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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

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EDITORIAL EXHIBITION "... THE BANK FOR ALBANIA IS THE SECOND VICTORY, AFTER FREEDOM..."

BESA PRELA*

*Money is a singular thing. It ranks with love as man's greatest source of joy.
And with death as his greatest source of anxiety.*

John Kenneth Galbraith 1908 – 2006

On 4 October 1913, on behalf of the Albanian Government, Ismail Qemal Bej Vlora signed the first concession agreement for the establishment of an Albanian national bank. The concession was also signed by the representatives of two prominent financial groups of that period, respectively Karol Pitner and Oskar Pollak on behalf of an Austro-Hungarian group and Pietro Fenolio and Guido Ansbaheer on behalf of the Italian group. Due to the unstable situation in Albania in the early years of the 20th century, against the backdrop of events following the outbreak of the First World War, the National Bank of Albania did not succeed in starting its operations. However, the compilation and signing of this concession on the establishment of the "*Banka Kombëtare e Shqypëniës - National Bank of Albania*" remains a significant document for the Albanian central banking history, a cornerstone for this institution, whose concept conformed to all the European standards of that period. For that reason, the founder of the Albanian modern state considered the national bank as "...the second victory, after freedom..."

One hundred years later, on 4 October 2013, the Bank of Albania opened the exhibition "...the bank for Albania is a second victory, after freedom ..."

The exhibition was staged at the National Historic Museum and stayed opened for the public for a week and featured coins and banknotes that have circulated in Albanian territories over the centuries.

The history of a country may be traced through the currency of that country. The exhibition sought to introduce visitors to the chronology of key moments in the history of currency circulation in Albania. Moreover, other milestones, such as the one related to a considerable loan about 50 million gold francs from the Italian financial group, endorsed by the Government of Italy in 1925, known as SVEA (*Societa per lo Sviluppo Economico dell'Albania – Society for Albania's Economic Development*), related to the establishment of the National Bank of Albania, were displayed in a series of photographs, showing public works (building of roads, bridges, harbours, government premises, and agriculture infrastructure) realised with the SVEA funds, over a decade.

** The views herein are those of the author and do not necessarily reflect the views of the Bank of Albania.*

From the ancient treasure of Torovica to a modern banking system...

The exhibition started with information on one of the most important documents attesting to Bronze and Iron Age exchanges. Known as the “Treasure of Torovica”, dating 10th century B.C., it consists of a bunch of 124 axes, found in the territory of Albania. During the Bronze Age, axes were valuable objects as they were made of multi-purpose metal alloys, used for tools, weapons and jewellery. The Treasure of Torovica has two types of axes: The large Albanian-Dalmatian type, and the small “Tullenbeile” type, used as a smaller unit. The axes are unfinished, as they were not meant to be used as tools or weapons, but as instruments for exchange, that is as monetary items. They reveal an organised exchange of products at the beginning of the Iron Age on the basis of the value of the metal used (in this case bronze) with a certain shape (axe) and weight.¹

The exhibition displays ancient coins that have circulated in ancient Albania inhabited by the Illyrians and Epirotes. Visitors could see that the origin of the currency, in other words, the genesis of the Albanian money history, dates back in the distant past, about 2400 years ago, when the first silver coin was introduced.

The first coins were struck in Dyrrhachium (present-day Durrës) and Apollonia (present-day Pojan, Fier), Greek colonies established in VII-VI BC by the Korkyreans and Corinthians. Coins were also struck under the renowned Illyrian kings Gent and Monunius. After 167 BC, when Albanian lands fell to the Romans, the Albanians continued to mint their local coins, throughout the Roman rule.

After the Roman conquest, coins continued to be minted even in cities that once used to mint the drachma. While the Roman rule was characterised by currency globalisation, in Illyricum and Epirus, mints in Buthrotum and Phoenike were circulating alongside those of Apollonia. They served the Roman emperors and coins featured their effigies on the obverse, but retained local traditional symbols on the reverse.²

During the centuries-long Byzantine rule, Albania fell under the Eastern Empire. According to archaeological discoveries, coin minting did not make much progress. Starting in mid-VI century, the circulation of Byzantine coins began to decline rapidly. During the break-up period from the Byzantine Empire, many other currencies circulated in our territories such as currencies of the Republic of Venice, other Latin Principalities, Despotate of Epirus, kingdoms of Sicily, Naples, Serbia, etc. In addition, there were also local mints of rulers that had established independent principalities such as the Balsha and Andrea Gropa.³ Unlike the Mediterranean and European monetary and economic

¹ Ilirian Gjipali, “Thesari I Torovicës” [eng: Treasure of Torovica], 2014.

² Shpresa Gjongecaj, Qarkullimi monetar në Shqipëri në shekujt V-I p.e.s [eng: Money circulation in Albania V-I B.C.], 2010.

³ Ekonomia dhe qarkullimi monetar në shek. IV-XIV në territorin e Shqipërisë. [eng: Economy and monetary circulation in IV-XIV centuries in the territory of Albania], Skënder Muçaj, 2013.

setting during XII-XIV centuries, the Albanian territories lagged behind with regard to establishing private and public banking institutions.⁴

Under the Ottoman rule, the imperial *akçe* was used as the official currency in Albanian vilayets. The *akçe* was made of silver, hence its name, meaning whitish. It was also called *aspra* (after the Byzantine Greek word *ασπρα* white, whitish). *Akçe* dominated in the Balkans until the second half of the XV century (1585), when it depreciated significantly. *Akçe*, however, prevented from circulation neither the earlier currencies, nor foreign ones. In addition to their value of gold or silver, the foreign currencies served mostly in trade exchanges with other countries. By the beginning of the XVII century, major European trade powers in the Mediterranean poured their currencies in the Balkans, which were highly regarded by the local population and were collected systematically as treasures. The Venetian ducat, which was widely used in Europe, was the most stable currency. In 1844, the Ottoman Empire reformed its monetary system. The bimetal system it applied led to the broad circulation of the gold *lira*.⁵ During the Ottoman period, loans, in simple words, debts were given by private lenders. Lending for an interest was their profession. These lenders were known as usurers. The first modern financial institution in the Ottoman Empire was the Imperial Ottoman Bank, with its head offices in Istanbul, established on 4 February 1863, with English and French capital. The Ottoman Imperial Bank, in French *Banque Imperiale Ottomane* was a bank of issue and credit. It opened branches only in Vilayet capitals. Like all European banks, the Ottoman Imperial Bank was forced to put in circulation banknotes that did not exceed three times its gold reserves. It also conducted financial operations similar to other contemporary European banks, both in relation to the state, and other pre-state and private entities. After the Imperial Ottoman Bank, the Agrarian Bank (*Ziraat Bankasi*), with its head offices in Istanbul, started its operations in Albanian territories in 1888. The scope of its activities was to develop and modernise agriculture throughout the Empire. This bank had a wider network expansion than the Imperial Ottoman Bank - it opened a branch in each *sanjak* (prefecture) and cash desks in each *kaza* (district).

Even after the declaration of Albania's independence, in 1912, the country continued to use the Ottoman monetary system, adopted in 1844. The main currency in circulation was the Gold Ottoman *lira*, which was worth 100 silver *gros*. This was a natural consequence of monetary funds still in circulation after the declaration of independence and public deposits. Political and economic developments during WWI and foreign occupation were determinant factors for the circulation of other currencies. The landscape of currencies in circulation during 1912-26 would perfectly fit the metaphor of the Tower of Babel. In addition to the silver and gold Ottoman currency, whose legal tender was envisaged to continue until the issue of the Albanian

⁴ *Monedha, krediti dhe banka në Shqipëri gjatë shekujve*, Kristo Frashëri 2011. [eng: *Currency, credit and banking in Albania throughout the centuries*]; *Historia e Monedhës, botim i Muzeut Numizmatik të Athinës*, 2010.5. [eng: *History of Currency, Numismatic Museum, Athens*, 2010.5].

⁵ *Ibid.*

national currency, other gold currencies circulated in that time in Albania such as American, French, Italian, and Greek ones. Silver coins, which, prior to WWI equalled 5, 2, 1 and ½ gold franc of various countries, circulated as well. In everyday life, they were called “*Korona Sermi*” (silver kroner). Although the monetary value had depreciated, the people had great confidence in them. In the absence of a formal exchange rate, this myriad of currencies was officially recorded in the state revenue and expenditure books.⁶ In 1920, with the internal organisation of the Albanian State and introduction of the fundamental elements of the constitution envisaging free and independent institutions from foreign interventions, the first measures were taken to set the monetary situation in order. According to the Decision of the Council of Ministers No 273, of 6 May 1920, for the first time, that state revenues would be declared on the basis of the gold franc.

“Emergency” banknotes...

Another considerable difficulty was the absence of currency subunits. Consequently, in 1920-21, the so-called regional banknotes were printed, guaranteed by the municipalities in some of the major cities. These low-denomination banknotes were for local use only. It was not until 1923, when the government formalised the action in a law dated 16.1.1923, establishing the issue of regional banknotes up to 80.000 gold francs.

Also, the exhibition introduced to the public the main coins and banknotes issued by the "step-grandmother" of the Bank of Albania, the National Bank of Albania (1925-44) and its grandmother the State Bank of Albania (1945-91). Similar to the previous historic periods, the issues of these institutions testify on every change of the country, in full compliance with the social, economic and historic conditions of the period when they were put in circulation.

Gold franc, the first national currency...

After the reconfirmation of Albania's Independence in 1921, the re-establishment of a national bank was discussed at length, and was materialised in 1925 under the agreement concluded between the Government of Albania, represented by Mufid Libohova and an Italian financial group, represented by Mario Alberti. The head offices of the *Banka Kombëtare e Shqipnis* (National Bank of Albania - NBA) were in Durrës, whereas the Administrative Committee had its seat in Rome. This bank was established on 2 September 1925. In 1926, it put in circulation the first Albanian currency, the gold franc. The gold franc was a heavy currency for the Albanian market, which needed more divisional coins. The divisional coin was *qindarka* (cent). 1 franc = 100 *qindarka*. There was a big gap between the gold franc and the *qindarka*. To

⁶ *Shqipëria më 1937, Veprimi Shtetnor gjatë njëzet e pesë vjetëve të parë të vetqeverimit, Vëllimi 1, botimet e Komisionit të Kremtimeve të Vetqeverimit, 1937. [eng: Albania in 1937, State Action during the first 25 years of self government, publications by the Commission for Celebrating the Self Government, 1937].*

fill in this gap, an intermediate unit was needed. Hence the introduction of the Albanian lek. The lek to franc ratio was 5 to 1, that is five lek equalled one franc and the qindarka to lek ratio was: 20 to 1, that is twenty qindarka equalled one lek.

In addition to issuing, the NBA operated as a bank of credit. For about 10 years, it operated under monopoly conditions, but, in 1938, it found itself in strong competition with the Bank of Naples' branch in Albania. Under the economic and customs convention of April 1939, immediately after the fascist invasion of Albania, the NBA was able to make essential changes to its monetary policy. A characteristic of this period was that the deflationary policy shifted to inflationary policy. The Bank was also active in the area of crediting. Facing strong competition from the Bank of Naples and National Labour Bank, it expanded crediting, hence maintaining its dominant position in the Albanian market.⁷

From franc to lek...

The new government that emerged after the National Liberation War (WWII), in November 1944, started the nationalisation process. On 13 January 1945, a law was approved abrogating the convention of the National Bank of Albania and its shares. On the same date, the organic law on the State Bank of Albania was approved. This bank was established as a key institution for the financial system of the new Albanian State. In 1945, the State Bank of Albania started issue and credit operations. The law decree no 445, dated 07. 07. 1947 "On withdrawing from circulation the franc banknotes and on a new issue", stipulated that the new national currency would be the Albanian lek, replacing the old franc. From February 1946 until the end of 1990, the State Bank of Albania sustained the development of the socialist economy. Throughout this period, only a limited number of banks operated in the country. This period was characterised by an extremely centralised and state-controlled banking system. As a central bank, the State Bank of Albania was the centre of the currency issue. It collected temporarily free and unused assets and extended short and long-term credit to state-run enterprises, agricultural cooperatives and some households. In addition, it served as the unique cash desk, maintained income and expenditure accounts, stored forex reserves of the state, conducted transactions on behalf of the state with other countries and foreign banks.⁸

The changes to the political system of Albania, in early 1990s, led to substantial changes in the banking system. Among others, these changes consisted in: dividing central bank from commercial bank functions; increasing the number of banks operating in Albania; expanding lending toward sectors of the economy; and introducing new foreign capital in the banking market. The Bank of Albania was established under law no 7559 of 22.04.1992 "On the

⁷ *Historia e bankës qendrore në Shqipëri, Banka e Shqipërisë [eng: History of the central bank in Albania, Bank of Albania] 2003.*

⁸ *Ibid.*

Bank of Albania". In the capacity of the monetary and supervisory authority, it discharges the classic functions of a modern central bank, with price stability and financial system efficiency as its primary objectives. Unlike commercial banks, the Bank of Albania does not service customers, i.e. businesses or households, directly. In simpler words, it does not: extend loans; host personal accounts; issue debit or credit cards. The central bank is a bank without cash desks. Its "customers" are the commercial banks and the government.

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 Meeting with the Chairman of the Socialist Party
and the Albanian Banking System Executives and Representatives
25 July 2013

Dear Mr. Rama,
Dear Mr. Pencabligil,
Dear banking system executives,

First of all I would like to thank you for the invitation. This round table is a follow-up of our philosophy of a dialogue between the Bank of Albania, the banking system and the Government to discuss the economic policies for Albania's fast, sound and stable growth. The presence of Mr. Rama, the incoming Prime Minister of Albania, gives this meeting special significance. The banking sector is not only the greatest and the most efficient driver of economic growth in Albania, but also the custodian of Albanian household savings and the determiner of funds destination in the economy. Today's round table precedes discussions on the economic programme and budget of the incoming government.

Dear guests,

The Bank of Albania has just completed its periodic analysis of the Albanian economy. Also, in view of the Financial Sector Assessment Program (FSAP), we have maintained regular contacts with the international institutions to assess Albania's financial soundness. Availing myself of this opportunity, I would like to share with you some preliminary conclusions and present the central bank's vision for future development policies.

The Albanian economy is facing big cyclical and structural challenges. The cyclical weakness of aggregate demand restricts Albania's economic growth in the short and medium term, whereas the solution of structural problems will determine its long-term development. Overcoming these challenges requires joint, brave, coordinated and forward-looking action. The Bank of Albania deems that this action should be based on four pillars: (i) safeguarding macrofinancial stability in the country and pursuing stimulating economic policies; (ii) reducing uncertainty in economy; (iii) ongoing structural reform and (iv) convergence with the European Union.

1. First pillar: Macroeconomic stability and economic stimulus

As already known, Albania's economic development is in a fragile stage. Against the backdrop of the global crisis, the economic growth rates have

decelerated, posing difficulties to the public and private sectors, to businesses, households and the financial system.

In plain terms, aggregate demand is weak and does not manage to fully utilise the country's productive capacity. Consumer spending is low, primarily due to households' uncertainties about the future, but also due to their slowing income. The two other aggregate demand components also show limited ability in providing stable economic growth impulses: public spending is limited, due to lack of fiscal room because of a higher public debt, while Albania's exports suffer the sluggish demand from the international markets and the low degree of diversification. Finally, business investments are downward, reflecting businesses' restricted room for boosting their sales and banks' tighter lending standards.

The economy is a complex and interdependent mechanism. All the aforementioned factors have led to a sluggish labour market and elevated pressures on public finances. They have also increased vulnerabilities to many businesses and the non-performing loans in the banking system.

In Bank of Albania's opinion, this situation requires pursuit of stimulating macroeconomic policies. Economic theory and practice suggest that the maintenance of macroeconomic balances is a prerequisite to pursue these policies. I have reiterated that these balances do exist in the Albanian economy. They constitute a strong point for its future outlook. Inflationary pressures remain weak, external balances of the economy are improving and the Albanian financial system is healthy. But the macroeconomic balances should be maintained and further strengthened in the future. This objective is a preliminary filter and every macroeconomic incentive should pass through it.

Every macroeconomic stimulus should also consider another vital equilibrium: that of financial stability in the country, otherwise it is at risk of becoming unproductive. The global crisis has significantly elevated a country's exposure to risks related to financial stability. Therefore, this equilibrium should remain a constant priority and in concert with stimulating development policies. The healthier we are financially, the broader the spaces available to stimulate the development of the country.

Having said the above and availing myself of the presence of the three main stakeholders responsible for designing and implementing the macroeconomic policies, let me now share with you Bank of Albania's opinion about promoting the country's development in the short term.

The Bank of Albania, being an independent institution responsible for the monetary policy and for the supervision and regulation of the banking system, has taken concrete actions to boost demand in the economy. We have lowered the key interest rate to record lows and are considering other spaces available in this regard. We have also supplied the banking system with the liquidity needed for a smooth functioning of the financial markets. Finally, we have introduced a new regulatory package to boost lending. Our policies

have been successful in maintaining macroeconomic balances, which is also the Bank of Albania's goal. However, their transmission to boosting economic activity requires better reflection by the banking system.

The banking system has worked well to preserve its soundness. It has supported the Albanian economy in its expansion phase and has shared a part of the economic slowdown costs with it. Unlike many other experiences, the Albanian banking system succeeded in withstanding the global crisis without using any public funds. On the contrary, at the peak of the crisis, many banks managed to bring fresh capital in the country, against the setting of fiscal contraction and funds withdrawal by the European banking groups and higher non-performing loans.

However, we deem that the banking system is capable of boosting lending. First, the banking system should intensify its efforts to cleanse its balance sheets through collateral enforcement and realistic assessment of borrowers' creditworthiness. Second, without violating the culture of observing the contractual obligations, it should be more active in the loan restructuring process to provide more room to businesses deserving it. Third, we think that Albania has in place business and development projects of a long-term interest that deserve greater attention. Lack of the loan demand is an already-known and well-understood problem. However, the banking system should be more flexible when assessing the submitted applications.

In all my public pronouncements, I have iterated the prudence needed for sound public finances in the country. We deem that the country's sustainable development economic paradigm requires taking swift measures for making the public finances healthier. Beyond the short-term challenges about the current year's budget, putting in place a reliable and transparent fiscal rule is a necessity to discipline the fiscal policy in the long term and guarantee the trust of the financial markets in the Albanian public debt.

Finally, the Bank of Albania deems that the macroeconomic stimulus should continue to be based on a stimulating monetary policy and a banking system more focused on the needs of the economy. Also, we believe that the fiscal policy lacks the room for such actions. This action path preserves the macroeconomic stimulus and the soundness of macroeconomic balances, hence providing the shape to the first pillar of development policies.

2. Second pillar: Reducing uncertainty in economy

The second pillar (of a short-term action, as well) relates to reducing uncertainty in the economy. This uncertainty is multidimensional and affects the private sector decisions intricately, hence making consumers and businesses reluctant to spend and invest.

The uncertainty is not only related to domestic developments, but a significant part of it originates from there. Several above-mentioned incentives – concrete-term recommitment to preserving the soundness of public finances

and enhancing balance-sheet transparency in the Albanian economy – are the appropriate steps in this regard. Other incentives to reduce uncertainty would be to:

- strengthen the contingency plans and relations with international financial institutions;
- enhance transparency and consistency of development programs, both at national and inter-sectoral levels;
- strengthen the legal, regulatory and fiscal framework, and minimise their volatility;
- improve the business climate in its relations with the tax administration and the judicial system.

Taking these steps would be a significant progress towards development.

3. Third pillar: Structural reforms

The third pillar of development, i.e., structural reforms in economy, should be stronger and deeper. Sticking to today's agenda, I would like to say that these reforms would open the way to a healthier and more competitive economy, with a balanced development across sectors. Our resolution and success in implementing these reforms would determine the long-term development of the Albanian economy.

