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Sheshi "Avni Rustemi", Nr. 24, Tirana
Tel: 355-4-241 93 01/2/3; 355-4-241 94 01/2/3
Fax: 355-4-241 94 08
E-mail: public@bankofalbania.org

www.bankofalbania.org

C O N T E N T S

EDITORIAL
BANK OF ALBANIA'S NEW CURRENCY ISSUE CENTRE

In the context of improving the infrastructure and technological standards, on 26 October 2012, the Bank of Albania held a ceremony to inaugurate the new Currency Issue Centre.

The Currency Issue Centre is built in the spirit of modern architecture, with two striking circular ends that symbolise the currency. With a total area of 1800 square meters, the Centre is located in Tirana and operates with 43 employees. The main operational environments include the parking lot of armoured vehicles used to transport cash, counter of transactions with Bank of Albania branches and commercial banks, safe rooms, banknote processing room, damaged banknotes offline shredding and briquetting room, coin production and processing room, National Centre for Analysis laboratory, and the workshop and conference room.

This centre has the best infrastructure and is equipped with modern technological systems that will be used for money processing. These automated systems are capable of processing up to 20 banknotes per second. They check for authenticity of banknotes and distinguish physically fit from unfit banknotes for recirculation, which are enabled through advanced sensors these systems are equipped with. Hence, the verification of authenticity is enabled through precise visual measurements and magnetic, phosphorescent and infra red elements of banknotes. The fitness checking of banknotes is enabled by measuring the size, soiling, stains, physical defects such as holes and tears, structural deterioration of banknotes due to wear, presence of adhesive tape and detection of inscriptions. It is worth noting that the processing systems installed at the Issue Centre are similar to the ones used in other European central banks. After being processed, fit banknotes are packaged for recirculation, while damaged banknotes are automatically destroyed. Concerning currency processing, new coin processing machines have been also installed. A fully automated system for packaging processed coins is also planned to be installed in the future.

The new Issue Centre will also include a modern laboratory, which will be part of the National Centre for Analysis. The latter may carry out professional expertise, analysing in detail technical characteristics and elements of suspected counterfeit banknotes and coins. This contemporary laboratory will not only contribute to strengthening fight against counterfeiting and improving the security of Albanian currency, but it will also meet one of Albania's commitments in the context of the Stabilisation and Association Agreement. Chapter 32 of this Agreement entitled "Financial Control"

establishes Albania's obligation to protect the euro against counterfeiting, which is met by setting up this kind of infrastructure. These new premises will be also used to host informative seminars and trainings for Bank of Albania and commercial banks' employees or other public.

Upon the modernization of infrastructure and technological systems used in currency processing, the functionalities will be improved and the work processes carried out at the Centre will be standardized. The improvement of functionalities at the Currency Issue Centre will be also accompanied by the development of a new regulatory framework for the authenticity and fitness checking and recirculation of Albanian banknotes. This regulatory framework, projected to enter soon into force, has approximated the European Union and European Central Bank standards. These standards are mainly laid down in Regulation EC 1338/2001 laying down measures necessary for the protection of the euro against counterfeiting, and Decision ECB/2010/14, amended by Decision ECB/2012/19 of 7 September 2012 to extend its scope to the authenticity and fitness checking and recirculation of new series of euro banknotes. The new regulation fills in the gap of the regulatory framework for automatic machineries used in banknote processing and recirculation, and sets unified standards for the circulation of Albanian banknotes, which are mandatory for each banknote processing and handling institution.

The processing of banknotes and coins, destruction of damaged banknotes, transfer of cash and analysis of suspected counterfeit currency will be carried out at the Bank of Albania's Currency Issue Centre in line with its European counterparts' standards. The new processing standards enhance the quality and ensure the integrity of the Albanian currency in circulation.

ADDRESSES AND PRESENTATIONS BY BANK OF ALBANIA'S ADMINISTRATORS IN ACTIVITIES IN ALBANIA AND ABROAD

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the workshop on "A sound and efficient Albanian banking system; activities and results achieved under the EU-funded Twinning Project", 4 July 2012

Dear participants,

The development strategy of the Bank of Albania provides, inter alia, for the swift approximation of the institutional, legal and operational framework with the best standards of European Union (EU) central banks, in view of the country's major priority, i.e. accession into the EU.

The Bank of Albania has been engaged in an EU-funded Twinning Project for strengthening the institutional capacities, particularly in the areas of banking supervision, statistics, payment systems and the implementation of monetary policy, capitalising on the extensive experience and outstanding professionalism of Bank of Italy and Bank of France experts.

This project had set challenging objectives, which had to be achieved within a relatively short time. Its success depended on the commitment and professionalism of participating institutions, and on their capability to implement a true cooperation.

Today, I have the pleasure to address this important event, which marks the successful completion of the twinning project after about 18 months of intensive joint work. I would like to thank all the experts that have been working for this project at the Bank of Italy and Bank of France, for their commitment and professionalism. I would like to also thank the representatives of the EU Delegation to Albania for their support as they monitored the project.

The twinning project was implemented in 6 modules as follows:

- Coordination of European integration process
- Financial literacy
- Supervision and financial stability
- Payment systems
- Statistics
- Inter-bank market

Coordination of the European integration process was implemented with the Bank of France and consisted in developing and mastering the required instruments for coordinating the European integration process with a view to preparing meetings at European level and coordinating Albania's accession process in the EU. The Bank of France provided its experience in organising meetings at European level and administering the process of approximating the banking legislation with the acquis communautaire.

Financial literacy was implemented with the Bank of Italy and consisted in drafting a financial education strategy for the public. Under this module, our research drew on the European experience and was adapted to Albania's needs. In addition, we established a standard for conducting surveys and questionnaires to assess the public's awareness and knowledge on financial literacy and the effectiveness of educational activities.

Thanks to this project, we have a modern infrastructure for compiling macroeconomic statistics at the Bank of Albania, in particular regarding the balance of payments.

The payment systems regulatory framework was reviewed with a view to amend and fully align it with the relevant EU directives and practices.

Further development of the inter-bank market was another important component of the project, given its significance in enhancing the monetary policy transmission mechanism to the economy.

The supervision philosophy started to change in January 2010 with the establishment of a new dynamic structure oriented towards risk identification and management. Therefore, in addition to human resources capacity building for its eventual application, best European standards had to be identified and acquired in detail. The precious experience of the Bank of Italy, one of the most prestigious institutions in Europe, helped the Albanian supervision process conform to the best European models.

I would like now to highlight several key developments:

First, we have migrated from the actual CAMELS evaluation system towards another evaluation model based on a wider spectrum of individual risks, as envisaged in Basel II and Basel III standards. That was the most intensive process of this project, which required maximum engagement of Bank of Albania's experts throughout these 18 months. Eventually, we produced a new supervision manual with European principles and methodology, broken down by risks and individual evaluation systems. Bank evaluation improved as qualitative criteria were taken into account in addition to quantitative data.

Second, the Regulation "On capital adequacy ratio" has been revised in accordance with the BASEL II and Capital Adequacy Directive. The revision is followed by introduction of the standard method for credit and market risks and the simple and standard method for operational risk. Given its significance, the draft-text of the Regulation is being consulted with the banking industry.

Third, to increase our prudence towards the financial system stability, we adopted new techniques for a more comprehensive systemic risk assessment, enriched stress test exercises with the "bottom up" approach and improved models for the indirect credit risk assessment.

The twinning project concentrated most of its resources on supervision and financial stability. In addition to constant motivation for improving the regulatory framework, supervision activities and risk administration, this priority becomes even more necessary given added challenges related to specific developments over the past years.

The Bank of Albania has undertaken a number of actions to face and overcome these challenges.

For the fourth consecutive year, the Albanian economy has been under the influence of the global economic and financial crisis. Its latest stage, the sovereign debt crisis and its interrelation with the balance sheets of the financial system have placed us on the frontline. Our two main trading and financial partner countries, Greece and Italy, have been severely hit by the crisis. Against this unfavourable landscape, the Albanian economy has grown and has maintained its financial soundness.

Private agents have an overall sound financial position, relatively low debt levels and positive savings rates. In contrast to other countries in the region, the Albanian financial system has continued to lend to the economy, although at slower pace and somewhat tighter terms.

Building on an appropriate and flexible regulatory framework, this response has been determinant to encourage the restructuring of the economy and guide it towards profitable sectors. Looking ahead, according to the Bank of Albania, the main risks to economic stability pertain to economic growth.

A number of signals from the real and financial sectors show that the contraction of consumers' balance sheets and slowdown of investments, used so far by economic agents as buffers to the crisis, may imperil the mid-term prospect of economic growth. The propensity to save and defer investments may affect the competitive advantages and growth potential of our economy. Deleveraging, mostly driven by regulatory requirements that are not related to the performance of the economy, may undermine the existing financing channels, which have been so far an important component for growth.

According to the Bank of Albania, the current situation requires higher attention and courage by all economic agents to make the right decisions for development and in response to the challenges arising from the external environment.

In a more general setting, the Bank of Albania believes that implementation of right macroeconomic policies by harmonising the monetary and fiscal policies, is a prerequisite for the country's sustainable and long-term development. They should have two main components: support growth and sustainable development for the country's economy and boost long-term development through encouraging structural reforms.

In Bank of Albania's view, our economy is flexible and the infrastructure of core services, financial services and regulatory framework is constantly improving. The labour force is competitive, in terms of cost, and increasingly qualified. Nonetheless, competitiveness indicators for the Albanian economy reveal that there is a lot more to be done in this regard, to face competition both in the region and globally.

The Bank of Albania is committed to maintaining monetary and financial stability through:

a) A prudent monetary policy. We have ensured price stability, complied with the inflation target and anchored long-term expectations of the economy.

This move has increased the space for harmonising better the short-term stimulation with the long-term stability of the economy. In response to shocks, we have progressively eased the monetary policy since 2009. This approach has brought the key interest rates to their record low to boost consumption and investments. The depreciation of the nominal and real exchange rate has provided another incentive for the Albanian economy, encouraging exports and discouraging imports.

We have continuously adjusted our monetary operations to guarantee an increasing supply of liquidity against an expanded collateral base with longer maturity terms. Given the current situation of the Albanian economy, we believe that macroeconomic policies should continue to be stimulating even in the future. The need for stimulating economic policies is conditioned first by the fact that the Albanian economy is operating below its potential, as the demand may not guarantee a complete utilisation of capacities. Second, it is enabled by short and medium-term controlled risks to economic stability.

In the context of harmonisation of fiscal and monetary policies, the Bank of Albania has supported the increasing orientation of the fiscal policy towards debt consolidation. We remain ready to respond within a short time to any consolidating initiative of the public sector. Our easing measures will remain within the legal framework of Bank of Albania's instruments and in line with the consolidated philosophy of central banks action.

The monetary policy may prove successful only if its transmission mechanism is functional. In this context, the banking system plays a key role, as the first actor of the transmission mechanism.

b) A prudent supervisory and regulatory policy. This policy maintains sound balance sheets of the financial system and the private sector. Thanks to the timely measures to manage credit, capital and liquidity risks, the Albanian economy has successfully withstood the shock from global financial markets and has now a consolidated financial stability and a banking system that is able to credit and support the Albanian economy.

Maintaining banking sector stability is one of the two main priorities of the Bank of Albania. I take this opportunity to draw the attention of the banking industry executives, to engage maximally to act in full compliance with the legal and regulatory framework and respect the standards for sound management of banking activities.

Our objective remains unchanged; maintaining and strengthening public confidence in the banking sector. To this end, the banking system should:

- Verify constantly the compliance and strengthen the internal audit systems.
- Empower capacities for risk assessment and management.
- Maintain adequate capital and liquidity levels. Thus, the system should monitor daily the performance of liabilities of a bank, in order to create and maintain the required liquid assets for these liabilities.
- Factor expected developments in capital requirements. Injection of additional capital by shareholders should consider the establishment of a security "zone" in the capital value, against unexpected developments. Therefore, the banks should cautiously interpret the requests to distribute dividends.

Credit quality remains the main concern of the banking sector. The increase in non-performing loans intensifies the banking stress and reduces the contribution to financial intermediation and economic growth. The Bank of Albania has monitored this situation closely, focusing on:

- Accurate identification of the problem, through inspection and verification of procedures for assessing the credit quality and category;
- Relevant contingency funds provided at the required amount and time;
- Encouragement to banks to address the issue by taking strict initiatives for collateral execution.

In our view, this is the only way to identify and tackle the problem on time, prevent its spillover and reduce uncertainties for the future.

The banking industry has intensified its requests for the revision of the supervisory regulatory framework, so as to soften it in relation to the handling of non-performing loans. The Bank of Albania is open to consider valid and realistic proposals by the banking industry, as long as they do not weaken the capacity of the banking sector in a situation with unclear developments.

Focusing more concretely on some recent opinions, we see the request for lower provisioning values as inappropriate, since we are dealing with an unrealistic improvement of the position of capitalising the operations.

I take the opportunity to clarify the public opinion that in this regard, the rates we have applied are in accordance with the experiences of other countries; in some cases, they are lower.

The Bank of Albania holds that the current regulatory framework creates the necessary space for the banking system to assist good clients, who may be facing temporary difficulties in the current situation. This assistance may come in various forms, including appropriate restructuring for parties. The Bank of Albania will consider the possibilities and forms so that this process becomes more stimulating for the bank as well.

As regards the collateral value for reducing the risk-bearing asset value, the Bank of Albania upholds that concentration of collateral as immovable property and difficulties in executing collateral and recovering the value for the loss loan void this initiative from the beginning.

Improvements to the legal and regulatory framework, as identified by the joint working groups with the banking industry, need to be implemented correctly, so that collateral earns its optimum value.

In the end, the banking industry should prove that it is active in tackling non-performing loans and releasing resources into the balance sheet to further support the activity. This is the best form to test the real possibilities, which may later be supported by amendments to prudential regulatory framework.

Our common goal is to stop progression of the value of non-performing loans and improve the situation gradually. Some banks, thanks to their prudent and steady efforts over the past three years in relations with their clients, have managed to significantly reduce the non-performing loans share. They have continued lending to the economy at good levels. Organisation and management of their work is an example for other banks.

The current legal and regulatory framework is comprehensive and in line with the best international standards, although it may require ongoing improvement. Our consolidated opinion, however, is that all the stakeholders need to exhaust all the available tools and gradually make further steps in the legal and institutional framework. More specifically, the banking industry and the business community need to work more closely. I believe there is more space for better understanding and more fruitful cooperation. The business community and the banking system should leave their trenches and cooperate in concrete terms to face future challenges.

The banking system is ready to increase its support to the economy with loans. This was confirmed to me in a meeting I had with the management of the largest five banks. Personally, I urged the banking system for a more active approach to lending.

This is a real challenge and many institutions and groups of interest are involved in it. Therefore, I would like to invite all other stakeholders to be open-minded and very cooperative to boost lending to the economy.

First, I would suggest to the business community to be more creative, transparent and formal in its operation. It should comply with all obligations

arising from the contractual relations with the banking system. This should be broadly understood and accepted. A correction is necessary in the economy, first of all implying a rebalancing of prices. There may be no reduction in non-performing loans, increase in lending to the economy, improvement in business and bank balance sheets, unless collaterals are executed and, subsequently, fix asset prices are corrected. This process would release huge financial resources that would be a vital serum of fresh money injected back into the economy. With this fresh money we must encourage the creation of new and effective initiatives that yield swift return on investment.

One of the lessons learned from the crisis is that any new healthy money should go to a healthy business initiative. We need to encourage highly productive sectors of the economy. This is the only way to ensure revitalisation of the economy and make it a dignified European partner.

Second, I would like to encourage the banking system to be more dynamic, by looking continuously for worth-funding opportunities. Offer reliable funding packages by assigning priority to economic health of the country, which would, in turn, guarantee the long-term success of your business. Do the utmost to increase the lobbying authority and capacity with the Albanian executive, parliament and judiciary. Intensify your contacts with business associations and analyse every claim or request, case by case, even if it comes from a single business. Take a public stance in any case so that speculations and abuse are reduced to maximum. Engage all your financial, human and media arsenal for a more solid anchoring of your expectations with the public. Turn the public into your most powerful anchor.

Third, I would like to call for the Albanian executive to increase the confidence in and support to the banking system, especially as regards finalising legal amendments on collateral execution.

Cooperation between public institutions and the banking system may be fruitful also in terms of introducing specific development programmes and providing financial and concession support to sectors, branches, important operators, including foreign investors.

Fourth, I would consider as vital a broad-based consensus of the entire political spectrum for supporting the Bank of Albania's efforts and moves to maintain the country's macro-financial stability. We remain open to explain continuously, transparently and responsibly our past, present and future decision-making. We remain firm in our position that a central bank is successful and enjoys the trust of the public when it makes independent, far-sighted and fully transparent decisions. In these moments, the unquestionable guarantee that the Bank of Albania gives to the public for the country's macro-financial stability is paramount.

Fifth, I would like to encourage the Albanian and international media to uphold the good tradition of accurate and real-time transmission of economic and financial developments in Albania, including the activity of the Bank of Albania and the financial sector, which occupy a significant place.

Last but not least, I would like the Albanian public to continue to be discreet and have full confidence in the financial architecture we have built. We commend its added prudence, which is reflected in its propensity to increase savings. Therefore, household balance sheets remain positive, an indicator that sends positive signals for a potentially growing consumption in the near and distant future. I take this opportunity to reiterate that optimism shapes our present and our future.

The time has come for the consumers' sentiment to start its take off. This would create the desired chain reaction for accelerating money velocity and circulation of goods in the economy, making the economy recover to its pre-crisis parameters.

On my behalf and on behalf of the Bank of Albania, I would like to thank the Bank of Italy and the Bank of France for the assistance and partnership during the twinning project. At the completion of this project, the Bank of Albania has upgraded the organisational and operational framework of its main departments and has approached to its European counterparties.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the 20th Anniversary of the Joint Vienna Institute
12 july 2012

Dear ladies and gentlemen,

It is an honor and privilege for me to address this event marking the 20th jubilee of the Joint Vienna Institute. It is also a great pleasure to have the opportunity to share with you my thoughts on current global developments and their implications for our economies.

Despite certain episodes of disorder and imbalances the major part of the last two decades has been characterized by a general political commitment towards free market and reforms across the SEE region. As a consequence all economies recorded remarkable achievements which have led to a fast and sustainable convergence. These developments were supported by a similar commitment from the EU public and private sectors, especially the financial sector, toward the economies of the Central, East and South East Europe.

Albania is one of those successful stories so far. For 20 consecutive years the country has gone through substantial reforms with the sole purpose of getting closer with the united European family.

From the painful reforms of broad price liberalization, followed by the introduction of a free floating foreign exchange rate regime and full current and capital account liberalization, to the current more sophisticated reforms, Albania has made significant progress towards establishment of democracy and free market principles.

The economic activity has remained solid throughout most of this period and the main indicators such as inflation, fiscal deficit, foreign exchange rate, unemployment rate, have performed positively, yielding a sound and stable macroeconomic environment. The financial system has become an important factor in supporting the economic activity.

The banking industry, the dominating segment of the financial sector, has contributed substantially to the overall developments by significantly boosting financial intermediation. The process has been dominated by and reflected the involvement of notable European banking groups operating in Albania as well as in other Balkan countries.

After this brief overview, allow me to make some comments on recent challenges and difficulties which our economies are facing.

Last year and the first part of this year showed that the crisis that began in 2008 has reached its most acute phase, characterized by the inter-connection between sovereign debt and banking system crisis.

I would like to use the title of the memorable movie "Enemy at the Gates" as an analogy to describe the gravity of the situation in our region, especially in Albania, as a result of the difficult economic situation of our southern neighbor, Greece, as well as the situation in Italy and the rest of Europe. About 80 per cent of our trade and financial activity is exchanged with them.

After several years through the crisis, our economies have shown an impressive resilience. This is not a coincidence. Rather, it is a testament of the careful work done prior and during the crisis. Coordination of monetary and fiscal policy responses across the region and in Albania has been successful in mitigating the adverse impacts of the crisis. In particular, central banks have undertaken unprecedented steps through their monetary, liquidity, and macro prudential policy instruments.

A lot has been done and achieved in terms of providing relief to financial markets, securing the rollover of the sovereign debt, and maintaining macroeconomic stability. However, long term macro financial stability is exposed towards certain potential risks. The South East European region is struggling to maintain the relatively sound economic and financial progress attained in the last 20 years of post communism era.

Currently, economic activity is weak, accompanied by high unemployment, low inflation pressures and increasing NPLs across the region. All economies are performing under their potential, mainly due to anemic credit growth, loss of confidence in domestic economy and weak economic activity in the EU. Last but not least, lost competitiveness and slowdown of structural reforms are acting as barriers to growth in the long term.

In addition to these pressures, since the end of 2011 we have been facing a new problem. More specifically, I am referring to the fast and considerable decrease of foreign banking groups' exposure towards private and public debt, as part of their deleveraging objectives. This process was not justified by the situation in Albania. It was imposed unexpectedly from abroad and it has created substantial difficulties in the financing of the public debt as well as private consumption and investment activities. All these negative implications might, in turn, further undermine financial and fiscal stability.

I believe that the recent set of measures undertaken to strengthen financial stability in the euro area countries have taken a closed economy approach. They have not sufficiently considered or accounted for the significant cross-border implications in the emerging Europe.

In general, the execution of EBA recommendations with regard to the implementation of policies that have resulted in deleveraging at a group level in the euro-area has created substantial problems in subsidiary level in emerging

economies. It has thus affected growth perspectives and confidence for both the group and the local economies. My main point is that financial burden of such rules is not shared proportionally among home and host countries and among the countries of the Eurozone and those in the emerging Europe.

This non-proportionality is larger in those transition economies in which financial intermediation has relied almost exclusively on domestic resources. For example, in Albania the overall stock of credit to economy covered only 62 per cent of total deposits, as at the end of 2008.

The stock of foreign currency loans were almost completely financed by total foreign currency deposits, with credit lines from parent banks to their subsidiaries and branches at negligible levels. In principal, financial intermediation has always been funded in domestic markets, did not impose any financial constraints on the parent bank's balance sheet, and yet, we had to carry a burden that feels unjust.

In fact, as a result of the interpretation of EBA's regulation, one of the foreign banks operating in Albania reduced the exposure in Albanian Government debt by 3 percentage points of GDP in a quarter or so. These actions caused liquidity imbalances in the interbank market that were not quick to settle due to structural problems.

They were associated with higher interest rates on government debt and constrained the monetary policy transmission mechanism.

The reduced exposure toward government debt securities is not matched by a similar increase in exposure toward private sector credit, and is therefore contributing to lower credit growth. This is all coming at a time when potential policy buffers (in terms of fiscal space) and public confidence in the economy have decreased, leaving no additional room for additional economic incentives.

On the other hand, certain "creative" measures to stimulate credit and growth through unconventional monetary policy and more relaxed supervisory requirements are potentially dangerous. Under extreme economic uncertainty, they can stimulate a further deterioration of the banks' balance sheet without having major impact on economic activity. This is the narrative of current economic problems faced by the entire region.

In general, while many of the measures were taken by the European authorities in the last three-years, have been necessary and important, they have given the impression of being taken late, half-heartedly and with hesitation to a "more Europe" approach, without properly considering the impact on neighboring countries.

More importantly, these measures have not contained the medium term negative impact of the financial crisis in the economic activity, triggering the need for a better balance and timeliness between "austerity" and "pro-growth" measures.

Dear ladies and gentlemen,

Integration in our vision represents a journey amongst friend and partners towards a common goal or destiny.

Because our economies are increasingly coming closer together and because our financial systems should be seen as one, we believe that we should be ready and willing to share both the benefits and the costs of this process. We are fully aware of the benefits and we have already enjoyed them.

At the same time, we are becoming aware of the potential costs of this process, which mainly come from asymmetric shocks and uncoordinated policy responses. For these reasons, I avail myself of this opportunity to appeal to all relevant EU policy makers to consider with the same attention the impact of their decisions on the converging economies. We are in the same boat and I believe we should row in the same direction.

Looking at emerging European countries, there is a strong need to associate previous policies that facilitated capital inflows into the region's economies with measures that would ensure the continuity of the necessary liquidity, once these flows change course or stop. The benefit of swap or similar agreements must be extended to our countries in order to enable us to access short term liquidity in foreign currency.

Due to our financial systems interconnections, I think this issue deserves more attention in the future.

Especially, the complex reform and growth agenda that supports the convergence process needs to be encouraged and facilitated by our partners, international development institutions and financial funds. We need to create the right incentives for the policy makers and economic agents in the emerging economies.

Convergence itself is a structural process. For that reason, all the development institutions should maintain and increase their support for growth and stability in the region. We need to learn the right lessons from the crisis: we need to convert the identified vulnerabilities in development priorities and integrate them in our growth agenda for the future.

The obvious question is: which economic model fits the best; which sources will fund their recovery; how are these economies going to converge and provide employment?

Our economies are small when considered individually. However, we should look at the big picture and realize that our region as a whole represents a sizable and a vital market.

I believe, by partnering together, we can make it.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Closing Ceremony of the IPA-funded Twinning Project
on strengthening the capacities of the Bank of Albania
16 July 2012

Dear guests,

Central banks, since their inception, have been vested with a "veil of mystery". This relates to their exclusive right to issue money, set a loan interest rate and control liquidity in the market. Precisely, this important role of central banks and the recent global developments put these institutions on the spotlight. Responding to these developments, central banks worldwide, in perfect coordination with one another and in addition to traditional instruments, took extraordinary measures that had never been employed before.

Through those measures, they intended to provide sufficient liquidity in the market, with a final goal, which has remained unchanged since ancient times, to restore public confidence in financial institutions. The Emperor Tiberius, dating to A.D. 33, had to inject one million gold pieces of public money into the financial system to keep it from collapsing.

Today, cooperation and coordination among central banks have become an integral part of institutional management. Technological developments and the globalisation process have aroused the need for coordination among decision-making institutions all over the world. Imagine the developments following the World War II, when central banks widely accepted their transition from private to public ownership and when they realised that it was not only necessary but also imperative to cooperate, regardless of physical barriers. Imagine, for example, the president of the Federal Reserve, who wasted three months to travel to Europe and two weeks to receive a letter from his homologues overseas.

Actually, central banks have increased their efforts for a better and more fruitful cooperation. This is an undeniable truth. It has been a distinct feature of our work in recent years. Since my first public appearance as Governor of the Bank of Albania, I have pronounced my ambition for Bank of Albania's legal and institutional transformation in line with the model of the European System of Central Banks (ESCB).

I am fully confident that the successful conclusion of the Twinning Project with the Banca d'Italia and Banque de France is another determinant step forward in the joint efforts to strengthen cooperation and elevate our work standards to European levels. Today, we see that, in a few months, a brilliant idea has turned into reality and the project has been crowned with success.

The project objective was to improve our work practices in the field of banking supervision, statistics, payment systems, interbank market, coordination of EU integration process and financial literacy.

More specifically, cooperation in banking supervision focused on implementing major reforms in areas such as consolidated supervision, approval of new regulations and staff training. This cooperation has fostered our relations with foreign supervisory authorities and international institutions. Staff capacity building and development in this area was another priority of the project. Our institution should take relevant measures to increase their skills for preventing or handling deficiencies or threats to financial system stability.

In terms of statistics, this cooperation has led to a thorough review of the existing regulatory framework to completely fulfil ECB standards on compilation and dissemination of monetary and financial statistics. The review aimed to identify items of noncompliance with EU standards and to subsequently draft a solid agenda for comprehensively reviewing our methodology and infrastructure to compile the Balance of Payments in accordance with EU standards.

Payment systems constitute another priority of our work under this project. In this area, our practices further improved, aiming at approximating them to the ESCB practices on payment systems. Also, pertinent legal acts and their compliance with the EU regulatory framework were reviewed.

Cooperation on interbank money market consisted in analysing the experience of other central banks in handling market obstacles and difficulties in relation to the regulatory framework. Other useful aspects for adapting, including identification of necessary actions to be taken by our institution in the interbank money market were also addressed.

Coordination of the EU integration process is another major area that was broadly addressed by this project. Thanks to this cooperation, our staff capacities were enhanced as regards the handling of responsibilities arising from the implementation of the Stabilisation and Association Agreement, approximation to the ESCB standards, and the challenges that we may encounter when Albania receives the status of a candidate country and starts negotiations of EU accession.

Last but not least, financial literacy is of key importance to the Bank of Albania. Thanks to support from and cooperation with the project team, an action plan was designed to promote financial literacy and enhance awareness of market-economy principles across various groups of the society. Also, a system for monitoring financial literacy in schools was set up.

Further on, due to complexity of our work and new developments in the banking and financial area, it is clear that the project has strengthened our institution and has helped us cope with new situations. Moreover, the cooperation and communication between our institutions intensified from both viewpoints, professionally and personally. We do live in a global society, where financial

developments take place at a rapid pace. Therefore, central banks should possess strong and reliable mechanisms of coordination and communication, which may prepare our institutions to cope with such situations.

A proverb says: "No matter how long the journey is, one has to take the first step to start off." This philosophy was made concrete through this twinning project, which along with the assistance in the afore-mentioned areas, was also the first step on the path of our institution to EU standards, as one of the priorities of the Stabilization and Association Agreement.

I would like to extend my sincere thanks to the Banca d'Italia and the Banque de France for the outstanding cooperation we have had during the project implementation. I commend the efforts of both honoured institutions and hope that the successful implementation of this project will provide us with an example to involve more in such initiatives in the future.

Also, I want to extend my thanks to the Delegation of the European Union for its ongoing assistance and prudence throughout the project performance. I am deeply confident that these are only the first steps towards a close cooperation.

I would like to conclude by bringing to your attention a statement of Mr. Shimon Peres, who, listening to his advisor, Agassi, who was speaking about developing alternative oil sources in the absence of oil, interrupted him by saying: Nice speech, but what are we going to do?

In light of this, we should think about what to do in the future. I think that the political coverage of this approximation process is important, with which I mean Brussels' probable acceptance of Albania's application for membership in September. This is an important step that would provide additional room for the country's rapid convergence and for Bank of Albania's rapid and irreversible development in line with the models of its European counterparties.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision-Making of
the Bank of Albania's Supervisory Council,
25 July 2012

Today, on 25 July 2012, the Supervisory Council of the Bank of Albania reviewed and approved the quarterly Monetary Policy Report. Based on the analysis of Albania's latest economic and monetary developments, and following discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to decrease the key interest rate by 0.25 percentage point, taking the one-week repurchase agreement rate to a new historical minimum of 4.0%. This decision reflects the Supervisory Council's opinion that the further eased monetary conditions in economy are adequate to meet the inflation target in the medium run.

Simultaneously, the eased monetary conditions will provide a further incentive to the economic activity at home, by increasing the monetary stimulus to support the domestic demand.

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

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During the first half of 2012, the Albanian economy continued to maintain the parameters of macroeconomic and financial stability, against an increasingly challenging global context. Consumer price inflation, budget deficit and public debt indicators, balance of payments and financial situation of the banking system were stable or improving.

In particular, the Albanian financial sector remains well-capitalised, liquid and able to conduct its intermediation role. During this period, the Albanian economy experienced some shocks on the supply side, with structural movements in the domestic financial markets, and a slowed domestic and foreign demand. These developments drove the fall in GDP in the first quarter of 2012 and made difficult the implementation of stabilising policies on the aggregate demand.

The Albanian economy is expected to record positive growth rates as tensions may be reduced in the second half of 2012.

Average annual inflation marked 1.9% in the second quarter of 2012, increasing by 0.8 percentage point compared to the first quarter of 2012.

The gradual rise in consumer prices has mainly reflected the increase in unprocessed food prices, whereas prices of processed foods and those of

non-food consumer goods lowered their contribution to inflation during the second quarter of 2012. The other categories in consumer prices basket showed a serene performance, and were characterised by low inflation rates. Within the macroeconomic context, consumer prices continue to reflect weak inflationary pressures, both on the supply and demand sides. On the demand side, the presence of free capacities in using the production factors is reflected in the costs control in economy and in declining pressures on inflation.

On the supply side, the slowdown of imported inflationary pressures, decrease in oil and basic materials prices, steady administered prices, low inflationary expectations and minimal second-round effects did not generate inflationary pressures. Consumer price inflation remains at low rates and is expected to maintain the same rate in the period ahead. These estimations conditioned the retaining of the stimulating nature of monetary policy during the second quarter of 2012. The key rate stood at the lowest historical level, providing eased monetary conditions in order to meet our inflation target and support the Albania's economic activity. Also, the Bank of Albania has continued to inject sufficient liquidity demanded by the banking system, against an expanded collateral base and at adequate maturity terms.

According to recent data from INSTAT, the Albanian economy recorded an annual fall of 0.2% in the first quarter of 2012. Industry contracted 19.3% y-o-y, mainly due to the significant decrease in electrical energy output. Also, Construction decreased its activity in real terms, by 17.6%, thus providing a negative contribution to the performance of the gross domestic product. By contrast, Services contributed positively to the economic activity, pointing to an annual growth of 6.0%. Agricultural sector grew 4.5%, y-o-y during this period, providing a positive contribution to the growth of the gross domestic product.

Estimations on the aggregate demand in the first quarter of 2012 suggest a continuing weak domestic demand. The consolidated fiscal policy determined the lack of fiscal stimulus in this period and a downturn in public sector's demand for goods and services. Private consumption remains slow, thus reflecting the prudent consumer's behaviour and the increasing tendency for saving. Private investments also remained low. Given the free production capacity, Albanian businesses found less room to increase their investments in machineries & equipment, and production, while the demand for resident buildings remains weak.

