is below its average. The unutilised capacities in the economy have led to low increase in employment and wages, production costs and profit margins, being the main drivers for low inflation rates. Imported inflation has been downward because of low inflation rates in our trading partners and the steady performance of the exchange rate. To a large extent, the downward imported inflation has also determined the downward profile of inflation at home during the first half of the year. Economic agents' inflation expectations remain subdued, not showing any grounds for a rapid increase of it.

Reflecting the poor performance of inflation and in the presence of a consolidating fiscal policy, the Bank of Albania has strengthened the easing trend of the monetary policy. Following the two cuts in February and May, the key interest rate currently stands at 2.50%. The Bank of Albania has continued to guide the public on the expected direction of the monetary policy in the future and has continued its liquidity-injecting operations in the banking system. Our monetary policy has been successful in calming financial markets, mitigating pressures for liquidity and controlling medium-term inflation expectations. Being in line with the specifics of particular segments and reflecting the time lag of the transmission mechanism, our monetary policy easing has been reflected across all the segments of the financial market. This policy has managed to cut down financing costs of the banking system and of the public and private sectors, and has contributed to establishing adequate conditions for the expected growth of demand and economic activity. Until now, however, it has not been reflected in the real economy up to the desired levels. As previously stated, it relates largely to high risk premiums, which arise from uncertainties for the future. The Albanian consumers and businesses appear reluctant to increase consumption and investment, despite the lower interest rates in the banking system. Credit supply has been relatively tight, due to the perceived risk by banks and risk aversion policies adopted by European banking groups operating in Albania.

The second quarter has provided signals for an increase in credit demand, although credit expansion remains in negative territory. In May, credit outstanding for the private sector was 1.8% lower than in the previous year. The Bank Lending Survey for the second quarter of 2014 suggests for easing lending standards applied to both businesses and households, and their upward demand for credit. New credit has been dominated, for months, by

credit extended in the Albanian currency. This is a welcomed development as regards the enhancement of monetary policy effectiveness. The Albanian reality and world experience suggest that credit recovery will continue to be conditioned by the steady improvement of the economic activity at home, reduction of risk premiums in certain sectors of the economy, and more positive developments in the labour market.

Looking ahead, economic growth and inflation will continue to experience low rates. In this context, our country does not differ from the rest of the countries in the region and other European countries in general. Baseline projections of the Bank of Albania show that the Albanian economy will grow at higher rates than in the previous year, sustained mainly by the expansion of domestic demand. Easing of monetary conditions, adjustment of private and public balances, and improvement of economic agents' confidence are expected to feed in the domestic demand. The fiscal policy is expected to be consolidating, in line with the medium-term budget plan and commitments with the International Monetary Fund. Structural reforms initiated in certain sectors of the economy are expected to regulate and stimulate their activity, as well as contribute to easing lending standards applied to them. The financial system remains well capitalised and liquid, while the expected revision, on the easing side, of lending standards will lead to a more active role of credit to the economy.

Weak inflationary pressures, present in the Albanian economy, are expected to be dominant in the near future. With 90% probability of occurrence, inflation is expected to range within the 0.9–3.6% interval, four quarters ahead. From the available information, taking into account our projections, the action force of the monetary policy transmission mechanism and other financial stability-related considerations, the Bank of Albania deems that the monetary policy will remain stimulating during the medium-term period. In our judgement, maintaining the stimulating side of the monetary policy ensures inflation's return to target within a reasonable timeframe, and corroborates the recovery of domestic demand.

Concluding, I would like to dwell also on the risks related to the above-mentioned projections. First, in the presence of a consolidating fiscal policy and under the current situation of global markets, our growth projections are conditioned by the increase in private consumption and investments. These components of demand have been upward during the first half of the year; yet, factors contributing to this growth do not appear consolidated. The easing monetary policy contributes to establishing more favourable lending conditions, but it should be followed by sustainable improvements in the labour market, company balance sheets, and business climate as well as boosted confidence on the country's long-term development perspective. Second, our projections and the country's economic development remain subject to unforeseen supply-side shocks. The performance of energy production, agricultural sector, oil price, commodity prices, and final product prices in international markets has a significant impact on economic activity and inflation in Albania. Third, macroeconomic policies should preserve the stimulating mix, as well

as the composition and intensity of this mix. Implementing consistent policies would contribute to enhancing the confidence at home and reducing the risk premiums. The fiscal policy should be in accordance with commitments for the consolidation of fiscal indicator and settlement of financial obligations to the private sector. Monetary policy will continue to remain stimulating, but its extent and duration will be exclusively serving to meet our inflation target. Finally, the Albanian economy needs comprehensive structural reforms that would enhance Albania's competitiveness in international markets and expand our productive potential. Without structural reforms, macroeconomic policies would not generate long-term growth for a country. Our country should honour all its commitments to the European Union, arising from the status of the candidate country. Moreover, the public sector should have well-integrated and long-term development plans, while the private sector should make more efforts to enhance its efficiency and find new markets. This is the only way we could ensure more sustainable growth and faster convergence with European Union countries.

* * *

At the end of the discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 2.50%. The monetary stimulus may increase further, in the event the economic and monetary developments will shift the balance of inflation risks downside. The Bank of Albania remains committed to complying with the medium-term inflation target, and stands ready to use all its instruments to reach this target.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA,

On the Monetary Policy Decision of the Supervisory Council of the Bank of Albania,
27 August 2014

Today, on 27 August 2014, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. After discussions on the recent economic and monetary developments in Albania, and their future course, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 2.50%. The Supervisory Council deems that the current monetary conditions are adequate to ensure the return of inflation to target in the medium term.

Let me now proceed with an overview of the economic developments and key issues discussed at today's meeting.

* * *

After falling in the previous three months, annual inflation picked up in July, standing at 1.8%. As in the previous months, annual inflation continued to be determined by the performance of food prices, especially seasonal fresh food. Other CPI items continued to provide low and steady contribution to the increase of inflation.

From the macroeconomic perspective, prices continue to be determined by low inflationary pressures, from both the demand and supply side. Below-potential economic growth and the negative output gap exerted contained pressures on prices. Imported inflation was also moderate and downward, due to low inflation in our trading partners' economies and the steady exchange rate. Inflation expectations remain low, and monetary expansion is in line with moderate price rises in the medium term.

New data on the real sector analysed in the last meeting are scarce. Signals from indirect indicators corroborate our previous assessments for a faster economic growth in the second quarter, in line with forecasts for a gradual recovery throughout the year. During the period, the positive performance of private domestic demand was driven by the more favourable lending standards and the enhanced confidence of both businesses and households. At the same time, foreign demand for goods and services continued to grow, but the increase in imports due to the recovery of consumption and investment has weakened its contribution to economic growth. Exports and imports of goods continued to grow, by 9.2% and 10.4%, respectively, in annual terms during the second quarter, and the trade deficit by 11.6%.

As expected, the consolidating fiscal policy conditioned the drop of public sector demand and its direct negative contribution to aggregate demand. The consolidation path of the fiscal policy is reflected in both revenue increase and spending decrease. The performance of revenues was affected by the rapid increase of tax revenues, due to the effects of the new fiscal package and improvement of the tax system administration. On the other hand, budget expenditure fell both for current and capital expenditure categories. Budget deficit stood at around ALL 22.2 billion, at the end of the first six months, or around 54% lower than in the previous year. The Bank of Albania supports the measures for fiscal consolidation, as the pursuit of such a policy contributes to maintaining long-term stability and reducing risk premiums in the economy. However, the Bank of Albania reiterates the need for a more uniform distribution of expenditure and budget deficit throughout the year, in order to minimise the volatility in economic activity and financial markets.

Financial markets were relatively calm during July and August. The activity in these markets ranged in normal levels, characterised by contained liquidity pressures and small fluctuations in interest rates. In response to the stimulating monetary policy, markets tended to reduce interest rates, although the intensity of reduction varied across market segments. Thus, a faster reduction of interest rates has been noted in the interbank market, on lek deposits and in the short-term segment of government securities. On the other hand, the interest rates on long-term government securities and on credit fell at a slower pace. The latter continue to reflect high risk premiums, related both to the burdened balance sheet of Albanian businesses and the conservative lending policies adopted by banking groups.

Annual growth of money supply was 0.9% in June. Its performance reflected the low need for funds by the public sector and the decline in credit to the private sector. The annual decline of credit to the private sector was 1.8% in June, maintaining the same pace as in May. In the meantime, in monthly terms, credit grew for the second consecutive month, albeit at lower levels than the historical ones. Signals for eased standards of supply and growth of credit demand, obtained from the surveys conducted in the second quarter, seem to materialise slowly in improved credit performance. As we have previously stated, the tightened lending standards and the sluggish credit performance is a regional and European phenomenon, which may be solved only in the presence of the steady growth of the domestic economy and the complete calming down of European financial markets. The Bank of Albania deems that the country's reality and perspective require adopting more realistic strategies for a faster crediting to the economy. While upholding the financial stability, we have taken and will continue to take the right measures to support this process. On the other hand, sound and improving balance sheets of the Albanian banking system guarantee the funding of the Albanian economy in the medium and long term.

* * *

At the end of the discussions, the Supervisory Council concluded that the

incoming available information does not change our baseline projections. The economy is expected to grow gradually during the year, driven primarily by domestic demand. Reflecting the monetary stimulus, the heightened confidence in the economy, as well as the expected improvement of financial conditions and business climate in our trading partners, the Albanian economy is expected to converge gradually towards its potential in the medium term. Closure of the negative output gap will lead to the gradual return of inflation to target.

At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 2.50%. Based on available information and in line with our projections, the Supervisory Council deems that the stable return of inflation to target will require keeping the key interest rate at low levels for some quarters ahead. Risks surrounding the basic projections remain on the downside, closely related to the stability of sources of growth, as well as economic and financial developments in trading partners. The Bank of Albania remains vigilant and is monitoring the situation; it is totally committed and has all the necessary instruments for meeting the inflation target.

WELCOMING REMARKS BY MS. ELISABETA GJONI, FIRST DEPUTY GOVERNOR OF THE BANK OF ALBANIA

The high-level seminar on "Deposit Insurance Funding: Key Questions,
Diverse Approaches"

Good morning and thank you for giving me the opportunity to take part and address this international gathering.

It is with great pleasure for the Bank of Albania (BoA) that the Albanian Deposit Insurance Agency (ADIA) is hosting the seminar "Deposit Insurance Funding: Key Questions, Diverse Approaches". I would like to thank all participants from around the world and wish them a warm welcome in Tirana. I hope you will enjoy it. I avail myself of this opportunity to express my gratitude to the International Association of Deposit Insurers, the Federal Deposit Insurance Corporation, and the Albanian Deposit Insurance Agency, who have made possible this event in Tirana.

The topic of this year's seminar is of great interest to the BoA and certainly to other institutions responsible for the financial stability. The BoA looks forward to hearing and learning about the different perspectives and approaches that will be shared in this seminar on the topic. Of course, the topic becomes more sensitive considering the current global financial complexity and its fast-changing landscape.

In my remarks today, I would like to share with you two key aspects:

- Some insight of recent developments in banking system in Albania and
- ADIA's perspective in the BoA point of view

Since the inception of the ADIA, the Bank of Albania has been strategically committed to creating and maintaining an efficient and effective deposit insurance scheme in Albania. The BoA is a relatively new institution; it was established in 1992. From the beginning, one of its responsibilities has been to develop a stable and safe banking system. Thus, BoA's efforts towards the new architecture of the banking sector, guided by international standards and consumer protection principles, and in coordination with government, helped set up the Albanian Deposit Insurance Agency. The Parliament approved the ADIA law in 2002 to restore public confidence in the nation's banking system. The Bank of Albania, by law, is the supervisory authority of the Agency. Initially, the Agency was fully under the umbrella of the central bank, and know-how and staff were transferred from the central bank to the ADIA, and a number of rules, even those on operational activity have to be approved by the supervisory authority.

For six years, the Agency has developed and grown normally, and only in 2008 – for the first time - the ADIA was put in focus. The banking system experienced an increased and continuous withdrawal of deposits by panicked customers. Besides several measures taken by the BoA, the financial stability advisory group (FSAG) – (established in 2006 and comprised the Minister of Finance, Governor of the BoA and Chair of the AFSA) - understanding the importance that the deposit insurance scheme has on the financial stability of the country and the role it plays in maintaining the Albanian citizens' confidence in it, proposed to the Parliament to triple the coverage level (from 700 thousand to 2.5 million lek/depositor).

The BoA and ADIA relationship has constantly evolved through the years to become a strong partnership and cooperation, allowing our institutions to fulfil their respective, but complementary, missions.

In Albania, banks dominate the financial system, accounting for 94% of financial system activity, about 88% of GDP. Subsidiaries of foreign banks represent about 93% of total banking assets. Bank credit is funded largely by local deposits.

As a result of legal changes in 2012, all foreign banks operate as subsidiaries. There are 15 foreign-owned bank subsidiaries of major international banks, including banks from neighbouring countries (Greece, Italy, Turkey and the largest bank, Raiffeisen, from Austria). Greek banks account for one-fifth of Albania's banking system.

The BoA supervises the domestic banking system, saving and credit associations (126), and other non-bank financial institutions, and the Albanian Financial Supervisory Authority (AFSA) supervises insurance companies (12), pensions and investments funds.

The Albanian banking sector has maintained its structure and stability during 2014. The volume of activity grew and the financial performance improved. Overall, it remained liquid, well capitalized and capable to withstand various shocks.

The risks to the banking sector as at end of September 2014 decreased compared to the previous year as reflected by the banking stability indicator - which combines the impact on certain major risk dimensions. Though there are improvements in liquidity and profitability, concerns over asset quality remain.

By September 2014, banking sector assets expanded by 3% from the end of last year. Assets continued to be negatively influenced by the low pace of lending, due to the unstable demand for loans and the sale of non-performing loan portfolio by banks. For this reason, banking sector investment in Government securities amounted to around 25% of total bank assets or 60% of total public debt.

The low pace of bank lending remains the major concern for the outlook of the Albanian economy.

The growth of lending remained below its historical rates - credit growth slowed down considerably in 2013 and shrunk in the first half of the current year. Both supply-side and demand-side factors impacted this performance. Changes in parent bank policies, weakening of bank' balance-sheets at home and tighter lending standards were factors that contributed to credit supply shrinking.

However, there are slight signs of credit growth recovery - more evident during the third quarter of this year. At the end of September, bank lending turned positive - increasing by 2% in annual terms.

The banking system activity continues to be fundamentally financed by deposits, which account for 82% of total assets. Deposits expansion slowed down, recording an annual growth rate of 2.3%. Household deposits, which account 86.7% of total deposits, grew at a lower annualized ratio of 1.8%, from 3.7% in the previous year. Business deposits grew by 6.2%, from 4% a year earlier.

The sound banking sector capitalization remains a distinguished feature of the Albanian banking sector. The capital adequacy ratio of this sector stands at 17.6% - well above the minimum required level of 12%. The largest share of current own funds of banking sector consists of Tier-I capital, providing flexibility against shocks.

Profit in the system showed positive and encouraging values this year. The RoA and RoE were positive, standing at 0.9% and 11%, respectively, due to increased net profit. The system started to show positive values for the indicators since December 2013.

Credit risk and impairments to the bank lending channel are the biggest financial stability challenge for the Albanian banking sector.

The quality of the loan portfolio did not improve during 2014; the NPL ratio stands at 25%. Although provisions for impaired loans were up at 65%, NPLs net of provisions to capital still remained at around 50% and further efforts to foster workouts -particularly as regards collateral execution - thus appear necessary.

The banking sector appears to be well hedged against direct risk from adverse exchange rate and IR movements, but the sensitivity to such changes has increased. The ratio of net open foreign exchange position to the regulatory capital stands at 6.8% and banks 'long' position suggests limited exposure to the exchange rate risk.

The liquidity position of the banking system remains strong. The banking sector exposure to liquidity risk was low due to an adequate liquidity situation.

Deposits remained the main source of funding for the banking sector operations; the loan-to-deposits ratio is around 55%. The liquidity ratio (liquid assets to the short-term liabilities), both in lek and foreign currency, are above the minimum regulatory ratio. At the end of September, the liquid assets accounted for 32.45 of total banking sector assets, about 5 percentage points up from the level at the end of last year.

The monetary policy has remained expansionary in order to support domestic demand and enable the return of inflation and of inflation expectations to target. The key interest rate was cut three times during the year by a total of 75 basis points. The latest cut was in November when the key interest rate was lowered at 2.25%. In addition, the BoA has continued to provide forward guidance to put downward pressure on interest rates and support aggregate demand.

The BoA, through moderate easing monetary policy, along with a set of legal and structural measures to address non-performing loans applied during this 2 recent years, aimed to deal with both supply and demand for credit. Considering the needed time for the transmission of these policies to the economy, they are expected to help establish a more favourable climate for lending. Still, there are challenges ahead for the industry. Margins remain under pressure in this low interest rate environment. Institutions have responded by extending asset maturities, which raises concerns about interest-rate risk. All of these issues continue to be matters of ongoing supervisory attention.

The BoA intends to implement Basel II by 2015 and complement the current focus on compliance with a forward-looking risk-based approach to supervision. We have adopted macro-prudential measures to safeguard financial stability.

Today, financial stability is more important than ever to the work of the BoA. With the lessons from the crisis still fresh, we are in the process of strengthening our financial stability capabilities. We are also cooperating closely with ADIA and other regulators to develop well-planned working protocols and a joint sense of responsibility for financial stability, while respecting the fact that each independent agency has its own specific statutory mandate and governing body.

Together with other key institutions responsible for financial stability in Albania, the Ministry of Finance and the Financial Supervisory Authority, we recognized the ever increasing importance of the role ADIA has in our financial system. As such, in recent years we have ensured that the Agency becomes an active participant in the Financial Stability Advisory Group, along with the three institutions. The Financial Stability Advisory Group, established in 2006, became fully operational in 2012. It meets on a quarterly basis to monitor developments and risks to the financial system. The FSAG shares information, discusses general economic policy, and engages in contingency planning and crisis preparation. The ADIA reports on issues of importance to its operations and solvency in accordance with a MoU entered into by

the parties in February 2012. The difficulty of coordinating among different regulators renders the degree to which macroprudential policies can be successful critically dependent on the institutional setup of communication.

In March 2014, the Financial Stability Advisory Group members, together with ADIA, signed an updated MoU that improves inter-institutional cooperation in support of preventing and addressing systematic risks in the financial system.

In recent years, the Bank of Albania, as the supervisory authority, has supported the Agency in both increasing its capacity to effectively fulfil its mission and becoming a key player for maintaining public confidence in our financial system.

To allow for increased capacity to better fulfil its mission in compliance with best practices in deposit insurance, the Bank of Albania supported the organizational and structural changes the Agency underwent in mid-2013. Among the main changes, we may highlight the creation of the Risk Analysis, Information Technology and Public Relationship functions within the Agency. This supported the implementation of the IT system for the data of deposits and depositors to ensure the functions of the scheme. This strategic function set the foundations for the Agency to fulfil its objectives more effectively in light of the current landscape and expected future developments for the deposit insurance scheme.

Estimated insured deposits are EUR 4.1 billion Euro. That means 66% of individual depositors or 55% of total banking system deposits. The reserve ratio —which is the fund balance as a percentage of estimated insured deposits — is increased; however, as required by law, the Deposit Insurance Fund must achieve a minimum reserve ratio of 5 per cent, that means EUR 38 million more or 19% of required fund. So, the Agency is well on track towards achieving that goal.

In 2014, a new law on deposit insurance was introduced, allowing for a more effective and efficient insurance scheme. The new law, whose objective was to better link the Albanian deposit insurance scheme with International Association of Deposit Insurers (IADI) core principles, addressed the recommendations by FSAP in late 2013. The new law intends to increase the authority of the ADIA without changing its pay box mandate and make its legal independence more robust.

This new law addresses several aspects for the improvement of the scheme and increases the institution capacity of the Agency.

Investment policies are based on its new law and it is following by an internally approved policy appropriately focused on safety and liquidity over return. The ADIA is managing an investment portfolio that has reached almost (ALL 23 billion), EUR 166 million (or approximately 1.4 per cent of the GDP). As the portfolio grows and considering the currency risk related to foreign currency deposits and other information on its liability structure, the ADIA

needs to set up a proper investment horizon and better adopt asset-liability management (ALM) principles.

In addition, the new law increased the administrative independence of the Agency from the Bank of Albania and improved its governance framework, which is followed by reviewing a number of ratification of many of its operations actions by BoA. Among other things, the Agency now approves its own budget, which allows for increased operational agility in fulfilling its mission and ensures legal protection for its employees.

Considering the topic of this seminar, it is worth mentioning that in 2013 the Agency started the negotiation for a EUR100 million stand-by credit line with the EBRD. The funds will be made available in case an insurance event arises, thus allowing for a faster and effective response by the Agency in such cases. The Bank of Albania has been supportive for this initiative with significant improvements in a key element for deposit insurers, such as funding.

As noted, the relationship between the Bank of Albania and the Agency has continuously evolved through the years as partnership and cooperation grew stronger, allowing our institutions to fulfil their respective but complementary missions.

In order to achieve full compliance with the EU directive on deposit guarantee schemes for tailoring the maximum levels of coverage with different types of subjects (banks and credit and savings associations) covered by the scheme, (according to their risks), in 2015, the Savings and Credit Associations will be included in the deposit insurance scheme. The Bank of Albania, as the supervisor of Savings and Credit Associations, and the Agency, as the deposit insurer have joined efforts to ensure a smooth process for the inclusion of such institutions in the scheme.

The ADIA continues working with the BoA on financial education trainings and conferences across Albania to educate the target audience about deposit insurance.

The goal of these trainings is to raise the awareness on the deposit insurance scheme and reduce the operational risk at banks' branches in Albania.

The new law addresses the need to increase the type and amount of information the ADIA receives from the BoA to better prepare the deposit insurer for possible payouts. The intense and ongoing cooperation between the two institutions would ensure a full implementation of the information sharing agreement between the BoA and the ADIA.

I would mention the increased emphasis placed by our institutions on opening and maintaining channels of communication at all levels, which allows for timely sharing of information on banking system.

In conclusion:

The deposit insurance framework in Albania, managed by the ADIA, broadly conforms to best international practice. We have confidence in a continuing commitment to these practices by the ADIA, which will serve the long-run interest of both the depositors and the banking industry.

I look forward to hearing your views on the best way to move ahead on these and the other important issues we have gathered to discuss.

Closing, I would like to thank you once again for the opportunity to speak to you today.

And I wish you all great success!
Thank you!

PERIODIC ANALYSES*

** The views expressed in these analyses are those of the authors and do not necessarily reflect the views of the Bank of Albania.*

TRENDS IN LENDING, 2014 Q4

Erjona Suljoti and Sofika Note
Monetary Policy Department, Bank of Albania

This analysis presents a detailed overview of the most recent lending developments in Albania. It studies the monetary data on the credit portfolio by economic agents, as well as lending standards. In more details, lending standards will be addressed in both price - interest rate - and non-price terms. In addition, the analysis will present a summary of trends in lending in Central, East and South-East Europe (CESEE) countries.

The spillover effects of the global financial crisis in the CESEE countries and its consequences on Albania have often been the subject of our periodic analyses. In this context, regularly updating such information becomes crucial, in order to better understand the impact of both domestic and external factors on the performance of financial indicators in general and of lending in particular.

The main statistics taken into account in this analysis are:

- Monetary data¹ for the volume of bank lending in the two main portfolios, businesses and households.
- Qualitative data from the bank lending survey, with a special focus on analysing lending standards and demand, and the factors affecting them. Based on this survey results, non-price elements are also analysed.
- Statistics on credit price, represented by the average interest rate weighted with the new credit, denominated both in lek and in euro. The intermediation margin applied by banks to the cost of funds is also analysed.
- Monetary data on the volume of lending in the countries of our region include data from: Bulgaria (BU), Croatia (CR), Romania (RO), Serbia (SR), Poland (PL), Hungary (HU), the Czech Republic (CZ), and Former Yugoslav Republic of Macedonia (MK).

The analysis covers data published as at 20 January 2015, which include information for monetary and financial data for November 2014 and data from the bank lending survey 2014 Q4.

¹ The monetary methodology is based on the resident and non-resident concept, and loan data include only loans to residents. For more information, refer to "Monetary and Financial Statistics Manual" of the International Monetary Fund, 2000 ed.

SUMMARY

Bank intermediation was sluggish during October - November 2014, characterised by the weak performance of loans and deposits. The positive developments in lek intermediation relied on both the growth of lending and the better growth of lek deposits. Foreign currency intermediation, on the other hand, was determined by the fall in foreign currency deposits, while foreign currency lending was almost inexistent. These developments have driven the shift of bank intermediation towards the national currency, creating therefore premises for strengthening financial stability and monetary policy effectiveness in the economy.

Lending to businesses was up during October - November. Bank lending to businesses was granted for both short-term liquidity and investment purposes. A highlight in the fourth quarter was lending to state enterprises, which was accompanied with preferential lending standards. Lending to businesses, however, remains segmented and suffers from the weak credit demand, especially for investment purposes. Lending supply remains concentrated in only a few banks of the system. Banks tightened the lending standards, driven by factors related to their balance sheets, parent bank policies, and economic-related concerns. This trend in lending to businesses is expected to persist in the next quarter.

Lending to households was sluggish, compared to both a year earlier, and to the first half of the year. Although the standards of lending to households remained on the easing side and interest rates on loans were downward, credit demand by households remains particularly weak. The volatility of the consumer confidence indicator, especially its deterioration in the last quarter, corroborates households' uncertainties and is materialised in the sluggish credit demand. Households demand was oriented towards financing consumption. The portfolio of mortgage loans continues to shrink, despite the more attractive products for the latter.

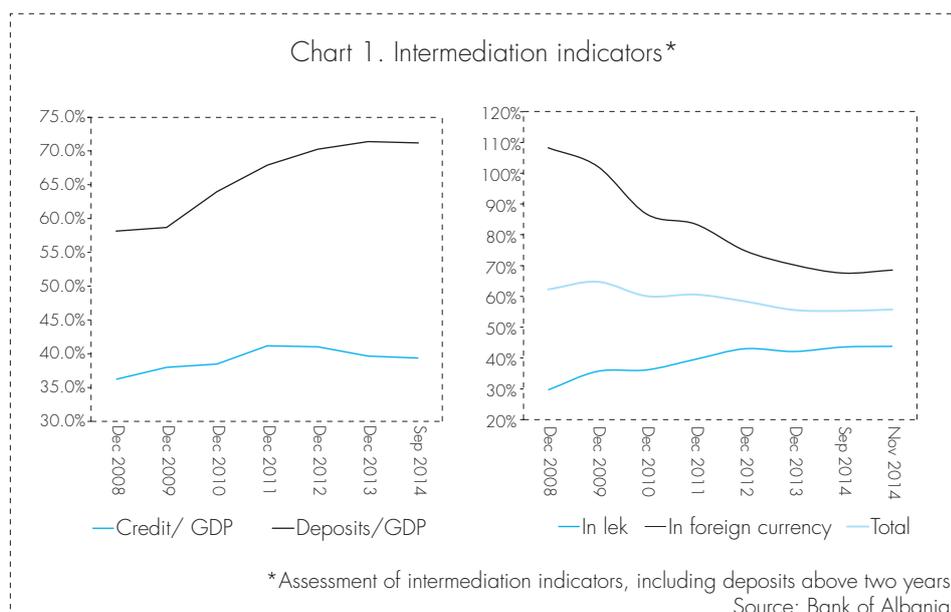
Interest rates on lek loans continued to fall, while those on euro loans remained unchanged, in October - November. The fall in interest rates on lek loans was noted across all the banks for all types of loans. It was, however, more pronounced for the businesses segment. The more contained drop in interest rates on lek deposits contributed to the further drop in the intermediation margin, supporting therefore the rise in lek intermediation. The latter appears to be also supported by the narrowing of the spread between lek and foreign currency interest rates.

The analysis of lending to the private sector in other countries of our region points to a slow and fragile recovery. Characterised by a large presence of foreign banks, all the countries of the region have been affected by their deleveraging strategy in these countries. This approach has been more significant for Balkan countries and is expected to persist in 2015. On a regional basis, Albania is ranked above the region's average as regards lending to businesses, but below the region's average as regards lending to households.

1. GENERAL OVERVIEW

Banks financial intermediation in October - November remained sluggish, characterised by slow growth of credit and deposits. During the period, bank lending was characterised by further increase in lek intermediation against the weak foreign currency intermediation. This landscape reflects the orientation of the low demand towards lek loans, driven by the eased monetary standards. Meanwhile, deposits showed different dynamics from that in the third quarter. Lek deposits increased, whereas foreign currency ones decreased. The creation of lek deposits remains low, affected by the shift of households' savings toward investments in securities.

In October - November 2014, banks financial intermediation appears to have slightly improved from the third quarter, but the improvement reflects mostly the weak performance of deposits, while the credit performance continues to be sluggish. Thus, the ratio of credit to total deposits recorded the highest level, 55.7% in November. It stands 0.4 p.p. higher than in September and close to the 55.6% recorded in the end of 2013. The slow and fragile recovery of intermediation was determined by an unsteady credit recovery.



In October - November, notwithstanding the annual credit growth to 3.8%² from 1.6% in September, the monthly net average flow, adjusted for the exchange rate volatility, was almost zero. Such performance was determined by economic agent's weak demand for loans and banks' risk aversion policies. Lending survey results for the fourth quarter confirmed both the weakening of demand for loans and the tightening of standards for businesses, compared to the third quarter of the year. In the meantime, the latest lending survey in the countries of our region³ (EIB, November 2014), shows that large European

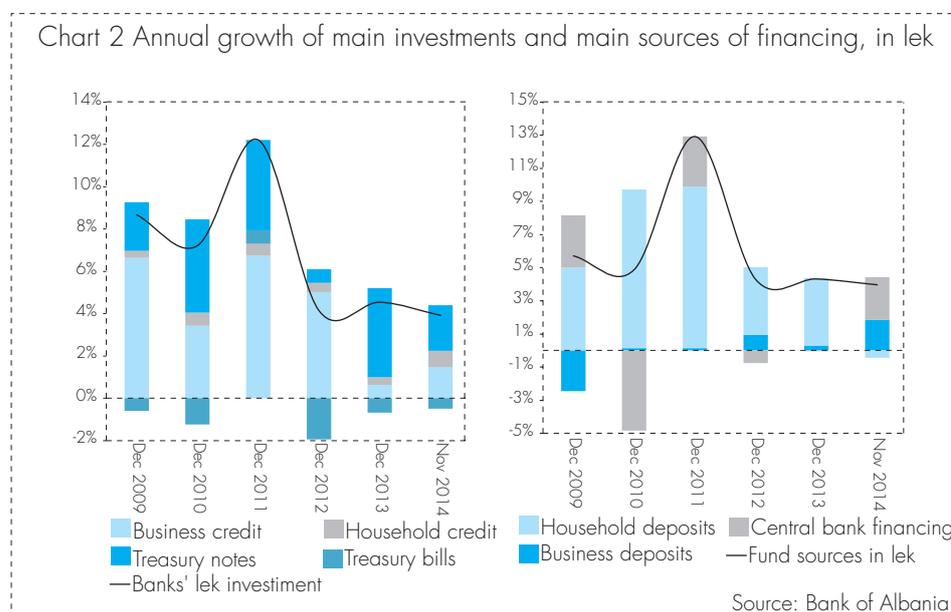
² The improvement of annual growth has mostly reflected the cancelling out of the negative effect from the reduction of the portfolio in October 2013.

³ CESEE Bank Lending Survey – H2 2014, by the European Investment Bank (EIB).

banks have adopted policies for reducing their exposure to Albania. This trend is expected to continue, although at slower pace, over the first half of 2015, and is expected to condition the recovery of banking system intermediary role in the economy.

During the fourth quarter, the pace of growth for total deposits⁴ is slightly higher than in the third quarter, up to 2.2% (from 1.7% in September). This pace, however, remains below the average growth rate of total deposits in the last two years. Low lending levels have been accompanied with low money creation levels in the economy, consequently a poor performance of deposits. As at end September 2014, the ratio of total deposits and loans to GDP stood at 71.2% and 39.3%, respectively, unchanged from the second quarter of 2014.

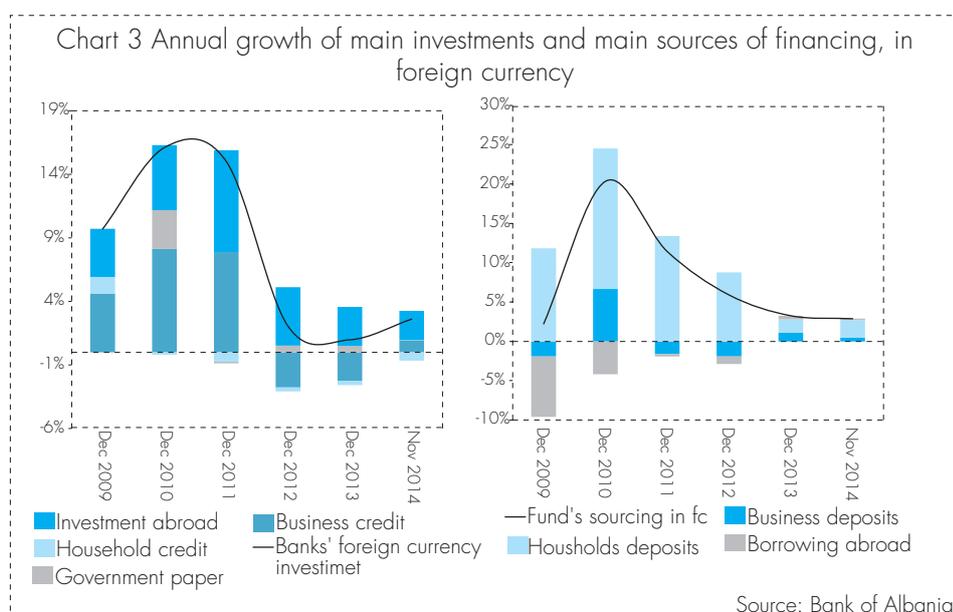
Intermediation in the national currency continued to show positive developments, characterised by increase of investments in lek. In contrast to the third quarter, during October - November, banks were more involved in investing lek funds in the private sector and less so in financing the government. The ratio of lek loans to lek deposits rose to 43.8% from 42.1% in September 2014 and December 2013, respectively. The improvement of lek lending to businesses contributed to deepening intermediation, whereas that to households was lower than in the third quarter. As at end November, lek lending stood 9.3% higher than in the previous year, compared to 5.7% in September.



⁴ For the purposes of financial intermediation analysis, in this section of the analysis we have referred to the total deposits in the banking system, including those above two years, which are not included under the item deposits according to the monetary methodology, but serve as a source of financing/intermediation for banks.

The pace of growth in lek deposits improved to 1.3% against contracting by 0.2% in the third quarter, which is reflected in the deceleration of improvement in intermediation in lek. The performance of lek deposits in October and November continues to be affected by the shift of deposits to maturities above two years, though at a slower pace than in the previous quarter. Unlike the third quarter, developments in lek deposits were driven by businesses deposits. Liquidity withdrawal from Bank of Albania has been one of the sources of financing the activity in lek, but this source has given lower contribution to the increase in funds, compared to the previous quarter.

In November, the ratio of foreign currency loans to total deposits improved to 55.7%, or 0.3 percentage points higher than in September. This improvement reflected the drop in foreign currency deposits, while the foreign currency lending has been steady, since the end of third quarter of the year⁵; it continues to contract in annual terms by around 0.9%. While banks have lowered their placements abroad compared to September, among other due to the penalising macroprudential measures that have been applied for more than a year. Unlike the third quarter, banks have lowered short-term foreign-currency financing of the public sector. Businesses and households foreign currency deposits continue to be the main source of financing the activity. However, in contrast to the third quarter, they provided negative contribution to the performance of funding sources for October - November. Thus, at the end of November, foreign-currency deposits resulted 3.2% higher than in the previous year. This rate has been slowing down. Especially in November, foreign-currency deposits contracted mostly due to downward business deposits and less so due to households ones.



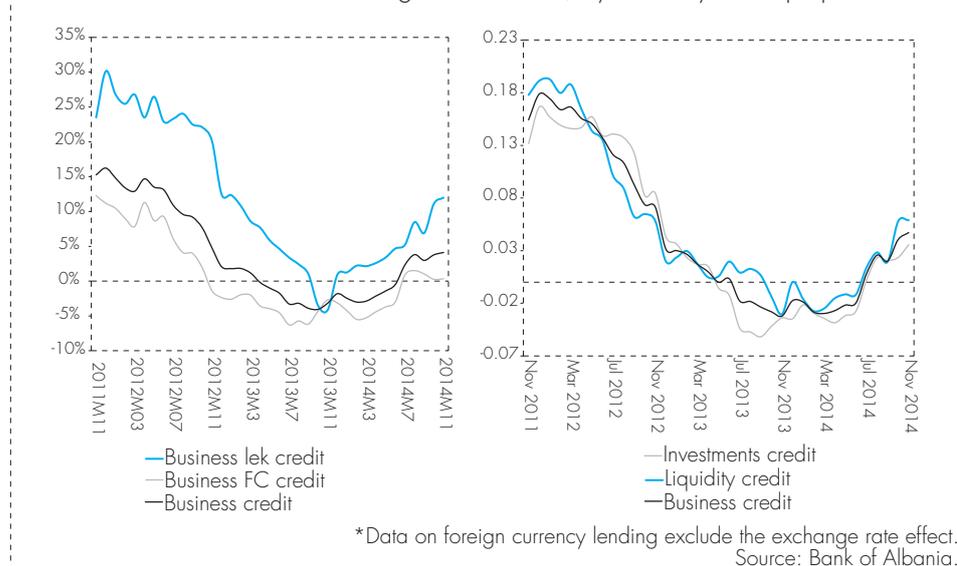
⁵ Foreign-currency lending excluding the exchange rate effect, in order to analyse the real performance of the portfolio.

2. LENDING TO BUSINESSES

Lending to businesses continued to grow in October - November 2014, improving further in terms of financing liquidity needs. Despite the annual improvement, the loan portfolio continues to be dictated by the weak demand and the tight supply. Demand for loans continues to be conditioned by the economy performing below potential, unutilised production capacities and uncertainties. In the meantime, the tightening of lending standards for businesses corroborates banks' reluctance to further increase intermediation for this segment. These tendencies are expected to persist in the first quarter of 2015.

In November, lending to businesses amounted to 5.1% higher than in the previous year, against 2.7% in September.⁶ Lending growth rates improved, owing to the significant growth in lek lending to businesses mainly for liquidity, whereas foreign-currency lending appears weaker than in the previous quarter. Under the conditions of downward lek lending costs during 2014 and due to the purposes of use, businesses demand was oriented to lek-denominated loans. By purpose of use, loans for liquidity showed accelerated growth to 5.9% in November, against 1.9% at the end of the third quarter. The performance of loans for liquidity purposes was affected, in October, by a loan for state enterprises. The annual growth rates for loans for investment purposes improved to 3.6% from 2.1% in September. Businesses demand for this product appears volatile and fragmented.

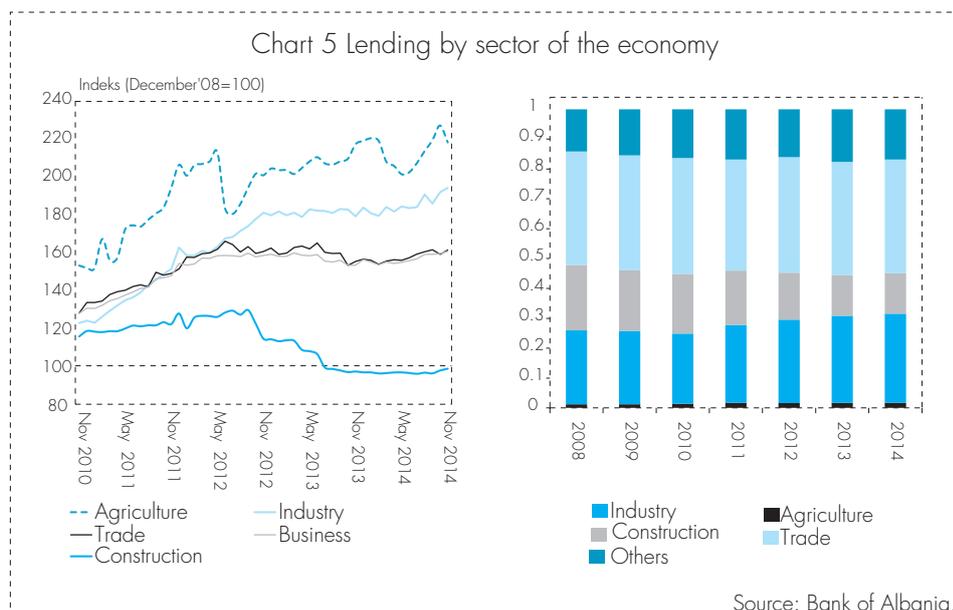
Chart 4 Annual increase of lending to businesses, by currency* and purpose of use



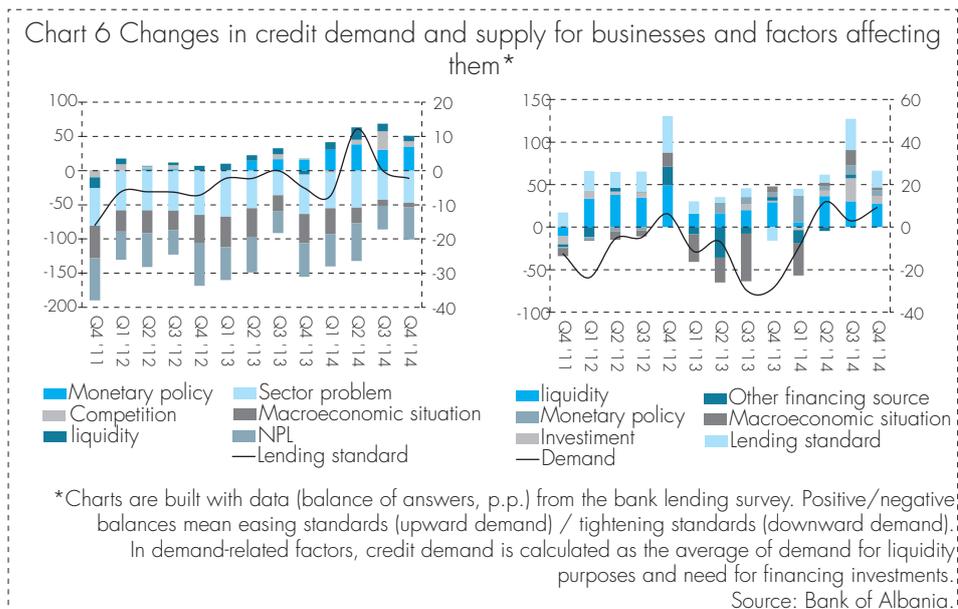
⁶ The annual performance of the portfolio of lending to businesses was affected by the strong contraction in the previous year.