4. Fourth pillar: Convergence with the European Union

I think that the identification, design and implementation of the structural reform package by closely cooperating with the specialised international institutions would be productive. Currently, Albania meets all the conditions for a fast convergence with the European Union. I also think that the European integration is the best way to withstand the current crisis and guarantee stable economic growth in the long term. The Bank of Albania, being an integral part of the Vienna II Initiative, is greatly committed to the process of reshaping the financial structure supporting the development of South-Eastern Europe.

Thanking you for your attention, I am open to further discussions.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Press Conference on the Monetary Policy Decision
of Bank of Albania's Supervisory Council
31 July 2013

Today, on 31 July 2013, the Supervisory Council of the Bank of Albania reviewed and approved the Monetary Policy Statement of the Bank of Albania on the first half of 2013. Based on the latest monetary and economic developments in Albania, and following the discussions about their outlook, the Bank of Albania's Supervisory Council decided to lower the key interest rate by 0.25% percentage points to 3.50%. Lowering the key interest rate would improve the conditions for a higher aggregate demand, hence helping inflation fall back toward the Bank's 3.0% target. Further easing of monetary policy takes into account expectations for a contractionary fiscal policy over the second half of the year and makes room for a fast and low-cost adjustment of public finances.

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

The first months of 2013 confirmed our assessments of Albania's slow economic growth and weak inflationary pressures. Albania's economic activity continues to suffer from sluggish aggregate demand reflecting economic agents' uncertainties about the future, relatively tight lending standards, and economic weaknesses of our main trading partners. However, amid a challenging macroeconomic environment, Albania's economic and financial stability remains stable. In the first half of the year, inflation remained low due to weak demand-side pressures and anchored inflation expectations. The latter reflect Bank of Albania's prudential monetary policy.

This policy has enabled the long-term interest rate cut and has contributed to maintaining the banking system soundness parameters. Also, Albania's improved external position, together with the national currency's stability and financial sector's overall sound balances, have further strengthened the financial stability and ensured one of the pillars necessary for its long-term development.

The second-quarter inflation turned out 2.2%, a lower rate than in the first quarter. Lower agricultural product inflation and steady prices for other CPI basket items shifted this quarter's inflation down. Agricultural price inflation accounted for about 90% of headline inflation, reflecting both the price volatility of agricultural products and their relatively high share in the CPI basket.

From the macroeconomic perspective, the presence of spare productive capacity continues to determine the inflation performance. The sluggish growth of aggregate demand is associated with low increase in investments, employment, wages and labour costs in the economy. This chain of factors is further translated into weak pressures for consumer price rise. It is also confirmed by the record low rates of core inflation over this period. On the supply side, the low price rise in the domestic market has reflected the price stability in global markets and economic agents' anchored inflation expectations.

With regard to economic developments, INSTAT data show that the first-quarter economic growth was 1.7%, remaining similar to the previous year's figure. The economic activity expansion in the first quarter relied heavily on the industrial sector growth, while the agriculture and services sectors marked a positive but weak growth.

By contrast, construction sector continued to contract. Available information on the second quarter suggests that the economy performed better, mainly reflecting the high fiscal stimulus during this period.

From the demand components perspective, economic growth during the first half of the year owes mainly to higher exports and public spending over this period, while the contribution of consumption and private investments appear weak. Though monetary stimuli increased during the last quarter, uncertainties about the future contracted consumption and private investments. These uncertainties are reflected in a cautious behaviour of Albanian households and businesses and their reluctance to take risks. Their higher inclination to save and the lower degree of borrowing improve the private sector balance sheets but impact negatively the aggregate demand and medium-term economic growth.

Performance of fiscal indicators in the first six months of the year reflected an expansionary fiscal policy, which was manifested in higher budget spending and fiscal deficit. This stance was more noticeable in the second quarter. The increase in budget spending impacted positively on the economic growth over this period, but the overall impact of the fiscal policy will depend on the degree of observing the budget indicators adopted for 2013. Public spending marked 12.2% annual growth in the first half of this year, influenced heavily by capital spending. On the other hand, budget revenues for this period were down by 2.9% on a year earlier, reflecting the weak performance of tax revenues. These developments are materialised in a significantly increased budget deficit, which turned out to be twice higher than a year earlier.

The budget deficit dynamics was reflected in a higher public debt over this period.

At the end of the first quarter, the public debt as a share of GDP accounted for 63.3%. The public debt constitutes one of the major weaknesses of the Albanian financial system. Therefore, the Bank of Albania suggests that taking

immediate measures to control this debt would contribute significantly to reducing uncertainties and risk premia in the economy. Taking advantage of the opportunity, we reiterate the need for putting in place a reliable and transparent fiscal rule. This is the best way to discipline the fiscal policy and preserve the trust of financial markets about the Albanian public debt in the long run.

Data on the external sector of the economy show that foreign demand contributed positively to Albania's economic growth and to trade deficit narrowing during the first half of the year. This behaviour was due to the 17.4% annual growth in exports and the 6.3% annual decline in imports over the same period. Consequently, the trade deficit dropped 22.2% over this period.

The insofar adjustment of the trade deficit is a positive development of the Albanian economy. However, this deficit reduction is heavily thanks to transient factors. A detailed analysis of trade exchanges confirms high concentration of Albanian exports in certain geographical regions or in certain product groups and their low value added. For a stable growth of exports and sound adjustment of the trade deficit, the policy-makers' attention should focus on increasing the competitiveness of domestic products and expanding the base of exports through accelerated structural reforms.

Financial market developments have reflected the low risk premia and inflation, hence enabling better transmission of easing monetary policy signals that started at the beginning of this year. Interbank interest rates have performed in line with the key interest rate, with slight volatility.

The primary market yields on government securities have dropped sharply, particularly on longer-term maturities. Over the last months, the interest rate cut was transferred faster on deposits but lower on loans. Interest rates on loans responded more slowly than other market rates due to low lending to economy during the last months.

Monetary developments highlight continuation of weak inflationary pressures in the economy. The annual money-supply growth acceleration reflected primarily the private sector's added demand for financing over the last two months. Also, households' and businesses' demand for money remained weak. Private sector credit slowed down sharply, and at the end of May it was 0.2% lower than a year earlier. The weak lending performance is increasingly reflecting the businesses' lower demand for loan, alongside the tight lending standards.

Meanwhile, the past three months recorded households' higher demand for loan, hence signalling a probable revival of this loan.

Our projections for the economic outlook support the assessment that the Albanian economic activity will grow slowly over the period ahead, at levels comparable with those of the first half of the year. Foreign demand will be

the driver of economic growth in the coming quarters, while the first-half fiscal stimulus is likely to lack in the second half of the year. Indirect data do not yet reveal any signals for consumption and private investment recovery. The below-potential economic growth will be associated with weak demand-side inflationary pressures and in the absence of any unforeseen supply-side shocks, consumer prices will increase at low rates. Annual inflation, as to four quarters ahead, is expected to fluctuate around the 1.1% - 3.8% range, with a 90% probability of occurrence. Against this setting, our monetary policy will keep on preserving its stimulating nature even over the quarters ahead.

Also, we will continue to provide the banking system with all the liquidity needed for a smooth functioning of financial markets.

Concluding, the Supervisory Council decided to lower the key interest rate by 0.25 percentage points, to 3.50%. The Supervisory Council deems that this lowering would create better monetary conditions to meet our medium-term inflation target, which will continue to guide our monetary policy.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the press conference on the Monetary Policy Decision-Making
of the Bank of Albania's Supervisory Council,
28 August 2013

Today, on 28 August 2013, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the latest monetary and economic developments in Albania, and following the discussions on their outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 3.5%.

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

According to INSTAT data, annual inflation in July was 1.6%, falling from a month earlier and standing below our 3% inflation target. Inflation's sharp decline in this month is expected to be temporary. It was driven by low seasonal food prices and the downward dynamics of prices for some other CPI basket items. However, the main consumer basket groups and items continue to be characterised by low annual inflation rates.

Albania's economic and financial developments have generated low inflation rates. Aggregate demand and economic growth remain weak, thus falling short of the full utilisation of the country's production capacities.

This situation does not support employment and creates low pressures on the increase of wages, production costs, and profit margins. Likewise, imported inflationary pressures appear contained, reflecting the moderate performance of global prices and the stability of the exchange rate. Finally, the expected inflation from the real and financial sectors appears low, whereas the situation of liquidity is in line with the moderate price rise in the medium term. The Bank of Albania deems that, in general, these trends will persist in the period ahead and will determine low inflation rates in the medium-term horizon.

Updated economic analyses suggest that economic activity expanded at low rates during the first half of the year.

Aggregate demand and economic growth appear to have improved slightly in the second quarter, in response to higher fiscal stimulus and better performance of consumer spending, while private investments remain weak. Moreover, foreign demand continued to provide positive contribution to boosting economic activity. The latest data from the external sector point to trade deficit narrowing by 14.6%, in July, in annual terms. It narrowed thanks

to the increase of exports by 23.9% and the slight increase of imports by 1.2%. Fiscal policy was stimulating during the first seven months of the year, being characterised by rapid increase of public expenditure and direct or indirect reduction in some of the taxes. During this period, budget expenditure surged 10.4%, whereas budget revenues fell 2.6%. This situation was reflected in the budget deficit being 2.3 times higher than in the same period a year earlier. The deficit expansion supported the aggregate demand in this period; however, it implies the implementation of a prudent fiscal policy for the rest of the year, under the conditions that space for borrowing in the second half of the year is exhausted.

The easing monetary policy, lower demand for borrowing by the public sector, and good liquidity situation in the banking sector have contributed to further cutting of interest rates in July and August. In particular, the interest rate cut was more noticeable on government securities and deposits in lek and less on loans in lek. This development continues to point to the presence of relatively high risk premia in the financial market and illustrates also the conservative lending policies applied by banks. Similarly to the experience of many other economies, it reveals that the complete transmission of the eased monetary policy to better lending terms for the private sector remains problematic.

On the other hand, the private sector demonstrates elastic demand against the relatively low credit cost, hence dampening the transmission of the monetary stimulus to the economy.

Under these circumstances, credit expansion to the economy continued to mark low growth rates. As at the end of the second quarter, credit to the economy stood 0.9% higher than in the same period a year earlier. In addition to the weak economic activity, the economic agents' perception of uncertainty continues to slacken the private sector's demand for credit. Nonetheless, in June, the private sector credit recovered slightly, compared to the previous two months. As at end-June, the M3 aggregate was up 4.5%, in annual terms. Looking ahead, the Bank of Albania deems that the drivers of economic growth remain weak and uncertain.

In particular, private investment and consumption suffer from uncertainties and reluctance of households and business to undertake long-term commitments. Furthermore, lending terms, both at home and abroad, remain relatively tight, hence discouraging credit and investment. The performance of these components will determine the economic outlook in the future.

In a medium-term horizon, the baseline scenario of expected developments is characterised by weak and below-potential economic growth - in line with the one noted over the past two years. In the absence of imported inflation pressures, or other supply-side shocks, inflationary pressures are expected to be weak and the annual consumer price rise is expected to be in the lower half of the target band.

This development scenario requires maintaining the stimulating trend for economic policies, to support aggregate demand and recovery of potential growth rates. In terms of macroeconomic policies, the Bank of Albania deems that the primary objective of the fiscal policy in the future should be to maintain and enhance public debt sustainability. This course of action will strengthen the confidence of financial markets in Albania's public finance and reduce the costs for servicing the debt in the long term. The macroeconomic context generated by it would create better conditions for the development of the private sector and would leave more space to transmit and strengthen the monetary stimulus to the economy.

At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 3.5%. The Supervisory Council deems that the monetary conditions are adequate to meet Bank of Albania's inflation target in the medium term. The current conditions ensure the necessary monetary stimulus to support the domestic demand. The Supervisory Council deems that the expected dynamics of economic and financial developments will require maintaining the easing trend of the monetary policy into the medium-term horizon.

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

At the conference “Strengthening linkages in South East Europe.
Policy anchors and business perspectives”,
19 September 2013

Your Excellency Prime Minister of Albania,
Honourable guests from the University of Oxford,
Dear representatives of the diplomatic corps and academia,
Dear participants,

I have the pleasure and honour to open this joint conference of the Bank of Albania and the University of Oxford, on strengthening the linkages between the economies in our region. Three years ago, in September 2010, we invited the University of Oxford to support the academic discussion of the Bank of Albania on the economic growth model and its regional character. At that moment, this debate was misinterpreted as a discussion on the advantages of the market economy and alternative philosophies of the economic organisation of a society. Nonetheless, after three years, we all find that the economic growth model has become the main topic of academic, economic and political debate.

For a number of years, our economy has been under the grip of the global crisis, reflected mainly in a decelerated economic activity. Consequently, investments and lending to the economy slowed down, deteriorating, at the same time, the private and public sector balances.

In spite of these developments, the Albanian economy has managed to maintain price stability and the overall macroeconomic and financial balances. The Albanian financial system has proven highly immune. Despite the economic growth slowdown, overall, this system remains liquid, well capitalised and profitable, reflecting the prudent work of the Bank of Albania over the pre-crisis years.

Bank of Albania’s prudent policies and the reaction of the banking sector enabled the system to avoid extreme problems, which would require the use of public funds. We should bear in mind that various banking groups from EU countries, heavily hit by the crisis, operate in Albania.

The stability of the banking sector has been at the heart of the work of the Bank of Albania, focusing on both financial stability and banking supervision, and on monetary policy and liquidity management.

The Bank of Albania has been proactive and has anticipated problems, aligning itself and the role of its policies with global developments and the domestic market state of affairs.

The dim global financial and economic situation has dictated the need to redefine the role of institutions, including the central bank. Presently, the central banks have turned to macroprudential measures, because the traditional mechanisms of monetary policy transmission are suffering from burdened balance sheets of the private and public economic agents. To better coordinate this role and monitor the economy, central banks around the world are supporting their monetary policy with the necessary macroprudential measures. These global developments find the Bank of Albania well prepared and equipped with the required experience. Its structure is similar to the one being adopted by the European Central Bank and other central banks in developed countries. Moreover, the Bank of Albania has now several years of successful experience in employing countercyclical measures to manage the country's macroeconomic and financial equilibrium.

I would like to underscore the change of risk coefficients for controlling the expansion of lending in foreign currency, and the introduction of limits of credit to collateral ratio for controlling the size of debt in the economy to mention just a few.

One of the most important lessons from the global crisis is that addressing the monetary stability (i.e. price stability) and financial stability issues independently does not provide an optimal solution and is crisis-prone. The economy functions as a complex mechanism with often fragile and interdependent equilibria, which do not respect boundaries of institutional responsibilities. For each economy, there is only one interest rate, only one critical mass of financial intermediation and a fragile equilibrium of financial sector balances that guarantee sustainable and long-term development for the country. Harmonising these three objectives is a prerequisite for maintaining the financial equilibrium of the economy. Therefore, their identification and harmonisation under one roof is considered as the optimum solution to guarantee the country's economic and financial stability. For that reason, one of the most pursued practices for post crisis institutional regulation is not only unification of supervisors of the financial system, but also their institutional integration with other functions of the central bank.

Your Excellency Prime Minister of Albania,
Dear participants,

Unquestionably, in the long term, economic growth of a country is determined by the labour force and its qualification, productivity, technology and innovation capacities; as well as the capital accumulation scale, which in itself, reflects both social preferences and fiscal stimuli and the development level of the financial system. These three sets of factors are conditioned by the economic structure of a country and they are encouraged and stimulated through structural reforms. Again, in the long term, economic growth is determined only by the structural reforms and the degree of competitiveness of our economy vis-à-vis our trading partners and the global market. On the

other hand, the duty of the fiscal and monetary policies is to avoid short-term deviations of the economy from this long-term trend and create a sustainable environment for the country's economic and financial development.

The Albanian economy has already started its journey towards integration with the European Union. The ultimate goal of this process is to improve the economic welfare. It also implies to fully integrate with the trading, industrial and financial chains; adopt a unique economic management philosophy, a unique regulatory and institutional practice; and acknowledge the harmonised rules of the game applied throughout the European area.

In this context, I would like to highlight two key moments:

First, the European integration process should be our strongest anchor for structural reforms: legal, regulatory, institutional, infrastructural, or political ones. Albania has still a long way to go and the peculiarities of our economy provide the necessary space to calibrate these models in accordance with the comparative advantages and primary needs of the country. However, I believe it would be useful to have all the reforms integrated in a unique vision of integration.

Second, the Albanian businesses should do a lot more to hasten the integration process. It should be more active to adopt advanced technologies, and production and management processes.

Likewise, the Albanian financial sector should be more visionary in its policies and priorities about the distribution of financial resources, and work harder to attract more foreign investments and build bridges of cooperation with local businesses.

We have rightly underlined that regional cooperation is a necessary move that should precede the European integration process. The economies of the region are small compared to our trading partners, but the establishment of unified zones in terms of customs duties, legal systems and practices, integration of financial practices and development policies provides the right incentives to attract foreign investments and empower our negotiation capacities with international partners.

Concluding, I would like to reiterate that the Bank of Albania considers the economic and financial stability of the country as a prerequisite for sustainable and long-term development. Now, this is no longer a theoretical matter of disciplining the behaviour of politics towards the economy, nor is it a discussion on respecting the equality of generations. It is a bitter lesson learned from the latest crisis and a tangible reality for many countries of the euro area. We have persistently invited policymakers and economic agents in the country to partake in this vision.

As the country's monetary authority mandated to guarantee price stability, we have worked and will continue to do so to ensure a low-inflation environment. This environment boosts the guarantees for savers and investors for their long-term plans and provides for financial system development. The Bank of Albania implements a modern monetary policy based on the most advanced principles of central banking, and employs instruments and communication approach in line with ECB practices. The commitment of the Bank of Albania to maintain price stability is the polar star of our work. Drafting and implementing the monetary policy independently, exclusively in the function of price stability, is one of the domestic anchors of the Albanian economy, which should be preserved and strengthened.

In parallel, the Bank of Albania deems that the Albanian economy needs two additional anchors: financial stability and fiscal stability.

Our regulatory and supervisory function over the banking system, which accounts for 95% of the financial system in Albania, has proven successful in guaranteeing the country's financial stability. This function has been carried out and is discharged in line with the international best practices, in constant cooperation with homologous institutions and other international partners.

The possibility to have an integrated vision of economic and financial developments, and to combine but not mix the monetary policy with macroprudential measures, has enhanced the effectiveness of Bank of Albania's actions, and has contributed to better achieving the two individual objectives: financial stability and price stability. The institutional regulation, which has proven effective and is in line with the latest global trends, should continue to function as a second anchor of domestic economic anchors.

Finally, the Bank of Albania deems that Albania should immediately establish not only a clear and transparent fiscal rule, but also an effective one to discipline the fiscal policy and maintain the trust of financial markets in public finance soundness.

This third anchor would complete the framework of domestic anchors of economic policy. Together with the close cooperation with international financial institutions, it would provide a consistent and transparent framework for the country's development. Provision of liquidity and solvency of the Albanian economy through bilateral and multilateral partnerships is a priority for central bank policies. This vision and partnership should become the axis of cooperation between national institutions.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the press conference on the Monetary Policy Decision
of Bank of Albania's Supervisory Council,
25 September 2013

Today, on 25 September 2013, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the most recent economic and monetary developments in Albania, and following the discussions on their outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 3.5%.

The Council notes that the inflationary pressures from the real and financial sector of the economy are weak and will remain so. This setting requires persistence of the stimulating monetary policy in the period ahead.

The monetary stimulus, transmitted through the low key interest rate and continuous injection of liquidity, provides the required conditions for meeting our inflation target in the medium-term period.