At the same time, foreign demand was sluggish in the second quarter of 2012, owing to the problems in euro zone and in our main foreign trade partners. The weak foreign demand, and the problems in electrical energy production, imposed the slow increase of the Albanian exports.

Data on economy for the second quarter of 2012 are incomplete. Indirect data signal a weak recovery of the economy in this period. Their analysis supports the estimation for a continuing sluggish aggregate demand, especially of the domestic demand. On the production side, economic sectors are expected to maintain in the second quarter of 2012 the dynamic showed in the first quarter of 2012.

Fiscal developments in the second quarter of 2012 were in line with those observed in the first quarter of 2012, characterised by the consolidated fiscal policy and its inclination to maintain budget deficit and public debt targets. This behaviour is reflected in the contraction of budget expenses by 2.5% in the first half of 2012

Furthermore, fiscal revenues increased by 3.7% during this period, continuing to show a slow dynamic of their taxing component. The performance of public expenditure and income in the first half of 2012 is materialised at the significant contraction of budget deficit in annual terms, at 37.7%. This deficit was ALL 16.8 billion in monetary value, and is assessed at 2.6% of GDP.

Data on developments in foreign trade of economy reveal a contracted trade exchange in the first five months of 2012. Value of exports marked a low annual growth of 1.3% in this period, reflecting the moderation of foreign demand and price developments in global markets. In this period, imports shrank by 2.0% in annual terms. These developments resulted to a decreased trade deficit in the first five months of the year by the annualised rate of 4.2%. Developments in foreign trade were determined mostly by electrical energy trade exchanges in this period. Excluding this effect, the growth in exports would be higher and the contraction in imports deeper, resulting in a contracted trade deficit, at 18.1%.

The performance of monetary indicators was in line with the developments in the real economy and our analysis show contained monetary pressures on inflation. The annual growth of M3 was 8.7% in May, maintaining the average rates of the previous month of the current year. The growth paces of money supply slowed down compared to a year earlier, reflecting the lower demand of economic agents for money. The consolidated fiscal position was coupled with a decrease of public sector borrowing, whereas private agents of economy reflected a low demand for financing. Lending to the private sector rose by 7.5% in May, pursuing the slowing trend, which has started since the end of previous year. Along with the low demand of businesses and households, its performance reflects the selective and prudent behaviour of banks in lending.

Regarding lending problems, the Bank of Albania deems that banking system's balances are sound, sufficiently liquid, and well capitalised to comply with the economy's demand for monetary assets.

The positive position of its balances triggered the lending growth during the past years, while many countries in our region experienced contraction of lending. The banking system has reviewed and tightened lending standards during the last years; this behaviour to enhance the financial discipline of the economy is welcomed and shall positively support the long-term growth of Albania. On the other side, credit performance is increasingly experiencing the lack of demand, which is triggered by the consumers and businesses reluctance to carry out expenses and investments.

Bank of Albania deems that, notwithstanding the cyclical situation of Albania's economy, the perspectives on medium and long-term development remain positive. This is reflected by the interest of foreign investors to increase their exposure toward the Albanian economy. In particular, economy sectors related to exports, tourism and agriculture, which serves to the domestic and regional markets, provide unused development potentials.

Bank of Albania deems that, within the sound business' logic parameters, the Albanian entrepreneurs and consumers have room for a more active approach toward the growth of investments and their consumption.

Financial markets showed low interest rate fluctuation and operated under sufficient liquidity terms in the second quarter of 2012. The transmission of reduced rates is also observable in lek deposits market, followed by normal growth pace of deposits. By contrast, government security yields increased in the primary market, particularly the long-term yields. This performance has reflected the re-positioning of some agents in this market and the demand for financing in this period, without implying a shift of inflationary pressures. At the beginning of July, ratios improved and borrowing costs were reduced in the primary market. The second quarter also transmitted signals on eased interest rates on ALL credits from banks. Nevertheless, credit-lending paces remain low and mainly designated for short-term use, leading to fluctuating interest rates.

The introduction of new financial intermediaries, specialised in channelling the public savings to government securities, was a positive development, worth mentioning in the analysis of financial markets for the first half of year. His development along with the increased public interest on government securities, enhances the deepness of our financial system, improves liquidity, enhances its risk management capability, limits the interest rates fluctuation, increases the Albanian public debt stability and provides pressures to reduce the financing cost of the public sector.

Verified performance of economic activity at home and the information filtered from indirect indicators have shifted downward our basic projections for the economic performance for the rest of year. This shift reflects the materialisation of some risks around the previous basic projections, being expected and factorised in our scenarios. The domestic economy is expected to slow down during the rest of year, being conditioned by the weakening of the domestic and foreign demand.

Given the consolidated fiscal behaviour and the slowed foreign demand, the performance of the private domestic demand will determine the economic activity growth. However, its two components, consumption and investments, have not shown any recovery signal so far.

Expected developments at home and abroad result in a contained balance of inflationary pressures, determining a slow increase in consumer price in the future. The demand growth below the potential of the economy in the

upcoming period will continue to exercise low inflationary pressures. At the same time, the pressures generated by supply-side factors appear contained. Based on the insofar developments of the determinant factors of inflation and the projections for their development in the future, with 90% probability, inflation will range within 1.0% – 3.3% band after 12 months.

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Based on the analyses of the information set out above, the Supervisory Council holds that pressures on consumer prices at home remain low over the monetary policy relevant horizon; they have been, however, on the downside over the recent months.

On the demand side, below-potential economic growth will continue to generate low inflationary pressures, while shocks from the supply side are expected to be moderate.

The expected developments in economy and inflation imply that the simulating nature of the monetary policy will be retained during the period ahead. The Bank of Albania remains heedful to future developments and new information, ready to respond in the appropriate time and extent in order to comply with its legal mission.

At the conclusion of discussions, the Supervisory Council decided to decrease the key interest rate by 0.25 percentage point, at 4.0%. This decision aims to establish the appropriate monetary conditions to comply with the inflation target in the medium run. The monetary policy, also, provides the necessary support to simulate the aggregate demand.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision of Bank of Albania's Supervisory Council, 28 August 2012

Today, on 28 August 2012, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the analysis of Albania's latest economic and monetary developments and following discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 4.00%.

The Supervisory Council deems that the monetary conditions are appropriate to meet the inflation target in the medium run and provide the needed monetary incentive to support the domestic demand.

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

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Annual inflation marked 2.7% in July, up 0.5 percentage points from a month earlier. The inflation rate went up mainly due to higher unprocessed food prices during this month. Similarly, non-food consumer prices added their contribution to annual inflation as a result of higher oil prices. Regardless of minor fluctuations, the contribution of other goods of the basket to inflation remained steady.

Despite rising, consumer price inflation remains in the lower interval of Bank of Albania's inflation target band. From the macroeconomic viewpoint, it rose due to impact of transient factors, while the poor performance of aggregate demand continues to generate low pressures on consumer prices. Furthermore, increase in production costs remains weak, imported inflation remains low, and inflation expectations of economic agents remain anchored.

Second-quarter data on the economy point to slow growth of economic activity during this period. While some of the indirect indicators signal improvement from the first quarter, consumers' propensity to save continues. This behaviour is reflected in the postponement of substantial expenditures, increase in deposits and investments in securities, and decline in consumers' demand for bank loans. Private investments remain weak, reflecting the poor performance of the final demand in the economy. Capacity utilisation rate remains low, whereas exports of machineries and equipment fell 9.5% in the second quarter, in annual terms, after expanding about 1.5% in the first quarter of the year. The banking system continued to grant credits for

private investments at rates comparable to those of the first quarter of the current year.

The fiscal policy pursued its consolidation during the first six months of 2012, materialising in budget deficit narrowing during this period. In the presence of slow growth of budget revenues, this behaviour was reflected in the contraction of budget expenditures by 1.2%. On the other hand, budget revenues increased 4.0% in annual terms, driven by low increase in tax revenues. The performance of revenues, expenditures and public borrowing materialised in a budget deficit about 31.6% lower than the corresponding period of a year earlier. The Bank of Albania notes that maintaining the fiscal discipline has contributed positively to the financial soundness of the Albanian economy and to the control of risk premia in the economy during the first half of 2012. Ongoing efforts to maintain long-term stability of the public debt will contribute to boost fiscal policy credibility and reduce funding costs to the Albanian economy.

Foreign demand improved in the second quarter. After shrinking in the first quarter, exports of goods recorded nominal annual growth by 19.2%. Imports of goods, in value, curbed by 4.4% in annual terms, reflected in budget deficit narrowing by 16.5% during this period. Stronger orientation of the Albanian economy towards exports and enhanced competitiveness of our products should be a priority for the public and private sectors. In spite of the unfavourable situation in international markets due to the prolonged crisis in our trade partner countries, boosting our exports should be seen as a national long-term strategy for supporting sustainable economic growth and converging with EU standards.

Monetary developments were in line with the real-economy performance. Annual monetary supply growth slowed down to 8.3% in June, reflecting the reduction of public sector's funding by the banking system and the weak demand for monetary assets from the private sector. Influenced by added uncertainties about macroeconomic developments at home and abroad, the private sector's demand for bank loans was low. For the same reasons, the banks continue their added prudence as regards lending. Consequently, the annual growth rates of lending to the private sector decelerated to 6.8% in June. Promoting healthy crediting has been and remains a constant priority of Bank of Albania's policies. In this regard, we have cut the key interest rate to historically low levels, reviewed and revised the regulatory and supervisory framework, and supplied the banking system with the required liquidity. Therefore, the Albanian banking system is among the few ones in the region that has maintained positive credit expansion rates over the recent years.

Financial markets were characterised by adequate liquidity and low interest rate fluctuations. Interest rates on the national currency continued their downtrend in July, following the easing cycle of the monetary policy and the improved demand and supply ratios in the domestic public debt market. Particularly, in the primary market, yields on government securities slowed down their pace of increase and there are signals for their further reduction

in the period ahead. Overall, financial market developments point to low liquidity and inflation risk premia.

Projections for the expected performance of the economy sustain earlier assessments for slow growth of the Albanian economy for the period ahead. Having performed poorly in the first half of the year, domestic demand is expected to continue to be conditioned by economic agents' reluctance to undertake private consumption and investments.

In parallel, meeting of public debt sustainability thresholds determines a consolidating stance and lower contribution of the fiscal policy to economic growth. On the other hand, foreign demand is expected to provide a positive but weak contribution to aggregate demand growth. Under these circumstances, economic growth is estimated to remain below its potential and generate low inflationary pressures during the upcoming period. Taking into consideration the other variables contributing to inflation, the Bank of Albania deems that in the medium run inflationary pressures remain controlled, determining therefore the maintaining of the stimulating monetary policy during this period.

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At the end of discussions, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 4.00%. For the period ahead, the Bank of Albania remains heedful to economic and financial developments at home and abroad and stands ready to intervene timely and duly, in compliance with its mandate.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision of Bank of Albania's Supervisory Council, 26 September 2012

Today, on 26 September 2012, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the analysis of Albania's latest economic and monetary developments, and following discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 4.0%. The Supervisory Council deems that the monetary conditions are adequate to meet the inflation target in the medium term and provide the needed monetary incentive to support domestic demand and economic growth.

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

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Annual inflation in August was 2.8%, increasing 0.1 percentage points from July.

Inflation continues to be determined primarily by price rise of foods and oil. Prices of other goods of the basket appeared relatively stable and provided low contribution to headline inflation.

According to our estimates, inflation reflects mostly the temporary effect of supply factors related mainly to developments in global markets, as well as the possible structural movements in the internal market. Against this setting, the inflationary pressures originating from the domestic economy appear contained. Weak domestic demand and below-potential economic growth are reflected in slow increase in production costs, anchored inflation expectations and controlled monetary expansion. The Bank of Albania deems that, overall, these developments will continue to determine inflation's performance in the period ahead.

Indirect data on economic performance in the second and third quarters of the year suggest positive-but-slow economic growth. The Albanian economy has capitalised on the better performance of foreign demand and exports during this period, while domestic demand has remained weak.

In the absence of stimulus by the public sector, indirect data point to weak dynamics of consumption and private investments. Hence, consumers' higher prudence is reflected in lower consumption and higher savings by Albanian households.

As noted in earlier statements, this behaviour reflects to a large extent the correction of consumption levels noted in the economy until the end of 2008. All the same, in the context of the current situation in the economy and global financial markets, the consumers' reluctance to purchase durable goods reflects also their uncertainty about future developments. The Bank of Albania deems that the deceleration of consumption in response to uncertainties about the economic outlook may become a spiral with macroeconomic indicators having mutual influence between them. Contraction of consumption is associated with downward domestic demand, leading to subsequent slowdown of economic growth and lower household income. Our analyses and projections have continuously suggested that the macroeconomic situation and the Albanian economy have sustainable basis for long-term development. This reality should be translated into a more realistic behaviour towards higher consumption levels in the economy, within the boundaries of solid household budgets.

Likewise, private investments are considered as relatively low and conditioned by spare production capacities, expectations for ultimate demand for goods and services in the future, and added prudence by banks to lend. In particular, private sector's weak demand is also reflected in its low demand for loans in the recent months. In response to these developments, private sector credit continued to decelerate its annual growth rates to 5.5% in July. The Bank of Albania has continuously provided the required conditions to stimulate crediting. This approach is implemented by easing the monetary policy, injecting continuously liquidity into the banking system and establishing the proper supervisory and regulatory framework. These actions have led to relatively rapid growth of lek-denominated loans against foreign currency-denominated ones. Nonetheless, in our view, businesses may cooperate more closely with the banking system. On its side, the banking system should be more flexible and pay attention to macroeconomic and sectoral development perspectives, while businesses have investment opportunities in those branches of the economy whose potential is still unexploited.

The third component of aggregate demand, public expenditures, had low contribution to Albania's economic growth.

In the first eight months of the year, fiscal policy was consolidative. During this period, budget expenditures shrank 0.4%, year-on-year, due to lower growth rates of current expenditure and contraction of capital expenditure. During the first eight months of the year, fiscal revenues increased 3.7%, registering record-low growth rates. Prudent expenditure policies were materialised in budget deficit contraction. In January-August 2012, the deficit was about 29% lower than a year earlier, contributing to maintaining long-term fiscal stability. We deem that continuing to pursue this policy, oriented towards medium and long-term stability of public debt indicators, is necessary and productive given the current condition of financial markets.

Aggregate demand continued to support economic growth in the second quarter of 2012. Net export deficit narrowed 23.9% during this period, reflecting higher exports and lower imports than a year earlier. Foreign trade data reveal that the positive impulse is carried forward in July as well. Year-on-year, exports grew 11.6% during these months, whereas imports recorded low annual growth rates, namely 1.1%. These developments have led to trade deficit narrowing by 5.2%, year-on-year.

Monetary developments point to moderate monetary inflationary pressures on the economy. Money supply retained its expansion rates of earlier months, registering 8.4% annual growth in July. Its performance reflects the low demand of the domestic economy for monetary assets. The performance of financial markets has reflected the improved liquidity conditions, lower risk premiums and inflation situation in the economy. Interest rates in the interbank market went down, transmitting the most recent cut of the key rate in July. Additionally, yields in the primary market of government securities continued their descent. Further easing of monetary conditions is expected to be transmitted also to interest rates in other segments of the financial market, conform to the time lag of monetary policy transmission mechanism. In the improved context of domestic financial markets and in the presence of a sound banking system, the Bank of Albania expects that its earlier decisions to ease the monetary policy will be eventually transmitted in full to the economy.

Projections for the economic outlook are in line with the baseline scenario assessed in previous months.

Economic activity at home is expected to remain low, conditioned by weak consumption and private investments as well as limited space for fiscal stimulus. Consequently, inflationary pressures remain low and in check, reflected in the performance of inflation expected to range close to Bank of Albania's target.

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At the end of the discussions, the Supervisory Council decided to keep the key interest rate unchanged at 4.0%.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the joint press conference of the IMF mission,
Albanian Ministry of Finance and Bank of Albania,
2 October 2012

Dear journalists,

During the last two weeks, intensive discussions have taken place between the IMF mission and Albanian authorities. As a key player in drafting and implementing macroeconomic policies, the Bank of Albania has been active in these discussions, sharing its vision on current and expected developments in the Albanian economy and concerns surrounding it, as well as optimum measures to address them.

The Albanian economy is increasingly facing the economic growth challenge. While the Albanian economy enjoys consolidated macroeconomic stability and sound financial foundations, aggregate demand has been weak during the first nine months of 2012. Both domestic demand and foreign one suffer from high uncertainty, relatively tight lending standards, and limited space for discretionary and stimulating policies. In the global context, the Albanian economy encountered a difficult setting, characterised by economic growth problems, high risk premiums in financial markets and decreased appetite of these markets to invest in emerging economies. In the domestic context, the economy continues to face relatively low consumption and private investments, as well as an absent stimulus by the public sector as a result of the increasing orientation of the fiscal policy towards maintaining long-term stability of the public debt.

In the presence of temporary shocks from the supply side, these factors were translated into negative economic growth for the first quarter. According to our estimations, the following months have recorded improved aggregate demand and economic activity, yielding economic growth for 2012. This growth, however, remains relatively low and inadequate to ensure full production capacity utilisation. It has led to low inflationary pressures during 2012 and is reflected in improved external position of the Albanian economy.

The banking and financial system remains sound. Banks that operate in Albania are characterised by satisfactory liquidity and capital levels, and fit for financial intermediation. Transaction and risk indicators are also improving, as perceived in the financial markets and, following fluctuation in the first half of the year, interest rates have trended down.

Given the above-mentioned circumstances, the monetary policy of the Bank of Albania has been increasingly stimulating. During the past year, we have sequentially eased the monetary conditions; after five consecutive key interest

rate cuts, the cost of money in the economy reached its record low. Moreover, through our monetary operations, we have supplied the banking system with the liquidity it needs for smooth operation. Finally, through the review of regulatory norms and application of a prudent supervision of the banking system, we have managed to establish a stable financial environment for the country's long-term development. Boosted confidence of the public in the banking system was followed by rapid increase of bank deposits, thus reducing reliance on foreign short-term financing. All these initiatives, coordinated with other policies, have proven effective. Inflation remains subdued and in check, inflationary expectations are anchored, macroeconomic environment is steady and financial stability is consolidated.

Looking ahead, the Bank of Albania holds that the Albanian economy will continue to face the above-cited concerns over 2013 and beyond. Although improving, economic activity is expected to remain below its potential, followed by low inflationary pressures, creating premises for maintaining stimulating monetary conditions in the future. Likewise, our projections suggest that external balances of the economy are expected to improve. On the other hand, slow economic growth rates may generate pressures on debt stability indicators, unless they are identified and taken into consideration in fiscal policy decisions.

In Bank of Albania's view, growth rate recovery will require combining the cyclical stimulus of the economy with structural measures that expand the growth potential.

Regarding the cyclical aspect, the Bank of Albania holds that macroeconomic policies are rightfully stimulating. In the absence of space, fiscal policy should continue to be oriented towards long-term stability of debt indicators. The monetary stimulus is expected to be transmitted more completely in the upcoming period. We continue to underline our message that businesses and consumers should have a more realistic approach on sound perspectives for the country's development as well as revise up their consumption and investment plans.

In the structural aspect, we welcome reforms and initiatives that contribute to the country's growth potential, through developing infrastructure, improving the legal framework, enhancing productivity and competitiveness of the Albanian economy, attracting foreign investments and maintaining and improving macroeconomic stability at home.

The Bank of Albania is fully committed and engaged in the latter. Our key focus will continue to be: maintaining price stability and establishing pre-requisites to step-up financial stability. Therefore, we are convinced that we are providing a valuable service to long-term economic growth and welfare.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the conference on 'Competition versus Risk-taking in the Banking Sector in SEE Countries', organized by the Central Bank of the Republic of Kosovo. Prishtina, 5 October 2012

Honourable Governors,
Dear participants,

Regular regional meetings are a good opportunity to discuss economic and financial developments in our countries. They help identify the similarities and differences among us, and the economic and financial policies we need for solving the problems we encounter.

The geographic position and economic relations with the same trade partners are factors that have led to similar economic and financial developments across our countries. They have determined the nature and size of contamination from the global economic crisis, in general, and the euro area crisis, in particular.

The impact of the crisis on our countries has often been the main topic of discussion in such meetings. Macro-financial difficulties and uncertainties in the euro area render the actual European crisis the main focus of this meeting as well.

Actual operations and commitments of the European Central Bank consist in a wide range of instruments that European authorities may use to support financial markets and institutions. Investors, however, are still waiting on additional decisions which will be more harmonised and stronger politically. The economic situation, especially in Greece and Spain, remains difficult, whereas Portugal and Italy have undertaken additional fiscal consolidation programmes. Unemployment in the EU and the euro area has reached historic levels, especially amongst the youth. Economic growth is weak and is mainly concentrated in central countries of the euro area.

Our countries have been affected by this situation for objective reasons. Trade relations, movement of capital and workers, and the financial system are channels that pass these problems on to our economies. The form, size and extent of this impact have evolved over the past four years.

At present, the situation is reflected in the decrease of domestic demand, decline of economic growth, reduction of available income, loss of confidence and deterioration of optimism; this is, in turn, reflected in higher savings.

Consequently, these developments have placed the focus of economic policies towards economic activity and revitalisation of optimism in order to boost investments and consumption. On the other hand, maintaining financial stability becomes a necessity, creating thus a binomial of priorities that condition each other and require a simultaneous solution.

The Albanian economy is increasingly facing the challenge of economic growth. Although the Albanian economy enjoys consolidated macroeconomic stability and sound financial foundations, aggregate demand has been weak during the first nine months of 2012. Both domestic and foreign demand suffer from high uncertainty, relatively tight lending standards, and limited space for discretionary and stimulating policies.

In the domestic context, the economy continues to face relatively low consumption and private investments and an absent stimulus by the public sector resulting from the orientation of the fiscal policy towards maintaining long-term stability of the public debt.

On the other hand, the banking and financial system remains sound and liquid and capital indicators are at relatively satisfactory levels. The activity of the banking sector continues to be strongly supported by the increase of publics' deposits. Banks have reinforced their capital position to boost resilience against risks arising from banking operations. As at the end of June 2012, the capital adequacy ratio stood at 15.6%. Credit developments, however, remain a problem that is subject to the performance of economic activity and expectations for the future.

Slowdown of economic activity and decline of demand for investments and consumption by businesses and households are determinants of private sector credit and credit quality performance. On their side, banks have evidently increased their prudence as regards lending.

Periodic stress tests show that the banking sector is resilient and can withstand any adverse events to economic performance. However, we are aware that the banking industry is facing difficult challenges. Besides recovery of economic activity and confidence for the future, improvement of credit quality requires also the completion of legal issues to enable and facilitate collateral execution. Selling impaired assets at their real market value is the starting point of the process for making financial correction and enriching the private sector's balance sheets and the financial system a whole. Cleaning up balance sheets would promote economic activity through consumer investments, by ensuring a constantly improved credit quality.

Currently, the mutual influence of economic activity and credit quality is the main concern to monetary policy. Efficiency of successive interventions by lowering the key interest rate is overshadowed by negative expectations.

Consequently, the effects of business and household consumption and investments on domestic demand are not at the desirable level. In spite of these problems, economic growth remains in positive territory, but below the potential. According to our estimates, it will remain positive even in the future. Economic and financial operators' inflation expectations remain anchored around the Bank of Albania's target.

Good liquidity condition and capitalization of the banking sector, and stability of macroeconomic indicators have led to harmonised economic policies for maintaining the status quo. If this situation remains as such in a predictable time horizon, the monetary policy may remain accommodative over the same period. The recovery of the domestic demand and economic growth is further related to expectations, which are also affected and contaminated by our trade partners' condition.

The fiscal policy has aimed at fiscal consolidation and has continued making efforts to prudentially provide necessary fiscal stimuli.

Currently, if the privatization process is successfully completed, then the fiscal opportunities for promoting economic growth and for revering any negative expectations are significant. The way of using privatization receipts should not only support the short-term economic growth objectives, but should also affect the economic operators' expectations for stable economic growth in the future. The latter can be achieved by using additional revenues to reduce debt levels and support reforms for structural changes in the economy.

Dear participants,

Currently, we are of the opinion that the concept of long-term development strategies of a deeply national character is an important issue for the stable long-term growth in our region. Lacking a regional perspective does not favour the individual success of small economies in the global economy.

The process of connectivity and integration of transport infrastructure should continue with the integration of development strategies, capital markets, the labour and primary commodities, and energy infrastructure. Our economies are vulnerable and contaminable from global developments because they are small economies in an economic region fragmented and dependent on foreign inflows in the form of investments, exports and remittances.

Increase in the market share, ease in production factors mobility (capital, labour, and raw materials), integration of financial and payment systems, integration and coordination of scientific and educational curricula and addressing of challenges from a regional perspective would make the region an attractive and integrating economic place. This integration would identify the comparative regional advantages, enhancing at the same time the competitiveness of each of our economies.

Consequently, it would convert the tendency of the region to be negatively contaminated from global developments into an opportunity, a positive impact, in order to achieve high and stable economy growth in the long run.

Thank you!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Opening of the Bank of Albania's Exhibition entitled "100 Years of Independence: Our History Reflected in the National Currency", National Historical Museum, 25 October 2012

Twenty years ago, in February 1992, the governments of 12 EC member states signed the Treaty of Maastricht, through which they committed to adopt a common currency.

Ten years ago, on the New Year's Eve 2002, the lights of the European central banks' top floors never turned off. The governors and their closest collaborators slept very little. The preparations for the launch of the Euro were punctual; however, this experiment had never been tested before. There had not been any similar actions they could base on and the variables at stake were numerous.

Twenty years ago, we, Albanians, re-experienced significant historical changes, showing no less powerful concerns and enthusiasm than that experienced by our predecessors founding the Albanian State 100 years ago. In this marked year for the European monetary system, significant economic changes took place in Albania. This transformation gave life to the two-tier banking system and paved the way for the establishment of a modern central bank in features and functions.

The last 20 years witnessed the unprecedented quality of an independent central bank, as one of the cornerstones of the Albanian state, and its efforts over the years to preserve the value of its national currency, the Lek.

Surely, the progress achieved by the Albanian economy in the last 20 years has not been similar to the one achieved by our European neighbours; however, the developments clearly show that it is a developed market-oriented economy aiming the final integration to the European Union. This period has pointed out the importance of structural reforms in the Albanian economy, making it more competitive and hedged against the crisis.

By hosting this exhibition celebrating Albania's 100th Anniversary of the Declaration of Independence, the Bank of Albania is proud to remember one of the major aspects of the country's state formation process, which does not usually receive the same attention as do the political and military events, or the real economy developments. This aspect refers to the history of our national currency.

In addition to the exhibition's theme area dedicated to monetary circulation during antiquity, dating back to the 4th century B.C. when the first domestic coin was minted, we also want to draw your attention to that part of the

exhibition dedicated to the circulation of the major European currencies in the Albanian historical territories. An additional and no less important message this exhibition seeks to convey is that the history of Albania is closely linked to that of the rest of the old continent, to which it undisputedly belongs – despite the historical consequences – is pre-determined to be a European one.

Although our national currency could not be instituted as the currency of the Albanian State soon after the Declaration of Independence, its historical events and hardships provide enormous contribution to telling the history of Albania, amid times of hope and trouble. Being one of the most important symbols of a sovereign state, the issue of the national currency of Albania and, consequently, the establishment of a national central bank was one of the main projects and aspirations of Albania's academics and ideologists.

Thanks to its national currency, Albania aspired to enjoy economic independence, in addition to the political one. It would contribute to developing Albania's economy and firming up its independence. In his speech held a few days following the signature of the agreement on the establishment of the National Bank of Albania, Ismail Qemali said: "As any man, who, no matter how rich he is, needs to borrow, indeed, by his loans you can understand the magnitude of his honour. Similarly, the countries need to borrow and they take pride in the loans they have in the overall stock exchange". This quote from Ismail Qemali is as old as it is relevant today. What has been proven today is that the countries' sovereignty depends on the price of government bonds in the market.

Dear guests,

The history of the currency is as old as the earth. Who would have ever thought that axes were the main medium of exchange in our region as a substitute for money in ancient times?

I also believe today's Europeans, the German, Dutch, French and Italian people, would be surprised if anyone told them after World War II that their Deutsche mark, Dutch guilder, French franc and Italian lira would no longer be legal tender by 2010, and that they were to be replaced by a common currency called the Euro. To everyone's surprise, the Euro was the first currency with no nationality. Bridges, maps, arches, buildings and stars replaced the images of kings, leaders and distinguished scholars. What surprised the most was that, from a single country's responsibility, it turned into a common responsibility.

In 1855, Victor Hugo predicted: "A continental currency, with a dual metallic and fiduciary base, resting on all Europe as its capital and driven by the activity of 200 million men: this one currency would replace and bring down all the absurd varieties of money that exist today, with their effigies of princes, those symbols of misery."

However, this currency still has a long way to go. Similarly, our journey with the Lek is still long.

The features, quality and technical characteristics of money are part of its credibility. However, its purchasing power is what characterizes the real value of money. In the last 20 years, the Bank of Albania has managed to ensure a fit and credible currency, dear to all Albanians.

Lastly, I would like to underline that this has been an important year for numismatics. A new series dedicated to Albania's 100th Anniversary of Independence has been launched and presented in today's exhibition.

I hope through this exhibition we have created an idea for the journey of our national currency and, consequently, of the current monetary system. I also hope all visitors will wish to revisit similar exhibitions as the Bank of Albania's museum will be opened soon. In order to carry out this project, we addressed to historians, economists, librarians, archivists, artists, communication experts and national and international architects.

The final outcome will derive from the meticulous cooperation between the academic sphere, institutions, cultural industry and the Bank of Albania. I believe the cooperation to store and expose the national values is the proper message to convey on the verge of Albania's 100th Anniversary of Independence.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the 10th international Conference on
"Monetary policy, from the past to the present"
26 October 2012

H.E. Prime Minister,
Your Excellencies Ambassadors,
Honourable Minister of Finance,
Honourable Governors,
Distinguished Guests and Participants,

I am very honoured and privileged to open the proceedings of the Tenth Conference of the Bank of Albania. This conference is particularly important this year as it is organised in the framework of activities for the 100th anniversary of the Declaration of Albania's Independence and the 20th anniversary of the Bank of Albania. While retaining the scientific approach, the conference pays tribute to the endeavours made over the years in the monetary and finance aspects.

In Bank of Albania's view, the past is an essential element for the analysis and decision-making, and a requisite for theoretic or empirical research. At present, this is a necessity, a challenge that the economics world is facing.

To scan, diagnose and cure the situation of the economy, a successful scholar would have to be able to read the human thought. Unfortunately, such a doctor does not exist.

Therefore, in our days, the economic science is turning its attention to individual characteristics such as: history, ethnography and other national traits, considering them as substantial determinants for the stochastic process that leads the behaviour of economic agents.

The history plays also a significant role in the formation and development of institutions. The declaration of independence introduced a new era for Albanian state institutions, paving the way for the establishment of a central bank, a unified Albanian monetary system, and the administration of economic life through the monetary policy. Despite its short life, the National Bank established in 1913 is a cornerstone in the history of the Albanian state. The then Prime Minister, Ismail Bej Vlora said about it: "I say the affair of the Bank is praiseworthy; for Albania, it is a second victory, after freedom, from both the economic and political perspective."

The events that followed the declaration of independence, in the national and international aspect, have played a crucial role concerning the nature and character of these institutions and, at the same time, determined the nature of the monetary policy.

Economic and political partnerships, and the charisma of the Albanian statesmen to build a modern society, led to the establishment of the first functional national bank in 1925, with the characteristic and distinctive profile embodied in the building that was constructed in the centre of Tirana.

Historic developments in early 1990s became once again determinant factors for the financial system and the central bank. Introduction of modern economics concepts led to the creation of the Bank of Albania as a bank with all the attributes of a modern central bank.

Its institutional evolution led to the development and modernisation of monetary and financial policies. The Bank of Albania became also an important institution for the development of the financial and economic systems in Albania.

The challenges of the past 20 years have transformed the central Bank into a modern, responsible and credible institution; a centre of professionalism; an institution that applies the most modern methods of monetary management; the heart of the financial system.

Aware of the decisive role that modern theories on economic growth assign to institutions for the prosperity of a nation, and taking advantage of the support from the political class and the trust of the Albanian society during these 20 years, the Bank of Albania has undertaken to transform itself into a modern institution and a dignified public entity across the institutional, moral, professional, ethical and intellectual dimensions.

The Bank of Albania considers this as a highly significant task and contribution to state formation and prosperity in the future.

Its efforts for the infrastructural and conceptual modernisation of the institution, including the Bank's construction projects during the last three years, are a requisite to guarantee contemporary standards for the management of the activities of the institution. In other words, this literally implies rapid approximation with homologous institutions in Europe. Upon the completion of these projects, the Bank of Albania will be more opened to the public that will benefit from financial education policies, scientific research, library services, and legislative, history, museum, and numismatic-related activities.

These novelties will be offered to the public as a modest contribution to the formation of a modern and dignified state for the Albanian nation.

At present, fulfilling these obligations has become a more difficult task due to negative effects arising from the global economic crisis. Most evidently, labour markets, capital markets and economic activity remain under the effect of contraction of consumption and investments in the private sector.

The anaemic reaction of the markets has placed central banks in a difficult position, a solution without any choice, i.e. intervene in the economy with all

the instruments to address current emergencies while the other factors are forced to contract in favour of the long-term stability of public and private balances. In this situation, central banks are obliged to undertake a series of extreme and qualitatively-different measures, which have been never tested before and exceed all imaginary boundaries of the monetary policy.