The monthly dynamics of the lending portfolio to businesses reveals a poor performance. The monthly expansion of the portfolio was ALL 1 billion, less than half the average monthly expansion in the third quarter. This performance confirms once again that credit recovery remains sluggish, as a result of both low demand, and tightening of lending standards by banks. Lending for this segment was also conditioned by the banks re-orienting lending toward small and medium-sized enterprises, which is less credited by banks but bears more risks amid the conditions of slow economic recovery.

During October - November, banks increased their lending to businesses operating in industry and construction sectors, by ALL 5 billion and ALL 1.4 billion, respectively. In annual terms, the lending portfolio to the industry saw the highest growth by 8.3%, mostly driven by lending to the subsector of production and distribution of energy and gas. The acceleration of the growth pace for the industry portfolio in the last three quarters has contributed to the increase in the share of industry in the total, to 29.8%, or 1 p.p. higher than in the previous year. Lending to the construction sector, for the first time after two years, saw 1.5% annual growth. The share of lending to this sector in the total lending to businesses recorded 13.5%, unchanged from the end of 2013. In the meantime, the portfolio of lending to trade, albeit dominating the portfolio of lending to businesses by 38%, saw weak performance, remaining at the same levels as in the third quarter. In annual terms, it expanded by 3.8%.



In the fourth quarter, banks tightened the lending standards for businesses, driven by the high presence of non-performing loans and sector-specific problems. Standards were tightened for both the small and medium-sized enterprises and the larger corporations, while banks were more conservative, especially for investment loans. Banks expect easing of standards for small and medium-sized enterprises and for liquidity loans in the first quarter of 2015, whereas standards for larger corporations and investment loans are expected to remain tight.



In the last quarter, factors that led banks to ease standards are the easing of monetary conditions in the economy, competitiveness among banks, and good performance of liquidity. Irrespective of the good performance of these factors, the negative impact by non-performing loans and sector-specific problems has been a decisive factor on the performance of lending standards for businesses. Increasingly fewer banks assess that the overall macroeconomic situation has affected negatively banks decisions, being in line also with the overall improvement of the macro situation in Albania.

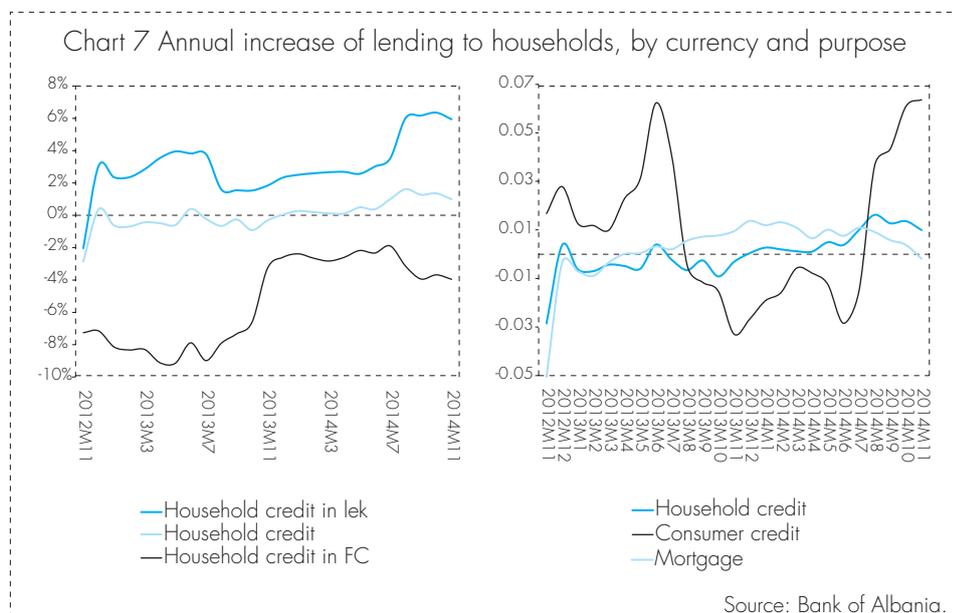
Businesses credit demand is assessed as slightly up in the fourth quarter and is expected to remain at these levels in the first quarter of 2015. According to banks, it has been driven mainly by the need for short-term financing for liquidity purposes, more favourable lending conditions and an improving economic situation. The latter is also confirmed by the performance of businesses confidence indicators, which have shown improvement over several quarters. This positive performance, however, has not been yet observed to stimulate a steady business demand for bank funding.

3. LENDING TO HOUSEHOLDS

Bank lending to households continued to perform moderately. Although banks have been easing the standards of lending to households for more than two years, households demand is still not picking up, reflecting the uncertainties for the future and deferment of home purchase. Banks expect that households' low credit demand will continue in the first quarter of 2015.

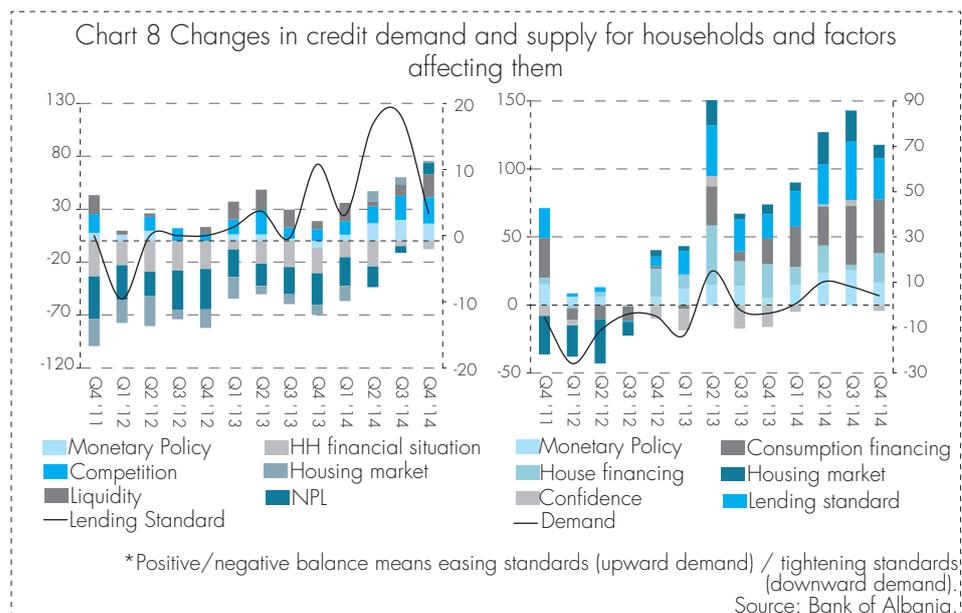
Lending to households continued to grow at low rates, 0.9%, compared to 0.4% recorded in the end of the third quarter. Although banks have been easing the standards of lending to households for more than two years, demand from households is still not picking up. This sluggish performance has

reflected on the one hand the continuous improvement of consumer loans and, on the other, the contraction of the mortgage loan portfolio. The latter accounts for 76% of the loan portfolio dictating the sluggish performance of lending to households. In annual terms, the portfolio of consumer loans surged by 6.1% whereas mortgage loans contracted by 0.2%.



Regarding the performance of lending to households by currency, since July, lending to households in lek has been growing steadily. As at end-November, this portfolio was 5.9% higher than a year earlier. This performance has been dictated not only by the performance of consumer loans, which is mainly disbursed in lek, but also due to the waning of the statistical effect of cleaning up non-performing consumer loans from the balance sheet. Thus, consumer loans surged during the two months by ALL 0.4 billion, maintaining the same growth as in the third quarter.

Foreign-currency lending to households contracted throughout the year, at a higher pace during October - November. The performance of foreign-currency lending to households was related particularly to the weak performance of mortgage loans. The small number of transactions in the real estate market and the lag in the adjustment of house prices confirm the sluggish demand of households for financing. Credit outstanding for house purchase in November was ALL 0.4 billion lower than at end-September, contracting at slightly higher pace.



Banks continued to implement easing policies on lending to households, albeit at a lower pace than in the third quarter. The easing of standards for households was supported by the better liquidity situation in banks, increasing competitiveness and easing of monetary conditions in the economy.

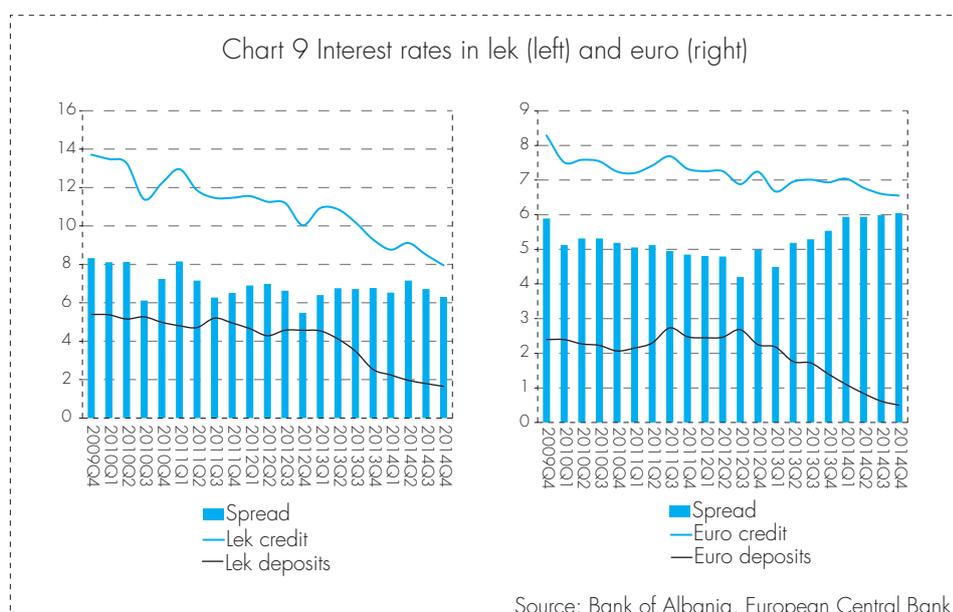
Households demand for bank lending, while positive, appears downward compared to the first quarter. The downward consumer confidence, as confirmed by the households' confidence survey in the fourth quarter, is the only factor with a negative impact on credit demand. All the other factors, such as lending standards, need for financing and housing market sustained the recovery of lending to households. This performance is expected to persist in the first quarter of 2015.

4. CREDIT PRICE AND OTHER STANDARDS

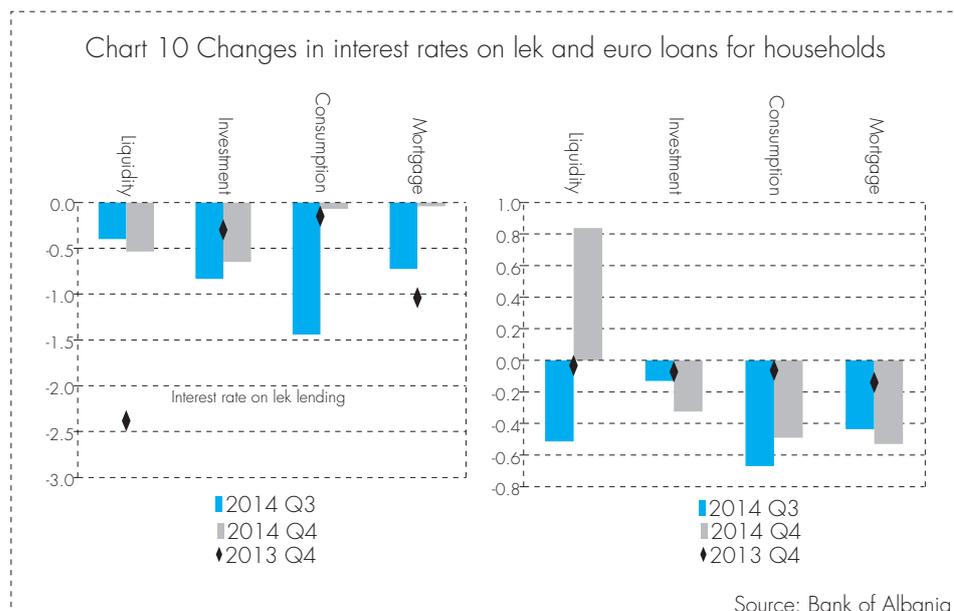
Interest rates on lek loans continued to fall, while those on euro loans remained unchanged, in October and November. The fall in interest rates on lek loans was noted across all the banks for all types of loans. It was, however, more pronounced for the businesses segment. The more contained drop in interest rates on lek deposits contributed to the further drop in the intermediation margin, supporting therefore the rise in lek intermediation. The latter appears to be also supported by the narrowing of the spread between lek and foreign-currency interest rates.

Interest rates on lek loans have trended down since the second quarter of 2014. On average for October - November 2014, the interest rate on lek loans stood at 8%, being 0.5 percentage points lower than in the third quarter of 2014 and 1.3 percentage point lower than in the last quarter of 2013. Notwithstanding the temporary fluctuations of the interest rate on lek loans,

it has been constantly and gradually falling for more than four years, in line also with the easing of monetary conditions. The average interest rate on lek deposits has also trended down, but, unlike in the previous year, the fall was more gradual. The interest rate on deposits in the fourth quarter averaged 1.65%, against 1.79% and 2.23%, respectively, in the third quarter of 2014 and the last quarter of 2013. This performance contributed to the narrowing of the intermediation margin to 6.3 p.p., among the lowest in the last four years. The easing of monetary conditions, together with the favourable bank liquidity conditions has determined the downtrend of the intermediation margin in the national currency. In addition, the relatively low risk for lek loans, compared to the foreign currency loans, has created more space for banks to reduce the intermediation margin. The cost reduction on lek loans has been one of the main factors for orienting loan demand towards the national currency. The shift of lending from foreign to the domestic currency sustains the stability of the financial system and establishes the premises for enhancing the efficiency of the monetary policy.



Reduction of interest rates on lek loans in the fourth quarter was noted across all the segments of lek loans, on a broad basis, in all banks that are active in lending. Thus, interest rates on loans by purpose of use show that they fell by 0.5 p.p. for liquidity loans, which account for most of new loans granted during the period. Interest rates on investment loans to businesses have also fallen, by 0.7 p.p. In the meantime, in the retail segment for households, changes in rates on both consumer loans and mortgage loans have been minimal, compared to the previous quarter, 0.1 p.p. But, interest rates on both these products showed significant drop in the third quarter. This performance is in accordance with the results obtained from the bank lending survey, which reports a lower easing in the households market.



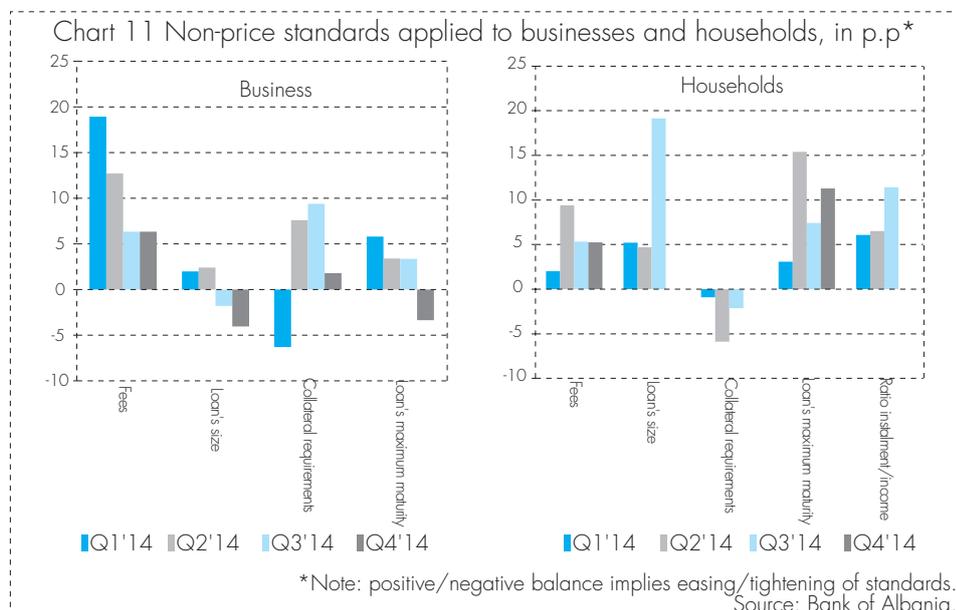
The average interest rate on euro loans stood at the same level as in the third quarter of 2014, at 6.6%. Compared to the end of 2013, this rate is 0.4 p.p. lower. Over four years, the 0.7 p.p. fall in euro interest rates is less than half the fall in lek interest rates on lek loans for 2014. This performance has also contributed to the significant narrowing of the spread between the interest rate on lek loans and the rate on euro loans, creating therefore better conditions for increasing the activity in lek and deepening intermediation.

On the deposits side, interest rates on euro deposits slowed down the accelerated decline that had been noted for more than a year. Thus, the 0.5% average interest rate on deposits for October - November 2014 was only 0.1 p.p. lower than the average of the third quarter. The weak performance of foreign-currency loans and low interest rates in international markets for foreign-currency investment has driven banks to lower interest rates on deposits. The intermediation margin in euro appears slightly upward. Throughout 2014, this margin fluctuated around 6 p.p. against 5 p.p. in the previous year. Furthermore, the spread of euro loans to the reference rate, Euribor 12M, remained in historically high levels, at 6.3 p.p.

The euro interest rates have been determined by the upward interest rates on short-term loans to businesses. Thus, the interest rate on loans for liquidity averaged 7.3%, around 0.8 p.p. higher than in the third quarter. Due to its high share in new loans granted during the period, the increase offset the decrease in rates on other segments of euro loans. The euro loan rates saw the highest drop in mortgage loans and consumer loans compared with the third quarter. However, it appears that this performance has not stimulated new foreign-currency loans from households, whose demand growth continues only for lek loans.

The easing of lending standards for households was reflected not only on the reduction of the credit price, but also on other lending standards.

According to the lending survey, banks have reduced their commissions and have extended the maturity for households' loans. On the other hand, the loan size and instalment/income ratio have remained unchanged. Likewise, collateral requirement, in contrast to the third quarter, was not tightened.



Tightening of standards for businesses was reflected not only in the upward interest rate on euro loans for liquidity purposes but also in the reduction of maturity and loan size. Meanwhile, banks state they have eased somewhat collateral requirements for businesses and have lowered the commissions. The latter have, throughout the year, served as a factor for easing lending standards.

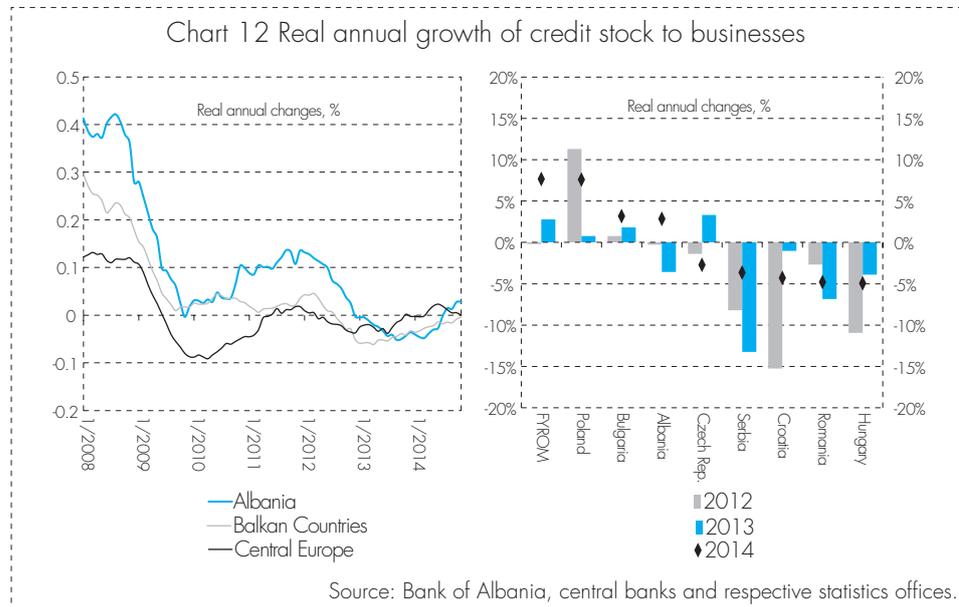
5. TRENDS IN LENDING IN THE COUNTRIES OF THE REGION⁷

In the region, lending to the private sector continued to improve gradually in the third quarter of 2014. The improvement, however, continues to be segmented and fragile. From a regional comparison, Albania is ranked among countries that performed better in terms of lending to businesses, but stands below the region's average in terms of lending to households.

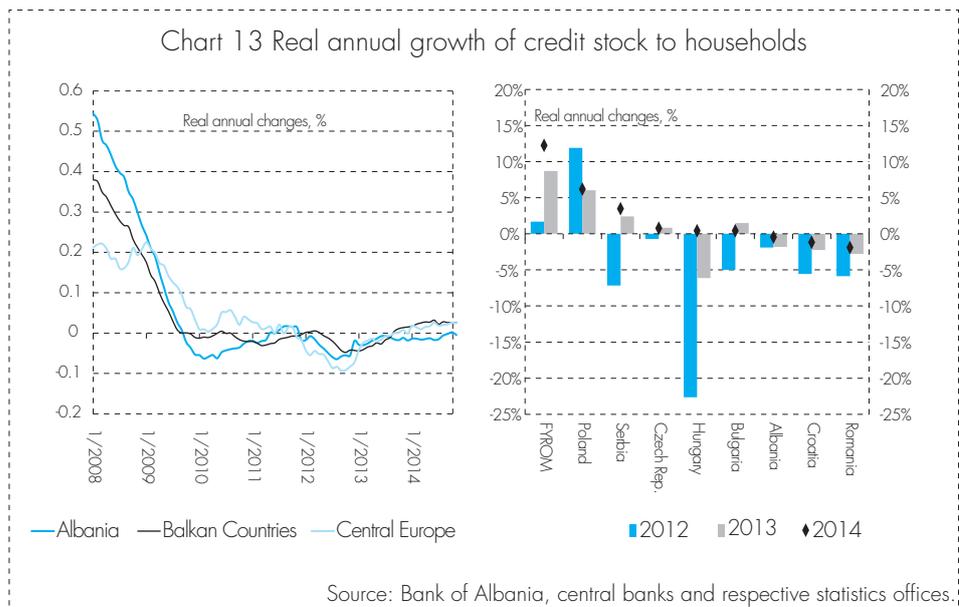
Lending to the private sector continued to improve gradually even during the second half of 2014. Overall, the recovery is slow and fragile. Characterised by a large presence of foreign banks, all the countries of the region have been affected by their deleveraging strategy in these countries. This approach has been more substantial for Balkan countries than the Central and Eastern European countries, and is expected to persist in 2015. Lending standards

⁷ For all the countries, most recent data for 2014 are from November, except for Bulgaria, whose data are from October. Lending in the countries of our region is analysed in real terms, that is, excluding the effects from the exchange rate and inflation.

in these countries have shown easing trends, though unsteady, as a result of still-high levels of non-performing loans. Demand is assessed as upward, in line with economic activity recovery, but it is mostly concentrated on short-term financing (EIB 2015⁸).



Lending to businesses continues to improve in most of the countries of our region. As at end-November, its annual average change resulted 0.1% from -2.2% at the end of 2013. In this landscape, the characteristics of lending to businesses vary across the countries. Thus, FYROM, Poland, Bulgaria and Albania are the only countries with positive growth rates of lending to businesses and saw improvement compared to the previous year. In Serbia



⁸ According to results from the CESEE Bank Lending Survey of the European Investment Bank (EIB) The results are published in November and may be accessed on EIB web site. <http://www.eib.org/infocentre/publications/all/cesee-bls-2014-h2.htm>

and Romania, lending to business continues to shrink, but at a lower rate than before. In Croatia and Hungary, lending to businesses continued to contract in real terms. Also in the Czech Republic, lending to businesses continue to slow down in the second half of the year and shrank in November.

Overall, lending to households performed better than lending to businesses in the countries of our region. It suffered less by the financial crisis compared to lending to businesses and saw a faster recovery afterwards. In average terms, its real growth improved to 2.2% from 0.7% at the end of 2013. The improvement is more evident in FYROM, Poland, Hungary, and to a lesser extent, in Serbia. In the rest of the countries, the dynamics of lending to households was slower and the annual changes stand close to the levels as at the end of 2013.

INFORMATION ON THE ECONOMIC PERFORMANCE OF ALBANIA'S MAIN TRADING PARTNERS, 2014 Q4

Medvin Shehu, Eralda Leka, Jonida Bollano, Doriana Lama

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Albania's main trading partners include Italy, Greece, Germany, Spain, China, Turkey, Macedonia and Serbia. Albania's trade with these countries accounts for around 70% of total trade activity

In the third quarter, economic growth in euro area was more sluggish than expected, mainly due to the low investments. Expectations for 2015 are revised downward in January 2015. Economic activity is expected to be supported by the improved financing conditions, consumption increase, euro depreciation and structural reforms in fiscal sector. The revision of economic growth factorises the risks that derive from external demand, in the light of a more sluggish economic activity in emerging countries, and the weak perspective for the fast recovery of investments.

Annual inflation rates were down in euro area, falling to negative values as at end-2014. Disinflationary environment drove to the postponing of both investments and consumption. On the other hand, the fast fall in oil price is expected to increase the disposable income for consumption. European Central Bank decisions on the beginning of a quantitative easing cycle shall support the sustainable recovery of economic growth and following the price increase.

China is expected to grow at a slower pace from 2014. Economic activity in Turkey continued to lower down the pace in the third quarter. The slowdown in the Turkish economy in the second quarter is expected to be followed by faster growth paces in the forthcoming quarters. Economic activity in Serbia will continue to suffer the negative effects of the floods in the first half of year, while Macedonia is expected to have the best regional economic performance.

Inflation rates fell rapidly, mainly affected by the decrease in oil price. Prices of main goods are expected to maintain the downward trend, at least until the first part of 2015.

Table 1 Economic growth forecast for 2015

GDP growth in 2015 (%)	IMF		Experts' forecast**	
	October 2014	January 2015	October 2014	January 2015
Euro area	1.4	1.2	1.2	1.1
Italy	0.8	0.4	0.5	0.4
Greece	2.9	-	1.9	1.8
Germany	1.5	1.3	1.5	1.4
Spain	1.7	2.0	1.9	2.0
China	7.1	6.8	-	-
Turkey	3.0	-	3.4	3.2*
Macedonia	3.6	-	3.6	3.3*
Serbia	1.0	-	1.5	0.6*

Source: IMF, Consensus Forecast.

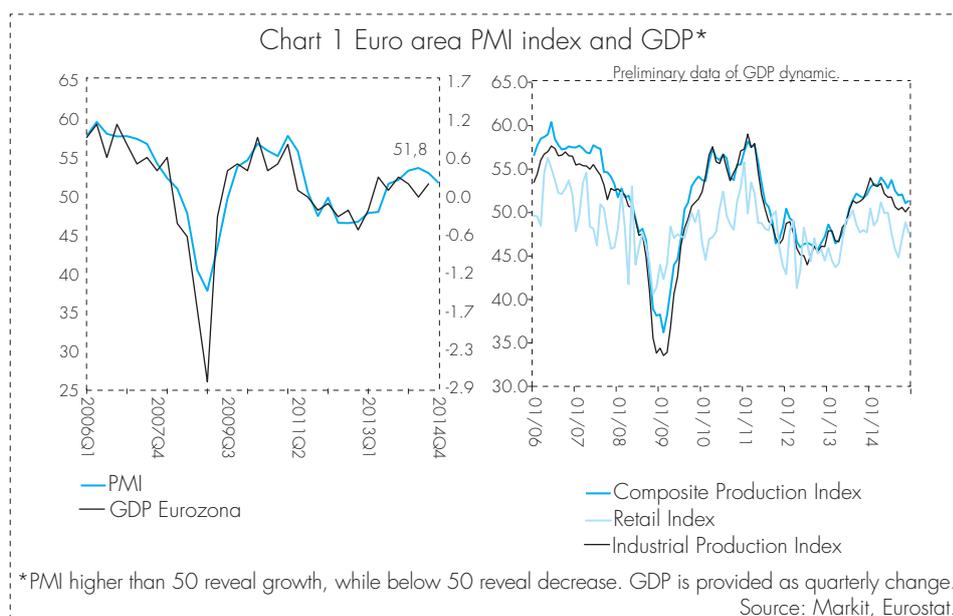
* December 2014.

**From Consensus Forecast, monthly issue of Consensus Economics, containing forecasts of the main macroeconomic indicators for G7 Countries, Asia, Eastern Europe and Latin America. Indicators are stated as simple average of the forecasts provided by the main financial markets' stakeholders, as banks, researching institutions, investment banks, rating agencies, etc.

I. ECONOMIES OF MAIN TRADING PARTNER COUNTRIES

EURO AREA

Economic growth in euro area stood¹ at 0.2% in the third quarter, while in annual terms it stood at 0.8%. Euro area economy improved slightly, by 0.1 %, compared to the second quarter, while recovery seems to be longer. The recovery of domestic consumption, which returned into positive territory after a long period, provided the main positive contribution to GDP formation. Investments resulted neutral, while net exports were negative. Economic growth by countries confirmed the positive values of countries with fiscal consolidation tasks, such as Greece, Portugal, Slovenia and Spain, while countries as Germany and France showed low growth paces. GDP of Italy remarked another contraction by considerably impacting the final value of euro area's growth in this quarter. Euro area's economy continues to be fragile, being impeded by high unemployment, particularly young people, high rate of spare capacities and low demand from the private sector. New loan to economy continues to be shrunk reflecting only some modest increase in the last months. The implementation of accommodative policy so far by ECB has not succeeded to return the boosting pace of prior crisis. In the last weeks, the financial markets and agents forecast the taking of the decision and the start of another accommodative program by ECB similar to that implemented by FED. The main purpose of these programs is to establish the conditions and lending incentive to real economy and the improvement of transmission mechanism of the monetary policy decisions in euro area. In addition to these factors, the Central Bank authorities deem as necessary the conduction of important structural reforms in many countries of euro area as an irreplaceable factor. Fiscal consolidation implemented during these years should continue and be followed by effective policies in production and labour market.



¹ Second estimate for the third quarter of 2014", 05 December 2014.

Preliminary and indirect indicators of the last months (sales index, manufacturing PMI, new orders for industry and those for export) mainly appeared in the downward direction, suggesting a fragile economic growth in the euro area in the last quarter.

Chart 2 Expectations for inflation from 5-year SWAPS on inflation



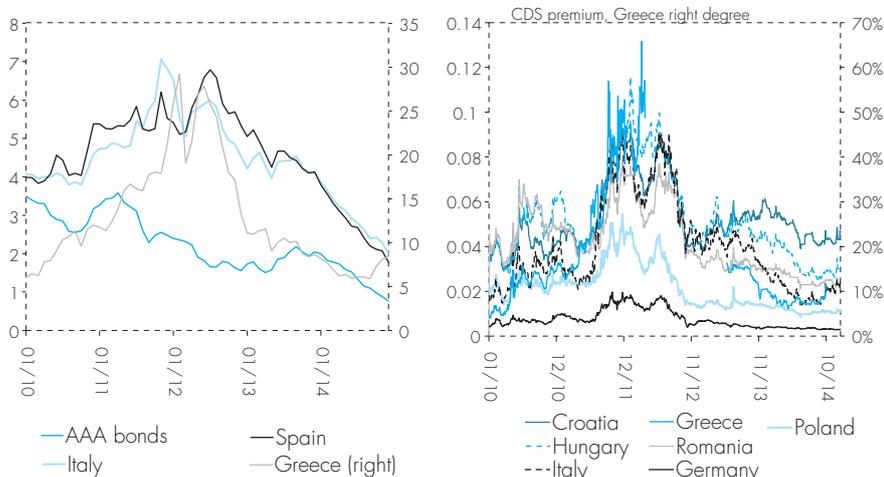
Source: Bloomberg.

Inflation rate in December was -0.3%, from 0.3% in November. Its performance, throughout the year, appeared below the ECB's target of 2%. Inflation fall is impacted by the overall downward performance of energy materials, commodity and food prices in international markets. In December the forecasts on economic growth and inflation in euro area are revised down, compared to September. In terms of economic growth, downward revisions concerned net exports and the domestic demand. Related to inflation, reviews have factorised the expected performance of oil prices and the lower forecast for the economic growth. Considering the continuing fall in oil price, annual inflation rates may be revised down in other times.

FINANCIAL MARKETS

In the meetings held in November and December, ECB kept the key interest rate unchanged. Interest rates in money market have fallen considerably since September, while many other debt instruments premium have factorised the agents' expectations on the possible start of another "quantitative easing" program by ECB. According to ECB, in the event the below-target inflation rate is prolonged, then the ECB will not hesitate to use additional unconventional instruments within its mandate.

Chart 3 Government bonds yield performance (10-year) in Euro area, Greece, right degree



Source: ECB, Eurostat.

Source: Bloomberg.

In euro area financial markets, long-term government bonds yields fell across all categories in the last months. The weak economic indicators impacted the yield performance in countries with maximum positive assessment, while the accommodative monetary policy drove yields down for countries with fiscal consolidation tasks. In stock exchange markets the main indices regained territory and trended up since end-September.

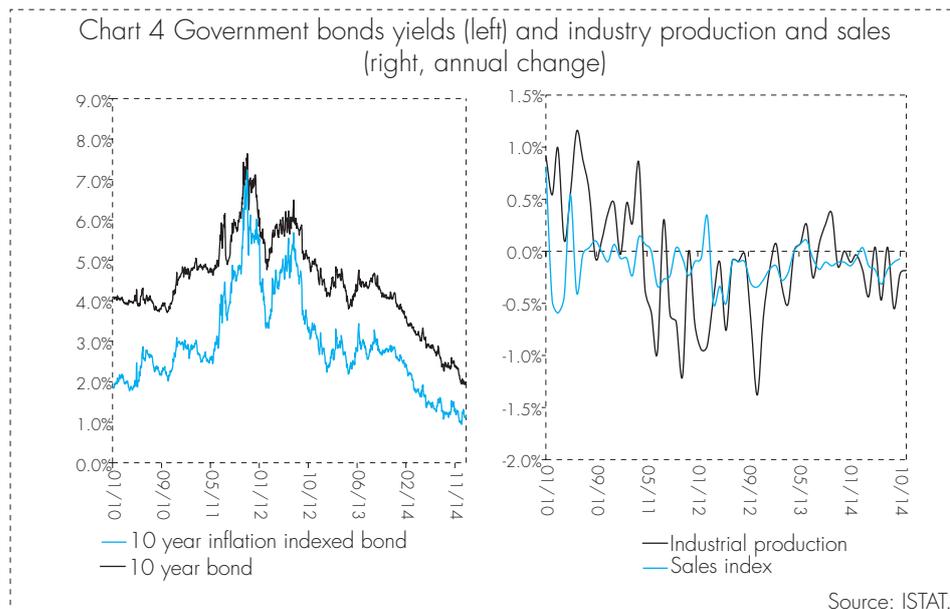
A. ITALY

Italian economy reduced the contraction in 2014 Q3, standing at -0.1%, from -0.2% a quarter earlier. In annual terms, economic growth shrank again by -0.5%, thus confirming the difficulties of Italian economy in this period. Main items providing a negative impact were the decreased investments and the domestic demand, while consumer spending and net exports increased slightly. Economic activity in Italy continues to suffer from the shortage of investments in the key sectors of production, high unemployment rates and the deterioration of banks' portfolio. Confidence indicators of main categories, business and consumers, after the slight recovery in the third quarter, decreased again in the last months. Preliminary indirect indicators of output dynamics in the last months, such as industry production, sales index new orders for industry mainly show similar GDP performance in the last quarter too. Notwithstanding the international uncertainties, net exports impacted positively the breathing of Italian economy during this year. Trade exchanges with non-euro area countries in these 11 months had a sharper increase in exports than imports.

The monthly and annual inflation rate recorded 0% in December, by closing a year denominated by strong downward pressures of prices. Analysis of core inflation shows that inflation rates in these months have reflected the fall in oil and energy commodities prices in international markets, also the weak pressures coming from the domestic demand. The forecast for 2015² confirms a low inflation rate and contained pressures on production prices. Notwithstanding the decrease of assessment in BBB-³ premium requested for public and private bonds of Italy in financial markets continued to trend down due to the accommodative monetary policy implemented by ECB, and its "non-traditional" interventions. Lending activity of banking sector in the last three months reduced the shrinking pace, while interest rates decreased month after month.

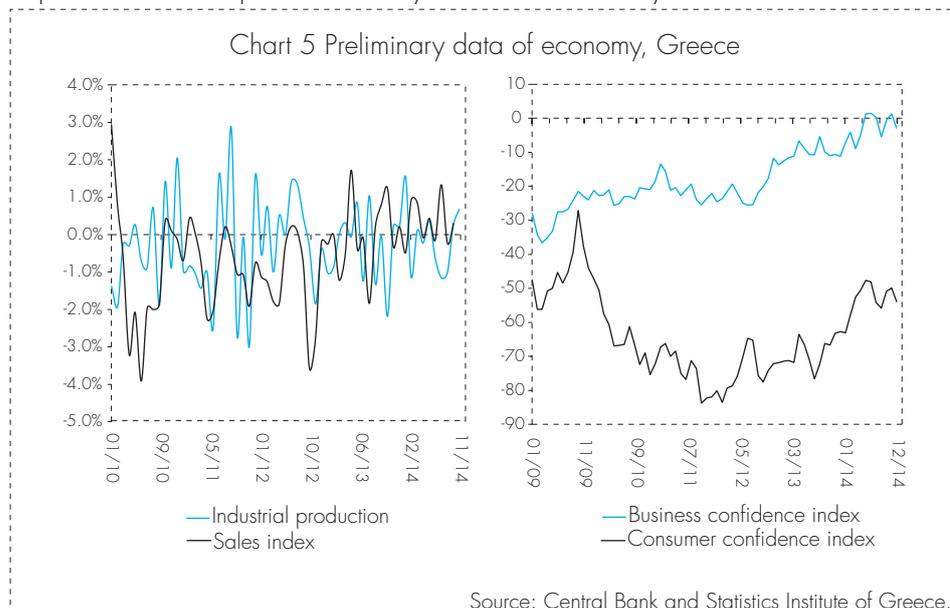
² Consensus Forecast, January 2015.

³ On Dec. 5, 2014, Standard & Poor's Ratings Services lowered its unsolicited long- and short-term foreign and local currency sovereign credit ratings on the Republic of Italy to 'BBB-/A-3' from 'BBB/A-2' (www.standardandpoors.com/ratingsdirect)



GREECE

Third quarter marked the Greece exit from recession. Economic activity grew by 0.7% in quarterly terms and 1.9% in annual terms, thanks to the positive developments in the domestic consumption and exports. Data from Institute of Statistics show that consumption and investments increased by 2.3% and 2.7%, respectively, from 2013 Q3. Exports increased considerably, by 6.9% mostly impacted by services. The third quarter figures strengthen the hopes that the economic growth projected at 0.6% in 2014 will be achieved. While, economic growth perspective remains unsure. Investments are weak, public sector spending is limited, banking system still unconsolidated to start a sustainable lending to economy and unemployment rate is considerably high⁴. In addition, political situation remains unstable, posing further risk to the expectations for a positive activity of Greek economy.