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

According to INSTAT's data, annual inflation fell to 1.2% in August. The rapid fall in inflation over the past two months was mainly attributable to the low rise in food prices, and particularly in seasonal food prices. The negative inflation of non-food consumables and housing prices also drove annual inflation down. Similar to the previous months, the inflation of other basket items' goods and services remained low and positive.

Despite the generally weak inflationary pressures, the Supervisory Council notes that the low inflation rates of the past two months were driven by transitory supply-side factors.

The analysis of macroeconomic factors suggests that the contained consumer prices continue to reflect, to a large extent, the low demand in the economy and the negative output gap. The low capacity utilisation rates have subdued the rise in wages, producer prices and profit margins. Imported inflation has also been low due to the low inflation rates in Albania's trading partners and the stable exchange rate. Lastly, the performance of liquidity and inflation expectations is in line with the low inflation rate.

There is scarce new information about developments in the real economy in the second and third quarter of 2013. The analysis of available indirect data signals positive, albeit low, growth.

Unlike the previous quarters, the public sector was the main driver of aggregate demand growth in the second quarter, whereas net exports made a slightly negative contribution. Private sector demand remains weak, signalling sluggish consumption growth and contracted investments.

The performance of budget indicators reflected the expansionary fiscal policy pursued in the first half of 2013. As at August, budget expenditures were 9.2% higher than a year earlier, considerably due to the increase in capital spending. On the other hand, revenues performed poorly, registering an annual decrease of 3.8%, which materialised into the budget deficit being around 1.3 times higher than a year earlier. The higher deficit is reflected in the further increase in public debt-to-GDP ratio to 63.5%, at the end of the second quarter.

The Supervisory Council notes that the adoption of a fiscal rule, which would effectively and transparently support the public debt sustainability, would be the right step toward lower risk premia and long-term fiscal policy discipline. The fiscal rule would also establish a consistent framework for drafting medium-term paths of budget expenditure and deficit, allowing in turn the simultaneous fulfilment of the cyclical needs of the economy and the long-term objective for fiscal stability.

Data on the external sector of the economy point to the negative contribution of external demand to economic growth in the second quarter of 2013, due to the increase in net export deficit by 1.5% over the same quarter. On the other hand, July data show that the trade deficit shrank 14.6% in nominal terms, driven primarily by the high annual increase in exports by 23.9%. Despite the short-term volatility, the external position of the Albanian economy remains one of its structural weaknesses. It reflects both the low competitiveness of Albanian products in the global markets and the need for better long-term balance between savings and investments in the economy.

The financial markets saw downward inflation and liquidity risk premia, and fuller transmission of key rate cuts to various market segments. Interbank rates stood close to the key interest rate and showed low volatility. Government security yields in the primary market dropped rapidly across all maturities, particularly on those with a longer maturity, hence smoothing the yield curve slope. Interest rates on deposits decreased as well, whereas those on lek loans continued to show little response to the Bank of Albania's monetary stimulus. The full transmission of monetary policy signals to the credit market was subdued by the presence of high default risk premia, and banks and businesses' low risk appetite. Consequently, lending to the private sector shrank 1.5% in annual terms, due to some balance sheet adjustments in individual banks, poor performance of lending to households and contraction in corporate lending.

New available information keeps our baseline projections for the economic outlook unchanged. The Albanian economy is expected to record low and positive growth rates, albeit substantially below potential. In the absence of

room for stable fiscal stimulus, the growth of aggregate demand in the short-term period is expected to be driven by the external demand. In the long run, the magnitude of economic growth will be determined by the performance of consumption and private investments. Below-potential growth will give rise to weak demand-side inflationary pressures. Supply-side pressures will also be subdued in the period ahead. In the absence of unexpected supply-side shocks, annual inflation is expected to be low in the quarters ahead.

At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 3.5%. The Council notes that the current monetary conditions are appropriate to ensure our inflation target is met in the medium-term period, providing at the same time proper monetary stimulus to recover private demand. In particular, the rapid drop in the yields over the past month reflects the low key interest rate, low inflation expectations and the reduced Government borrowing from the domestic markets. The drop in the yields, in turn, provides room for lower rates on private sector credit. The projection of a similar setting for the future would allow better monetary policy transmission to the economy.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the opening ceremony of the exhibition of the Bank of Albania,
4 October 2013

Dear Mr. Speaker of Parliament,
Dear participants,

In pursuit of alternatives to present the 100-year journey of central banking, the Bank of Albania opens today an exhibition on “The currency and financial literacy through it”. The consolidation history of the state and the currency shows they have walked hand in hand over the centuries. We are all aware of the importance of currency in everyday events of our civilisation. Cash, lek, franc, ecu, euro, dollar... instruments. Call it as you wish. Money is important! It is important not only for its functions to pay, save, or deposit, but also as an historical and artistic legacy of a nation’s journey through the centuries. To the religious, love for money was the root of all evil. To generals, it was the strongest weapon in the battlefield. To revolutionaries, it represented shackles on the workers wrists. What is money, after all? A mountain of silver, a ceramic tablet, or a piece of paper? How did it evolve into its present-day form, when we seldom see physical money? More often than not, a set of digits on computer screens? Where does money come from and how did it evolve? As you will shortly see in the displays, this exhibition seeks to give an answer to these questions in a comprehensive language for all of us. Above all, however, it commemorates an important date in history.

The opening date for the exhibition “... The bank for Albania is a second victory, after freedom...” is 4 October 2013. Today 100 years ago, on behalf of the Provisional Government of Albania, Ismail Qemal Bey Vlora signed the first concession agreement on establishing an Albanian national bank. At the opening of this exhibition, I feel happy and excited at the same time, not only as the Governor of the Central Bank, but also as an Albanian citizen. The exhibition brings to the fore for the Albanian public one of the meritable contributions of the father of the country’s Independence, placing him on the pedestal he rightfully earned through the activity and vision of a real statesman.

The history tells us that central banking was not built in a day. It did not come into being following a specific event; neither was it a by-product of an accident. Central banking developed as a need of the countries to have an institution that would create and guarantee the supply of the economy with money.

It followed the need to fill the treasuries of the kingdoms, which were emptied to fund military campaigns to expand their territories and colonies, to absorb

the economic and financial crises shocks, and restore the economy to equilibrium.

Against this backdrop, the Albanian central banking has a different story to tell. The wise man Ismail Qemali conceived the idea of a central bank based on the principle of freedom, which the Albanians had been longing for in centuries. At the inauguration of the bank, he would say: "I say, for Albania, the bank is a second victory, after freedom, both in economic and political terms."

Whenever I read these words, I understand how simply Ismail Qemali managed to synthesise the necessity to consolidate the infant independence with a solid financial basis for a prosperous society. Ismail Qemali envisioned the bank as a financial institution that would give life to economic development and stabilization of the newly-independent state of Albania.

It is not a coincidence that in his speech, a few days after the signing of the concession agreement establishing the National Bank of Albania, Ismail Qemali said: "From the day Albania was fortunate to become a state among other Balkan and European peers, it is entitled to have one and even more banks to ensure both overall credit as a nation, and individual credit for each Albanian citizen."

His visionary words are still relevant today. I am proud today, a hundred years later, that thanks to endless efforts we have a modern central bank that has the trust of the public and is capable to fulfil its mandate: price stability and financial stability. During the past twenty years, many women and men, mothers and fathers, young ladies and young gentlemen, or grandchildren of the first professionals, have contributed and continue to contribute wholeheartedly to the life of the modern and successful institution of the Bank of Albania. The characteristics of their work and contribution may be summarised in three simple words: dedication, professionalism, and integrity.

I take this opportunity to thank the staff members of the Bank of Albania for their work insofar, and express my confidence that their dedication will continue to be unlimited in the future as well.

The last economic and financial crisis showed that the role of central banks is essential to ensuring a country's stability and prosperity. I am certain the Bank of Albania has accomplished its mission with professionalism providing a stable environment, especially with regard to banking system stability. This, however, is not accidental. Not wanting to repeat myself, I have to restate that the Bank of Albania has been vigilant, monitoring scrupulously the financial soundness of the system, both before and after the onset of the crisis.

With professionalism, dedication and farsightedness, we have succeeded in consolidating the independence of the institution, thanks to constant communication with all market actors, upholding the "independence - accountability" principle. Transparency is the basis of decision-making in the

field of monetary policy and financial stability. Our effort to inject rational optimism with regard to the behaviour of economic agents has been in the synthesis of our stance throughout the difficult period that the global crisis has imposed on us.

Looking ahead, I believe it is indispensable for this spirit to be embraced and transmitted to the economy by all policymakers, economic agents, financial market, including the members of the public. The gist of this philosophy consists in comprehensive structural reforms that would accelerate our progress towards sustainable long-term development of the country.

Dear participants,

The Albanian central banking needs a date of birth. This date provides the opportunity to honour the efforts of the fathers of the nation to establish a central bank and consolidate the Albanian state; commemorate the efforts of all contributors to the development and promotion of this institution; and look at future challenges and find ways to face them. The Bank of Albania will continue to be a responsible and reliable actor, to accomplish its legal mission and support the country's sustainable development.

This first centennial of central banking in Albania is a good omen for all of us.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the press conference on the Monetary Policy Decision
of the Bank of Albania's Supervisory Council,
30 October 2013

Today, on 30 October 2013, the Supervisory Council of the Bank of Albania reviewed and approved the quarterly Monetary Policy Report. Based on the most recent monetary and economic developments in Albania, and following the discussions on their outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 3.5%.

The Council notes that the inflationary pressures deriving from the real and financial sectors of the economy are weak and will continue to remain so. These circumstances require the stimulating monetary policy to persist in the period ahead. The monetary stimulus, transmitted through the low key interest rate and continuous injection of liquidity, provides the required conditions for meeting our medium-term inflation target.

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

The Albanian economy was characterised by slow economic growth and weak inflationary pressures throughout 2013. Economic growth slowed down to 1.1% in the second quarter, while available information suggests weak economic activity will continue in the third quarter.

The weak private demand offset the increasing positive impulses generated by the fiscal stimulus and foreign demand, in the first half of the year. Consumption and private sector investments were weak, whereas foreign demand continued to slow down, given the economic situation in our trading partner countries.

The private agents' uncertainty about the future was reflected in low propensity to spend and weak credit demand. This uncertainty prevented the transmission of the monetary stimulus to the economy. Moreover, banking system conservative policies maintained the lending standards tight, and prevented the normal functioning of the monetary policy transmission mechanism.

Against this backdrop, economic and financial stability of the country was preserved. Private agents' expectations on inflation were anchored around Bank of Albania's target, showing a good perception of monetary policy signals, and effective communication of the Bank of Albania. The banking system remains sound and well capitalised with ample liquidity to ensure the

return of financial intermediation to adequate levels, in spite of credit quality-related problems.

Average annual inflation continued the decelerating trend in the third quarter, settling at 1.5%. The profile of inflation was determined almost entirely by the contribution of inflation from prices of agricultural products.

Beyond the seasonal effect related to satisfying demand with domestic agricultural produce, these prices fell thanks to the drop in import prices for processed foodstuff in the countries of origin. Prices of other consumer goods categories provided low contribution to headline inflation, hence offsetting each other.

Low inflation rates, especially in the long-term component, point to the presence of the negative output gap. The weak domestic demand has created spare capacities in the economy, and has led to weak pressures for higher production costs and wages. Additionally, stable prices and exchange rates in global markets resulted in contained pressures from imported inflation. Developments in the real economy, especially the weak domestic demand and low monetary expansion, will condition low inflation rates to continue even in the period ahead. Inflation expectations remain anchored and in line with price stability.

During the second quarter, economic growth was driven by public sector demand, whereas other components were weak. Though higher than in the first quarter, consumer spending did not manage to provide significant contribution to economic growth. The performance of this domestic demand component continues to be affected by high uncertainties and limited financing resources.

Against the low consumer demand, presence of spare capacities, and relatively tight lending standards, private investments remained low.

Developments in fiscal indicators during the first nine months of the year point to a stimulating fiscal policy, especially in the first half of the year. Stimulating features were present both in terms of expenditure and revenues. During this period, budget expenditure increased 8.3% from a year earlier, driven by both current and capital expenditure. At the same time, revenues marked a 4% annual decrease, reflecting the decline in most of its constituent items. The performance of revenues and expenditure led to the budget deficit amounting about 1.25 times higher than a year earlier, most of which was funded through domestic long-term instruments. Budget deficit dynamics was reflected in further expansion of public debt.

Data from the external sector of the economy show that foreign demand, net, was weak in the second quarter. Real exports, net, narrowed by 1.5% during this period, contributing negatively to aggregate demand.

Their performance was determined simultaneously by increase in imports and deceleration of exports, in real terms. Foreign trade data for goods, for July-August, reveal that trade deficit narrowed 15.1% in annual nominal terms, during this period. Exports surged 15.8% during this period in annual terms, whereas imports dropped 3.0%.

Financial markets continue to reflect low risk and inflation premia. In the interbank market, trading volume increased and interest rates fell, showing lower volatility. In the primary market, yields fell further, especially on securities with longer term to maturity. The yields curve moved downward and its slope was reduced. Interest rates continued to fall in the deposits market, while, in August, interest rates on credits fell as well. In spite of this, credit performance was weak during these months.

Following the persisting deceleration over the first half of the year, private sector credit contracted in July and August. As at end-August, it stood 2.0% lower than a year earlier. Credit performance reflected the weak credit demand from both businesses and households, as well as the tight standards of the credit supply.

In the last months, a positive factor observed, and encouraged by the Bank of Albania was the write-off of non-performing loans having no hope of recovery from banks balance sheets. Beyond its statistical effect in the short run, cleaning the banks' balance sheets is part of a complex process of non-performing loan portfolio management.

If implemented efficiently and actively, in the long run, this process may establish the premises to release lending capacities in the economy and recover healthy credit increase.

The monetary indicators analysis attests to weak monetary inflation pressures in the economy. Annual growth of monetary supply decelerated significantly, to 2.7% in August. The deceleration was driven by the weaker performance of foreign currency inflows and lower demand for borrowing from the private sector. On the other hand, increased lending to the public sector through the banks supported the growth of money in the economy.

Economic growth is expected to be weak for the rest of the year, in the presence of sluggish foreign demand and absence of the fiscal stimulus. Meanwhile, available data insofar do not signal recovery of consumption or investments in the near future.

Below-potential growth of the economy will condition contained consumer price rise in the period ahead. In the absence of unexpected supply-side shocks, one-year ahead annual inflation is expected to range 0.4% - 3.1%, with 90% probability.

Taking into account the above forecasts, the stimulating nature of the monetary policy will continue in the quarters ahead. The Bank of Albania will

continue to supply the banking system with adequate liquidity for the smooth functioning of financial markets.

At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 3.5%. The Supervisory Council deems that the current monetary conditions are adequate to meet our medium-term inflation target, and provide the monetary stimulus necessary to recover the domestic private demand.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the 7th Hellenic – Albanian Business Forum
“The role of Banks – Bridges to Development”
13 November 2013

Good morning ladies and gentlemen!

For me it's a pleasure to participate in this economic forum that brings together representatives of Greek and Albanian entrepreneurs, and also of banks operating in our countries. I am particularly pleased to have with us today the Governor of the Bank of Greece, Mr. Provopoulos, whose participation in this forum shows the attention that he personally, and the Bank of Greece, is paying to support the business sector in general, and more specifically, the economic relationship between Greece and Albania. This approach is the right one. The private business sector is the main contributor in the GDP of the respective countries. The business sector is undergoing some severe difficulties in Greece currently, related with the need to deleverage and restructure in order to improve productivity and become competitive. These are fierce challenges that are associated with huge economic and social costs. I do believe though that these sacrifices of Greek people will pay off in the future, by giving way to a more vibrant and stronger economy, a more competitive business sector.

In Albania, the business sector faces challenges too. Albanian businesses must restructure to become more competitive. It must do so, at a time when Albania's economic growth is subdued and the demand is weak. This year we expect GDP growth to be around 1.9%. The figure could be a little higher next year, but is still more reliant on foreign demand, which, on its own, is quite uncertain. Our business sector must find new ways and new markets to sustain its activity and grow.

Our experience has shown that businesses or industries which had more diversified product markets, which took care of their cost structures and their balance sheets, have fared better through the downturn and have brighter prospects on the expected upturn. It serves to show that, as in other areas of life, a long term approach to business yields better results.

Financing is important at growth times, but is also needed at difficult economic times to facilitate business restructuring and ensure time consistency of change implementation. Both in Greece and Albania, and indeed in Europe, the banking sector is the dominant source of finance.

This fact highlights the importance of a sound banking system for our economies and has raised deep concerns in Europe about the chances of a credit-less recovery, given the actual very weak credit growth. While the long-

term objective should be to create conditions for achieving a more balanced and diverse financial system, the shorter times objectives should focus one having a stable financial system that provides adequate financial services to its customers, both savers and borrowers, thus maintaining its fair share of contribution to the economic developments of a particular country.

The banking sector in Albania has felt the impact of the international financial crisis, as the weaker credit standards before the crisis and the weaker economic growth afterwards, have been translated into lower asset quality and difficulties to consistently maintain positive financial results. In front of higher credit risk, credit terms have been tightened and credit growth has been sluggish. In September 2013, credit growth turned negative driven by credit in foreign currency and to businesses.

However, the banking sector remains well capitalized and liquid. Banks have been able to raise new capital and financial support from their mother banks. Especially, Greek banks operating in Albania have enjoyed strong support from their mother banks so far, and we expect this to continue in the future too, if needed. Overall, in September 2013 the risk weighted capital of the banking sector stood at 17.8%, while the ratio of liquid assets to short term liabilities was 36.5%. The sector has shown strong preference for investments in Albanian government debt securities and placements abroad.

Bank of Albania has been taking a number of measures to support credit growth and address the loan quality problems. Given the subdued inflationary pressures, we have lowered the policy rate to the record level of 3.5%. The path of the credit interest rate has followed this trend, although at a slower pace. Given the weakness of the credit channel in the monetary transmission mechanism, we have tried to strengthen our impact by adopting some countercyclical measures to promote credit growth. In this regard, we have temporarily increased capital requirements for placements of banks abroad and have reduced those for credit in the domestic economy.

In addition, we are promoting credit restructuring at an early phase by reducing provisioning requirements if that is the case. Several legal and regulatory measures have been taken in cooperation with other authorities and the banking industry, to improve collateral execution process and facilitate loan write-offs.

The results of such measures have been mixed so far, but in the coming months we expect their impact to be noticeable. This is also linked with the commitment of the Government to pay its arrears to the private sector in the next year. Nonetheless, it is important that the banking industry continues to support sound business propositions of borrowers. Banking activity may be driven by profits but is based on relationship with its customers. Now is the time when such relationship is being tested, and good bank management must look beyond the current challenges to keep and strengthen such relationship.

Our focus as the supervisor of the banking sector will remain in having institutions that are well capitalized and liquid, and that continuously improve their standards of risk management. In our forthcoming communication with banks, we shall pay special attention to how they assess and monitor credit; market and liquidity risks; and how they include the results of this process in the management decisions.

Finally, I want to stress again the importance of economic reforms that would ensure stronger economic growth in the medium term, and will provide for more effective banking activity. The objective of such reforms must be to improve the productivity and competitiveness of our economy through: reducing uncertainties over the direction of future developments by identifying the right policies and reforms; creating a favorable fiscal, legal, business and political climate that will promote investments in the economy; improving the workforce education and specialization; generating the benefits of economies of scale through integration of businesses in the regional or European market; and increasing the efficiency of the public and private sector through the improvement of governance. In the financial system, the reforms must focus on deepening and broadening the financial market, with the objective to improve access to finance, enhance efficiency and reduce risks.