Actually, politicians are obliged to cope with debt crisis through an extreme fiscal policy aiming at short-term balancing and long-term stability of the fiscal policy. The focus and emphasis of the economic policy remains long-term rebalancing by cutting on expenses. An important part of these measures is very focused on the short-term problematic, hence risking to disregard the undesired effects in the long term. Under the pressure from social costs, the philosophy of current policies is to overcome the situation and maintain social peace and macroeconomic stability at the expense of sovereignty.

This emergency compromise has shifted the focus away from structural reforms, which guarantee rebalancing through the increase of income. Often, the perspective of economic policies does not extend beyond some quarters ahead, while a much longer time vision should be considered. The anchoring of the future should start from the present.

The actual philosophy of stabilising policies is based on past experiences with the hope that the current crisis is similar to previous ones. This reasoning has urged the authorities to insist on recycling stabilising measures. The time, however, shows that the global economy has undergone radical changes. The current crisis is happening as the global economic map is being redesigned in terms of economic size, geographic distribution of savings, debt, and trade and current balances. Advanced economies have traded positions with the emerging ones across all these dimensions.

Consequently, old recipes do not provide an exit given that axioms on which they are based have changed. The solution of current and future challenges requires a new philosophy of thinking based on the new global reality.

This reality, globalisation, is no longer a choice, but a fact that should be taken into account when formulating long-term development strategies.

Turning to a regional setting, I think that this philosophy should be embraced and supported without hesitation. In order to make it more productive, we should be more opened to each other and take regional cooperation to new and higher levels.

Individual prosperity of the economies of the region requires that we leave behind the philosophy of competition encouraged and inherited by state-formation efforts and sclerotic models that dominated the last century. We need to prepare the way for elevated economic and financial cooperation and coordination.

We need to tear down Balkan barriers and raise, instead, a comprehensive functional infrastructure, a regional payments system, a regional energy system, a regional market of financial products and lastly but may be most importantly a regional market of production factors. In Martin Luther King's words "we may have all come on different ships, but we're in the same boat now".

Dwelling a little longer on the regional theme, I would like to briefly touch on another problem.

The experience of the past year shows that as a result of regulatory capital requirements imposed by euro area supervisors, various bank groups reduced their participation not only in the euro area markets but also in our region.

This process, known as deleverage, yielded negative consequences. To prevent such phenomena, policymakers and supervisors of partner economies need to cooperate more closely.

In this regard, the Vienna Initiative is a good but limited cooperation platform. It is conceptualised as an instrument to address emergency crisis situations, whereas the current situation requires platforms for dialogue to enable effective and persistent communication among policymakers. This dialogue should aim at preventing undesired mutual effects; a more ambitious programme, on the other hand, would aim at drafting and implementing coordinated initiatives of mutual interest.

Nonetheless, potential emergencies arising from contamination from euro area partners would create additional difficulties and huge effective costs for the economies of the region.

Therefore, we call for the establishment of appropriate mechanisms and instruments for liquidity provision by the European Union to peripheral euro area countries.

I believe that the financial integration makes this common defence more urgent, through the right understanding of the common fate of our trade partner economies. I take the opportunity, given the presence of many central bank officials from the region, to call for an en bloc coordinated position in this regard.

The experience of the latest crisis showed that the countries which had more space to react, in the form of healthier fiscal balances or the financial system, and in the form of more reliable public institutions, were able to cope better with the consequences of the crisis. This lesson should not be neglected. Among other things, it implies timely measures and, through counter-cyclical policies, establishment of the necessary space to buffer potential shocks. Likewise, it implies ongoing efforts by macro and micro-prudential policies to minimise financial misbalances across all the sectors of the economy and the financial market.

These policies, which are often known as "leaning against the wind", have been and will continue to be part in the logics behind the actions of the Bank of Albania.

Concluding, I would like to assure you that the Bank of Albania will make maximum efforts to continue its success story into the third decade of its life. I am confident that these issues I shared with you provide a summarised vision of some of the main directions of our work during this period.

Looking forward to a productive exchange during the proceedings of the conference.

I thank You for your attention!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision of Bank of Albania's Supervisory Council, 31 October 2012

Today, on 31 October 2012, the Bank of Albania's Supervisory Council reviewed and approved the quarterly Monetary Policy Report. Based on the analysis of Albania's latest economic and monetary developments, and following discussions on their performance outlook, the Bank of Albania's Supervisory Council decided to keep the key interest rate unchanged, at 4.0%. The Supervisory Council deems that the current monetary conditions are adequate to meet Bank of Albania's inflation target in the medium term. Keeping the key interest rate at its minimum historical level ensures the necessary monetary incentive to promote Albania's domestic demand and economic growth.

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

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The Albanian economy was faces with a challenging global environment over the first three quarters of 2012 due to difficult situation of the world economy, and particularly of the euro area. Domestically and externally generated supply shocks determined the economic growth profile and continued to test Albania's macroeconomic and financial foundations. Over this period, the Albanian economy was faced with slow foreign demand growth, increased financial risk premia and tendencies of several financial market agents to reduce exposure to Albanian economy. These developments were also reflected in low consumption and investment levels. Along with the reduced fiscal stimulus in 2012, they resulted in a weak aggregate demand and low economic growth during the first three quarters of the year.

Despite the negative impact on economic growth rate, the financial and macroeconomic stability resulted stable. In spite of demand volatility and supply concerns, inflation resulted low and in check, reflecting, inter alia, good anchoring of public expectations around the 3% target. Fiscal balance sustainability, Albania's improved external position, and sound real-sector and financial-sector balances in the economy further strengthened Albania's economic and financial stability over this period.

Average annual consumer price inflation resulted 2.7% in the third quarter of the year, increasing gradually along the year.

Added contribution of prices for unprocessed food and non-food consumer goods mostly created this quarter's annual inflation rate. On the other hand,

prices of other basket items were stable and slightly volatile. The economic and monetary analyses confirm the presence of weak demand-induced inflationary pressures. Developments in the real sector of the economy conditioned the controlled price rise of domestic products. These tendencies have been reflected in the downward trend of core inflation and low non-traded inflation of the consumer price index basket.

Consumer price performance continued to reflect the low pressures from other cost elements. In particular, import prices were low and given the relative exchange-rate stability, they transmitted low pressures from imported inflation.

Following the economic contraction in the first quarter, Albanian economy fell by 2.0% y-o-y, in the second quarter. Economic activity growth was generated by agriculture, industry sectors and some branches of the services sector, while the construction sector fell sharply.

From the viewpoint of aggregate demand, the second quarter's economic growth was mostly supported by the foreign demand, while the domestic demand remained sluggish. Consumer spending, though higher than in the first quarter, did not return to past year's rates of increase. This component of the domestic demand remained influenced by the perceived uncertainty, lacked dynamisms in the labour market and slowed available income. Confronted with a low ultimate demand for their products and in the presence of spare capacities and relatively tight lending terms, private investments also remained low. In particular, during the first half of the year, the low private investment level reflected households' low demand for housing.

Public spending and fiscal stimulus were also weak, reflecting the consolidating fiscal policy and observing the fiscal restrictions required by law. Fiscal consolidation, which is based mostly on reduced expenditure, is illustrated through the downward trend of budget deficit over the period. The budget deficit resulted about ALL 25.7 billion during the first three quarters of the year, down by about 19%, y-o-y. Until September, the realised expenditures were about 0.2% lower than a year earlier, while the budget income increased 2.3%.

The data on developments in the external sector of the economy show Albania's significantly improved external position. The value of exports increased 6.7%, y-o-y, in the first quarter, reflecting the moderation in the foreign demand and performance of global market prices. Over the period, imports contracted by 0.9%, y-o-y. These developments led to an annual contraction of trade deficit by 5.4% until August, positively influencing the aggregate demand growth. Also, the sharply decreased current account deficit in the second quarter is a positive signal for the long-term stability of this indicator and assists in stabilizing the demand for and supply of foreign currency in the domestic market.

Developments in the monetary sector attest to low inflationary pressures in the economy. Monetary assets expansion slowed over the third quarter, reflecting the decline in the domestic demand for money.

The public sector's prudential behaviour has led to a low demand for monetary assets, particularly from the banking sector. On the other hand, the slow economic activity and available spare capacities appear to have restricted the private sector's demand for monetary assets. Private sector credit increased by 5%, y-o-y, in August, following the slowing trajectory having started since the second half of 2011. Developments over the past months show that banks are more active in national currency intermediation, while they have decreased their foreign currency intermediation. This development is driven by banks' readiness to invest lek funds and economic agents' increased awareness of foreign currency credit risk.

Regarding lending concerns, we would emphasise that the weak credit performance owes mostly to economic agents' low demand for monetary assets. However, the bank credit supply appears somewhat tightened.

The banking system remains prudential in selecting the projects it finances, as a consequence of deteriorated loan portfolio quality and uncertainties surrounding the future outlook. Banks continued to maintain tight lending standards, appearing rather selective in assessing the business plans and meeting the demand for loan. Overall, the Bank of Albania assesses that creating a positive climate assists in recovering lending and the demand for loan. The Albanian banking system remains well-capitalised, liquid and capable of meeting the economy's needs for credit. However, within the parameters of financial prudence, it should be forward-looking about its decisions and more flexible in providing financial support to Albanian business.

Financial markets were characterised by a downward interest rate trend over the third quarter, associated with low liquidity pressures and reflecting the Bank of Albania's easing monetary policy.

Increased interbank market activity suggests the increased efficiency in using this market and is a good premise for developing the overall monetary market in Albania. Over the period, the easing monetary policy signals in terms of lowering the government security yields were better transmitted. This transmission was favoured by completion of structural movements in the banking system and reduced government demand for funding. Deposit interest rates continued to fall as well, but as already reflected by the high deposit growth over this quarter, they did not restrain the increase in financial savings at the banking system. The easing of financial costs was not fully transmitted to the private sector credit segment during July-August. In particular, additional costs required by banks to anchor the new credit remain tight, in response to the perceived uncertainty and their reacting mechanism for credit risk reduction.

Against the backdrop of slow current and expected economic developments, aggregate demand and inflation, the monetary policy deepened its stimulating nature in the third quarter. As at end-July, the key rate was lowered by 0.25 percentage points, down to its historical minimum of 4.0%. This was the fifth key rate lowering since September 2011. Parallel to that, the Bank of Albania

continued to supply the banking system with the required liquidity through its variable liquidity-providing operations.

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Future outlook suggests that inflationary pressures remain low. Our analyses and projections conclude that the economic activity will remain below potential, exerting pressures on the downside inflation. At the same time, the supply generated pressures appear contained.

Based on current performance of inflation-determining factors and their future outlook, after 12 months inflation is expected to fluctuate around 1.2% – 3.4%, with a probability of 90%. The expected inflation and economic outlook imply the maintaining of a stimulating monetary policy for the period ahead. The Bank of Albania remains heedful to future developments and new information, and stands ready to intervene timely and duly to meet its legal mission.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Opening of the Exhibition "100 Years of Independence: Our History Reflected in the National Currency", Vlora, 16 November 2012

Dear Mayor,
Dear Ladies and Gentlemen,

It is a great pleasure for me to be here today in Vlora on the occasion of the opening of the Exhibition "100 Years of Independence: Our History Reflected in the National Currency". It is extraordinary that we are only a few days away from the celebration of Albania's 100th anniversary of independence.

In the capacity of the institution responsible for issuing the currency in Albania, the Bank of Albania considers that it is its duty to inform the public at large about Albania's monetary history. The exhibition we are opening today is a contribution in this respect. It presents the journey of currency in Albania from the declaration of independence to this day. It features a vast collection of artefacts of the Albanian state monetary history. It has great material and cultural value as many of these objects are unique and date back to prior the issue of our national currency by the Bank of Albania.

By touring a number of cities in Albania, such as Berat, Gjirokastra, Korça, Shkodra and Tirana, and making a stop in the city where Albania's independence was declared, we are walking along the same path as our national currency – the lek. We aim to draw the public's attention to the fact that the state formation process and our modern history are not only about political and military events, or about biographies of people and institutions, but they are also closely linked to the history of our national currency.

As soon as you enter this exhibition, you can immediately feel how the history of the Albanian currency has walked hand in hand with our nation's history and its major historical figures. They are so closely linked that when you hold a coin or banknote in your hand, the historical period during which it has been minted, printed and used, flashes in front of you just like in a photo.

The currency, along with the language, constitute an inseparable part of our national identity and cultural heritage. By unfolding in its images people, events and the most important values of our history, the currency has contributed to strengthening the feeling of national identity in the Albanian people.

By acting as a common medium of social interaction, the currency has also played an irreplaceable role in creating a national tradition and memory, strengthening in turn the sense of belonging to the Albanian nation and the sharing of a common destiny. All these have contributed to strengthening national sovereignty, particularly when the currency is managed in a stable way.

William Camden, a British historian in the late 16th century, considered money as the fifth element after air, fire, earth and water. The universal character of money has captured the interest of numerous generations of philosophers and has stimulated human imagination in different kinds of ways. Money is not only an economic act but also a political one. It establishes the boundaries, contributes to consolidating a country's identity and may lead to conflicts and wars. But despite all, having a good will, money may precede peace and stability of one or more countries. As also stated by Helmut Kohl, former Chancellor of Germany, "the real flag of the Federal Republic of Germany is the Deutsch Mark".

If you had lived in Albania in the period when its independence was declared, your money would have mainly consisted in French gold francs – what we still refer to as "Napoleons" to this day – and Austrian silver coronas. Being citizens of a coastal city, you would have probably used Italian liras and copper coins for your small purchases. During World War I, the main forms of money were not only gold and silver coins, but also local banknotes – for instance, banknotes issued by the autonomous region of Korça.

Nowadays, in addition to the currency issued by the Bank of Albania, we also use cheques and means of electronic payments. Hence, although money has taken many forms through different times, it has always been very important to the people and the economy. It has been so important that even to this day, people still continue to keep and collect coins, banknotes, cheques or notes of past times – which today have no economic value – as a sign of their trust in money.

The project for an Albanian national currency was part of the general modernizing policy implemented by Ismail Bej Vlora in the newly-established Albanian state.

According to him, the sooner Albania strengthened its economic freedom, the better it could preserve the newly-gained political freedom, hence turning into a prosperous country. The father of independence considered the establishment of a central bank as crucial to Albania's economic development, in line with the models provided by foreign banks, and particularly the Bank of England, which at the time was the centre of the global financial system. As Ismail Bey Vlora noted "... Let me say with admiration that the work of the Bank of Albania is, both economically and politically, a second victory for Albania, after that of independence". Despite being established as a privately-held institution, the Bank's activity would not be oriented towards generating profit or other commercial interests. It would rather orient towards providing public goods, such as issuing the currency and acting as banker to the government, banks and other financial intermediation agents in Albania.

Despite the numerous efforts, gaining independence did not bring the establishment of a national monetary system and Albania continued to be one of the few countries still having a gold-based coin circulation system.

The establishment of the central bank was vital to inspire the Albanian public trust, by encouraging investment of savings in shares and bank deposits, hence turning the bank into an engine of the lending system in Albania.

If we look back in the past, we can see how much the Albanian currency has evolved. From the declaration of independence – when gold and silver were considered to be the only real forms of money – we come to the present with the Bank of Albania projecting to put electronic money into circulation.

Unlike precious metals, which hold their value over the centuries, a currency's value is equal to public's trust in the stability of the economy and in the central bank putting it into circulation. It is this public trust that guarantees the stability of the currency and enables the development of a modern monetary system.

The latter is the product of a long period of practical experience and a large number of economic studies suggesting that the central bank, through its monetary policy, contributes to improving the economic perspective and people's living standards by preventing prolonged periods of inflation and deflation. In addition, price stability contributes to increasing economic activity and employment; hence promoting economic welfare. Firms and consumers make informed decisions about consumption and investment; the market allocates the resources more effectively; productive potential and incentives to invest in the economy increase; while the redistribution of welfare and income improves, hence contributing to strengthening social cohesion.

In order to facilitate monetary policy implementation and efficiency in the economy, the Bank of Albania pays great attention to encouraging economic and financial education in Albania. We believe that broadening the basic knowledge on economic environment improves people's ability to process the necessary information and make right economic decisions.

In addition to providing the public a more effective participation in the society, economic and financial education contributes to ensuring public support for the policies the Bank of Albania implements.

In carrying out this mission, our compass remains oriented towards Europe and the incessant progress towards economic and legal convergence with the EU. Our activity will continue to focus on strengthening the Bank of Albania's independence as key precondition for safeguarding monetary and financial stability. The common European currency has itself turned into the basic anchor of the EU.

The best way the Bank of Albania can fulfil its mission to the public is for the latter to know and trust the national currency. A strong and sound currency will be an inseparable companion in our journey towards Brussels and Frankfurt.

Dear Mayor, Ladies and Gentlemen, I hope you will enjoy the visit to the Bank of Albania's exhibition we are opening today in "the city of flag". On behalf of the Bank of Albania, it is my great pleasure to declare it open.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the 6th South-Eastern European Economic Research Workshop
19 November 2012

Dear workshop participants,
Dear central banks colleagues,

I am very happy to be here today, in this 6th South-Eastern European Economic Research Workshop. This Workshop is an annual event that Bank of Albania organizes, aiming to successfully bring together researchers and their work from the region and beyond. We are very glad for your personal contribution and your institutions' commitment to this activity. The participation map extends every year and we take this development as a sign of recognition. This activity takes place as Albania celebrates its 100 anniversary of independence, which happened on 28 November 1912; we are, therefore, very happy to welcome you on the occasion of this very important event.

The South-Eastern European Economic Research Workshop provides a platform to discuss and, most importantly, improve our work. It also provides a platform that contributes to the extension of regional cooperation in the area of research, making an additional contribution to the cooperation in other important areas of Central Banking in the region.

As I have previously mentioned, countries of the SEE region are similar in many aspects including the state of economic problems and economic research. We are focusing on finding the problems in the existing models. However, the actual economic conditions, the state of policy variables and level of policy instruments represent tails events rather than normal behaviour. Therefore, our empiric understanding lies outside the set of solutions offered by models, which are built and tested in normal times. Above all, the biggest challenge is adopting a new philosophy and a new way of thinking into policy design and implementation.

Central banks are perfect environments for these new ideas to emerge and develop. They bring together distinguished analysts and the research community with a demanding set of problems that need solutions. Its network is available to researchers while financial, technological, statistical and intellectual support for research is practically limitless. Moreover, the research community in central banks has the opportunity to directly influence policy design and implementation. This particular characteristic endows central bank researchers with the opportunity to implement their findings and practically test their conclusions in practice.

In this respect your conclusions have far reaching impact on people's welfare and economic outcome. Therefore, you have an immense responsibility to

adopt the best practices of academic methods and writing and make your research available to scrupulous critique at the bank and outside it as well as for the research community. Always be reminded that when your research and analysis have potential effects on other people's lives.

I sincerely invite you to adopt this spirit of cooperation during the proceedings of this workshop, as you have always done in the previous workshops.

I would also like to remind you of the relatively long journey that you have taken together with the Bank. The quantity and quality of your work has increased and improved throughout this journey. Therefore, I would like to challenge you to reach beyond this particular event and present your work more frequently in similar activities in the region or in the EU. I would like to encourage you to spend more time and efforts to disseminate and implement your research findings within the institution.

Results and conclusions should not be your last station. Organize activities that focus on explaining and disseminating results and research techniques to the rest of the bank. Raise the awareness on research developments and extend your cooperation with your colleagues within the bank. I invite you to extend cooperation beyond borders. Benefit from this wonderful network that we have created and extend the spirit of cooperation beyond workshop participation by engaging in joint research projects with national and regional focus. You will be amazed by how much you can learn.

Finally, I would also like to encourage the others economists of the bank to crush the monotony of repeated dull analysis and frequent reliance on untested hypothesis. Enrich your work with results of recent research, engage in research work yourself. Devote more efforts and energy to the study of economic phenomena and the way they affect your work.

Research is not and should not be an exclusive monopoly of monetary policy and financial stability. It takes many forms, and should extend across all areas of central banking. Few of the materials that will be discussed today and tomorrow illustrate this initiative very well. I hope there will be more similar examples in future workshops.

The presentations and discussions today and tomorrow address a wide range of issues, reflecting the nature of problems that our economies are facing.

I understand from the programme that our guests' focus of research is similar to the one at the Bank of Albania. During the past year, we have focused on financial stability and monetary policy, trade integration and trade relations, and the modelling of stochastic economic process. But above all, the crisis, its implications, the channels of transmission, and policy response have become the focus of empiric and theoretic research in the central banks and academia during the last 4 years. The results of this research and analysis have taken central banks and their monetary and regulatory policies beyond what was considered sacred limits of monetary policy. However, this has not proven very helpful for the economy.

It is now five years since the crisis began and the more authorities deal with short-term problems of growth and unemployment, the more they reveal long-term imbalances and structural problems of national and global scale. In the mean time, we still cannot fully define, understand and model the economy in its true stochastic form.

Typically, long and deep economic and social crisis have become the breeding ground of new philosophies of economic thinking, which, in turn, have encouraged significant policy changes and opened the road to economic prosperity. Adam Smith, John Keynes, Milton Friedman, and their economic thinking have emerged in the dusk of big crisis. Unfortunately, we are still waiting for a new philosophy; so the question arises: where is our philosopher? We clearly need a new way of thinking, a new approach to economic policy, a lot of new ideas.

These new ideas are not easily discovered. They do not pop up themselves; they hide in the layers of economic and financial data, history of economic developments and economic thought, and philosophy of social interaction in the macro and microeconomic scale. It is not surprising that economists and politicians have started to challenge some beliefs that are regarded as universal economic truths. For example, GDP and growth are challenged as the best measure of happiness and prosperity, globalization is challenged for its externalities in the labour market and inequality, inequality itself is under investigation as a potential culprit of economic slowdown. Economic research must broaden its scope to consider all these areas in their work. Research must be designed like an increasing spiral, where the newly gained knowledge in philosophy, economic history, empiric research and application of mathematic and statistical models must return to the starting point to confront the set of all new and old problems, prove the generality of its application, and evaluate the set of potential externalities.

As I mentioned at the beginning, this is the 100th jubilee of Albania's independence and our annual conference this year focused on the development of monetary policy during the last 100 years and paid particular attention to the impact that domestic and international political and economic events have had on the nature of the central bank and its monetary policy. Addressing the mixture of historic and economic developments, the large variety of monetary regimes, abrupt swings in economic, politic and philosophy systems, and modern economics was amazingly refreshing, interesting, and thought-provoking. It certainly deserves more attention.

Our traditional approach to research has largely contributed to our understanding of monetary and financial stability issues and models with a large set of parameters, forecasts and shock analysis. It has enriched the envelope of models and methodologies that are available in the process of policy design and implementation and has increased our confidence. However, it is time to go deeper in the understanding the fundamental of economic behaviour as an individual and social phenomenon. This understanding requires, among others, proficient research in economic

history and economic behaviour and economic welfare. I reiterate you do not have to do this alone and isolated.

International scientific collaboration allows for increased access to research resources and infrastructure. Teaming up with professionals with complementary skills, benefitting from knowledge generated beyond boundaries is a modern and effective endeavour. We hope this Workshop as well as other conferences and activities we are hosting throughout the year will contribute to this end.

I wish you great success during the Workshop proceedings and in your everyday efforts. It is my hope that getting to know each other's work will lay the foundations for further future cooperation.

Thank you!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Opening of the Exhibition "100 Years of Independence: Our History Reflected in the National Currency", Prishtina, 23 November 2012

Dear guests,

Let me begin by saying that as an Albanian, I am very delighted to be, on the eve of Albania's 100th anniversary, here in Kosovo, in the land of Ymer Prizreni, Hasan Prishtina, Isa Boletini and many other patriots who contributed to making Albania gain its independence. In the capacity of the Governor of the Bank of Albania, I am proud to open the exhibition held to celebrate Albania's 100th anniversary: "100 Years of Independence: Our History Reflected in the National Currency". After touring a number of cities in Albania, such as Berat, Gjirokastra, Korça, Elbasani, Shkodra, Tirana and Vlora, it could not miss being opened in Prishtina, as the history the Albanian currency unfolds is ours; it is common; it is the history of Albanians wherever they may live.

This exhibition seeks to draw the public's attention to the fact that the state formation process and the history of modern states are not only about political and military events, or the real economy, but they are also closely linked to the history of their national currency. The value of a nation's currency goes beyond its price! Over the centuries, empires, kingdoms and international powers have documented the glory, history, tradition, cultural values and national heroes through the configuration of coins and banknotes. You can clearly see in them how the history of the Albanian currency – despite not being instituted as such with Albania's Declaration of Independence – reflects the history of the Albanian State and nation. It reminds us of the sacrifices of those Albanians, whose values and braveries led to the state formation 100 years ago.

The sacrifices of our common history are best embodied by the Albanian League of Prizren, one of the greatest events of modern Albanian history. It stands as the foundation of the Albanian State, representing the first massive movement that aimed to accomplish the greatest mission of the Albanian National Renaissance: acknowledgement of the Albanian nation as an inseparable unity, protection of nation's territory and the formation of an autonomous and democratic Albanian State.

The period between 1912-24 was very important in the past century. They were years of political rotations, revolutions and world wars. They were years when entire civilizations gradually vanished. The power and domination of politics became clear in those years; therefore, politics and geography were the theme of the day.

But November 1912 was fortunate for Albanians; it would bring them independence. The history that had progressed slowly over the centuries would shift gears in this year. But not just that. Year 1912 brought Albanians their national symbols: their flag and anthem, which would be bound to one another as the latter united all Albanians singing around the common flag. The flag also brought the double-headed eagle, which later became the symbol of all Albanians worldwide and, naturally, the symbol used in our national currency.

I am delighted to bring, through this exhibition, similar historical events to the public's attention. Likewise are the merits of Ismail Qemali, which place him on a deserved pedestal due to his activity and vision as a statesman and not to his romantic idealisms. Among these merits is his effort to establish the first Albanian central bank, by expressing his clear vision for its role in the economic system, as a basic cell for the nation's recovery and prosperity. His effort is still actual in the present days.

Soon after the declaration of independence, the establishment of the central bank, which would operate in line with the models provided by other European national banks, was among the main concerns of the Government. Ismail Qemal bej Vlora considered the establishment of the first Albanian central bank as a financial institution that would give life to economic development and stabilization of the independent state of Albania. Unfortunately, the Albanian State was established on the eve of World War I and the following historical events left the project for the establishment of the central bank only on the paper. However, Ismail Qemal bej Vlora considered its establishment as the second victory after that of Independence. In one of his speeches, he noted: "From the day Albania had the good luck to become a state among the other Balkan and European states, it is entitled to have one or more banks to ensure foreign credit as a nation, and individual credit for each Albanian. This is what our soul wanted, but we could not dare to expect it to happen this soon due to Albania's concerns, both in terms of its borders and the country's present organization, not being resolved yet..... After endorsing a number of agreements and exchanging many opinions, the cabinet approved and signed the last project. Let me say with admiration that the work of the Bank of Albania is, both economically and politically, a second victory for Albania, after that of independence".

His visionary words are similarly valid even today. The last economic and financial crisis clearly showed that the role of central banks is key to ensuring a country's stability and prosperity. It is also very much related to other aspects, such as to the role of money as a historical and artistic testimony of nations over the centuries. If we turn our attention to money reading, we should understand that each coin and banknote is a story printed in metal or in paper; it is a colourful rebus or puzzle. Hence, there is a message behind monetary credibility. However, this message or story will gain greater importance if another story will be "issued" through the issue of new currency series. Therefore, "the story of money" is always being written.

The message conveyed by "the story of the Albanian currency" through Ismail Qemali, whose portrait is featured on the 500 lek banknote, tells us that he, Ismail Qemal Vlora, together with our nation's patriots, knew how to mitigate all contradictions and disagreements and give us extraordinary results.

I think their vision as Albanian statesmen should be at the centre of a common story in the future. We, Albanians, must work together to live under the same sky and around the same flag: The EU flag!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision of Bank of Albania's Supervisory Council, 27 November 2012

Today, on 27 November 2012, the Bank of Albania's Supervisory Council reviewed and approved the monthly Monetary Policy Report. Based on the latest monetary and economic developments in Albania, and following the discussions on their future outlook, the Bank of Albania's Supervisory Council decided to keep the key interest rate unchanged, at 4.00%. The Supervisory Council deems that the current monetary conditions are adequate to meet Bank of Albania's inflation target in the medium term. These conditions ensure the necessary monetary stimulus to support the domestic demand.

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

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Annual inflation fell for the second consecutive month, down to 2.4% in October. Its performance was driven by food price developments, which account for almost 70% of the inflation rate. Prices of other consumer basket items moved in different directions, retaining their contribution at the same levels as in the previous months.

From the macroeconomic viewpoint, inflation rate continued to be determined by temporary externally-generated supply factors and structural changes in the domestic market. The slow performance of economic activity is associated with low increase in producer costs and low pressures on inflation.

Also, moderate growth of monetary indicators, low increases in global prices and well-anchored inflationary expectations have generated contained inflationary pressures. In general, this situation is expected to continue over the period ahead.

Data on third-quarter economic activity are partial and are based on indirect indicators. Their analysis suggests positive but low growth of the domestic economy over this period. Industry, agriculture and services are the sectors that have supported the economic growth, while construction does not highlight any signs of improvement in the current and expected activity. In the aggregate demand, foreign demand remained the main driver to economic growth in the third quarter. The domestic demand appears to have weakened due to lack of fiscal stimulus and sluggish private investments and consumption.

Fiscal policy was consolidating in 2012. It is reflected in the 19% decline in the budget deficit of the first ten months of the year, leading to maintaining of fiscal indicators sustainability over this period. On the other hand, the performance of expenditure and budget deficit did not support the aggregate demand growth.

Public spending for the first ten months of the year resulted 0.2% less than a year earlier, reflecting the low increase in the budget revenues. The latter increased at low annualised rates during the year, resulting at the end of October only 2% higher than a year earlier. The Bank of Albania deems that though the cautious consumer behaviour has not made any direct impact on economic growth over this period, it has helped keep risk premia on track and has led to low long-term interest rates, thus contributing to boosting private investments. Looking forward, we deem that the fiscal policy should retain its orientation toward fiscal indicators sustainability, supporting Albania's economic and monetary stability and being an important pre-requisite for a stable and long-term growth.

Foreign demand continued to support the growth of exports and economic activity throughout 2012. Trade deficit narrowed by 7.9% in the third quarter, reflecting mainly the good performance of exports. The latter increased by 17% in the third quarter, retaining the previous quarters' positive trend. On the other hand, imports performed poorly, reflecting the low demand for consumption and investment. In the third quarter, imports recorded positive annual growth of only 0.7%.

Performance of monetary indicators attests to moderate pressures on monetary inflation. The annualised broad money growth rate decelerated to 6.8% in September. Reflecting the sluggish domestic demand, economic agents' demand for money has been low.

The weak demand for money has been associated with a constantly falling contribution of funding from public and private sectors to increasing the monetary supply throughout 2012. Private sector's contribution continued to slow during this month; its annual growth rate reached 4.2%, recording one of the lowest historical levels.

Latest financial market developments have reflected the easing monetary conditions and low or downward premia of inflation and liquidity risks. Interbank rates have been downward, following the monetary policy signals. Also, upon resolving the structural problems in the primary market, the treasury bill yields dropped sharply on all maturities. In a tranquil financial market and lacking additional shocks in the future, the previous monetary policy easing is expected to be passed on to other financial market segments. Under these conditions, raising the monetary stimulus in the economy would further boost aggregate demand, without affecting the price stability in the medium term.

Developments in lending and financial markets reflect households' and businesses' reluctance to make long-term commitments. However, the low

degree of credit growth reflects the banks' cautious in terms of lending. In this context, the Bank of Albania points out that, notwithstanding the externally generated short-term risks, the medium and long-term outlook for Albania remains sound. Albanian consumers and businesses should be more realistic about their development plans and adopt a more pragmatist approach to increase current investments and consumption.

Also, the banks' sound balance sheets should provide more financial funds to support the economy by increasing lending.

Looking forward, the new information obtained during the last month confirms our previous projections on the expected performance of the Albanian economy over the monetary policy-relevant horizon. The Albanian economic activity is expected to grow at positive but low and below potential rates. The poor performance of private investments and consumption restricts the room for economic growth. On the other hand, preliminary information suggests that the fiscal stimulus may be upward in the next year, complementing the foreign demand as a short-term contributor to next year's economic growth. However, the overall effect of fiscal stimulus will depend on the response by the private sector and financial markets. At the same time, its long-term effect will depend on additional costs that it will bring about on the budget.

The Bank of Albania deems that the aggregate demand will not exert upward pressures on inflation. Against the backdrop of a stable monetary environment, well-anchored inflation expectations and moderate impact from import prices and exchange rate, inflation is expected to remain within the Bank of Albania's target over the period ahead. Under these circumstances, our monetary policy is expected to retain its stimulating nature in the medium term.

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Concluding the discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 4.0%.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the monetary policy decision by
the Supervisory Council of the Bank of Albania,
20 December 2012

Today, on 20 December 2012, the Bank of Albania's Supervisory Council reviewed and approved the monthly Monetary Policy Report. Based on the latest monetary and economic developments in Albania, and following the discussions on their future outlook, the Bank of Albania's Supervisory Council decided to keep the key interest rate unchanged, at 4.00%. The Supervisory Council deems that the current monetary conditions are adequate to meet Bank of Albania's inflation target in the medium term. Moreover, these conditions ensure the right monetary stimulus to support the domestic demand.