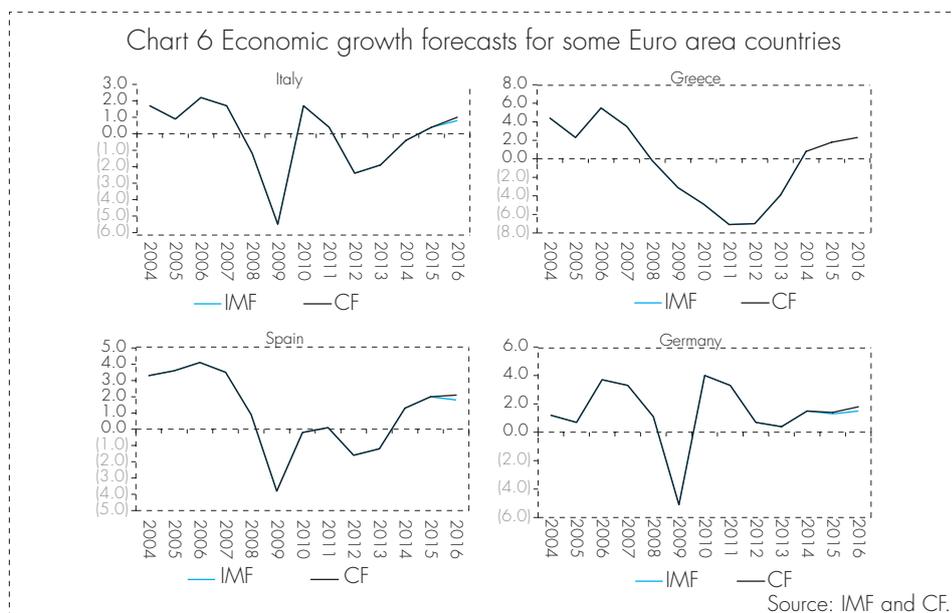


⁴ 25.8% in October 2014.

Inflation rate pursued a negative trajectory, down at -2.5% in annual terms in December from -1.1% in September.

GERMANY

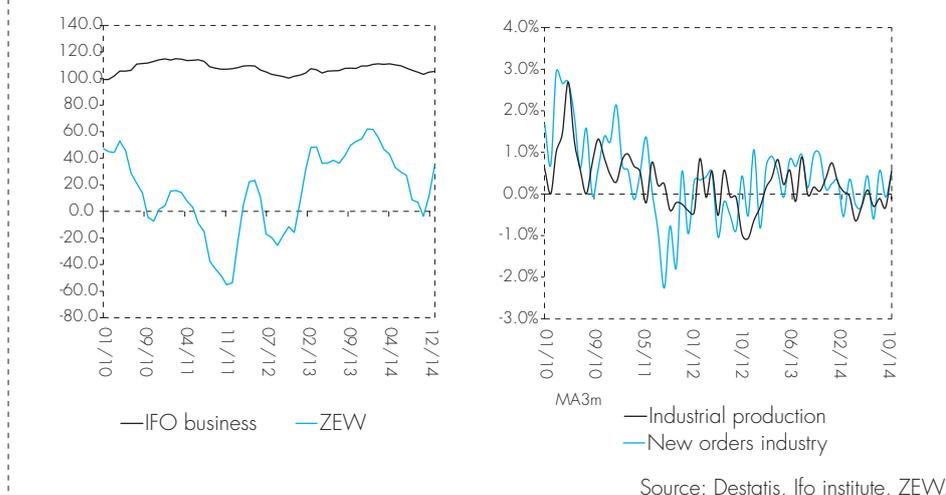
German economy returned to growth in the third quarter of 2014, 0.1% from a quarter earlier. Economic growth was positive by +1.2% in annual terms. The increase in domestic consumption and net exports supported the economic growth. In the light of a detailed analysis, the domestic consumption turned to the values observed in the first quarter. The increase of consumer confidence indicators performed at the same direction, while employment rate increased throughout the year. Net exports continued to be the main item in GDP power while their balance-sheet by zones shows than net exports with non-euro countries continue to perform positively. Unemployment rate was 5.0% as at end-November 2014, confirming its downward trend throughout this period.



The monthly and annual inflation rate, 0.0% and 0.2%, respectively, got closed to 0 by confirming the descending performance of all the year. The Industrial Product Price Index (IPPI) shows negative values from some months. The fall in oil and primary commodities prices, in international market, were the main factors that drove to this dynamic. The short-term GDP dynamic indicators in October and November, such as industrial production, new orders, purchase PMI index and export data for November suggest a further growth of German economy in the last quarter. Preliminary estimation of economic activity for 2014⁵ shows a stronger economic growth compared to 2013. IFO and ZEW indices increased in the last quarter by confirming the favourable economic situation.

⁵ Federal Statistical Office (Destatis), 15 January 2015. https://www.destatis.de/EN/PressServices/Press/pr/2015/01/PE15_016_811.html

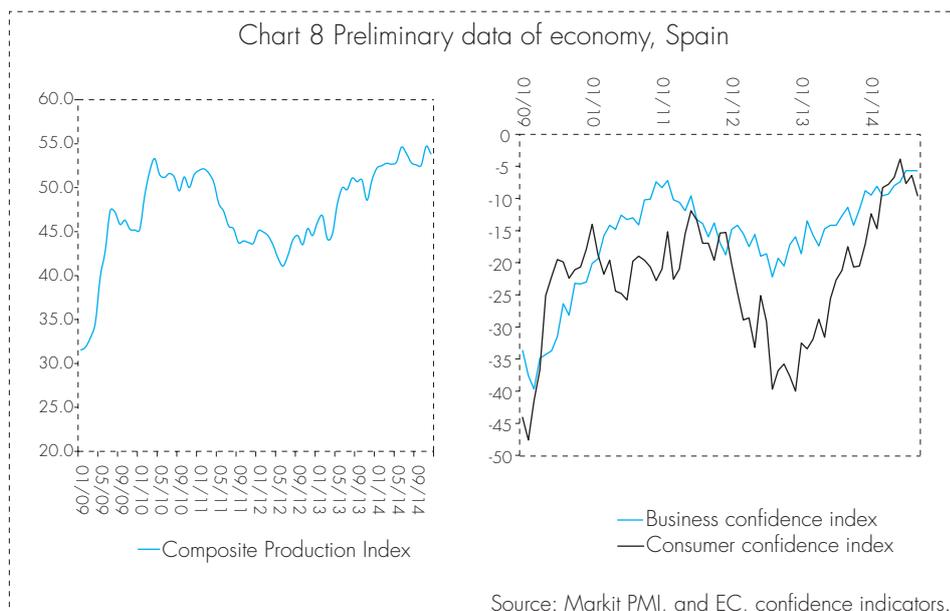
Chart 7 Business climate IFO indicator and financial experts' survey indicator ZEW (left) and industrial production index and new orders in industry (right)



SPAIN

Economy of Spain continued to grow at secured paces during 2014, sustained by the improved financial conditions, the increased investors' confidence and the improved labour market. Economic activity grew by 1.9% in annual terms in the fourth quarter driven by the strengthening of the domestic demand. External demand provided a negative contribution in the economic growth. The increased employment indicators reflected the important contribution of industry and construction. During 2014, employment was up by 1.0%, from shrinkage of 3.3% a year earlier. Expectations for 2015 are positive, and economy is assessed to grow by 2% from 1.4% in 2014, driven by the further improved financial conditions and the increase of the domestic demand. Also, currency depreciation trend is expected to sustain the recovery of external demand. Year 2015 is an electoral year, where the planned decrease of taxes and a recovery of construction, noted after seven years of shrinkage, should help in accelerating the domestic demand and economic activity in Spain.

Inflation fall in the fourth quarter was stronger than expected, due to the accelerated decrease in prices of oil and energy sub-products. These trends were transmitted to the other goods and services groups, driving core inflation in negative territory. In December, the annual inflation rate was -1.0%, from -0.2% in September. This indicator is expected to be negative in the first quarters of 2015, particularly in case of the continuous fall of oil price.



CHINA

Similar to the previous quarter, economic growth in China in 2014 Q4 stood at 7.3% in annual terms. In quarterly terms, GDP increased by 1.5%, from 1.9% in the third quarter. In 2014, economic growth was 7.4%, from the target of 7.5% as declared by the Chinese Government, thus recording the weakest growth of economic activity for the last 24 years. The weak demand for investments and the slowdown of the activity in construction dominated the GDP developments. Notwithstanding these developments, Chinese economy is assessed to have pursued a gradual adjustment of its structure during 2014. In 2014, consumption contributed by 51.2% in GDP growth, or three percentage points higher from a year earlier. On the other hand, services generated about 48.2% of economic activity, up by 1.3 percentage points from 2013. Economy experts deem that Chinese economy will continue to slow down in the current year. Economy is expected to grow by 6.8%, impacted by the weaker demand at global level.

In December, inflation was 1.5% from, 1.4% and 1.6%, respectively in November and October. The downward trajectory of inflation since June 2014 provided the central bank room for stimuli. The central bank cut the reference rates⁶ in November.

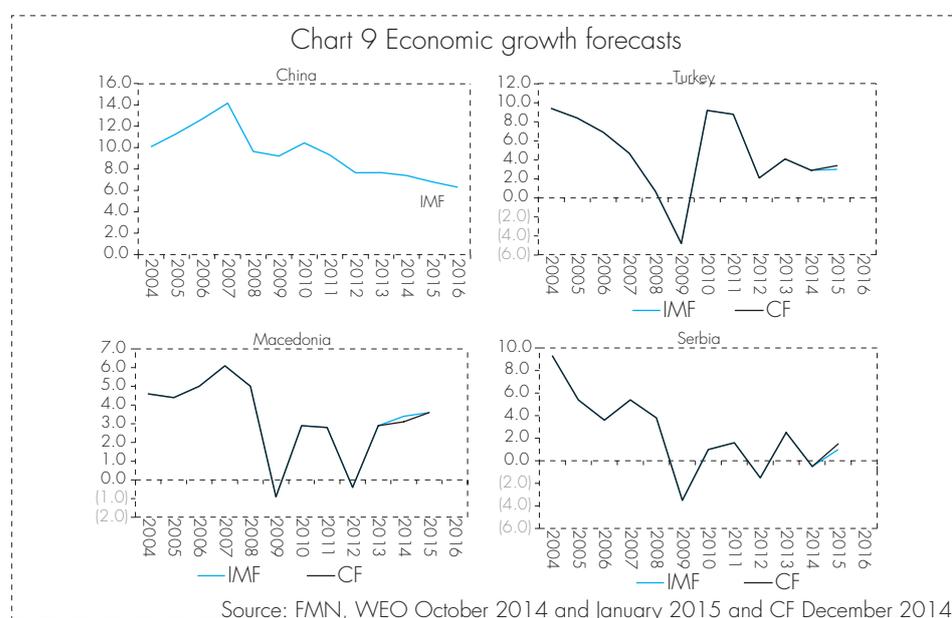
TURKEY

In 2014 Q3, economic activity grew by 1.7% y-o-y, by deepening the fall started since the second quarter (2.2% in 2014 Q2 and 4.7% in 2014 Q1). The easing of monetary conditions started in May 2014 along with the

⁶ Interest rate for 12-month deposits reduced by 0.25 p.p. to 2.75%. Interest rate for 12-month credit was cut by 0.45 p.p. to 5.6%.

cut of reference rate by -1.75 percentage points by the central bank failed to drive to the expected recovery of aggregate demand. Increased exports by 8% y-o-y and the increased government spending by 3.8% y-o-y provided the main contribution in the economic growth. Both demand and supply side factors remained fragile. Economic growth in Turkey continues to be supported by external sources and less by the domestic sources, for the third successive quarter. In addition to exports increase, imports decreased by -1.8% y-o-y, driving to an improvement of current account. Unemployment increased by 0.3% to 10.4% in this quarter. In annual terms employment increased 5% higher, compared to a year earlier.

Annual inflation stood at 8.2% in December, down from 8.9% in September, still far from the target value of the central bank, 5%. Fiscal consolidation remains a priority for 2015, aiming the value of 1.1% of GDP for the budget deficit.



MACEDONIA

Economy continued to grow during the third quarter, with an annual growth of 4.1% (4.4% in 2014 Q2), mainly sustained by the private sector lending by the domestic banks⁷. The interest rates responded to the easing of monetary policy started a year earlier, was present in this quarter, albeit it remains quite weak⁸. In this light, it was deemed that the interruption of the accommodative monetary policy will be decided in future, mainly depending on the changes in the external position of the country.

⁷ Lending to private sector of economy increased by 8.2%, during the first eleven months of year. Total bad loans to total loans increased to 11.7% as at end-September 2014.

⁸ Spread increased, compare do end of July, due to the decrease domestic currency-denominated loans rates by 0.1 p.p., while deposits rates fell by 0.4pp.

Investments increasing by 17% y-o-y, also contributed in the expansion of the gross domestic product, mainly being concentrated in the public infrastructure, while private consumption growth pace was down. Regarding international trade, imports increased by 2.5 percentage points compared to the previous quarter, while exports recorded a very low fall. Unemployment rate improved, decreasing by 0.8 percentage point y-o-y, at 27.9%. Inflation recorded a negative value of -0.5% y-o-y in December, 0.3% lower from a year earlier and 0.9 lower from the previous quarter. This fall was mainly due to food items which accounts for 40% of CPI structure. In fiscal view, deficit expanded in the third quarter at 3.6% of GDP, due to the issue of new Eurobond⁹, by remaining in line with the annual plan for maintaining the deficit at the level of 3.9%. Public debt stood at 45.5% of GDP (5 p.p. higher than end-2013), mainly due to the financing public structure projects.

The country forecasts a real economy growth of 4% in 2015. IMF has suggested a strengthening of fiscal consolidation and a prudential estimation of spending priorities.

SERBIA

In the third quarter, economic growth fell by 3.6% y-o-y, by deepening the economic fall that started in the second quarter due to the rain and floods that hit the country in spring. Domestic demand and investments recorded negative increase rates. Credit to private sector was up, albeit fragile and was due to a lending program for non-public sector that was subsidised by the government for commercial banks. Labour market improved. The unemployment rate was down, from 20.3% in the second quarter, to 17.6% in the third quarter.

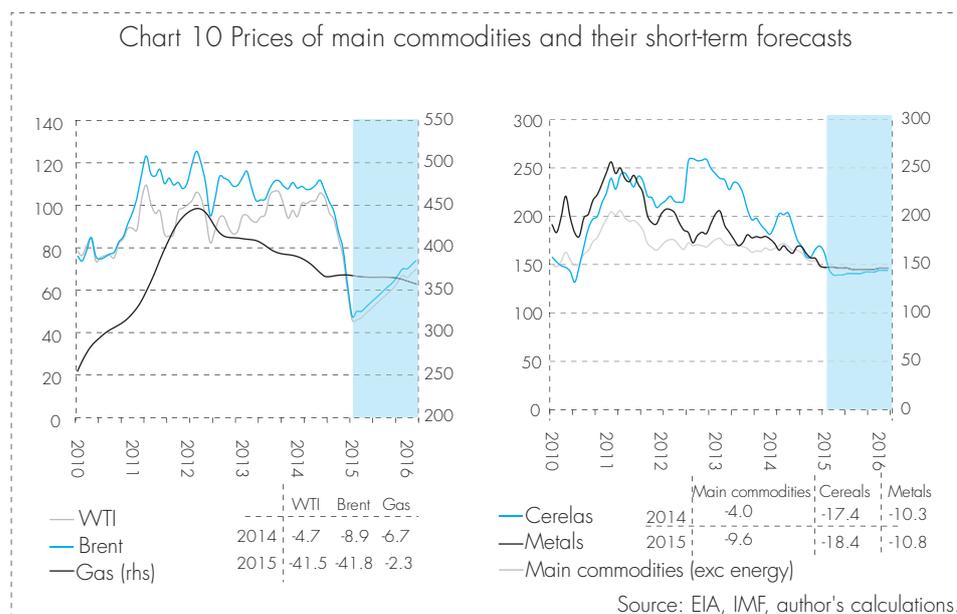
Exports of goods fell by -8.9% y-o-y, in November 2014. Nevertheless, exports growth was pronounced in the first months of year, with a positive value 1.7% y-o-y in January – October 2014. Imports grew by 1.5% y-o-y. Inflation rate in November 2014 was lower than the tolerance band of $4 \pm 1.5\%$, standing at 2.4% y-o-y. Albeit the increase of goods prices since September, other factors, such as the weak domestic demand, low oil price in international markets and the low inflationary pressures as imported from trading partners limited the increase of inflation to the aimed level.

Fiscal consolidation provided very positive results in the third quarter due to the improved collection of incomes and the halving of primary deficit. In the view of a negative economic growth forecasted at -0.5% for 2015, fiscal consolidation remains a priority even for the 2015, aiming at a budget deficit close to 6%.

⁹ The Eurobond issued on 17/07/2014 amounted Euro 500 and the maturity period is 7 years. Coupon interest rate is 3.975% and is the lowest among the other issues that Macedonia has performed in the international financial markets. The demand by investors was higher than the double of the announced amount (Ministry of Finance of the Republic of Macedonia).

II. DEVELOPMENTS IN THE MAIN GOODS MARKET

In 2014 Q4, oil price continued to pursue a strong falling trajectory, standing at the lowest levels of the last five years. The oil price fell to \$62.3 per barrel in December, from \$79.4 per barrel a month earlier. WTI index of US market pursued the same trend. As at end-December this index stood below the quota of \$60 per barrel, dictated by a supply which was considerably above the demand level in the market. These developments were mainly dictated by the continuous increase of production in the North America and the decision of OPEC countries, at the middle of November, to not reduce the supply level for this product in the international markets. On the other hand, the weak demand in Europe and China and the strengthening of US dollar against main foreign currencies impacted the further decrease in oil price. Related to the forthcoming months, the above-stated factors will continue to be present till in the first part of year. Based on data of EIA (U.S Energy Information Agency), average oil price in 2015, is expected to fluctuate within the band \$46 - 70 per barrel. Gas price in Europe fell particularly in November conditioned by the moderated temperatures, the lower oil prices and the Agreement between Ukraine and Russia. However, the decision of Russia for the delivery of gas through Turkey is assessed to strengthen the increasing pressures.



In line with energy prices, primary commodity prices fell by 7.4% y-o-y. Similar to the previous quarter, this performance mainly reflected the downward trend of food prices driven by an ample supply and the lack of demand-side pressures. Cereals price fell considerably during the period under review, by about 14% in annual terms. Nevertheless, quarterly developments dictate an increase in cereals price due to the restrictions against Russian exports. During the quarter under review, metal prices were under the pressure of US dollar strengthening, reduction of oil cost, and the slowdown of the demand of industry in China. The further appreciation of US dollar and the fall of oil price are expected to impact the further fall of these prices, while fiscal stimulus in China and Japan may sustain the prices of these goods.

ANALYSIS OF EXTERNAL SECTOR DEVELOPMENTS 2014 Q3

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I. BALANCE OF PAYMENTS HIGHLIGHTS¹

Albania's net current account balance recorded a deficit of EUR 316.4 million in 2014 Q3, maintaining an upward trend for the fourth consecutive quarter. During the quarter under review, the current account deficit increased by around 66.2% in annual terms, and was estimated at 12.8% of nominal GDP.

Similarly to the first half of the year, the deterioration of deficits in both net exports and primary income contributed on the expansion side. Meanwhile, secondary income, which increased slightly compared to the previous year, contributed on the narrowing side.

In this quarter, external demand did not help maintain the uptrend in exports of goods and services. Imports of goods and services showed a downtrend, but at more moderate rates. The balance of the primary income account remained in negative territory for the third consecutive quarter, deepening further the registered deficit compared to the first half of the year. On the other hand, secondary income registered a 3.0% increase due to , the annual growth in remittances by around 1.9%.

Net inflows in the capital account were estimated at EUR 20.7 million, from EUR 15 million in the third quarter of the previous year. Net flows in the financial account doubled compared to the same quarter a year earlier, financing 44.5% of the current account deficit. Net foreign direct investments,

¹ The latest BoP data are as of 2014 Q3. Since 2014 Q1, the Financial Stability and Statistics Department at the Bank of Albania prepares the Balance of Payments statistics, in compliance with the International Standards laid down in IMF's BPM6. Earlier, they were compiled based on IMF's BPM5. The main differences between the two methodologies are synthesised in the guideline "Publication of Financial Statements of external sector statistics, in accordance with BPM6-IMF", published by the Bank of Albania at http://www.bankofalbania.org/web/pub/01_commentary_for_changes_in_the_publication_of_external_sector_statistics_according_to_bpm6_june_2014_6689_1.pdf. For the purposes of internal analysis, the BoP data from 2002 to 2013 are reclassified in line with the new methodology, by the Monetary Policy Department.

in the quarter, fell by around 38.5% annually.² On the other hand, in other net investments, liabilities expanded by around EUR 91.6 million, due to the rise in liabilities in the form of central government debt.

Division of the financing of the current deficit according to debt-creating and non-debt creating flows reveals a more pronounced support to the second type of financing, during the third quarter. However, it must be noted that financing through debt-creating flows increased significantly over the last two quarters.

The overall balance of payments saw increased foreign reserve assets by about EUR 154 million in 2014 Q3. At the end of September, the stock of the foreign exchange reserve stood at around EUR 2.21 billion, sufficient to cover 5.3 months of imports of goods and services and 182% of the short-term foreign debt.

Table 1 Balance of Payments indicators

	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Current account (in EUR million)	-285.0	-190.4	-336.2	-260.8	-324.6	-316.4
y-o-y (%)	13.2	-23.2	63.3	16.7	13.9	66.2
/ GDP (%)	-10.9	-8.2	-13.4	-11.1	-12.2	-12.8
Goods and services	-442.5	-394.9	-518.1	-396.8	-468.8	-459.8
Exports, f.o.b.	805.6	981.0	960.3	609.7	753.0	842.1
Imports, f.o.b.	1248.1	1375.9	1478.4	1006.5	1221.8	1301.8
Travel - net	-31.5	26.1	34.0	-21.8	10.6	32.0
Primary income	-11.0	22.2	0.0	-7.1	-28.6	-44.5
Credit	35.7	40.2	33.4	29.2	25.8	28.3
Debit	46.7	18.0	33.4	36.3	54.3	72.8
Net FDI income	-20.1	6.2	6.9	-15.9	-31.4	-51.3
Secondary income	168.4	182.3	181.9	143.0	172.9	187.8
Credit	200.5	216.5	213.5	170.2	201.7	221.0
Debit	32.0	34.2	31.6	27.3	28.8	33.2
Net remittances	129.6	152.5	140.1	115.9	134.8	155.4
Capital account	4.8	15.0	18.2	22.5	15.3	20.7
Net borrowing/net lending	-280.2	-175.4	-318.0	-238.3	-309.3	-295.8
Financial account	-262.4	-70.9	-226.1	-231.3	-225.4	-140.7
y-o-y (%)	213.8	78.4	-16.2	82.5	-14.1	98.5
/ GDP (%)	-10.0	-3.0	-9.0	-9.8	-8.5	-5.7
Direct investments	-270.5	-307.0	-231.2	-192.6	-144.5	-188.9
Portfolio investments	104.4	6.2	-18.1	12.8	12.3	-14.2
Financial derivatives	1.1	0.0	-2.4	0.0	0.0	0.0
Other investments	-183.8	195.4	18.6	-11.1	-115.8	-91.6
Reserve assets	86.4	34.5	7.1	-40.3	22.5	154.0
Errors and omissions	17.8	104.5	91.9	7.0	83.9	155.1
Net borrowing/net lending	-280.2	-175.4	-318.0	-238.3	-309.3	-295.8

Source: Bank of Albania.

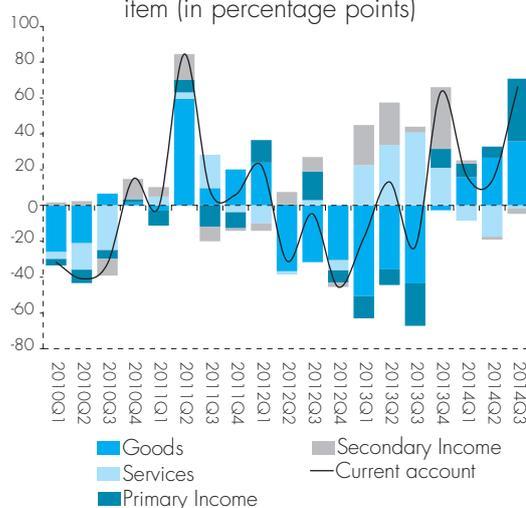
² Estimation of foreign direct investments of quarterly frequency during the year is based on the data that are obtained from banks and are not included in the information on borrowing/lending in relation to FDIs in Albania. For the year "x", this information is provided only by the annual survey of FDIs at the enterprises, which is published in September of year "x+1". Due to the data taken from this survey, FDIs values are reviewed for each quarter. Thus, FDIs value for each quarter of 2014 shall be reviewed after the FDIs survey in the publication of September 2015.

II . CURRENT ACCOUNT³

Albania's net current account balance recorded a deficit of EUR 316.4 million in 2014 Q3. The trend in the current deficit was expansive for the fourth consecutive quarter. In this quarter, it widened by around 66.2% in annual terms. The registered deficit was estimated at around 12.8% of nominal GDP, or about 4.7 percentage points higher than in the same period of a year earlier. Excluding income from official transfers, the current account deficit was at about 12.9% of nominal GDP. For the same period a year earlier, the current account deficit, excluding official transfers, stood at around 8.3%.

The current account deficit continued to expand for the fourth consecutive quarter, owing to the annual performance of net exports in goods and services. Imports of goods and services fell by about 5.4%, in annual terms. In the meantime, the same trend was observed in the performance of exports of goods and services, but the size of the annual drop was more pronounced. Therefore, the net exports deficit expanded by around 16.4% in annual terms, providing the main contribution to the deterioration of the current deficit. The worsened net position of the primary income account contributed to the same side.⁴ Secondary income⁵ grew slightly by 3% in annual terms, contributing to the narrowing side in the annual performance of the current account deficit.

Chart 1 Contribution to current account deficit by item (in percentage points)



Source: Bank of Albania.

Viewed from the perspective of the national savings and investment gap, the private sector impacted at a greater magnitude the formation of the current account deficit compared to the first half of the year.⁶ The private savings and investments gap was estimated at 10.4% to nominal GDP, about 3.7 percentage points higher from a quarter earlier. For the fourth consecutive quarter, the private sector contributed on the expansion side, whereas the public sector contributed on the narrowing side on the creation of current account deficit. The public savings and investments gap narrowed, both annually and quarterly. At the same time, the share of the public sector in the formation of the current account deficit is significantly below its historic average. The reduction

³ Overall, the shift to the international standards laid down in IMF's BPM6 does not envisage changes in the overall presentation of the current account, compared to the previous standards. The most significant changes consist in the goods and services accounts. Their composing sub-items are reclassified, re-nominated and further detailed.

⁴ In accordance with the standards laid down in IMF's BPM6, "primary income" corresponds to "income" in IMF's BPM5.

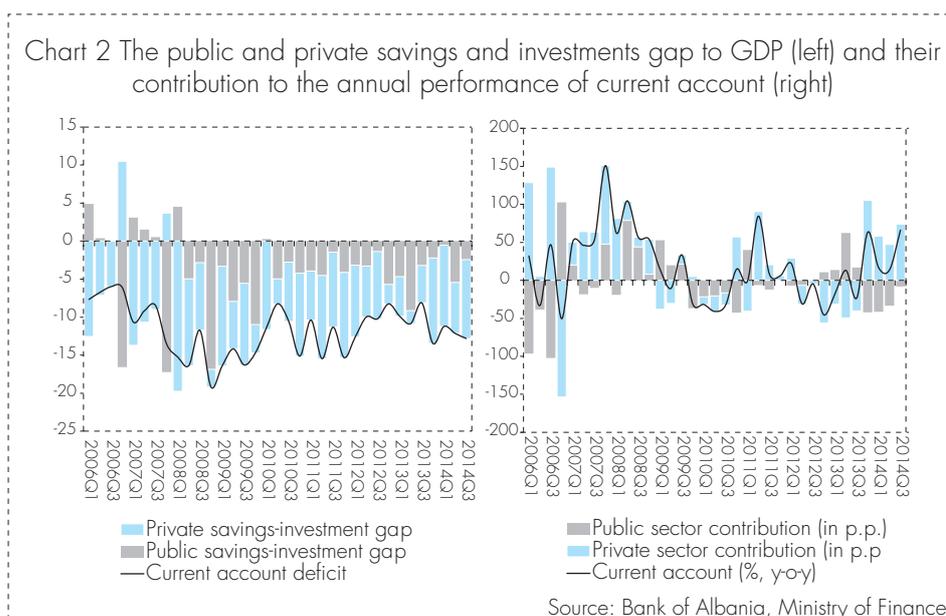
⁵ In accordance with the standards laid down in IMF's BPM6, "secondary income" corresponds to "current transfers" in IMF's BPM5.

⁶ An alternative but equivalent measurement of the current account net position for a given period is the method of gap between savings and national investments. Thus, the net realised position of current account is equal to the amount of gap realised between savings and public and private investments in period t.

$$CA_t = (S_{public} - I_{public})_t + (S_{private} - I_{private})_t$$

of the share of the gap between savings and public sector investments in the formation of the current deficit is a welcomed development.⁷

The private savings and investments gap increased faster in annual terms. Private sector' contribution to the creation of current account deficit was 77.1%, about 34.1 percentage points higher compared to the same period a year earlier. More concretely, in the total annual expansion of the current account deficit by about 66.2%, the public sector contributed negatively (-8 percentage points), whereas the private sector contributed positively (+74.2 percentage points).



OTHER CURRENT ACCOUNT ITEMS⁸

The situation in the services account was slightly improved. The net balance of inflows from this account registered a net surplus of EUR 96.8 million, mainly due to the higher flow in foreign-currency income from "processing services for physical inputs owned by others". In the meantime, the surplus in the sub-item "travel services (personal and business)", which are closely related

⁷ Various studies conclude that when the current deficit is created by the private sector, in an economy that is accumulating capital, the latter becomes more tolerant against persistently high current deficit rates. That is different from the cases when the public sector provides the main contribution to the establishment of current deficit. See: Milesi-Ferretti & Razin (1996), 'Sustainability of Persistent Current Account Deficits', NBER, WP5467.

Cusolito & Nedeljkovic (2013), 'Toolkit for the Analysis of Current Account Imbalances', WB, WP83248.

⁸ In the process of alignment with the international standards of IMF's BPM6, the constituent sub-items of the services account were subject to a series of reclassifications and renomination. Thus, the most important changes relate to the sub-items of services account "processing services on physical inputs owned by others" (Manufacturing services on physical inputs owned by others in BPM5) and "services for maintenance and repair" ("manufacturing goods in BPM5), which are reclassified from "goods" to "services". "Merchandising" (net exports of goods under trading intermediation) and other services related to trade are re-classified from "services" to "goods". Due to methodical changes, net balance of goods and services account reveals changes, particularly sensitive in the case of services account.

to the tourism season in Albania, expanded at moderate rates in annual terms. On the other hand, net income in the “transport services” account was in negative territory, for the fourth consecutive quarter.

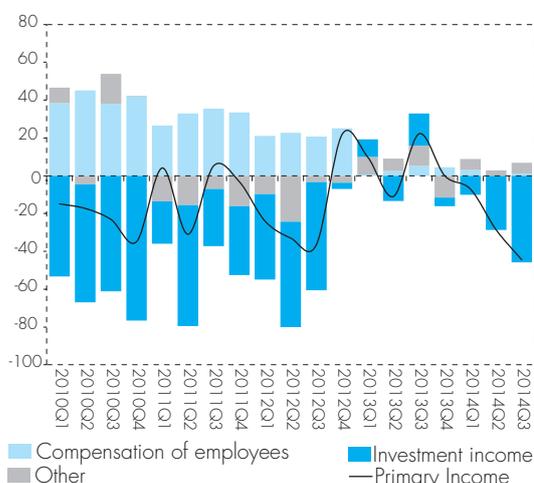
Net income from “travel services” for tourism and personal purposes, recorded a positive balance. This item’s surplus was EUR 32 million, around EUR 5.9 higher than in the same period in the previous year. Foreign currency inflows and outflows for personal travel point to an expansion in these two constituent sub-items. This performance is also enhanced by the increase in the number of incoming travellers in Albania and increase in the number of Albanian travellers abroad.

Net balance of primary income account closed in negative territory in 2014 Q3. This was a characteristic trend throughout 2014. Net foreign-currency flows resulted in a deficit of around EUR 44.5 million. The latter was higher than in the previous quarter, while, a year earlier, the primary income account ended in surplus. The widening deficit in the sub-item “investment income” determined the direction of developments in this account, during the considered period. Net “worker compensation” resulted EUR 1.3 million, being lower compared to the previous year.

In 2014 Q3, the deficit of the “Investment income” sub-item widened considerably, by around EUR 45.8 million, from EUR 17 million surplus in the same period a year earlier. The increase in FDI income outflows determined the direction of developments in this account. In 2014 Q3, net income deficit from “foreign direct investment” income widened further compared to the first half of the year, reaching around EUR 51.3 million. Among them, income repatriation from investments in capital and shares in investments funds played the main role.

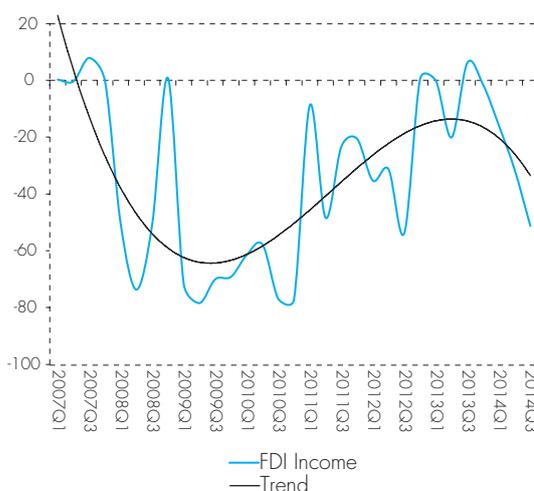
The balance of the “Portfolio investment” income continued to record positive values for the third consecutive quarter, at about EUR 4.7 million, during the period under review. In this sub-item of the income account, inflows represent mainly interests arising from debt instruments. Conversely, net income balance from “other investment” recorded a deficit of about EUR 9 million, from the deficit of about EUR 4.8 million recorded in the same period a year earlier. Income

Chart 3 Income balance (net flows, in EUR million)



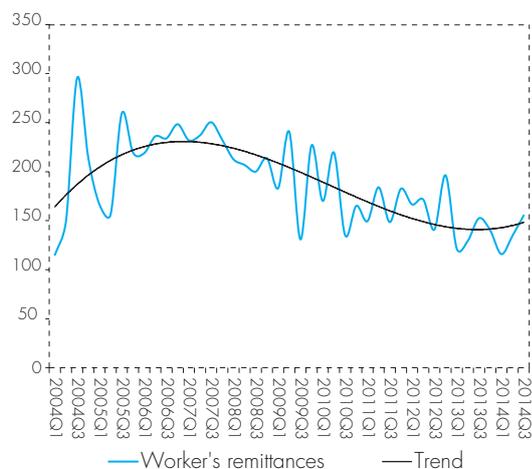
Source: Bank of Albania.

Chart 4 FDI income (net flows, in EUR million)



Source: Bank of Albania.

Chart 5. Remittances (net flows, in EUR million)



Source: Bank of Albania.

from investment in reserve assets⁹ stood at EUR 9.8 million in 2014 Q3.

The net balance of the secondary income account continued the upward trend of financial flows that had started a quarter earlier. During the third quarter, this account recorded a surplus of EUR 187.8 million, up by around 3% in annual terms. Foreign currency flows in the secondary income account were estimated at around 7.6% to the nominal GDP.

The main sub-item of this account, net secondary income from "financial and non-financial corporates, households, and non-profit institutions serving households", increased by about 4.5% in annual terms. In this period, remittances stood at EUR 155.4 million, up by about 1.9% in annual terms. They were estimated at about 6.3% of nominal GDP.

III. CAPITAL ACCOUNT

Capital account debits and credits all the transactions on the acquisition and disposal of non-produced, non-financial assets/goods¹⁰ and the capital transfers¹¹ between residents and non-residents (on which there is no economic value in the exchange). In 2014 Q3, the capital account recorded a surplus of about EUR 20.7 million, up from around EUR 15 million during the same period a year earlier. This account's net capital flows accounted for about 0.8% of nominal GDP. Incoming capital transfers expanded by 12.1% compared to the same period a year earlier. Capital transfer outflows decreased by 2.7%, in annual terms. Net capital transfers in the "central government" account amounted to EUR 10.8 million, while those in "financial and non-financial corporates", "households and non-profit institutions serving households" amounted to around EUR 9.9 million.

The combination of net non-financial transactions of the current account and capital account provides the net position of the domestic economy, as net lender (surplus) and net borrower (deficit) versus the non-resident economies. Conceptually, this result is equal to the net balance of the financial account,

⁹ In accordance with standards laid down in IMF's BPM6 in the primary income account, the item "investment income" includes income from "foreign exchange reserve" investment.

¹⁰ Acquisition and disposal of non-produced, non-financial asset include: 1. Acquisition and disposal of non-produced, non-financial asset include: 1. natural resources (land, mineral rights, forestry rights, water, fishing rights, air space, and electromagnetic spectrum); 2. contracts, leases, and licenses (intangible goods); 3. marketing assets (brand names, mastheads, trademarks, logos, and domain names)

¹¹ Capital transfers consist in: 1. debt forgiveness; 2. non-life insurance claims; 3. grants; 4. guarantees; 5. taxes (inheritance taxes, gifts, etc.); 6. other capital transfers.

which reflects the way how the net lending or net borrowing by non-residents is being financed. In quantitative terms, our economy reveals a net borrowing position, about EUR 295.8 million, which is financed by the inflows in the financial account (minus errors and omissions).

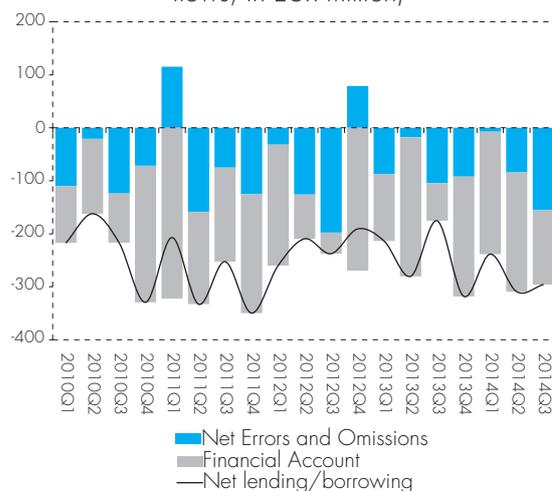
IV. FINANCIAL ACCOUNT¹²

Net position in the financial account resulted in lower assets of around EUR 140.7 million during 2014 Q3. Net inflows in this account financed around 44.5% of the current deficit registered during the period. Financial flows rose by about 98.5%, accounting for about 5.7% of nominal GDP, relative to the same period a year ago. The increase in foreign currency flows in the financial account was mainly attributable to the increase in net inflows in the form of other investments.

Residents' financial liabilities to non-residents fell by 5.6% in annual terms, due to lower FDI inflows. Albanian assets invested in non-resident economies fell by about 31.4% during the period under review.¹³ The decrease in assets in the form of other investments was the main determinant of developments in Albanian assets invested abroad.

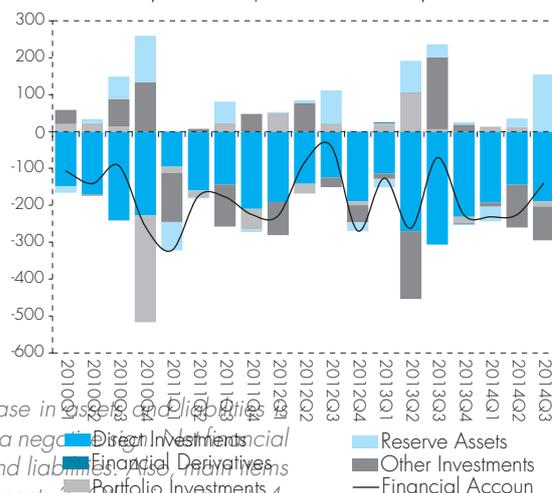
Net foreign direct investments dropped by about 38.5%¹⁴, from 2013 Q3. FDI inflows, excluding foreign capital privatisation receipts, recorded a more moderate decline, as a result of higher privatisations a year earlier. Domestic assets invested in the form of FDIs increased by EUR 18.4 million, compared to the decrease by EUR 8.5 million in 2013 Q3. Net FDIs were estimated at about 7.6% of nominal GDP, or about 5.5 percentage points lower, compared to the same

Chart 6 Financial account, errors and omissions (net flows, in EUR million)



Source: Bank of Albania.

Chart 7 Financial account components (net flows, in EUR million)



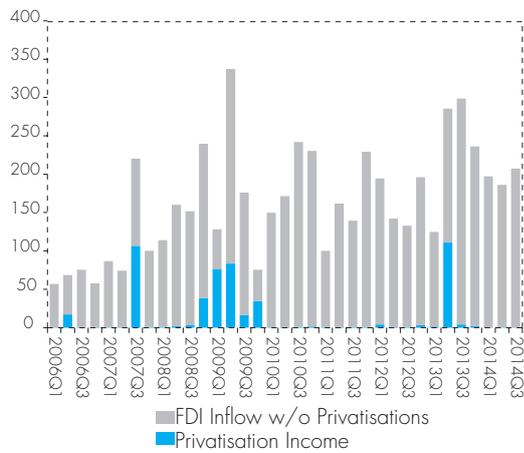
Source: Bank of Albania.