I hope that this forum will bring up new ideas on how to overcome current challenges that the real economy and the financial sector is facing. In any case those ideas can be implementable only if they do not focus on a single sector, but also recognize the close relationship and inter-linkages among various sectors in the economy. Thank you very much!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the press conference on the Monetary Policy Decision
of Bank of Albania's Supervisory Council,
27 November 2013

Today, on 27 November 2013, the Supervisory Council of the Bank of Albania 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 Supervisory Council decided to lower the key interest rate by 0.25 percentage points. The key interest rate now stands at 3.25 per cent.

The key interest rate cut reflects our projections for low inflation in the period ahead, as a result of slow economic growth and downward inflationary pressures from the external economy. It reinforces the monetary stimuli in the economy and creates more favourable conditions to achieve the inflation target in the medium term.

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

Annual inflation stood at 1.7% in October, unchanged from a month earlier. After the rapid reduction in July and August, inflation increased in the two following months, confirming the temporariness of the pronounced inflation decline during the summer months, while remaining in line with the overall assessment for low inflationary pressures. During 2013, inflation volatility was driven mainly by food prices, which accounted for much of the headline inflation. On the other hand, prices of other goods and services of the CPI basket were overall steady and provided very low contribution to inflation.

From the macroeconomic perspective, the low profile of inflation continues to be determined by weak inflationary pressures, from both demand and supply side. The recent data confirm our assessment that the Albanian economy is growing below its potential. The presence of spare production capacities is accompanied by slow growth in employment, wages and production costs, hence reflecting low core inflation levels. In parallel, downward inflation in our main trading partners and exchange rate stability contributed to deceleration of imported inflationary pressures. Lastly, inflation expectations remain anchored and in line with price stability.

Available macroeconomic data point to slow economic growth rates during the third quarter of the year and a slight improvement in the fourth quarter. The volatility of growth rates over the year was driven mostly by the volatility of budget expenditure realisation levels.

On the other hand, foreign demand provided low contribution to economic growth, whereas private consumption and investments remained weak.

Private consumption and investments continue to slow down because of the high uncertainty and relatively tight lending conditions. The successive easing of the monetary policy was not reflected as expected in increased consumption and investments at home. As pointed out earlier, the Albanian consumers and businesses appear rather reluctant to make long-term commitments for consumption and investments. The Bank of Albania deems that the mitigation of uncertainties and easing of lending conditions would provide the prerequisites for a better performance of these two key aggregate demand components.

Fiscal stimulus weakened significantly over the third quarter. After rapidly increasing in the first half of the year, budget expenditure slowed down in the third quarter. The fiscal stimulus, for the first nine months, was reflected in budget deficit of about 1.2 times higher than in the same period a year earlier.

The expected increase of expenditure and budget deficit, in the third quarter, takes the contribution of fiscal stimulus to economic growth back to positive territory. Nevertheless, high debt levels limit the possibility for the fiscal policy to support economic activity in the future. The Bank of Albania deems that the fiscal adjustment in the upcoming year is necessary for returning the public debt to more sustainable parameters. The expected fiscal adjustment for 2014 and beyond would have its impact on Albania's economic activity. In the meantime, less public borrowing in the domestic financial markets would make room for lending to the private sector.

Foreign trade data reveal the positive contribution of external demand to economic activity during the third quarter. During this period, trade deficit narrowed by 17.7%, in annual terms, hence reflecting the good performance of exports and downward imports. Exports picked up 13.6%, annually, in the third quarter, whereas imports fell about 5.2%.

The period was characterised by downward interest rates in financial markets. The interest rates on public debt securities went down, as government borrowing was down in this period. The performance of yields and interbank rates were in line with the easing cycle of monetary policy. On the other hand, the interest rates on deposits and credits have reacted more slowly, due to high risk premiums included in the credit price. The banking system has adopted a conservative approach to lending, in response to tighter policies imposed by parent banks and higher non-performing loans in their balance sheets. This approach has been reflected in tighter lending terms and in interest rates that do not follow the trend of the monetary policy easing. In the presence of low demand for credit, it was reflected in the downward credit during the recent months. As at end-September, lending to private sector was 2.6% lower than a year earlier.

High risk premiums for credits and the weak response of consumers and businesses to interest rates have dampened the effect of monetary stimulus' transmission to the economy. The expected return of these two indicators to more normal parameters would enhance the transmission of the monetary stimulus and create the conditions for domestic demand recovery.

The Bank of Albania deems that inflationary pressures will remain weak in the period ahead. Evidences on the current developments have not changed significantly our macroeconomic projections, but have, instead, added risks on the downside. Economic growth is expected to remain weak and not generate inflationary pressures. This projection reflects the decelerating effect of the expected fiscal adjustment in the next year. Likewise, imported inflation is expected to remain low, whereas inflation expectations are anchored.

At the conclusion of discussions, the Supervisory Council decided to lower the key interest rate by 0.25 percentage points. The wave is expected to be reflected in lower interest rates on credit to the economy. Taking into account the expected fiscal developments for the upcoming year, this action seeks to maintain the macroeconomic stimulus in the economy and provide for appropriate conditions to meet our inflation target. The Supervisory Council deems that the expected economic and financial developments, at home and abroad, will require maintaining the easing nature of the monetary policy, in the period ahead. Depending on the direction and intensity of the fiscal policy in the future, the Bank of Albania stands ready and remains heedful to assess and respond swiftly through the monetary policy.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the high-level conference “On international central bank cooperation before, during and after the crisis”, hosted by the European Central Bank
09 December 2013

Dear Participants,

It is an honor for me to participate in this important conference and I want to thank the organizers for inviting me. In my speech I will focus on how the recent financial crisis has changed the central bank work with respect to the adoption of macro-prudential policy and its relationship with monetary policy. Then I will share some thoughts on the experience of SEE countries during the crisis, and highlight some of the challenges they face given the recent economic, financial and regulatory developments in the EU.

The crisis we are going through, being so profound and lasting, will leave its mark on economics in general, and central banking in particular. Up until the Great Recession, monetary policy was living in a world that we may call “the inflation targeting era”. In many ways inflation targeting made the central bank’s job relatively simple, as long as it followed the policy correctly. The Central Bank, seen by the public as an independent institution, had to credibly commit to an explicit inflation target, in order to anchor mid-term inflation expectations. Self-fulfilling expectations from economic agents and price setters would, in turn, help deliver the objectives of monetary policy. Economists believed that by stabilizing consumer prices, financial assets would also behave in a stable and predictable way. The crisis painfully reminds us that behavior in financial markets is not always rational and lack of confidence in the markets can spiral out of control, sending shockwaves throughout the economy. Escalating asset prices and their sudden burst affected significantly the behavior and balance sheets of the economic agents and challenged the stability of the financial system. In this respect, the concept of financial stability was seen as a byproduct of monetary stability.

Micro-prudential supervision was focusing on the soundness of individual financial institutions, with the belief that this was sufficient to ensure aggregate stability of the financial system. Again, the recent financial crisis made it clear that micro-prudential supervision was insufficient to detect and address buildup of risks in the entire financial system due to externalities, herd behaviors, common exposures and pro-cyclicality in financial system activity. Moreover, financial institutions of systemic importance proved to be “too big to fail” and measures were needed to deal with existing systemic institutions on a global and local level. Recovery and resolution powers of financial institutions are being strengthened.

Limiting systemic risk, both in its time and structural dimension, is the objective of macro-prudential policy. In the last 3 years, there has been significant progress in the identification of several instruments designed to:

- address the rapid expansion and concentration in lending;
- ensure that banks have sufficient liquidity to cope with different shocks;
- and discourage risky behavior by financial institutions, by increasing demand for capital for such activities.

These measures may have countercyclical nature and could apply to financial institutions based on their systemic importance.

These standards require building an institutional framework with clear identification of the authority /authorities that will have macro-prudential powers, in accordance with the structure and level of market development. Central bank appears to be better positioned than other authorities to perform the macro-prudential role. In addition to its exclusive responsibility on formulating and implementing monetary policy, a central bank has other advantages related with:

- its involvement in developing the payments systems infrastructure;
- its access to wide market and financial system data;
- and, many times, its role as a regulator and supervisor of banks.

Nowadays it is widely accepted that there has been huge progress worldwide in ensuring legal and operational independence of the central bank and this is another important reason why it can be entrusted with macro-prudential policy.

In order to correctly define the macro-prudential function of the central bank, it is important to establish the right relationship with monetary policy. This can be done with the understanding that both policies, if designed and implemented properly, complement each other. Monetary policy can still pursue its course following low inflationary pressures, while the macro-prudential measures can be used to address early risks developing under a low interest rate environment. On the other hand, macro-prudential measures can also be used to mitigate risks from incoming capital flows, in an environment of relatively high real interest rates.

Instances of conflict among the two policies should not be neglected though. These instances can be more pronounced if the objectives of the two policies are wrongly defined in a certain financial situation, or respective tools are used out of their scope. For this reason, I believe that it might be helpful to uphold the monetary policy as the primary objective of the central bank. Stabilizing inflation should be something that central bankers may be proud of, something that we should cherish and continue to strive for. But we must recognize that financial stability issues and related macro-prudential measures have to gain significantly more grounds in central bank discussions and decisions. Clearly, the course of the monetary policy will continue to be extensively discussed in the future, based on our improved understanding of the role of asset prices

and financial frictions. Incorporating financial stability objectives with the inflation targeting regime, we have considered in Albania as an opportunity to understand and address economic developments and potential macro-financial risks, in order to preserve long-run economic stability.

While the mandate on macro-prudential policy and its tools must be clear, one has to recognize that it can have wider effects in the financial system and the real economy. For this reason, discussions on macro-prudential policy and measures must involve other authorities, including the fiscal one. Many countries have now established an inter-institutional entity with soft or hard powers in designing and implementing macro-prudential policy to mitigate systemic risk. The role of the central bank in these inter-institutional entities will reflect their legislation and tradition, and independence objective. Although central banks may not always chair such entities, central banks do play a critical role in underpinning their functioning given the information and expertise they provide.

How have such policies developed in the South Eastern Europe (SEE) region? In spite of solid growth in the run up to it, the global crisis found SEE in a vulnerable position. To a large extent, its growth model was based on encouraging domestic absorption which in turn was partly financed through external borrowing. Financial inflows were channeled in SEE economies largely through EU bank subsidiaries. In SEE, they encouraged investment in real estate and services sectors and were reflected in large current account deficits. External competitiveness and structural reforms slipped gradually through the policymaker's agenda, while fiscal positions were allowed to deteriorate and financial safety nets were weak.

As a result, when the crisis-hit SEE faced both a structural and a cyclical problem. The overall economic structure was not competitive while growth declined as external demand collapsed and domestic demand suffered from higher uncertainties, higher risk premium and lack of funding. On the financial side, our economies suffered as foreign banks deleveraged and reduced their exposure to SEE. On top of this, several countries faced high vulnerabilities in the financial system, as the NPL's grew rapidly on a combination of weak growth and FX currency loans to unhedged borrowers.

This picture is of course a generalization. Different countries have had different experiences, depending from their initial conditions and policy responses. However, the crisis exposed several weaknesses of this economic model. At the same time, to the extent that there are differences among countries, we can draw more conclusions from our experience:

Countries with favorable initial conditions suffered the least. Albania has been one such case. We have not entirely avoided the build-up in imbalances, but we have been careful enough to avoid currency mismatches in bank lending, to foster a prudent business model for the banking system, to avoid short-term currency inflows and to focus on overall stability as a precondition for long-term growth.

Countries with stability and long-term oriented policies have performed better. The policy dilemma in SEE has largely been whether to support economic growth through countercyclical policies or to prioritize economic and financial stability through tough corrective action. Providing macroeconomic stimulus if your economy is import-oriented may prove to be a futile exercise. As a result, in Albania we have increased our efforts to restructure the economy. The BoA has also sought to increase transparency in the banking system and to strengthen its balance sheets, both through capital increases and through tackling bad loans. The latter has been done through promoting credit restructuring or credit write-offs. In this regards the focus of the Bank of Albania will include a micro-approach in analyzing the bad debtors of systemic importance.

International cooperation is a prerequisite for mitigating contagion effects and for successful crisis management. Particularly, the Vienna Initiative has been instrumental in limiting the deleveraging process of the private banking system in our economies.

Safety nets have to be improved, in order to make them more efficient and sustainable.

Several issues remain to be solved. SEE economies have rightly chosen integration in EU as their main goal. It helps to anchor their political systems, their structural reforms, their legal and regulatory environment and their macroeconomic and financial policies. However, the economic growth model has to change. The main focus of national authorities in SEE should be to facilitate the allocation of capital to more productive sectors, by providing the right incentives structural reforms, legal environment, tax policies, and economic stability.

In the financial system of these countries, dominated by banks, the deleveraging process is undergoing under the pressure of the deteriorating loan quality. Credit is made scarce as banks have become risk averse and hesitate to lend to potential borrowers by tightening lending terms. Hence, real sector agents, particularly firms operating in ailing sectors of the economy, are facing surmounting short-term financing difficulties and have lost sight of their future objectives. The process of restructuring in these firms has to find ways for their business to change and become efficient, in order to survive and restart growth. Finance and knowhow is particularly important during such restructuring phase.

What role has the financial system in this process? We have to be clear on two issues: (1) we have constructed a financial system and pursued a financial integration strategy based on banks. In fact, they comprise more than 90% of the financial system throughout the region. We think this model is successful and with some minor revisions should serve our economies in the future. For one, foreign banks bring expertise and mostly stability to the financial system. But, recent experience has softened this argument. (2) Banks should be the main vehicle of financial inflow. As converging economies, SEE is expected

to run current account deficits. As such, it is a capital hungry region which international banks should intermediate. A new business model relying purely on domestically generated deposits is a wrong answer to the previous extreme of huge capital inflows. A more happy medium should be sought, one based on careful and sustainable inflow of funds.

How is the Single Supervisory Mechanism going to affect the work of the central banks in the region?

I believe the SSM mechanism is going to have a positive impact on central bank (and regulatory authorities) in the region discharging their responsibilities with regard to supervision and macro-prudential policies. Regulators in the region will now talk to a single "home" supervisor, and this is expected to bring more attention to their supervisory concerns. This process could be strengthened further if the central banks in the region improve their own cooperation and are able to identify common position in their communication with the European Central Bank. This could address better the concern that the single supervisor could be more distant to worries of regulators coming from small countries in the region.

Being able to cooperate with a single "home" supervisor, will be instrumental in achieving faster progress in the process of regulatory convergence, and establish a more level playing field for financial institutions in the region. This is something that is being closely guided by the Vienna II Initiative. In addition to preparing implementation of various regulatory standards related with countercyclical macro-prudential tools, with particular short term importance is the issue linked with recognition and the treatment of the NPL.

In the recent past, some of the countries in the region have been affected by the deleveraging process started in the EU financial system. This was mostly felt during 2012, following the higher capital requirements associated with EBA stress test of November 2011 and relevant steps taken by national "home" authorities to comply with capital requirements. Next in line is the Asset Quality Review by the ECB. Our hope and belief is that this time, concerns of the SEE countries regarding potential further deleveraging, will be considered more carefully and more specifically, to avoid further potential deleveraging. Let me reiterate that the economies in our region currently rely heavily on bank financing and there is a growing need to make credit flow again in the economy.

To conclude, allow me to point out the importance of establishing a sound framework for macro-prudential policy, both in terms of tools and institutional approach, in order to deal effectively and timely with prevention of systemic risk. They should be accompanied however, by measures related with the strengthening of crisis management framework. If designed properly, macro-prudential policy should avoid any conflict with monetary policy, and instead should complement it appropriately. Countries in the SEE should benefit from synergies related with the adoption of the Single Supervisory Mechanism. These benefits could be larger if we manage to strengthen our regional

cooperation. We are still concerned with potential further deleveraging following the forthcoming Asset Quality Review process and we hope that ECB and other authorities in the Eurozone and EU, could design it to limit these impact in maximum.

Thank you very much for your attention!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Press Conference on the Monetary Policy Decision
of Bank of Albania's Supervisory Council,
16 December 2013

Today, on 16 December 2013, 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 outlook, Bank of Albania's Supervisory Council decided to lower the key interest rate by 0.25 percentage points, at 3.0%.

The key interest rate cut – subsequent to that of November 2013 - reflects our projections for weak inflationary pressures in the medium term. Aggregate demand and economic growth are likely to remain below potential, being associated with slow rise in production costs and consumer prices. Also, imported inflation pressures are likely to be weak and downward. Reflecting the expected fiscal adjustment in the current and next year, easing monetary policy aims to support the aggregate demand by improving financing terms and creating proper conditions to meet our medium-term inflation target.

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

Annual inflation was 1.0% in November, dropping significantly from its rate in October. This drop was driven almost totally by the drop in food price inflation during this month. In a broader context, the food price inflation slowed in the countries of the region during the second half of this year, reflecting the global conjuncture of prices. Prices of other CPI basket goods contributed very slightly to headline inflation, resulting in an insignificant impact.

From the macroeconomic viewpoint, the low inflation rates in the last months of the year reflect the overall downward inflationary pressures on the economy. The poor performance of aggregate demand continues to condition the incomplete productive capacity utilisation in the economy, thus causing a slow increase in production costs of domestically produced goods and services. Also, the significantly slower foreign price rise and the stable exchange rate have led to a lower imported inflation. On the other hand, inflation expectations and liquidity situation in the economy convey signals for moderate price rise in the medium term.

Real-economy data on the second half of the year are scarce. The new information gathered during the last weeks supports our previous projections for a low but positive growth of the Albanian economy over this period.

However, some new indicators from the last month signal a slower than expected economic performance.

The external sector of the economy highlights weaker contribution of the foreign demand to aggregate demand growth. The real-term net export deficit expanded in the third quarter of the year, mainly due to weak performance of tourism over this period.

On the other hand, the latest foreign trade data show that the annual nominal trade deficit continued to narrow in October, by 12.2%, mainly due to 17.1% annual export growth, while imports dropped 0.3%.

The public sector's contribution, which supported the demand growth in the first half of the year, diminished in the second half. Fiscal policy was expansionary over the first ten months of the year, focused mainly on the third quarter of the year. Budget spending increased 7.1% from the previous year, mainly due to higher current spending. On the other hand, fiscal revenues dropped 2.7% in annual terms over this period, reflecting the weak economic activity and imports in the country. Despite the slower expenses in the second half of the year and lower drop in revenues, the budget deficit continued to grow. Until October, this deficit was almost twice that of the previous year. Taking into account the high public debt level, the Bank of Albania deems that the current fiscal trajectories are unsustainable in the medium term. Therefore, we support and welcome the measures for a fast adjustment and fiscal sustainability.

Both important components of domestic demand - private consumption and investments - remain weak due to uncertainties about the future, incomplete capacity utilisation, low consumer confidence and limited financial resources. Against the backdrop of weak inflationary pressures, the Bank of Albania eased further the monetary policy in November, cutting the key interest rate, at 3.25%. The monetary policy signals were swiftly transmitted to most of financial market segments, helped also by reduced liquidity premiums for them.

The interbank market rates, primary market yields and lek-denominated deposit interest rates continued to trend down, following the key interest rate cut in the economy. Recently, credit interest rates have also dropped but at a slower pace. Their sluggish response and the common time lags in the transmission mechanism reflect primarily the high credit risk premiums and the rather conservative policies imposed by developments in the European financial market.

Monetary indicators have performed in line with the real-economy developments and highlight weak monetary inflation pressures on the economy. Annual monetary supply growth slowed to 2.3% in October, reflecting the economy's low demand for money. Banks' reluctance to lend to the economy and the private sector's weak demand for funding are materialised into lending performance deterioration.