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

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Annual inflation in November stood at 2.5%. The major part of inflation continues to be determined by the performance of food prices. Contribution of other goods was steady from the previous month. Inflation fluctuation owed mainly to the supply-side factors, of external and internal origin. Nonetheless, the intensity of supply shocks was low and lasted for a short period of time. The Supervisory Council finds that developments in the real economy and financial markets produced low inflationary pressures. The Albanian economy continues to remain below its potential. This development is reflected in the low increase of wages and production costs. Prices in the global markets and the exchange rate were relatively stable; hence, they did not exercise pressures for upward prices at home. Likewise, expected inflation remains anchored around Bank of Albania's 3% target. Finally, monetary developments are characterised by low demand for liquid monetary assets. The monetary policy pursued by the Bank of Albania has contributed to stimulating the aggregate demand, administrating the liquidity in the system, and keeping inflationary expectations in check. This situation of inflationary pressures is expected to remain steady in the medium run.

Available figures on the economic activity over the second half of the year are partial. Indirect data analysis, however, confirm earlier estimates for positive growth during this period, at levels similar to the second quarter of the year. Economic growth was mainly driven by foreign demand, while domestic demand was weak.

Consumer spending is assessed to have been up during the third quarter, reflecting also better activity of the services sector. Private consumption, however, remains weak, due to the slow economic performance and the

perceived uncertainties about the future. Its prospect in the medium run remains unclear. Private investments remain at low levels, in the presence of partial utilisation of production capacities, uncertainties about foreign and domestic demand, and tightened lending terms by the financial sector.

Public sector demand was also low during the third quarter and did not, therefore, contribute to higher aggregate demand. As at end-October, the budget deficit for this year was about 19.0% lower than a year earlier. The fiscal policy applied during the three first quarters of the year materialised in the annual fall of public spending for this period, whereas income growth was low and budget deficit was in check. On the other hand, the fourth quarter of 2012 and year 2013 are expected to be characterised by upward fiscal spending and budget deficit. This fiscal policy increases the macroeconomic stimulus in the short run; however, it should be sensitive to the need for medium and long-term stability of the public debt.

Foreign demand was the main driver of economic activity in the third quarter of the year. Latest foreign trade data confirm the same trend for the successive period. Thus, in October, the trade deficit continued the corrective trend, narrowing down to 10.3% in annual terms. Its performance has reflected mainly the good performance of exports, which maintained positive rates of their annual growth, 12.0% in this month. Imports have also contributed to narrowing the trade deficit, contacting 2.3% in annual terms, in this month.

The analysis of monetary indicators points to low monetary pressures on prices. Higher money supply, the M3 aggregate, continued to decelerate in October, settling at 6.2%. In particular, lending to the private sector slowed down significantly. Annual credit growth for the private sector was 2.4% in October, reaching its all-time low. To a large extent, it is influenced by the low demand of households and business for loans, as reflected by the performance of consumption and private investments. On the other hand, the banking system continues to apply additional prudence with regard to lending, albeit it is under good liquidity and capital conditions.

Financial markets are characterised by downward liquidity risk premiums. Interest rates in the inter-bank market fell even further in November, reflecting the ample liquidity and eased monetary conditions. In the primary market, government security yields continued to fall. Moreover, the interest rate on deposits and loans denominated in the Albanian lek were downward, in response to monetary policy signals. In the period ahead, a more comprehensive response of the real economy to the eased monetary conditions is expected.

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The Supervisory Council of the Bank of Albania deems that inflation will remain at low levels and close to the medium-term inflation target of the Bank of Albania. The performance of the domestic economy, global economy, and financial markets is not expected to generate any deviation from the 3.0% inflation target. Under these conditions and in the absence of unexpected

shocks from the supply side, consumer prices will increase at low rates and will range within the target of the Bank of Albania.

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At the conclusion of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 4.00%. Keeping the key interest rate at minimum rates helps maintain the stimulating character of the monetary policy, thus enabling the real economy to take advantage of better lending terms in 2013. Furthermore, this policy contributes to keeping inflation expectations in control, by helping lower long-term interest rates.

ADDRESS BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the year-end event with the Albanian Association of Banks,
20 December 2012

Dear bank managers,

At the end of this calendar and financial year, I take this opportunity to share with you some of the achievements and challenges facing the banking sector, confident that they will serve to guide our actions in the future.

As expected, the year 2012 was a very challenging year for the financial and economic activity of the country and of various economic agents. Very likely, this year's economic growth will remain positive, but significantly lower than last year. This economic performance is dictated by the weakening of the fiscal and monetary stimuli, as well as the slowdown of private investment and consumption. The slowdown in the latter is, however, accompanied by a reduction of imports. On the other hand, foreign demand has supported higher growth of exports, especially of energy products. This has led to an improved trade balance during 2012, hence marking a decrease in the deficit-to-GDP ratio. The impact of the global economic crisis continues to be present and its prospects to overcome it in 2013 remains our hope, which is not supported by the expectations of international financial institutions and public authorities, especially with regard to the economic situation in the euro area.

During 2012, the banking sector marked a positive financial result, overall. Net interest income was stable but provisions on credit risk reduced the size of profit. Generally, the banking sector maintained control over other costs of the activity. Liquidity indicators, short-term and structural ones, stand at satisfactory levels. All banks complied with the requirements set out in the regulatory framework regarding the size of liquid assets, both in the lek and in major foreign currencies. Deposits continued to grow at good rates, although at lower levels than in the last year.

Due to the credit growth slowdown, the credit/deposit ratio appears at very suitable levels to support the liquidity needs of the sector. Indicators of activity capitalization stood at good levels, due to capital increase by some banks and slowdown in risk-bearing assets growth. In the course of the year, the Bank of Albania applied tighter requirements for liquidity and capitalization of banks in accordance with the risk profile of their activities.

In the interbank market, trading volumes and participation increased in the 2012. This performance is influenced by structural liquidity movements, banks demand and market operations of the Bank of Albania to support them.

Market interest rates were downward, reflecting the trend of policy interest rate and banks' actions to control operations costs and profit margins. The foreign exchange market has been stable, despite increasing trading volumes and higher number of participants in the market. Banks were active and prudent in servicing their clients' demand for foreign currency.

Dear bank managers,

Let me now focus on a number of issues of concern to the banking industry and the Bank of Albania, which we believe should be addressed carefully during the next year.

I would like to start with lending as the activity that has the main impact on the banks' financial result. We find that lending growth rates decreased and credit quality continued to deteriorate, particularly for foreign-currency denominated loans. This performance is due to the fall of demand for loans; however, it also reflects a persistent reluctance of banks to lend. This trend needs to be reversed by addressing problems related to the pace of lending and non-performing loans.

The stable growth of deposits as well as the significant increase in non-residential investments show that banks have sufficient financial resources to lend at higher growth rates. These resources should be used to lend mainly to the private sector in Albania, acting in accordance with the established regulatory framework and your policies for investment diversification. On the other hand, efforts to address the non-performing loans should multiply, in terms of both prevention and addressing them properly. Your focus should be placed on the cautious process of loan restructuring, especially before such loans are transformed into non-performing loans. Further, you should act discreetly, but consistently, for the execution of collateral. We are all aware of the problems that exist in this area. Nonetheless, also thanks to your work, I find that the awareness of decision-making public authorities in this regard has improved significantly. I had the opportunity to communicate about these issues today to the parliamentary, Commission of Economy and Finance. I am confident that the work started by the Ministry of Justice for the revision and improvement of some important legal acts, including the Code of Civil Procedures, will be finalized, incorporating and approving some concrete proposals for amendments submitted by the banking industry and the Bank of Albania in order to enhance the process of collateral execution.

In addition, upon the conclusion of legal processes, it is pivotal to proceed swiftly to write-off loss loans from the bank's balance sheets, in accordance with the requirements of the regulatory framework. We would kindly ask you and your shareholders for dedication in this process, not only to find the necessary human and financial resources, but also the most appropriate forms for a quick, transparent, and consistent handling of non-performing loans.

We need to bear in mind that lending carries along risks that are difficult to identify at the time of disbursement. These risks are determined not only

by the quality of bank lending procedures, but also by significant external factors, including the performance of the economy. This uncertainty permeates the current phase our banking sector is going through. Therefore, it is indispensible that bank management structures and their shareholders commit the necessary financial resources to cope with the possible additional costs in the future. For shareholders, this implies not only retention of profits in the bank, but also adding new capital in case of need. Remember that it also represents a more general trend in the banking industry globally, with a number of new forthcoming standards that provide for improving the quality of bank capital and increase of its size. Our banks should gradually begin to adapt to these new standards.

For senior managers, strengthening the control systems of the bank activity remains a primary objective, especially for those activities that generate the main revenues and expenses arising from the activity. Risk management structures should be really empowered and have a stronger voice in decision-making. Banks should continue to further improve the efficiency of their operations, including the establishment of a better control over the costs of the activity. Setting priority activities for your institution will allow you to identify new investment needs as well as those activities that use bank resources inefficiently; they should, in turn, be restructured. This process will positively affect the financial performance of the institution, and will allow the implementation of other active policies in areas that benefit the activity of the bank.

We all know that banking is an activity based on trust. For this reason, the bank's services to customers should be "first class" across the entire bank network. This means that customers should be served correctly, timely and transparently. Banking services should be provided in accordance with the clients' financial literacy, in any case highlighting, the benefits and the risks that customers may incur as they use your bank products.

In the context of its role as the supervisory and regulatory authority of banking operations, the Bank of Albania will continue to carefully monitor and address the challenges facing this activity. Our regulatory framework and supervisory and operational activities will be adapted to provide all the necessary support for the banking activity to be safe and have multiple benefits for the banking industry, customers, and the economy in general. The professional and continuous communication with you will be at the basis of our activity, to identify together the best solutions that address your needs and those of other interest groups.

Dear bank managers,

In conclusion, I would like to bring to your attention one of the biggest lessons learned from the crisis of the latest global financial system, which I think remains applicable for Albania: concentration on short-term time horizons is counterproductive to both individual financial institutions that engage in them, and the overall financial system and economy of a country. In this context, I

invite you all to be farsighted in your analyses and decision-making processes with regard to the future of the economy of Albania and its banking industry.

In my view as well as in the conclusions by all the analyses that focus on this issue, Albania has huge potential, to a large extent unutilised, to support a sustainable economic growth, convergent to the economies of our trade partner countries in the euro area. Despite short-term difficulties, originating largely from external sources, the fundamentals of Albania's economic development remain sound. The macroeconomic stability, natural resources, structure and cost of the labour force, render the long-term investment in the Albanian economy an investment with a guaranteed return.

In invite you all to be partake in this vision; engage even more intensively in supporting the Albanian economy with loans and financial services; and explore new areas and directions for the country's economic development. I am confident that this is not only the best service you may provide to Albania, but also the best strategy to ensure sustainable and profitable development of the banking industry in Albania.

In unison, we should not allow short-term problems to be transformed into weaknesses and lost opportunities in the long run.

You will always find in the Bank of Albania an institution that is fully determined to comply with its objective on price and financial stability; a fair and farsighted regulator on banking supervision; an efficient administrator of liquidity and financial markets; and a profoundly professional institution and provider of useful macroeconomic analyses.

Finally, I would like to make my most sincere wishes for a successful New Year 2013 in your professional career and personal life!

Thank you!

PERIODIC ANALYSES*

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

ANALYSIS OF FINANCIAL INTERMEDIATION 2012 Q4

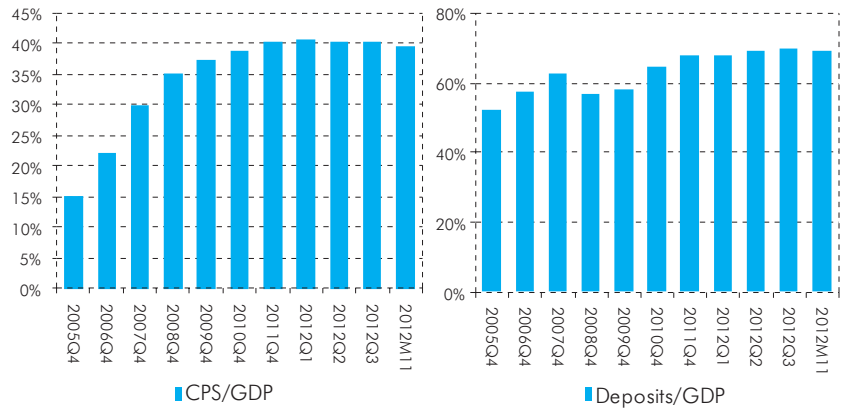
ERJONA SULJOTI, SOFIKA NOTE, OLTA MANJANI
MONETARY POLICY DEPARTMENT, JANUARY 2013

1. BANKS AND FINANCIAL INTERMEDIATION

Banking sector continued to dominate the Albanian financial system at the end - 2012. Banking sector is composed of 16 private banks, denominated by foreign capital banks, sharing about 90% of the system's total assets. Loan portfolio to private sector, at the end of November 2012, shares about 42.7% of banking system total assets, whereas deposits about 75% of liabilities.

Overall, financial intermediation indicators in the last quarter[1], have triggered a declining trajectory versus a quarter earlier. The private sector credit-to-GDP ratio, at the end of November, stood at 39.4%, or 1 percentage point lower, compared to end of September. These developments reflected the weaken performance of lending activity to private sector over this period. The banking system remains well-capitalized and amply liquid. Notwithstanding the increasing monetarisation, banking system has slowed down the intermediation of these funds through the lending channel. Low credit demand and the prudent lending policy applied by banks impacted the further slowdown of loan growth rates to private sector, both to households and businesses.

Chart 1 Private sector credit and deposits as a percentage of GDP*, (in %)

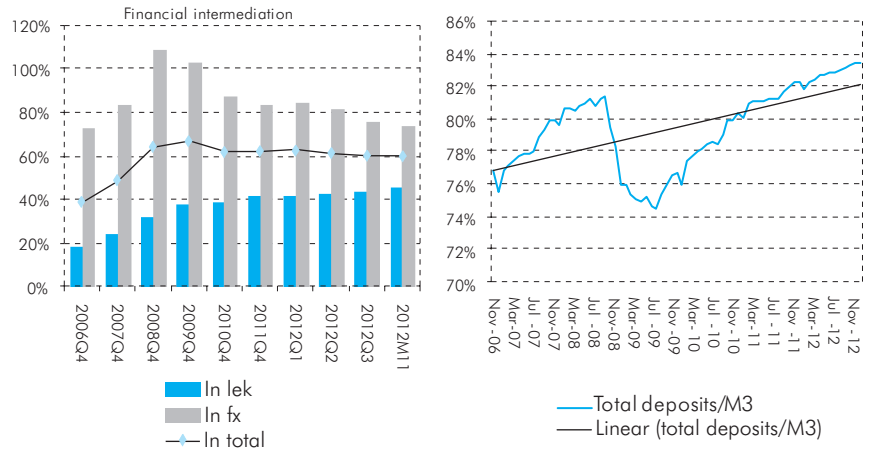


*According to an approximate estimation of nominal GDP for November, this is based on the GDP published by INSTAT and on Monetary PolicyDepartment's estimates. The latest publication of GDP by INSTAT is published January 2013.
Source: Bank of Albania.

[1] *The latest analysed monetary data belong to November 2012.*

Financial intermediation measured as credit to total deposits ratio in the banking system, manifested deceleration sings over 2012, especially during the second half of year. In November, this ratio stood at 59.6%, from 59.9% at the end -2012 Q3, and about 2.3 percentage points lower than the end-2011. The slowdown of stock deposits increase in October and November 2012, impacted the slight fall of their ratio to GDP, compared to the third quarter, pointing at 69.1%.

Chart 2 Loan-to-deposit ratio and deposits to broad money



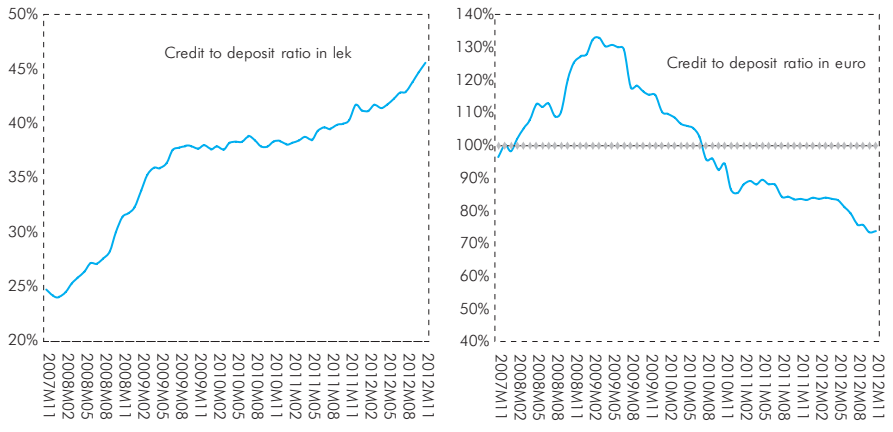
Source: Bank of Albania.

2. INTERMEDIATION

Fourth quarter indicators show a deepening of banking system intermediation role in the domestic currency. Loan-to-deposits ratio in lek stood at 45.6% or 1.7 percentage points higher than in the previous quarter, and about 3.8 percentage points higher compared to the end-2011. Also, this indicator marked the highest quarterly increase for the year 2012. This positive performance is supported by the lending policies direction toward the domestic currency, and by the main purpose of loan use, granted to economic agents. Deposits recorded a positive performance, albeit maintaining the slowing trend of the annual growth rates.

Foreign currency intermediation in 2012 Q4 contracted at lower rates than in the three other quarters of 2012. Hence, the loan-to- deposits ratio in foreign currency of 73.9%, is about 2 and 10 percentage points lower, compared to 2012 Q3 and end-2011, respectively. This performance is determined not only by the decrease of loan portfolio since April, but also by the good performance of foreign currency deposits, as a response to the foreign currency inflows. The fall in foreign currency deposits, in November, compared to third quarter helped to limit the tightening rates of foreign currency intermediation ratio.

Chart 3 Intermediation in lek and foreign currency

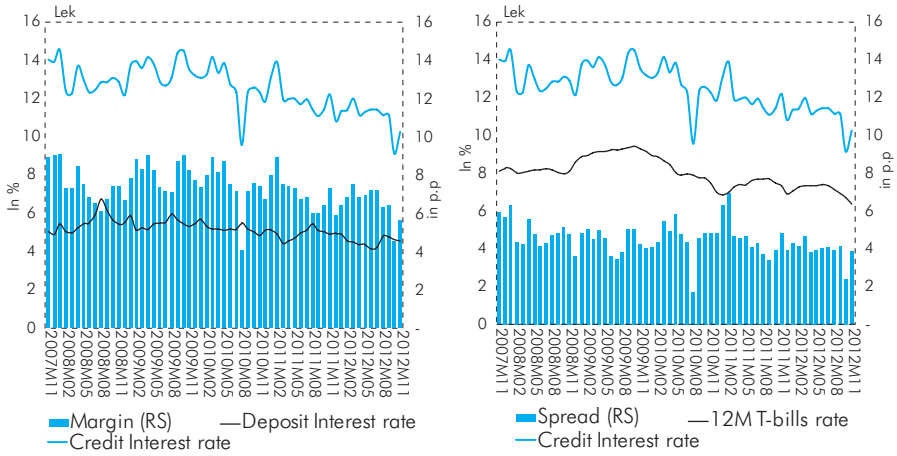


Source: Bank of Albania.

3. INTERMEDIATION COST

The deepened lek intermediation in Q4 is supported also by the reduced cost of intermediation activity. The average intermediation cost at the end of November was 5.1 percentage points, from 6.6 percentage points in 2012 Q3. The average lek intermediation margin is 0.5 percentage point lower, compared to the average of 2011. The lower intermediation cost in Q4 is attributed to the significantly higher decrease of interest rate on lek loan (1.52 percentage points), while the average interest rates remained similar to the third quarter. Nevertheless, the interest rates' performance on lek loan is influenced by a high amount of preferential loan granted to public enterprises. Avoiding this effect, lek loan interest rates will be slightly lower than previously. Whereas, the spread between the lek loan interest rate and 12-month T-bill yield is 1 percentage point lower than the the average rate of 4.1 percentage points in the previous quarter.

Chart 4 Intermediation cost in lek*

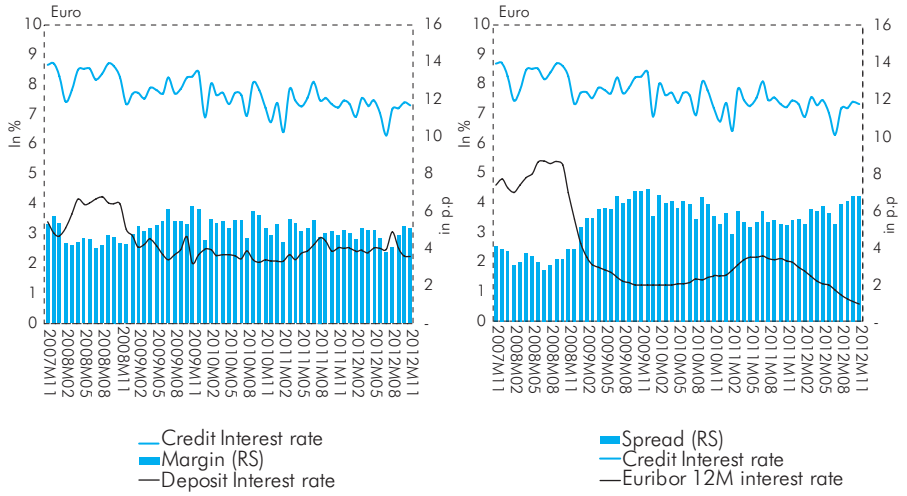


*The margin is calculated as the spread between loan and deposit interest rates. Spread is calculated as the difference between credit/deposits interest rate and the reference one.
Source: Bank of Albania.

Intermediation cost in euro[2] increased in October and November compared to the previous quarter, averagely standing at 5.1 percentage points, compared to 4.2 percentage points in the third quarter. This performance is driven by the slight increase in interest rates loan both in euro and lek and by the decrease in interest rate of euro denominated deposits, owing to the completion of third quarter promotional offers. The 2012 Q4 developments appears to have returned the intermediation margin close to the average of year 2012, by excluding the temporary fall it manifested in 2012 Q3. Intermediation margin in November maintains the same rates with end-2011.

Average interest rate spread of loan to international market reference rate, 12-month Euribor, excluding the temporary contraction of two summer months, pursued the increasing trend observed since the end of previous year. This indicator was considerably impacted by the decrease of interest rate in international market. On the other hand, this performance continues to reveal the divergence between the euro-deposits interest rate in Albania against the international market rate, reflecting the increased risks premium required by banks for the foreign currency intermediation.

Chart 5 Intermediation cost in euro



Source: Bank of Albania.

4. NON-PRICE CRITERIA IN INTERMEDIATION

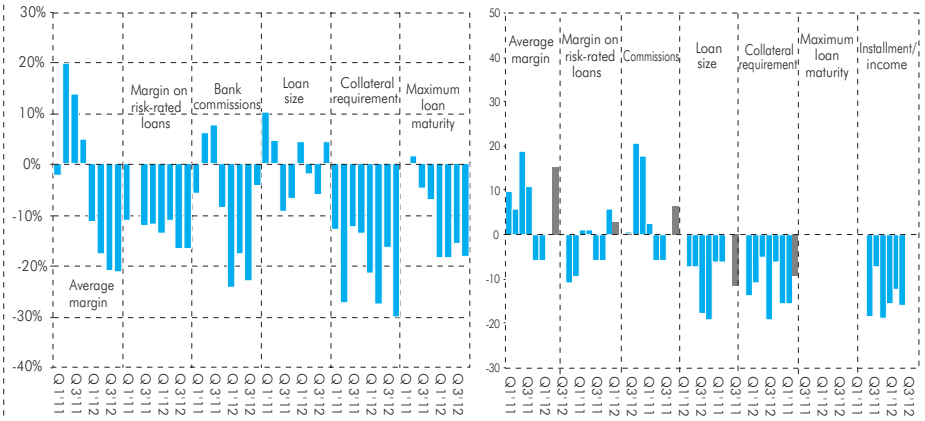
The lending standards applied to businesses tightened further while those applied to households remained unchanged, in 2012 Q4. Most non-price criteria continue to tighten.

Lending standards applied to businesses tightened further in the fourth quarter of 2012 to the same extent as in the previous three quarters. Excluding the condition on loan amount, which is eased in this quarter, the collateral

[2] *Foreign currency activity of banks is denominated from their activity in EUR, which shares more than 80% of foreign currency activity.*

requirement enhanced and maximum maturity decreased, thus impacting the tightening of the overall lending standards applied to businesses in this quarter.

Chart 6 Lending standards applied to businesses (left) and households (right)*



*Net balance of responses in this survey.
Source: Bank of Albania.

For the third quarter in a row, lending standards applied to households remained unchanged in the fourth quarter of 2012. The eased price criteria to lending to households balanced the tightening of loan amount and the collateral requirements. The standards applied on maximum loan maturity[3] and those on instalment/income ratio remained unchanged in the two last quarters.

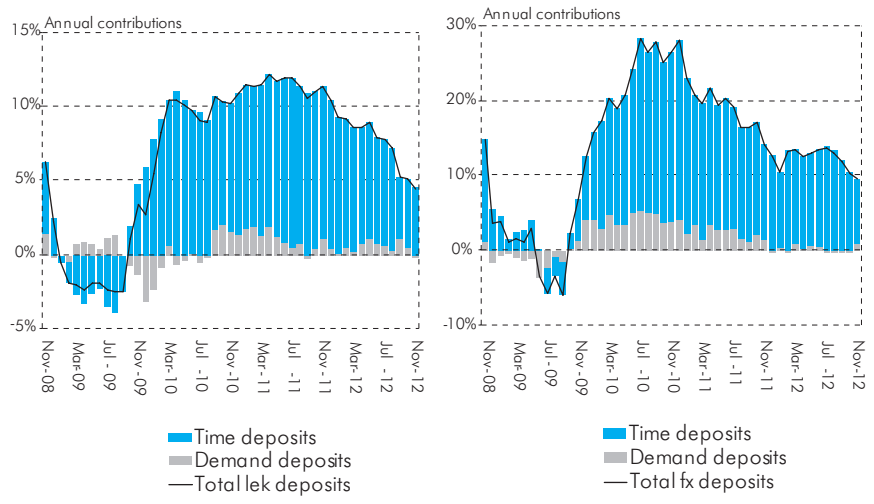
5. DEPOSITS

The ratio of total deposit stock to broad money remained almost unchanged, compared to the previous quarter, standing at 83.3%, at the end of November. This ratio is about 1.6 percentage points higher than in the end-2011, recording one of its highest historical rates. The positive developments during the year are broadly supported by households' tendency to save. At the same time, high foreign currency flows from external sector, mainly during the summer months, have also affected the increase of deposits against GDP, compared to end- 2011.

A more contained increase of deposits is observed in October and November compared to 2012 Q3. Total deposit stock increased by 7.3% in average annual terms during this period, from 9.7% in the previous quarter. Nevertheless, their total stock remains almost equal to the end of September.

[3] *Standards applied on loan maximum maturity to households remained unchanged in the last two years.*

Chart 7 Deposits by currency



Source: Bank of Albania.

The growth in deposits was mainly in the form of lek deposits in the last quarter, which increased by about 4.7% y-o-y, compared to the average of 6.8% in the previous quarter. In absolute terms, lek deposit stock is about lek 5 billion higher than the end of September. Lek deposits growth is mainly supported by households' deposits and at a lower rate by enterprises' deposits.

Foreign currency deposits slowed down their annual growth rate, averagely at 10%, or about 2.8 percentage points lower compared to 2012 Q3. Deposits monthly performance confirms a slowing down and a decrease in foreign currency deposits in November. This negative contribution of deposit stock foreign currency component owed mainly to businesses' deposits. Developments in businesses' foreign currency deposits vary according to the economic activity and appear to have supported the growth of imports in certain sectors of the economy.

Time deposits provided a higher contribution to the increase in total deposit stock, particularly in the national currency. Total time deposits grew higher than lek 1 billion, against the fall in the demand deposits. The growth in time deposits was mainly in the form of households and businesses' time deposits in the national currency.

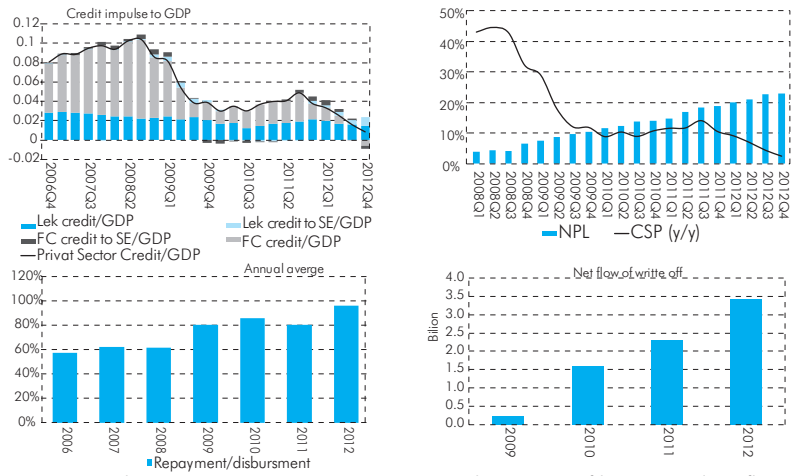
6. LENDING

Lending in the fourth quarter confirmed the considerable slowdown of loan growth rates impacted by loan to private sector. After a decrease in October, banks' loan portfolio slightly increased in November. At the end of November, annual loan portfolio growth stood at 4.0%, from 5.6% in September and 10.4% in 2011. The ongoing slowdown in loan portfolio growth rates has reflected the decrease in granted loans compared to the previous year and the settlements in advance of credits, as well as the writing off processes of bad loans from banks' balance-sheets. These phenomena have simultaneously

reflected the weak demand of private sector to finance the sluggish economic activity and the more prudent policies applied by banks against the exposure to credit risk. Owing to the increase in non-performing loans ratio to total, banks continued to maintain tighten standards applied to lending. At the same time, uncertainty about the future has conditioned both bank's clients and banks themselves to be more prudent regarding lending activity.

Loan to state-owned enterprises provided a positive impact on loan portfolio performance, by considerably increasing it. Lek lending dominated in 2012 and state-owned enterprises provided an important contribution. Impulse of loan to state-owned banks to GDP for the year 2012 is estimated at 0.7%, compared to 0.9% provided by the private sector.

Chart 8 Developments characteristics in lending*

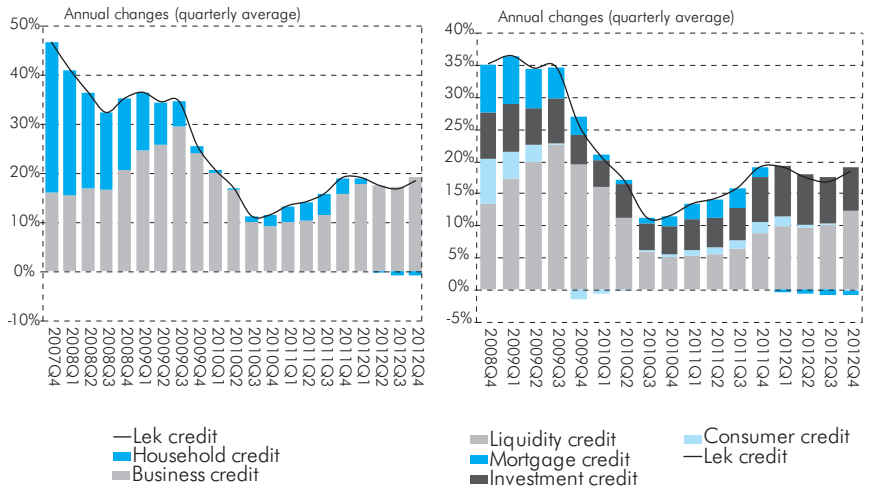


*Loan impulse to private sector in GDP is measured as a ratio of loan annual net flows to GDP. This indicator is estimated as a signal for the contribution that loan provides to economic growth. The abbreviation SE refers to State-owned Enterprises.
Source: Bank of Albania.

Lending in lek during the fourth quarter returned to the positive tendency of annual growth rates. Lek loan portfolio grew by lek 10 billion in October and November, by recording the highest quarterly growth for the year 2012. In annual terms, this portfolio is about 18.1% higher, compared to 15.8% in the third quarter. This positive performance is supported by lending growth for liquidity purposes, mainly driven by the loan granted to state-owned enterprises. Part of this loan served to settle a part of foreign currency loan. Meanwhile, the contribution of loan for investment purposes in lek, averagely by 6.8 percentage points, lowered further in October and November.