¹² In accordance with standards laid down in IMF's BPM6, increase in assets and liabilities is shown with a positive sign; decrease in assets and liabilities with a negative sign. The financial account balance is calculated as a difference between assets and liabilities. The main items in financial account are: 1. Direct investment; 2. Portfolio investment; 3. Other investment; 4. Financial derivatives and employee stock options; 5. Reserve assets.

¹³ In addition to methodical amendments stipulated in BPM6, total domestic financial assets invested in non-resident economies include foreign (reserve) assets.

¹⁴ Estimation of foreign direct investments of quarterly frequency during the year is based on the data that are obtained from banks and are not included in the information on borrowing/lending in relation to FDIs in Albania. For the year "x", this information is provided only by the annual survey of FDIs at the enterprises, which is published in September of year "x+1". Due to the data taken from this survey, FDIs values are reviewed for each quarter. Thus, FDIs value for each quarter of 2014 shall be reviewed after the FDIs survey in the publication of September 2015

Chart 8 Composition of foreign direct investment (flows, in EUR million)



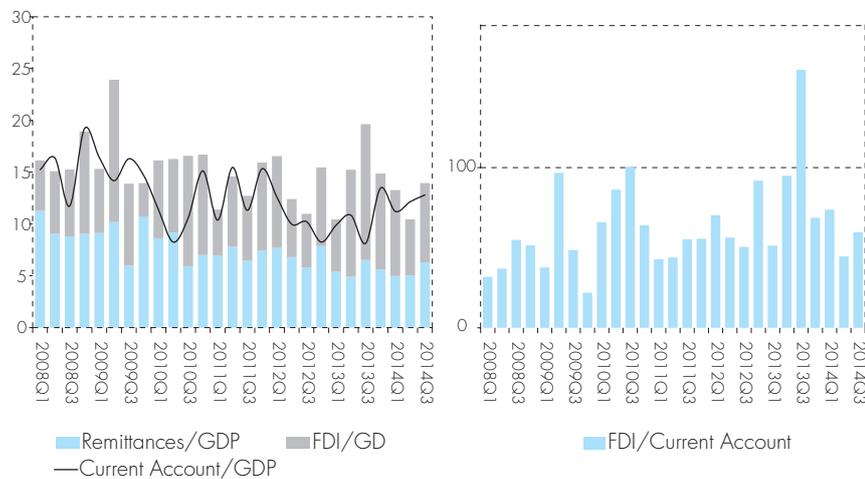
Source: Bank of Albania.

period a year earlier.

In accordance with the instruments used for investments¹⁵, net direct investments as “capital and shares in investments fund” decreased by about 32.8% in annual terms. Net FDIs in the form of “reinvestment of earnings” stood higher. Direct investments in the form of “debt instruments” were used less during this year. While in 2013, the most broadly used forms of FDIs were “capital and shares in investment funds” and “debt instruments”, in 2014 investments in debt instruments were replaced by reinvestment of earnings.

In the long run, FDIs are an important foreign-currency inflow in financing the trade and the current account deficits in Albania. This trend was dominant especially at the beginning of 2009, when the importance of other foreign-currency flows, such as the ones in the form of remittances, begun to

Chart 9 Financing sources of current deficit (left) and covering of current deficit from net FDI (right)



Source: Bank of Albania.

progressively contract. Since 2013, FDIs have been the main financing source of external sector deficit in Albania. In 2014 Q3, the ratio of net FDI flows against the recorded current deficit was estimated at 59.7%.

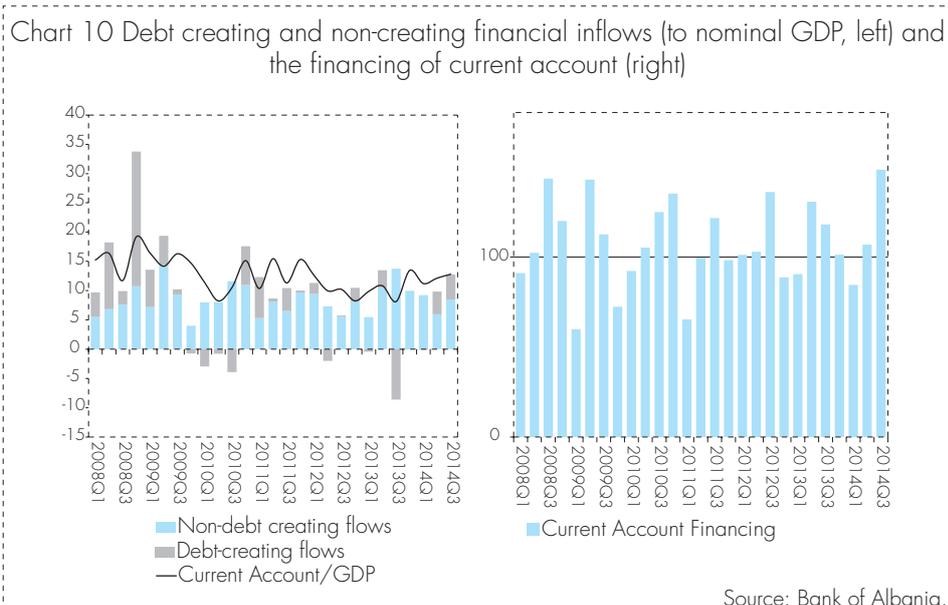
Net portfolio investments for 2014 Q3 recorded a negative balance of EUR 14.2 million. For the period under review, residents’ assets (depositing corporations, excluding the Bank of Albania) invested abroad fell by around

¹⁵ In accordance with BPM6 standards, direct investments are realised through three main instruments: 1. Capital and shares in investment funds; 2. Reinvestment of earnings; 3. Debt instruments.

EUR 21.1 million. Liabilities in the form of portfolio investments also recorded a negative position of EUR 6.9 million.

Other investments account closed with a negative balance by around EUR 91.6 million. In this account, Albanian assets invested abroad surged by around EUR 44.2 million. The figure is downward in annual terms, as Albanian assets invested abroad in the third quarter of the previous year amounted to around EUR 248.5 million. On the liabilities side, non-residents increased their investments in Albania by about EUR 80 million, from 10.8 million a year earlier. The increased borrowing by the central government during 2014 was the key factor contributing to the expansion of liabilities in the form of loans.

As regards the profile of external financing of the current deficit, it is important to monitor the reliance on debt-creating flows vis-à-vis the more desirable non debt-creating flows.¹⁶ Thus, in 2014 Q3, non-debt-creating inflows from net FDIs and from the capital account were estimated at 8.5% of nominal GDP, about 5.3 percentage points lower than in the same period a year earlier. On the other hand, the upward trend in debt-creating flows persisted in two consecutive quarters. In this quarter, they were estimated at 4.3% of the nominal GDP. The overall financing of the current account deficit is estimated by adding net errors and omissions to net debt-creating and non-

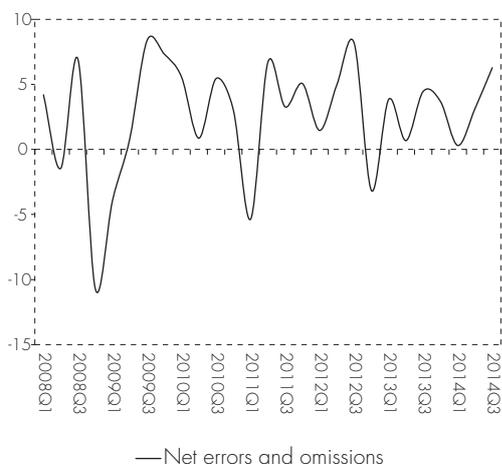


debt creating foreign-currency flows. During the quarter under review, the ratio of current account financing stood at 148.7%, implying a rapid expansion in the foreign exchange reserve stock.

Foreign exchange reserve assets expanded by about EUR 154 million, at the end of 2014 Q3. This performance was determined mainly by the increase in assets placed as Special Drawing Rights (SDRs) and the decrease in assets in the form of "other reserve assets". At the end of September, the stock

¹⁶ This breakdown serves to monitor the impact of financial and capital flows on Albanian's external debt. FDI and capital inflows are classified as non-debt-creating flows. Portfolio investment and other net investment are classified in debt-creating flows.

Chart 11 Errors and omissions



Source: Bank of Albania.

of the foreign exchange reserve stood at around EUR 2.21 billion, sufficient to cover 5.3 months of imports of goods and services and 182% of the short-term foreign debt.

V. ERRORS AND OMISSIONS

Due to the problems that may be faced in information sources and during the compilation of external sector statistics, the balance of payments may have discrepancies. Thus, in the balance of payment statistics, they are aggregated under the errors and omissions item, that is calculated as “the rest” (difference between the balance in financial account and the balance in current account plus the balance in capital account). In 2014 Q3, “errors and omissions” recorded a positive value of EUR 155.1 million, estimated at around 6.3% of nominal GDP.

GROSS EXTERNAL DEBT ANALYSIS, 2014 Q3

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Monetary Policy Department, Bank of Albania

MAIN CONCLUSIONS

- At the end of the third quarter of 2014, Albania's gross external debt stock amounted to EUR 6,618.1 million. In annual terms, it increased by 9.8% to around 66.4% of nominal GDP.
- By sectorial breakdown of the external debt stock the general government accounts for around 39.3% to total, the deposit-taking corporations 18.6%, other sectors 17.6%, FDIs 23.3%, and the monetary authority 1.2%.
- By investment instruments, loans and investments in currencies and deposits dominate the external debt stock.
- By maturity composition, around 81.6% of the external debt stock is long-term debt, up by 0.6 percentage point from the same period a year earlier.
- Indicators of long-term external debt repayment capacity have worsened since 2008.
- The ratio of long-term gross external debt to annual exports of goods and services stood at 182%. It stands above the hypothetical optimal benchmark of 150% since the third quarter of 2011.
- Liquidity adequacy indicators pointed to weak short-term pressures arising from the repayment of gross external debt obligations.
- Albania's foreign exchange reserves are sufficient to withstand external negative shocks.

1. A DETAILED ANALYSIS OF GROSS EXTERNAL DEBT¹

At the end of 2014 Q3 Albania's gross external debt totalled EUR 6,618.1 million, up around EUR 243.5 million from the previous quarter, and around EUR 587.9 million compared to its stock as at end-2013 Q3. In annual terms, it increased by around 9.8%. Current gross external debt is assessed at

¹ The latest external debt data are as of 2014 Q3. The previous year's data have also been revised. Starting from 2014 Q1, Financial Stability and Statistics Department at the Bank of Albania compiles the External Sector Statistics in compliance with the international standards laid down in the sixth edition of the IMF's Balance of Payments Manual (BPM6). Earlier, they were compiled in compliance with the fifth edition (BPM5). The main differences between the two methodologies are synthesised in the guideline "Publication of external sector tables according to BPM6", published by the Bank of Albania at:

http://www.bankofalbania.org/web/pub/01_commentary_for_changes_in_the_publication_of_external_sector_statistics_according_to_bpm6_june_2014_6689_1.pdf

66.4% to nominal GDP², about 4.4 percentage points higher from the same period a year earlier.

The central government has the largest share in total external debt stock, at around 39.3%. Its share in the total external debt stock increased by around 0.8 percentage point from the corresponding quarter in 2013. As at end-2014 Q3, the central government's external debt stock amounted to EUR 2,604.1 million, or nearly 26.1% of nominal GDP.

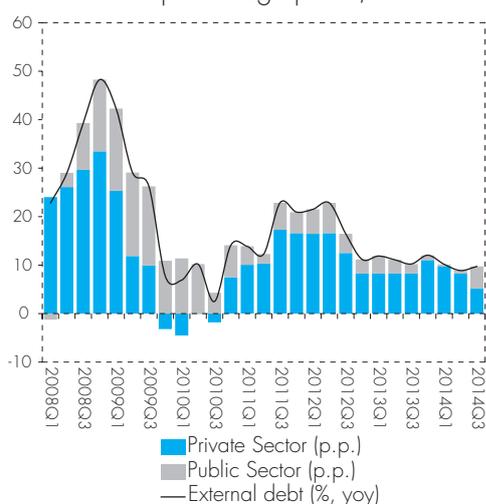
At the end of 2014 Q3, the gross external debt stock of the deposit-taking corporations (except the central bank) amounted to around EUR 1,229.0 million, up around EUR 117.5 million from the end of 2013 Q3.

Other sectors' external debt stock totalled around EUR 1,167.4 million, up around EUR 125.6 million from 2013 Q3. Its share in the total external debt stock was around 17.6% in the period under review, up around 0.4 percentage point from 2013 Q3.

The stock of FDIs – intercompany loans amounted to around EUR 1,541.3 million, up around EUR 68.2 million from 2013 Q3.

At the end of 2014 Q3, around 81.6% of the debt stock was long-term debt, mainly in the form of loans. For the same period, short-term debt accounted for around 18.4% of the total debt stock, mainly in the form of currency and deposits from the deposit-taking corporations (except the central bank). General government and the monetary authority hold only long-term debt, whereas the deposit-taking corporations and other sectors hold a composite portfolio of long and short-term debt.

Chart 1 Gross external debt by sector (contribution in percentage points)



Source: Bank of Albania.

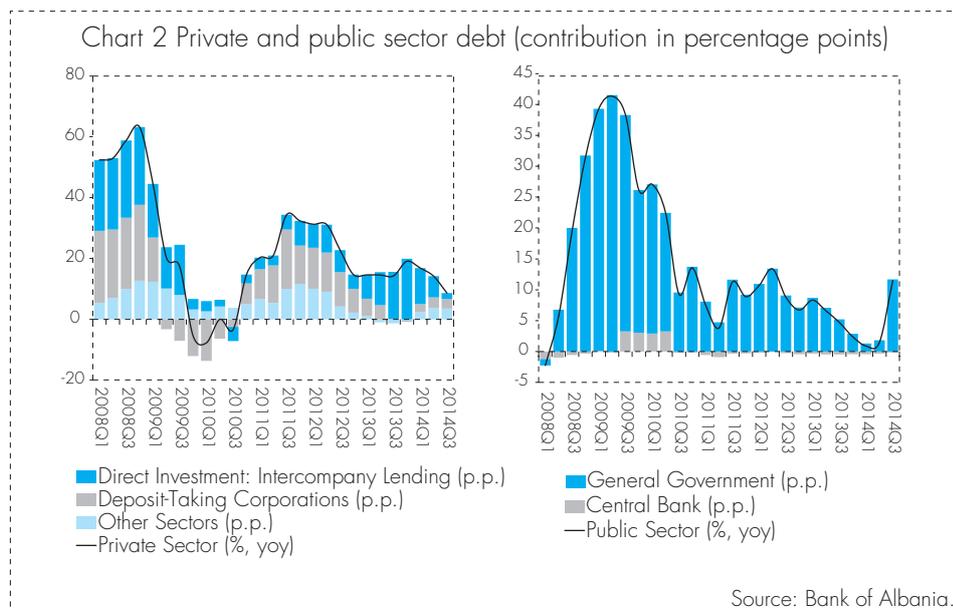
a) External debt by sectors of economy³

The increase in the gross external debt stock during 2014 Q3 continued to be driven by the deepening total borrowing from the private sector of the economy (deposit-taking corporations, other sectors and direct investments). However, the positive contribution of the latter in the annual increase of gross domestic debt is lower compared to the two previous quarters. The private sector's debt stock increased by around 8.6% in annual basis, and shared about 53% of the contribution in the annual growth of the gross external debt.

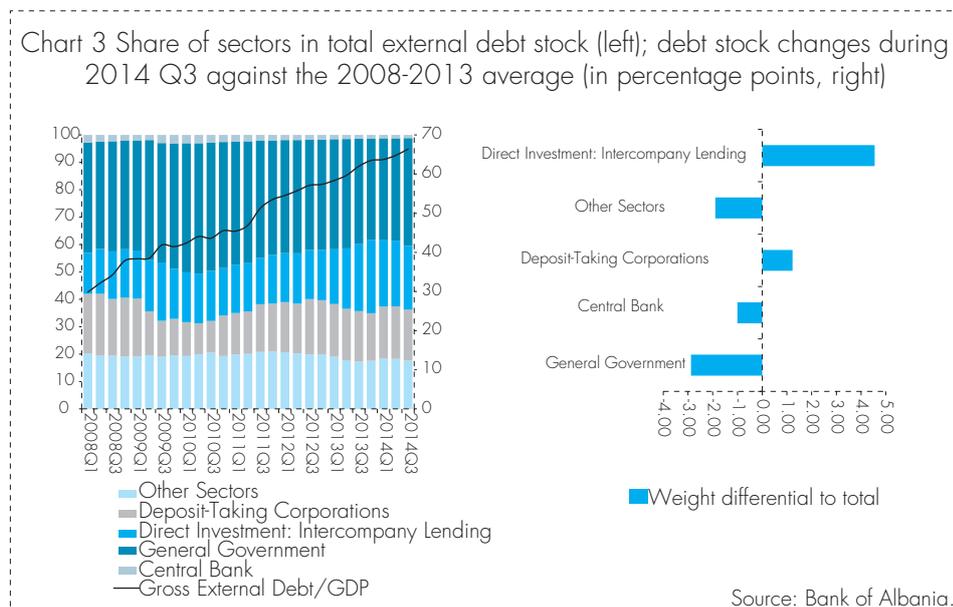
² Four-quarter rolling sum of GDP.

³ According to BPM6, the sectors of the economy include: 1. general government; 2. central bank; 3. deposit-taking corporations except the central bank; 4. other sectors; 5. foreign direct investments.

Over the years, the private sector has played a dominant role in the dynamics of Albania's gross external debt stock, except the period between 2009 Q2 -2010 Q3. The three categories within this sector - deposit-taking corporations, other sectors and direct investments - have progressively increased their share in total debt stock. External debt in the form of intercompany of foreign direct investments loan had the most accelerated growth. As at end- 2014 Q3 and for the third successive quarter, the three categories provided an increasing contribution to total gross external debt.



The public sector's (general government and central bank) contribution to total external debt stock trended up during this quarter, after a period of eight quarters trending down. In 2014 Q3, the public sector's external debt increased by about 11.5% in annual terms. The increased debt in the public sector was driven by the general government, whereas the central bank continued to reduce its exposure to the external debt.



In a more detailed sectorial breakdown, the external debt stock of general government historically has a major share in the total debt stock. At the end of 2014 Q3, the general government accounted for around 39.3% of the total external debt stock. The rest of the debt stock has been allocated to the deposit-taking corporations (except the central bank) 18.6%, other sectors of the economy 17.6%, FDIs 23.3%, and the central bank 1.2%.

At the end of 2014 Q3, the general government's external debt stock amounted to EUR 2.6 billion, up around 12.1% in annual terms. This performance is impacted by the increase of general government's external debt in the form of long-term loans. By maturity composition, the general government's external debt stock includes only long-term external debt, mainly in the form of loans and debt securities.

FDIs - intercompany loans were the second largest sector in terms of share in total debt stock in 2014 Q3, accounting for around 23.3% of the total external debt stock and around 15.5% of nominal GDP at the end of the period. Accumulation of this sector's external debt has trended up more rapidly since the data were made available.

The share of the external debt stock in the form of deposit-taking corporations (except the central bank) was around 18.6% at the end of 2014 Q3. The deposit-taking corporations' external debt stock was estimated at around 12.3% of nominal GDP, up 0.9 percentage point from the ratio recorded in the previous year. Broken down by maturity, the deposit-taking corporations' debt is mainly a short-term debt. At the end of 2014 Q3, it accounted for around 87.4% of the total external debt stock of this sector.

Other sectors' debt⁴ stock accounted for around 17.6% of the total gross external debt stock, as at end-2014 Q3. Their debt stock has been falling progressively since 2012, to later rise again in 2014. At the end of the period under review, the external debt of other sectors of the economy was estimated at around 11.7% of nominal GDP. Broken down by maturity, 87.6% of other sectors' debt stock was long-term debt and the rest, 12.4%, short-term debt.

The central bank's gross external debt stock has the lowest share in the total stock compared to the other sectors of economy. The monetary authority's liabilities in the form of debt have shrunk continuously since 2010 Q3. At the end of 2014 Q3, they accounted for around 1.2% of the total external debt stock and around 0.8% of nominal GDP. The monetary authority holds only long-term debt, mainly in the form of other debt liabilities and long-term loans.

⁴ It consists in pension funds, insurance corporates, non-financial corporates, non-profit organisations serving to families and families.

b) External debt instruments

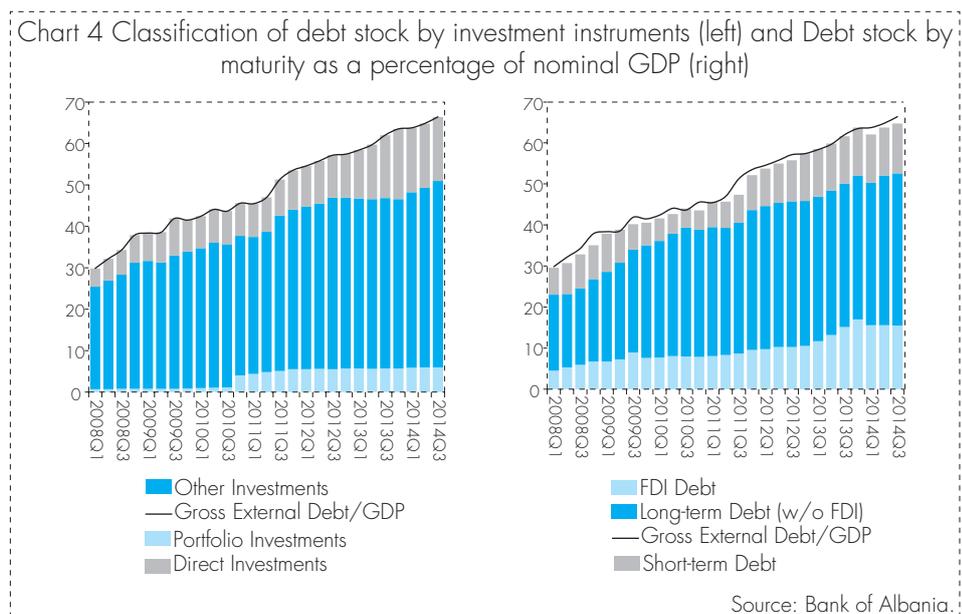
Broken down by instruments, investments in the form of other investments⁵, have a major share in total external debt stock, around 67.7%. This ratio is around 1.4 percentage points higher than a year earlier. Long and short-term loans have the main share within this item. Since early 2008, the share of this instrument in total other investments has trended down in favour of other investment instruments, settling at the lowest value of 70.5% to total of other investments during 2013 Q4. This trend changed during 2014, and as at end of the third quarter, the share of long and short-term loans instruments covered around 72.9% of other investments.

From years, the stock of FDIs intercompany loans showed the most accelerated increasing trend, concentrated in the periods 2007-2009 and 2011-2013. At the end of the period under review, the stock of FDIs – intercompany loans was estimated at around 23.3% of the total debt stock.

Investments in the form of portfolio investments accounted for around 9% of the total gross external debt and were estimated at around 6.0% of nominal GDP.

c) External debt by maturity

Broken down by maturity, the largest portion of the external debt stock is long-term debt. At the end of 2014 Q3, the long-term debt stock (which also includes FDIs methodologically) accounted for around 81.6% of the total gross external debt stock, up by around 0.6 percentage point in annual terms. Since 2013 Q3, the contribution share of gross external long-term debt's increase to total performance has continuously trended up.



⁵ Other investments include: long and short-term loans, currency and deposits, trade credits and other unspecified liabilities.

At the end of 2014 Q3, the short-term debt amounted to around EUR 1.22 billion, up by around 6.4% in annual terms. The share of short-term debt in total gross external debt stood at 18.4%, during the last year. The deposit-taking corporations and other sectors of the economy hold only short-term debt. These two sectors' short-term debt consists largely of currency and deposits, and trade credits.

d) Gross external debt service by sector

During the quarter under review, total external debt service (principal plus interest payments) by all sectors of the economy amounted to around EUR 111.0 million, about 4.5% of nominal GDP. Of this, around 90.7% was paid in principal. In debt service by sector, principal payments make up the largest portion of payments.

Table 1. Gross external debt service by sector

		2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
General government	Principal payments	11.2	28.0	10.8	51.3	14.4
	Interest payments	5.5	7.2	6.7	7.9	6.9
	New debt	19.8	18.8	27.3	107.7	189.7
Privat (long-term and short-term)	Principal payments	13.0	25.2	25.9	14.8	36.6
	Interest payments	0.3	0.3	1.9	2.3	1.7
	New debt	6.6	59.1	104.4	8.1	11.3
Banks (long-term and short-term)	Principal payments	6.1	26.1	10.1	9.8	46.8
	Interest payments	0.4	0.5	1.8	2.0	1.6
	New debt	7.4	1.3	23.5	26.0	7.5
Others	Principal payments	3.8	7.9	3.2	0.3	2.9
	Interest payments	1.1	1.5	0.1	0.0	0.1
	New debt	0.0	0.0	0.0	0.0	0.0
New debt service		41.4	96.8	60.5	88.4	111.0
Total new debt		33.8	79.2	155.3	141.8	208.4

Source: Bank of Albania

New external debt disbursements for the entire economy amounted to around EUR 208.4 million. The general government's debt dominated the new debt disbursements, accounting for around 91% of the total new disbursed debt for the period. The general government's new debt hit a considerably higher level compared to the same period a year earlier. The other sectors' new debt increased at lower paces.

2. EXTERNAL DEBT SUSTAINABILITY INDICATORS

The monitoring of the gross external debt sustainability over time is based on two categories: (a) indicators that measure a country's continuous and uninterrupted repayment capacity against its international lenders; and (b) indicators that measure the adequacy of liquidity in case of obligation to repay immediate liabilities.

Table 2. Indicators of repayment capacity and indicators of the adequacy of liquidity in years

	2008	2009	2010	2011	2012	2013	2014 Q3
Repayment capacity indicators							
Gross external debt/Exports (goods and services)	128.0	142.4	140.3	157.3	172.3	181.0	182.0
Gross external debt/Fiscal revenues	140.6	158.7	174.0	210.5	232.2	264.8	258.9
Central government gross external debt/Fiscal revenues	55.8	72.7	80.0	87.9	93.7	98.2	101.9
Liquidity adequacy indicators							
Short-term external debt to total	24.5	13.2	13.6	17.0	20.2	18.6	18.4
Short-term external debt/Exports (goods and services)	31.3	18.7	19.1	26.8	34.8	33.8	33.5
International reserves/Gross external debt	205.2	348.3	342.0	226.3	177.0	174.9	181.5
Net external debt/GDP	11.9	12.1	11.7	19.0	19.5	23.1	23.2
Net external debt/Exports (goods and services)	40.2	41.5	36.1	56.0	58.4	66.5	64.1
External debt service/Exports (goods and services) ¹	5.1	7.7	33.7	9.3	10.0	10.1	11.2
External debt service/New debt disbursement ¹	16.0	132.8	607.7	80.1	102.4	123.6	53.2

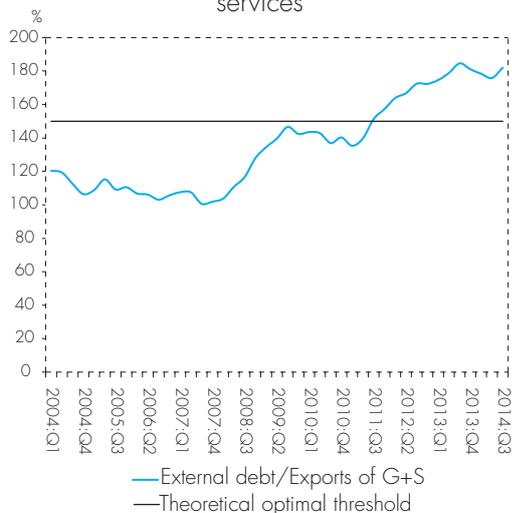
a) Indicators of repayment capacity

The export of goods and services represents a direct source of foreign currency inflows into an economy. If viewed in a comparative approach against the gross external debt denominated in foreign currency, it may serve as an analytical indicator that approximates a country's long-term repayment potential and capacity. The growth of gross external debt at a more accelerated pace than the growth of total exports of goods and services signals a country's weaker long-term repayment capacity, which may, in turn, cause a country to face difficulties in meeting contractual external debt obligations in the long run.

The relative ratio of gross external debt to the exports of goods and services has exceeded the hypothetical optimal benchmark proposed through empirical analysis by the international financial institutions, which varies depending on a country's institutional development⁶, since 2011 Q3. The ratio of gross external debt to the exports of goods and services was around 182% at the end of 2014 Q3, down by around 7.2 percentage points annually, but up by around 6.2 percentage points quarterly. This performance was affected by the more moderated growth of the exports of goods and services in quarterly terms, compared to the recorded trend of the gross external debt.

⁶ IMF (2003), "External Debt Statistics: Guide for Compilers and Users", International Monetary Fund, Washington D.C.

Chart 5 Gross external debt to exports of goods and services



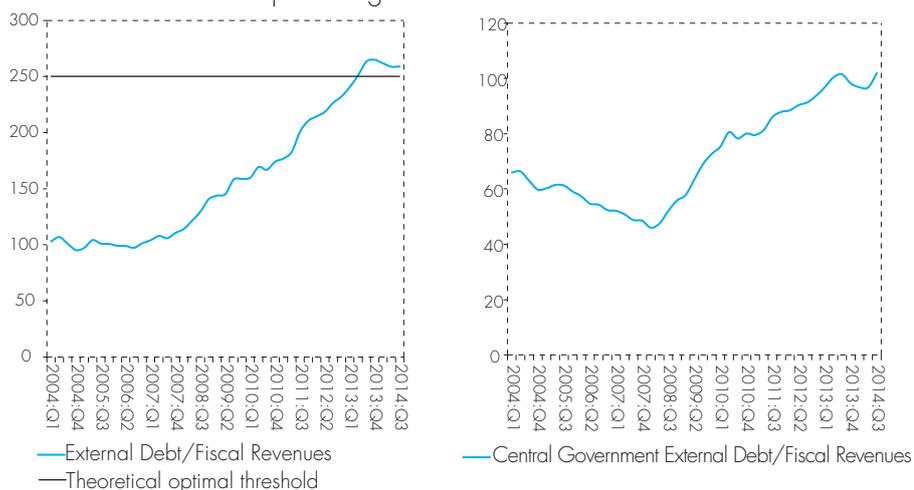
Source: Bank of Albania.

Measuring a country's repayment capacity by estimating whether the intake of fiscal revenues is sufficient to cover a certain ratio of the total gross external debt or of the central government's external debt stock is of prime importance. The first ratio serves to monitor the central government's room to intervene in times of crisis and prevent the country's loss of credibility across international lenders. While the second ratio helps monitor the riskiness of the government's external debt level. If the latter is too high, it may affect the transfer of fiscal revenues from the more efficient expenditures with an effect on the economic performance to amortization disbursements.

At the end of 2014 Q3 the ratio of gross external debt to fiscal revenues for Albania was estimated at 258.9%.⁷ This ratio has shown a declining trend

during the last three quarters. In the quarter under review the recorded ratio was 4.4 percentage points lower than a year earlier. However, this ratio has, since 2013 Q2, been standing above the hypothetical optimal benchmark proposed by the literature⁸. The ratio of the central government's gross external debt to fiscal revenues registered an opposite trend. This ratio stands 0.4 percentage point higher at annual level, due to the accelerated increase in the stock of central government's gross external debt. The value of 101.9% is the historical peak level of this indicator.

Chart 6 Gross external debt (left) and central government's gross external debt (right) as a percentage of annual fiscal revenues



Source: Bank of Albania, Ministry of Finance.

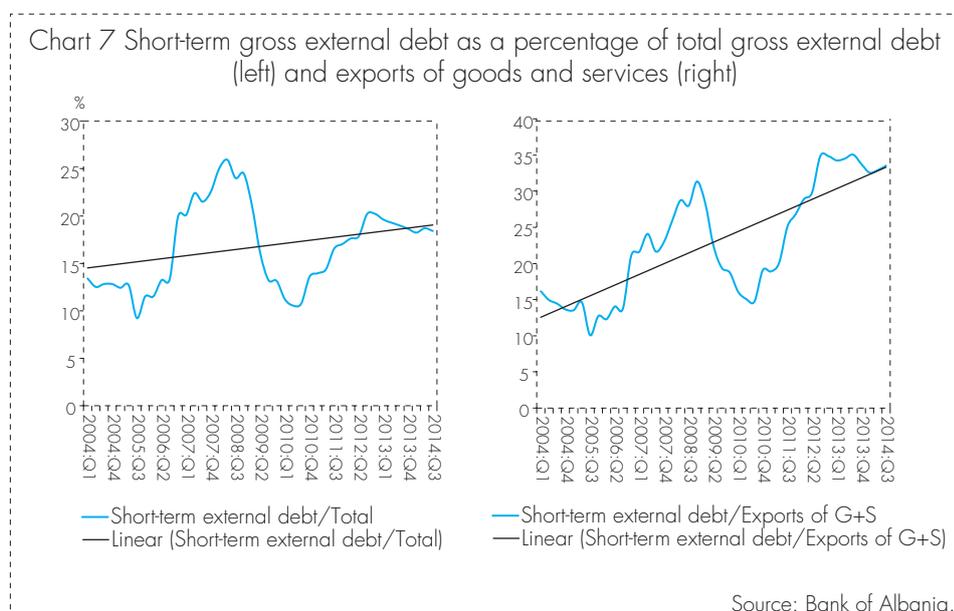
⁷ Quarterly fiscal revenues have been annualised through a four-quarter rolling sum.

⁸ IMF (2000), 'Debt- and Reserve-Related Indicators of External Vulnerability', International Monetary Fund, Washington D.C.

A country's long-term repayment capacity is closely linked to both the performance of the economy and the distribution of external debt service⁹ over time. Under optimal conditions, external debt servicing should not have a negative impact on the economy, which may arise from the allocation of financial resources to this function. In order to avoid such a phenomenon, an economy should, at any time, be capable to meet its immediate obligations with respect to the external debt principal and interest payments. The accumulation of arrears on external debt service obligations or continuous payment rescheduling may increase the risk premiums in the economy and exert pressure on economic activity at a later time.

b) Liquidity adequacy indicators

An economy's liquidity adequacy, which serves to repay external debt obligations, is largely affected by the reliance on short-term external financing. Albania's external financing profile has been mainly oriented towards long-term debt. The short-term debt has ranged between the minimum of 9.2% and the maximum of 25.9% of the total external debt stock. The annual inflows from the exports of goods and services¹⁰ managed to cover the short-term external debt entirely, albeit this indicator has showed an increasing long-term trend. The total short-term external debt as a percentage of total exports of goods and services was estimated at 33.5% during 2014 Q3, around 1.5 percentage points lower annually. This ratio provides evidence of the availability of regular foreign currency inflows in covering the short-term external debt.



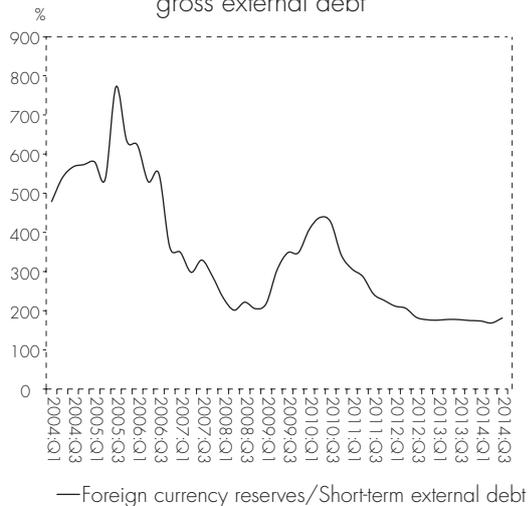
⁹ The country's long-term repayment capacity improves if the economy grows at a fast pace in the future and the distribution of external debt servicing is uniform over time. In the opposite case, a country's long-term repayment capacity indicators deteriorate.

¹⁰ Stated through a four-quarter rolling sum.

Foreign exchange reserves availability in covering short-term external debt is another important indicator of liquidity adequacy. Against an imperfect access to international capital markets, the foreign exchange reserves may help cover short-term external debt obligations in cases of unexpected economic shocks. Albania's foreign exchange reserve level is sufficient to withstand external negative shocks. The critical benchmark of foreign exchange reserve cover of short-term external debt is 100%, and the ratios below this benchmark provide evidence of insufficient foreign exchange reserve stock¹¹. In Albania's case, this ratio, after showing a downward trend for about four years, increased

during the quarter under review. At the end of 2014 Q3, the foreign exchange reserve stock covered around 181.5% of the short-term external debt, around 4.3 percentage points higher than in the corresponding quarter of 2013.

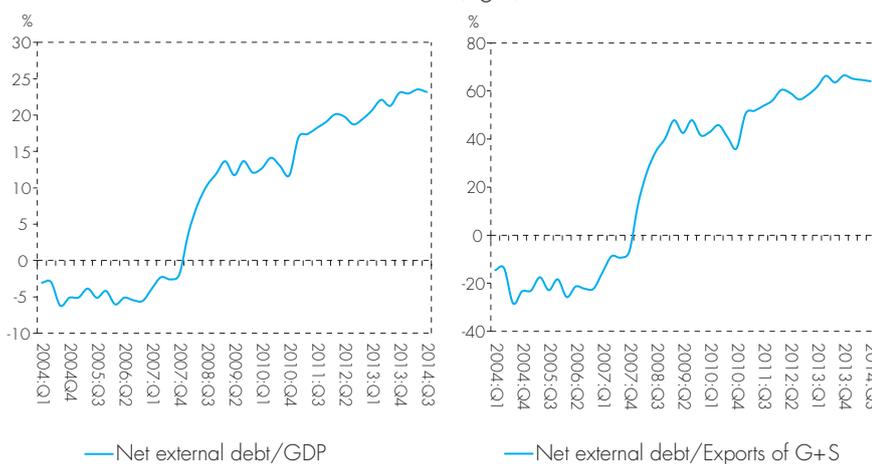
Chart 8 Foreign exchange reserve stock to short-term gross external debt



Source: Bank of Albania.

Net external debt helps in monitoring the short-term pressures as a result of expectable obligations within the year. The cumulative sum of banks' net foreign assets and foreign exchange reserves is subtracted from the gross external debt. Albania's net external debt is relatively low, fluctuating below 25% of nominal GDP¹², mainly due to banks' net foreign assets increasing faster than the gross external debt. At the end of 2014 Q3, net external debt-to-nominal GDP ratio was 23.2%, around 1.9 percentage points higher from the ratio in 2013

Chart 9 Net external debt to nominal GDP (left) and exports of goods and services (right)



Source: Bank of Albania.

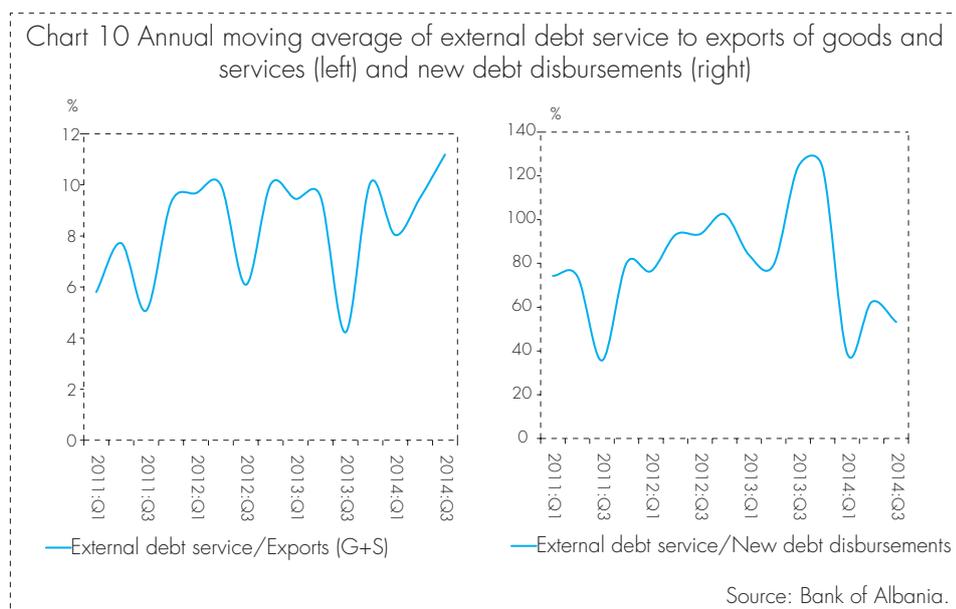
¹¹ According to Guidotti-Greenspan rule. For more information: IMF, "Assessing reserve adequacy", 2011.

¹² By the end of 2012, Albania's net external debt-to-GDP ratio of 19.5% was below the regional countries' average. Net external debt-to-GDP ratio for the countries in the region averaged 30.4% in 2012, ranging from the minimum ratio of -13% and 11.5% in Kosovo and Macedonia, to the peak ratio of 59.8% and 50.6% in Croatia and Montenegro.

Q3. Following the reduction in the previous quarter, net external debt indicator to the export of goods and services returned to the increasing tendency, estimated at 64.1% at the end of the quarter.