Particularly in October, lending to the economy deepened its annual contraction to 2.2%, reflecting a poor performance across all its segments. Our baseline projections for the economic outlook remain generally unchanged. Economic growth in the next quarters is expected to be positive but below the productive potential of the economy. Against the backdrop of a weakening net foreign demand and expected public finance consolidation, the economic growth will be heavily determined by the performance of private consumption and investments, which show no recovery sign yet. The continuation of negative output gap will provide weak pressures on medium-term prices, while the supply-side pressures are likely to be subdued. In the absence of unexpected shocks, inflation is expected to range low over the quarters ahead.

At the end of discussions, Bank of Albania's Supervisory Council decided to lower the key interest rate by 0.25 percentage points, now standing at 3.0%. Our assessments show that the monetary stimulus pass-through to financial markets and the real economy will contribute to gradually bringing inflation back to our 3% target. The Bank of Albania will continue to keep the easing monetary policy stance until meeting the inflation target.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the year-end event with the Albanian Association of Banks,
17 December 2013

Dear bank executives,
Your Excellency Ambassador Sequi,
Dear Mr. Ilahi,
Dear Mr. Pencabligil,

It is a pleasure for me to participate in this year-end meeting, as we reflect about the challenges we faced and the objectives we accomplished in this year, and endeavour to identify issues that may arise over the next year. Given the celebrations time and the spirit of this meeting, I would rather not dwell upon all the issues I would have liked to. However, I will share with you my opinion on two issues I consider as important for a good performance of the banking sector over 2014.

Before moving on, we should acknowledge that the year we are leaving behind was a difficult one for the banking sector. In its development cycle for over more than one decade, this year, the banking sector's growth slowed down sharply and annual lending levels contracted.

Deteriorated asset quality, dictated by credit, has led to lower financial profit due to higher provisions needed. These developments have reflected the overall economic slowdown and domestic demand drop resulting from lower private consumption and investments. However, other developments highlighted the banking sector's capacity to properly respond to and cope with these challenges. The banking sector has maintained ample liquidity and capital levels thanks to the further rise in public deposits and added capital by parent banks. In terms of non-performing loans, obvious efforts have been made to restructure credit and sell off non-performing loans to non-bank financial institutions.

The Albanian Association of Banks has played an active role in discussing the problems with relevant authorities and identifying solutions through the regulatory treatment of non-performing loans, notably, the legal amendments to collateral execution process, which entered into force in September 2013. Through its activity, the banking industry may transform 2014 into a better year for both the banking industry and the Albanian economy. I think that this may be achieved through harder work in the following aspects:

The first aspect pertains to restoring lending to adequate levels in Albania. This objective may be achieved by interlinking these three elements:

a) Cleaning up balance sheets from non-performing loans. It is indispensable that you should mark evident progress during 2014 to write off loss loans from their balance sheets and engage in cautious credit restructuring, where necessary. The improvement in the fiscal handling of loan write-offs, in the near future, is expected to better support this process; however, this does not justify the sluggish and protracted action. I, therefore, call for your utmost commitment to successfully implement projects initiated with the World Bank in this regard.

Additionally, quantitative objectives for reducing the level of non-performing loans should be included in your institution's annual work plans for 2014;

b) Evaluating and selecting new loan applications in a professional fashion. Indeed, credit demand remains weak; however, this exists and must be viewed in terms of its potential for growth in the future. In this regard, the banking industry should strengthen its analysis to steer lending toward those sectors of the economy with high development potentials. Priority should also be given to launching banking products that boost credit demand from small and medium-sized enterprises, mitigating credit risk through portfolio diversification and improving the stable return on bank lending;

c) Reducing lending costs. I refer to the interest rate applied to lek loans. To our opinion, it has inadequately reflected both the key interest rate trend and our expectations. From the decrease in the interest rates applied to government borrowing, we understand that the inert moves in the cost of lending reflect the risk premia the banking industry imposes when lending to the private sector. For 2014, we think that the banking industry should better support the private sector, considering that:

- IMF's agreement with Albania will mitigate government's need for borrowing;
- Public arrears to the private sector are expected to begin to be paid off shortly;
- Worsening financial ratios in the banking industry imposes the gradual return to lending to the private sector, in order to improve the generation of income.

Second, I would like to underline the need for the significant improvement of technical capacity and structures for risk management. In this regard, your decision making should include analytical assessments of the performance of your institutions against various scenarios. This is a requirement stipulated in the existing regulatory framework, which we will monitor with additional caution over the next year. In our view, this element constitutes a bank management quality indicator.

Sparing the details, I would like to emphasize that the Bank of Albania will continue to provide the necessary support for all these processes. We appreciate the professional and direct cooperation with you, as an important element to comply with the requirements of the supervisory and regulatory framework.

Moreover, the IMF's agreement and additional financial support from the World Bank and the European Union will contribute to restoring the country's long-term economic stability, translating the macroeconomic stability into higher economic growth rates. I am confident the banking industry will use this moment to identify the best opportunities to restructure and improve its performance and expand its activity, thus reassuming its role as the engine for the country's economic development.

Thanking you for the invitation, I would like to wish you all good health and a prosperous and successful New Year!

Happy New Year!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the joint press conference with the Ministry of Finance
and the International Monetary Fund,
18 December 2013

Dear media representatives,

In recent days, intensive negotiations have taken place with the International Monetary Fund (IMF) on the direction of economic and financial policies that Albanian authorities will undertake for the medium-term period 2014-2016. I have the pleasure to say that, overall, these discussions have been successful. Upon their conclusion, we were able to reach an agreement with the IMF on compiling a package of measures, which would help Albania cope with immediate problems and support sustained economic growth. From the central bank perspective, the agreement addresses our main concerns, which we have shared with you in earlier communications.

I believe that, in the period ahead, you will be informed in more detail about the agreement. At this press conference, however, I would like to brief you on Bank of Albania's views regarding the situation of the economy and financial system in Albania, and highlight the main points that will steer our policies in the next three years.

The Albanian economy is characterised by slow and below potential growth. This situation poses a number of problems to the economy, such as:

- difficulties in businesses financial situation;
- deceleration of employment and wage growth rates;
- deterioration of financial indicators, especially of credit;
- more conservative financial agents; and,
- added pressures on the deficit and debt indicators.

All the above-listed problems are present in the Albanian economy. For that reason, the Bank of Albania has persistently pointed out that low growth rates are a primary concern facing the Albanian economy. Hence, the right understanding of growth-related problems is the key to appropriate development policies.

In our view, like in other countries of our region, economic growth-related problems pertain to both cyclical and structural aspects. In order to bring the Albanian economy on the track of sustained economic growth, they should be addressed simultaneously.

Given the current situation, I believe the agreement with the IMF is an optimal solution.

On the cyclical aspect, aggregate demand appears low and unable to fully utilise the country's production capacities. The reasons are evident:

- foreign demand for Albanian goods and services is problematic, in part owing to the problems facing our trading partners;
- public sector has limited capacities for fiscal stimulus because of the high public debt;
- private sector is reluctant and faces tight lending terms by the financial system.

Against this backdrop, the Bank of Albania deems that the agreement with the IMF contributes to solving the standstill. First, the signed agreement will serve as a guarantee for consistent economic policies and provides low-cost financial guarantees for the country.

As such, it boosts the national and international investors confidence in the Albanian economy and has positive effects on investments and consumption. Second, the agreement opens the way for a softer fiscal adjustment than the one we could be obliged to do in its absence. In other words, the envisaged financial assistance avoids a stronger fiscal contraction, which could be imposed by financial markets. Third, financial support by the IMF and the World Bank implies reduced government borrowing in domestic markets, allowing more liquidity for lending to the private sector.

On the structural aspect, the Albanian economy should adopt a new growth model to create a more competitive and dynamic profile, which is more immune to global conjuncture volatility. This objective requires reallocation of financial, enterprise and human resources in the economy, from domestic market-oriented industries to those focusing on regional and global perspectives. Moreover, to achieve this objective, structural reforms should continue with improving the legal and regulatory framework, investing in infrastructure and upgrading the skills of workforce. All these actions require time, financial resources and technical expertise. I believe the agreement with the IMF addresses these issues structurally and duly.

In our view, these policies pave the way for a progressive economic growth in the years ahead. They will certainly require constant attention, clarity and flexibility to align the dynamics of the economic and financial reality with our objective and policies.

Maintaining and strengthening the country's macroeconomic stability is yet another important aspect of economic and financial policies.

The Bank of Albania will keep focusing on compliance with the price stability objective. In the last two meetings of the Supervisory Council, the key interest rate was cut twice, settling at 3%. These decisions were made exclusively to abide by our 3% inflation target. They seek to ease lending to the economy, boost domestic consumption and investments, and bring the rate, presently standing at low levels, in line with the target. We have been and will continue

to be heedful to this indicator, standing ready to take the necessary measures to guarantee price stability in the economy.

Finally, the banking system has been and continues to be sound and profitable. According to the Financial Sector Assessment Program (FSAP), the Albanian banking system is sound, capable to withstand shocks, supervised and regulated by sound principles. The Bank of Albania is committed, also in the framework of FSAP recommendations, to improve the supervisory and regulatory framework, in order to provide the economy with a sound banking system. Furthermore, in the framework of multilateral initiatives, such as Vienna Initiative 2.0, or bilateral cooperation with counterpart institutions, the Bank of Albania will seek to raise the attention of public and private financial institutions to investments in the Albanian economy.

Such initiatives and projects, besides other commitments that are part of central bank's business, serve the improvement of lending terms and Albania's economic growth.

Thank you for your attention!

PERIODIC ANALYSES*

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

FINANCIAL INTERMEDIATION ANALYSIS 2013 Q4

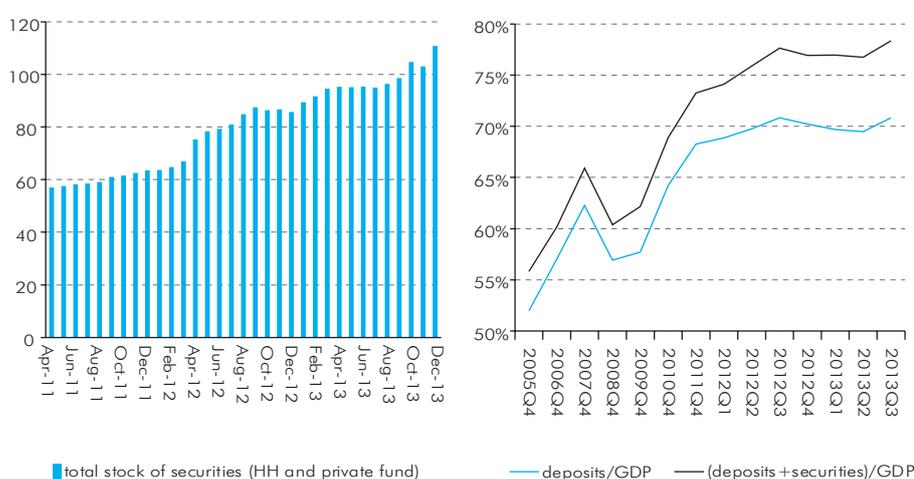
ERJONA SULJOTI, SOFIKA NOTE, OLTA MANJANI

MONETARY POLICY DEPARTMENT, JANUARY 2014

1. FINANCIAL SECTOR AND BANKS

The banking system dominates the financial system in Albania. Currently, 16 commercial banks are operating in Albania, most of which foreign owned. The banking sector is the main player in financial intermediation in the economy.¹ The financial system is also complemented by other financial corporations, namely savings and loan associations and private investment funds, whose role in the Albanian economy has been increasing in the past two years. The launch of new financial institutions, combined with new financial instruments², has provided more diversification opportunities for household savings, thereby contributing to enhanced role of non-bank institutions in the economy. This development has also helped shift a part of household savings held with banks to other financial corporations, which has also been encouraged by the lower interest rate on bank deposits during 2013.

Chart 1. Investment in securities and banking intermediation indicators (deposits)



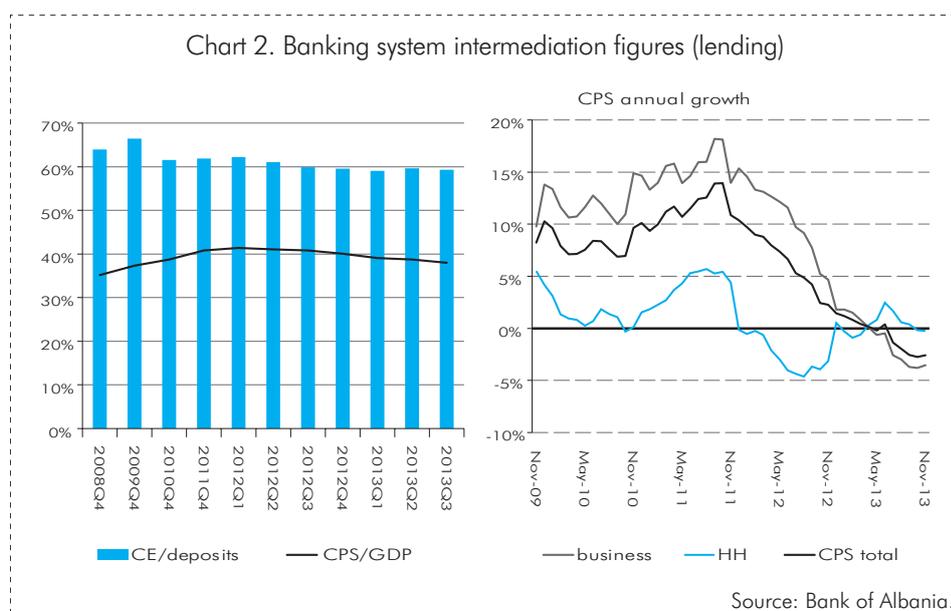
Source: Bank of Albania.

The banking sector continues to dominate financial intermediation in the economy. As at end-September, its assets accounted for about 92% of total assets of financial institutions operating in Albania, from 93% at end-June. Banks' intermediation role weakened further in the last quarter of 2013. Banking intermediation, as measured by the ratio of the loan portfolio to

¹ For more information, see *Financial Stability Report for 2013 H1*.

² The establishment of "Prestigj" private investment fund in lek and euro during 2012, and the issue of 10-year bonds in lek and 2-year bonds in euro during 2013.

deposit stock, confirmed its reduction to 56.9% in November, down about 0.4 percentage point and 2.7 percentage points from end-September and end-2012, respectively, driven primarily by the sluggish lending to the economy. The growth pace of deposits slowed to around ALL 20.3 billion as at November 2013. Deposit-to-GDP ratio remained flat at end-September³, standing at 70.8%, similar to a year earlier. The lower money creation in the economy and weaker foreign inflows, and the shift of savings toward other non-bank financial institutions led to lower collection of deposits.



Despite the adequate monetisation of the economy, with broad money-to-GDP ratio standing at 85.5% at end-September, lending was sluggish throughout 2013. Lending to the economy as a percentage of GDP was around 40.6% at end-September, down 1.8 percentage points, y-o-y. Lending to the economy slowed at an escalating pace, moving to negative territory in the second half of the year and registering an annual change of -2.4% in November. The pace of lending to the economy continued to be driven by demand and supply-side factors, which were also carried over to the last quarter of 2013. The sluggish economic activity and uncertainties about the economic outlook were the main reasons behind the weak business and consumer demand for loans, which, combined with banks' cautious approach to selecting customers and projects to lend, contributed to worsening lending in the last quarter of 2013. To a large extent, the shrinking loan portfolio also reflected banks' clean-up of their balance sheets from non-performing loans.⁴

Year 2013 saw high participation of non-bank financial institutions in financing the budget deficit through Government securities. In addition to individuals' direct participation in these auctions, their investments in Government securities were, in several cases, intermediated by private investment funds.

³ According to an approximate estimation of nominal GDP, which is based on INSTAT's figure of GDP and Monetary Policy Department's calculations.

⁴ During 2013, several banks in the Albanian banking system took measures to clean up their balance sheets from non-performing loans. Otherwise, the loan portfolio would have shrunk less.

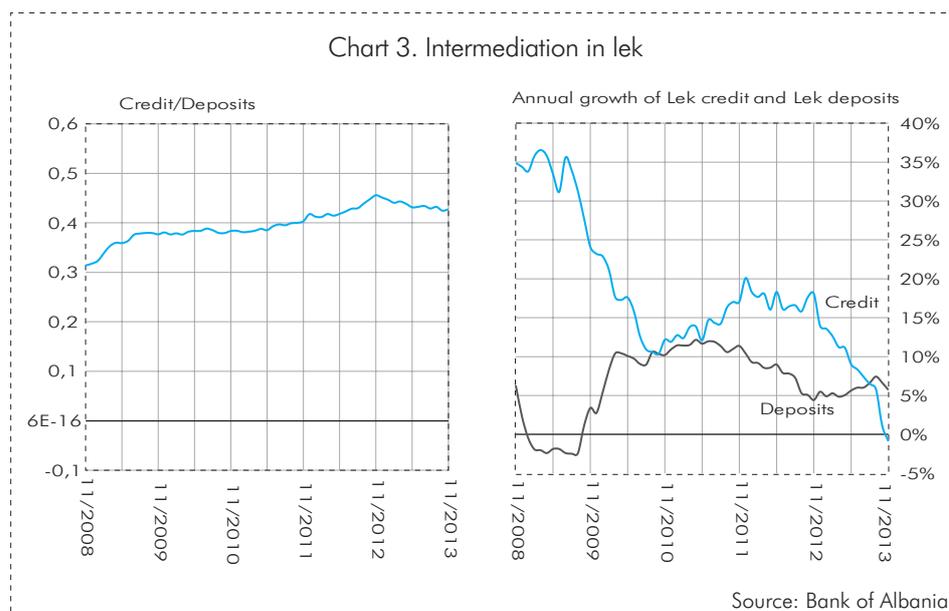
A considerable portion of these investments was provided through household savings. In the past two years, there has been a partial shift of household savings from bank deposits to Government securities and investment fund shares. This shift was also influenced by the launch of other financial instruments into the market during 2013, thereby widening the range of investment instruments. This performance attests to diversification of Albanian households' financial portfolio and a wider concept of financial intermediation beyond the banking sector. Although still at low levels, this is a good indication of the development of the Albanian financial system.

2. FINANCIAL INTERMEDIATION IN THE BANKING SYSTEM

Financial intermediation in lek and foreign currency was weak in October and November. The former continued to fall, reflecting low lek deposit mobilisation in lending. Intermediation in foreign currency maintained the third quarter's low levels, driven by the shrinking foreign currency loans and deposits. Overall, the intermediation cost was higher for both currencies, reflecting the high risk premium and provision cost.⁵

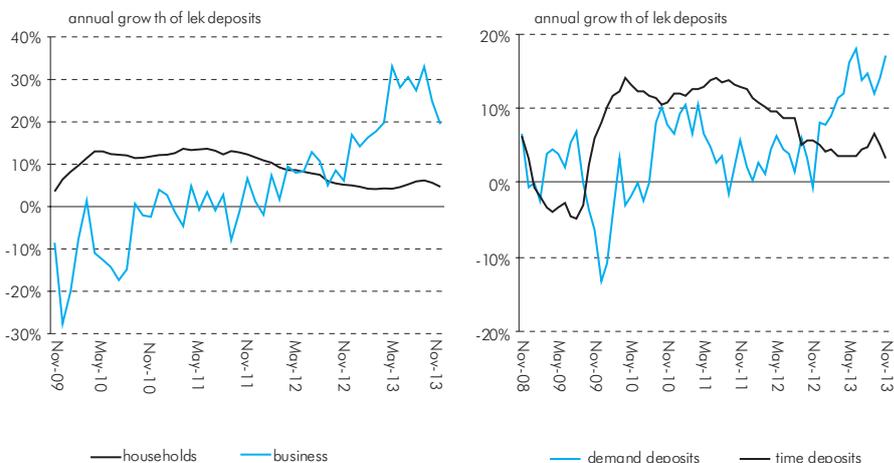
2.1 Intermediation in Lek

In October and November, the intermediation ratio in lek maintained the downtrend begun since early 2013. In November, loan-to-deposit ratio in lek averaged 42.6%, down 0.6 percentage point from the third quarter, and 2.8 percentage points, from a year earlier. While lek deposits maintained the high pace of growth, the lower intermediation ratio in lek was attributable to the slow and shrinking lending in lek.