Lending in foreign currency began to slow at rapidly rates since the first quarter of year. As at end-November, this loan was 3.2% lower than a year earlier, the tightening rate decreased in the last two months. The fast decline in working capital loans denominated in foreign currency and the lack of loans granted for investment purposes to both enterprises and households provided the major contribution to this slowdown. As reported by bank lending surveys, as a whole, the economic agents' demand for this type of loan has been considerably decreased, owing to the macroeconomic situation in Albania,

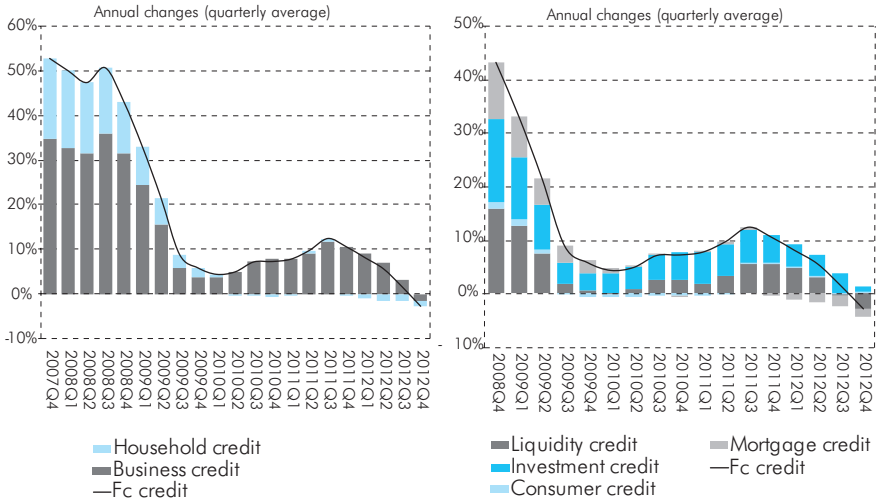
Chart 9 Lek lending by economic agents and purpose of use



Source: Bank of Albania.

the real estate market and uncertainties for the future. At the same time, banks show more prudent in selecting the investment projects that they finance.

Chart 10 Foreign currency lending by economic agents and purpose of use



Source: Bank of Albania.

INFORMATION ON SELECTED ECONOMIC AND MONETARY INDICATORS IN CENTRAL, EASTERN AND SOUTH-EASTERN EUROPE, Q4 2012

DORIANA LAMA, MEDVIN SHEHU
MONETARY POLICY DEPARTMENT, JANUARY 2013

INTRODUCTION

Global economy has continued to expand at a moderate pace and its recovery has been slow and surrounded by uncertainties. Survey results and preliminary estimates on recent months point to signs of stabilisation, signalling slight improvement in Q4. Problems related to severe sovereign debt crisis in many advanced economies in the euro area remain present in the global economic and financial landscape, hence conditioning the economic recovery. Recent positive developments in achieving a stable and widely accepted solution for a proper mechanism to cope with the public debt problems have improved the climate of confidence in the market and the agents' financial activity. The latest decisions adopted by the European Central Bank (ECB) and the attitude of the ECB's governor in meetings with other central monetary institutions have positively affected the lowering of businesses' and financial agents' uncertainties. Financial markets have reflected these developments, and asked yields and risk premiums have dropped significantly. However, the prolonged crunch in many segments of the equity market has conditioned the capital flows needed to support economic recovery. The economic activity slowdown has been present in many developed economies and has affected many euro-area countries, which have registered negative growth.

CEE economies[1] have displayed an economic landscape characterised by economic decline and slowdown, in the best case (Poland). A common feature of the CEE economies is the contraction of domestic consumption and investment (in some of them). The weakening external demand, conditioned by the fragile global economy in general, and by that of the euro area in particular, is another important item. The high share of this area in respective exports of these countries has strengthened its impact on economic performance. The respective governments' need to pursue consolidated balance sheet policies has limited the room for fiscal stimulus, hence making the recovery more difficult. In 2012 Q4, agencies did not report any deteriorated estimates for these countries and in several cases there was improvement, but it was not yet translated into considerable investment flows to these economies. Overall risk perception by major market agents on this region factored into the current situation of the euro area, the weakening domestic demand and the overall condition of international markets. The inflation dynamics was contained in the euro area, in the CEE economies and in major advanced economies. Inflation dropped month-on-month, reflecting the weak pressure stemming from the domestic demand, and the downward price of energy and primary commodities in the world.

[1] Central and Eastern Europe

1. SELECTED ECONOMIC INDICATORS AND MONETARY POLICY ORIENTATION IN ADVANCED ECONOMIES

EURO AREA

The euro area economy in 2012 Q3 continued to contract. Its economic growth was -0.1% on a quarter earlier and -0.6% in annual terms. Direct and indirect preliminary indicators for Q4 are not encouraging and point to continuation of negative performance. The economic landscape for Q4 remained unchanged, being characterised by dampened domestic consumption and investment, and generally weakened production sectors. Net exports in this quarter, reduced their contribution to GDP, increasing the share of negative items to its formation. Unemployment continued to rise, reducing the hopes for rapid recovery of domestic consumption in the near future. The ECB has focused its actions mainly on the well-functioning of the financial market and overcoming of crunches induced in certain financial market segments. In this regard, ECB president Mario Draghi's statements, and the establishment and functioning of automatic mechanisms to cope with the public debt concerns have also helped. These moves have impacted positively, thus restoring signs of optimism and certainty to businesses and market climate. In this context, debt securities of the euro area countries have benefited and have been generally characterised by reduced risk premiums in general and spreads in particular. The revival of this activity is seen optimistically by ECB's experts, regarding it a precursor of economic recovery. Inflationary pressures remained contained during those months, reflecting the downward prices of energy and related products.

Table 1 Key interest rates in advanced economies

	Euro area (ECB)	USA (FED)	UK	Japan
Inflation target	< 2%	n.a.	2%	1%[1]
Key interest rate change	08.11.12 (0.00) 06.12.12 (0.00) 10.01.13 (0.00)	13.09.12 (0.00) 24.10.12(0,00) 11.12.12 (0,00)	07.11.12 (0,00) 05.12.12 (0,00) 09.01.13 (0,00)	19.11.12 (0.00) 19.12.12 (0,00) 21.01.13 (0,00)
Actual interest rate	0.75%	0-0.25 %	0.50%	0-0.1 %
Latest inflation rate[2]	2.2%	1.7%	2.7%	0.4%[3]
Schedule of MPC meetings	07 February 07 March 04 April	29-30 January 19-20 March 30 April	06-07 February 06-07 March 03-04 April	13-14 February 06-07 March 03-04 March
Upcoming events	14 February 14 March Monthly bulletin	06 March 17 April Beige book	13 February 15 May Inflation report	15 February 08 March Monthly report

[1] *The Bank of Japan has not adopted the inflation targeting regime and the level considered as price stability by this bank is the 0-2% range, or more precisely, the midpoint 1.00%.*
[2] *December 2012*
[3] *November 2012*
Source: Respective central bank[s]

After the final change at the beginning of July, the ECB has not changed its key rate, keeping it at 0.75% (the lowest historical level) and leading the overnight deposit remuneration rate to zero. During this period, the ECB has pursued an easing policy, continuing to use unconventional monetary policy

instruments. Besides improvement of regulatory requirements of many bank liquidity indicators, it is worth of note the easing of conditions on required capital and liquidity stipulated under the Basel III accord, which will be implemented gradually from 2015 to 2019. Finally, the ECB announced that it will continue conducting its main refinancing operations at a fixed rate with full allotment until July 2013.

USA

The U.S. economy gained momentum in Q3, registering sharper growth on a quarter earlier. Economic activity expanded by 0.7% in quarterly terms and +2.6% in annual terms. Latest estimates by the Central Bureau of Statistics show that the economic recovery was positively due to higher consumption and private spending and expanded net exports. Preliminary direct and indirect estimates on Q4 show that the paces of growth will remain at levels seen in the previous quarter. The recently published Beige book[2] presents positive values for the U.S. economy and in the most pessimistic scenario the economic activity is estimated to have retained the third quarter's values. The Fed, the U.S. central bank, deemed necessary to extend its unconventional operations in an effort to create best conditions to bolster the economy. In this regard, it has announced continuation of its quantitative easing (QE) program for an indefinite time and limit, to $ 45 billion per month, and the monthly purchases of $40 billion mortgage-backed securities. Also, the Fed has not changed its key interest rate during this period and has projected to keep it at this level as long as unemployment remains above 6.5% and one to two-year ahead inflation forecasts remain below 2.5 %. Inflation has dropped during these months due to food and energy prices.

2. ECONOMIC ACTIVITY, INFLATION AND MONETARY POLICY ORIENTATION IN SOME CEE COUNTRIES[3]

The CEE countries surveyed in this report posted decelerated growth and weakened economic activity during three quarters of 2012. The continuously weakening consumption due to contracted domestic demand was a common feature of these countries. The need to pursue and maintain fiscal consolidation policies reduced the room for government intervention to stimulate the economy, thus contributing negatively to GDP performance. The pace of growth is likely to slow down and it will gain momentum in 2013 H2. Poland is the only country that has posted positive growth, but the alarm bells are ringing there as well, since its growth rate weakened further this quarter, signalling a non-competitive position of the economy. Other states continued to post economic decline on a year earlier and on a quarter earlier.

The fragile economic condition of major advanced economies that account for the main market share in exports of these countries has conditioned the

[2] *Beige Book, January 2013*
[3] *This region includes the Czech Republic, Hungary, and Poland.*

external demand. The weakening of this item, which is the main driver of GDP of these countries, has speeded up and deepened the economic slowdown. The pursuit of rigorous policies for fiscal consolidation of balances has added the restraining pressures on GDP growth. Lacking a strengthened domestic demand, the economic growth projections for 2012 are revised down. The upward trend of inflation in 2012 H1 was mainly driven by temporary factors, such as increase in VAT and some excise taxes, while in 2012 H2, inflation rates were generally downward and inflationary pressures diminished. In the absence of an inflation risk and in the presence of ongoing economic tightening, central banks in this region have conducted successive key interest rate cuts to ease monetary conditions and boost lending to economy.

2.1 Economic activity

CZECH REPUBLIC Rating		
A1 (stable) (Moody's)	AA- (stable) (S&P)	A+ (positive) (Fitch)

The Czech Republic's GDP growth (y-o-y) in 2012 Q3 was -1.3%, from -1.0% a quarter earlier. The landscape of developments is similar to the previous quarter's, with the continuously diminishing private consumption as a key factor affecting the negative result. The other items contributing to GDP also declined, with the industrial production, specifically mining, manufacturing and energy sectors, suffering from the double effect of weakening domestic demand and moderate external demand. The weakening domestic demand is obviously reflected in household spending, which has been contracting throughout the year. Net exports in this quarter, despite good performance, did not offset these items' negative contribution to GDP. The latest data on industrial production, retail sales and construction suggest an ongoing weakening economic activity of the Czech Republic, in Q4.

HUNGARY rating		
Ba1 (negative) (Moody's)	BB+ (negative) (S&P)	BB+ (negative) (Fitch)

Hungary's economy continued to shrink by -1.5% y-o-y, in Q3, a higher figure than in the previous quarter. In quarterly terms, the slowdown was similar to that of the previous period (-0.2%). Besides weakening consumption, other key factors affecting the economic contraction were the performance of agriculture output and the negative performance of many industrial branches. Only some specific branches of the production sector, mainly those of transport and communication, registered positive values. Net exports also slowed down and their impact was negative. Preliminary data from October and November on industrial production, household consumption and retail sales suggest that the slowdown will continue in Q4. National Bank of Hungary's experts' analyses depict that Hungary's economic growth is expected to strengthen by end-2013, primarily relating it to recovery of external demand and more expanded spaces

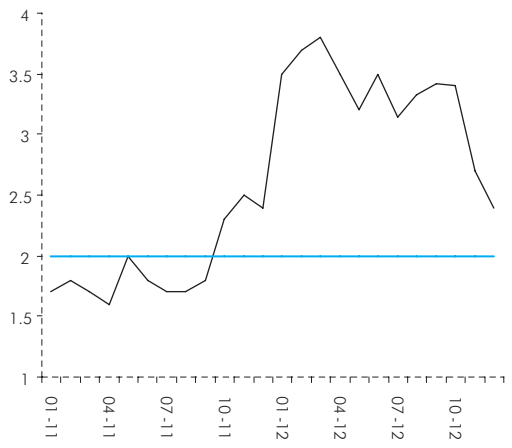
that the government will have available next year to stimulate domestic demand. Inflation pressures are on the downside due to the impact of weak domestic demand on prices. The National Bank of Hungary lowered its key interest rate in Q4 to create appropriate conditions for boosting lending in the country.

POLAND Rating		
A2 (negative) (Moody's)	A- (stable) (S&P)	A- (stable) (Ftich)

Economic data on Poland for Q3 confirm the downtrend seen throughout the year. Though at a positive value (1.9%), Poland's annual GDP growth slowed down to 2.55% on a quarter earlier, while the economic growth was 0.4% in quarterly terms. The economic growth slowdown was driven by weakening private consumption. Also investment flows have contracted for the first time since 2010. Indicators of credit to economy growth confirm a non-positive economic performance during this year. Net exports contributed positively to GDP growth. Poland's exports are oriented mainly toward Germany and shares of foreign market, which continue to perform positively even during this moment of the crisis. However, against the background of a markedly weakening domestic consumption and non-optimistic economic outlook, the Polish central bank tried to ease monetary conditions by cutting the key interest rate for the third time over the last months. As in the case of Hungary, the domestically and externally generated inflation pressures have been and will remain contained, allowing the central bank to focus its actions more on boosting lending activity.

2.2 Inflation and monetary policy

Chart 1 Inflation rate and target, Czech Republic



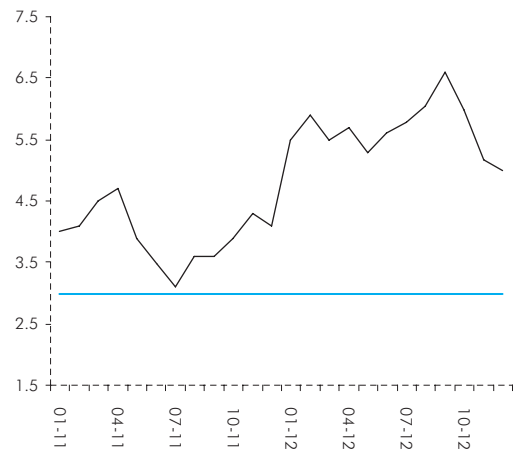
Source: National Bank of the Czech Republic.

The Czech Republic's inflation rate trended down in Q4. Its annual rate was 2.4% in December, from 2.7% in November and the relevant monetary-policy inflation was close to the lower bound of inflation target[4]. The poor economic performance and weakening consumption transmitted strong downward pressures on inflation. After the dropping out of effects from temporary events, such as the pass-through of change in VAT and some administered prices to many commodity items, inflation trended down. The labour market (rise in unemployment), domestic consumption and stable exchange rate were some anti-inflationary factors. During this period, the central bank lowered the key interest rate twice, by 45 basis points. With a 0.05% key interest rate, central bank experts think that foreign exchange intervention may be another way of monetary easing.

[4] *Inflation target is 2%, with +/- 1 tolerance band.*

In Hungary, the inflation rate was 5.2% in December, from 6.0% in November. During this year, it remained above the 3% central bank's inflation target. Inflation was mainly driven by the effect of rise in many indirect taxes and excise duties. Inflationary pressures were driven mainly by temporary factors and the pass-through of increase in international food prices, while the share of domestic demand pressures on inflation was downward. The Central Bank of Hungary lowered the key interest rate three times during the period, down to 5.75% in December, from 6.50% in September. Inflationary pressures from temporary factors during the year appear to have exhausted their effect and the downtrend from the domestic demand appears stronger. Central bank forecasts over the short run show that inflation will pursue a downward trajectory and the pressures will be balanced mainly over the medium term. However, the level of uncertainty about forecasting the relevant monetary-policy inflation is considerable. This is so because the rising pressures effect from higher administered prices and the degree of their pass-through into producer prices, as well as the quantity of compensation arising from the weak domestic demand are not yet clear.

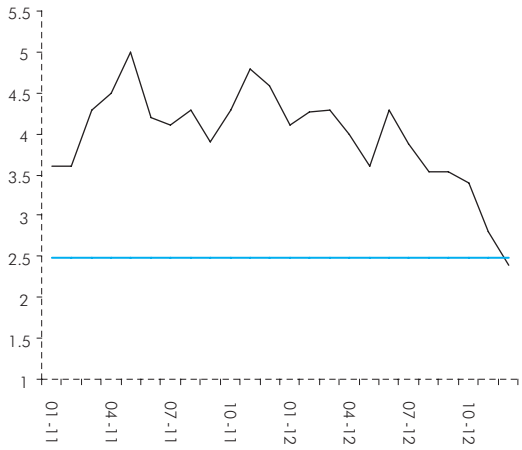
Chart 2 Inflation rate and target, Hungary



Source: Central Bank of Hungary.

Poland's annual inflation rate trended down in the second half of this year. In December, it was 2.4%, below the inflation target (2.5%). Since July 2012, inflation has fallen below the upper bound of the target band. The National Bank of Poland has lowered the key interest rate three times over the last three months, to 4.00%. This Bank's experts have expressed their concerns that the inflation rate will drop further to below the inflation target in the coming periods, while the real-economy data are not encouraging. Further decline in core inflation and producer prices confirms strong non-inflationary pressures from the domestic demand, given higher effects from rise in several administered prices, VAT and excise taxes in the first half of the year. Performance of domestic economic indicators, global economy and labour market are reflected in professional forecasts for inflation, which is expected to be close to the target in 2013 H1.

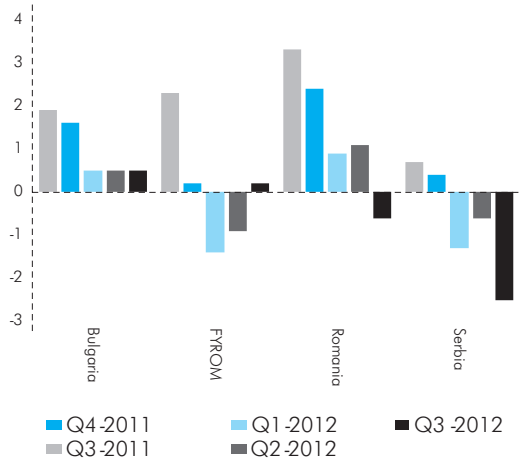
Chart 3 Inflation rate and target, Poland



Source: National Bank of Poland.

3. ECONOMIC ACTIVITY, INFLATION AND MONETARY POLICY ORIENTATION IN SOME SOUTH-EASTERN EUROPEAN ECONOMIES[5]

Chart 4 Annual real GDP growth



Source: Central banks and respective statistical agencies.

After a modest improvement in Q2, the South Eastern European economies posted decline in their economic activity, in Q3. Serbia remained at a negative territory (y-o-y GDP), marking a sharper contraction on a quarter earlier. Romania, after marking positive values in the first two quarters of the year, contracted in Q3, while Bulgaria and Macedonia marked a positive but slow growth rate.

Strong economic and financial relations with the European Union have made this region suffer from the effects of advanced economies' debt problems and the volatile international markets in the form of reduced demand for exports in the region, reduced foreign capital inflows and remittances, and tight lending standards (*deleveraging*).

The weak domestic demand, coupled with falling real wages, rising unemployment, and lower paces of investments have led to economic slowdown. Credit to economy has dropped sharply in all the countries under consideration. This trend has reflected partly the decline in credit demand and partly the tightening of credit supply due to policies pursued by major European banks.

Also, the negative economic growth rates (y-o-y) in some countries (Serbia, Romania) appear to have been influenced by the comparative base effect, given the very good performance of agriculture sector in the previous year. In Q3, unfavourable weather conditions damaged the agriculture output, hence impacting negatively on GDP growth. In Romania, the November 2012 elections appear to have postponed the conduct of structural reforms, hence decelerating the growth.

Inflation rate increased further in Q4. In Serbia and Romania, which apply the inflation targeting regime, it exceeded significantly the central bank's primary target, hence reaching record highs at the end of the year.

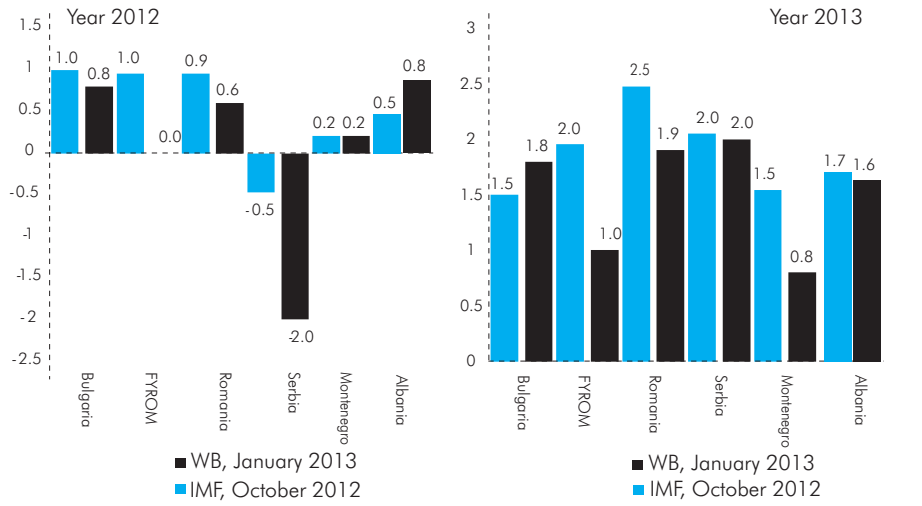
Romania's central bank has not changed its monetary policy stance, while Serbia's central bank has taken successive decisions, increasing the key rate by 0.75 percentage points in total during August-December.

In January 2013, the World Bank published its global economic prospects for the countries in the region for 2012-2013[6], figures which were revised down by the IMF in October 2012. Prospects for 2013 assume that the external

[5] *The selected countries include Bulgaria, FYROM, Romania and Serbia.*
[6] *Global Economic Prospects, World Bank, January 2013*

environment will not undergo any unexpected negative developments, while internal factors affecting the economic growth are likely to remain.

Chart 5 Growth outlook for 2012 and 2013



Source: World Bank and International Monetary Fund.

On the other hand, the report underlines the need for structural reforms and adjustment of domestic measures to address problems related to external imbalances (current account deficit), domestic ones (fiscal deficit, public debt, labour market conditions), and improve competitiveness.

3.1 Economic activity

BULGARIA Rating		
Baa2 (stable) (Moody's)	BBB (stable) (S&P)	BBB- (stable) (Fitch)

Bulgaria's economy grew at a slow rate in Q3 (0.5% y-o-y), similar to a quarter earlier. Private consumption, the main component of GDP, was the key driver of economic growth. This component increased by 3.0% in annual terms, from 3.2% in Q2. The relatively high real-term wages and seasonal employment growth were the main drivers of consumption. For the first time since 2008 Q4, investments recorded a positive annual growth rate (1.0%), hence increasing the optimism that this sector has entered the growth cycle. The good pace of withdrawing the EU funds has boosted investments significantly. The share of investments in GDP dropped from 37% in 2008, to 23% in 2011, partly due to the considerable decline in foreign direct investments (about 7 times). Net exports made a negative but mitigated contribution compared to Q2 due to slowing imports.

Macedonia Rating		
- (Moody's)	BB (stable) (S&P)	BB+ (stable) (Fitch)

Unlike a quarter earlier, Macedonia's GDP posted positive growth in Q3 (0.2% y-o-y). This growth was mainly supported by construction investments. Private consumption and exports were downward (2.4% and 2.9%, respectively, down from a year earlier). Private consumption appears to have been affected by higher food prices in Q3, while exports have suffered from the prolonged crisis effects on Europe and the difficult situation in trading partners. Industrial production figures as at November were downward, warning of slower economic activity in Q4.

ROMANIA Rating		
Baa3 (negative) (Moody's)	BB+ (stable) (S&P)	BBB- (stable) (Fitch)

In Romania, GDP contracted by 0.6% y-o-y, in Q3, from growing by 1.1% a quarter earlier. The economic activity was influenced by the significantly deteriorating domestic demand and lower contribution of foreign demand. Private consumption fell by 1.4% in annual terms, while public one fell by 1.7%. The first appears to have been influenced by decline in real wages and rise in food prices. On the other hand, the pace of investments, albeit positive, slowed to 9.9%, from 15.5% in Q2. It is attributed to decreased public investments in the construction sector. From a sectoral viewpoint, the decline in agriculture output is a key factor that may have negatively affected this value. This sector's good performance a year earlier was not repeated in 2012. On the contrary, the summer drought led to lower than expected crops, resulting in reduced agriculture output (29.8%) in Q3.

Serbia Rating		
- (Moody's)	BB- (negative) (S&P)	BB- (negative) (Fitch)

Serbia's economic activity shrank by 2.5% in annual terms, in Q3, from -0.6% a quarter earlier. The financial, telecommunication and transport sectors grew during this period. Agriculture remained the sector with the poorest performance, contracting by 17.1% in annual terms, in Q3. This value was affected by unfavourable weather conditions over this year, and the previous year's very positive pace of agriculture output growth. Construction and energy sectors contributed negatively to annual GDP.

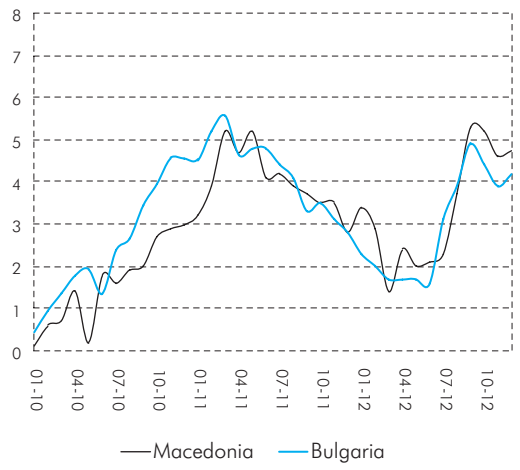
Data on industrial production as at November indicate a further weakening economic activity in Q4. Sales indicators dropped sharply in October-November, partly reflecting the rise in indirect taxes (VAT rise from 18% to 20%). The central bank expects negative GDP growth for Q4 due to negative contribution of private and public consumption, and the slightly positive contribution of net exports and investments. However, the greatest difficulties facing Serbia relate to the fiscal sector. The IMF mission in November did not agree on activating the stand-by agreement with the Serbia's Government.

The mission expressed its lack of confidence in the country's fiscal position and objectives, against a background of a sharply increased public debt and an unsustainable fiscal deficit. According to Serbia's Fiscal Council, at the end of 2012, the fiscal deficit would account for 6.7% of GDP, while the debt would be close to 60% of GDP, hence exceeding significantly the 45% fiscal rule.

3.2 Inflation and monetary policy

In Bulgaria, the price level continued to rise, averaging 4.2% in Q4, from 4.0% in Q3. The annual inflation was 4.2% at year-end, from 2.8% a year earlier. The main factors pushing inflation to these levels were food and fuel prices rise in international markets. The increase in gas and energy prices since 1 July has also affected and is expected to affect the inflation formation. In Macedonia, inflation rate, after falling in November, edged up again to 4.8% in December. The main factors leading to higher prices relate to pressures from import and regulated prices. The central bank has not changed its monetary policy stance, though it has drawn attention to the fact that the future outlook for inflation is surrounded by risks stemming from uncertainties in the international markets. Foreign reserve level is deemed as appropriate and the country's external position as sustainable over the medium term.

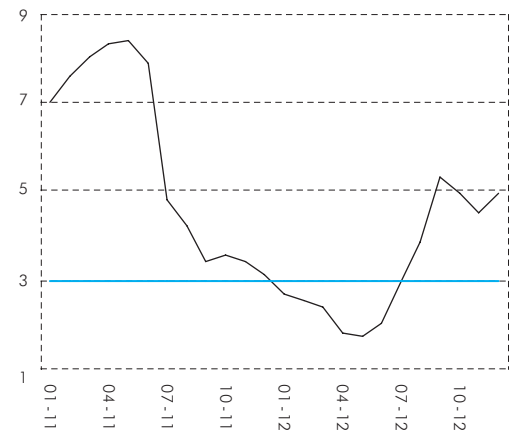
Chart 6 Annual inflation rate



Source: Respective central banks.

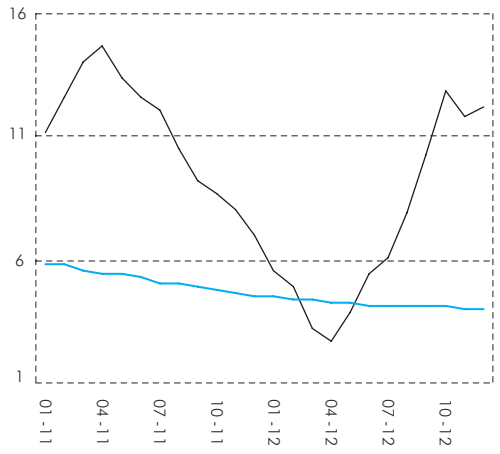
In Romania, the annual inflation has pursued an upward trajectory, recording 5.0% in December, from 3.1% a year earlier. Inflation surge in December was in line with the central bank's projections, which took into account the higher food prices, as a result of prolonged drought and reduced agriculture output. Demand pressures remained weak, against the backdrop of a negative output gap. The central bank has maintained the key interest rate unchanged, at 5.25%, in response to disinflationary pressures that may be more pronounced in the context of economic crunch in the country and the euro area. On the other hand, the completion of the elections process in November and the efforts to fulfil fiscal parameters have elevated investors' confidence, hence mitigating the exchange rate pressures. The central bank forecasts that the inflation rate will enter the tolerance band (2%-4%) in 2013 H2.

Chart 7 Inflation rate and target, Romania



Source: Central Bank of Romania.

Chart 8 Inflation rate and target, Serbia



Source: Central Bank of Serbia.

The inflation rate in Serbia surged to 12.2% (y-o-y) at end-2012, due to higher agricultural product prices and administered prices, as well as the comparative base effect. Responding to a higher inflation rate, in an effort to control inflationary expectations and possible second-round effects, Serbia's central bank increased the key rate to 11.25% in December, from 10.50% in August. Inflation is expected to enter the tolerance band only at the end of 2013. Fiscal consolidation measures are expected to contribute substantively to this performance. Risks surrounding this projection relate to performance of food prices in the country and international markets, and administered prices in the country.

ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY, 2012 Q3

MERITA BOKA, OLTI MITRE
MONETARY POLICY DEPARTMENT, JANUARY 2013

1. BALANCE OF PAYMENTS HIGHLIGHTS[1]

As in the past two years, trade transactions with abroad during 2012 were under the pressure of the international macroeconomic setting, particularly of the euro area and the neighbouring countries. The decelerating economic growth in these countries and the weakening external demand led to a significant moderation of the growth rate of exports of goods and services in 2012 Q3. The moderate domestic demand and the subsiding effects of the visa liberalisation regime for Albanian citizens travelling to the Schengen area led to lower imports of goods and services over the period under review. Net export deficit narrowed at an annual rate of 14.4% in 2012 Q3. The strained employment situation, particularly for Albanian immigrants, in the countries with their highest concentration, led to a progressive decrease in remittances. Due to foreign flows in these accounts, Albania registered a current account deficit of EUR 198.1 million, decreasing at an annual rate of 18.8%. Foreign inflows into the capital and financial account amounted to about EUR 176.8 million, down at an annual rate of 22.3%. The surplus in this account financed about 89.2% of this period's current account deficit.

Table 1 Balance of Payments indicators

	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2011 9M	2012 9M
Current account (in EUR million)	-244.1	-352.1	-253.1	-219.9	-198.1	-769.9	-671.1
yoy	1.8%	-1.2%	19.4%	-29.9%	-18.8%	16.3%	-12.8%
/ GDP	-10.2%	-15.2%	-11.8%	-8.6%	-7.7%	11.1%	9.2%
Trade balance	-593.1	-658.6	-465.3	-475.5	-540.5	-1,583.0	-1,481.4
Exports, f.o.b.	344.1	360.0	325.8	394.2	402.5	1,045.5	1,122.5
Imports, f.o.b.	-937.2	-1,018.6	-791.2	-869.7	-943.0	-2,628.5	-2,603.9
Balance of service	116.7	41.2	8.5	26.2	132.6	93.4	167.3
Credit	629.8	428.5	293.8	381.1	578.1	1,318.9	1,253.0
Debit	-513.1	-387.3	-285.4	-354.9	-445.4	-1,225.4	-1,085.7
Travel - export	469.4	285.1	185.1	246.4	445.3	884.3	876.8
Travel - import	-386.5	-256.8	-180.8	-240.1	-325.6	-864.8	-746.5
Travel - net	82.9	28.4	4.3	6.2	119.7	19.5	130.2
Balance of income	14.1	14.5	-1.9	-10.2	20.8	33.1	8.7
Credit	77.5	67.5	59.7	60.9	74.9	202.0	195.5
Debit	-63.3	-53.0	-61.6	-71.1	-54.1	-169.0	-186.8
Net FDI income	-22.0	-7.9	-30.2	-30.1	-18.7	-48.2	-79.0
Current transfers	218.2	250.8	205.7	239.7	188.9	686.6	634.2
Credit	245.6	279.1	242.3	279.6	227.3	771.2	749.2
Debit	-27.5	-28.3	-36.7	-39.9	-38.4	-84.7	-115.0
Net remittances	153.8	188.7	159.5	178.6	138.9	499.2	477.0

[1] *The latest balance of payments data are as at 2012 Q3.*

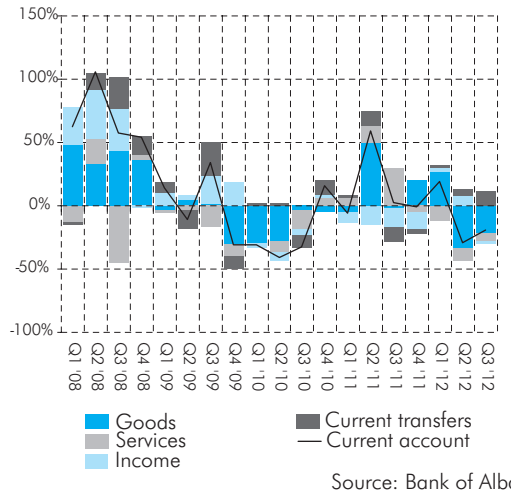
Capital and financial account (in EUR million)	227.6	277.1	258.3	172.2	176.8	649.9	607.4
yoy	29.1%	-32.6%	12.2%	-10.3%	-22.3%	40.9%	-6.5%
/ GDP	9.5%	11.8%	12.1%	6.7%	7.0%	7.0%	8.4%
Capital account	6.5	27.8	12.9	43.0	9.8	57.1	65.8
Financial account	221.1	249.3	245.4	129.2	167.0	592.8	541.6
A. Liabilities	413.3	390.7	307.5	268.6	375.9	860.9	951.9
FDI	160.1	289.7	201.8	178.3	171.2	457.2	551.4
Portfolio investment	11.1	11.4	14.3	13.2	14.9	28.4	42.4
Other investments	242.1	89.6	91.3	77.1	189.8	375.3	358.2
Borrowing	110.2	39.2	41.5	30.8	27.2	181.4	99.5
Currency and deposits	137.2	54.1	73.0	44.6	149.9	191.7	267.5
B. Assets	-192.3	-141.3	-62.0	-139.4	-208.9	-268.1	-410.3
FDI	-3.9	-19.8	-2.6	0.0	-7.3	-10.4	-9.9
Portfolio investment	-57.1	14.4	-61.0	9.9	-26.4	-103.1	-77.5
Other investments	-131.2	-135.9	1.5	-149.3	-175.2	-154.6	-322.9
Currency and deposits	-114.8	-94.3	-11.0	-137.6	-173.8	-79.9	-322.4
Credit (for commercial financing)	-34.5	-57.0	9.7	0.6	-1.7	-62.6	8.6
FDI (net)	156.2	270.0	199.3	178.3	163.9	446.9	541.5
Portfolio investment (net)	-46.0	25.7	-46.6	23.1	-11.5	-74.7	-35.1
Other investments (net)	110.9	-46.4	92.8	-72.2	14.6	220.7	35.2
Errors and omissions	72.9	68.8	-2.0	55.2	111.0	97.6	164.1
Reserve assets	-56.4	6.2	-3.2	-7.5	-89.7	22.4	-100.4

Source: Bank of Albania.