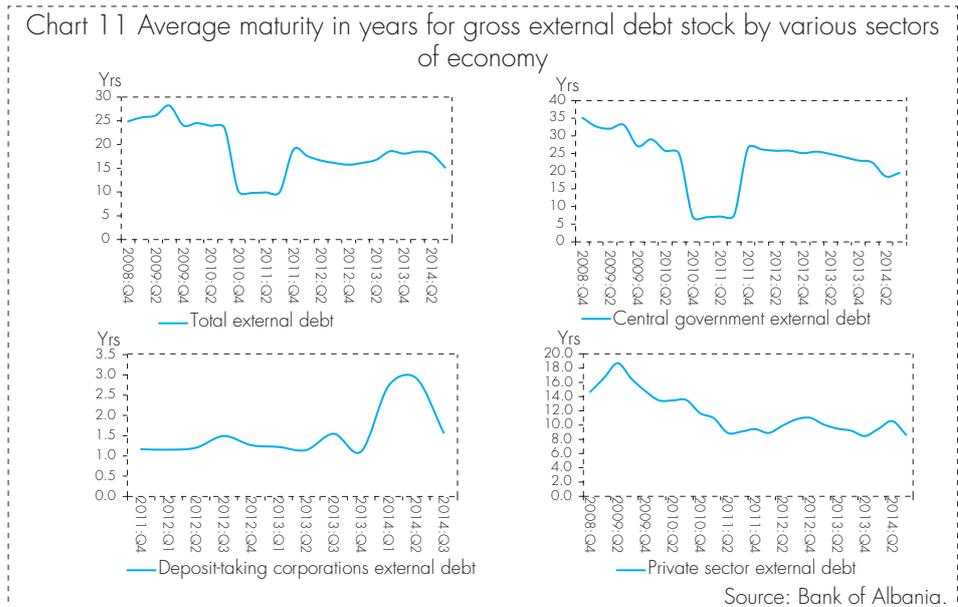
The indicators based on regular principal and interest payments flow provide an evaluation of the foreign exchange resources in the economy, which are commonly used to service the gross external debt. They are important in supervising pressures of external debt servicing. The level of amortization is closely linked to the maturity of external debt in various sectors of economy. Also, the initial time, during which there exist temporal concessions with regards to contractual obligations against amortisation. An important indicator in monitoring the significance and the relative size of external debt servicing is the ratio of the latter to foreign currency inflows from the exports of goods and services. In 2014 Q3, this indicator stood at 11.2%, up by around 7 percentage points on an annual level. This indicator's ratio stands considerably below the critical benchmark of 20% as suggested by the international organisations¹³.

On the other hand, the ratio of external debt amortization to new debt disbursements measures the extent of debt rollover. A ratio below 100% indicates larger new external debt disbursements than repayments of old debt. In the case of Albania, the ratio of external debt rollover has averaged 83.8% since 2008 Q1. If we exclude 2010 Q4, which is an outlier, the average falls to 63.7%. During the quarter under review, the ratio of external debt rollover was 53.2%, showing a new debt disbursement twice higher than the amortisation of the previous debt.



¹³ IMF (2003), "External Debt Statistics: Guide for Compilers and Users", International Monetary Fund, Washington D.C.

Indicators of average maturity performance of long-term external debt stock show a slight decrease of the latter in 2014 Q3. Given the higher disbursement of the new debt for the central government and consequently the extended time of the average maturity of this sector's external debt, depositing corporates and other components of private sector have provided the main impact to the reduction of the average maturity in years. The average maturity of public sector's external debt increased by about one year, of private sector's decreased by about two years and of deposit-taking corporations decreased by about one year and four months.



RESEARCH PAPERS*

ESTIMATING THE DETERMINANTS OF FINANCIAL EUROIZATION IN ALBANIA¹

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ABSTRACT

This paper examines the phenomenon of financial euroization in Albania, focusing on the liability side of the banking system. It explores some of the main theoretical and empirical determinants of deposit euroization in the context of the high euroization rates originating in the transition period of the early 1990s. Despite gradual improvements in the macroeconomic framework, euroization rates have continued to be persistent throughout, long after the reversal of the original triggers of such phenomenon. The high level of euroization entails policy relevant concerns for euroized economies, as it has been shown to have potential adverse effects on macroeconomic policies and financial stability, issues of vital importance for a central bank. Using a Johansen cointegration procedure and VECM to capture the simultaneous dynamic relationships between macroeconomic aggregates, this paper finds evidence that euroization rates are influenced by several factors such as interest rate differentials, exchange rates, and credit euroization.

Key words: euroization, deposits, banking system, cointegration, vector error correction model

JEL classification: E51, E52, E58

I. INTRODUCTION

The literature refers to dollarization as the process of substituting away from domestic currency to a foreign currency to carry out the main functions of money as a medium of exchange and/or as a store of value. Three main types of dollarization/euroization² are broadly recognized: monetary dollarization or currency substitution – the substitution of domestic currency with foreign currency for transaction purposes; financial dollarization, also known as asset dollarization – economic agents' holding of foreign currency assets and liabilities; and real dollarization – the indexation of wages, real estate and/

¹ This study has been completed under the Bilateral Assistance and Capacity Building for Central Banks, supported by the Graduate Institute Geneva and SECO, and its full version can be found in the following link: http://graduateinstitute.ch/files/live/sites/iheid/files/sites/bcc/shared/docs/euroization%20in%20Albania_Olta%20Manjani.pdf

² Depending on the currency of denomination, it could be USD, euro or some other currency. Since its introduction the euro has been the mostly widely used currency in Albania, and dollarization and euroization will be used interchangeably in the remainder of the paper.

or durable goods prices in foreign currency (Nicolo et al, 2003). Though all of these three types are present in the Albanian economy, this study mainly focuses on asset euroization. Thus, its main contribution is to understand the theoretical and empirical determinants of deposit euroization in Albania. In general, a better understanding of the determinants of euroization is critical in determining and undertaking the appropriate mix of policy measures for monetary or macroprudential regulators.

The main motivation to investigate the euroization phenomenon in the context of Albania is derived from the lack of empirical research that focuses on the specifics of Albanian euroization. Most of the research studies for European countries that include Albania in their data conduct their analysis and draw conclusions for the whole pool of countries, ignoring the specifics of each country. In addition, except for some sporadic descriptive analysis on the factors affecting the high euroization rates, a full empirical analysis has been lacking for the case of Albania. This fact becomes even more relevant, given the already existing vast literature and empirical work on other euroized countries in the region with similar economic traits and experiences.

In terms of policy making, the high level of euroization raises several concerns. A high level of euroization has been shown to have potential adverse effects on macroeconomic policies and financial stability, including reduction or loss of control of monetary and exchange rate policy, loss of seigniorage and increased foreign exchange risk in the financial system and other sectors (Kokenyne et al., IMF 2010). In terms of financial stability, liquidity risk and solvency risk are worrisome for a central bank. As Levy-Yeyati (2006) points out, prudential regulations requiring banks to match their portfolio currencies, neither eliminate the currency exposure of firms/households indebted in foreign currency, nor protects the banking sector from a deposit run in anticipation of a solvency problem. In addition, devaluation of the currency affects the solvency of financial institutions and their clients (Driessen, 2005). In terms of macroeconomic policies, evidence has shown that high euroization rates undermine the effectiveness of monetary policy (Brown and Stix, 2015). In extreme cases, the central bank cannot step in as a lender of last resort, being limited to the use of international reserves. Understanding the determinants of financial euroization both theoretically and empirically is thus important to build a better functioning monetary policy transmission mechanism.

Furthermore, Albania has been long aspiring to become a member of the EU and during the two decades of governance under a free-market economy it has been working towards fulfilling the economic criteria for joining the EU and later on, the Eurozone. Seen in the context of this trajectory, issues of euroization, credibility of the domestic currency, stability of the exchange rate, and other related concerns are naturally of paramount importance. Thus a thorough comprehension of the factors behind the prevalent high euroization rates is important not only for the general macroeconomic stability of the country, but an additional motivation in terms of fulfilling the Maastricht Criteria.

Hence, the purpose of this study is to analyze and empirically estimate the factors that have affected the high financial euroization of the Albanian banking system, given its important implications in terms of financial stability, policy making and/or the country's prospects to join the EU. The empirical analysis is conducted within a vector autoregressive framework. Results show that euroization is affected by variables like interest rate differentials, exchange rates, credit euroization and average price level. Euroization exhibits high persistence, proving the existence of the hysteresis effect. But, as the number of lags increases, the explanatory power of its past values reduces and other variables gain ground. Interest rate differential of deposits and the exchange rate explain on average around 25-30% and 3-5% of the variation in deposit euroization, respectively. Meanwhile credit euroization and the consumer price index share a modest explanatory power in the variance of deposit euroization.

II. EMPIRICAL ANALYSIS

A. Data and methodology

The data used in the deposit euroization model are of quarterly frequency, starting from 2001Q1 to 2014Q3. The proxy for deposit euroization is given by the share of foreign currency deposits to total deposits. Other variables include the exchange rate, both nominal (NEER) and real (REER), the volatility of the exchange rate, the consumer price index (CPI), the minimum variance portfolio index as suggested by Levy-Yeyati (2005), the interest rate differential of deposits and credit, the share of credit in foreign currency to the total credit of the banking system, remittances, the money multiplier as a proxy for financial development, and the openness of the external sector calculated as the trade volume share to GDP. All variables are in logarithms, except for the ones that represent ratios.

The following table shows all the endogenous variables and the expected signs of their impact on deposit euroization, as explained by theory and empirical findings in literature.

Table 1. List of the endogenous variables and their respective notations and expected signs

Variables	Notation	Expected sign
Deposit euroization	γ	+
Credit euroization	λ	+
CPI	π	+
Nominal effective exchange rate (NEER)	ϵ_n	+
Real effective exchange rate (REER)	ϵ_r	+
Exchange rate volatility	ϕ	+
Interest rate differential (credit and deposits)	i	+/-
Minimum variance portfolio (MVP)	δ	+
Remittances	ρ	+
Financial development	γ	+/-
Trade openness	θ	+

In order to capture the dynamics of developments in deposit euroization and its determinants, a linear Johansen cointegration procedure and a reduced-form vector error correction model (VECM) is estimated. This framework is suitable when dealing with nonstationary variables, whose combination of stochastic trends gives an equilibrium relationship in the long run. In literature, this method is widely applied with financial data that exhibit these features.

As a first step, the procedure requires all series to be integrated of the same order, usually I(1). Various forms of Johansen tests can detect differing orders of integration of the series, but in practice mixing series with different orders of integration is not usually recommended (Enders, 2010). To check for unit roots, augmented Dickey-Fuller tests obtained through a modified test statistic using a generalized least squares rationale are applied. Elliot et al (1996) show this modified test has a better overall performance as compared to the usual Dickey-Fuller test, in terms of small sample size and power, especially when an unknown mean or trend is present. The test is also more powerful in controlling for autocorrelation and heteroskedasticity. Augmented Dickey-Fuller regressions are usually very sensitive to the lag length, so the number of lags specified through the Schwarz (1989) information criterion calculated from the sample size is taken into account. In order to cross-check the results, the Kwiatkowski-Phillips-Schmidt-Shin (KPSS) tests to check the null of stationarity of the series are also performed.

The second stage of the procedure requires cointegration among variables, which is a long-run equilibrium relationship that determines their dynamic paths and the current deviation from such equilibrium (Enders, 2010). The VECM restricts the long-run behavior of the endogenous variables to converge to their cointegrating (equilibrium) relationship by allowing for short-run adjustment. The following is a general specification of the VECM:

$$\Delta y_t = \alpha \beta' + \Gamma_1 \Delta y_{t-1} + \dots + \Gamma_{p-1} \Delta y_{t-p+1} + e_t \quad (1)$$

Where Δ is the first difference operator, y_t is a vector of endogenous variables, α is the coefficient vector measuring the speed of adjustment to equilibrium, β is the cointegrating vector of coefficients, Γ s are coefficient matrices of lagged values of Δy_t , and e_t is a vector of white noise residuals. In the context of our empirical model, the vector y can be written as:

$$y = \{\varepsilon, i, \pi, \lambda, \varphi, \delta, \rho, \gamma, \theta\}$$

following the notation introduced earlier.

The general-to-specific method is followed to test for the rank of cointegration: the model is estimated with the largest number of variables with combinations of one, three and four lags, as suggested by different criteria of lag-order selection

statistics³. More specifically, the Johansen trace cointegration test is performed using the decomposition of Hansen and Juselius (1995) of the deterministic components as shown in the following equation, with γ representing a vector of constants, and t a linear time trend:

$$\Delta y_t = (\gamma + \tau t) + \alpha (\beta' y_{t-1} + \mu + \eta t) + \sum_{i=1}^{p-1} \Gamma_i \Delta y_{t-1} + \varepsilon_t \quad (2)$$

According to Hansen and Juselius (1995), the deterministic components of the above equation can be modeled in five ways, starting from the model with the highest number of restrictions to the one with the least restrictions⁴.

1. Not including a trend or a constant ($\mu=\tau=\gamma=\eta=0$)
2. Including a constant only in the cointegrating equation ($\tau=\gamma=\eta=0$)
3. Including an unrestricted constant ($\tau=\eta=0$)
4. Including a trend in the cointegrating equation ($\tau=0$)
5. Including a linear trend in the cointegrating equations and a trend in the differenced data

Restrictions in case 1 do not allow any deterministic components in the data, suggesting the variables do not have a trend and their means revolve around zero. On the other hand, in case 5 there are no restrictions placed on the deterministic components, that is, allowing for linear trends in the differenced data (Δy_t), implying quadratic trends when expressed in levels (y_t). A quick eyeballing of the data plots shows that none of the variables exhibit these characteristics⁵. So in order to determine the cointegration rank of the variables only cases 2, 3 and 4 are considered. The model in case 2 allows for constants in the cointegrating equation, but no linear trends in the data. Case 3, along with the constant in the cointegrating equation allows for linear trend in the data levels, while case 4 allows both for constant and linear trends in the cointegrating relationship. Both Hansen and Juselius (1995) and Johansen (1995) recommend including the minimum deterministic component. Hence, the exercise is performed by testing first the hypothesis of no cointegrating relationship for case 2, and upon rejection, proceeding with the hypothesis of one or more cointegration ranks. The exercise starts with the minimum number of deterministic components and continues until the hypothesis of one cointegrating relationship is not rejected.

B. Results

Following this order, Johansen's trace cointegration tests point towards accepting one cointegrating relationship allowing for a constant (case 2), at both three and four lags between the following variables: deposit euroization,

³ The final prediction error (FPE), Akaike's information criterion (AIC), Schwarz's Bayesian information criterion (SBIC), and the Hannan and Quinn information criterion (HQIC).

⁴ See Ahking (2002) for a summarized discussion.

⁵ Hansen and Juselius (1995) also consider these scenarios as unusual.

NEER, interest rate differential of deposits, CPI and credit euroization⁶. The findings are also supported by Engel and Granger tests, rejecting the null that the residuals of the cointegrating vector have a unit root.

The vector error correction model including the abovementioned variables that exhibit one cointegrating relationship is estimated taking into account the different suggestions of the information criteria for the number of lags. The model with four lags, as recommended by the Akaike information criterion performs the best, fulfilling the diagnostics of stability and rejecting autocorrelation of up to 16 lags⁷. At the same time, robustness checks of the results by changing the significance level of cointegration rank suggest that cointegration holds even at 99% level.

Table 1. Long-run coefficients of cointegrating vector and short-run adjustment parameters of deposit euroization

Variables in the cointegrating vector	β	p-value	α	p-value
_ce1				
Deposit euroization	1		-0.14**	0.044
NEER	-1.23***	0.00	0.05	0.648
Interest rate differential of deposits	9.38***	0.00	-0.05*	0.059
CPI	-0.52***	0.00	0.09***	0.002
Credit euroization	-1.60***	0.00	0.17***	0.009
Constant	8.59***	0.00	.	.

The presence of cointegration suggests that there is an equilibrium relationship between these variables in the long run, as specified in the following equation (standard errors are displayed in parentheses):

$$\text{deposit euroization} = 1.23 \text{ NEER} - 9.38 \text{ int.dif.deposits} + 0.52 \text{ CPI} + 1.6 \text{ cred.euro.} - 8.59 \quad (3)$$

(0.230) (1.371) (0.116) (0.255)

Table 1 provides in more details the normalized cointegrating vector and the speed of adjustment parameters. The ordering of the variables is not important at this stage. The variables are all highly significant in the long run (beta coefficients of the cointegrating vector) and display the expected signs, in compliance with theory and most of them adjust normally in the short run. A simple Gregory and Hansen procedure is employed to test for cointegration in the case of level, trend and regime shifts. However, in all cases the hypothesis of no cointegration with regime shifts is not rejected⁸.

IMPULSE RESPONSES

The orthogonalized impulse response functions using Cholesky decomposition show the effects of shocks on the adjustment path of the variables. The

⁶ Other specifications of the model including different combinations of variables that suggest two or more cointegrating relationships are attempted/ tested, but apart from the difficulty in interpreting the error correction terms economically, at the same time they do not satisfy most of the stability and other performance criteria.

⁷ The hypothesis of autocorrelation is still rejected even with a higher number of lags.

⁸ Research has shown that as euroization increases during times of macroeconomic stability, it might continue to be persistent beyond a threshold level.

magnitude of each shock is normalized to one standard deviation of the relevant variable. Given the series have unit roots, most of the shocks appear to have permanent effects, or their effects die out after a long time. In the short run, the ratio of credit in foreign currency and consumer price index are the variables that appear to adjust faster, correcting by almost 21% and 12% respectively within one quarter.

Interest rate differential of deposits is a significant variable with the expected negative sign. Economic agents seem to be sensitive as interest rates in domestic currency grow in comparison to those in foreign currency, encouraging them to switch to the former and induce a reduction in the euroization rate. Hence, the direct impact of the positive interest rate differential between lek and euro deposits should be to encourage depositors to save in domestic currency. On the other hand, the continuous reduction of interest rate differentials in Albania might be an indication of the natural convergence process towards the interest rates in the euro area⁹. The narrowing gap between the two seems to provide the grounds for movements in the opposite direction, i.e. an increase in the share of deposits in foreign currency. Kokenyne et al. (2010) find that despite interest rate parity holding in the medium to long-run, there is arbitrage in the short-run as interest rate differentials do not cover the fluctuations in the exchange rate, inducing economic agents as such to euroize their balance sheets.

Exchange rate is another determinant of deposit euroization, as also recognized by the market failure view (Levy-Yeyati, 2005). A positive shock of the exchange rate translates to a devaluation of the domestic currency. As expected, such shock encourages economic agents to switch to foreign currency, which in turn induces an increase in deposit euroization. Empirical results show that economic agents react more swiftly to changes in the nominal exchange rate, as compared to the real exchange rate. This reaction seems plausible for two reasons. First, the nominal exchange rate is more comprehensible and easily observed¹⁰. In addition, eyeballing the two exchange rate series one can see that the series tend to co-move closely¹¹. This is consistent with the findings from Chari et al. (2002), who document that that most of the fluctuations of the REER come from fluctuations in the NEER.

Consumer price index is significant and exhibits the expected positive sign. A positive shock on the index suggests the following chain reaction: as consumer prices go up, purchasing power reduces in terms of consumption, inducing economic agents to switch to foreign currency as a better store of value. Theory suggests that market integration leads to price convergence and as prices in Albania follow the "catch-up" process, expectations of price level increases in the future might induce further euroization. The currency substitution view motivates such a reaction, highlighting the negative correlation between

⁹ Xhepa (2002) in an early descriptive analysis of euroization patterns hints to similar behavior.

¹⁰ Ivanov et al. (2011) find similar results in a study on deposit euroization in Croatia; they observe that the effect of nominal exchange rate is stronger compared to real exchange, while drawing similar conclusion.

¹¹ Their correlation coefficient is around 80%.

inflation and the demand for local currency¹². The magnitude of the response to such shock is small.

Credit euroization also turns out to be a significant determinant of financial euroization. A positive shock in the share of credit in foreign currency to total credit increases deposit euroization. This result supports the feedback loop theory. Loans disbursed in foreign currency mean higher money creation in foreign currency through the money multiplier mechanism, feeding back into the system as deposits in foreign currency. In addition, a high stock of deposits in foreign currency serves as a good source of financing funds for the banks, and so forth. The finding on loan euroization being positively correlated with deposit euroization is supported by several other studies that justify the results in the light of banks' tendency of portfolio currency matching (Neanidis and Savva, 2009), the importance of the feedback loop mechanism consistent with banks' currency matching and risk-averse behavior (Luca and Petrova, 2008) or prudential regulations that limit banks net foreign currency positions (Levy-Yeyati 2006). These results are consistent with the widely followed practice in the literature of using deposit dollarization ratios as a proxy for credit dollarization as well as and findings of Shijaku (2013) for the case of Albania. The impulse response function shows an immediate and long-lived positive impact of such shock on deposit euroization, however with a small magnitude.

III. CONCLUDING REMARKS

The main focus of this research is to explore the dynamics of deposit euroization and understand the factors behind it, using a Johansen cointegration approach and vector error correction model. The empirical results presented here show that deposit euroization in Albania is the result of a combination of several factors such as the interest rate differentials, exchange rates, the price level, and credit euroization, similar to the results of other studies in literature. The developments in the spreads between interest rates in foreign and domestic currency have had an impact on euroization as well. Stable exchange rates and domestic prices turn out to be important in minimizing currency substitution and keeping euroization rates under control. Levy-Yeyati (2005) suggests that an inflation targeting regime, combined with flexible exchange rates¹³ minimize dollarization incentives by increasing real exchange rate volatility relative to price volatility. Nonetheless, despite the floating exchange rate regime and inflation targeting being long prevalent, deposit euroization in Albania has been persistent. Fast exchange rate pass-through¹⁴ is a possible explanation for this fact. In addition, empirical results also reflect the high inertia in the behavior of economic agents.

¹² See Savastano (1996).

¹³ He highlights that in a high and volatile inflation environment, floating exchange rates could have the opposite effect.

¹⁴ Istrefi and Semi (2007) find that complete pass-through takes place within a year for the period 1996-2006.

Currency-blind regulations might further incentivize euroization, affecting both banks and economic agents' behavior. In terms of policy making, introducing currency-discriminating measures could prove useful in having the opposite effect, like central bank's decision of zero remuneration of foreign currency deposits during the financial crisis. Other measures could include currency discrimination practices such as increase of the reserve requirements of deposits in foreign currency, increasing banks' costs of operating in foreign currency; or measures aimed at providing some general awareness of economic agents about currency risks and balance sheet mismatches.

However, using regulation to curb euroization rates is not an easy and straightforward task. First and foremost, studies have shown that even a stable monetary policy might not be able to halt hysteresis of deposit euroization, as holding foreign currency deposits, among others, has become a habit in the eastern European region¹⁵. Second, the extent to which euroization is a serious concern should be evaluated in a broader context. Financial euroization focusing on the liabilities side of the banking system is one side of the story. Including measures of public debt issued in foreign currency, known as "original sin" and estimates of cash and other liquidities in foreign currency would provide a more complete framework on euroization. As limited data on these indicators hampers the process for the moment, it should certainly remain an interesting area for further research in the future.

In spite of the relatively good performance of the model with respect to signs, long-run and short-run adjustments and the stability conditions being satisfied, several aspects of the analysis may be improved upon. For example, the relatively short span of the time series (almost 14 years of data) remains one of the main concerns within an autoregressive framework with a considerable number of lags. Bayesian estimation procedures to account for such problem could be employed in future work

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¹⁵ See Brown and Stix (2014).

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BANK OF ALBANIA TRANSPARENCY - REVISITING THEORETICAL CONCEPTS AND QUANTITATIVE MEASURING OF TRANSPARENCY

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1. INTRODUCTION

Together with independence and accountability, transparency is an essential pillar of a central bank. This institutional triangle, which has been reinforced even more in the last two decades, forms the foundations of the best practices governing a central bank (Amttenbrink, 2005) and is a precondition for successfully conducting the monetary policy.

This article proposes a brief, yet comprehensive, discussion on central bank transparency and, in general, discusses its level in the case of the Bank of Albania. It is organised as follows: Section 2 gives a definition of transparency and discusses its importance for a central bank. Section 3 describes the quantitative measurement of transparency through an index that is broadly used in literature. Section 4 makes a summary of earlier assessments of this index for the Bank of Albania and a reassessment for 2014, and presents a comparison with other central banks. Finally, Section 5 concludes.

2. TRANSPARENCY AND ITS IMPORTANCE

The literature provides several definitions on central bank transparency. The two most representative definitions are found in Geraats (2000) and Winkler (2000). According to Geraats, central bank transparency can be defined as the extent to which central banks disclose information to the public. Winkler goes further and defines transparency as the degree of genuine understanding of the monetary policy process and policy decisions by the public. According to this definition, only making information available does not automatically translate into transparency; it should be followed by the understanding of the information by the public. This dimension of transparency has motivated the intensive engagement of central banks in activities aimed at enhancing the public's financial literacy.

Initially in industrialised and later in developing economies, the trend in central bank independence, as a requisite for fulfilling its duties towards the society, has been clearly upward. Based on theoretical arguments and proven in practice, with the separation of the central bank from the influence of politics and of short-term interests provides for stability of prices in the medium term

and reduction of political cycles in the economy¹. But, the need for central bank accountability grows alongside its independence. Transparency ensures exactly this: increased accountability and responsibility of a central bank.

In addition to being an institutional obligation, enhancing transparency has benefits for the central bank, especially in the area of monetary policy. Empirical literature shows that transparency contributes positively to enhancing the effectiveness of the monetary policy in the economy. Expectations are the main channel through which transparency contributes to the economy. When the central bank is clear about its objectives, policies and actions taken both for the present and the future, economic agents may create more accurate expectations on inflation and risk premiums in the economy. In this way, the public's expectation about the economic outlook are approximated to those of the central bank and the real long-term interest rates in the economy are more easily guided by the key interest rate, thus boosting the control of the central bank in the economy.

Transparency assumes more importance in the context of an inflation targeting regime. The trend for increased transparency has been present along with the adoption of this regime. In an inflation targeting regime, central banks are free to use monetary policy instruments in the short term (for example to minimise short-term deviations of output and employment) while maintaining and complying with their commitment to provide stability of prices in the medium term (Bernanke and Mishkin, 1997). For this mechanism to work, economic agents' expectations should be anchored to the inflation target of the central bank. In this case, transparency contributes to inflation expectations remaining anchored and not affected by the short-term behaviour of the monetary policy.

Empirical studies confirm the important impact of transparency on monetary policy. Various authors² find that a higher level of transparency leads to lower values and less volatility in inflation. Moreover, higher transparency is accompanied with lower costs of disinflationary policies in terms of employment.

3. MEASURING TRANSPARENCY

Central bank transparency is a qualitative concept that is hard to measure in quantitative terms. Various economists have tried to measure transparency through indices, whose calculation is based on posing some questions and scoring the respective answers. Surveys for calculating such indices focus mainly in the field of monetary policy and cover such aspects as: setting clear objectives and prioritising them, publication of the monetary policy and decisions, explanations for each action/decision and publication of projections, publication of nominal votes in the council, etc.

¹ Literature abounds about the need for an independent Arguments about this subjects may be found in Eijffinger and de Haan (1996) and Berger, Eijffinger and de Haan (2001).

² See Crowe and Meade (2008) for a more detailed description of literature in this field.

The most used index to measure transparency is that constructed by Eijffinger & Geraats (2002). It is a comprehensive index that addresses transparency from a multi-faceted approach. They define transparency as the extent to which central banks disclose information that is related to the process of formulating and implementing the monetary policy. The authors identify five types of transparency, each belonging to a given stage in the process of the monetary policy implementation: political transparency (of the objective), transparency of economic data and policy models, procedural transparency (decision-making), policy transparency and operational transparency. For each of the five types of transparency, authors establish three criteria. They are scored depending on their realisation. 0- not realised; 0.5 partly realised; 1-fully realised. The index has a score between 0 and 15. The higher the score, the higher is the level of central bank transparency. The five types of transparency used in calculating the index are explained below.

Political transparency (of the objective) refers to the clarity of monetary policy objectives. This comprises a clear statement of the objective of the monetary policy, including prioritization in case of potentially conflicting goals, and quantitative targets of the final objective.

Transparency of economic data and policy models focuses on providing economic information that is used for monetary policy formulation and implementation. This includes the economic data the central bank uses, the policy models it employs to construct economic forecasts or evaluate the impact of its decisions, and the internal forecasts the central bank relies on.

Procedural transparency (of decision-making) is about the way monetary policy decisions are taken. It is achieved by the release of monetary policy strategy, minutes and nominal voting records of the Supervisory Council.

Policy transparency means a prompt announcement of monetary policy decisions. In addition, it includes an explanation of the decision and a monetary policy inclination or indication of likely future monetary policy actions.

Operational transparency concerns the implementation of the central bank's policy actions. It involves an assessment of the achievement of operating targets of the monetary policy and providing information on (unanticipated) macroeconomic disturbances that affect the transmission mechanism of the monetary policy, as well as the assessment of monetary policy results from the perspective of macroeconomic objectives.

This index has a number of advantages. First, it serves as a map of achievements and shortcomings about transparency, identifying also the aspects where further improvements need to be made. Second, it may be calculated at any given time, ex post, thus enabling the assessment of transparency evolution over time and the use of this index for other statistical models. Lastly, it may be easily calculated for various countries, enabling thus the comparison of the level of transparency among them. On the other hand,

this index has the disadvantage of being influenced by the author's judgment, given that the answers to the question are based on individual, not necessarily universal judgments. This disadvantage is less significant when an author assesses the transparency of many countries and applies the same standard for all of them; in this case the comparison between the countries is possible.

4. TRANSPARENCY AT THE BANK OF ALBANIA

Since its early stages, the Bank of Albania has considered the monetary policy transparency as a significant aspect and has worked towards increasing it. Over the years, Bank of Albania's publications have become clearer for the public to understand, decisions have been promptly announced, and statements have been increasingly forward guiding. Moreover, in parallel to the increase in the quantity and quality of information it discloses, the Bank of Albania has worked towards increasing the public's understanding of central banking issues. To this end, it has organised seminars and training sessions with various groups of interest, introducing textbooks for elementary and high school students, etc.

Over the years, efforts have been made to assess the transparency of the Bank of Albania. Note (2005) uses the Eijffinger & Geraats (2002) index to measure the transparency at the Bank of Albania for two given points in time, the years 1996 and 2004. The index scores were 2 and 8.5 respectively in these years, revealing a significant increase of transparency over this period. The scores for the respective transparency criteria in these two years are given in Table 1. The Bank of Albania was given maximum score for the political transparency (of the objective) (3 points) and very good score for the operational transparency (2 points). In the meantime, drawbacks included non-publication of forecast models and projections they produced, and of Supervisory Council minutes and nominal voting records. However, the lack of transparency in these aspect was explicable and justifiable³. Publication of forecast models should occur in parallel with the increase in the level of their understanding by the public. Otherwise, the publication of this information would not produce the desired effect; on the contrary, it could generate unwanted consequences with regard to public's confidence in the central bank. The benefit from the publication of Supervisory Council minutes and nominal voting records has been and remains a controversial subject among academics and central bankers, as this may affect negatively the quality of Supervisory Council's decision-making process.

If we tried to re-assess the transparency index for the actual period, we would see a further increase in transparency over the recent years (Table 1). The monetary policy explanation and inclination or indication of likely future monetary policy actions have improved significantly, increasing the policy transparency by 1.5 points. In the last 3-4 years, the announcement

³ For a detailed discussion of this argument and a summary of relevant literature, see Freedman and Laxton (2009).

of monetary policy decisions has been accompanied with an explanation of reasons that led to the decision and an assessment for the future. Furthermore, in 2013, the forward guidance instrument was introduced providing a direct and clear indication of the monetary policy stance in the quarters ahead. Since 2011, the Bank of Albania has been publishing, on monthly basis, the inflation forecast in the form of an interval with 90% probability. However, the criteria of the transparency index foresee the publication of all forecasted variables by the central bank. Therefore, the assessment for this criteria has not changed. With this reassessment, the score of the transparency index rises to 10 points, from 8.5 points ten years ago.

Table 1 Calculation of the transparency index for the Bank of Albania

Type of transparency	Question	1996	2004	2014	Comments
Total		2	8.5	10.5	
1. Political transparency		1	3	3	
Formal objective	Is there a formal formulation of the monetary policy objective (objectives), which clearly determines the priorities in case there are many objectives?	0.5	1	1	Yes, the objectives are laid down in the Law, and the price stability priority is clear.
Quantitative objective	Is the main target expressed in quantitative terms?	0	1	1	Yes, it is set out by the Supervisory Council
Institutional agreements	Is the independence of central bank provided under the clear institutional/legal/contractual agreements?	0.5	1	1	The Law on the Bank of Albania provides the high independence of the Bank in terms of compiling and implementing the monetary policy.
2. Data transparency		0	1	1.5	
Economic data	Are the important monetary policy data published? 5 variables are considered: monetary supply, inflation, GDP, unemployment rate and capacity utilisation, for which the time series should be published at least at quarterly frequency?	0	1	1	All variables are published, except for the capacity utilisation, which is not available. Assessment 1 is set as the non-publishing reason of the later is not to hide information to public, but stands for its non-availability.
Models	Does the central bank report the formal macroeconomic model used for the analyses for its policy?	0	0	0.5	The models used in the forecast are published as research works. Albeit, still there is not a technical summary of forecasting process and of the use of these models in producing short and medium-term projections.
Forecasts	Does the central bank publish regularly its forecast?	0	0	0	It publishes only the forecasted inflation after one year, in the form of confidence interval, of occurrence probability 90%, while the criteria stipulates the publication of projections for all macro-economic variables.
3. Procedural transparency (of decision-making)		0	1	1	
Monetary policy strategy	Does the central bank publish a clear rule or a strategy that describes the structure (framework) of monetary policy?	0	1	1	Yes, the Monetary Policy Document.

Protocol publication	Does the central bank publish a detailed report on the discussions of the decision-making authority (or of explanations, in case of decision-making by a solely one person), within a reasonable time period?	0	0	0	No.
Publication of votes	Does the central bank publish how it is taken each decision of the decision-making authority on the instrument level or on the main operational objective? (the question is on either publication or not of votes, and if yes, are the names provided)	0	0	0	No.
4. Transparency of operations		0	1.5	3	
Immediate announcement of the decisions	Are the decisions on the adjustments in instruments or main operational objectives published immediately?	0	1	1	It is immediately performed following the Supervisory Council meeting.
Explanation of the implemented policy	Does the central bank provides an explanation when announcing the monetary policy decisions?	0	0.5	1	It is accomplished through the speech by the Governor/ Council and the reports at the Parliament.
Policy trend in the future	Does the central bank publish a clear future trend of monetary policy after each meeting (at least on quarterly basis)?	0	0	1	It is performed monthly since 2013
5. Operational transparency		1	2	2	
Operational objectives	Does the central bank assess regularly the level of its operational objectives' accomplishment ?	0.5	1	1	Yes, in quarterly reports.
Transmission disorders	Does the central bank provide regular information on (unexpected) macro-economic disorders that affect the transmission process of monetary policy?	0	0.5	0.5	Transmission mechanism disorders are discussed, but not in standartised and quantitative terms.
Assesment of financial result	Does the cntral bank provide regular assesment of policy results in the light of macro-economic objectives?	0.5	0.5	0.5	A qualitative assesment is provided, but there is not a standartised and formal procedure.

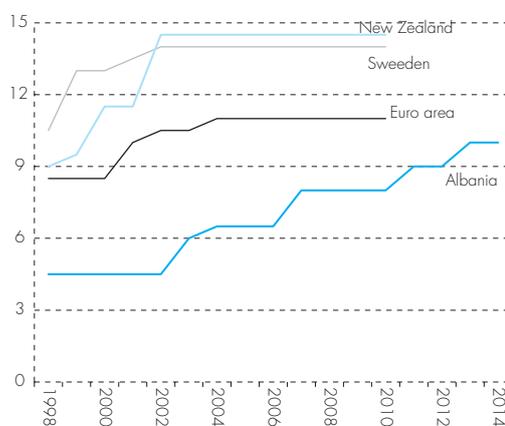
Source: Note 2005 and this article.

The index score may improve in the aspects of publication of forecasting models and of minutes of discussions and voting records of the Supervisory Council. It must be noted that the above-mentioned arguments on transparency in these two aspects remain valid for the actual period. Such information, to which the public is sensitive, should be disclosed commensurate to the level of understanding by the public and introduced gradually.

Over the last years, a series of studies have focused on assessing the transparency index for a large number of countries, including Albania. A recent study by Dincer and Eichengreen (2014) calculates the transparency index for 100 industrialised and developing economies for the period 1998 - 2010. For 2004, their score is 6.5 points, standing 2 points lower than the score by Note (2005), reflecting differences in authors' individual judgements⁴. It must be also noted that the indices calculated by these authors differ from the indices calculated by Eijffinger & Geraats (2002) for some of the countries.

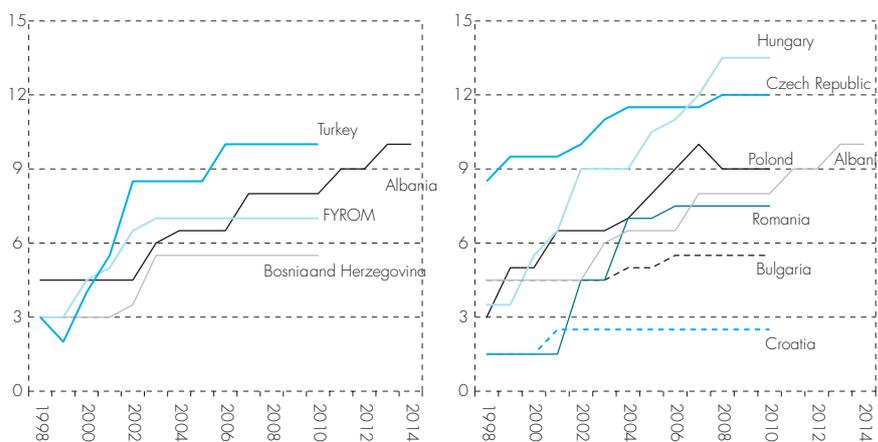
Transparency indices have been calculated by Dincer and Eichengreen (2014) up to year 2010. Given that their scores are not available for individual criteria of the index, it is difficult to update them until 2014 for all the countries. However, for Albania, an exercise may be carried out by adding our 1.5 points on the improvements during 2011-2014. The index would rise then from 6.5 points in 2010 to 8 points in 2014.

Chart 1 Comparison of the Bank of Albania transparency index to the best practices



Source: The indices' values are calculated by Dincer and Eichengreen (2014). The updating for Albania after 2010 is based on this material.

Chart 2 Comparison of transparency indices of the Bank of Albania to some central banks in the Central Eastern Europe and South East European countries



Source: Values of indices are calculated by Dincer and Eichengreen (2014). The updating for Albania after 2010 is based on this material.

⁴ The study by Dincer and Eichengreen (2014) does not explain the scoring and it is therefore impossible to identify the differences in judgment between the two studies.

The results of Dincer and Eichengreen (2014) are important. They provide for a comparison with other countries, for which they have calculated the index. The comparison results are given in charts 1 and 2. The central banks of New Zealand and Sweden are most transparent ones. They have spearheaded the efforts for the inflation targeting regime and are the first examples of the increase in central bank transparency. Transparency at the Bank of Albania stands below these maximum level, and below the score of the European Central Bank. This score is, nonetheless, in line with the socio-economic differences between Albania and these countries.

A more logical comparison is the one with CESEE countries, divided in two groups: EU and non-EU countries. The chart shows that the Bank of Albania is among the most transparent central banks, following Hungary, the Czech Republic, Poland and Turkey.

5. CONCLUSIONS

This article revisits the issue of transparency at the Bank of Albania, briefly presenting the discussion on its definition and significance for the central bank. It introduces a reassessment of the transparency index presented in 2005 and an assessment of this index for the Bank of Albania by foreign authors. The latter allows for a comparison of the level of transparency of the Bank of Albania against the best standards and other central banks of countries with similar social and economic development levels.

The analysis shows some important conclusions. First, the transparency level of the Bank of Albania has continued to increase over the recent years, with material improvements in the area of explaining monetary policy decisions and providing a clear indication of likely future monetary policy actions. Openness to the public in this aspect helps approximate the economic agents' expectations to those of the Bank of Albania. This creates the premises for increasing the efficiency of the monetary policy transmission mechanism by strengthening the expectations channel.

Second, in the areas of publication of forecast models and publication of Supervisory Council discussions and nominal voting records, the transparency index of the Bank of Albania may receive higher scores than the actual ones. Many academics and central bankers argue that for these two aspects the information to the public should be disclosed carefully and in line with adequate understanding of central banking issues. Therefore, the lower values for these transparency criteria should not be seen necessarily as lack of transparency of the Bank of Albania, but a prudent approach in the context of a developing economy.

Third, the comparative analysis with similarly-performing economies shows that the Bank of Albania, whose transparency currently stands below maximum levels, is nonetheless ranked among the countries with the highest transparency score in the surrounding region. The relevant index score stands close to the average level of central banks in EU countries.