⁵ As shown by the ratio of non-performing loans to total loans.

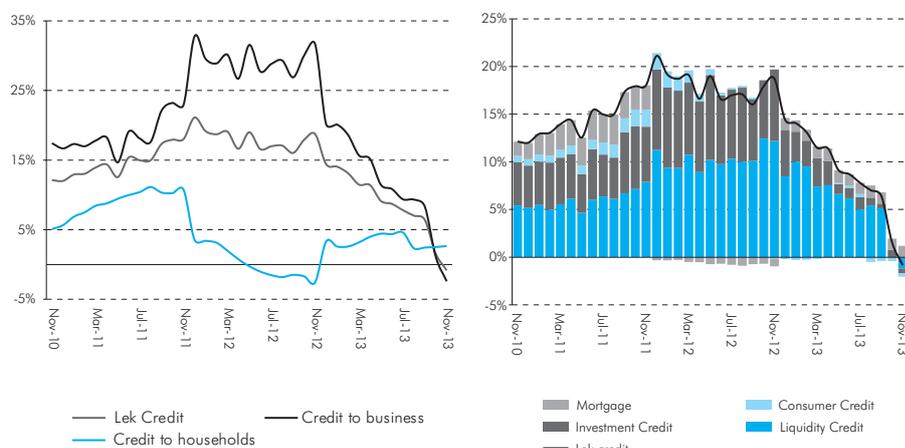
Chart 4. Lek deposits by maturity and economic agents



Source: Bank of Albania.

Total lek deposits saw stable performance across 2013. As at end-November, they were 5.7% higher, y-o-y, being broadly driven by the added public sector activity. In October and November, lek deposits shrank ALL 2.8 billion versus the low growth in the third quarter. This performance was attributable to lower lending in lek and shift of a portion of deposits to other non-bank financial institutions. This period also saw the shift of lek deposits to demand deposits. As at end-2013, the structure of lending by currency remained similar to end-September, with lending in lek accounting for 39.2% of the total. After the high growth rate of 11.3% in the first half of the year, lek loan portfolio slowed at a fast pace in the second half, and in November shrank 0.9%. The decrease in business lek loans by 1.7% in annual terms was the main factor behind this performance. Business lek loans are mostly used to cover liquidity needs (60% of total business lek loans). As at end-November, this portfolio shrank considerably by 1.7% in annual terms, compared to the shrinkage by 0.4% in lek loans for investment purposes.

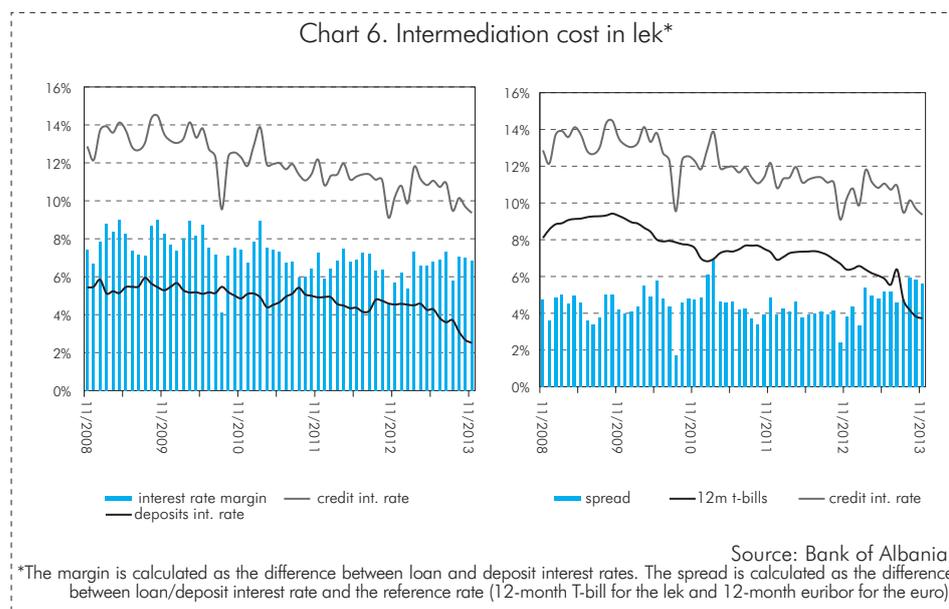
Chart 5. Lending in lek and contribution by purpose of loan (annual change in %)



Source: Bank of Albania.

In parallel, household lek loans continued to maintain positive growth rates of around 2.7%. The annual contraction in consumer loans by 2.9% was offset by an adequate increase in home loans by 6.7%. The latter, in particular, was also supported by banks' policies to promote some mortgage loan products at preferential rates. The performance of lek lending to households in August and November 2013 was also affected by banks' policies to clean up their balance sheets from non-performing loans.

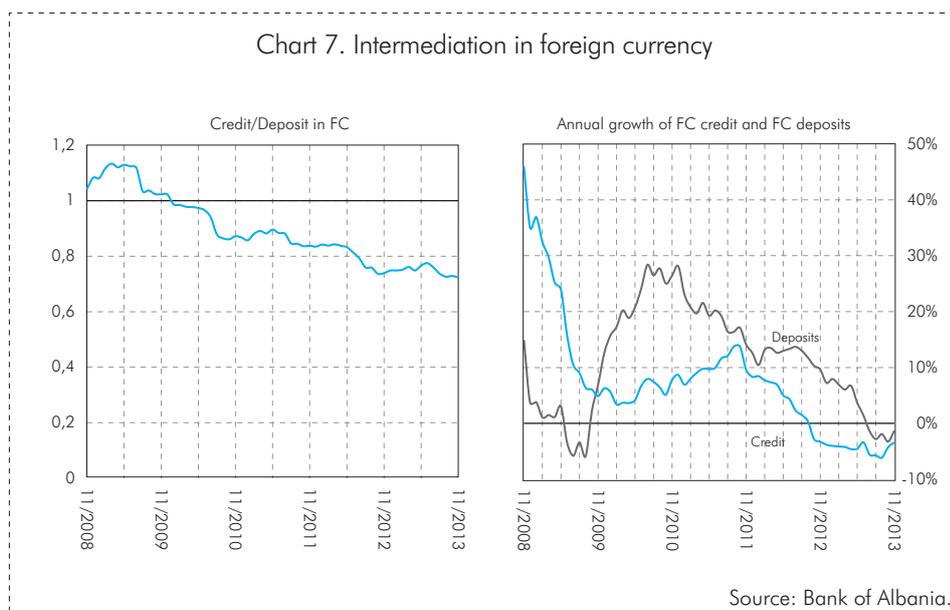
The intermediation cost in lek averaged 6.93 percentage points in October and November, up from the average of 6.73% in the previous two quarters. It was volatile across the months due to higher loan interest rate volatility. Against the background of weak new lending, interest rates were affected considerably by the preferential rates applied to specific loans. The intermediation cost increased y-o-y, both in average terms for the entire year and the last quarter of 2013, due to a rapid decrease in deposit rates, particularly in the second half of the year, following the easing monetary policy signals. The weighted average interest rate on lek deposits was 2.51% in November, down 1.31 percentage points from end-June and 2.02 percentage points, y-o-y. On the other hand, the key interest rate cut was not fully transmitted to the lending rates. They began to decrease in the second half of the year, down to 9.36% in November, from 10.73% at end-June.



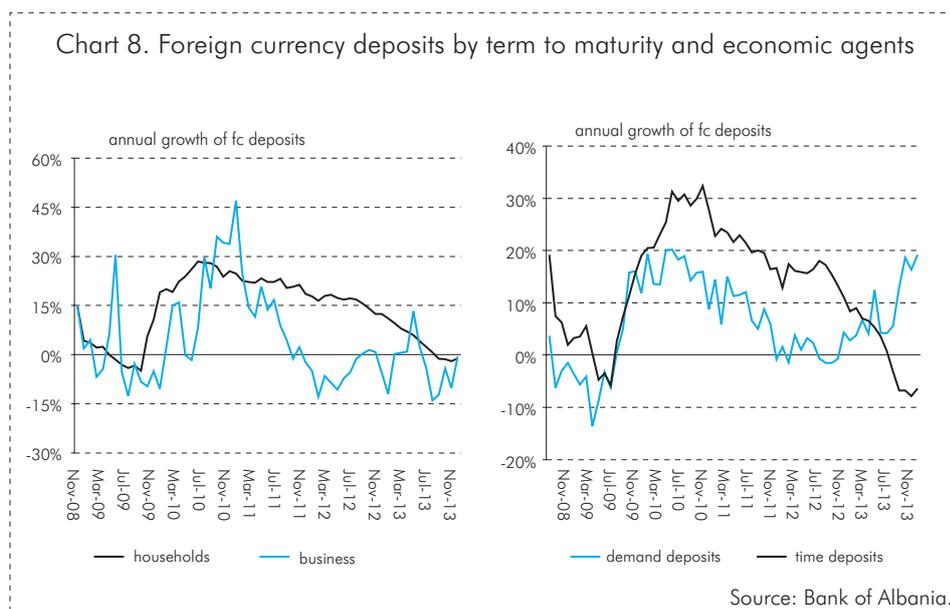
Interest rates on lek loans remained considerably higher than 12-month T-bill yields, which are generally used as a reference rate to price loans. The spread between lek loan rates and T-bill yields widened during September-November due to a rapid decrease in the yields. The 12-month T-bill yield was 3.41% in November, down by 1.2 percentage points and 1.6 percentage points from end-June 2013 and end-2012, respectively. The high lending rates reflected banks' cautious approach to lending and the higher perceived credit risk.

2.2 Intermediation in Foreign Currency

The intermediation ratio in foreign currency averaged 72.6% in October and November, remaining close to end-September but down by 3.7 percentage points from the second quarter's average. It dropped by 1.6 percentage points on a year earlier. The weak intermediation in foreign currency reflected the sluggish performance of foreign currency loans and deposits, with the former showing greater impact.



As at end-November, total foreign currency deposits were around 1.3% lower y-o-y, due to lower foreign inflows from abroad and weaker foreign currency lending to the economy. In October and November, foreign currency deposits fell around ALL 2.1 billion. This performance was attributable to the temporary decrease in household deposits in October, which were partly

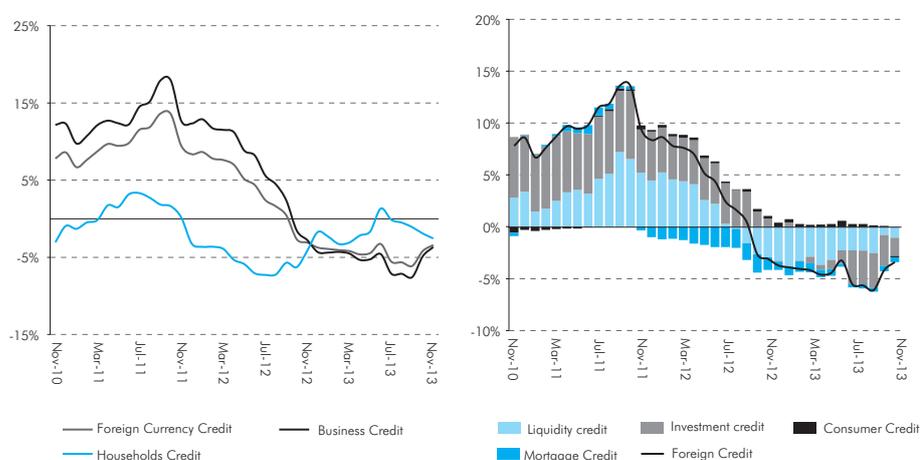


restored in November. Business deposits were volatile in the last two months, reflecting their economic activity. The maturity structure of foreign currency deposits pointed to their shift toward demand deposits, which was sharper in November.

Lending in foreign currency shrank 3.4% annually in November, improving slightly from the 6.1% shrinkage in the third quarter of 2013. The shrinking foreign currency loan portfolio reflected the weaker lending to businesses and households. The business foreign currency loan portfolio shrank 3.7% in annual terms. The moderate shrinkage pace compared to the third quarter of 2013 reflected the waning comparative base effect due to previous year's decrease in lending. In October and November, investment loans fell by around ALL 2 billion, whereas working capital loans increased moderately. The two portfolios were 2.4% and 0.9%, respectively, lower y-o-y.

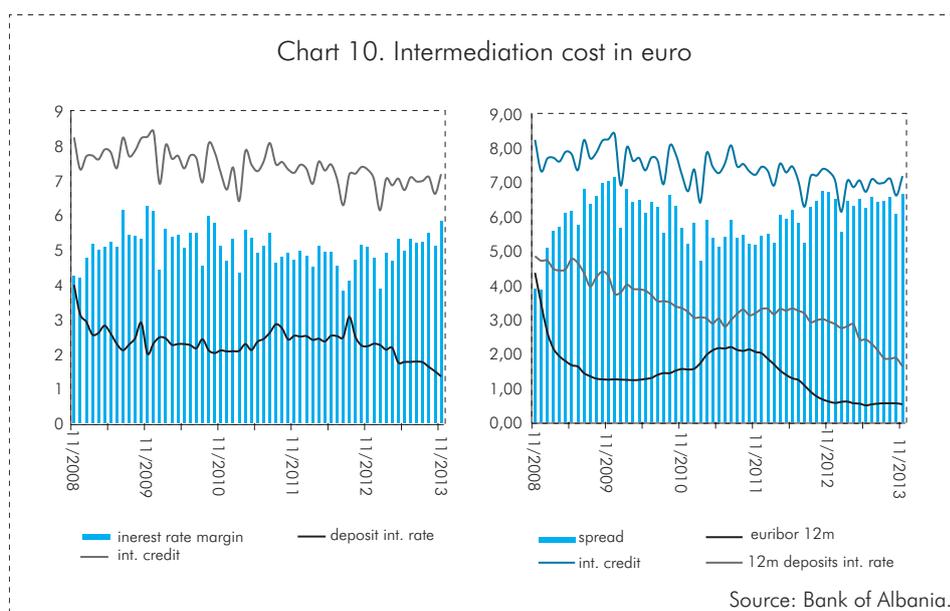
The structure of household foreign currency loans in the past two years has shown continuous decrease in home loans and high volatility of consumer loans. During October and November 2013, both household loan components saw decrease from the third quarter. This performance, coupled with demand-related concerns, reflected banks' policies to lend in the currency of the borrower's income. After the positive annual growth in the third quarter of 2013, in November, consumer loans in foreign currency were 4.7% lower y-o-y. In the meantime, the annual contraction in foreign currency mortgage loans maintained a similar rate at around 2.3%. The performance of consumer loan portfolio in foreign currency is closely linked to consumer needs to finance durable goods, whose demand may have been affected more than the one for short-term personal loans. The shrinking mortgage loans in foreign currency are not only an indication of the low preference for new home loans but also of the shift toward household borrowing in lek for real estate purposes.

Chart 9. Lending in foreign currency and contribution by purpose of use
(annual change in per cent)



Source: Bank of Albania.

For the third quarter in a row, the intermediation cost in euro⁶ increased in the last quarter of 2013. It averaged 5.47 percentage points, or 0.48 percentage point higher y-o-y. Similar to intermediation in lek, the reason behind the high intermediation margin in euro was the rapid decrease in the deposit rates versus the rigid loan rates. The weighted average interest rate on euro deposits was 1.35% in November, down by 0.42 percentage point from end-June and 0.87 percentage point from end-2012. This decrease was also reflected in the narrowing spread between these rates and euro rates in the international markets, which were stable during 2013. The 12-month euribor interest rate averaged 0.54% during the year under review.



Similar to the previous quarters, the interest rate on euro loans was volatile in the last quarter of 2013. It averaged 6.89%, dropping slightly from the previous two quarters, and down by 0.3 percentage point from end-2012. Similar to lek-denominated loans, the high interest rate on euro loans reflected banks' high perceived risk premium. It remained considerably higher than euribor interest rates. The spread between the two rates averaged 6.4 percentage points in the second half of 2013.

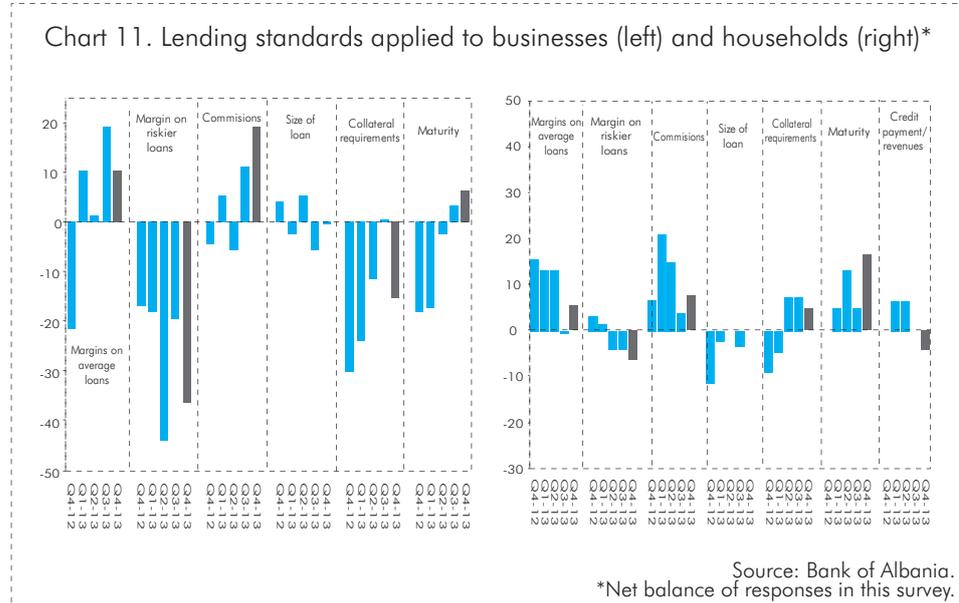
3. LENDING STANDARDS

In the last quarter of 2013, banks tightened the lending standards applied to businesses further, while easing those applied to households. Banks' tight policy was mainly applied through the increase in the interest rate on high risk loans, whereas interest rates on normal risk loans and commissions were lower. Banks eased most non-price criteria over the stated period.

After remaining unchanged in the third quarter of 2013, the lending standards applied to businesses were tightened in the last quarter, reflecting the concerns

⁶ Banks' foreign currency operations are dominated by those in euro, which account for more than 80% of total foreign currency operations.

over the macroeconomic situation in Albania, specific business sector-related concerns and the high level of non-performing loans. Among non-price criteria, banks tightened only the collateral requirement, while keeping the other non-price criteria neutral or slightly easing them.



Banks eased the lending standards on households in the last quarter of 2013. The easier standards were applied to non-price criteria, more specifically the collateral requirement and maximum loan maturity. However, the lower maximum level of instalment-to-income ratio had a tightening effect on the lending standards applied to households.