1.1 CURRENT ACCOUNT

Albania's net current account balance recorded a deficit of EUR 198.1 million in 2012 Q3. The current account deficit shrank at an annual rate of about 18.8%, hence reinforcing the trend begun since 2012 Q1. It was estimated at 7.7% of nominal GDP[2] or about 0.8 percentage points lower y-o-y. As in the previous two quarters, the current account dynamics during 2012 Q3 was broadly determined by the performance of net export balance. The narrowing of the trade deficit at an annual rate of 8.9% and the improving services account balance by about 13.7% shrank the net export deficit by about 14.4%. The net balance of the income account registered a surplus of EUR 20.8 million, mainly due to the lower outflows of foreign direct investment income and improved portfolio investment income balance. The surplus in the current transfers account narrowed at an annual rate of 13.4%. Remittances, the main sub-item in this account, continue to maintain a downward annual trend. On a nine-month cumulative basis, the current account deficit shrank by about 12.8% y-o-y, hence alleviating its sustainability issue.

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



Source: Bank of Albania.

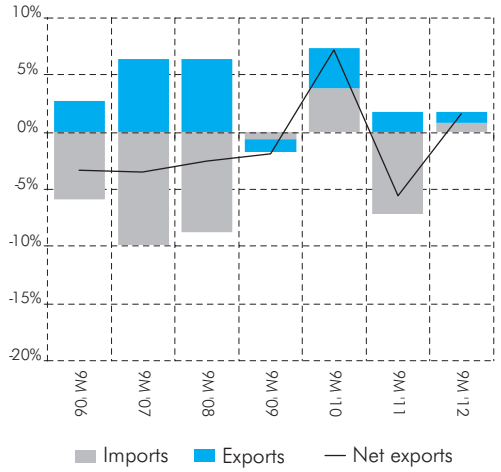
[2] *Nominal GDP for 2003-10 as published by INSTAT. The quarterly distribution is based on quarterly real GDP weights. The authors use Bank of Albania Monetary Policy Department's projections for 2011 and 2012.*

Albania's degree of economic openness stood at 92.4% in 2012 Q3, 8.9 percentage points lower y-o-y.

The performance of external sector indicators shows the annual narrowing of the real net exports deficit[3] during the first nine months of 2012 due to the lower imports of goods and services in real terms by about 1.1% and the higher exports by about 2.0%. The developments in real imports and exports of goods and services materialized into a positive contribution of this component to aggregate demand growth over the period under review.

Financial flows from the combined net position of income account, current transfers and services fell at an annual rate of 1.9% in 2012 Q3. Consequently, the net flows of these three accounts altogether financed about 63.3% of the trade deficit, up about 4.5 percentage points y-o-y.

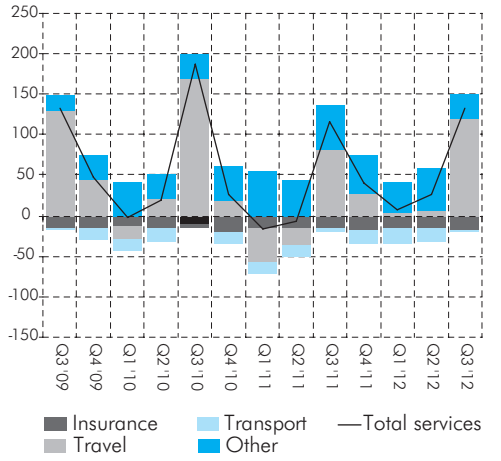
Chart 2 Contribution of net exports to real GDP (in percentage points)



Source: Bank of Albania.

The net balance of the services account yielded a surplus of EUR 132.6 million in 2012 Q3, up about 3.7% y-o-y. After the sharp narrowing of its surplus in 2011 due to the visa-free regime for Albanian citizens travelling to the Schengen area, the first nine months of 2012 saw a very positive performance. The increase in foreign flows in the services account was more considerable in 2012 Q3, which corresponds to the summer tourist season. The net balance of travel services (personal and business) therefore played the most important role in this account for the period under review. It improved at an annual rate of about 44.4%, mainly due to the lower spending on residents' travel services for tourism or business purposes abroad at an annual rate of 15.8%. Foreign inflows from non-residents' personal travel services in Albania fell about 5.1% over the period under review. Other services (which include communication, construction, government, financial, computer, information services, etc.) recorded a positive balance of EUR 31.5 million, down at an annual rate of 40.5%. On the other hand, the negative balance of transportation and insurance services continue to make a negative contribution to the total services balance for 2012 Q3.

Chart 3 Balance of services (net flows, in EUR million)

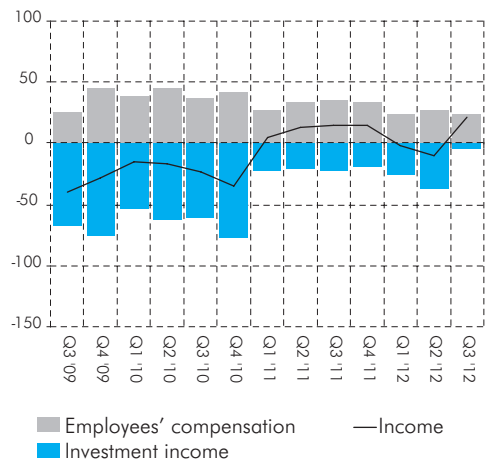


Source: Bank of Albania.

[3] *In order to switch from nominal to real terms of imports and exports of goods, we use the Unit Value Index obtained from international trade volume statistics. While for imports and exports of services, we use the Consumer Price Index of services, as measured by the Bank of Albania.*

Against a background of high perceived risk, the income balance has continuously deteriorated since 2009, owing mainly to the accelerated increase in investment profit repatriation. In 2011, the income balance improved due to the lower outflows of total income at an annual rate of about 44.9%. The net balance of the income account recorded a surplus of EUR 8.7 million during the first nine months of 2012, down at an annual rate of about 73.6%. This account's performance over the period under review was primarily driven by the decline in employees' compensation at an annual rate of 21.6%. The net deficit on investment income provided further impact, widening by about 5.2% y-o-y.

Chart 4 Income balance
(net flows, in EUR million)

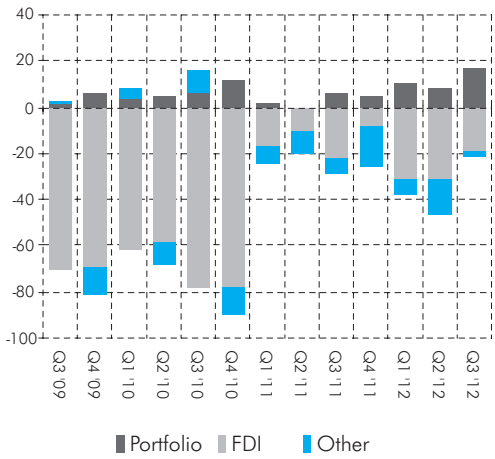


Source: Bank of Albania.

After deteriorating in two quarters in a row, the net income balance saw a positive figure of EUR 20.8 million in 2012 Q3, up at an annual rate of 47.6%. Foreign inflows of net labour income, albeit lower y-o-y, contributed to improving the total income account. The higher inflows from investment income and their lower outflows led to the narrowing of the net investment income deficit by about 83.9% y-o-y. The deficit of net foreign direct investment income shrank at an annual rate of 14.9%. In contrast to 2011, the net balance of portfolio investment income yielded a surplus of EUR 17.6 million in 2012 Q3, compared to EUR 6.0 million in 2011 Q3.

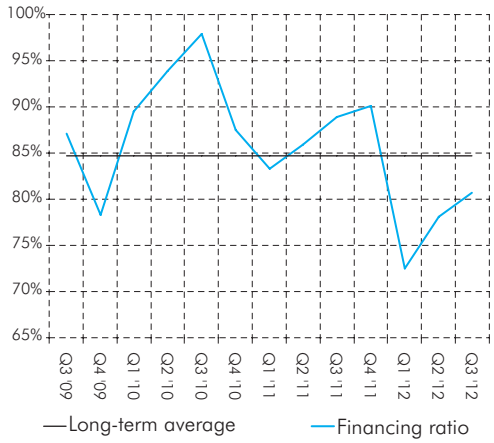
The balance of income from other net investment has been recording negative figures since 2010 Q4, owing mainly to the higher net interest payments on public and private debt. The deficit of this income account sub-item was EUR 2.4 million in 2012 Q3, compared to EUR 6.0 million in 2011 Q3. Net interest payments on public and private debt lowered Albania's liabilities by about EUR 26.7 million over the period under review.

Chart 5 Composition of investment income
(net flows, in EUR million)



Source: Bank of Albania.

Chart 6 Financing ratio of imports of goods from the sum of exports, remittances and FDI



Source: Bank of Albania.

Current transfers account surplus, an important source of current account deficit financing, recorded progressive decline during the first three quarters of 2012. The narrowing of current transfers surplus in the first nine months of 2012 at an annual rate of 7.6% was largely driven by the decline in other current transfers items.

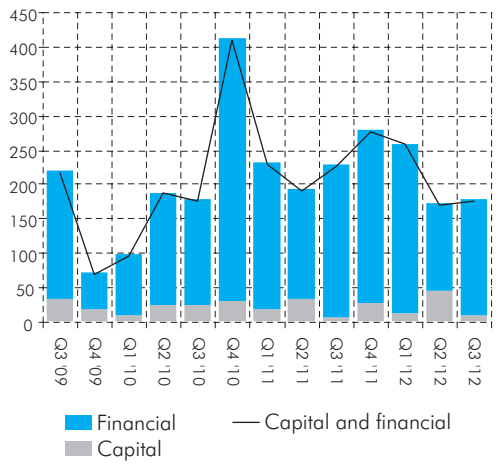
Net current transfers surplus shrank by about 13.4% in 2012 Q3. Public and other sectors' transfers fell at an annual rate of 38.2% and 12.7%, respectively. Due to labour market constraints in the countries with the highest concentration of Albanian immigrants, net remittances maintained their annual downward trend begun since 2007, albeit at more moderate rates. Remittances fell at an annual rate of 9.7% in 2012 Q3. Remittances-to-trade deficit ratio is estimated at 26.0%, or about 0.6 percentage points lower y-o-y.

1.2 CAPITAL AND FINANCIAL ACCOUNT

Net flows in the capital and financial account recorded a positive balance of EUR 176.8 million in 2012 Q3, financing 89.2% of the current account deficit. Capital and financial flows fell by about 22.3% y-o-y and were estimated at 6.9% of nominal GDP. The annual fall in foreign flows in this account was largely driven by the lower financial flows at an annual rate of 24.5%. As a percentage of nominal GDP, the financial account was estimated at about 6.5%, 2.7 percentage points lower y-o-y. Net flows in the capital account recorded a surplus of EUR 9.8 million in 2012 Q3. Residents' financial liabilities to non-residents fell at an annual rate of 9.1%, partly as a reflection of the lower liabilities in the form of other investments, while those in the form of portfolio investment and FDI increased. Albanian assets invested in non-resident economies increased at an annual rate of 8.6%, driven mainly by the higher assets in the form of other investments and FDI. Assets in the form of portfolio investments fell in 2012 Q3.

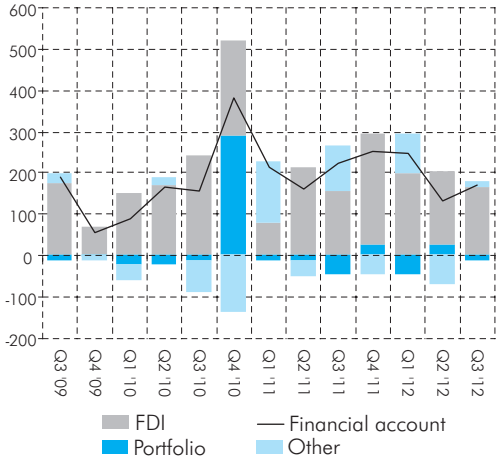
Net foreign direct investment (inflows – outflows) increased by about 4.9% y-o-y. This change owes, to a large extent, to the increase in liabilities in the form of FDI (FDI inflows) by about 6.9%. By type of investment instrument, FDI inflows in the form of shares and reinvested earnings fell at an annual rate of 12.9%. Capital inflows in the form of other capital increased slightly in 2012 Q3, while in the same quarter in 2011, this item recorded capital outflows. Net foreign direct investment increased at an annual rate of 21.2%, owing mainly to the higher residents' liabilities to non-residents. FDI sectoral distribution in 2012 Q3 suggests their concentration in the hydrocarbon extractive sector (about 64%) and telecommunication (about 11%).

Chart 7 Capital and financial account
(net flows, in EUR million)



Source: Bank of Albania.

Chart 8 Financial account and its components
(net flows, in EUR million)



Source: Bank of Albania.

Portfolio investment inflows contributed to the increase in Albania's assets invested in foreign economies by about EUR 26.4 million in 2012 Q3, or EUR 30.7 million lower y-o-y. Residents invested about EUR 27.4 million in debt securities over the period under review. Portfolio investment inflows increased at an annual rate of about 33.7%, being primarily concentrated in debt securities. The net portfolio investment position stood at EUR -11.5 million in 2012 Q3, reflecting the higher Albanian assets invested in this type of instrument in the foreign economies. On a nine-month cumulative basis, net portfolio investments were about EUR -35.1 million compared to EUR -74.1 million in 2011 Q3. The direction of this type of investment was determined by Albanian assets invested in foreign economies.

Other net investments recorded a positive figure in 2012 Q3, contributing by about EUR 14.6 million to the increase in residents' liabilities to non-residents. This figure is markedly lower than in the same period in 2011 when other net investments amounted to about EUR 110.9 million. The direction of financial flows in this account was determined by the increase in Albanian assets invested in foreign economies by about EUR 175.2 million in 2012 Q3. Albania's liabilities to non-residents in other investments fell at an annual rate of 21.6%, owing mainly to the lower public and private borrowing. The latter amounted to about EUR 27.2 million during the quarter under review compared to EUR 110.9 million in 2011 Q3. Debt (principal) payments lowered Albania's liabilities by about EUR 34.8 million in 2012 Q3.

Our assets invested in non-resident economies have been increasing since 2012 Q2, primarily due to the higher assets of the Albanian banking system invested abroad in the form of currency and deposits. Albania's banking system deposits grew EUR 173.8 million from EUR 114.8 million in 2011 Q3.

Gross External Debt

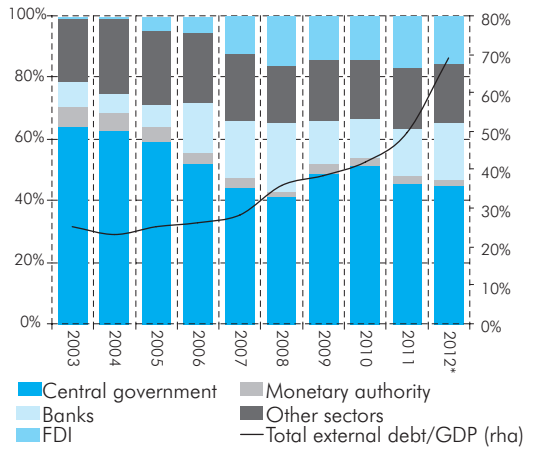
As at end-2012 Q3, Albania's gross external debt stock totalled EUR 5,044.6 million, up about EUR 184.8 million q-o-q and about EUR 633.1 million y-o-y. For the most part, the higher debt stock as at end-2012 Q3 was triggered by the increase in banking system and central government borrowing. Broken down into institutional sectors, as at end-period, general government's share in total debt stock was about 44.9%. The remainder of debt has been allocated to other sectors (19.1%), banks (18.8%), foreign direct investment – intercompany loans (15.4%) and monetary authority (1.8%).

Central government continues to have the highest share in total debt stock. As at end-2012 Q3, its debt stock totalled about EUR 2.3 billion. During the first three quarters of 2012, the share of central government debt has been in the range of 44.9%-51.5%, with the lowest share in Q3. Relative to end-2011, the share of central government debt has fallen from 46.0% to 44.9% as at end-2012 Q3. The banking system's gross external debt amounted to EUR 946.6 million, up about EUR 235.3

million from end-2011. Other sectors' external debt amounted to EUR 964.6 million, slightly higher by EUR 43.8 million from end-2011. Its share in total external debt stock for the period under review stood at about 19.1%, down from end-2011 and 2010. Foreign investment stock totalled EUR 778.0 million, up about 9.2% y-o-y.

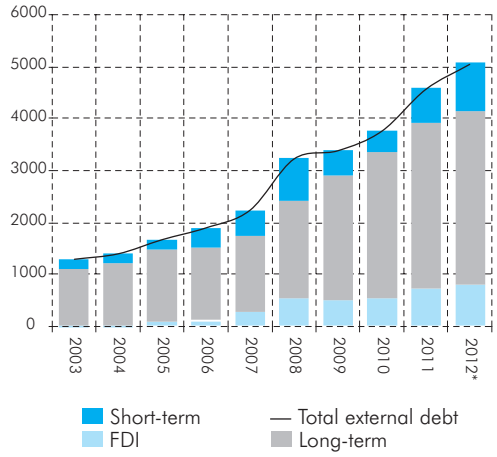
As at end-2012 Q3, about 66.2% of the debt stock (excluding direct investment – intercompany loans) accounted for long-term debt mainly in the form of loans. For the same period, short-term debt accounted for about 18.4% and was mainly in the form of banking sector currency and deposits. FDIs account for 15.4% of total public debt stock. General government and the monetary authority hold only long-term debt, while the banking sector and other sectors hold a composite portfolio of long and short-term debt.

Chart 9 Gross external debt by institutional sectors (year-end stock, as a percentage to total)



*Note: This chart refers to end-2012 Q3 debt stock.
Source: Bank of Albania.

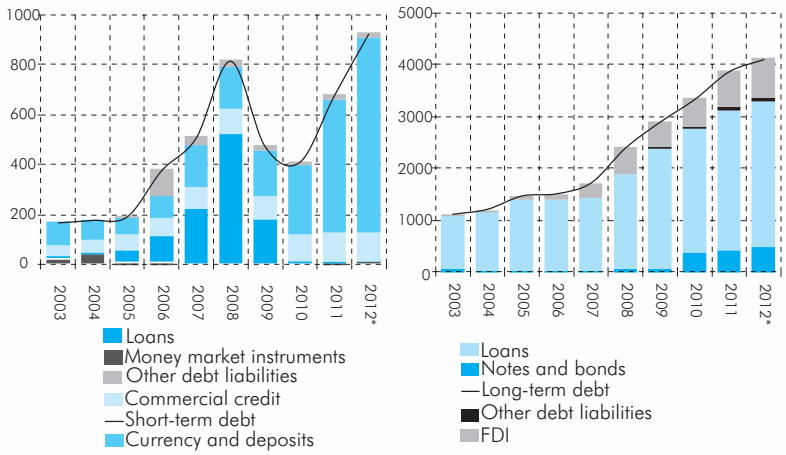
Chart 10 External debt by maturity (year-end stock, in EUR million)



Source: Bank of Albania.

Broken down into instruments and maturity, loans represent the main long-term investment instrument, accounting for about 84.2% of total long-term debt. About 14.2% of long-term debt is held in the form of notes and bonds.

Chart 11 Short and long-term external debt (year-end stock, in EUR million)



*Note: This figure refers to end-2012 Q3 debt stock.
Source: Bank of Albania.

Short-term debt is mainly represented by currency and deposits, accounting for about 84.7% as at end-2012 Q3. Commercial credit accounted for about 12.2% of short-term debt stock.

International reserves increased by about EUR 89.7 million in 2012 Q3. As at end-September 2012, international reserves totalled EUR 2.024,3 million, sufficient to cover 4.5 months of imports of goods and services.

PAPER*

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

"TRAINING, TRANSITION, AND DEVELOPMENT: THE ROLE OF THE JVI"

WINNING ESSAY JOINT VIENNA INSTITUTE TWENTIETH ANNIVERSARY ESSAY & VIDEO CONTEST

ALBINA DEMOLLARI

Thinking about the role of education and training, I am reminded of a difficult situation when I was driving a car amidst dense fog down a mountainous road, not knowing what direction to take, how to raise the visibility, with only the guardrails keeping me from death. That is a situation so much resembling that of a person without education and training, not knowing what steps to take, what option to choose and on which path to make headway. That is how Albania was prior to 1990s, pursuing a wrong road, planning the economy centrally, knowing nothing about a market-based economy. That is a situation education in general, and training offered by the Joint Vienna Institute (JVI) in particular, have helped correct by enhancing the knowledge level and professional skills of public officials, helping them lift the fog of obscurity and find the right path, making transition easier and market economies flourish.

Prior to the transition years, Albanians knew nothing about liberalization, price-setting by market forces, freedom of speech or pluralism. They did not even dare to think about private property or ownership rights; the whole economy was owned by the state, and everything was controlled and planned by the government.

Fortunately, the year 1991 stepped in, bringing about inevitable and permanent changes, fundamental transformations, the dawn of a new era, marking the collapse of the centrally-planned economy and the start of transitioning to a market-based economy. It was a process that had already started in other former socialist countries and that knocked on the door of our country as well, affecting both our life and our mindset.

During the first years of transition, Albanians realized that huge transformations had to be made. The situation called for fundamental, legal, structural and economic reforms. Because Albania had been a closed country, people were unfamiliar with the advanced world and its accomplishments, and ignorant of the way market economies worked. The education they had acquired until then had laid emphasis on central planning and the benefits of common property. People opted for change and aspired to reform the wrongly-governed country and obtain membership in the united Europe, but they did not know what particular reforms to carry out, or what regulatory changes to make.

As Albania opened to the world, the awareness of the benefits of a market-based economy and accomplishments of the industrialized countries started to grow, leading to officials' pressing need for education and training in the economic arena. Trying to learn from the lessons drawn from countries that

had performed better economically, feeling their progress, Albanians realized that their country's fate was in their hands. Therefore, they turned their head to the developed countries, intending to eradicate the economic and financial backwardness that had been deeply rooted for about 50 years, gain from their advanced experience and successful policies and practices, acquire best practices and standards, make the new stage produce positive outcomes and build a clear vision for the economic outlook of the country.

More specifically, Albanians turned to international training organisations, eager for knowledge about the way a market economy works, privatization is carried out, financial stability is achieved and financial products are provided. They became aware that they had nothing to invent, just to seek assistance, hear good advice and expertise, and be trained in generally accepted international standards, whose implementation would help the economy grow and the country prosper.

International training organisations, in turn, considered the urgent training need of public officials from Albania and other transition economies, and put this issue on focus. They willingly worked out comprehensive training programs and invited mid- and senior-level officials and private-sector managers from transition economies, such as from Albania, Central and Eastern Europe, the Caucasus, Central Asia, Ukraine, Russia and other New Independent States to participate in conferences, seminars, workshops, academic round-tables and constructive meetings, aiming at furnishing them with a thorough knowledge and practical skills on issues related to market economy, providing them with opportunities that would help them make their contribution to their country's successful transition from planned to market-based economy.

As a result, numerous training courses were offered by different international organisations, such as the International Monetary Fund and the Joint Vienna Institute, the Financial Stability Institute and Bank for International Settlements, World Bank, European Central Bank, Deutche Bundesbank, Banca d'Italia, Bank of Germany, Czech National Bank, Banque de France, the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), Federal Reserve Bank of New York .... to enumerate just a few. They were delivered to eligible participants from Albania and other afore-mentioned countries, providing them with the opportunity to attend professional courses in various economic areas, hence developing their skills on a variety of economic issues and fostering their professional development.

Due to the pivotal role played by education and training provided by international training centres in general, Albanians have passed from a time when they were completely unaware of the risks arising from investing in pyramid schemes that eventually collapse to Albanians' growing awareness of risk-return relationships; from a time when the number of professionals was planned by the Government to a liberalized education system; from a time when private property did not exist to privatization of many state-owned enterprises; from a time when financial products were unknown to having available a wide range of financial products, hence Albanians' growing awareness of risk diversification benefits.

Having a look at the Bank of Albania's human resources database on its staff training and administering a questionnaire to different participants in training courses, one can easily recognise that among the international training centres, the JVI is highlighted as one that has unquestionably played a crucial role in economic training of public officials since 1992.

It is a valuable contribution witnessed daily at the Central Bank of Albania, an institution that marks the shift into a two-tier banking system, an institution that staffed by a great number of academics and experts trained at the JVI. The trained officials have come back well-equipped with refreshed ideas about their profession, with much inspiration, but above all with boosted practical skills and profound knowledge of economic issues, determined to contribute to this changing world.

As stated in its mission, the "Joint Vienna Institute provides instruction of the highest standard to help countries making the transition to full market-based economies".

Since its creation, the JVI has helped Albanians witness accomplishments of the advanced world and realize the clear link between training and prosperity. Moreover, it has facilitated the transition process, bringing Albanians and public officials from other transition economies together to discuss and address transition-related issues and concerns, promoting their international collaboration, involving their active participation in analysing different economic issues, getting them acquainted with successful models, helping them conduct research and put forward new plans for successfully carrying out economic reforms.

More specifically, the JVI, this international training institute that is sponsored by the IMF, the Austrian Authorities and other organizations, has tremendously contributed to preparing the Bank of Albania's staff for the new stage and for playing an active part in Albania's process. For about two decades, it has invested in Albanian officials and managers, providing them with the opportunity to participate in numerous seminars covering a large number of specialized topics, training them on an ongoing basis, expanding their professional knowledge and practical skills, bringing as an outcome fundamental changes to the functioning of the Bank of Albania and contributing to huge transformations taking place in the Albanian banking system and beyond.

From 1992 onwards, participating in JVI seminars and workshops has not only provided detailed analyses on economic issues, but also experience-exchange among central bankers, ministry of finance experts and experienced lecturers. Numerous discussions have taken place, in which dedicated lecturers have answered participants' questions about technical details and concerns related to different topics. Thanks to this cooperation and information sharing, the Bank of Albania's image has improved, the financial system has become more sustainable, the banking system has grown stronger and the economy has grown robustly.

Casting a glance at the numerous topics covered by JVI seminars, workshops and conferences, what is striking is that most of them are re-addressed year in year out, providing the possibility to deliver the same topics to other representatives, and updating and enriching them with new research findings, in line with innovations and new developments taking place in this globalised world.

Topics addressed in JVI training courses range from common transition-related issues and concerns, and ways to address them, to central banking, monetary and exchange rate policies, their implementation, transmission channels and mechanisms, all contributing to macroeconomic stability and successful transition to a market economy. It is very difficult to pinpoint the most valuable topics, as they are numerous and all highly productive. Nevertheless, I would like to highlight several of them, which to the best of my knowledge have contributed to promoting reforms and have significantly affected transformations taking place in the Albanian financial system in general and the banking system in particular.

FINANCIAL STABILITY

During the first years of transition, central planning, though collapsing, posed weaknesses, vulnerabilities and inherited deficiencies to transition economies, which were carrying out fundamental transformations in an effort to build free-market economies.

As a consequence, the JVI has assigned top priority to financial stability. Related courses, seminars, lectures, case studies and panel discussions have comprehensively covered financial sector issues. They have furnished central bankers and representatives of the ministries of finance and regulatory agencies with information on the role and importance of financial markets, securities markets, financial instruments, pricing, risk management, market and credit risks, capital and money markets, the role of financial sector in the economy, the role of government in the financial sector, the interrelation between central banking and financial sector, lessons drawn from different crises, bank risk management models, liquidity-providing instruments, stress testing, etc., all contributing to improving financial analysis and assessment, and leading to overall financial stability.

The JVI has assisted Albania, like other transition economies, in successfully carrying out financial system reforms, resulting in innovations regarding financial instruments in particular and financial markets in general. Primary and secondary securities markets have been established; the number of financial institutions has picked up; access to financial services has been provided even in the remotest districts of the country; the spectrum of financial products has broadened; the public confidence in the Albanian financial system has increased; the overall panorama of the financial sector has been completed; and financial stability has been achieved.

MONETARY POLICY

Monetary policy of transition economies has evolved in line with huge transformations taking place in every country. In Albania, the early years of transition were chaotic, with pyramid schemes destined to collapse in 1997 and a galloping inflation rate, with people totally unaware of sound banking systems and products.

JVI seminars and workshops have covered a broad variety of issues related to monetary policy, considering it as a key priority for achieving and maintaining macroeconomic stability. They have gathered together central bankers from transition economies, getting them acquainted with theoretical foundations, central bank objectives and role in the conduct of monetary policy, monetary policy role in maintaining macroeconomic balances, the interrelation between monetary and fiscal policies, monetary policy regimes and so on.

Related seminars have prepared participants to assess different monetary policy regimes and put forward the most suitable one for their own country, thus highlighting price stability as the primary objective of many central banks. Thanks to such training, the Bank of Albania's officials have contributed to implementing inflation targeting in Albania, aiming at keeping inflation in check.

The JVI has also paid special attention to strengthening central bank independence through transparency and efficiency. As a result, Albanian central bankers have frequently addressed this issue and have eventually succeeded in enhancing Bank of Albania's accountability and transparency, its independence and credibility, as well as its monetary policy effectiveness. The shared experience has led to a methodology to compile the transparency index and to better communication with the broad public.

Related seminars have identified relevant factors impacting exchange rate regimes, their advantages and disadvantages, as well as the lessons drawn from countries that had already implemented a certain regime. Learning from the experiences faced by different countries in this regard, Albanian experts have succeeded in implementing a free-floating exchange rate regime in Albania, leading to reduced exchange rate volatility, strengthening the overall banking system and boosting public confidence in the Bank of Albania.

REGULATORY FRAMEWORK

JVI training courses have greatly influenced the completion and improvement of a transition economy's regulatory framework. In Albania, they have helped in transforming the legal and regulatory framework, leading to drafting of new laws and by-laws. Major results have been achieved in terms of:

Privatization

In Albania, the JVI has contributed in drafting laws and by-laws that would lead to rapid privatization, a prerequisite for switching to a free-market economy. As a result of recommendations and knowledge-sharing provided by related JVI activities and other international training institutions, and Albanians' willingness to privatise the economy, the regulatory framework has been amended, improved and completed; different governmental institutions have been established; the private sector has started to flourish; physical and intellectual property rights have been properly implemented; and the people have become better off.

Institutional challenges on the road to the European Union

Albanians aspire for EU membership; however, they are facing various challenges related to EU integration and central bank legislation. Thanks to discussions and shared experience, the Bank of Albania's staff have put forward and encouraged initiatives leading to changes in Albanian legislation and transformations in the overall economy. As a result, Albanian legislation has been approximated to that of the EU, economic efficiency has increased, the legal and regulatory framework has been strengthened and institutional independence has been fostered.

Banking supervision

The transition years posed many challenges to banking supervisors, who lacked knowledge in this regard. However, the JVI came to their assistance by providing many opportunities for Albanian supervisors to be trained in related topics, concepts, core principles and standards. As a result, they have acquired necessary qualifications and have become capable of carrying out on-site and off-site examinations. Moreover, they have succeeded in implementing core principles, improving the licensing framework, paying attention to risk-based supervision, establishing a credit information bureau, improving bank lending and credit risk management in Albania, establishing consolidated supervision and maintaining overall stability.

Payment systems

Seminars related to payment systems have highlighted their importance and provided information about, for example, associated risks and e-money service. As a result of such training, Albanian officials have worked on implementing a real time gross settlement system and the Albanian interbank payment system, bringing about innovations in terms of e-banking, increasing the number of credit and debit card holders and the number of electronic transactions, curtailing the use of cash in the economy, and reducing the risk arising from the Albanian payment systems, hence furnishing our country with developed payment systems and boosting public confidence in the Albanian banking sector.