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DETERMINANTS OF HOUSE PRICES FROM A DEMAND PERSPECTIVE IN ALBANIA

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ABSTRACT

The latest financial crisis emphasizes the importance of the housing market in the economy. The comprehensive assessment of house price determinants, especially from the demand perspective, has gained more importance among academic studies. This study aims to assess the role of the demand factors in the performance of house prices for Albania through the co-integration analysis of VECM. The empirical findings show that in the long run house prices are determined by bank lending, Treasury bills yield and exchange rate volatility. These findings are broadly in line with the empirical literature and complement the existing literature on the determinants of house prices for Albania.

1. INTRODUCTION

Buying a house is one of the most complex decisions people make because it combines the necessity for good living conditions with an investment in a long-term asset that is expected to generate benefits in the future. Also, the housing market is affected by multiple interferences of government policies, in terms of both urban management and housing and social policies, which radically affect people's decision to buy houses (Igan et al 2010). Additionally, this market is closely related with the banking sector and its core activity: lending. Through their role as financial intermediaries, banks spread in a spiral pattern the existing problems of the housing market into several sectors of the economy and vice versa, influencing the decision-making of economic agents (Doling 2013). Furthermore, house prices play an important role in the macroeconomic policies of central banks, and the debate on whether central banks should be targeting these prices has strongly returned to focus after the recent global crisis of 2007/2008 (Taylor 2007). This crisis, triggered by the housing market and its financing from the banking system, stressed further the importance of the housing market for the entire economy.

The Albanian economy has undergone significant changes during the transition from a centrally-planned to a market economy, as regards both the institutional and the regulatory aspect. In particular, the construction sector and the housing market have experienced significant changes and have been major contributors to economic growth during this period (Ibrahimaj et al

¹ The views expressed in this article are of the author and do not necessarily reflect the views of the Bank of Albania. This article is a summary of findings of a research article under the same title presented in the VIII Research Workshop in SEE (Tirana, 3-4 December 2014).

(2014)). Furthermore, the banking sector has been one such sector that has experienced substantial changes and, with the deepening of the financial intermediation, has supported the economic growth (Suljoti et al (2012)). In view of these facts, and taking into account the abundant literature on the housing market, this study aims to explore the role of demand determinant factors in the developments of house prices in Albania. Through empirical findings, it also aims to complement the existing literature on the determinants of house prices in Albania.

This article focuses on empirically analyzing the impact of demand factors contributing to house prices. By employing a cointegration model of VECM, this study assesses the long-run and short-run relationship between demand determinant factors and house price performance in the case of Albania. The methodology employed is the same approach as followed by Fitzpatrick dhe Macquinn (2007), Valverde and Fernandez (2010) and Zhang et al (2012). Unlike previous studies, this one observes the influence of the exchange rate volatility on the performance of house prices, taking into account that this is a highly euroised market. In more details, this article studies the impact of mortgage loans, disposable income, 12 months T-bills yield and exchange rate in house price dynamics. The selected method is judged to be appropriate to fulfill the objective of this study, because it addresses the endogeneity problem between variables; at the same time it fulfills the need to study the long and short-run relationship.

The article begins with stylized facts on determinants of house prices in Albania. Then it continues with the empirical analysis of house prices and its determinants for long and short run developments. The article concludes with the main findings of this empirical research.

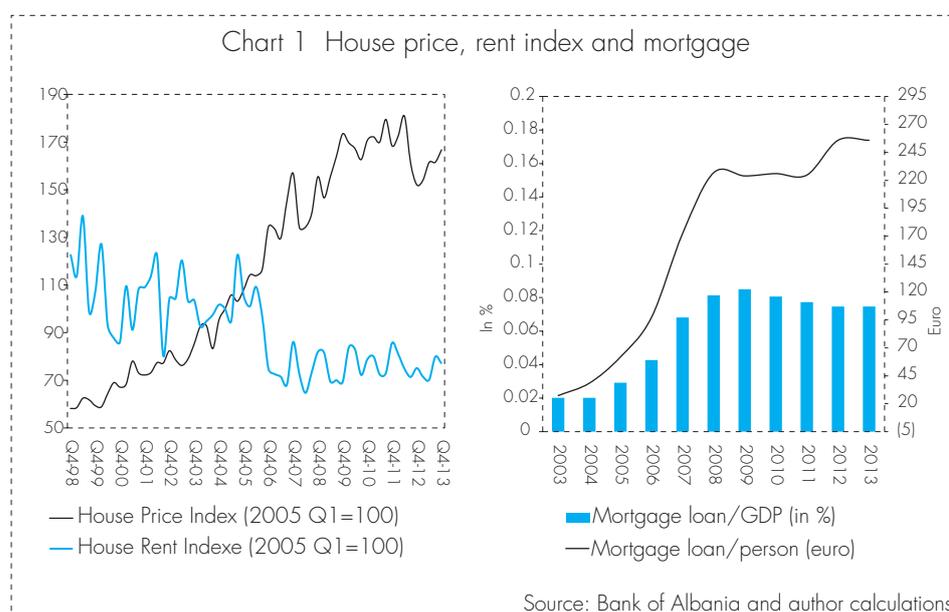
2. DEVELOPMENT OF THE HOUSING MARKET IN ALBANIA

The Albanian economy, similarly to other countries of the CESEE region, has undergone significant changes during the transition period. In particular, the housing market has been highly dynamic. Data show that house prices have grown significantly in the period 2000-2007, when house prices rose by an average of 15 % per year. Meanwhile, developments during the period 2008-2013 show that the real estate market has reached a bottleneck, with prices fluctuating and shrinking occasionally, since year 2009.

In the absence of house price data, at national level, our analysis is based in Tirana house price index. In the city of Tirana, the first factors that have triggered the increase in the demand for new construction, beginning in the early 1990s, have been the lack of sufficient housing space and the poor quality of existing housing; shifting of households behavior towards living in smaller families; as well as the alteration of the demographic map driven by economic and social factors (UNECE 2000). During the transition period, an important source of demand for new houses originated from emigrants, which

has been growing until the end of 2007². Meanwhile, since the onset of the crisis, the demand from emigrants has declined, reflecting deteriorating conditions in labor markets abroad (Suljoti et al 2012).

Another important factor in house prices rising over the years has been the increase in disposable income³, which appears to have supported demand and house price rise in until early 2008. After that, along with the deceleration of income, there is a reluctance of households towards both house purchasing and mortgage loans. In addition to this factor, the general uncertainty for future income, including increased unemployment and overall uncertainty about the labor market, was reflected in a contraction of households' demand for housing (Unicredit 2011).



The consolidation of the banking system and its increased flexibility to finance households and construction companies are additional important factors that have led to increased demand and supply in the housing market. During the period 2002-2007, financing through bank loans constituted an important source of funding for households. High property prices provided their owners with sufficient collateral to obtain new loans and to expand the demand for housing (Suljoti et al (2012)). After year 2008, the rate of growth of the loan portfolio declined significantly, marking negative growth during 2012-2013.

Another component of the demand for housing in Albania is its purchasing for investment purposes. Renting out the houses increases the profitability potential of the investment of savings/assets in housing. The rent represents the expected profit from the capital, and resembles the profit from investments in securities. In this context, the stock and securities markets are alternative markets for the investment of savings and as such their returns' dynamics could

² Stepanyan et al 2010 in their paper make evidence on the importance of remittances as one of the main sources for house purchasing. This source is also important for Albania.

³ In absence of data published by INSTAT, the series of Gross Domestic Product has been used as the best proxy to disposable income.

affect the demand for housing. In the absence of a stock market, in Albania, the 12 month T-bills represents a typical alternative for the investment of funds. Therefore, the 12-month yield is expected to have an inverse relation with the housing demand and price. Also, the yield of 12-month treasury bills can be seen as a reference rate of the cost of money in the economy, indirectly influencing the decision for house purchasing.

The exchange rate is an important factor for the Albanian economy. The euro is broadly used in the real estate market. In particular, the euro quotation of housing prices is emanated by the constructors⁴. In addition, the choice to use a hard currency is linked to the fact that housing is seen as a long-term investment and saving instrument. As such, to protect it from fluctuations in the value of the local currency, or the possibility of high inflation, economic agents have preferred quotations and transactions in foreign currencies. Therefore, it is expected that households, motivated by increased uncertainty in the financial market, will aim to shift their saving in the housing market, increase as such the housing demand and furthermore the house prices⁵.

3. EMPIRICAL ANALYSIS OF HOUSE PRICES DETERMINANTS

The selected variables for the empirical analysis of the house price determinants from demand perspective in Albania are mortgage loans; disposable income; interest rate on new loans; and exchange rate. This approach is similar to that followed by Valverde and Fernandez (2010), who investigated the house price performance in Spain.

3.1 DATA

In the absence of comprehensive data on the housing market in Albania, the analysis is based on the house price index for Tirana⁶. Data included in the empirical analysis are quarterly and cover the period 1998-2013. Data sources are Bank of Albania for the house price index, total banks' outstanding mortgage loans; interest rates on 12m Treasury -bills and period average fixed exchange rate EUR/ALL. Meanwhile for the gross domestic product (GDP) series is published by INSTAT. Exchange rate volatility data has been generated from official statistics of exchange rate and measures the

⁴ Constructors sell their products in euro in order to be hedged against exchange rate fluctuations. Official data show that majority of raw materials for constructions are imported, thus are paid in euro.

⁵ Another possible channel of the influence of Exchange rate to the house prices is through the supply side of houses. Whereas the constructors motivated by high volatility in the Exchange rate, will rise the prices in the way to cover the unexpected expenditure in domestic currency. Even at this case the Exchange rate fluctuation will impact positively the house prices.

⁶ The official statistics do not provide a house prices index that covers the entire territory of the country. However, Tirana represents a good studying sample, representative of the developments of the housing market in Albania, since it is the city/district with the largest population and economic activity in the country.

recursive standard deviation for a 3 year period (Sun et al 2002). The 3 year period has been selected to capture persistent volatility of exchange rate. Data included on the model are in log and adjusted for the inflation rate.

The analysis of the data revealed two moments of structural changes in the behavior of the key variables included in the model. The first point refers to year 2004, when banks began to play an active role in financial intermediation in the economy (Dushku et al (2014)). For this purpose a dummy variable was generated (Dumm04). This dummy variable takes a zero value prior to 2004 and 1 afterwards. Another variable generated considering the behavior of the data is variable Dumm08, which represents the shock that hit both the housing market and the bank loans due to the global financial crisis. More specifically, this variable is zero until the third quarter of 2008 and 1 for the remaining period. The existence of these two breaking points was confirmed by statistical tests on the behavior of the series.

3.2 METHODOLOGY

The Johansen methodology emphasizes that if between two or more non-stationary variables of the first order, exists at least one vector who is a product of the two series and is a stationary variable, then the variables are cointegrated of the first order. According to Julius (2006), the vector error correction model (VECM) provides a convenient reformulation to estimate several time series variables in levels. Furthermore, Julius (2006) emphasizes another key advantage of using this model. This is encapsulated in the significant reduction of multicollinearity, which is present in time series and summarizes information on the long-term relation between endogenous variables in a matrix form. Moreover, the model evaluates within the same system the short-term relationship between the variables. A schematic representation of the functional equation of the vector error correction model of the first order is:

$$\Delta X_t = \pi X_{t-1} + \sum_{j=1}^{q-1} \tau_j \Delta X_{t-j} + \delta D_t + \epsilon_t \epsilon_t \sim N_p(0, \Lambda)$$

$t=1 \dots T$

where:

πX_{t-1} represents the vector of cointegration relation which contains endogenous variables (not stationary) with lag one. π is a matrix of coefficients of long-term relation. The coefficient of this matrix should be negative and statistically significant. This coefficient indicates the speed of return to equilibrium whenever there are deviations from the equilibrium between variables in the short term.

ΔX_t represents the vector of first differences of the endogenous variables included in the model.

- represents exogenous variables included in the model.

$\tau_1 \Delta X_{t-1}$ - represents endogenous variables in the first difference, with predetermined lag, which serve to identify short-term relationship. τ is a matrix of short-term parameters.

ϵ_t - is a vector of random errors which represent the model errors. This vector is expected to have values that are uncorrelated, with a constant (λ) covariance/ variance matrix - and normal distribution.

The empirical analysis aims to answer the following questions: is there a long-term relationship between the selected factors (credit, income, exchange rate and interest rate) and the house prices; and if so, are the variables growth rates related also in the short term?

Before identifying the vector error correction model, we have undertaken the main steps for determining the components of the model (Juselius 2006). Firstly, we tested for the existence of the unit root for each of the variables, which confirm that the series are integer of the first level (I1) and as such they fulfill the condition to be included in VECM cointegrated analysis. Then we tested for the existence of cointegrating relationship by employing cointegration tests, Trace and Maximum Eigenvalue. The results of the tests reveal that there is at least one cointegrated relation within the variables with lag 2 quarters. The selection of lag is determined by the four tests of lag length criteria. Furthermore, by applying the Granger Causality / Block Exogeneity Wald test, we assessed for the endogeneity of the main variables. Fulfillment of this requirement is a prerequisite for the inclusion of variables in a VECM model. Results of this test indicate that the variables included in the equation explaining the house prices, all together are endogenous. More detailed information may be found in the tables in the Annex.

The selection of the best model for the long-run cointegration relation has been also based on the investigation of residual characteristics. As shown in Table 1, the 3 tests employed show that the models' residuals are stationary.

3.3 RESULTS

In assessing the above described VECM models, we found that in long run, house prices have a cointegrating relationship with the mortgage loan to GDP ratio, the yield of 12M Treasury bill, and the fluctuation of exchange rate. In table 1 below, show that an increase of 1 percentage point in the ratio of mortgage loans to GDP is associated with an increase of housing prices by 0.31 percent in the long run. This relationship has the expected sign and is statistically significant. Furthermore positive relation is found also with the fluctuation of exchange rate. An increase of one standard deviation of the exchange rate is linked to a 0.062 percent growth in housing prices in the long run. Also, this coefficient has the expected sign and is statistically significant.

Table 1 Empirical finding for long term period

Variables	Coefficient	Statistics-T
Mortgage/ GDP	0.31203	-10.8034
Exchange rate volatility	0.061955	4.22865
Treasury bills 12m yield	-0.119554	-4.11569
C	-5.94028	
ECT	-0.483753	-2.39121
Adjusted R-squared	0.284687	
S.E. of regression	0.053307	
Residual test	Test value	p-value
Jaque bera	1.367525	0.505
LM test	17.86267	0.332
Hetereskedacity	220.4931	0.296

Sources: Authors calculations.

Stemming from previous studies, (Egert & Mihaljek (2007), we analyzed the impact of 12M treasury bills yield to the house prices, as an alternative yield of investing savings in the economy. As shown in Table 1, the relationship between housing prices and TB yield was in line with the theoretical expectations for an inverse correlation and was statistically significant. Thus an increase in the 12-month treasury bills yield at 1 percentage point is associated with a decline in housing prices by 0.12 percent in the long run.

The long run vector described above shows the long term adjustment. The statistically significant error correction term, with a negative value of 0.48, shows that the speed of return to equilibrium of house prices is about two and a half quarters.

Within the system equations of the long-run relationship, we analyze also the short term relation between the variables (Annex). In the short-term part, the included variables are in difference (dlog), as to be stationary. In the short term, equations reveals that all the coefficients of the endogenous variables resulted not statistically significant in determining the short-term performance of house prices. This result may come due to the friction of the housing market (Suljoti et al (2012)). This friction may be related with the long time needed to sell a house and some handicaps of the housing market, such as governmental interference on prices setting (reference price), the institutional shortcomings, flawed enforcement of property rights etc. (World Bank 2012).

The behavior of housing prices in the short term is largely determined by the error correction term, by the seasonality of the house price series, dummy variables of 2008 and other factors that are not consider in the model. This finding confirms the negative role that the crisis has had in the housing market for the short term development. Meanwhile the Dum04 variable was statistically insignificant, even though with the expected sign. Even for short-term equations, models residual fulfilled all three features of the stationary series (annex table 7).

To judge for the stability of the models some sustainability tests have been undertaken. Thus, by changing the specification of the model, it has been shown that the estimated coefficient of the mortgage to GDP ratio maintain the same sign and remain statistically significant. Furthermore the levels of coefficient remain broadly stable. Another robustness check is done through the substitution of the mortgage credit with the total credit and domestic credit as proposed by Gerlach (2005). As it is shown to the table 2, the result did not bring significant changes to the coefficients and model parameters. Another test for robustness of the results is done following the approach suggested by Valverde and Fernandez (2010), by taking in consideration different periods within the sample. These tests showed that the coefficients before the main variables maintain the sign and remained statistically significant, fluctuating close to the level of table 1. However, the interpretations of the result for this period have to be interpreted with caution, due to the small sample size.

Table 2 Results of alternative models

VECM1 (total credit)			VECM2 (2004-2013)		
Variable	Coefficients	t-value	Variable	Coefficients	t-value
Total credit/ GDP	0.376554	-7.89492	Mortgage/ GDP	0.406	-24.59000
Exchange rate volatility	0.112122	-4.71552	Exchange rate volatility	0.091	-10.30000
Treasury bills 12m yield	-0.249081	5.30148	Treasury bills 12m yield	0.264	-8.13400
C	-5.94028		C	-5.56	
ECT	-0.131823	-1.81391	ECT	-0.71	-1.89600
Adjusted R-squared	0.229468		Adjusted R-squared	0.237935	
S.E. of regression	0.055385		S.E. of regression	0.055326	

Source: author's calculations.

4. CONCLUSIONS

In recent years, economists around the world have paid special attention to the dynamics of house prices, due to the implications that the housing market has in economy. Special consideration is given to the role that house prices have on the financial stability and macroeconomic policies of central banks. The literature investigates on all these aspects both at a comparative level for groups of countries, and at individual countries level. Academic empirical findings, despite the chosen approach, have confirmed the strong correlation between house prices and some financial indicators such as banks' lending, disposable income, exchange rate and interest rate. To elaborate this relationship, this paper undertakes a cointegration analysis of determinants from demand perspective in the development of house prices in Albania. The main hypothesis of this research paper is to assess the role of demand factors has on housing price performance over the long run, and whether this influence is also confirmed for the short term.

Economic studies on the housing market in Albania and its interrelation with macroeconomic indicators are scarce. The inclusion of exchange rate as determinants of house prices makes our analysis different from previous studies. Hence, this research paper, along with confirming the main hypotheses that it raises, aims to provide an added value to the existing literature as well as to help in the practical use of its findings.

Through the application of the cointegrated method VECM for Albania, this study confirms the positive correlation of mortgage loans with house prices in the long run, in accordance with findings in foreign literature. This result highlights the fact that despite the low level of mortgage lending in Albania, its development has a statistically significant effect on the long-term development of house prices. Furthermore, this study confirmed a statistically significant negative relationship between house prices and the 12 months treasury bills yield, in line with the expectation that the treasury bills market represents an alternative for the investment of funds. Meanwhile, the interest rate of new Euro loans, as noticed in previous papers regarding Albania, resulted statistically insignificant to the house price developments. A novelty of this study is the inclusion of the exchange rate in the empirical analysis of housing prices. In a housing market where the use of foreign currency is dominant, the role of the exchange rate and its volatility resulted positive and statistically significant.

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ANNEX 1

PRELIMINARY TESTS FOR BUILDING THE VECM MODEL:

Table 3 Unit root test, (probability for the null hypotheses= non-stationarity)

Variable Characteristics		level		First Difference	
		ADF (p-value)	PP (p-value)	ADF (p-value)	PP (p-value)
HPI	T+ C	-1.0(0.74)	-0.87 (0.79)		-7.8 (0.00) -14.36 (0.00)
MCG	T+ C	-0.21 (0.99)	-0.93 (0.95)		2.56 (0.01) -6.67 (0.00)
TCG	T+ C	-1.4(0.85)	-1.02(0.93)		-1.55(0.11) -6.82 (0.00)
INTCE	none	-0.72(0.4)	-0.68(0.42)		-8.1 (0.00) -8.49 (0.00)
BTH	none	-0.99(0.28)	-1.0(0.28)		-9.16(0.00) -9.17 (0.00)
ER	C	-3.20(0.1)	-2.4(0.38)		-5.2 (0.00) -6.13 (0.00)
ERSTD	C	-2.71(0.24)	-2.2(0.25)		-3.75(0.03) -3.75 (0.03)

Note: The null hypothesis for the ADF test is that the series has a unit root. The critical values for the rejection of this hypothesis are taken from MacKinnon (1996). Meanwhile, the characteristics of the series have been confirmed also by employing the Philips Perron tests.

Table 4 Endogeneity test (VAR Granger Causality/Block Exogeneity Wald test)

Dependent Variable (LHPI)	Chi-sq	Df	Prob.
LMCG	12.55809	2	0.0019
LERSTD	3.159709	2	0.2060
LBTH	4.074374	2	0.1304
Të gjitha	17.34014	6	0.0081

Note: VAR Granger Causality/Block Exogeneity Wald test control for the null hypotheses that the variables are exogenous. The results of this test confirm that the included variables taken all together are endogenous.

Table 5 Tests for lag length criteria

Lag	LogL	LR	FPE	AIC	SC	HQ
0	20.40256	NA	1.01E-05	-0.149239	0.41416	0.070689
1	214.18	335.0051	2.46E-08	-6.175594	-5.048794*	-5.735737
2	239.4814	40.31073*	1.82e-08*	-6.490896*	-4.8007	-5.831111*
3	251.8537	18.03407	2.13E-08	-6.367921	-4.11432	-5.488206
4	259.2606	9.79221	3.02E-08	-6.07663	-3.25963	-4.976987
5	271.0982	14.0446	3.79E-08	-5.935531	-2.55513	-4.61596

Note: In the head of the table, the abbreviations reveal the name of statistical tests. The * is the selected lag by each tests. The lag 2 has been selected by most of the tests.

Table 6 Unrestricted cointegration test

Hypothesized		Trace test			Max-Eigen		
No. of CE(s)	Eigenvalue	Statistic	Critical Value (0.05)	Prob. **	Statistic	Critical Value (0.05)	Prob. **
r=0*	0.366399	53.50967	47.85613	0.0134	27.83654	27.58434	0.0464
r ≤ 1	0.257266	25.67314	29.79707	0.1388	18.14245	21.13162	0.1246
r ≤ 2	0.111166	7.530683	15.49471	0.5169	7.188525	14.26460	0.4671
r ≤ 3	0.005593	0.342158	3.841466	0.5586	0.342158	3.841466	0.5586

Note: Trace test confirm that there is 1 cointegration relation within variables with 99.5% confidence. The * shows that the null hypothesis is rejected with 99% confidence. The ** show the P-value according to MacKinnon-Haug-Michelis (1999).

Table 7 Short-term equation

	VECM	
	Coefficient	t-value
ΔCredit/ GDP (-1)	-0.108071	-0.834439
ΔExchange rate fluctuation (-1)	0.072446	1.508590
ΔYield-i TB 12M (-1)	0.011484	0.377941
C	0.033057	2.411826
ECT	-0.483753	-2.391207
Dum08	-0.059947	-2.529529
Dum04	0.023180	1.147342
Seas (1)	-0.039314	-2.344644
ΔLHPI(2)	-0.155682	-0.980472
Adjusted R-squared	0.284687	
S.E. of regression	0.053307	
Residual test	Test value	p-value
Jaque bera	1.367525	0.5047
LM test	0.822892	0.8440
Hetereskedacity		

HOW MUCH DOES THE INFORMATION PROVIDED IN THE BANK LENDING SURVEY MATTER?"

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ABSTRACT

Bank of Albania regularly monitors the credit standards, demand and other terms and conditions that banks apply to their customers through Bank Lending Survey (BLS). The information provided in this survey, is currently used to complete the credit market analysis. The question raised in this study is: does the information provided in the Bank Lending Survey serve to explain the changes in lending or in broader economic activity? Tests of causality results used in this study show that bank lending survey contains valuable information.

INTRODUCTION

Bank of Albania in collaboration with commercial banks conducts the bank lending survey¹ since 2005. Through this survey, banks' credit express themselves on the latest changes in their bank credit standards and provide opinion on the loan demand to businesses and households. In more details, the qualitative aspects addressed in the survey, relate to factors that have affected the change in credit standards and conditions upon which banks have implemented these standards, such as: change of average margin, collateral requirement, commissions, maximum credit maturity, etc. Also, the survey provides qualitative information about the performance of the demand for loans. Banks have close and frequent contacts with their customers. Given their unique position, banks' experts provided information on the demand for loan and the factors that affect this demand. The general characteristics, the questionnaire and the way the qualitative information is aggregated, are addressed in the Methodological Explanation (2008)².

Monitoring qualitative aspects of credit from the bank lending survey completes the analysis of the monetary and economic development. In literature, frequently is mentioned, that although interest rate, in theory, connects the financial markets to the economic activity, it is not the only one channel³. The relation between financial markets and economic activity is also ensured through credit availability, particularly when banks want to limit the

¹ Organised by the Monetary Policy Department

² Bank of Albania, (2008): "Bank Lending Survey - Methodological explanations", link: http://www.bankofalbania.org/web/Bank_lending_survey_5311_2.php

³ Blanchard and Fischer (1989), Chapter 9 "Goods, Labor and Credit Markets", reference on financial markets and credit rationing, pg.478.

granted credit. Banks may prefer to tight credit standards without increasing the interest rate, with the purpose to not make the customers, who are more sensitive to an increased interest rate (risk-adverse) to go away, or in case they want to expel the borrowers who do not meet the required standards.

Many central banks in advanced countries employ bank lending survey to attain information on the qualitative aspects of lending, which are not found in the official statistics. As the credit market does not function like all the other markets, where price is the only one regulating mechanism to balance the demand and supply, the central banks, in addition to the interest rates and the amount of the granted credit, are interested in the credit standards (Lown et al. 2000)⁴.

Since the publication, Bank Lending Survey data are used for the analysing purposes in and out the Bank of Albania⁵. The monetary Policy Department uses these data to complete the analysing of factors that have affected the loan demand and supply. Change in lending standards (their tightening or easing) is interpreted as a sign of bank's availability to change the amount of credit being granted in a given quarter. The literature provides evidence that the qualitative information deriving from lending survey is available for quantitative forecast. Various authors show that lending standards to businesses (Lown et al. 2000) and to households (Duca and Garrett 1995, McCarthy 1997) impact the amount of granted credit.

In addition to the advantages of using Bank Lending survey, as the only one information source on the non-price factors that affect lending, its disadvantages should be considered as well. First, banks assess qualitatively the change in the aspects of price and non-price in granting the loan. That means, banks' experts provide their opinions, but not figures, whose truthfulness is easier to be proved. Second, banks' responses may avoid responding or lack the sincerity, because they are supervised by the Bank of Albania.⁶ In order to test the usefulness of the information provided by the Bank Lending in the regular analysis and lending market studies, it should be tested if responses are rational and if it is can be used to provide early signals. This material seeks to look formally at the advantage on the use of information provided by Bank Lending Survey.

In this paper, through the employment of causality tests, we have analysed if the balances of credit standards and loan demand of businesses and households as measured through the Bank Lending Survey, do affect lending to private sector and the overall economic activity. Tests results suggest that the changes in credit mostly reflect demand factors rather than the supply side.

⁴ Lown S. et al (2000): "Listening to loan officers: the impact of commercial credit standards on lending and output", FRBNY Economic Policy Review/July 2000.

⁵ Based on the result of the separate section in the first quarter 2014, a considerable number of banks use regularly the results of this survey published at Bank of Albania website to see the bank's answers trend compared to the overall market, also the view of the banking sector relate to both, business and households' demand for loan.

⁶ This concern, the avoidance of answers or lack of sincerity, is arisen by other central banks which carry out this survey.

On the other hand, the research reveals that Bank Lending Survey contains information even for the development of the overall real economy.

The paper will continue as following: the first part provides a historical description of Bank Lending Survey and a comparative analysis to the regional data; the second part describes the used methodology and data; the third part will describe the results; and the fourth part provides the conclusions of the study.

SURVEY

Bank of Albania organised the Bank lending Survey for the first time in 2005. This survey was conducted twice a year. In H2 2007, Bank Lending Survey Questionnaire was subject of a set of changes and the continuation for some time series was lost⁷. Since 2009 Q1 the Bank Lending Survey was developed on quarterly basis.

The questionnaire is submitted electronically to 10 banks, each sharing at least 3% of credit market⁸. Outstanding loan is used to calculate the share of banks' market. Since 2005, survey sample has not changed and banks included in the survey account for 95% of the granted credit in the system. The questionnaire consists of 16 qualitative questions⁹ on the developments in the past (the quarter during which the survey takes place) and expectations for the future (the quarter ahead). The questions are submitted around 10th of the last month of each quarter and require the opinion of credit's experts on the standards and the loan demand. Each question has four alternative responses. For example, the alternatives for the question "how have lending standards changed?", are: 1) tightened considerably; 2) tightened somewhat; 3) remained unchanged; 4) eased somewhat; and 5) eased considerably. The survey results are available for internal use for around five days after the closure of the quarter for which it is conducted the survey.

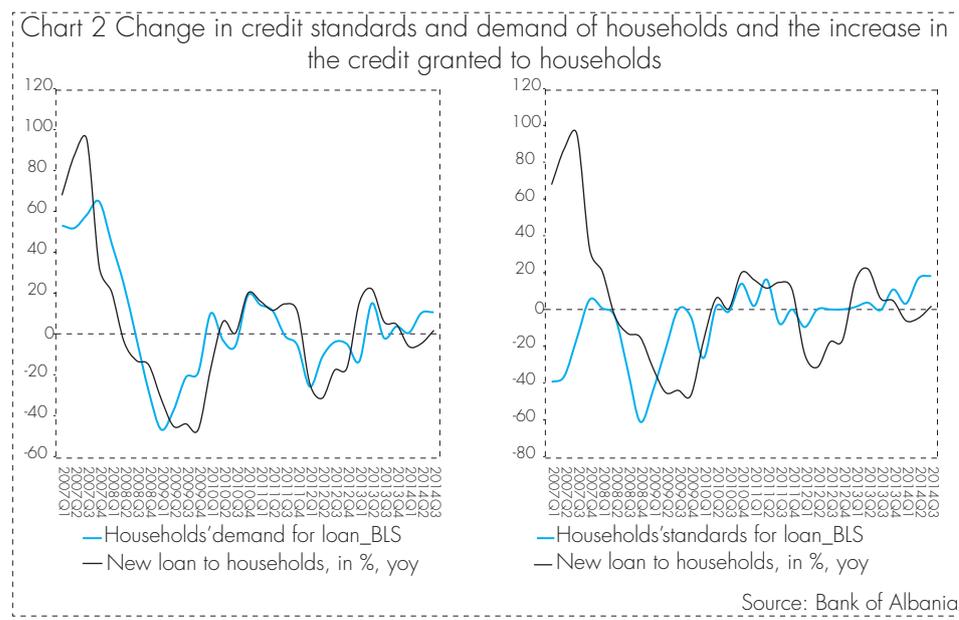
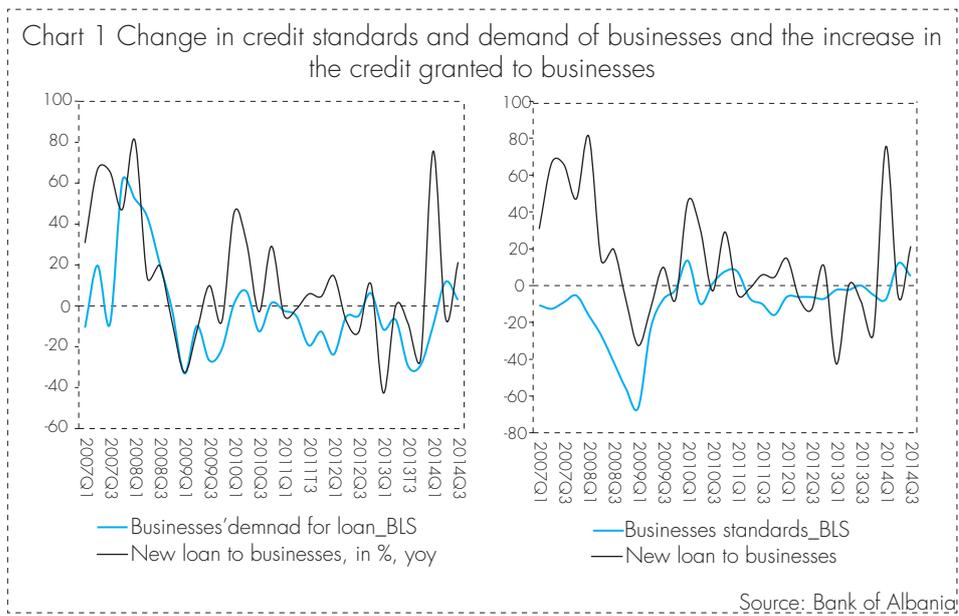
Each question is quantified through the net balance statistic. The net balance is defined as the difference between the weighted responses of banks which have eased standards or reported an increase the demand, and the weighted responses which have tightened the standards or reported a fall in the demand. Banks' responses are weighted based on the share that each banks have on the total of credit granted for a specific loan type, household or business.

⁷ These amendments aim at simplifying the questionnaire, facilitating the quantification of qualitative data and starting the establishment of time series. Also, the questionnaire was standardised with the one used by the European central Bank on the survey of lending activity.

⁸ To avoid the selection volatility from one quarter to the other, the sample is chosen based on the share that each bank has in the credit market during the last twelve months. Overall, a bank shall be included in the sample, if its market's share is higher than 3% over the year. Once included in the question are, a bank shall stay in the surveyed sample so far its market's share falls below 2%.

⁹ The qualitative questions need a reply as an opinion by the interviewed person, the perception or opinion about the previous or expected developments, different from the quantitative questions which need a figure - quantitative data.

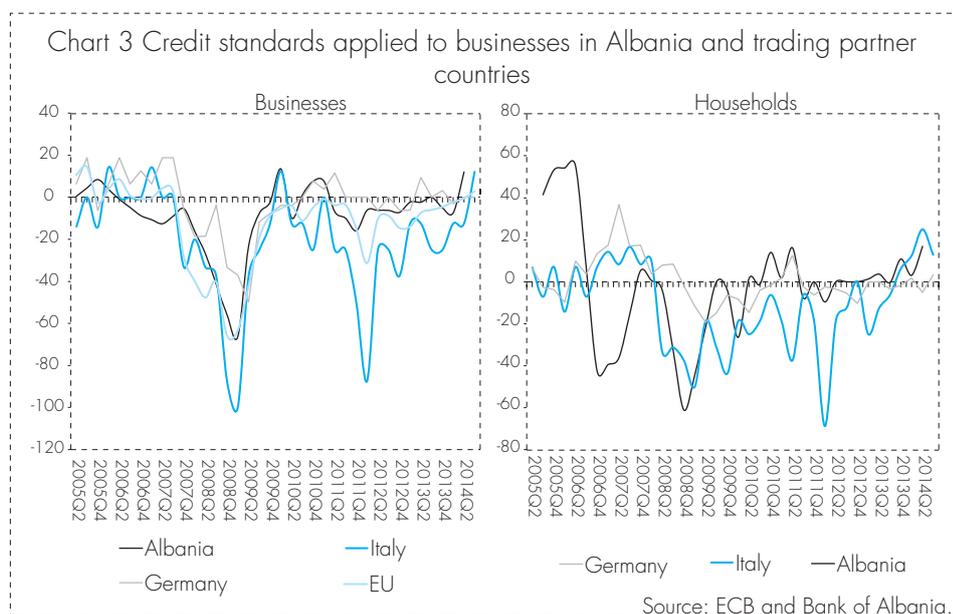
For example, 5 questions on standards are coded 1 = eased considerably, 0.5= eased somewhat, 0= remained basically unchanged, -0.5 tightened somewhat and -1 = tightened considerably. Each response, once being coded, is multiplied to the respective bank's weight and is aggregated to provide the net balance of standards. A positive net balance indicates that credit standards are eased, and a negative net balance indicates that standards are tightened. The net balance is scaled in order to acquire values within the interval of +/- 100. In this way the time series on standards, factors, conditions and demand are established. The indicator on terms and conditions on which banks agree with their clients is the shortest one. This question was included in the questionnaire in 2008.



The survey results, the aggregation methodology of results and time series are regularly published at the Bank of Albania’s official website and are consistent with the practice observed by central banks in other advanced countries¹⁰.

Chart 1 shows the changes in credit standards and demand to businesses, in addition to the annual increase of credit granted to businesses. In similar way, Chart 2 shows the series for households. In an intuitive way, the chart displays that the tightening of credit standards drives a fall in the amount of the new credit. The positive connection is shown by the fluctuation in the credit demand to businesses and households and the increase in the granted credit.

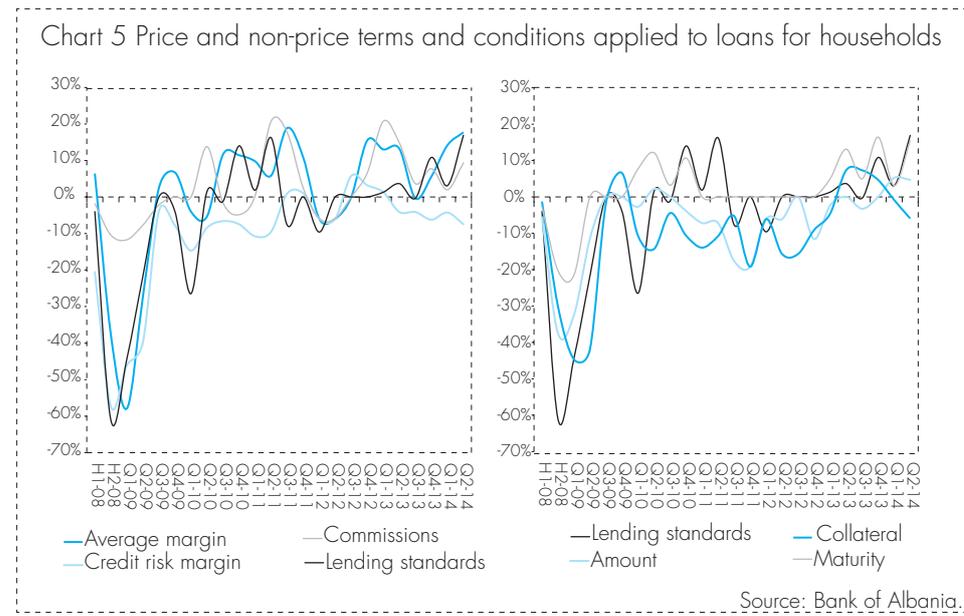
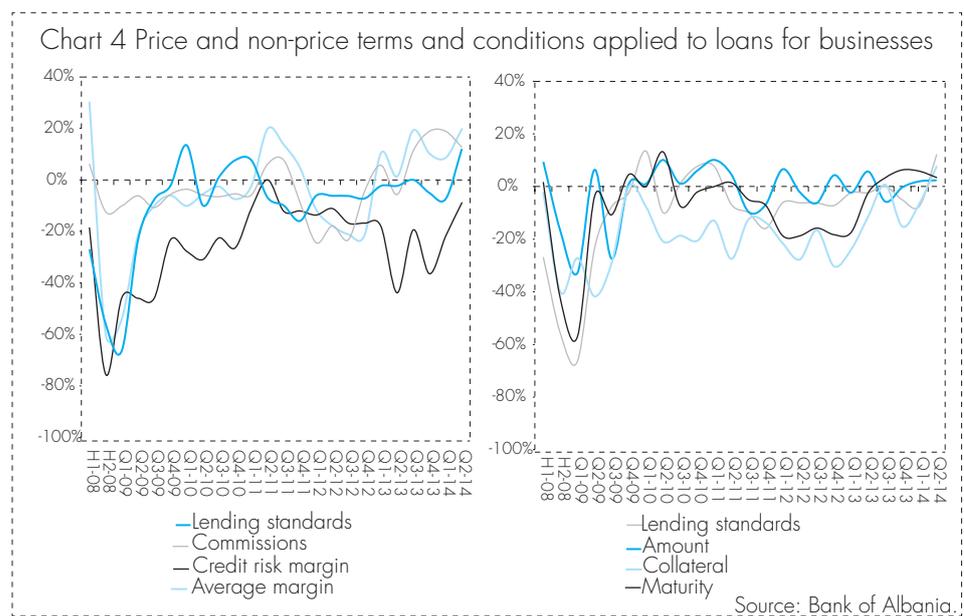
The cycle of credit standards to businesses is similar to the one applied by the Albanian main partner countries (See Chart 3). Standards were considerably tightened during the last global financial crisis, to be eased somewhat in 2009-2010 (the standards balance begun to record positive values). Standards tightening during 2011, reflecting the crisis in euro area, although, as shown in the Chart, at a lower degree in Albania, compared to the other countries. Credit standards on households display a lower synchronisation degree with the other countries. Excluding the crisis of 2008 and its reflection in the tightening of standards, the fluctuations in the standards of various countries are not synchronised. The cross correlation analysis provides similar conclusions.



The tightening of credit standards to businesses, during and after the crisis of 2008, were implemented mainly by reducing the average margin and reduce

¹⁰ Some of the major central banks conducting the bank lending survey are the European Central Bank (since 2003), Bank of England (since 2007), Bank of Japan (since 2000) and the Federal Reserve (since 1967). The periodical analysis, methodology and time series of the results of BOA Bank Lending Survey are published at: http://www.bankofalbania.org/web/Bank_lending_survey_5311_2.php

of risk-credit margin¹¹, as shown in Chart 4. In terms of non-price conditions that banks employed to implement the tightening of standards, the decrease of credit maturity provided the main contribution. After 2009, the overall conditions relaxed, while it is noted that banks continue to use the widening of credit risk margin and the increase of the demand for collateral, almost throughout the time of the conduction of the survey (2008-2014). As shown in the Chart, these time series contain negative values for the whole considered period, indicating high rate of uncertainty encountered by banks in this period. In the second quarter of 2014, credit standards applied to businesses were eased for the first time after a three-year period. The accommodative policy applied to businesses was mainly realised through the terms and conditions related to credit price (reduction of commission and the narrowing of the average margin).