ECONOMIC AND MONETARY DEVELOPMENTS IN SOME OF ALBANIA'S TRADING PARTNERS, 2013 Q4

DORIANA LAMA, JONIDA BOLLANO, MEDVIN SHEHU
MONETARY POLICY DEPARTMENT, JANUARY 2014

EURO AREA

The euro area economy confirmed the positive signals noted in the second quarter, and continued to grow in the third quarter of 2013. Although the growth pace was somewhat lower (0.1% from 0.3%), the performance of many sectors, which are indicators of an economic recovery, increased the confidence of economic and financial agents for the performance of the economy in the future. The detailed analysis shows that most euro area countries experienced positive growth rates, whereas, the countries experiencing economic contraction showed deceleration of the negative growth rates. Preliminary and indirect data of the last months (retail sales, PMI index for purchases, new orders for export and index for production) endorse the idea that economic growth in the last quarter will confirm the positive signals, and will strengthen further in 2014. Survey results and business and consumer confidence indicators also confirm these expectations. Financial markets and monetary policy have been supporting and stimulating during this period. In the monthly statements, the Governor of the European Central Bank, Mario Draghi, has highlighted the readiness to maintain the key interest rate at lower levels, if the overall economic and financial conditions remain fragile. Inflation pursued a downward trajectory in the last months, thus confirming ECB experts' projections on contained inflationary pressures.

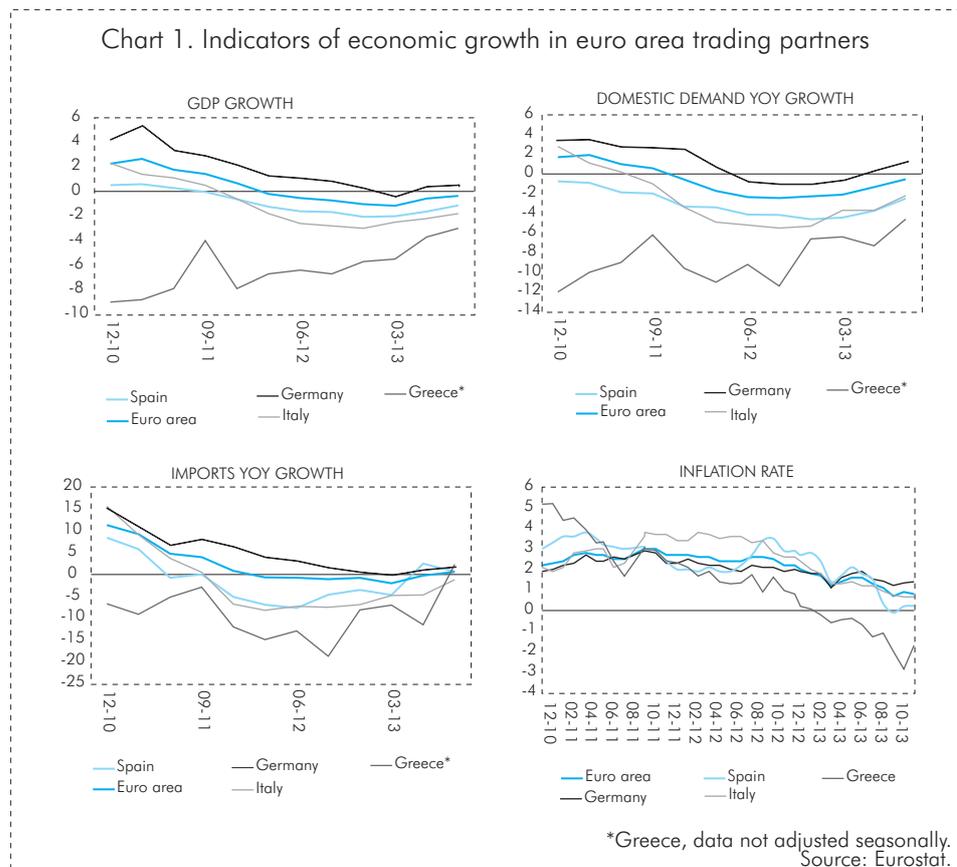
ITALY

Economic activity in Italy slowed down contraction in the third quarter, while GDP (0%) did not change compared to the second quarter. The economy fell, in annual terms, at 1.8%, from a 2.2% contraction in the previous quarter. The main factors providing a positive contribution were the recovery of trade and external demand, and the positive change in inventories, while consumption continues to have a negative impact on GDP. Indirect current data for November and December show recovery signals of the Italian economy in the last quarter. Preliminary data of GDP developments (industrial production, new orders in industry, business and consumers confidence) signal a recovery of economic activity, which is expected to be supported also by the foreign demand. Economic growth is expected to be in a positive territory in the last quarter of 2013 and to strengthen further in the first quarter of 2014. Data from foreign trade point to continuous improvement in 2013, and are expected to further increase during 2014, providing a positive contribution to the formation of GDP. Unlike other economic indicators with positive

signals, the labour market¹, in the period under review, confirmed the negative performance, thus increasing the uncertainties about the force and starting point of the recovery of consumption and overall economic activity. Consumer price index performed downward throughout the year, along with the production prices. In November and December, inflation fell at 0.7%, whereas headline inflation for 2013 stood at 1.3%, compared to 3.3% in 2012. Analysis of core inflation and ECB experts' forecasts point to contained inflationary pressures even in the forthcoming period.

GREECE

Greek economy continued to shrink in 2013 Q3, although the rate of -3.0% is lower compared to the two previous quarters (-3.7% and -5.5%, respectively), and it confirms that the contraction trend has come to an halt. Consumption, investments and domestic demand continued to fall during this quarter, albeit the contraction paces lowered down. The trade activity and tourism performed better, thus providing a positive contribution to GDP. Fiscal consolidation-related problems, notwithstanding being the main challenge and concern of the Hellenic Government and business agents, seem to have been addressed at the time that the Troika approved the loan instalments this year. Growth is expected to turn positive at the end of 2014, albeit it remains surrounded by



¹ Unemployment in November was up 0.2% from October to 12.7%. Youth unemployment rate stood at 41.6%, from 41.4% in October.

uncertainty. Adjustment of fiscal balances continued by making possible and less expensive the businesses access to capitals markets². Several indicators for October and November (industrial production, purchases and construction indices) continued to perform downward both in annual and monthly terms. Inflation pursued a downward trajectory during this period, recording negative values, both in annual and monthly terms. In 2013, Consumer Price Index went down, standing at - 0.9%, compared to 1.5% in the previous year.

GERMANY

German economy continued to record positive economic growth rates, albeit at lower paces compared to 2013 Q1 and Q2. The country's GDP grew by 0.3% in the third quarter, compared to the previous quarter, and 0.6% compared to the previous year. Economic activity was supported by a recovery of the domestic demand, while foreign demand still has not generated considerable incentives. Demand for imports remained unchanged from the previous quarter, whereas energy imports increased. Also, a higher share of imports from non-EU countries was noted. Consumer spending was encouraged by a sustainable situation in the labour market and growth of wages. Unemployment rate stood at 6.9% in December, and remains among the lowest rates. Data of November-December suggest a positive performance of the economy even in the fourth quarter. Confidence indicator (Ifo, November) pointed at the highest value since April 2012 and recorded an improvement in all sectors. The sustainable economic growth and an upward tendency of wages are reflected in higher prices. Annual inflation increased in December to 1.4%, from 1.3% in November³.

Table 1 Forecast for some indicators of Albania's economy partners, EC, November 2013

Changes in per cent	GDP		Inflation*		Unemployment		Exports		Imports	
	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014
Euro area	-0.4	1.1	1.5	1.5	12.2	12.2	1.3	4.2	-0.1	3.9
Italy	-1.8	0.7	1.5	1.6	12.2	12.4	0.1	3.6	-3.5	3.6
Greece	-4.0	0.6	-0.8	-0.4	27.0	26.0	2.5	4.6	-7.1	-1.3
Germany	0.5	1.7	1.7	1.7	5.4	5.3	0.3	4.6	1.0	5.7
Spain	-1.3	0.5	1.8	0.9	26.6	26.4	4.5	5.2	-1.9	1.5
China	7.5	7.4	2.7	3.0	4.1	4.1	4.1	6.0	4.4	6.3
Turkey	3.5	3.0	7.7	7.2	9.6	9.9	2.2	6.6	8.0	5.7

*For euro area countries, the Harmonised Index of Consumer Prices will change. For China, IMF forecast is used.

SPAIN

Gradual economic recovery in Spain continued in the third and fourth quarters of 2013, benefiting by a better financial climate in euro area. Economy grew by 0.1%, q-o-q, thus recording the first positive value after nine quarters. In annual terms, GDP fell at 1.1%, from 1.6% a quarter earlier. Foreign demand, albeit with a lower contribution than in the previous

² In November, Moody's upgraded Greece by two notches, from single C to Caa3.

³ Inflation based on the domestic index of consumer prices.

quarter, contributed positively to annual growth. At the same time, private consumption, notwithstanding the negative contribution, improved due to the increase of wages in real terms and of consumer's confidence. Consumer Confidence Index rose by 11 points in the third quarter, reflecting the outlook for a better current and expected economic situation.

Annual inflation fell to 0.3% in September and 0.2% in December. Along with the decrease in unprocessed food prices, this performance shows the fading out effect of increases of VAT and of some administered prices in the previous year. Unemployment rate stabilised at 26.7% in October and November, while the number of unemployed was down.

Economic data for Spain show stability and recovery signs of the economy at the end of 2013. Industrial production was up by 2.6% in November, the highest value since February 2011. In December 2013, Economic Sentiment Indicator recorded the highest value in the last six years. During 2014, the improvement of confidence indicators is expected to lead to a recovery of the domestic demand of private sector.

Fitch and S&P reviewed the outlook for Spain in November. They rated Spain as "stable", from "negative", without, however, changing the debt rating. Fiscal consolidation, banking system restructuring and diversification of economic sectors have affected positively the new outlook. At the beginning of January 2014, Spain's 10-year bond spread against the German one fell below 200 basis points, for the first time since 2011.

CHINA

In 2013 Q4, China's GDP grew 7.7% in annual terms, from 7.8% in 2013 Q3. The economic activity expanded averagely 7.7% in 2013, being one the lowest values since 1999. Increase in exports and fixed investments, and the improved domestic demand remained the main supporting factors to economic activity during this period. Also, agricultural sector provides positive data, while employment rate has remained the same. In December, domestic inflation stood at 2.5%, considerably below the 3.5% target.

Experts assess that Chinese economic growth will lower down its pace to 7.7% in 2014. The reforms package implemented recently to limit credit growth, while aiming at generating a more stable increase in time, is expected to weaken the domestic demand in the short run.

TURKEY

In Turkey, real GDP growth in the third quarter of year was higher than the forecasts, recording the annual rate of 4.4%. Similar to the second quarter, GDP growth was based on the domestic demand, whose share to total growth stood at 4.7 percentage points. Net exports contribution to economic activity

expansion was negative, 2.2 percentage points, for the third successive quarter, compared to -3.4 percentage points and -0.6 percentage points, respectively, in the first and second quarters. Indirect indicators show an increase of the domestic demand in October and November, although at moderated paces. Notwithstanding the political tensions at home during the last months, business confidence indicator remained optimistic. In December, annual inflation stood at 7.4%, from 7.3% in November, thus fully transmitting the weakening effect of the Turkish Lira in May-October of 2013.⁴ In order to protect the domestic currency and control inflation the Central Bank of the Republic of Turkey (CBRT), intervened continuously in the foreign exchange market and kept its reference rate unchanged. The depreciation of the Turkish Lira in real annual terms by about 9.6% in December, urged the CBRT to sell about EUR 2.5 billion only in the last week of the year.

FYROM

In FYROM, economic growth in the third quarter stood at 3.3% in annual terms, recording one of the highest rates among South East Europe countries. Activity expansion in construction by 33% on annual basis, mainly based on public investments, played the main role on GDP growth in the third quarter. In addition, services sharing 65% of GDP, grew in this quarter (annual growth by 1.5%, from 0.9% in the second quarter), suggesting an increase in the domestic demand. Agricultural production provided a positive contribution to the overall growth. It increased by 1.1% (y-o-y), compared to the decrease by 0.4 % in annual terms and a zero contribution in 2013 Q2. Preliminary forecasts show a growth of the domestic economy, averagely by 2.1% in 2013, recording the highest rate since 2008.

Annual inflation in December was 1.4%, or 0.3 percentage points higher than the rate recorded in November. The increase in food and fuels prices, in line with their performance in international markets, were the primary factors contributing to higher inflationary pressures at home.

SERBIA

After a sluggish second quarter, Serbia's GDP accelerated considerably in annual terms by 3.7%, in the third quarter. Thus, along with the expansion of the economic activity, the effect of a low comparative base for the same period of 2012 was another explanatory factor of the current rate. In the context of a weak domestic demand, the Serbian economy performance during the quarter under review was mainly generated by the positive performance of exports (+26.7% y-o-y). The considerable improvement of industry (10% y-o-y) was mainly supported by the high growth of energy production and the expansion of production activity by 8.7% (y-o-y), which reflects a recovery of competitiveness in REER terms⁵. High inflation rates, recorded till August 2013, resulted

⁴ Turkish Lira depreciated by 11.6% in real effective terms during this period.

⁵ REER index depreciated by 8.3% during the last four years.

considerably down in December (2.2%), reflecting a continuing downtrend in food prices. In the following quarter, the National Bank of Serbia expects a moderate increase of annual inflation and its stabilisation at about 4%, due to the increase in administered and VAT prices, from 8% to 10%. While, the low production costs of food and the weak aggregate demand will continue to provide low inflationary pressures.

ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY, 2013 Q3

EGLENT KIKA, MERITA BOKA, OLTİ MITRE
MONETARY POLICY DEPARTMENT, JANUARY 2014

1. BALANCE OF PAYMENTS HIGHLIGHTS¹

A further reduction in trade deficit and a positive net income balance were the main drivers of the annual decline in the current account deficit for 2013 Q3. Higher demand by our traditional trading partners and penetration of Albanian exports into new markets helped maintain the upward trend of goods exports during the quarter. At the same time, the income account recorded a surplus of EUR 35.3 million for the first time after six consecutive quarters with a negative net balance. On the other hand, the coinciding of the tourism season with the post-election period was the main driver behind an accelerated annual contraction in the net positive balance of the services account. The maturation of the immigration cycle and the unfavourable labour market conditions in the host countries where Albanian emigrants reside (particularly in Italy and Greece) led to a continuous worsening of the balance of net current transfers. In 2013 Q3, the current account deficit dropped by about 21.1% in annual terms. Regardless of an accelerated increase in Foreign Direct Investments (FDIs) into Albania, net financial flows in the capital and financial account contracted by about 54.4% in 2013 Q3 due to the negative registered balance (by EUR 204.7 million) of the other investment account. The net flows in the capital and financial account managed to finance about 41.5% of the current account deficit in 2013 Q3.

Table 1: Balance of Payments indicators

	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3
Current account (in EUR million)	-290.4	-251.8	-242.8	-236.3	-224.7	-296.9	-191.6
Annual change	26.7%	-23.9%	-6.2%	-35.5%	-22.6%	17.9%	-21.1%
/ GDP	-13.8%	-10.0%	-9.6%	-9.9%	-10.2%	-11.5%	-7.8%
Trade balance	-465.3	-475.5	-540.5	-517.8	-332.4	-397.6	-437.6
Exports, f.o.b.	325.8	394.2	402.5	403.1	381.6	458.8	454.7
Imports, f.o.b.	-791.2	-869.7	-943.0	-920.9	-714.0	-856.4	-892.3
Balance of services	8.5	26.2	132.6	27.9	-43.9	-37.3	46.6
Credit	293.8	381.1	578.1	402.1	283.6	346.9	524.7
Debit	-285.4	-354.9	-445.4	-374.2	-327.5	-384.2	-478.1
Travel services - export	185.1	246.4	445.3	268.4	171.2	227.3	361.7
Travel services - import	-180.8	-240.1	-325.6	-256.1	-205.8	-258.7	-335.7
Travel services - net	4.3	6.2	119.7	12.3	-34.6	-31.5	26.1
Balance of income	-40.4	-27.7	-20.6	-0.2	-11.3	-23.7	35.3
Credit	48.2	43.0	57.8	55.3	42.2	47.4	53.1
Debit	-88.6	-70.7	-78.5	-55.5	-53.5	-71.1	-17.8
Net FDI income	-54.8	-29.8	-42.0	-26.2	-35.1	-47.6	4.9
Current transfers	206.8	225.3	185.8	253.9	163.0	161.7	164.1
Credit	243.5	265.2	224.1	285.8	195.7	193.8	198.1

¹ The latest data on the balance of payments are of 2013 Q3.

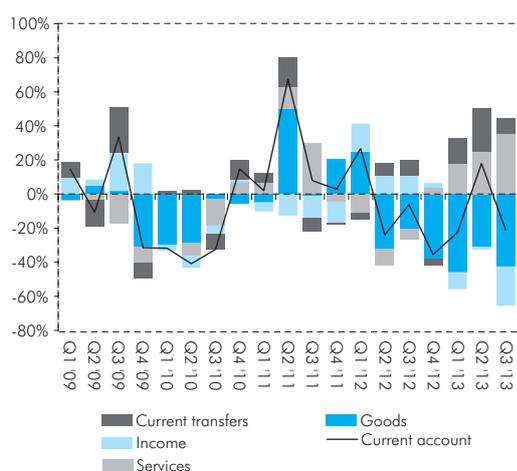
	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3
Debit	-36.7	-39.9	-38.4	-31.9	-32.6	-32.0	-34.0
Net remittances	166.5	171.6	140.8	196.3	122.3	104.4	119.0
Capital and financial account (in EUR million)	258.3	185.5	174.4	249.1	208.5	338.5	79.5
Annual change	15.1%	-21.3%	-25.2%	-12.5%	-19.3%	82.5%	-54.4%
/ GDP	12.3%	7.4%	6.9%	10.4%	9.5%	13.1%	3.2%
Capital account	12.9	43.0	9.8	15.6	9.7	4.8	14.8
Financial account	245.3	142.5	164.6	233.5	198.9	333.7	64.7
A. Liabilities	307.5	277.7	378.4	224.4	229.3	322.3	333.6
FDI	205.5	191.1	164.5	183.7	197.0	249.3	265.6
Portfolio investment	14.5	19.6	7.8	21.0	21.8	21.9	21.8
Other investment	87.5	67.0	206.0	19.7	10.5	51.1	46.1
Currency and deposits	69.1	34.8	164.8	3.7	6.1	21.9	41.2
B. Assets	-62.2	-135.2	-213.8	9.2	-30.4	11.4	-268.9
FDI	-2.7	-0.3	-7.7	-7.0	-2.1	-11.7	-7.5
Portfolio investment	-61.0	9.9	-26.4	-10.0	-28.9	-106.5	-10.5
Other investment	1.5	-144.8	-179.7	26.2	0.6	129.6	-250.9
Currency and deposits	-11.0	-133.2	-178.2	67.0	-4.0	92.4	-278.5
Errors and omissions	35.4	73.8	158.0	-36.0	-7.5	44.8	146.5
Reserve assets	-3.2	-7.5	-89.7	23.1	23.6	-86.4	-34.5

Source: Bank of Albania.

1.1 CURRENT ACCOUNT

Albania recorded a net current account deficit of EUR 191.6 million in 2013 Q3. After expanding in Q2, the current account deficit returned to its contracting trend in Q3, down by about 21.1% in annual terms and estimated at about 7.8% of nominal GDP² or 1.8 percentage points lower than in the same period a year earlier. Excluding income from official transfers, the current account deficit was estimated at about 8.0% of nominal GDP in Q3, declining from about 9.9% in the same period a year earlier.