INSTITUTIONAL DEVELOPMENT

Related JVI seminars have trained officials in identifying economic and financial stability indicators, the way they are compiled, and the main principles and methods of their compilation. They have enhanced participants' expertise on related concepts and institutional aspects, making them better professionals, updating their information in line with new scientific findings, preparing them for a new way of doing their work, leading to comprehensive changes in the institutional framework, improving institutional capacity, hence affecting the overall institutional performance.

In this regard, it is impressive how highly professional, skilful and effective lecturers of JVI training courses, after having extracted the essence of a particular topic, organised case studies and other interactive activities, thereby involving participants in discussions about related examples, interweaving theoretical aspects with practical ones, alluring their interest, opening their mind to multiple choices, thus making them bring to light their individual opinions, testing their knowledge level and preparing them to successfully apply the lessons drawn.

From a practical viewpoint, interactive activities have generally proved far more effective than the theory ascertained through individual reading. They have promoted analysis of transition-related issues, country-specific experiences, economic development across countries, determinants to economic policy options, and advantages and disadvantages of each option. In this way, they have broadened participants' knowledge on related issues and have contributed to shaping their overall understanding about the best choice for a specific country, making them distinguish between what is right and what is wrong.

The above-mentioned issues and numerous other activities organised by the JVI have transmitted the best know-how and expertise, the rich professional heritage, thereby making transition easier, cooperation and partnerships with foreign counterparties raised to a higher stage, best theory and practice acquired, and the benefits of market-based economy tangible throughout the country.

Actually, countries have successfully overcome their transition-related challenges; however, the JVI's role is not yet completed. Against the backdrop of fragilities and vulnerabilities posed during these hard times of global financial crisis, JVI has much work to do. This prestigious institution should respond to current developments and put forward plans for enriching the course curricula with new issues in the light of new developments and occurrences, in order to prepare course participants to professionally address current problems and concerns and help them contribute, in turn, to their countries' successful exit from the turbulence that has recently settled around the world and restore financial tranquillity.

CONCLUSIONS

Now that the JVI is celebrating its 20th Anniversary, we are overwhelmed with gratitude and esteem for this multilateral training institute, which has played an active role in Albania's transition process and which has become a fruitful centre of experience sharing, knowledge transfer and economic and financial advice, providing incentives for furthering economic development, enhancing public officials' professional skills, making them come to the fore with novel ideas, and contributing to successful implementation of economic reforms.

Completing my imaginary journey on training, transition and development, I still find myself driving a car, up a mountainous road, full of ups and downs, full of challenges and risks, however, approaching a rising sun and gaining clear visibility amidst fresh air and a favourable climate. That is a situation the JVI's tremendous contribution has helped create in transition economies, moving them from obscurity induced by central planning to sunlight, transferring a body of professional, theoretical and practical knowledge to them. It has helped lift the shroud of fog and enhance visibility for public officials from recipient countries, making them aware of the benefits of market economies and helping them contribute to their country's successful transition from a centrally planned to a market-based economy.

It is this tremendous contribution that has made the JVI, this highly professional training centre, become a pre-eminent knowledge provider, giving people power to successfully implement economic reforms that contribute to overall development.

Considering the topic in a wider framework, I would say that training is a gift that makes trained individuals skilful and broad-minded, capable of making the right choice. It is a quality that distinguishes them from others, an attribute that makes them successful, a tool that lights up their mind. It is the light that drives them from ambitions to tangible accomplishments. It is the means that leads to further economic development worldwide.

NGDP TARGETING: THE ALBANIAN CASE

ENDRIT YZEIRAJ
RESEARCH DEPARTMENT

I. INTRODUCTION

The recent global financial crisis and its aftermath have caused a lot of economists to rethink the framework under which they operated. Given the depth of the economic contraction and the inability of various economies to quickly recover, many of the previous theories are being reanalyzed using newly collected evidence. In an important article Olivier Blanchard, IMF's chief economist, lays out in very clear terms how the crisis affected the thinking of much of the field of economics[1]. Inflation targeting, the preferred framework for central bank policy, is being scrutinized as well. This is not surprising since inflation has been relatively stable in most of the countries affected but it has been accompanied by weak economic growth. One of the strongest arguments for implementing an inflation targeting regime was that by reducing volatility and insecurity it would lead to higher long run growth. Having seemingly failed to achieve that objective it is entirely normal to expect a discussion of potentially new targets.

The Bank of Albania has been one of the central banks that implemented an inflation targeting regime. We are also experiencing effects similar to those seen abroad in our local economy. Inflation has remained within the BoA's target range and yet the growth rate that has slowed down in recent years. When implementing the inflation targeting regime, Governor Fullani (2007) declared that: "The central bank should assess in a timely fashion the effects of economic, political and social changes in order to respond to any expected changes timely and efficiently". As the central bank of a small open economy we also cannot afford to lose touch with the recent developments in monetary economic theory and policy. It is of interest to analyze what an alternative regime would entail for BoA's monetary policy and its effects in the economy.

The purpose of this article is to present in brief one of the most popular new targets that are being discussed, nominal GDP. The rest of the article will proceed as follows. In Section II an introduction of the NGDP target is presented followed by the rationales for and against such a policy. Section III presents a discussion on what such a target would entail for the Albanian economy. The article concludes with final remarks and considerations.

[1] *Blanchard et al. Rethinking Macroeconomic Policy. IMF Staff Positions Note. http://www.imf.org/external/pubs/ft/spn/2010/spn1003.pdf*

II. THEORETICAL CONSIDERATIONS

One of the ideas that seems to have made major inroads in influencing economic thinking even among the highest level of decision makers is the so-called "Nominal GDP Level Targeting" (NGDP targeting henceforth). It is considered the first idea born out the economic blogosphere. Nonetheless the idea spread out quickly. Financial institutions such as Goldman Sachs lend it its support. Widely respected publications such as "Financial Times" and "The Economist"[2]also came out in support of it as well as other economists[3]. However the major breakthrough came during the Annual Jackson Hole Symposium hosted by the Federal Reserve in September 2012. Michael Woodford, one of the most prominent monetary economists in the world, presented an extensive paper in which he argued for central banking to focus more on targeting nominal level of GDP than simply inflation[4]. The paper seems to have succeeded in shifting some of the policy thinking at the major central banks around the world. The language used in recent statements by FED Chairman Ben Bernanke has changed distinctly compared to previous communications; it has included new targets and expectations.

Before we begin with an explanation of the method it is important to mention two disclaimers. First, at the moment there is no formal, that is mathematical, model or methodology agreed upon in the literature regarding NGDP targeting. Economists are developing most of this as we speak. Therefore this article will be descriptive in nature, relying on the economic intuition that supports an NGDP target. Second, the idea for an NGDP target has grown given the inadequacy of the current framework to lift the hardest hit economies due the zero lower bound interest rate. This is not necessarily the case for the Albanian economy. The Bank of Albania's REPO rate is 3.75% as the moment of this writing, indicating that standard monetary policy has considerable maneuver room in case of further deteriorating economic conditions. Therefore this article should be seen not as a call for a policy change but as an overview on how this hypothetical target would affect monetary policy in Albania.

An NGDP target essentially means that the Central Bank chooses a specific growth path for nominal GDP and tries to uses all possible instruments to achieve it. The NGDP growth rate is of course the sum of real growth rate and the inflation rate[5]. Therefore according to an NGDP target, the Central Bank would have to maintain a constant growth rate for this variable.

A novelty of this framework is that it is a level target. This would require the Central Bank to achieve a specific level. If the economy were suffering from low NGDP growth for a period, then according to an NGDP target, it would require higher than average growth for some time in the future in order

[2] *The Economist http://www.economist.com/node/21526886*

[3] *Christina Romer, NY Times http://www.nytimes.com/2011/10/30/business/economy/ben-bernanke-needs-a-volcker-moment.html?_r=0*

[4] *Woodford, Michael. Methods of Policy Accommodation at the Interest-Rate Lower Bound. http://kansascityfed.org/publicat/sympos/2012/mw.pdf?sm=jh083112-4*

[5] *Inflation for NGDP is usually measured as changes in GDP deflator rather than the CPI for reasons that are beyond the purpose of this article.*

to "catch up" to the previous path. The opposite case, that of an economy suddenly growing with a higher than average pace, would also require an adjustment. But in this case this would mean a lower growth rate for NGDP. This framework would enforce that "byognes are not forgones". That is, previous failures to reach the target path have to be corrected and monetary policy would be "history dependent". A Central Bank builds credibility not only by minimizing deviations from the path at a given period, but also by minimizing deviations across all periods.

Mathematically this can be written as:

$$x = \sum_{t=1}^{\infty}(Y_t - Y_t^*) \qquad 1$$

where is a measure of Central Bank credibility, is actual nominal GDP and is the optimal target. The objective of the Central Bank is to have as close as possible to zero. The term inside the brackets is not squared or considered in absolute value, as often in economic equations, precisely to show that the objective is to return nominal growth to its previous path level.

Determining what should be considered an optimal growth path is something that is being debated among economists. For developed economies this path should be easier to compute. Given that these countries are at the technology frontier or steady-state, they are not likely to experience periods of high growth rate. They will most likely continue to grow along a stable path as they have in the recent past. An optimal path target would consist in the sum of average growth rate and an optimal inflation rate[6]. It should be easy to see that this calculation would be more problematic for developing countries and we will return to this point at depth when we discuss the arguments not in favor of an NGDP target.

As for the possible instruments to be used there are also different ideas mentioned. A possible NGDP futures market, similar to that for government securities, has been proposed by some of the earliest NGDP supporters[7]. More orthodox proposals such as the one by Woodford call for continued usage of the base interest rates and a policy of powerful "quantitative easing" when the interest rates are at the zero lower bound.

There are some influential reasons given as to why an NGDP target should be considered by monetary policy. The point of departure is the suggestion from economic theory that expectations tend to be self-fulfilling. That is, if agents expect the economy to grow at a specific pace, they will then spend and borrow in line with that expectation. Thus their expectations would become reality and this would result in a lower volatility for the business cycle.

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[6] *This suggests an optimal target level between 4-5%. That is because developed economies have usually grown with rates of 2-3% in the last decades. To achieve the optimal target level we add an inflation objective of around 2%.*

[7] *These proposals are usually encountered in the economic blogosphere. The most prominent is Scott Sumner's blog www.themoneyillusion.com, which has been at the forefront of arguing in favor of an NGDP target. Further information is found in the bibliography section.*

Intuitively, the NGDP approach is an evolution of the monetarist tradition. It was initially assumed by Milton Friedman that a central bank's job was to keep money supply growing at a constant pace. That is why today we try to measure this according to various variables known as monetary aggregates. Friedman believed that by keeping a constant money supply growth, a central bank could perform its stabilization role. Unfortunately these variables have shortcomings during recessions when people tend to save more than usual and the relationship between the monetary aggregates and growth breaks down. Money supply might be constant, but due to more money being saved the velocity of its circulation tends to decrease. An NGDP target can help overcome this problem[8].

Therefore according to an NGDP target, a central bank would respond to decreasing velocity by further increasing money supply in order to make up for it (with the opposite case being true as well). While propensity to spend during recessions might decrease, under an NGDP target a Central Bank would guarantee that the amount of the actual liquidity in the economy does not. Such a property would lead to fewer defaults, as many non-performing loans are "state dependent" - that is they are dependent on the state of the economy.

An NGDP target could also help a central bank to deal better with real (supply) shocks. A negative supply shock leads to an increase in the inflation rate, and decrease in GDP as well. The resulting inflation rate might temp a policymaker to tighten monetary policy when it shouldn't. The opposite case is true as well, when a positive shock could lead a policymaker to maintain a monetary policy more expansionary than it should. By combining the inflation rate with the real GDP growth rate, decision making in the face of a supply shock would be improved. It is due to these properties that an NGDP target is seen as a better stabilizer of the business cycle. This potentially could lead to fewer recessions.

On the other hand, there are possible drawbacks as well to this regime that its proponents often fail to mention. We already hinted at a major one earlier. In the cases of a developing economy, which Albania represents, having a good measure of potential growth rate is difficult.

An optimal real growth rate is difficult to calculate due to the convergence process that these developing countries are undertaking. They are currently experiencing higher real growth rates than developed countries, as the wealth gap closes. Eventually these rates will decelerate. Macroeconomic theory offers two possible scenarios for this. The first is that developing countries will approached the technology frontier, and exhaust their opportunity for "catch-up" growth. This process is otherwise known as unconditional convergence – in which all countries will eventually reach the same income levels. The other, more problematic, scenario is known as conditional convergence. It assumes that the long run level is dependent on other variables. If we assume this

[8] *According to the Quantity Theory of Money, , where is money supply broadly defined, is the velocity of money circulation, is real GDP, is the price level, and is nominal GDP. According to the identity above, targeting nominal GDP would be a way of targeting both money supply and velocity.*

type of economic process, it is possible that growth might slow down before reaching the technology frontier and grow at a steady-state from there. This has serious implications for a possible NGDP target. Potential growth has to be recalculated consistently for developing countries. Unfortunately, as we saw from the discussion on the convergence process, potential GDP calculations are not a precise science and the possibility of erroneous judgments exists. It is difficult for any researcher to pinpoint with accuracy at not only the potential at the present but also the long run level[9]. In addition, a good target is one that is easily communicated and understood by the public. It should also be consistent in order to steer expectations. A target that is constantly changing, as potential growth changes due to the economy approaching a steady-state, is no target at all!

This leads to another possible problem with an NGDP target – difficulty of communication. Inflation targeting was supported because of its simplicity to communicate and execute. Once credibility was achieved it often leads to well-anchored expectations. It is not clear that this would be the case for an NGDP target, which would require agents to constantly calculate an inflation and real growth rate. This becomes even more difficult in the case of a developing country like Albania, where as we mentioned earlier, the optimal path could require adjustments. If that was to be the case, it might be difficult for a central bank to communicate the target and for the public to either understand or credibly expect it. Therefore the main property of an NGDP target, that of a self-fulfilling event, might fail to materialize at all.

A third and last problem might be the availability of data within the required time frame. As mentioned above, an NGDP target might be more suited to dealing with supply shocks than an inflation target is. However, it is not easy to understand immediately whether a certain shock is a supply or a demand one. GDP data is available with a lag10 and often subject to readjustments later on. Inflation data is available quite sooner. This suggests that a Central Bank would have to rely on "nowcasting" methods for GDP11, which are also not an exact science.

III. THE ALBANIAN CASE

We now turn our attention to the Albanian case keeping in mind the previous disclaimers. As we mentioned earlier, Albania has experienced a period with a relatively low and stable inflation rate but low growth rates. These are the circumstances that have led elsewhere to doubts over inflation targeting as the optimal regime for monetary policy.

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[9] *Kota (2007) suggests "a potential output which is closely related to technological improvements, employment and capital stock of the country". Even if we assume perfect accuracy for the present, we cannot be certain of the future path of those three variables. In turn this makes an NGDP future path target problematic.*

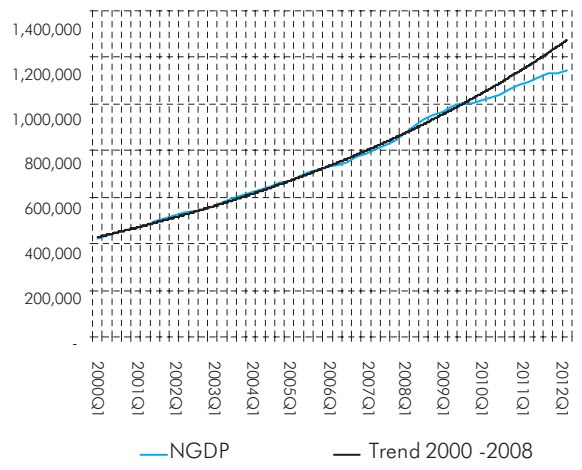
[10] *GDP data is published in Albania by INSTAT (www.instat.gov.al) with a lag of up to two years. Monthly inflation rates are available within a week from the end of the month.*

[11] *Studies by Mancellari (2010) and Boka et al. (2010) into "nowcasting" for Albania have been conducted.*

In order to perform a descriptive analysis over the Albanian economy the article uses nominal GDP data obtained from INSTAT starting with the year 2000 up to 2010. Recent data has been calculated with the usage of real GDP and the inflation rate instead of the GDP deflator. Lastly, a rolling sum of four quarters of nominal GDP has been used in order to increase the amount of data and control for seasonal effects.

Chart 1 represents the evolution of nominal GDP in Albania, measured in million leks on the vertical axis, during the time frame considered. A slowdown of NGDP growth can be observed from the beginning of 2009. In order to provide a better picture of the process a trend line12 has been fitted to the data previous to the slowdown. For this and the charts and analysis that follow, a slightly different cutoff point does not substantially change the conclusions.

Chart 1 NGDP



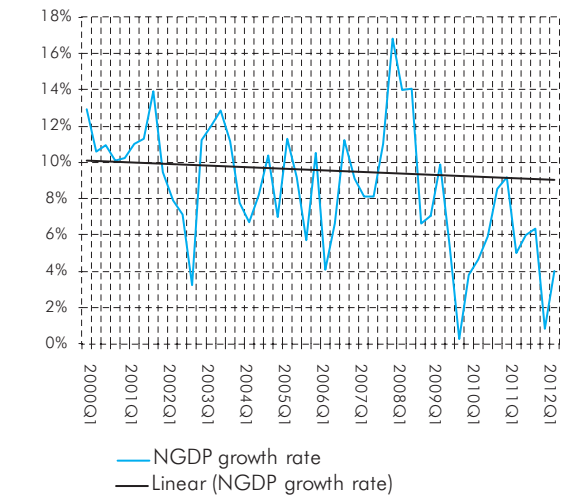
Source: INSTAT and author's calculations.

We can see that nominal GDP growth after 2009 made up for the gap for a very brief period at the end of 2010 but afterwards resumed its lower growth path. Using the most recent data points there is a gap of about 90 billion lek, or close to 8%, between the trend of the previous path and that of current NGDP growth.

Because we use level data in Chart 1 a linear trend was not justified. In order to correct for this potential pitfall in Chart 2 we represent the same data, but now in percentage change. This is a scenario when using a linear trend could be justified.

In Chart 2 we perform a similar procedure fitting a trend to the data for the period up to 2009 and comparing it to the most recent developments. We again see that since the slowdown began, only briefly did NGDP growth achieve a growth similar to the previous path. All the other data points lie firmly below the previous trend.

Chart 2 NGDP growth rate



Source: INSTAT and author's calculations.

Irrespectively of whether we use level or percentage change data, according to a hypothetical NGDP target we observe that a gap has emerged. If we turn to the data, the period 2000-2008 was characterized by a relatively high NGDP growth rate averaging almost 10%. This suggests an inflation rate of 3-3.5% and optimal growth rate of 6-6.5%. Since the slowdown[13], NGDP has grown by an average rate of close to 6%, with an equal spit between inflation and growth.

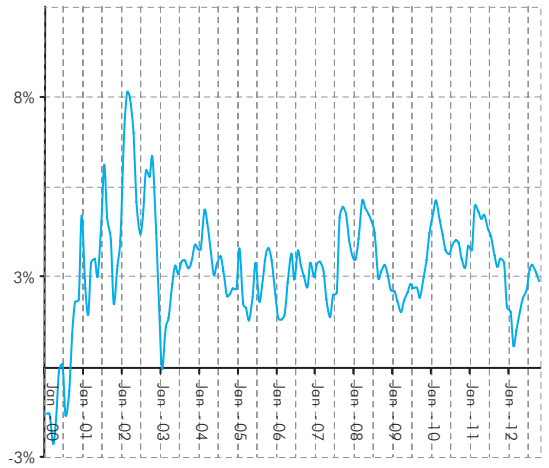
[12] *The trend is an exponential one because we are dealing with data in levels, rather than logs or percentage change.*

[13] *Again, a specific cutoff point of +/- 2 quarters does not change our analysis.*

If we were to follow a strict NGDP target, the previous results suggest that to make up for a loss of real GDP growth we would have required a much higher inflation rate. In fact the inflation rate would have to double or increase even further to keep up with the previous target. We should ask ourselves whether an inflation rate of 6-7% would truly be optimal.

Inflation has been one of the macroeconomic successes of Albania in the last decade. Chart 3 presents the evolution of the inflation rate during the period. After it overcame a few shocks at the beginning of the 2000s, beginning with 2003 inflation has been remarkably stable in our country. It has been oscillated around the target 3 +/-1% that the BoA has set for itself.

Chart 3 Inflation in Albania



Source: INSTAT and author's calculations.

We can observe this behavior at more detail in Table 1, where average inflation rates are presented as well as the standard deviation. Again, an irrefutable pattern emerges. Not only are average rates close to the target, but the standard deviation figures confirm that the volatility of this variable has been quite low as well. According to this, the Bank of Albania has fulfilled the duty that it has been entrusted to it by law[14]. This means that the BoA should not try to decrease the real or nominal GDP gap that we mentioned earlier as it would lie outside its current mandate.

But there is another purpose in showing this process. An NGDP target would disrupt the stability that we have observed as we mentioned earlier. Economists tried to eradicate these hypothetically high inflation figures in the 1980s, and would certainly worry in seeing them materialize again.

Table 1. Inflation Descriptive Statistics

Year	Mean	St. Deviation	Year	Mean	St. Deviation
2000	0.52%	1.84%	2007	2.94%	1.00%
2001	3.13%	1.14%	2008	3.36%	0.85%
2002	5.22%	1.73%	2009	2.28%	0.58%
2003	2.37%	1.03%	2010	3.55%	0.54%
2004	2.87%	0.76%	2011	3.45%	0.81%
2005	2.37%	0.71%	2012	1.95%	0.75%
2006	2.38%	0.66%			
Total	2.77%	1.5%			

Source: Author's Calculations.

In trying to reach a final recommendation on the applicability of an NGDP target for Albania, we have to go back to one of the main concerns we mentioned earlier: potential GDP and its growth path. Our recent data suggests that

[14] *The Bank of Albania has a mandate to protect price stability according to current law. This is different from some other central banks, such as the Federal Reserve or Bank of England, which have a "dual mandate" to promote both price stability and maximum sustainable output or employment.*

while growth has slowed down in our Albania, unlike other countries, this has not been a case of a prolonged recession. Real positive growth has continued even during this period. We cannot be certain at this time on how this growth relates to our potential. It might be the case that there is a slowdown even in our potential GDP after a period of relatively high growth. Conditional converge would certainly suggest that this is entirely possible.

If we were to experience a slowdown in potential GDP, trying to manufacture inflation might have severe consequences on the rest of the economy. It could create unsustainable bubbles which would cause even further pain in the future. In addition we would also lose the inflation credibility that has been earned and contributed to a major success in Albania's macroeconomic policy.

The difficulty of know exactly what our optimal NGDP target path should be makes would make communication difficult as well. With economic agents unsure of their expectations we could also increase risk in the marketplace, and therefore diminish rather than increase long run growth with this new target.

IV. CONCLUSIONS

We present a brief overview of what an NGDP target, one of the new regimes that are being discussed for monetary policy, would entail for Albania. If we were to follow such a target, monetary policy would have to engineer a much higher inflation rate to close some of the gap that has been slowly increasing since 2009. However an NGDP target carries considerable risk for the Albanian economy. Difficulty of knowing precisely what our potential growth path is, makes its implementation difficult for our case.

This suggests that future research could be centered on two areas. The first is further testing on potential GDP measures in order to achieve a high certainty regarding not only its current level, but most importantly its future path. GDP "nowcasting" could also play a role in guiding decision making when economic slowdowns manifest themselves. The second is to conduct research on possibly better targets. With inflation targeting now under serious scrutiny, there is no doubt that new targets will emerge. Most of them try to achieve stability in both the real economy as well as inflation. Possible "hybrid" targets that assign specific weight to various variables could be a way to not give up the inflation stability that has been hardly earned but also maintain a watchful eye on the developments in the real economy.

To conclude, it is beneficial to keep up with recent developments in monetary policy and theory. A nominal NGDP target represents such a development which might yield positive results within a specifi set of circumstances. However, given the availability of data and information and the moment, as well as the fact in the case of Albania we are dealing with a developing country, it is difficult to state with certainty that for the time being such a target represents a meaningful upgrade over our current framework.

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BANK OF ALBANIA BULLETIN NEWS JULY-DECEMBER 2012

Workshop with the banking system

On 4 July 2012, Bank of Albania in cooperation with Banca d'Italia, in the framework of the twinning project, held a workshop with the banking system on: "A sound and efficient Albanian banking system. Activities and results achieved under the EU-funded Twinning Project".

In his speech, the Governor of the Bank of Albania, Mr. Ardian Fullani commended the assistance and partnership provided by Banca d'Italia and Banque De France throughout the twinning project. At the completion of this project, the Bank of Albania has upgraded the organisational and operational framework of its main departments, and has approached to its European counterparties.

Completion of European Union project on the rapprochement of the Bank of Albania to the national Banks of EU-member countries

On 16 July 2012, took place the closing ceremony of the IPA-funded Project between Bank of Albania and Banca d'Italia and Baque de France. The ceremony was attended by the Governor of the Bank of Albania, Mr. Ardian Fullani, the Head of European Union Delegation to Albania, Ambassador Ettore Sequi, Mr. Franco Passacantando, Executive Director at Banca D'Italia and Twinning Project Manager, Mr. Bruno Phillipe Jeudy, representative of the National Bank of France, Mr. Rocco Schiavone, resident advisor for the project, managers of commercial banks operating in Albania, and representatives from business community.

Through the implementation of this project, Bank of Albania has strengthened its capacities in important fields of its activity, particularly in the areas of banking supervision, financial stability, and coordination of integration process, financial literacy, payment system, statistics and development of interbank market.

The twinning project of the Bank of Albania is funded by the European Union at EUR 1 million. The project started to be implemented on November 2010 and was completed on July 2012. It took 20 months.

Bank of Albania's exhibition on "100 years of Independence: Our history reflected in the national currency"

This year Albania celebrated the 100th Anniversary of Declaration of its Independence. In the framework of this jubilee, the Bank of Albania organized a touring exhibition on "100 Years of Independence: "Our history reflected in the national currency", which on 25 October 2012, was opened in Tirana, at the premises of National Historical Museum.

This exhibition displayed collections of coins and banknotes belonging to different historical periods of the country. The symbols of coins and banknotes reflect the historical changes that have taken place in Albania, thus making the national currency be appreciated not only for its monetary value, but also for its historical one.

This exhibition displayed a series of commemorative coins on "The 100th Anniversary of the Declaration of Independence", issued by the Bank of Albania on this occasion. In the framework of this momentous event in the

Albania's history, the Bank of Albania has minted a medallion on "The 100th Anniversary of the Declaration of Independence". The medallion depicts a design of the two-headed eagle on whose wings the Albanian flag flies, with the years 1912-2012 inscribed.

This was the sixth exhibition organised by the Bank of Albania in the framework of celebrating the 100th Anniversary of the Declaration of Independence. The first exhibition opened in Berat and later moved on to Gjirokastra, Korca, Elbasan and Shkodra.

New Building of Currency Issue Centre Inaugurated

On 26 October 2012, the Bank of Albania held a ceremony to inaugurate the Currency Issue Centre, in the framework of improving the technological and infrastructural standards.

Governors of central banks in the region and broader, and senior representatives of Albanian and foreign financial institutions attended this ceremony. The Governor of the Bank of Albania, Mr. Ardian Fullani, and the Minister of Finance, Mr. Ridvan Bode, inaugurated the centre.

This ceremony marked the completion of one of the major building projects that the Bank of Albania has undertaken over the three past years.

The Currency Issue Centre is built in the spirit of modern architecture, with two striking circular ends that symbolise the coin.

This centre is characterised by a high infrastructure and is equipped with modern technological systems that will be used for money processing. Using the facilities offered by the new building, this process will be carried out through high-speed automated systems, guaranteeing a swift checking of the currency as regards its authenticity, physical condition and security.

Upon completion of this new building, the coin and banknote processing at the Bank of Albania will be done according to standards of the European counterparties.

Bank of Albania's 10th International Conference "Monetary policy, from the past to the present"

Bank of Albania, hosted the tenth International Conference on "Monetary Policy from past to present", which coincided this year with the celebration of the 100th Anniversary of the Declaration of Albania's Independence.

The Governor of the Bank of Albania, Mr. Ardian Fullani, opened the proceedings of this Conference. The Prime Minister of the Republic of Albania, Mr. Sali Berisha, greeted the Conference.

The conference was attended by governors of central banks: Mr.Kemal Kozaric, Governor of the Central Bank of Bosnia & Herzegovina, Mr.Grigory Marchenko, Governor of the National Bank of Kazakhstan Republic, Mr.Gani Gërguri, Governor of the Central Bank of Kosovo, Mr.Dimitar Bogov, Governor

of the National Bank of the Republic of Macedonia, Mr. Dorin Dragutanu, Governor of the National Bank of Moldavia and Mr. Radoje Zugic Governor of the Central Bank of Monte Negro, and other central banks' representatives from Azerbaijan, Belgium, Czech Republic and Italy.

Also, managers of commercial banks operating in Albania, prominent academics in the field of economics and finance, diplomatic corps accredited to Albania, representatives of international financial institutions and many Albanian and foreign personalities attended this conference.

On the activity organised at Partizani High School

For the second year in a row, the Bank of Albania has offered to high school students the elective module "Personal finances in your hands", which is one of the elective subjects designed for the high school education curriculum for the academic year 2012-13. This subject has been elected by 10 thousand high school students across Albania and it is offered by the Bank of Albania free of charge.

In the framework of the cooperation with the Bank of Albania, this year, the Albanian Association of Banks enabled the printing of 4,000 copies of the elective module "Personal finances in your hands". In addition, the Albanian Association of Banks will enable the high school students electing this module to take practice classes in branches of commercial banks in Tirana and in other cities across Albania.

On this occasion, an introductory meeting was organized at the premises of Partizani High School, which is one of the high schools with the largest number of students electing this module. This meeting was attended by Ardian Fullani, Governor of the Bank of Albania, and Seyhan Pencabligil, Chairman of the Albanian Association of Banks.

In his speech, Governor Fullani highlighted the importance of financial literacy, considering it as a third pillar of the Bank of Albania, equally important as the pillar of monetary policy and safeguarding of financial stability.

The text of the module "Personal finance in your hands" was formulated in 2010 by the Bank of Albania, in cooperation with the Education Development Institute (EDI) and high school teachers of Economics. The main objective of this project was to design a didactic textbook absorbable by the target age group and based on the Albanian financial reality. Starting in 2011, this textbook has been distributed free of charge by the Bank of Albania to all high schools in Albania.

Sixth regional workshop: "Economic Research in South-Eastern Europe"

Research Department of the Bank of Albania hosted, on 19-20 November 2012, the sixth regional workshop "Economic Research in South-Eastern Europe". There were 20 participants (presenters and discussants) from Bank of Albania and other central banks of the region: Bank of Italy, Central Bank of Croatia, Central Bank of Republic of Macedonia, Bank of Kosovo, and

Central Bank of Turkey. Following a consolidated tradition, the aim of this workshop was to further expand cooperation among research economists, in the regional framework and broader. The discussed topics covered a broad range of issues and problems mainly dealing with: fiscal and monetary policies in an unstable economic framework, global crisis and transmission mechanisms, identification of disequilibrium in banking system, evaluation of densities in economic data series.

Touring exhibition of the Bank of Albania in the framework of celebrations for the 100th Anniversary of Independence arrives in Prishtina

On the eve of the 100th Anniversary of Independence, the touring exhibition of the Bank of Albania "100 years of Independence: Our history reflected in the national currency" was opened, on 23 November 2012, at the National Museum in Prishtina. This was the first time the Bank of Albania organises a touring numismatics exhibition abroad.

The exhibition was brought to Prishtina to honour the patriots of the Albanian Awakening, who have contributed to the country's Independence.

The exhibition and the history of Albanian coins and banknotes aim at introducing the public to the development of the central bank in Albania. The first efforts to establish a central bank were made immediately after the country's independence by Ismail Qemali through an agreement signed with the Austrian-Hungarian and Italian financial groups.

The inauguration ceremony was attended by Ardian Fullani, Governor of the Bank of Albania, Gani Gërguri, Governor of the Central Bank of the Republic of Kosovo, Hajdin Abazi, Deputy Minister of Culture of the Republic of Kosovo and many other prominent personalities.

Governor Gërguri, Deputy Minister Abazi and Governor Fullani addressed to the audience on this occasion.

In addition to the numismatic collection, the public was able to see the set of commemorative coins issued by the Bank of Albania on the occasion of the 100 Anniversary of Independence. Prishtina was the eighth destination of the touring exhibition. Before, it had travelled through seven cities of Albania, namely: Berat, Gjirokastra, Korça, Elbasan, Shkodra, Tirana and Vlora.

Meeting of the Governor of the Bank of Albania, Mr. Ardian Fullani, with journalists, analysts and media directors

On 18 December 2012, the Governor of the Bank of Albania, Mr. Ardian Fullani, met with renowned publicists, experts of politics and economics, and journalists of print and electronic media on an event marking the end of 2012. This meeting has become a tradition already for the Bank of Albania.

In his address, Governor Fullani extended his best wishes for a successful and prosperous year for the participants and their families. He commended the work of the media for informing the public in real time on Bank of Albania's decisions and welcomed the analysis and remarks in this regard. The Governor presented a brief overview of the Albanian economy, considering 2012 as a

year full of economic events. He highlighted the measures taken by the Bank of Albania to guarantee the country's macroeconomic stability and maintain the financial and banking system stability.