¹¹ The margin is the difference between the loan interest rate and the reference interest rate of the bank. The expansion of the margin implies strengthening of standards, whereas the narrowing implies easing of standards.

Charts 5 shows a similar view of lending conditions applied to households. Banks implemented their conservative polity by increasing the margin on riskier loans, by increasing the collateral requirement, and unlike businesses, banks reduced continuously the average amount credit granted to households. The easing of lending standards to households started since the last quarter of 2013, was implemented through the narrowing of average margin, decrease of commissions and increase of maturity.

DATA AND METHODOLOGY:

Methodology:

The methodology used to test the validity of Bank Lending Survey information is based on the study carried out by Cunningham (2006). Through some tests of causality, we will see if the bank lending survey results contain information that explains the changes in the lending and economic activity.

The tests of causality will take place through the following equation:

$$Y_t = \alpha + \beta*(VAK)_{t-1} + \gamma(X)_{t-1} + \varepsilon$$

The dependent variable Y stands for a loan or economic quantitative indicator, expressed as annual change in per cent. BLS stands for a balance taken from the bank lending survey expressed in net percentage, and Xs are other control variables which affect the credit. As such we have used the credit interest rate, as a measurement of borrowing cost, and the ratio of nonperforming loans to total, as a risk indicator in the banking system. As in case of Cunningham (2006), to test the link between the surveys' variables and the dependent variable, the equations are assessed with or without including the other control variables.

Data:

The analysis will be based on the two longest survey series. The first series is the net balance of responses on the question how banks have changed credit standards (on businesses and households). The second series is the net balance of responses on the question of how banks perceive the businesses and households' demand for credit during the reference quarter. In that way, we analyse two aspects of information provided by the bank lending survey; supply side and demand side. The period under analysis is from 2005 Q2 to 2014 Q3. The selection of period is conditioned by the availability of data. To make possible the analysis, time series of credit standards and demand for loan by businesses and households, were extended for the period 2008-2008, by interpolating the semi-annual frequency data in quarterly frequency¹².

¹² Through the linear interpolation method, which assumes a linear connection between two known points, practically being the simple average of two six-month values around the point where it is interpolated.

In total, three variables are used, respectively:

CB: This indicator represents the annual growth of new credit to businesses, as published by Bank of Albania;

CH: This indicator represents the annual growth of new credit to households, as published by Bank of Albania;

VA: This indicator represents the annual growth in gross value added, in real terms, as published by INSTAT;

4 explanatory variables of BLS, respectively are:

S_B : standards balances applied to businesses; Credit standards are the net percentage balance of banks' responses regarding the question " how have your bank standards/criteria changed related to the loan to businesses?". Credit standards are eased if they take positive values and are tightened in case of negative values. The easing of credit standards (growth of net balance) is expected to affect positively the credit and economic activity growth.

D_B: Balance of demand to businesses; Loan demand to businesses and households is the net balance in percent of the question responses "in addition to seasonal fluctuations, how has the loan demand to businesses/households changed in the last quarter?". In bank lending survey, banks are asked about the demand by dividing them into small and medium-size businesses and large enterprises. For the purpose of this study, the average of two balances is used. Demand balance shows an increase if entering into positive territory and vice-versa, decrease if recording negative values. The increase in loan demand signals how banks' experts perceive the demand to businesses and households, form the position and frequent contacts they have with these economy agents.

S_H¹³ : standards balances applied to households;

D_H: Demand balance to households

NPL: Non-performing loans ratio to total loans in the banking system. It represents an indicator of uncertainty in the market that negatively affects the granted loan. Banks' experts list the situation of non-performing loans, as one of the key factors that affects the change in standards, according to the bank lending survey results. The annual change in percentage points of the ratio is used in the equation.

Interest rate: The respective interest rate on the loan to businesses and households. This indicator is mostly used to explain the change in the loan from the demand side. The increase of interest rate drives credit to become

¹³ The balances of credit standards and demand to households are calculated based on the responses to the identical question related to the standards and demand to businesses described above.

more expensive, thus theoretically causing a fall in the amount of the granted credit. It is transformed into the annual change in percentage points.

Notwithstanding the questionnaire asks banks to answer the questions on the change in the standards and demand by comparing to the previous quarter, the answers reflect changes which may have occurred during some quarters. Granger causality tests demonstrate that they relate to annual changes¹⁴. Such a connection is noted in the qualitative surveys organised by other advance central banks¹⁵. For that reason, the information provided in Bank Lending survey will be compared to the annual changes in the new granted loan and in the economic activity.

The following table shows the correlation coefficient between the qualitative measurements of loan (from Bank Lending Surevy) and its quantitative measurements. The table also shows the coefficients between the balances from Bank Lending Survey and economic activity growth, approximated by the annual growth in the gross value added. Correlation coefficients results higher for businesses and households' demand series as measured under the Bank Lending Survey. These coefficients have the highest value when the qualitative and quantitative series are simultaneous. Overall, the correlation coefficients in the standards to businesses with the quantitative loan are lower simultaneously, in all anticipating time periods. Related to standards to households, the highest correlation is found with four anticipating quarters.

Table 1 Correlation analysis results

Quantitative indicators, in t quarter	Lending to businesses		Lending to households		Increase in AV			
	S_B	D_B	S_H	D_H	S_B	D_B	S_H	D_H
Bank Lending Surevy Indicator								
BLS 4 quarters anticipation	0.00	-0.27	0.48	-0.01	0.18	0.19	0.00	0.54
BLS 3 quarters anticipation	0.17	0.03	0.24	0.43	0.10	0.47	-0.03	0.61
BLS 2 quarters anticipation	0.16	-0.05	0.00	0.65	-0.11	0.53	-0.07	0.54
BLS 1 quarter anticipation	0.24	0.26	-0.16	0.78	-0.25	0.53	-0.12	0.41
Simultaneous	0.15	0.53	-0.06	0.84	-0.30	0.61	-0.27	0.42

Source: Authors' calculations.

The results of regressions are shown in the three following tables. In the first table, the dependent variable is the new loan to businesses, in the second the new loan to households and in the third one, the gross added value to economy. In the first two tables, for each dependent variable of surveys, three tests are provided: in the first equation, the survey indicator is an explanatory variable, in addition to the dependent variable with a time lag; in the second, the change in the non-performing loan ratio is added to the first equation; and in the third equation the interest rate on businesses or households is added.

The question in this case is: "Does the bank lending survey contain additional information to explain the changes in credit amount or in the broader economic activity?". Does this information remain valid even after we have controlled the other channels that affect the loan?

¹⁴ "Granger causality" statistical tests show that survey variables cause the annual credit changes.

¹⁵ For the Bank of Canada: Faruqui U. et al, (2009), for the Federal reserve: Lown S. et al (2000).

In the three equations of Table 2, credit standards applied to businesses, as provided in the survey, are not statistically important to explain credit growth. The equations 4-6 testing the demand series, show that the information provided in the Bank Lending Survey is has explanation power for the quantitative change in credit. "Businesses demand" indicator is statistically important even when in the equation are included two additional control variables, the NPLs growth and the change in interest rate.

Table 2 Results of causality tests between BLS variables and the loan to businesses

Dependent variable, loan to businesses						
	(1)	(2)	(3)	(4)	(5)	(6)
c	0.129* 0,071	0.389*** 0,116	0.157** 0,081	0.144*** 0,057	0.295*** 0,104	0.142** 0,059
Standards to businesses (t-1)	0,366 0,323	0,444 0,293	0,508 0,380			
Businesses' demand				0.803*** 0,278	0.635*** 0,285	0.808*** 0,284
Interest rate			0,063 0,087			-0,014 0,067
NPL (t-1)		-0.079*** 0,029			-0.052* 0,030	
Credit_businesses (t-1)	0,261 0,181	0,006 0,189	0,257 0,183	-0,067 0,203	-0,154 0,202	-0,070 0,207
R2	0.06	0.24	0.04	0.25	0.30	0.22

Note to all tables: For each explanatory variable the coefficient and standard error are reported.

* shows the importance of indicator at 10%,

** shows importance at 5% and

*** shows importance at 1%.

In table 3, the surveys' indicators are tested if they provide information on the annual growth of new loans to households. In this case, it is clear that the standards on credit and households' demand for loan are important to explain the new loans growth to households, until the moment when the loan interest rate to household is added. Equations 1, 2, 3, 4 and 5 drive to two conclusions: first, as in the case of businesses, the balance of households demand for loan has the highest explanatory power; second, credit standards may anticipate the changes in the new loans to households at four quarters lead (this leading structure does not change even when we control for the non-performing loans ratio and for the loan to households at a quarter of delay).

Table 3 Results of causality tests between BLS variables and the loan to households

Dependent variable, loan to households						
	(1)	(2)	(3)	(4)	(5)	(6)
c	0,009 0,034	0,036 0,068	-0,054 0,035	-0,020 0,029	-0,035 0,065	-0,064** 0,031
Standards to households (t-4)	0.262* 0,144	0.264* 0,147	0,134 0,131			
Households' demand				0.484** 0,188	0.497** 0,198	0,243 0,191
Interest (t-1)			-0.085*** 0,026			-0.076*** 0,028
NPL (t-1)		-0,009 0,020			0,005 0,019	
Credit households (t-1)	0.747*** 0,094	0.714*** 0,118	0,526 0,107	0.496*** 0,143	0.504*** 0,150	0.425*** 0,132
R2	0.72	0.71	0.79	0.75	0.74	0.79

Source: Authors' calculations.

Table 4 shows the results when the dependent variable is the increase of the added value to economy. In this case, it is aimed at explaining if the information provided by BLS is valuable to explain the growth of the economic activity, and in more concrete details, if banks' behaviour in lending or both, businesses and households' demand does affect the value added growth. The main conclusion derived from econometric tests is that the demand is a statistically important indicator to explain the changes in economic growth in the next quarter, while the change in banks' standards no. These results are predictable for two reasons: first, the standards' impact to the growth of new loans was weak; second banks are in close connection to businesses and households. The perception of banks' experts on the demand of their customers is an indicator that may be used to explain the economic growth with an anticipating quarter.

Table 4 Results of causality tests between BLS variables and the economic growth

Dependent variable (Y)	GDP growth			
	(1)	(2)	(3)	(4)
c	2.299** 0,856	3.20*** 0,77	2.465*** 0,861	2.358*** 0,811
S-B (t-1)	-0,025 0,031			
C_B (t-1)		0.082*** 0,021		
S_I (t-1)			-0,003 0,020	
C_I (t-1)				0.049** 0,019
GDP (t-1)	0.344** 0,161	0,198 0,154	0.352** 0,168	0,248 0,176
R2	0.10	0.42	0.07	0.30
LM test	2.36 0.66	1.92 0.74	2.61 0.62	2.93 0.56

Source: Authors' calculations.

In conclusion, the information provided in BoA's Bank Lending Survey helps to some extent to forecast the credit and economic growth, where demand factors are the dominant ones. This result is in line with the studies conducted in other advanced countries on the availability of the information provided in Bank Lending Survey. In the research work by De Bondt et al (2010) loan demand in the major part of equations is found as rather important and with a considerable impact in explaining the credit growth in euro area countries¹⁶. Cunningham (2006) concludes that in the case of credit to households, only changes in the demand are important to explain the consumer loan and the loan for real estate purchase, while the changes in the supply side do not affect the credit to consumers¹⁷. Nevertheless, the interpretations of this paper's results should consider some points: first, time series are short and a considerable part of the provided information is not included in this material (mainly the information on the terms and conditions that banks employ to implement the lending policies), second, the period of time analysed in this material is characterised by significant developments, as global crisis after 2007 and later the euro area financial crisis after 2009. The importance and availability on the forecasting of information provided in this survey will be better understood with the prolongation of time series.

CONCLUSIONS

Through this paper, we deliver evidence on the importance of the information provided in the Bank Lending Survey and we have tried to analyse how relevant this information is in explaining the lending and economic activity. Bank Lending Survey data improve the information that is available from the official statistics on the behaviour of banks lending. They provide a more complete view of factors that explain the banks' position, credit demand and standards banks employ to implement their lending policy. Bank Lending Survey results provide ground to compare credit standards to the other advanced countries.

Through some causality tests, we tested the question if the information provided in Bank Lending Survey is relevant to forecast developments in credit to the private sector and economic activity. Overall, results show that the response to the question is positive. Fluctuations in credit amount are mainly affected by the development in the demand. Lending standards are a good anticipating indicator in case of households, but not in case of businesses. The final conclusion shows that businesses were not sensitive

¹⁶ De Bondt G. et al (2010): "The Euro Area Bank Lending Survey matters. Empirical evidence for credit and output growth", ECB Working Paper Series NO 1160.

¹⁷ Cunningham J.(2006), "The predictive power of the Senior Loan Officer Survey: Do lending officers know anything special?", Federal Reserve Bank of Atlanta, Working Paper 2006-24.

to standards applied to them to receive a loan¹⁸. These result may be subject of change upon the passing of time and the change in businesses' behaviour. Also, tests results show that, in addition to lending, Bank Lending Survey provides information and anticipates economic growth. We expect the prolongation of time series and the period on which it is conducted the comparative analysis, to confirm the relevance of Bank Lending Survey information. Also, the prolongation of time series on the price and non-price terms and conditions upon which it is granted the loan, will help to complete this study in the future.

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¹⁸ This is in line with the information provided by the direct meetings, where banks continuously admit that in the case of businesses, loan demand is not affected by the conditions and terms upon which the loan is granted. However, banks deem that businesses have started to become more sensitive against the terms and conditions upon which the loan is granted.

ANNEX

Table 5 List of indicators used in the material

Indicator	Description	Source
Cred_B	Credit to businesses, annual change in %	Bank of Albania
Cred_I	Credit to households, annual change in %	Bank of Albania
S_B	Credit standards applied to businesses, balance in net %	Bank Lending Survey, Bank of Albania
S_I	Credit standards applied to households, balance in net %	Bank Lending Survey, Bank of Albania
D_B	Demand for loans to businesses, net in net %	Bank Lending Survey, Bank of Albania
D_I	Demand for loans to households, net in net %	Bank Lending Survey, Bank of Albania
VA	Gross value added, in real terms, annual change in %	INSTAT
NPL	Non-performing loans interest rate to total loans in the system, in annual change in percentage points	Bank of Albania
Interest rate	Interest rate applied on credit to businesses and households, in annual change in percentage points	Bank of Albania

CONSTRUCTING A HOUSE PRICE INDEX FOR ALBANIA

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ABSTRACT:

In this paper the author has described a methodology for constructing a house price index based on the data of collateral evaluations. The study focused on single house apartments. The mix adjustment or stratification approach was used to calculate the HPI. For the construction of HPI, Albania will be divided in 4 zones. After calculating the prices for different zones, a weighted average was computed to aggregate the prices in one. Through this paper we gave to policymakers and users of the information from house prices a methodology for calculating the House Price in Albania.

Keywords: House Price Index, mix adjustment method, regression analysis.

Jel Classification: C21, C43, E31

Introduction

The measurement of house prices is important for consumers, policy-makers, real estate and financial markets participants, and researchers into housing, macroeconomic and regional issues (Schulz and Werwatz, 2004).

From the individuals' point of view, residential property is both an important source of wealth and of expenditure so consumer spending is mostly affected by the changes in house prices. From the policy makers' perspective; house prices are important because they are generally considered to be procyclical with the economic activity. Prices influence the profitability of house building. In this view higher house prices simulate increased construction activity which leads to higher employment and income in the economy (Hwang and Quigley, 2006). Monitoring the development of house prices is considered important, especially in times of economic turbulence. As higher prices are supposed to simulate economy falling prices go into the reverse (Catté et al 2004). That is the reason why policy makers want to have at their disposal accurate and timely information on movements of real estate prices. In fact the six major banking crises in advanced countries since the mid-1970s were all associated with the bursting of a housing bubble (Reinhart and Rogoff, 2009).

According to Plosser (2007) asset prices contain information about the current and future state of the economy and can play an important role for Central bank's decision as they seek to achieve their objectives of price stability and sustainable output growth. On the other hand Central banks use

the information on house prices to monitor households borrowing capacity, debt burden and their effects on aggregate consumption (Finocchiaro and von Heideken, 2007). In addition rising prices will generate wealth effect that can lead to increased consumption and household borrowing. In this view, house prices represent a good leading indicator of financial stability.

Of major concern in literature are the data used to calculate house price indexes as well as the procedure for the calculation of house prices. When considering the suitability of different data sources we have to control for coverage, quality and timeliness. When considering for quality of house prices we must assure that house prices are able to distinguish between movements in prices and changes in the composition of dwellings. In Albania there exists no house price index because no official data exists and the Bank of Albania publishes only one house price Index for Tirana.

The aim of this paper is to construct a house price index that ensures most of the qualities of the hedonic index, but would be substantially easier to calculate and administer. The value added of the paper is that we will present a new methodology of prices calculation that will enable us to construct the first house price Index for Albania. By using data on collateral evaluations, we will calculate sub-indexes for different regions of Albania and then aggregate them into a single one. A separate price index will be constructed for Tirana which will be compared to the hedonic price index, published by the Bank of Albania which is constructed based on data obtained from a specialized announcements journal. The relative quality of the two price indexes produced with two different techniques and data sources will be discussed in paper. The results show that the proposed method of calculation produce an index which is very much alike the hedonic house price index published by the bank of Albania from 2012 and on.

The reminder of this paper is structured as follows: Section 3.2 introduce the literature on house prices calculation methods and data sources, section 3.3 present the methodology and database, section 3.4 describe the indexes and compare the newly constructed index with the hedonic one, by means of a regression the factors that influence house prices will be analyzed. Section 3.5 resumes main results and their implications.

1. LITERATURE REVIEW AND DISCUSSION

Housing prices are measured differently in each country and in some cases there are also different methods of measurements within one country. The handbook on RPPIs compiled by Eurostat and OECD, (2013 edition) shows that many countries including some developed ones do not have reliable residential price indexes. In order to construct the index, an agency delegated to construct a price index chooses a sample of sellers (retail outlets in the case of consumer price indexes, or CPIs, producers for producer price indexes, or PPIs) and products and it collects a price in the initial period for each of the products selected. Then, it collects the price for exactly the same product

after some months (quarters or years) from the same seller that was selected in the initial period. The price index is computed by matching the price for the second period with the initial price, observation by observation, or "model by model," as it is often somewhat inaccurately called.

The OECD handbook advises that the problem of quality change potentially arises in price indexes whenever transactions are not homogeneous. It affects all price indexes, not just price indexes for high tech products, or price indexes for goods and services that are thought, by some measure, to experience rapid quality change. Even if the commodity is homogeneous (which is infrequent empirically), transactions are not homogeneous.

Diewert (2009) stated that in the case of House price indexes it is impossible to have the exact matching of properties due to depreciation and renovation problems.

Case and Wachter (2003) stated that the methodological problem related to housing price index is to distinguish the pure price evolution from changes in the quality of houses. Two houses are never exactly the same, because they have many characteristics, the unique combination of which translates in a particular housing service. These "qualities" include construction type, number of rooms, plumbing, heating and other facilities, but also a specific location (hence access to local public goods) and neighbours, not to mention family ties to a place. The alternative solution of considering repeated sales of the same house does not allow constructing a better index because houses are durable goods they rarely change hands.

Several methods have been proposed for producing a house price index. These include simple (mean and median) measures repeat-sales methods and hedonic pricing models.

Despite the methods, the Eurostat and OECD (2013) define types of data sources in computing house prices.

Specialised newspapers and real estate agents: Seller's asking price

Data on seller asking price can be collected through surveys of real estate agents or specialised newspapers and magazines. The advantage of the newspapers information is the timeliness because they are not based on subsequent transactions (like the ones of selling contract or based on information from mortgage). The information that they provide may not be accurate because agreed selling price may change or the property may be withdrawn from the market. So the indexes may give an optimistic view especially in a downturn market. The advantage that agent's survey is that they provide information on statistically significant sample while the advertisement journals are random. In addition they have additional information on the agencies which will help the decision making concerning prices. Due to the high uncertainty related to this data, information from those data should be considered carefully.

The Mortgage companies: initial offer, valuation and final transaction prices

Another source of timely information normally used for the real estate market prices analyses is mortgage lenders databases. These databases may include the initial offer price made by the potential purchaser, the valuation price and sometimes the final transaction price. One of the drawbacks of this database is that data from mortgages exclude non-financial home purchases but this issue is important only if prices do not change for houses sold with mortgages than for houses sold in cash. The valuation that the mortgage company provides is been made after the buyer and seller have agreed on the final price and the loan application has already been made. The HPI measured by (the prices of mortgage valuations depend also on the objectivity of the evaluation process. Thus they can be influenced by the credit policy of the bank and the valuation methodology can differ from the HPI constructed by the initial offer price and the final transaction price (In the case of Albania houses sold with mortgages do have a higher price than houses sold with cash due to the high degree of informality. Generally houses sold with cash are unregistered houses. The registration status is a very important attribute in the Albanian Housing market).

Administrative data: The final transaction price

Ideally a house price index should be based on the actual transaction price at the time when the property is sold and the sale completed. It is timeliness and covers all kind of property sold for any reason. In practice there is a disincentive for owners to register properties due to tax reasons. To avoid the cost owners may not register the property at all or may be registered with some missing detail which leads to data inaccuracy. The data inaccuracy may also come due to lower declared transaction price not in line with the market prices.

Other expert opinion: Surveys of professional Body's.

In the opinions survey, experts provide opinions of revising upwards (or downwards) house prices. The surveyors do not give an indication of the size of the change but they provide a clear picture of the direction and can be used to supplement and help to add credibility to the property prices index.

To the date there are only two studies on house price indexes published in Albania. Both papers have constructed house prices based on sellers' asking prices. Kristo and Bollano (2012) described the methodology used to construct the house price index by the Bank of Albania. Based on a database from 1998 to 2006 concluded that the best method is the constant quality method and the significant characteristics are surface, furnishing, location and age. Ibrahimaj (2014) constructed a house price index for Tirana. In constructing the price indexes the previously studied methodology was enriched by the distinction between centre and periphery and the adding the registration status as an important attribute of house and rent prices and quality in Tirana.

The paper will construct a house price index for different regions of Albania and for the whole country based on bank collateral valuations and the study wants to make the first step towards producing a HPI based on the entire banking sector collateral evaluation for apartments and properties in general.

2. METHODOLOGY AND SAMPLE

The house price index will be constructed based on the data of collateral evaluations of one of the biggest banks in Albania. For the period under consideration the selected bank issues 10% of the mortgage credits of the system. The study will focus on single house apartments. The database contain 5100 observations on evaluated apartments in the time horizon 2010-2014 which is the totality of collateral evaluated for credit purposes by the bank as well as information on the date of evaluation, type of collateral, type of client, location of collateral. The collateral is estimated by professional appraisals based on international standards of evaluation and the assessment of Mortgage Lending Value has been made with the sales comparison approach (market data approach). This is the main method for determining the value of single-family homes and each property is compared to recently sold comparable properties. However, because no couple of properties are exactly the same, the sales prices of the comparable properties is adjusted up or down for each of the differences between the subject property and the comparable properties. When comparing different properties, this method takes in consideration the differences in the properties, such as the actual structures, its ages, and conditions be compared and accounted for, but also what property rights are being transferred or were transferred in the comparable properties. To the final evaluation personal judgement is applied which is based on supply and demand factors affected by the economic environment. In this view this method is coherent with the hedonic method which has been acknowledged as one of the best methodologies for constructing house prices. Another reason for choosing this methodology of price computation is the data accuracy and availability. There exists no real estate private database in Albania. The administrative data from the immovable property registration Office have a high degree of informality. The main reason for this is that in Albania the current legal framework define the amount of taxes on the basis of the misalignment between real estate prices and a reference price defined by the government and an incentive exists in order to define transaction prices not different with respect to the expected one (Thanasi and Hysi, 2013). So any index constructed on public data related to real estate transaction could be biased by criteria adopted for defining the expected price by the Government and the bias will be more significant the lower is the frequency of updating the reference price. One of the major drawbacks of data on collateral evaluations is that the focus is only on financial purchases and not cash ones. In the case of Albania houses sold with mortgages do have a higher price than houses sold with cash due to the high degree of informality. Generally houses sold with cash are unregistered houses. The registration status is a very important attribute in the Albanian Housing market (Ibrahimaj and Mattarocci, 2013).

The mix adjustment or stratification approach will be used to calculate the HPI. Post –stratification of a sample is a general technique for reducing the sample selection bias. Stratification is nothing else than separating the total sample into a number of sub-samples or strata. After constructing a measure of change in the central tendency of each stratum, such as mean or median the aggregate mix adjusted house price index, is calculated as a weighted average of indexes for each stratum.

In our case stratification is needed in order to produce price indexes for different market segments. The stratification criterion has been used to identify homogeneous markets. Like Prasad and Richards (2006), we have grouped together subgroups according to an average price level of apartments in different regions. This method of stratification is designed to control for the most important forms of compositional changes. We have identified areas (stratas) based on the reference prices per m² of the apartments of different geographical units published by the National Housing Regulatory Body in 2013. For the construction of HPI, Albania will be divided in 4 zones (Tirana will count as a separate zone, Z4). The zones have been divided as by the table below (Table 1). In appendix there is a description of the geographical division of the 4 zones.

Table 1 – Areas

Zone	ALL/m ²
Z1	0-30000
Z2	30000-50000
Z3	50000-75000
Z4	75000-on

Source: Author's own work.

The method that we have selected consists on constructing the median prices for each zone. The median is not sensitive to extreme values or outliers, and therefore it may be a better measure of central tendency than the arithmetic mean. After calculating the prices for different zones, a weighted average will be computed to aggregate the prices in one. In the aggregation process of the House Price Index we will follow the Bank of Greece guidelines for real estate prices. The weights will be measured based on the share of transaction for each given zone in the total transactions/ evaluations available. The methodology used by the Bank of Greece has been selected because it is based on banks evaluations database. The price indexes constructed by this methodology are standardized, fast (maximum one month lag of publication) and are based on a secure qualitative and quantitative data reporting system for real estate appraisals.

The price index of Tirana will be compared with the actual price index produced by the Bank of Albania. The average prices of the other zones will be compared with the Prices per m² published by the National Housing Regulatory Body.

The index that will be computed based on the above methodology is limited in controlling for the quality change of the property evaluated. In

order to control for changes in the composition of the apartments we have to compute a more precise index, we have to identify other types of strata's. For this reason, by the use of a simple regression we will analyze the different factors that affect prices including borrower type, size of collateral, location, and currency of evaluation. The variables have been selected based on the database availability. If these characteristics are significant there is room for adding other sub strata's to the above described stratification technique.

The below equation has been used to analyse the factors :

$$Y_t = \alpha + \beta_1*(Type) + \beta_2 (Size) + \beta_3*(Z1) + \beta_4*(Z2) + \beta_5*(Z3) + \beta_6 (Curr) + e$$

Yt: is the price per m2.

Type: The type of borrower is a dummy variable that assume value 0 when the apartment is sold to individuals and 1 it is sold to businesses. Since the database that we are using is for credit lending purposes we expect a different valuation of collateral for the type of borrower.

Size: The second factor under consideration is the size of the collateral. For this purpose the collaterals have been divided in big and small apartments. Following the data published by the national statistical institute (2013) the standard house in Albania is from 40 to 69 m2. We have defined big the apartments bigger than 70m². This factor has been inserted in the regression as a dummy variable. This variable is 0 for smaller apartments and 1 for bigger ones. Previous studies (Ibrahimaj, 2014) have shown that the average price per m2 is higher for smaller and central apartments so we expect size to affect the price per m2

Z1, Z2, and Z3: The third factor that we will consider is the Zone. Since we have 4 categories for explaining this variable, we have inserted 3 dummy variables in the equation (n-1).

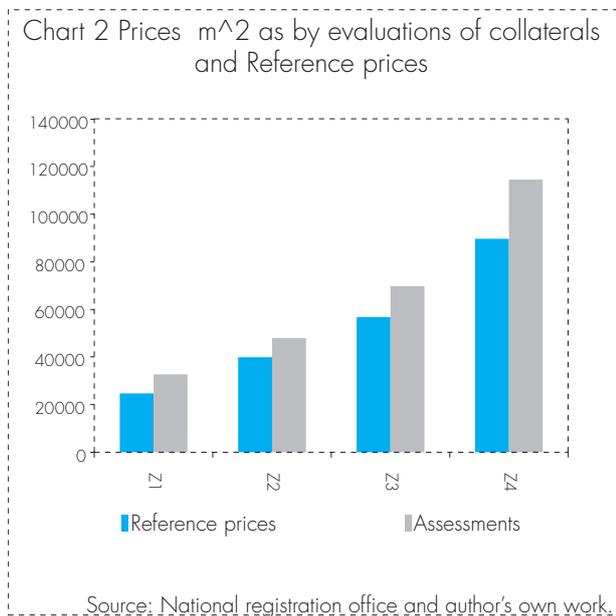
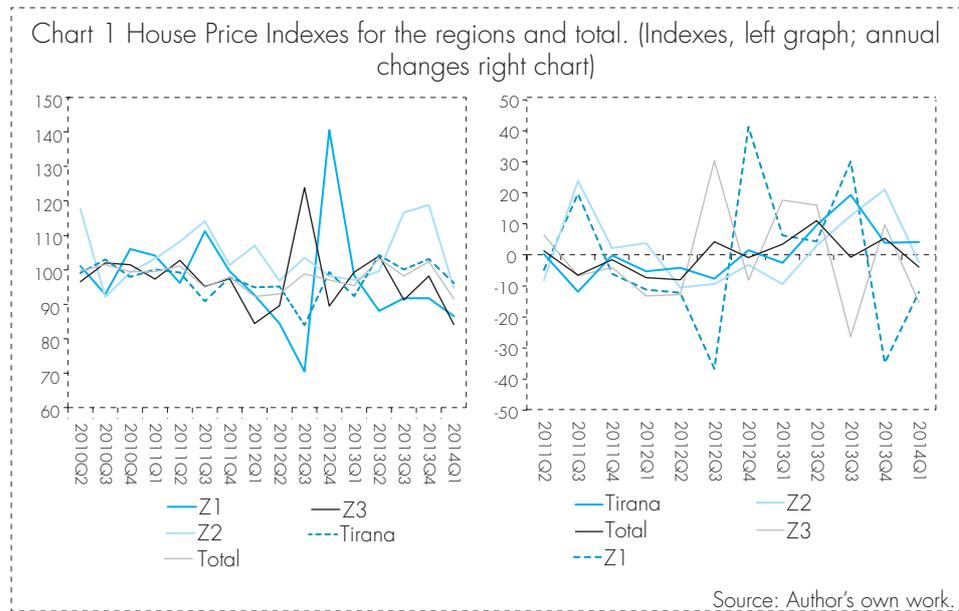
Curr: The currency is included in the regression as a dummy variable that is 0 when the evaluation has been made in local currency and 1 if it has been denominated in euro.

Previous studies (Ibrahimaj, 2013) in Albania have shown that the size of the apartments and the zone and currency are important attributes in determining the house prices.

To conclude a comparative analysis will be computed for the House Price Index calculated by the appraisal database and the more sophisticated hedonic price index computed based on a specialised journal database.

3. RESULTS

We constructed the house price indexes for 4 regions and Albania. Figures below show the behaviour of the indexes constructed (See Chart 1).



From the graphical representation and the correlation analysis, we can see that the indexes are not so correlated with each other while they are correlated to the total index which is expected since the regional indexes are part of it. The significance t-test was performed to the correlation coefficients. The results showed in table 2 reveal that the higher the correlation, the higher the significance of relationship between the indexes.

The regional house prices have been compared with the house prices published by the National Registration Office for 2013. Chart 2 shows the differences in prices and, as expected, the evaluated prices per m² are higher than the reference prices for all the regions.

After computing the house prices, by the use of a simple regression, we analysed the factors that may influence the house prices. Table 3 summarises the results of the regression analysis.

Table 7 Regression results

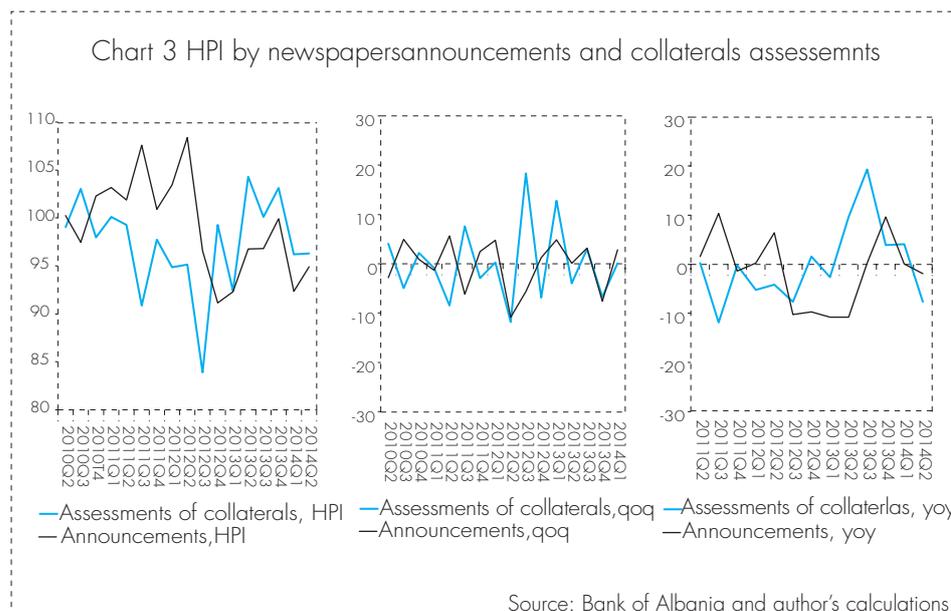
Dependent Variable: PRICE_V				
Method: Least Squares				
Date: 11/10/14 Time: 14:40				
Sample: 1 5055				
Included observations: 5027				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
TYPE	-14.79431	1.286026	-11.50389	0.0000
SIZE	4.468772	1.081277	4.132865	0.0000
Z1	9.221201	2.405968	3.832636	0.0001
Z2	31.30079	2.467745	12.68397	0.0000
Z3	75.06215	2.419508	31.02373	0.0000
CURR	9.777220	1.137750	8.593469	0.0000
C	44.73806	2.575945	17.36763	0.0000
R-squared	0.430949	Mean dependent var	79.75800	
Adjusted R-squared	0.430269	S.D. dependent var	47.60145	
S.E. of regression	35.92984	Akaike info criterion	10.00240	
Sum squared resid	6480585.	Schwarz criterion	10.01149	
Log likelihood	-25134.04	Hannan-Quinn criter.	10.00559	
F-statistic	633.6171	Durbin-Watson stat	1.793912	
Prob(F-statistic)	0.000000			

Source: Author's own work.

The analysis showed that all the considered variables (type, size, currency and zone) are important in determining house prices, but only 0.43 of the variance of the price is explained by the considered variables. More in detail the results of the regression show that the prices of the evaluations of apartments are more expensive if the apartments are sold to business entities compared to households; the price per m² is higher for bigger apartments; the prices are higher for apartments evaluated in euro and the zone is an important characteristics in determining house prices in Albania.

The result suggests that there is room to add substrata for the type of borrower, size and currency in the house price calculation in the future.

The House Price Index of zone 4, which represents Tirana, has been compared to the house price for Tirana constructed on a database of a specialised announcement journal by the use of hedonic method. As we can see from the graphical representation (Figure 3) the two indexes have a similar path from the last quarter 2012. For this period both indexes show the same turning points. For the period from 2010 to 2012 the announcements based hedonic price index shows higher values than the evaluation of collaterals. In the latter 2 years the collateral appraisals show similar values. The result is consistent with the literature, which suggests that specialised journals do show sellers asking prices which in most of the cases reflect an overoptimistic view of prices. The period under analysis has been characterised by slowdown of economic activity in Albania. In particular the residential construction sector has shown negative growth rates mainly due to the lack of demand. The results of our analysis suggest that after 2012 the sellers have reflected the slowdown of economic activity and the low demand by reducing the asking prices of their apartments.



The following tables (Table 4) resumes some descriptive statistics of the two methodologies.

Table 4 Descriptive statistics

	mean	st.dev	Min	max	Average. growth
Evaluation of collateral	98,0	5,0	83,9	104,3	-0,04
Announcements, hedonic	99,9	5,1	91,1	108,4	-1,24

Source: Author's own work.

In order to compare the two methods of indexes calculation we have constructed the following table (Table 5). As measures of robustness of indexes as in the study by Bourasa et al (2004) we have used the degree of constant quality, the sample selection bias, the quality of data and the ease administration of the database. In the table + + indicates that the criterion is satisfied; + indicates that the criterion is partly satisfied; - indicates that the criterion is not satisfied; and - - indicates that the criterion is not satisfied and the problem is more severe than is the case for criteria rated -.

Table 9 Comparison of two indexes

	constant quality	sample selection	quality of data	easy to administer
Evaluation of collateral	+	-	+	++
Announcements, hedonic	++	-	+	-

Source: Author's own work.

The hedonic index calculated by the Bank of Albania is a constant quality index. In calculating this index we hold qualities constant by defining a standard house to have the average characteristics of the houses in the first period sample. The collateral appraisal method is estimated based on collateral estimated by professional appraisals with the sales comparison approach (market data approach). Through this approach, each property is compared to recently sold comparable properties added to the evaluators judgement based on the supply and demand as well as market conditions. In this view the qualities of the properties are maintained constant.

Both the indexes suffer from sample selection bias. The hedonic house price index is constructed based on a specialised journal of announcements database. This sample is limited and does not include all the announcements. The appraisal method is calculated based on one bank appraisals so it does not include the totality of the appraised apartments'.

We argue that the quality of data is better for the index based on evaluation of collateral since the information provided by the specialised announcements journals may not be accurate because agreed selling price may change or the property may be withdrawn from the market.

The index constructed by the appraisals of banks is easier to understand and administer based on the ease of computation compared to the more complicated hedonic method.

4. CONCLUSION

In this paper we constructed a House Price Index for Albania based on mortgage credit collateral evaluations of one of the major Banks in Albania for the period from Q2 2010 to Q1 2014. The mix adjustment method (stratification) has been used to calculate HPI. For the purpose of the study, Albania has been divided in 4 zones and 4 regional sub-indexes have been constructed. The total house price index has been constructed by aggregating the regional sub-indexes by means of a weighted average. The study shows that the type of borrower, size and currency are important factors influencing the house price indexes. One of the sub-indexes refers to Tirana, the capital. The sub-index has been compared to the previously published one published by the Bank of Albania. From the comparison we observe that from 2012 on; the two indexes reveal a similar pattern. The index constructed with the appraisal data, has most of the qualities of the hedonic index, but it is substantially easier to calculate and administer. Through this paper we gave to policymakers and users of the information from house prices a methodology for calculating the House Price in Albania. The previous research has been focused on constructing house price indexes for Tirana and no published house price index exists for Albania to date. In the future, we will try to get data of the collateral evaluations of more sources and add the relevant factors as additional strata in order to eliminate the sample selection bias and to assure that the difference in price is not a consequence of change in the composition of prices. By eliminating these problems, the index calculated by described methodology will be of higher quality compared any other proposed methodologies for Albania.

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APPENDIX

GEOGRAPHIC DIVISION OF THE FOUR ZONES.

Z1	Z2	Z3	Z3	Z4
Puke	Vore	Rrogozhine	Përrenjas	Tirana
Vau Dejës	Kamez	Krujë	Belsh	
Fushë - Arrëz	Kavajë	Shijak	Gjirokastrë	
Selenice	Durrës	Sukth	Përmet	
Delvine	Fushë-Krujë	Koplik	Tepelene	
Konispol	Shkodër	Sarandë	Laç	
Erseke	Vlorë	Bilisht	Mamurras	
Maliq	Oricum	Lushnjë	Rrëshen	
Leskovik	Himarë	Ballsh	Kukës	
Patos	Korçë	Roskovec	Peshkopi	
Poliçan	Pogradec	Berat	Burrë	
Çorovodë	Fier	Kuçovë	Bulqizë	
Memaliaj	Divjake	Ura - Vajgurore	Klos	
Këlcyre	Lezhë	Elbasan	Komuna Milot	
Libohovë	Komuna	Librazhd		
Rubik	Komuna Kashar	Cërrik		
Bajram Curri	Komuna Dajt	Gramsh		
Krume	Komuna Farke	Peqin		
Komuna Krrabë				

BANK OF ALBANIA NEWS
JULY-DECEMBER 2014

Meeting with the executives of banking system in Albania on boosting the lending to economy

On 2 September 2014, Mr. Ardian Fullani, Governor of the Bank of Albania, held a meeting with executives of banking system in Albania. The latest developments in the banking system, with particular attention to the situation of non-performing loans and the progress of the project on businesses' loan restructuring were at the focus of the discussions.

Bank of Albania in cooperation with the World Bank's Vienna-based Financial Sector Advisory Centre (FinSAC) has designed a platform to address the non-performing loans problem. This project is part of the measures taken earlier by the Bank of Albania, among the most important ones being the legal amendments related to the facilitating process of collateral execution; the modalities for the bailiffs payment, and the loan write-off from banks' balance sheet.

The commitment of banks in this project is highlighted as indispensable that addressing the non-performing loans. The commitment of banks in this project is highlighted as indispensable in addressing the non-performing loans. More frequent contacts and sustainable relations between banks and borrowers will drive to a well-studied restructuring process of non-performing loans and will boost lending.

In Bank of Albania's opinion, the suitable conditions are now in place for a more vigorous activity by banks. The payment of arrears to private companies for public works is a positive step in this regard.

Banks committed to take all the necessary measures to fulfil the objectives set forth in this project. The close cooperation with the FinSAC experts aims at a deeper and more professional restructuring and the improved management of non-performing loans. The FinSAC was established by the World Bank with the purpose to provide technical assistance on the regulation and supervision of the financial sector to central banks and financial regulators in Europe and Central Asia.

ECB and Bank of Albania successfully conclude the Technical Assistance Programme

On 29 September 2014, the European Central Bank (ECB) together with 11 central banks of the European System of Central Banks concluded successfully a technical assistance programme with the Bank of Albania. The purpose of the programme was to assist the Bank of Albania in the approximation process with the European Union central banking rules, procedures and standards. With funds from the European Commission, the programme started on 17 April 2014 and was implemented by the European Central Bank in partnership with Deutsche Bundesbank, Banque de France, Banca d'Italia, the Central Bank of Malta, De Nederlandsche Bank, Oesterreichische Nationalbank, Banco de Portugal, Banka Slovenije, and Národná Banka Slovenska. Experts were also provided by the Bulgarian National Bank and Česká Národní Banka in support of the programme.

During the six-month duration of the programme, experts from the ECB and the participating central banks assessed and analysed 13 functions of the Bank of Albania vis-à-vis the European Union and international standards and

policies. The First Deputy Governor of the Bank of Albania, Mrs Elisabeta Gjoni, underlined that the cooperation programme with the ECB provided an important contribution towards accelerating the harmonisation of Bank of Albania practices with the European ones, as well as towards building administrative capacities of the institution, which are also useful for the Albanian economy, in general. The Bank of Albania committed to implement the recommendations presented in the final report, incorporating them in its strategic and operational plans.

This cooperation programme contributed to strengthening the existing relations and expanding the collaboration network between the Bank of Albania, the regional and Euro system central banks. The diligence showed by the Bank of Albania, the prominent confidence, the professionalism and devotion of the engaged domestic and foreign experts throughout the programme duration were among the main the factors that led to the programme's success.

The conclusion of this cooperation programme is a core step towards strengthening the independence, transparency, accountability and professionalism of the Bank of Albania, as well as towards promoting monetary and financial stability in Albania.

On 3-5 December 2014, the Bank and the Bilateral Assistance and Capacity Building for Central Banks organised the 8th South-Eastern European Economic Research Workshop on "Financial globalization and its consequences on the transmission of macroeconomic fluctuations"

On the 8th South-Eastern European Economic Research Workshop, organised by the Bank of Albania and the Bilateral Assistance and Capacity Building for Central Banks programme

Renowned representatives of the academia and central bank researchers participated in the workshop. The workshop aims at furthering economic research in South-Eastern Europe (SEE) and extending the knowledge of special features of the economies in the region. Through scientific knowledge sharing and joint projects' development, the workshop enhances regional cooperation.

During the workshop, discussions focused on:

- Financial globalization and its consequences on the transmission of macroeconomic fluctuations;
- Exposure to international funding in the Central and Eastern European (CEE) banking systems and liquidity shocks during the crisis;
- Central bank policies counteracting the effects of the financial crisis;
- Coordination among central banks and other supervisory authorities in the region;
- Role of monetary policy in the financial stability of the region during the recent crisis.

The First Deputy Governor of the Bank of Albania, Ms Elisabeta Gjoni addressed the proceedings of the workshop. In her address, Ms Gjoni said that research is a essential activity of central banking in modern days. The analysis on the role of banks in transmitting macroeconomic and financial

fluctuations should be based on scientific research.

In addition, Ms Gjoni thanked the Bilateral Assistance and Capacity Building for Central Banks (BCC) programme, with which the Bank of Albania has been implementing a very successful cooperation programme since 2013. This seminar is organised in this framework.

Participants in the workshop discussed on the positive impact of financial globalisation through the increase of competition and efficiency in the domestic banking system. Moreover, the recent global financial crisis highlighted the fact that this globalisation contributes to transmitting shocks, contributing therefore negatively to reducing financial intermediation, especially in SEE countries. The transmission of these shocks, however, is low when foreign bank subsidiaries are well capitalised, have adequate provisioning and are have independent legal personality from parent banks.

At the conclusion of the workshop, participants affirmed that such workshops are very important not only in the academic but also on in the practical aspect both for central banks and academia in the field of economy.

The Bilateral Assistance and Capacity Building for Central Banks (BCC) is a program jointly funded by the Swiss State Secretariat for Economic Affairs (SECO) and the Graduate Institute of International and Development Studies (GIIIDS). Its purpose is to support partner central banks in emerging and developing countries in building the analytical and technical expertise required for the efficient conduct of monetary policy.

MONETARY POLICY DECISIONS

30 July 2014

The Supervisory Council of the Bank of Albania decided to keep the interest rate on repo and reverse repo agreements unchanged, at 2.50%.

27 August 2014

The Supervisory Council of the Bank of Albania decided to keep the interest rate on repo and reverse repo agreements unchanged, at 2.50%.

24 September 2014

The Supervisory Council of the Bank of Albania decided to keep the interest rate on repo and reverse repo agreements unchanged, at 2.50%.

27 October 2014

The Supervisory Council of the Bank of Albania decided to keep the interest rate on repo and reverse repo agreements unchanged, at 2.50%.

26 November 2014

The Supervisory Council of the Bank of Albania decided to lower the interest rate on repo and reverse repo agreements by 0.25 percentage points from 2.50% to 2.25%.

18 December 2014

The Supervisory Council of the Bank of Albania decided to keep the interest rate on repo and reverse repo agreements unchanged, at 2.25%.

LEGAL EVENTS 2014 H2

MONETARY POLICY

On 30 July 2014, the Supervisory Council of the Bank of Albania adopted with the Decision No. 41 the "Monetary policy statement of the Bank of Albania for the first half of 2014". The Albanian economy improved in the first half of the year. Economic growth stood in positive territory and apparently there are progressive signs of recovery; the country's economic and financial stability remains solid, while the trend of domestic and external financial conditions are on the easing side. In the first half of the year, the economy performed, overall, in line with our projections; however, inflation's performance was worse than expected, as a result of disinflationary pressures from the external environment and other supply-side shocks.

On 27 October 2014, the Supervisory Council of the Bank of Albania adopted with the Decision No. 58 the "Monetary policy report on the third quarter of 2014". Recent data on the real sector show deceleration of economic activity in Albania. This deceleration, however, appears to be temporary. Overall inflation expectations and consumer price inflation remained low. Annual inflation averaged 1.7% during the period under review. In accordance with the fiscal consolidation strategy, the fiscal policy has generated and will continue to generate decelerating impulses on aggregate demand. The monetary policy remained strongly on the stimulating side, to endorse the domestic demand and enable the sustainable return of inflation and inflation expectations to target.

On 26 November 2014, the Supervisory Council of the Bank of Albania approved the Decision No. 64 "On cutting the interest rate on repurchase and reverse repurchase agreements". The Supervisory Council upon this Decision cut the interest rate on repurchase and reverse repurchase agreements by 0.25 percentage points, from 2.5% to 2.25%.

BANKING SUPERVISION

On 30.07.2014, the Supervisory Council of the Bank of Albania approved the Decision No. 43 "Amendment to the Regulation "On Capital Adequacy Ratio"". Upon this Decision, Annex 7 is added to this Regulation, including the reporting forms on capital requirements (COREP) and methodology instructions for filling them out.

On 01.10.2014, the Supervisory Council of the Bank of Albania approved the Decision No. 55 "Some amendments to the Regulation "On licensing and carrying out the business of banks and branches of foreign banks in the Republic of Albania". The amendments consist in the articles which regulate the opening of the branch, subsidiary, agency or representative office; the change in the qualifying holding; requirements laying down the documents for other preliminary approvals; requirements to meet the obligations on notifications, etc.

On 18.12.2014, the Supervisory Council of the Bank of Albania approved the Decision No. 68 "On granting to Procredit Bank Albania sh.a. the preliminary approval to conduct additional activity". Upon this Decision, Procredit Bank was granted the preliminary approval to conduct the additional trade activity on its account, even related to a foreign exchange in an over-the-counter (otc) market, or differently of transferable securities.

On 18.12.2014, the Supervisory Council of the Bank of Albania adopted with the Decision No. 69 the Regulation "On the Bank's regulatory capital" This Regulation lays down the structure, components and method of calculating regulatory capital of the Bank and set forth its minimum level. This Regulation will apply on banks being granted the licence to conduct banking and financial activities in the Republic of Albania, in compliance with the licence granted by the Bank of Albania. This Regulation lays down: the regulatory capital and its two sub-categories, Tier 1 capital and Tier 2 capital; prudential filters; subtractions from the core capital of Tier 1 capital; and the supervisory and monitoring requirements.

On 18.12.2014, the Supervisory Council of the Bank of Albania approved the Decision No. 70 "Amendment to the Regulation "On Capital Adequacy Ratio"". The amendments consisted in Article 6, which regulates risk-weighted exposures, and Annexes 7 and 8, with the respective forms on capital adequacy reporting.

MONETARY STABILITY

On 24 December 2012, the Council of Ministers approved by Decision No. 54 "Financial Stability Report 2014 H1". The Albanian banking sector and financial system showed stable performance in the first half of 2014. The volume of activity grew and the financial performance improved. The banking sector's liquidity and capitalisation ratios were at an adequate level during the period and afterwards. The loan portfolio quality remained a concern, although the non-performing loan ratio appeared more stable and the non-performing loans, in terms of absolute value, lower year-over-year. The macroeconomic setting is stable, supporting the performance of the financial system.

PAYMENT SYSTEMS

On 18.12.2014, the Supervisory Council of the Bank of Albania approved the Decision No. 71 "On the approval of some amendments to the Regulation "On the function of Interbank Payments System– AIPS". Amendments laid down in this Decision consist in articles that regulate: the scope of application of the Regulation; management and function of AIPS; reconciliation, control and reporting; procedures for participation in AIPS; suspension of participant's access in AIPS; modification of AIPS schedule; control on funds adequacy; order of payments; levels of priority; reclassification of queued payment orders; resolution of Gridlock situation; and net settlements.

On 18.12.2014, the Supervisory Council of the Bank of Albania approved the Decision No. 73 "On the approval of some amendments in the Regulation "On the function of the accounting and treasury management (ATM) system". The purpose of this decision is to reflect the structural changes of the Bank of Albania in the Regulation accordingly. The amendments consist in the articles that determine and regulate: the definition; tasks of the Payment Systems and Accounting and Finance Department, tasks of Information Technology Department. The Decision repeals the article that lays down the tasks of the Payment Systems Department.

MONETARY OPERATIONS

On 18.12.2014, the Supervisory Council of the Bank of Albania adopted with the Decision No. 74 the Regulation : "On intraday credit to banks" The purpose of this Regulation is to set out the conditions for the extension of intraday credit to meet the needs of banks for intraday liquidity, and guarantee smooth operation of the interbank payment system.

On 18.12.2014, the Supervisory Council of the Bank of Albania adopted the Decision "On the functioning of the central Albanian Financial Instrument Settlement and Registration (AFISaR) system" This regulation shall lay down the rules and procedures for the organisation and function of the Albanian Financial Instrument Settlement and Registration system (AFISaR). This Regulation shall apply to the participants and administrator of the AFISaR system. This Regulation lays down: the principles of the system; role of the administrator; participation in the system; securities operations in the system; recording of the operations in the account, reporting and reconciliation; payment instructions; procedures on insolvency; technical aspects to manage the system; contingency events and emergency procedures; etc.

On 18.12.2014, the Supervisory Council of the Bank of Albania approved the Decision No. 77 "Some amendments to the Regulation "On the guaranties in the crediting transactions of the Bank of Albania" . The amendments consist in articles which regulate the measures to control risk and the measures in case of failure to meet the requirements on the guarantee. Also, the Article 6/1 " Collateral replacement" is added to the Regulation.

On 18.12.2014, the Supervisory Council of the Bank of Albania approved the Decision No. 78 "Some amendments to the Regulation "On repurchase and reverse repurchase agreements". The amendments consist in the articles that lay down: legal ground, definition; entities and their obligations; requirements to participate in the auction; clearing periods of the accounts; and the operations for accounts clearing.

ECONOMIC POLICY

On 09.07.2014 the Council of Ministers approved the Decision No. 456 "On the increase of pensions". The Decisions lays down the increase at 2%, for many pension categories, including: special state pensions; pensions determined by the Decree of the President; special financial treatment for the families of flying pilots, special financial treatments of the workers that have worked in underground mines, etc. The Financial effects deriving from the implementation of this Decision, amounting ALL 998 000 000 million (nine hundred and ninety-eight million), are charged to the Social Insurances Institution and the Contingency Fund, as stipulated in the Government budget for 2014.

On 09.07.2014 the Council of Ministers approved the Decision No. 457 "On some amendments to Decision No. 1114 dated 30 July 2008 of the Council of Ministers "On some issues in compliance with the Laws No. 1103 dated 11.5.1993 "On social insurances in the Republic of Albania", as amended, No. 9136 dated 11.9.2003 "On the collection of mandatory contributions of social and health insurances in the Republic of Albania", as amended, and No. 10383 dated 24.2.2011 "On the collection of mandatory contributions of social and health insurances in the Republic of Albania", as amended, and No. This Decision sets out that the minimum monthly wages, for the purposes to calculate the health and social insurances contributions, from 01.08.2014 and in continuing, shall be no lower than ALL 19 406 (nineteen thousand and four hundred and six). Whereas the minimum monthly wage, for the purposes to calculate the health and social insurances contributions, shall be ALL 97 030 (ninety-seven thousand and thirty).

On 09.07.2014 the Council of Ministers approved the Decision No. 462 "Approval of Regulation "On the Registration of naval vessels in the Republic of Albania"". The purpose of this Regulation is to ensure the relation between Albania and the ships carrying its flag, in order to effectively exercise the jurisdiction and control of the state on these ships; to set out a regulatory framework of the general principles and procedures for the registration of all types of ships; and to eliminate the technical restrictions on the transfer of ships that hold the flag of an EU member country, providing a high security and protection level of naval environment, in compliance with the international convents.

On 17.07.2014, the Parliament of the Republic of Albania approved the Law No. 81/2014 "On the ratification of the loan agreement between

the Republic of Albania and the International Bank for Reconstruction and Development on the first loan of the developing policy for public finances". The International Bank for Reconstruction and Development will grant a loan to the Republic of Albania, pursuant to the terms and conditions laid down in this agreement, amounting EUR 72,600,000.

On 17.07.2014, the Parliament of the Republic of Albania ratified by Law No. 82/2014 "The loan agreement between the Republic of Albania and the International Bank for Reconstruction and Development on the first loan of the developing policy for the modernisation of financial sector". The International Bank for Reconstruction and Development will grant a loan to the Republic of Albania, pursuant to the terms and conditions laid down in this agreement, amounting EUR 87,000,000.

On 17.07.2014, the Parliament of the Republic of Albania approved the Law No. 84/2014 "Some amendments to Law No. 9920 dated 19 May 2008, "On tax procedures in the Republic of Albania", as amended". The amendments to the Law "On tax procedures in the Republic of Albania", consist in the articles that stipulate: the removal of entities which are subject of taxes; warning letters, order to pay the contributions and tax obligation.

On 17.07.2014, the Parliament of the Republic of Albania approved the Law No. 85/2014 "On some amendments to Law No. 9632, dated 30.10.2006, "On local taxes system", as amended". The amendments consist in the articles which lay down the taxation degree and declaration.

On 17.07.2014, the Parliament of the Republic of Albania approved the Law No. 86/2014 "Some amendments to Law No. 9975, dated 28.7.2008 "On National taxes", as amended". Amendments pursuant to this Law consist in the articles that lay down the purpose and definitions of the Law "On national taxes", and which regulate: the statements on the payment of national taxes; statement on the payment of national tariffs and the transitional provision.

On 17.07.2014, the Parliament of the Republic of Albania approved the Law No. 87/2014 "Some amendments to Law No. 9136 dated 11.9.2003 "On the collection of mandatory contributions of social and health insurances in the Republic of Albania", as amended. The amendments adopted upon this Law consist in the articles that lay down the definitions and regulate: the calculation of contributions for the employer; calculation of contributions for the self-employed person and the unpaid employee of the family; the obligation to declare; assessment, etc.

On 27.07.2014, the Parliament of the Republic of Albania approved the Law No. 92.2014 "On value added tax in the Republic of Albania". The purpose of this Law is to lay down the value added tax (VAT) as a general tax, applied to the consumption of goods and services, proportionality to their price, charged in any stage of production and distribution of price not taxed. This tax shall apply to all the supply of goods and services, conducted versus

the payment, within the Republic of Albania, by a person subject of taxation, and all imports of goods in the Republic of Albania.

On 31.07.2014, the Parliament of the Republic of Albania approved the Law No. 102/2014 "Customs Code in the Republic of Albania". This Code lays down the general rules and procedures applicable on goods that enter in or exit out the territory of the Republic of Albania, as well as the status, competences on the organisation of the personnel in the customs administration. It shall be applied uniformly throughout the customs territory in the Republic of Albania, without infringing the international agreements and convents as well as the applicable Albanian legislation.

On 31.07.2014, the Parliament of the Republic of Albania approved the Law No. 104/2014 "Amendments to Law No. 7703 dated 11.5.1993 "On social insurances in the Republic of Albania", as amended. The amendments laid down in the Law consist in articles that regulate: the general system of social insurances; the supplementary social insurance, social pension, personal funds and voluntary pension funds; pregnancy income; retirement pension; level and amount of pension; income in case of temporary inability; income for permanent invalids; the base being assessed to calculate the profits; profits indexing; and the reserve fund.

On 31.07.2014, the Parliament of the Republic of Albania approved the Law No. 107/2014 "On the planning and development of territory". The purpose of the Law is to ensure the stable development of the territory, through the rational use of land and natural resources; to assess the current and future potentiality for the development of territory at national and local level, based on the balancing of natural sources, by coordinating the work for the protection of natural resources. The law lays down the core principles, responsibilities and rules for the planning and development of the territory in the Republic of Albania.

On 06.08.2014 the Council of Ministers approved the Decision No. 527 "On approval of procedures, criteria and priorities to receive subsequent grant for houses at low cost". This Decision lays down the procedures, criteria and priorities to be implemented by the central and local government units for the granting and benefiting the immediate grant of low cost. Accordingly, local government units, within 30th January of every year, shall submit the applications for immediate grants for low cost houses, at the Ministry addressing the inhabitation issues, along with the financial cost for each family.

On 21.08.2014, Ministry of Economic Development, Trade and Entrepreneur, approved the Guideline No. 394 "On the economic development program of state-owned trade associations". In compliance with this Guideline, the programs on economic development shall be compiled by all public companies with total state-owned capital, for one-year period, short and long-term periods, in line with the objectives set forth by their management bodies and shall be based in the National Strategy of Economic and Social Development, on the respective sectoral strategies and the applicable legal

acts and by-laws.

On 10.09.2014 the Council of Ministers approved the Decision No. 592 "On the establishment of the Fund for supporting the enterprising women". Pursuant to this Decision, The fund to support the Enterprising Women will have the general value of ALL 26 500 000, for an implementation period of four years. It aims at subsidising the interest rate on loans for micro, small and medium-sized enterprises, which are managed by the women.

On 10.09.2014 the Council of Ministers approved the Decision No. 593 "On the establishment of the Fund for supporting the new "Set-up" enterprising. The overall amount of this fund shall be ALL 25 000 000, and the implementation period shall be four years. A new or "Start-up" enterprising shall be a recently established company in search of new markets. The purpose of the fund is to provide financial aid to new enterprises, micro and small enterprises, that conduct their activity on production and services, light industry, tourism, in research and development field, and in designing, modelling and handicraft.

On 17.09.2014, the Council of Ministers approved the normative act No. 1 "Some amendments to the Law No. 185/2013 "On 2014 budget". The amendments according to this normative act determine budget income for 2014 at ALL 367 949 million, spending amounting ALL 456 404 million and the deficit ALL 88 455 million. While, the overall number of employees in structure for this year is 86 100 employees.

On 01.10.2014 the Council of Ministers approved the Decision No. 634 "Approval of rules on the assessment and granting in concession/public partnership of public work and services for construction, functioning, maintenance and rehabilitation of national ways". These rules lay down the preparatory actions to grant a concessionary/public private partnership contract, assessment of acceptance, content, addressing of proposals and the procedures and criteria to assess and approve the concessionary/public private partnership projects that require financial support to public works, for construction, functioning, maintenance and rehabilitation of national ways.

On 01.10.2014 the Council of Ministers approved the Decision No. 635 "Approval of business and investments development strategy and the action plan for 2014-2020". Business and Development Strategy 2014-2020, is the basic document for the identification and implementation of national policies to encourage business and investments for the period 2014-2020. This document is in line with the European Commission main documents in the field of encouraging business and investments. As such its focus is one the main EU priorities for the period 2014-2020, the increase of competitiveness of the economy.

On 29.10.2014 the Council of Ministers approved the Decision No. 709 "Approval of the Inter-sectoral Strategy for the Rural and Agricultural development 2014-2020". The objective of this document is to lay down the strategic framework to deal with the challenges the agricultural and agro-

processing sector come across, and the development of rural areas, in a stable economic, environmental and social way, paying special attention to the preparation of sectors, policies instruments and the institutional adoption for EU membership, to achieve a stable improved competitiveness of Albania.

On 03.11.2014, the Minister of Finance adopted the guideline No. 19 "Implementation of special regime of the compensation scheme of agricultural producers for the purposes of value added tax". This compensation scheme shall apply to farmers that conduct their own activity in the framework of an agricultural enterprising, as an activity to produce agricultural, vegetable and animal products, in the framework of the activities of agricultural and livestock.

On 05.11.2014 the Council of Ministers approved the Decision No. 735 "Some amendments to the decision No. 54, date 5.2.2014, of the Council of Ministers "On the establishment of the criteria, procedure and way of granting for rent, enphiteos or other contracts of the public wealth. The amendments laid down in this Decision consist in these articles that regulate: tariffs and ground value on public wealth given in rent or enphiteose; contract of symbolic tariff 1euro/contract; and the monitoring of contracts.

On 05.10.2014 the Council of Ministers approved the Decision No. 737 "On the financing of public health services of the primary healthcare from the obligatory scheme of healthcare insurances". This decision stipulates that the services primary public healthcare services be financed by the obligatory scheme of health insurances. Health centre is a public, non-profit institution of the primary health care service holding a separate account that include the whole network of providers on its charge.

On 02.11.2014 the Council of Ministers approved the Decision No. 724 "Approval of Medium-Term Budgeted Program', revised, 2015-2017". Medium-term Budget Program 2015-2017 details the purposes, objectives and products of programs of each of ministry of line, for the years 2015, 2016 and 2017. Hence, this document realises for a medium-term framework the connections between the purpose sand objectives of policies, with the budget sources allocation, respectively at program level.

On 18.11 2014, the Parliament of the Republic of Albania approved the Law No. 153/2014 "On the granting of delayed interests and fees on the obligatory contributions of unpaid social insurances by the persons who are self-employed in agriculture. Pursuant to this Law, the persons who are self-employed in Agriculture will not pay the the delayed interests and fees on social insurance contributions, which are not pay till the entry into force of this Law. They may pay the social insurance contributions for the previous periods and for the year 2014 with no delayed interest. The unpaid delayed interests and fees shall be paid even if the contributions for social insurances are paid prior to teh entry into force of this Law.

On 19.11.2014 the Council of Ministers approved the Decision No. 784 "On the establishment of the Fund for supporting the Fasson industry". This

Decision lays down the establishment of budget fund to support the Fassion industry, as a particular item within the program structure of the relevant Ministry for employment, from the state budget. The fund shall start in 2015 and shall be used to support the Fassion industry. The Ministry of Finance shall determine the amount to be transferred to this fund, every year.

On 26.11.2014 the Council of Ministers approved the Decision No. 818 "The Approval of National Strategy on Employment and Capacity Building 2014-2020, and the action plan for the implementation of this strategy". In compliance with this document, the Government, for the period 2013-2017, shall implement a new model on the country growth over the 15 to 20 forthcoming years, based on structured and well-developed structures, to provide a maximum incentive to economic growth, and shall provide the conditions for the creation of a large number of job places in the most strategical economic sectors of the country.

On 27.11 2014, the Parliament of the Republic of Albania approved the Law No. 156/2014 "On some amendments to Law No. 8438, dated 28.12.1998, "On income tax", as amended". The amendments to this Law consist in the articles that regulate the tax to be paid. Hence, the transfer of ownership right on real estate, land, buildings, shall be taxed 15% of realised profits.

On 27.11 2014, the Parliament of the Republic of Albania approved the Law No. 157/2014 "Some amendments to Law No. 9975, dated 28.7.2008 "On National taxes", as amended". These amendments consist in the articles that set forth and regulate the types of national taxes. Also, upon the approval of this Law, the circulation tax on business and gas oil is set forth at 27 lek per litre of oil and 27 lek per litre of gas oil.

On 27.11 2014, the Parliament of the Republic of Albania approved the Law No. 158/2014 "Some amendments to Law No. 61/2012 "On excises in the Republic of Albania", as amended. The amendments to this Law consist in articles that regulate the way to determine the types of obligations for coffee and energy drinks.

On 27.11 2014, the Parliament of the Republic of Albania approved the Law No. 160/2014 "On 2015 budget". Accordingly, the budget for 2015 amounts ALL 414 469 million; spending ALL 472 697; deficit ALL 58 228 million. The overall number of employees for this year is 88 550 employees.

On 04.12 2014, the Parliament of the Republic of Albania approved the Law No. 164/2014 "Some amendments to Law No. 9920 dated 19.05 2008, "On tax procedures in the Republic of Albania", as amended". Amendments laid down in this Law mainly consist in the articles that regulate: personnel expenditures and investment spending; the obligation to use fiscal appliances and the establishment of the monitoring system for the circulation; providing information on the implementation of international agreements, VAT reimbursing and compensation tax obligations; completion of incorrect tax

declaration; tax evasion and other penalties.

On 11.12.2014, the Parliament of the Republic of Albania approved the Law No. 170/2014 "On the ratification of the loan agreement between the Republic of Albania and the International Bank for Reconstruction and Development on funding the electrical energy recovery project". Upon this Agreement the International Bank for Reconstruction and Development agrees to grant a loan to Albania, in accordance with the terms and conditions laid down in this Agreement, the amount of EUR 112,100,000. This amount may be converted occasionally through the currency exchange rate.

On 16.12.2014, the Minister of Finance adopted the guideline No. 25 "Some amendments in the Guideline No. 32 dated 31.12.2013, "On simplified taxation applied to small business' profit". This guideline set forth the change on tax degree. Hence, the taxpayers, subject of the simplified tax on small-business' profit, with an annual turnover from ALL 2 million to ALL 8 million, will be subject of tax degree of 7.5% on the taxable profit.

On 16.12.2014, the Minister of Finance adopted the guideline No. 26 "Some amendments in the Guideline No. 24, dated 02.09.20 2008, "On tax procedures in the Republic of Albania", as amended"". The amendments set forth in this Guideline lay down the means and procedures to be used to transmit the information, the decisions and official communications to the tax administration, addressed to taxpayers and vice-versa; the procedures and documentation to be completed to register the persons that carry out trading activity.

On 16.12.2014, the Minister of Finance adopted the guideline No. 27 "Some amendments in the Guideline No. 26, dated 4.9.2008 "On National taxes", as amended". These amendments consist in the general provisions of the Guideline " On national taxes"; the turnover tax for the business; carbon tax on benzine; mine rent tax on minerals or exported products; and tax on glass and plastic wrapping.

On 26.12.2014 the Albanian Energy Regulator Authority adopted the Decision No. 139 "On setting the electrical energy production tariff by KESH, sh.a. for 2015.". Accordingly, the tariff on the production of electrical energy by KESH sh.a. for 2015 shall be 1.45 lekë/kwh.

On 26.12.2014 the Albanian Energy Regulator Authority adopted the Decision No. 140 "On setting the electrical energy tariff to the wholesale public supplier for 2015.". Accordingly, the tariff for the electrical energy on the wholesale public supplier for 2015 shall be 3.0 lekë/kwh.

On 26.12.2014 the Albanian Energy Regulator Authority adopted the Decision No. 141 "On setting the tariff on auxiliary services by KESH, sh.a. for 2015.". Accordingly, the tariff for auxiliary services for 2015 by KESH sh.a. shall be 158 lekë /Mwh

On 29.12.2014 the Council of Ministers approved the Decision No. 928 "On the criteria, procedures and documentation for the social pension" In accordance with this Decision, the Albanian citizens, aged 70-years old, permanent resident in Albania for at least the last five years, does not meet the conditions for pension and does not have any income, or the incomes from any other source are lower than the incomes deriving from the social pension, has the right to apply for financial treatments of social pension.

BANK OF ALBANIA MANAGEMENT, AS AT 31 DECEMBER 2014

SUPERVISORY COUNCIL

ELISABETA GJONI	Deputy Chair
ERMELINDA MEKSI	Member
DHORI KULE	Member
ELA GOLEMI	Member
PETRAQ MILO	Member
GENT SEJKO	Member
TONIN KOLA	Member
NATASHA AHMETAJ	Member

GOVERNOR

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DEPUTY GOVERNORS

ELISABETA GJONI	First Deputy Governor
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GENERAL INSPECTOR

--

GOVERNOR'S OFFICE

GENC MAMANI

HEAD OF COORDINATION, GOVERNOR'S OFFICE

GRAMOZ KOLASI

SECRETARY OF SUPERVISORY COUNCIL

ELVIS ÇIBUKU

DEPARTMENTS AND OTHER UNITS

HUMAN RESOURCES DEPARTMENT	Elvis Çibuku
MONETARY POLICY DEPARTMENT	Erald Themeli
RESEARCH DEPARTMENT	Altin Tanku
MONETARY OPERATIONS DEPARTMENT	Marjan Gjermeni
SUPERVISION DEPARTMENT	Indrit Banka
FINANCIAL STABILITY AND STATISTICS DEPARTMENT	Klodion Shehu
INFORMATION TECHNOLOGY DEPARTMENT	Mariglen Biti
ISSUE DEPARTMENT	Stefan Sevo
PAYMENT SYSTEMS AND ACCOUNTING AND FINANCE	Anjeza Harizaj
LEGAL DEPARTMENT	Altin Naqe
AUDIT DEPARTMENT	--
ADMINISTRATION DEPARTMENT	Agron Skënderaga
SECURITY AND PROTECTION DEPARTMENT	Ilir Mollaymeri

BRANCHES

Shkodra	Ermira Istrefi
Elbasani	Thoma Rula
Gjirokastra	Anila Thomaj
Korça	Liljana Zjarri
Lushnja	Shpresa Meço

BANKS AND BRANCHES OF FOREIGN BANKS LICENSED BY THE BANK OF ALBANIA, AS AT 31 DECEMBER 2014

1. RAIFFEISEN Bank

Licence no. 2/1998, dated 11.01.1999

Approved by the Bank of Albania Supervisory Council Decision No 163, dated 11.12.1998.

Certificate No 2 "On deposit insurance"

CEO: Christian CANACARIS

Address: Bulevardi "Bajram Curri", Qendra Tregtare Evropiane, Tiranë.

Tel.: +355 4 2274 910

Fax: +355 4 2275 599

E-mail: info@raiffeisen.al

Website: www.raiffeisen.al

2. UNITED BANK OF ALBANIA

Licence no. 3/1998, dated 11.01.1999

Approved by the Bank of Albania Supervisory Council Decision No 165, dated 11.12.1998.

Certificate No 3 "On deposit insurance"

CEO: Emina ŠIŠIĆ

Address: Rruga e Durrësit, sheshi tek Zogu i Zi, Godina Teknoprojekt,

P.O. BOX 128, Tiranë.

Tel.: +355 4 2404 575

Fax: +355 4 2228 460, 2228 387

E-mail: info@ubaal.com

Website: www.uba.com.al

3. VENETO BANK

Licence no. 5/1998, dated 11.01.1999

Approved by the Bank of Albania Supervisory Council Decision No 164, dated 11.12.1998.

Certificate No 4 "On deposit insurance"

CEO: Daniele SCAVAORTZ

Address: Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Tiranë.

Tel. : +355 4 2280 555

Fax: +355 4 2280 356

E-mail: info@venetobanka.al

Website: www.venetobanka.al

4. NATIONAL COMMERCIAL BANK

Licence no. 6/1998, dated 11.01.1999

Approved by the Bank of Albania Supervisory Council Decision No 162, dated 11.01.1999.

Certificate No 5 "On deposit insurance"

CEO: Seyhan PENCABLIGIL

Address: Bulevardi "Zhan Dark", Tiranë.

Tel.: +355 4 2250 955

Fax: +355 4 2250 956

E-mail: info@bkt.com.al

Website: www.bkt.com.al

5. TIRANA BANK

Licence no. 07, dated 12.09.1996

Approved by the Bank of Albania Supervisory Council Decision No 9, dated 12.09.1996.

Certificate No 6 "On deposit insurance"

CEO: Savvas THALASSINOS

Address: Rruga "Ibrahim Rugova", Tiranë.

Tel.: +355 4 2269 616, 2233 441

Fax: +355 4 2233 417 / 2369 707

E-mail: info@tiranabank.al

Website: www.tiranabank.al

6. NATIONAL BANK OF GREECE, ALBANIA

Licence no. 08, dated 25.11.1996

Approved by the Bank of Albania Supervisory Council Decision No 4, dated 14.03.1996.

Certificate No 7 "On deposit insurance"

CEO: Ioannis KOUGIONAS

Address: Rruga e Durrësit, godina "Comfort", Tiranë.

Tel.: +355 4 2274 802, 2274 822

Fax: +355 4 2233 613

E-mail: nbgalbania@icc-al.org

Website: -

7. INTERNATIONAL COMMERCIAL BANK

Licence no. 09, dated 20.02.1997

Approved by the Bank of Albania Supervisory Council Decision No 9, dated 30.04.1996.

Certificate No 8 "On deposit insurance"

CEO: Gideon van den BROEK

Address: Qendra e Biznesit, rruga "Murat Toptani", Tiranë.

Tel.: +355 4 2254 372, 2256 254

TelFax: +355 4 2254 368

E-mail: info@icbank-albania.com

Website: -

8. ALPHA BANK ALBANIA

Licence no. 10, dated 07.01.1998

Approved by the Bank of Albania Supervisory Council Decision No 01/03/96, dated 27.12.1997.

Certificate No 9 "On deposit insurance"

CEO: Periklis Drougkas

Address: Rruga e Kavajës, G – KAM Business Center, kati II, Tiranë.

Tel.: +355 4 2278 500

TelFax: +355 4 2232 102

Website: www.alphabank.al

9. INTESA SANPAOLO ALBANIA

Licence no. 11, dated 10.08.1998

Approved by the Bank of Albania Supervisory Council Decision No 105, dated 10.08.1998.

Certificate No 10 "On deposit insurance"

CEO: Silvio Pedrazzi

Address: Rruga "Ismail Qemali", nr. 27, P.O. BOX 8319, Tiranë.

Tel.: +355 4 2248 753 / 4 / 5 / 6, 2276 000.

Fax: +355 4 2248 762

E-mail: helpdesk@intesasanpaolobank.al

Website: www.intesasanpaolobank.al

10. PROCREDIT BANK

Licence no. 12, dated 15.03.1999

Approved by the Bank of Albania Supervisory Council Decision No 22, dated 03.03.1999.

Certificate No 11 "On deposit insurance"

CEO: Adela LEKA

Address: Rruga "Dritan Hoxha", nd. 92, H. 15, Njësia nr. 11, kodi postar 1026, Tiranë.

Tel.: ++355 4 2389 300

Fax: ++355 4 2233 918

E-mail: info@procreditbank.com.al

Website: www.procreditbank.com.al

11. CREDIT AGRICOLE BANK ALBANIA

Licence no. 14, dated 28.10.1999

Approved by the Bank of Albania Supervisory Council Decision No 105, dated 19.10.1999.

Certificate No 13 "On deposit insurance"

CEO: Luc Beiso

Address: Rruga e Kavajës, nr. 59, "Tirana Tower", Tiranë.

Tel.: +355 4 2258 755 / 56 / 57 / 58 / 59 / 60

Fax: +355 4 2258 752

E-mail:

Website: www.creditagricole.al

12. CREDIT BANK OF ALBANIA

Licence no. 15, dated 28.08.2002

Approved by the Bank of Albania Supervisory Council Decision No 66, dated 28.08.2002.

Certificate No 14 "On deposit insurance"

CEO: Sherine KAMEL

Address: Rruga "Perlat Rexhepi", Al-Kharafi Group Administration Building, kati 1 dhe 2, Tiranë.

Tel.: +355 4 2272 168, 2272 162

Fax: +355 4 2272 162

E-mail: creditbkalb@icc-al.org

Website: -

13. CREDINS BANK

Licence no. 16, dated 31.3.2003

Approved by the Bank of Albania Supervisory Council Decision No 22, dated 26.03.2003.

Certificate No 15 "On deposit insurance"

CEO: Maltin KORKUTI

Address: Rruga "Ismail Qemali", nr. 4, Tiranë.

Tel.: +355 4 2234 096

Fax: +355 4 2222 916

E-mail: info@bankacredins.com

Website: www.bankacredins.com

14. SOCIETE GENERALE BANK ALBANIA

Licence no. 17, dated 16.02.2004

Approved by the Bank of Albania Supervisory Council Decision No 06, dated 11.02.2004.

Certificate No 16 " On deposit insurance".

CEO: Frédéric BLANC

Address: Bulevardi "Dëshmorët e Kombit", Kullat Binjake, kulla 1, kati i
9-të, Tiranë.

Tel.: +355 4 2280 442/3

Fax: +355 4 2280 441

Cel.: 068 (69) 20 60 974

E-mail: info@societegenerale.al

Web site: www.societegenerale.al

15. UNION BANK

Licence no. 18, dated 09.01.2006

Approved by the Bank of Albania Supervisory Council Decision No 101, dated
28.12.2005

Certificate No 17 "On deposit insurance"

CEO: Gazmend KADRIU

Address: Bulevardi "Zogu I", pallati 13-katësh, përballë Stacionit të
Trenit, Tiranë.

Tel.: +355 4 2250 653, 2258 081

Fax: +355 4 2272 880

E-mail: info@unionbank.com.al

Website: www.unionbank.com.al

16. FIRST INVESTMENT BANK, ALBANIA

Licence no. 19, dated 06.07.2007

Approved by the Bank of Albania Supervisory Council Decision No 35, dated
27.06.2007.

Certificate No 12 "On deposit insurance"

CEO: Bozhidar TODOROV

Address: Bulevardi "Dëshmorët e Kombit", Kullat Binjake, kulla 2, kati i
14-të, Tiranë.

Tel.: +355 4 2276 702/3

Fax: +355 4 2280 210

E-mail: -

website: www.fibank.al

As at 31 December 2014, the Bank of Albania also licensed the following entities:

No.	ENTITIES
22	NON-BANK FINANCIAL INSTITUTIONS
356	FOREIGN EXCHANGE BUREAUS
2	UNIONS OF SAVINGS AND LOAN ASSOCIATIONS
113	SAVINGS AND LOAN ASSOCIATIONS

PUBLICATIONS BY THE BANK OF ALBANIA - 2014 H2

The following list is intended to inform our readers of Bank of Albania publications over the second half of 2014. To subscribe to our publications' mailing list, please visit our official website: www.bankofalbania.org; fill in the subscription form and send it via e-mail to public@bankofalbania.org or via fax +355 4 2419408. You may also subscribe to the automatic feed of the Bank of Albania. Every midnight, you will be informed in your mail inbox about news feeds for the categories you have selected.

Following is a list of Bank of Albania publications over the second half of 2014. The list does not include surveys by the Bank of Albania, which are published only electronically. Please visit: http://www.bankofalbania.org/web/vrojtime_1709_1.php

FINANCIAL STABILITY REPORT
Financial Stability Report 2014 H1

PERIODIC MONETARY POLICY REPORTS
Monetary Policy Report 2014 Q2
Monetary Policy Report 2014 Q3

PUBLICATIONS ON STATISTICS
Monthly statistical report (published monthly)

OFFICIAL BULLETIN
Official Bulletin - Vol. 16, No 4
Official Bulletin - Vol. 16, No 5
Official Bulletin - Vol. 16, No 6
Official Bulletin - Vol. 16, No 7

BULLETIN OF THE BANK OF ALBANIA
Bulletin of the Bank of Albania - 2014 H1

RESEARCH NEWSLETTER OF THE BANK OF ALBANIA
Research Newsletter of the Bank of Albania, No 12