In the meeting, Governor Fullani presented Bank of Albania's Calendar 2013, highlighting central bank developments in Albania from 1913, which marks the establishment of the National Bank of Albania until the present-day Bank of Albania, which is vested with attributes of a modern, independent, transparent and responsible central bank. The calendar displays stylised designs from Albanian banknotes issued over the years as well as two drawings of two Bank buildings (the early days one in Durrës and the renovation project design), so as to show the journey of the central bank throughout its history.

During this year, the Bank of Albania continued to implement its financial education strategy. Governor said that in the upcoming years, the Bank of Albania will continue to work to educate the younger generation on financial issues. As part of this strategy, Governor Fullani announced the winner of the "Governor's award for the best diploma thesis 2012".

Friday Seminar

The Research Department at the Bank of Albania organises a fortnightly "Friday Seminar". This initiative welcomes Bank of Albania's experts, researchers from the academic and other financial, research and scientific institutions to present and discuss their theoretical and empirical research papers.

During the second half of 2012, the Friday Seminar welcomed five presentations by the Bank of Albania's experts. These presentations covered various issues, like: credit and its main determinants, businesses' perception on payment instruments, income and prices elasticity, Greek crisis impact. The following section provides a more detailed summary of these papers.

The Friday Seminar in the second half of 2012 opened with the working paper by Gerti Shijaku, Research Department and Irini Kalluci, Supervision Department on: "Determinants of banking credit to private sector - case of Albania". This study focuses on the identification and estimation of long-term determinants of bank's credit to private sector in case of Albania, using Vector Error Correction Mechanism (VECM), based on demand and supply indicators. The study uses quarterly data from 2001 to 2011. Results show that there is one cointegration relationship which converges credit to its equilibrium level, and a positive relationship between credit and economic growth.

The next paper introduced in this seminar was: "Survey report on use of payment instruments - businesses. February-March 2012", by Kliti Ceca, Alban Pllaha, Research Department and Valentina Semi, Payment systems Department. The aim of this survey is to identify the main characteristics of businesses, which affect positively or negatively the use of payment instruments by businesses. The survey was enabled by the Bank of Albania, conceived and elaborated by the Research Department, supported by the Payment Systems Department and Statistics Department, and was carried out on the field by INSTAT. The survey

was conducted in Tirana – Durrësi area, with about 400 businesses. Half of them accept payments through non-cash banking instruments, and the other half do not expect payments through such instruments.

Other research paper presented in the "Friday Seminar" series was: "Determining the effectiveness of the Danish packing tax policy: The case of paper and paperboard packing imports", by Enian Çela, Research Department. The purpose of this paper is to analyse the effectiveness of the environmental taxes applied on paper and paperboard industrial packing in the case of Denmark. Using a panel data analysis, the investigation focuses on the taxation impact on these products' imports. Gravitational regression model encompass imports at value as dependent variable., whereas tax impact is rep[resented by a binary variable across explanatory variables. Results reveal that environmental taxes were effective in reducing the quantity imported of paper and paperboard. The reasons that might have simulated the positive implementation are also emphasised as a reminder for future applications of the policy.

"Role of Exchange rate in international trade models: "Does M-L condition stand for Albania", by Bledar Hoda, Research Department, was the next working paper presented in the "Friday Seminars"series. The material aims to estimate the degree of real activity transmission from trading partner countries. The recent economic slow down of advanced economies has become a concern for the growth rate in developing countries. Of a particular interest is the role of exports as a source of growth engine, as well as the estimation of the Marshall-Lerner condition in case of a developing country having exports lower than imports. The latter estimates the effectiveness of exchange rate on the growth of monetary flows from external trade and the improvement of an economy's external balance through measuring the elasticity of real trade inflows. Results show that while income is the main driver of trade flows in Albania, exchange rate pals a significant role in fostering export growth and substituting imports.

The closing paper in the "Friday Seminar" series for the second half of 2012, dealt with: "Greek Economic crisis and its impact in Albania", by Enkela Gaçaj, Reserach Department. The main focus of this paper is finding the causes of Greek economic crisis referred to as debt crisis. It analyses the main channels: the high government spending, fiscal evasion, the existence of informal economy (which composes 25% of GDP) and corruption, as the main injuries of Greece economy. Also, the study focuses on proposing some solutions, like: reformation of legal and fiscal institutional system; and reduction of public administration, by highlighting the need to interconnect fiscal and growth policies which would enable the exit from vicious circle of budget deficit and recessions.

MONETARY POLICY DECISIONS

25 July 2012
The Supervisory Council of the Bank of Albania decided to cut the key interest rate by 0.25 percentage point, at 4.00%.

28 August, 26 September, 31 October, 27 November, 20 December 2012
The Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 4.00%.

LEGAL EVENTS, JULY-DECEMBER 2012

MONETARY POLICY

On 25 July 2012, the Supervisory Council of the Bank of Albania approved by Decision No. 46 the Monetary Policy Statement of the Bank of Albania for the First Half of 2012. The statement notes that the Albanian economy continued to preserve the parameters of macroeconomic and financial stability during the first half of 2012. Consumer price inflation, budget deficit and public debt figures, balance of payments and banking system's financial situation appeared stable or improving. The Albanian economy faced several supply-side shocks and a sluggish domestic and external demand. This performance led to a lower GDP in the first quarter of 2012 and hampered the effect of stabilizing policies on aggregate demand. While tensions are expected to reduce in the remainder of the year, the Albanian economy is forecast to post positive growth. Annual inflation averaged 1.9% in the second quarter of 2012, up 0.8 percentage points from a quarter earlier. The expected developments, both domestically and externally, show a low rise in future consumer prices.

On 25 July 2012, the Supervisory Council of the Bank of Albania approved Decision No. 47 on cutting the interest rate on repurchase and reverse repurchase agreements. This decision cuts the interest rate on repurchase and reverse repurchase agreements by 0.25 percentage points to 4.00%. It aims to create appropriate monetary conditions for meeting the inflation target in the medium run, and provide proper support to boosting aggregate demand.

On 31 October 2012, the Supervisory Council of the Bank of Albania approved by Decision No. 61 the Monetary Policy Report on the Third Quarter of 2012. The report notes that despite the environment's negative impact on the economic growth rates, Albania's financial and macroeconomic stability were preserved. CPI annual inflation averaged 2.7% in the third quarter of 2012, increasing gradually over the course of the year. The growth of monetary assets showed signs of deceleration in the third quarter due to the reduced domestic demand for money. Against a similar setting of decelerated economy, monetary policy deepened its stimulating nature in the third quarter by cutting the key interest rate by 0.25 percentage points to the record low of 4.0%. Based on the current performance of inflation-determining factors, with a 90% probability, inflation will fluctuate around the range of 1.2%-3.4% after 12 months.

BANKING SUPERVISION

On 28 August 2012, the Supervisory Council of the Bank of Albania approved Decision No. 51 on granting IUB Holding S.A. preliminary approval for acquiring 100% of the qualifying holding in the shareholders' equity of Emporiki Bank sh.a. The purpose of this decision is to grant IUB Holding S.A. preliminary approval to acquire 100% of voting rights of the shareholders' equity of Emporiki Bank sh.a.

On 12 September 2012, the Supervisory Council of the Bank of Albania approved Decision No. 55 on some amendments to Regulation "On licensing savings and loan associations and their unions". The amendments approved upon this decision affect the articles regulating the procedures for the approval or rejection of applications for licensing, suspension and revocation of licence, and merger of licensed savings and loan associations.

On 12 September 2012, the Supervisory Council of the Bank of Albania approved Decision No. 54 on some amendments to regulation "On establishing the level of decision-making in the supervision of banking and financial activities". The amendments provided for in this decision affect a number of paragraphs in appendices 1, 2, 3 and 4, attached to the relevant regulation. They mainly relate to the parties that shall be notified of the different decisions made by the Bank of Albania in view of meeting its supervisory function.

On 14 November 2012, the Supervisory Council of the Bank of Albania approved by Decision No. 63 the Regulation on basic management principles of banks and branches of foreign banks and criteria for the approval of their administrators. The purpose of this regulation is to set out the basic principles and rules for an effective management of banks and branches of foreign banks, and establish the requirements for an effective risk management system, including compliance risk. The articles in this regulation also aim at setting out the criteria to be met by the administrators of banks and branches of foreign banks, and the required documentation for their approval by the Bank of Albania.

On 27 November 2012, the Supervisory Council of the Bank of Albania approved Decision No. 67 on granting Intesa Sanpaolo Bank Albania sh.a. preliminary approval to conduct additional activity. According to this decision, Intesa Sanpaolo Bank sh.a. is granted preliminary approval to conduct the additional financial activity of insurance vault service.

ISSUE

On 28 August 2012, the Supervisory Council of the Bank of Albania approved Decision No. 52 on minting coins for numismatic purposes in 2013. According to this decision, in 2013, the Bank of Albania will mint no legal tender coins for numismatic purposes, themed "135th Anniversary of

the League of Prizren (1878-2013)" and "105th Anniversary of Congress of Monastir (1908-2013)". For each theme, the Bank of Albania will mint coins with a face value of 100 and 50 lek, in silver and plain metal.

On 17 October 2012, the Supervisory Council of the Bank of Albania approved Decision No. 59 on the exposure of precious metal coins in the exhibitions hosted by the Bank of Albania. The purpose of this decision is to provide for the security of the exposure of gold and silver coins from the numismatics fund, in the exhibitions hosted by the Bank of Albania in Tirana and Vlora, in the framework of the celebrations marking the 100th Anniversary of Albania's Declaration of Independence.

FINANCIAL STABILITY

On 12 September 2012, the Supervisory Council of the Bank of Albania approved by Decision No. 53 the Financial Stability Report for the First Half of 2012. According to this report, during the period under review, banking sector and financial system's performance and situation were stable. Despite the highly challenging environment, the banking sector generated profit and capitalisation and liquidity figures were at satisfactory rates. The financial system expanded its activity further, albeit at lower rates. In addition, direct and indirect credit risks represent the major risk to the banking system. Considering that the loan quality has worsened for both lek and foreign currency loans, the Bank of Albania encourages public authorities and the banking sector to cooperate and take measures to provide a lasting and comprehensive solution to this concern.

MONETARY OPERATIONS

On 27 November 2012, the Supervisory Council of the Bank of Albania approved by Decision No. 68 the Guideline on reporting foreign exchange transactions. The purpose of this guideline to set out clear rules and procedures for the manner and form of reporting of institutions licensed by the Bank of Albania on their foreign exchange transactions.

MEDIUM-TERM STRATEGY OF THE BANK OF ALBANIA

On 12 December 2012, the Supervisory Council of the Bank of Albania approved by Decision No. 69 the Medium-Term Development Strategy of the Bank of Albania for 2013-15. This document sets out the main challenges facing the central bank in the next three years. The medium-term development strategy aims to provide a proactive response to challenges in the central bank's operating environment, promote cooperation within the institution, encourage an efficient use of resources; and promote the Bank's accountability.

ECONOMIC POLICY

On 4 July 2012, the Council of Ministers approved by Decision No. 423 the draft medium-term budget programme for 2013-15. This document finalises the first phase of the process preparing budget requests for the period in question. It is an operational instrument for the management of public expenditure and an essential component of the integrated planning system. It elaborates the purposes, objectives and products of the programmes of each line ministry.

On 11 July 2012, the Council of Ministers approved Decision No. 442 on approving the grant agreement No. TF 011576 of the Swedish Trust Fund between Albania and the International Bank for Reconstruction and Development (IBRD), acting as administrator of grant funds provided by Sweden, to fund the natural resources management development project. According to this agreement, Sweden will provide to the Albanian party a fund amounting to no more than USD 2,716,027.50. This project aims at establishing or maintaining sustainable, community-based natural resource management in upland and mountainous erosion-prone lands across the country through investments and planning of environmental services.

On 11 July 2012, the Council of Ministers approved Decision No. 445 on establishing the minimum wage on a country level. According to this decision, the minimum monthly wage for employees on a country level, mandatory to be applied by all natural and legal persons, becomes ALL 21,000. It is paid to employees working for 174 hours per month and the minimum wage rate per hour is ALL 121.

On 10 July 2012, the Council of Ministers approved Guideline No. 1 on leasing procedures for unallocated agricultural lands. This guideline sets out the procedures and the responsible authorities for managing the leasing process of unallocated agricultural land. The lands falling under this category are registered in cadastral registers as agricultural lands that were part of former agricultural cooperatives and have not been allocated yet; and land areas under the ownership of communes and municipalities, registered under the category of forest vegetation land, pastures and meadows, and unproductive land areas.

On 18 July 2012, the Council of Ministers approved Decision No. 465 on gender integration in the medium-term budget programme. According to this decision, the Ministry of Labour, Social Affairs and Equal Opportunities and the Ministry of Agriculture, Food and Consumer Protection shall establish in the 2013-15 medium-term budget programme requirements at least one objective of gender policy. In addition, starting from 2013, all line ministries will be involved in the gender budgeting process. They are expected to establish adequate and measurable gender indicators for the objectives of each programme.

On 18 July 2012, the Council of Ministers approved by Decision No. 468 the agreement between the Council of Ministers of the Republic of Albania and the Government of the Republic of San Marino on the Promotion and Reciprocal Protection of Investments. By signing this agreement, the two countries aim at deepening economic cooperation, on the basis of mutual benefit, by establishing favourable conditions for investments made by investors of each party in the other party's territory. This agreement shall apply to all investments made by investors of either party, whether made before or after the coming into force of this agreement.

On 25 July 2012, the Ministry of Finance approved Instruction No. 16 on some amendments to Instruction No. 5, dated 30 June 2006 "On income tax", as amended. The amendments to this Guideline affect paragraphs and articles that provide for the annual individual statement of income and related information, information on gross income, documentation, tax level, paid tax etc.

On 25 July 2012, the Council of Ministers approved Decision No. 476 on an amendment to Decision No. 55, dated 3 February 2010 of the Council of Ministers "On mandatory declaration through electronic means of the tax returns and other tax documents", as amended. Based on this amendment to the previous decision, the entities required to declare and pay social security and health insurance contributions shall, by the legal deadline and in paper form, submit to the tax institutions the list of payments and information on the change in the number of employees for all tax periods of 2012.

On 26 July 2012, the Parliament of the Republic of Albania adopted Law No. 78/2012 on some amendments to Law No. 8873, dated 29 March 2002 "On deposit insurance", as amended. The amendments to this law mainly relate to articles that provide for the Deposit Insurance Agency, its initial fund, purpose of using financial assets and their management, and contributions and premiums accounting.

On 1 August 2012, the Council of Ministers approved Decision No. 544 on some amendments to Decision No. 60, dated 18 January 2012, of the Council of Ministers "On approving the macroeconomic and fiscal framework for 2013-15". According to the amendments approved upon this decision, the inflation rate is expected to average 3% during 2013-15. Real GDP is expected to grow 3% in 2012, 4% in 2013 and 4.5% at the end of the period. Unemployment is expected to fall from 13.5% in 2012 to 10.9% in 2015.

On 22 August 2012, the Council of Ministers approved by Decision No. 567 the economic cooperation agreement between the Council of Ministers of the Republic of Albania and the Government of the United Arab Emirates. The two countries aim at strengthening their friendly relations and develop economic, trade and technical cooperation between them, on the basis of equality and mutual benefit. The parties commit to intensify their cooperation in the sectors of trade, industry, agriculture, transportation, tourism etc.

On 29 August 2012, the Council of Ministers approved Decision No. 570 on approving the State Aid Annual Report for 2011. This report provides elaborate information on spending of entities granting the aid, and the progress achieved in State Aid Commission's activity and the governmental structure related to state aid control in Albania. It provides full information on entities granting the aid, beneficiaries and total aid value granted to different sectors, excluding the fishing sector, which is out of the scope of state aid law.

On 5 September 2012, the Council of Ministers approved Decision No. 612 on implementing provisions of excise tax law. The articles and paragraphs of this decision set out detailed definitions; fiscal representatives and their role; declaring and paying the excise tax; conditions and procedures for the exemption from this obligation; cases when reimbursement for different products is implemented, management of applications, etc.

On 5 September 2012, the Council of Ministers approved Decision No. 589 on disciplining the use of budget spending for 2012. The purpose of this decision is to set out a number of measures for budget spending to be used in a disciplined fashion. Among others, it establishes that each approved government unit function not filled in yet shall freeze until the end of the year. Similarly, trainings of employees abroad, projected to be covered by budget funds, shall be frozen.

On 18 September 2012, the Parliament of the Republic of Albania ratified by Law No. 84/2012 the loan agreement between Albania and the International Bank for Reconstruction and Development (IBRD) for funding the social assistance modernization project. According to this agreement, the IBRD agrees to grant Albania EUR 38,000,000 to assist in funding the project. The purpose of this project is to support the implementation of reforms improving equality and efficiency of social assistance programmes.

On 26 September 2012, the Council of Ministers approved by Decision No. 658 the methodology for evaluating immovable property in the Republic of Albania. The scope of this methodology is to establish methods, rules and procedures for evaluating immovable property. It seeks to guarantee and provide fair evaluation of immovable property for the effect of compensating properties or evaluating immovable property in general.

On 11 October 2012, the Parliament of the Republic of Albania ratified by Law No. 94/2012 the agreement between the Council of Ministers of the Republic of Albania and the Government of the Republic of Macedonia on solving Albania's debt to the Republic of Macedonia, related to the settlement of amounts on accounts on the basis of goods exchange between the Republic of Albania and Former Socialist Federal Republic of Yugoslavia. According to this agreement, the final settlement amount between the two countries, including the common interest rate, is USD 1,788,478.82.

On 17 October 2012, the Council of Ministers approved Decision No. 706 on approving in principle the economic cooperation agreement between the

Council of Ministers of the Republic of Albania and the Government of the Republic of Bulgaria. By signing this agreement, the two countries commit to contributing to developing and enhancing economic cooperation of mutual benefit. Both parties will therefore make efforts to enhance economic cooperation in the fields of industry, agriculture, forestry, transportation and telecommunication, etc.

On 18 October 2012, the Parliament of the Republic of Albania approved by Law No. 98/2012 the actual state budget for 2011. The purpose of this law is to approve the actual budget for 2011 and its financial resources. Budget revenues for 2011 amounted to ALL 275,479,000,000, while budget spending amounted to ALL 309,297,000,000.

On 8 November 2012, the Parliament of the Republic of Albania adopted Law No. 105/2012 on Republic of Albania's adherence to amendments to the IMF's articles of agreement. Upon the adoption of this law, the Republic of Albania adheres to amendments to the IMF's articles of agreement on reform of the Executive Board, and accepts to increase IMF membership quota.

On 15 November 2012, the Parliament of the Republic of Albania adopted Law No. 110/2012 on cross-border mergers of commercial companies. The purpose of this law is to set out the conditions, procedures and legal consequences of cross-border mergers between Albanian and European commercial companies, and the provision of protective measures for employers and creditors of these companies. This law does not apply to cross-border mergers involving companies whose scope of activity is the collective investment of public capital, and which operate on the basis of risk allocation principle and whose securities are repurchased or settled through the company's assets.

On 15 November 2012, the Parliament of the Republic of Albania adopted Law No. 111/2012 on integrated water resources management. This law aims to protect and improve the water environment, and ensure that the water resources necessary to life and the country's social and economic development are used rationally. This law sets out the institutional framework, on a national and local level, in order to implement a national policy for the management of water resources to the benefit of the community and Albania's interests.

On 16 November 2012, the Council of Ministers approved Decision No. 777 on some amendments to Decision No. 693, dated 10 October 2012, of the Council of Ministers on approving the government guarantee issued in favour of Raiffeisen Bank sh.a., Albania and Intesa Sanpaolo sh.a., Albania, in the framework of respective contracts between these banks and KESH sh.a. The amendment to this law approves the government guarantee issued in favour of Raiffeisen Bank sh.a., Albania, in the framework of the loan contract between this bank and KESH sh.a., for the equivalent amount in Lek of EUR 50,000,000.

On 12 December 2012, the Council of Ministers approved the Normative Act No. 6 on some amendments to Law No. 10487, dated 5 December 2011, "On 2012 budget". These amendments, among others, establish that budget revenues for 2012 amount to ALL 332,758,000,000, while budget spending amount to ALL 382,296,000,000. The threshold of budget deficit financing through domestic and foreign financing shall be ALL 49,538,000,000, of which ALL 900,000,000 shall be financed through privatisation receipts.

On 12 December 2012, the Council of Ministers approved by Decision No. 898 the protocol of talks between the Government of the Republic of Albania and the Government of the Federal Republic of Germany for economic cooperation and development in 2012. The purpose of this cooperation is to benefit the entire Albanian population, promote regional cooperation and support Albania's EU accession. The Government of the Federal Republic of Germany commits to granting Albania during 2012-13 a new amount of EUR 31,100,000 for technical and financial cooperation.

On 17 December 2012, the Parliament of the Republic of Albania adopted Law No. 119/2012 on 2013 budget. According to this law, budget revenues for 2013 are projected to amount to ALL 360,661,000,000, while budget spending are projected to amount to ALL 409,594,000,000. The threshold of budget deficit financing through domestic and foreign financing shall be ALL 48,933,000,000, of which ALL 500,000,000 shall be financed through privatisation receipts.

On 19 December 2012, the Council of Ministers approved Decision No. 874 on granting immediate economic assistance to persons receiving retirement benefits. The purpose of this decision is to grant immediate economic assistance amounting to ALL 2,000, untaxable, to different categories of persons receiving retirement benefits. The financial effects arising from the implementation of this decision amounting to ALL 1,170,000,000 shall be borne by the 2012 budget approved for the Ministry of Labour, Social Affairs and Equal Opportunities.

On 20 December 2012, the Parliament of the Republic of Albania adopted Law No. 122/2012 on some amendments to Law No. 8438, dated 28 December 1998 "On income tax", as amended. The amendments to this law affect a number of articles in the existing law. They refer to articles providing for exempt income, deductible expenses, tax loss carried forward and transitional provisions.

On 25 July 2012, the Parliament of the Republic of Albania adopted Law No. 125/2012 on some amendments to Law No. 7928, dated 27 April 1995 "On Value Added Tax", as amended. The amendments to this law affect articles providing for the import of goods and VAT exempt supplies. The law also adds a new article providing for the cases when iron and cement shall be a VAT exempt supply.

BANK OF ALBANIA MANAGEMENT, AS AT 31 DECEMBER 2012

SUPERVISORY COUNCIL

ARDIAN FULLANI	Chairman
ELISABETA GJONI	Vice Chairwoman
ADRIAN CIVICI	Member
ARJAN KADAREJA	Member
DHORI KULE	Member
ELA GOLEMI	Member
ERMELINDA MEKSI	Member
HALIT XHAFA	Member
PETRAQ MILO	Member

GOVERNOR

ARDIAN FULLANI

DEPUTY GOVERNORS

ELISABETA GJONI — First Deputy Governor

GENERAL INSPECTOR

ELIVAR GOLEMI

GOVERNOR'S OFFICE

GENC MAMANI

HEAD OF COORDINATION

GRAMOZ KOLASI

DEPARTMENTS AND OTHER UNITS

HUMAN RESOURCES DEPARTMENT	*Roden Pajaj*
MONETARY POLICY DEPARTMENT	*Erald Themeli*
RESEARCH DEPARTMENT	*Altin Tanku*
MONETARY OPERATIONS DEPARTMENT	*Marjan Gjermeni*
SUPERVISION DEPARTMENT	*Indrit Banka*
FINANCIAL STABILITY DEPARTMENT	*Klodion Shehu*
INFORMATION TECHNOLOGY DEPARTMENT	*Xhilda Deliana*
STATISTICS DEPARTMENT	*Diana Shtylla*
ISSUE DEPARTMENT	*Dorian Çollaku*
ACCOUNTING AND FINANCE DEPARTMENT	*Fatos Ibrahimi*
PAYMENTS SYSTEM DEPARTMENT	*Dashmir Halilaj*
LEGAL DEPARTMENT	*Altin Naqe*
AUDIT DEPARTMENT	*Elivar Golemi*
FOREIGN RELATIONS, EUROPEAN INTEGRATION AND COMMUNICATION DEPARTMENT	*Oneda Andoni*
ADMINISTRATION DEPARTMENT	*Agron Skënderaga*
SECURITY AND PROTECTION DEPARTMENT	*Eduard Sinani*

BRANCHES

SHKODRA	*Ermira Istrefi*
ELBASANI	*Valentina Dedja*
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 2012

1. RAIFFEISEN BANK SH.A.
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"
Director: Christian CANACARIS
Address: Bulevardi "Bajram Curri", European Trade Center, Tirana, Albania
Tel: +355 4 2274 910
Fax: +355 4 2275 599
E-mail: info@raiffeisen.al
Website: www.raiffeisen.al

2. UNITED BANK OF ALBANIA SH.A.
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"
Director: Hikmet GÜLER
Address: Rruga e Durrësit, sheshi tek Zogu i Zi, Godina Teknoprojekt, P.O. BOX 128, Tirana, Albania
Tel: +355 4 240 45 75 / 76 / 77
Fax: +355 4 240 45 58
E mail: info@ubaal.com
Website: www.uba.com.al

3. VENETO BANKA SH.A.
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".
Director: Lucio Luigi GAITA
Address: Bulevardi "Dëshmorët e Kombit", Ndërtesa Kullat Binjake, Tirana, Albania
Tel: +355 4 2280 555
Fax: +355 4 2280 356
E-mail: info@venetobanka.al
Website: www.venetobanka.al

4. NATIONAL COMMERCIAL BANK SH.A.
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"
Director: Seyhan PENCAPLIGIL
Address: Bulevardi "Zhan D'Ark", Tirana, Albania
Tel: +355 4 2250 955
Fax: +355 4 2250 956

E – mail: *info@bkt.com.al*
Website: *www.bkt.com.al*

5. TIRANA BANK SH.A.
Licence No. 7, 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"
Director: *Georgios CHARALAMPAKIS*
Address: *Rruga "Ibrahim Rugova", Tirana, Albania.*
Tel: *+355 4 2269 616 / 7 / 8, 2233 441*
Fax: *+355 4 2233 417 / 2369 707*
E – mail: *info@tiranabank.al*
Website: *www.tiranabank.al*

6. NATIONAL BANK OF GREECE – ALBANIA SH.A.
Licence No. 8, 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"
Director: *Ioannis KOUGIONAS*
Address: *Rruga e Durrësit, Godina "Comfort", Tirana, Albania*
Tel: *+355 4 2274 802 / 2274 822*
Fax: *+355 4 2233 613*
E – mail: *nbgalbania@icc-al.org*

7. INTERNATIONAL COMMERCIAL BANK SH.A.
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"
Director: *Gideon van den BROEK*
Address: *Qendra e Biznesit, Rruga "Murat Toptani", Tirana, Albania*
Tel: *+355 4 2254 372 / 2256 254*
Tel/Fax: *+355 4 2254 368*
E – mail: *info@icbank-albania.com*

8. ALPHA BANK - ALBANIA SH.A.
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"
Director: *Periklis Drougkas*
Address: *Rruga e Kavajës, G – KAM Business Center, kati II, Tiranë.*
Tel: *+355 4 2278 500*
Tel/fax: *+355 4 2232 102*
E – mail: *tiranabranch@alpha.gr*

9. INTESA SANPAOLO BANK ALBANIA SH.A.
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"
Director: *Stefano FARABBI*
Address: *Rruga "Ismail Qemali" Nr. 27, P.O. Box 8319, Tirana, Albania*
Tel: *+355 4 2248 753 / 4 / 5 / 6, 2276 000.*

Fax: *+355 4 2248 762*
E – mail: *info@intesasanpaolobank.al*
Website: *www.intesasanpaolobank.al*

10. PROCREDIT BANK SH.A.
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"
Director: *Flutura VEIPI*
Address: *Rruga "Dritan Hoxha", Nr. 92, H. 15, Njësia Bashkiake nr. 11, Kodi Postar 1026, Tirana, Albania*
Tel: *+355 4 2389 300*
Fax: *+355 4 2233 918*
E-mail: *info@procreditbank.com.al*
Website: *www.procreditbank.com.al*

11. EMPORIKI BANK - ALBANIA SH.A.
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"
Director: *Luc BEISO*
Address: *Rruga e Kavajës, Nr. 59, "Tirana Tower", Tirana, Albania*
Tel: *+355 4 2258 755 / 56 / 57 / 58 / 59 / 60*
Fax: *+355 4 2258 752*
E-mail: *headoffice@emporiki.com.al*
Website: *www.emporiki.com.al*

12. CREDIT BANK OF ALBANIA SH.A.
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"
Director: *Sherine KAMEL*
Address: *Rruga "Perlat Rexhepi", Al-Kharafi Group Administration Building, Kati 1&2, Tirana, Albania*
Tel: *+355 4 2272 168, +355 4 2272 162*
Fax: *+355 4 2272 162*
E-mail: *creditbkalb@icc-al.org*

13. CREDINS BANK SH.A.
Licence No. 16, dated 31.03.2003
Approved by the Bank of Albania Supervisory Council Decision No. 22, dated 26.03.2003
Certificate No. 15 "On Deposit Insurance"
Director: *Artan SANTO*
Address: *Rruga ''Ismail Qemali'', Nr. 21, Tirana, Albania*
Tel: *+355 4 2234 096*
Fax: *+355 4 2222 916*
E-mail: *info@bankacredins.com*
Website: *www.bankacredins.com*

14. SOCIETE GENERALE ALBANIA BANK SH.A.
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"
Director: *Hubert de SAINT JEAN*
Address: *Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Kulla 1, Kati 9, Tirana, Albania*

Tel: *+355 4 2280 442 / 3*
Faks: *+355 4 2280 441*
Mobile: *068 (69) 20 60 974*
E-mail: *sgalb.info@socgen.com*
Website: *www.societegenerale.al*

15. UNION BANK SH.A.
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"
Director: *Gazmend KADRIU*
Address: *Bulevardi "Zogu I", pallati 13-katësh, përballë stacionit të trenit, Tirana, Albania*
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 SH.A.
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"
Director: *Bozhidar TODOROV*
Address: *Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Kulla 2, 14&15, Tirana, Albania*
Tel: *+355 4 2276 702 / 3*
Fax: *+355 4 2280 210*
Website: *www.fibank.al*

In addition to banks and branches of foreign banks, the Bank of Albania has as at *31 December 2012* licensed the following entities:

Nr.	ENTITIES
21	NON-BANK INSTITUTIONS
322	FOREIGN EXCHANGE BUREAUS
2	UNIONS OF SAVINGS AND CREDIT ASSOCIATIONS
126	SAVINGS AND CREDIT ASSOCIATIONS
1	REPRESENTATIVE OFFICE OF FOREIGN BANKS

PUBLICATIONS ISSUED BY THE BANK OF ALBANIA OVER 2012 H2

This list is designed to inform readers about publications issued by theBank of Albania over the second half of 2012. By visiting our website (www.bankofalbania.org) you can subscribe to our mailing list either by e-mail at public@bankofalbania.org or sending a fax to + 355 4 2419408 and enrolling the mailing list for the publications of the Bank of Albania.

Also, you can take advantage by the automatic information service provided by the Bank of Albania. You will receive e-mail notices, at midnight, on any change or news related to arguments you have selected.

Listed below you can find all the publications issued by the Bank of Albania over 2012 H2. This list does not include surveys carried out by the Bank of Albania as they are available only (http://www.bankofalbania.org/web/surveys_3405_1.php).

FINANCIAL STABILITY REPORT:

Financial Stability Report 2012 H1

MONETARY POLICY PERIODICAL REPORTS:

Monetary Policy Report 2012 Q2
Monetary Policy Report 2012 Q3
Monetary Policy Report 2012 Q4

PUBLICATIONS ON STATISTICS:

Statistical Report (Published monthly)

OFFICIAL BULLETIN:

Official Bulletin - Volume 14, no. 6 Year 2012
Official Bulletin - Volume 14, no. 7 Year 2012
Official Bulletin - Volume 14, no. 8 Year 2012
Official Bulletin - Volume 14, no. 9 Year 2012
Official Bulletin - Volume 14, no. 10 Year 2012
Official Bulletin - Volume 14, no. 11 Year 2012
Official Bulletin - Volume 14, no. 12 Year 2012

BULLETIN OF THE BANK OF ALBANIA:

Bulletin of the Bank of Albania - 2012 H2

WORKING PAPERS:

Empirical investigation of forecast uncertainty with Monte Carlo simulation- Altin Tanku, Elona Dushku, Kliti Ceca

Performance evaluation: Uncertainities in forecasting inflation - Evelina Çeliku, Gent Hashorva

Optimal level of reserve holdings: An empirical investigation in the case of Albania Gerti Shijaku

Equilibrium exchange rate in a developing economy – Bledar Hoda

Sustainability of Fiscal Policy: The Case of Albania - Gerti Shijaku

Free Trade Agreements and Trade Integration among South Eastern European Countries: Gravity Model Estimations - Alban Pllaha (19 July)

Credit behaviour in Albania: a sign of convergence or a deviation from its long-term trend? - Irini Kalluci

A model for the credit risk in Albania using banks' panel data - Hilda Shijaku, Kliti Ceca

SCIENTIFIC NOVELTIES AT THE BANK OF ALBANIA:

Scientific Novelties at the Bank of Albania No. 8
Scientific Novelties at the Bank of Albania No. 9

EDUCATIONAL AND INFORMATIVE PUBLICATIONS:

Brochure “How an Albanian banknote is made?!”
Brochure “How an Albanian coin is designed?!”
Book "Personal finances in your hands"
Exercises book "Personal finances in your hands"
Leaflet on "Purple Codex of Berati- Beratinus 1” numismatic coin
Information leaflets on numismatic coins "The 100th Anniversary of Independence Declaration of Albania"