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



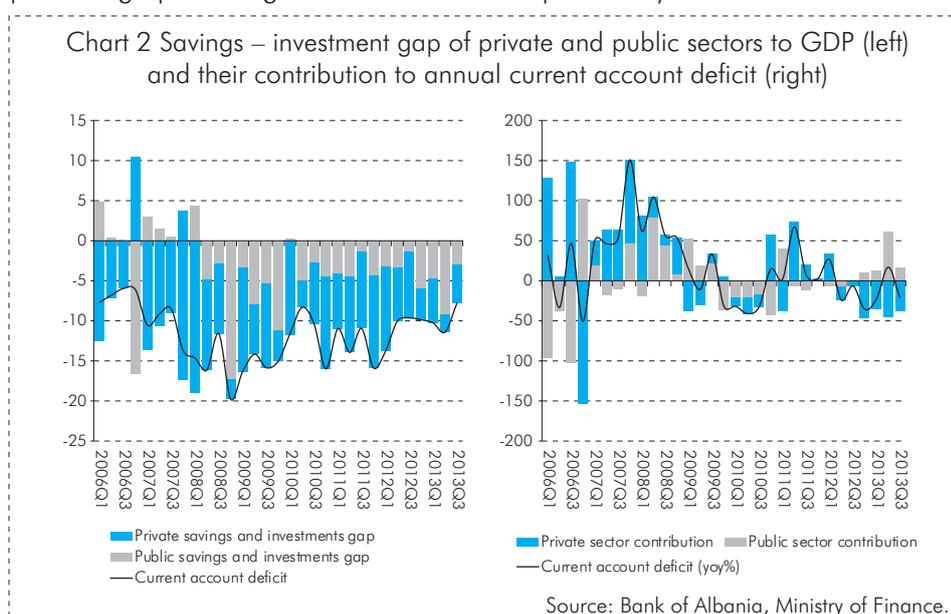
Source: Bank of Albania.

The current account dynamics in 2013 Q3 continued to be heavily influenced by the balance of trade in goods and services. In annual terms, the trade deficit narrowed by about 19.0%, while the net services account balance contracted by about 64.9% compared to the same period of a year earlier. The combined position of both accounts led to a contraction of the net exports deficit for 2013 Q3, by about 4.1% in annual nominal terms. Improvement in the balance of the income account contributed to a narrowing in the current account deficit, in annual terms. The decline in current transfers negatively affected the total current account balance.

Analysis of the current account deficit for the first three quarters of 2013 based on a national savings and investments gap approach confirm the public

² Nominal GDP for 2003 - 2011 as published by INSTAT. The quarterly distribution is based on quarterly real GDP weights. Bank of Albania's Monetary Policy Department projections are used for 2012 and 2013.

sector's substantial impact on the current account deficit formation.³ Thus, the gap between public savings and investments expanded sharply in annual terms, during the first three quarters of 2013, mainly due to lower public savings. On the other hand, the gap between private savings and investment halved in annual terms, and the share of private sector in the current account deficit averaged at around 44.7%. Though the public sector contributed to deepening of the annual current account deficit, the accelerated contraction in the private sector gap led to a lower current account deficit in annual terms. In 2013 Q3, the public sector's contribution to year-on-year contraction of the current-account deficit was positive (about 16.6 percentage points), while the private sector's was negative (about 37.7 percentage points). Albania's degree of trade openness was valued at 95.5% in 2013 Q3, about 1.6 percentage points higher than in the same period a year earlier.



Albania's trade openness was valued at 95.5% in 2013 Q3, about 1.6 percentage points higher than in the same period a year earlier.

In 2013 Q3, net financial flows from the combined position of income account, current transfers and services account fell by 17.4% in annual terms. As a result, the total net flows of these three accounts financed about 56.2% of the trade deficit for this period, or about 1.1 percentage points lower than in the same period a year earlier.

The external sector of the economy contributed negatively to the aggregate demand in 2013 Q3. The real net exports deficit widened by about 2.5% in annual terms⁴,

³ The national savings - investment gap model is an alternative measurement equivalent to the net current account balance for a certain period. Thus, the realised net current account balance is equal to the sum of the public and private savings - investment gap in period t .

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

⁴ We use the Unit Value Index, as measured and published by INSTAT, to translate nominal values of imports and exports of goods from to real terms. As this index is not yet available for 2013 Q3, we estimate it through modelling the behaviour on a historical basis of the unit value index for imports and exports (ARMA). To deflate nominal imports and exports of services, we use the Consumer Price Index and the Harmonised Consumer Price Index of services, as measured by the Bank of Albania and Eurostat, respectively.

mainly due to a higher unit price for exports. Real exports and imports of goods and services dropped by 3.5% and 1.6%, respectively, in annual terms.

Other current account items

Albania's June 2013 parliamentary elections and the post-election period coincided with the tourism season. This influenced greatly the net financial inflows from the services account. For the period under review, this account posted a net surplus of EUR 46.6 million, down by about 64.9% from the same period a year earlier. Foreign-currency flows accounted for about 1.9% of nominal GDP, down from 5.3% in the same quarter a year earlier. The year-

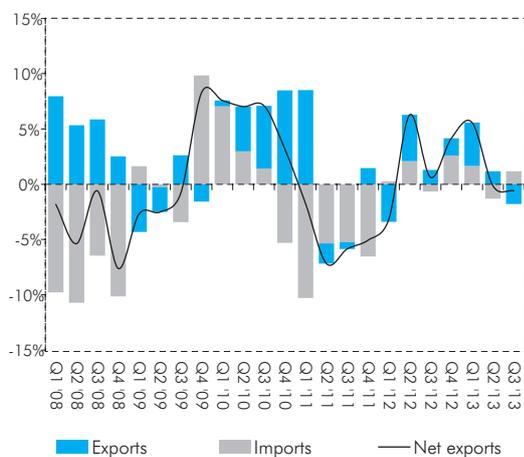
on-year contraction in foreign-currency inflows by about 9.2% and increase in foreign-currency outflows by about 7.3% determined the negative contribution (on the widening side) of the services account to the total current account balance.

The net balance of the services account was significantly affected by the performance of (personal and business) travel services. The decline in foreign inflows from travel services of non-residents for tourism and business purposes in Albania, and the increase in foreign outflows in the form of expenses of Albanian residents for personal travel services abroad, led to a lower surplus of this services account sub-item, down to about EUR 26.1 million from EUR 119.7, a year earlier.

In 2013 Q3, transport services made a positive impact on the services account. Insurance services continued to contribute negatively to the services account, almost at the same level of contribution as a year earlier. Other services (the sub-item including communication, construction, government, financial, computer, and information services) registered a positive balance of about EUR 30.1 million, remaining at similar levels to a year earlier.

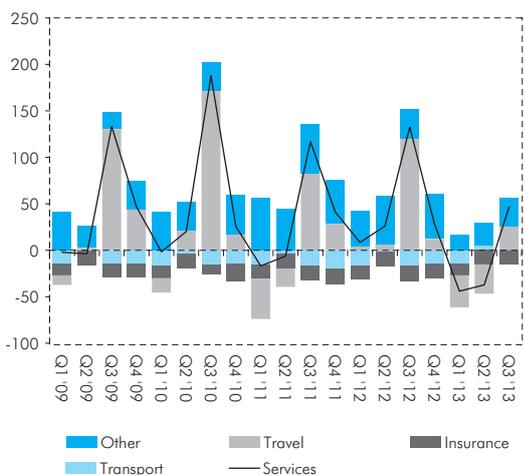
After a long period of negative performance, the net balance of the income account was positive in 2013 Q3. Net flows in the income account recorded a surplus of about EUR 35.3 million, from a deficit of EUR 20.6 million in the same period a year before. During the period under analysis, the registered direction of this account's was determined by the considerable decelerated repatriation of investment income. Even though slightly lower

Chart 3 Contribution of net exports to real GDP (in percentage points)



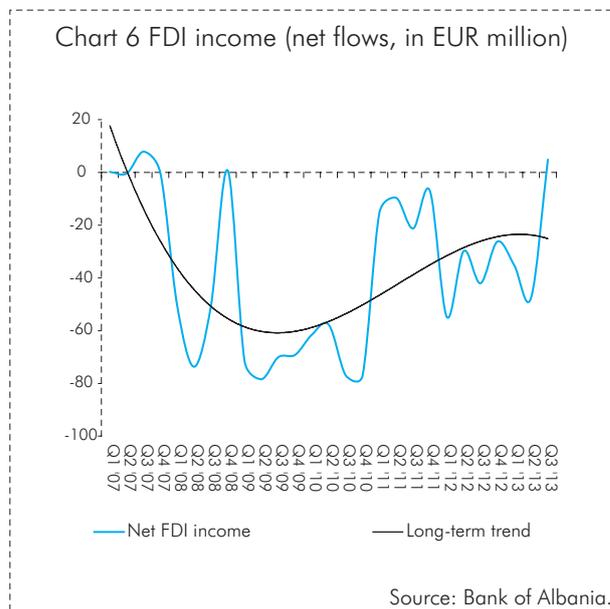
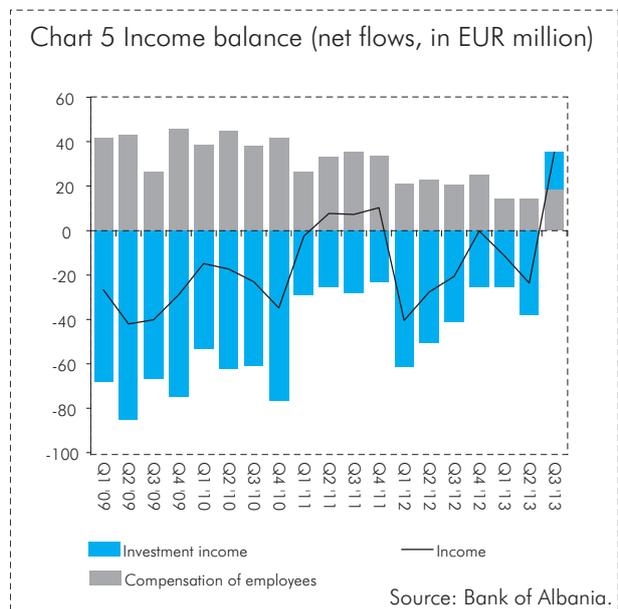
Source: Bank of Albania.

Chart 4 Balance of services (net flows, in EUR million)



Source: Bank of Albania.

than a year earlier, income from the compensation of employees contributed positively by about EUR 18.4 million to the total balance of this account.

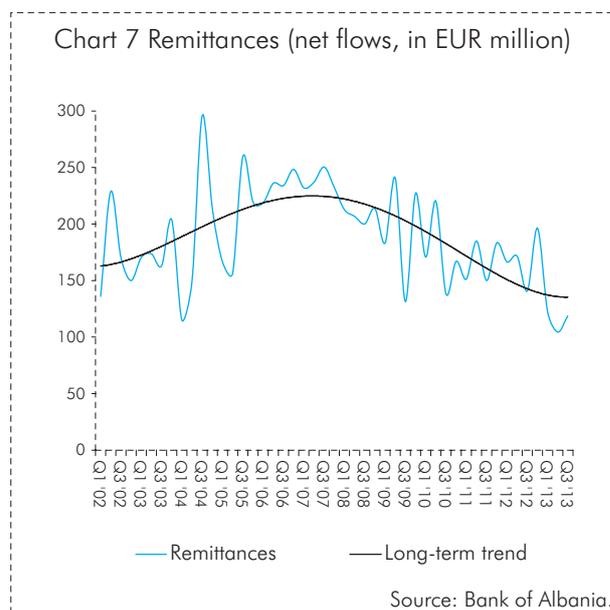


The investment income improved significantly in 2013 Q3, due to positive developments in its three components. The FDI related income account recorded a surplus of about EUR 4.9 million, from a deficit of EUR 42.0 million in the same period a year earlier. Switching from a deficit to a surplus was due to significantly lower outflows (only EUR 1.5 million from EUR 47.2 million a year earlier), the lowest recorded level since 2009.

The balance of the portfolio investment income was positive for the third consecutive quarter, at about EUR 4.1 million. The balance of net other investment income was also positive for the fifth consecutive quarter, mainly due to lower net interest payments on the private and public debt. These payments amounted to EUR 6.9 million for the period under review.

The net current transfers account recorded a positive balance of EUR 164.1 million in 2013 Q3, down by about 11.6% in annual terms.

Since early 2013, the financial flows in the current transfers account have continued to shrink at an accelerated rate. Decline in net remittances by about 15.5% in annual terms was the main driver behind the registered performance. In 2013 Q3, they were estimated at about 4.8% of nominal GDP, down by 0.7 percentage points from the same quarter of the previous year. Developments in remittances over the last three years confirm their

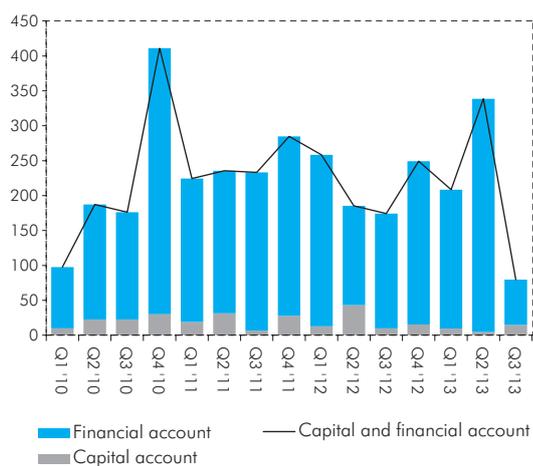


declining trend and the maturation of the emigration cycle. Concomitantly, the ongoing macroeconomic difficulties and labour market weaknesses in countries that have a high concentration of Albanian emigrants are estimated to be equally important defining factors.

1.2 CAPITAL AND FINANCIAL ACCOUNT

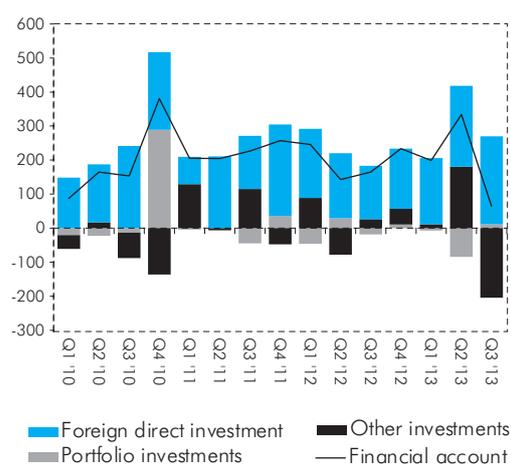
Net flows in the capital and financial account registered a positive balance of EUR 79.5 million in 2013 Q3, financing around 41.5% of the current account deficit. Capital and financial flows fell substantially by about 54.4% from the same period of the previous year and were estimated at about 3.2% of nominal GDP. The year-on-year fall in foreign-currency flows in both accounts was mainly due to the 60.7% decline of net flows in the financial account. As a percentage of nominal GDP, the financial account was about 2.6% or 3.9 percentage points lower than in 2012 Q3. The net flows in the capital account registered a surplus of EUR 14.8 million in 2013 Q3.

Chart 8 Capital and financial account
(net flows, in EUR million)



Source: Bank of Albania.

Chart 9 Financial account components
(net flows, in EUR million)



Source: Bank of Albania.

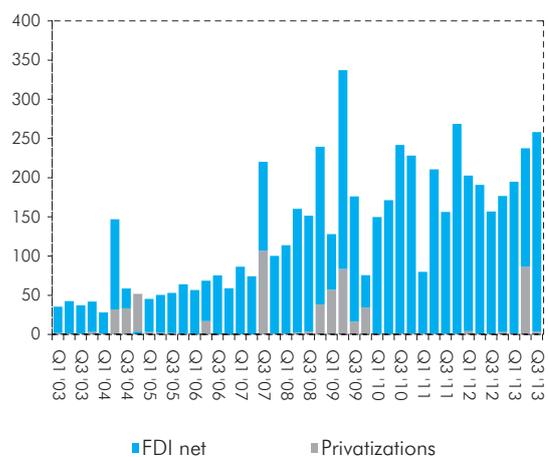
In 2013 Q3, the flows in the financial account contracted by 60.7% in annual terms. Financial liabilities to non-residents fell by 11.8% in annual terms, mainly due to lower inflows of non-residents' investments in the form of currency and deposits in the domestic banking system. Albanian assets invested abroad increased by EUR 268.9 million in 2013 Q3, recording a 56.2% annual growth in investment in the form of currency and deposits. Its direct impact on the financial account was smoothed slightly due to positive developments in FDIs and portfolio investments.

Net FDIs increased by about 64.6% compared to 2012 Q3. This change was due to higher liabilities at about 61.5% in annual terms in the form of FDI inflows.

By investment instrument breakdown, FDI inflows in the form of shares and reinvested earnings increased by about 67.7% in annual terms. Other capital inflows were valued at about EUR 4.5 million, down from EUR 8.8 million in the same period a year earlier. During the quarter under review, the flow of privatisation receipts⁵ made a modest contribution to total FDIs. Excluding privatisation receipts from FDI inflows, FDIs increased by about 63.4% in annual terms in 2013 Q3.

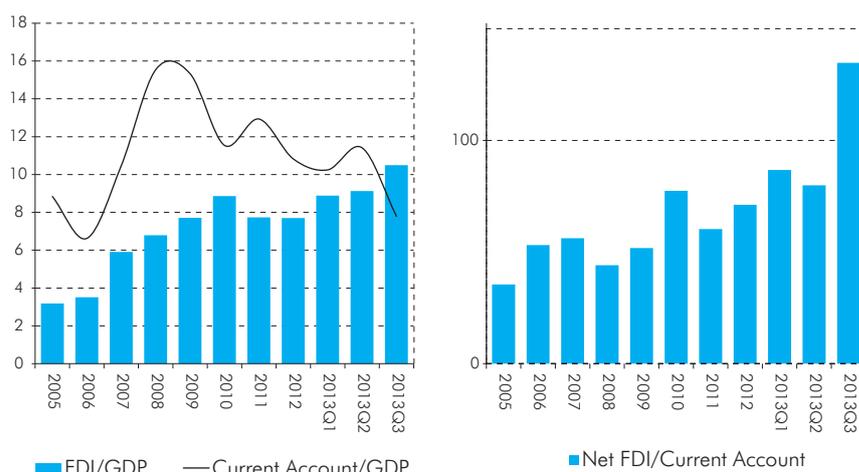
FDI performance over a longer run reveals clearly their rising importance in financing Albania's current account deficits. Given that FDIs represent a stable financial flow that does not generate a direct increase in the gross external debt and that contributes directly to higher productivity and indirectly to dissemination of new technological and productive know-how, such a development is welcomed for Albania's long term economic progress and current account sustainability. In terms of financing the current account deficit, excluding years 2008 and 2009, when the high current account deficit was financed mainly from debt-creating flows, the ratio of net FDIs to the current account deficit has maintained an upward trend. This positive performance continued in 2013, influenced also by FDI-related privatisation operations of public assets. For 2013 Q3, the ratio of net FDI flows to current account deficit was 138.7%, thus managing to completely finance its deficit.

Chart 10 FDI components (flows, in EUR million)



Source: Bank of Albania.

Chart 11 Current account and net FDIs to GDP (left) and current account deficit-financing ratio by FDIs (right)



Source: Bank of Albania.

⁵ According to data from the Ministry of Finance http://www.minfin.gov.al/minfin/Statistika_Fiskale_Mujore_1675_1.php

In 2013 Q3, net portfolio investments recorded a positive balance of EUR 11.3 million. Residents invested about EUR 10.5 million in debt securities abroad. Portfolio investment inflows increased substantially from the same period a year earlier, mainly in debt securities. During the period under review, non-resident portfolio investments were EUR 21.8 million, up from EUR 7.8 million in the same period a year earlier.

In 2013 Q3, the net other investment account contributed by about EUR 204.7 million to the increase in residents' assets invested abroad. In this account, Albanian assets invested abroad increased by about EUR 250.9 million, up from EUR 179.7 million in the same period a year earlier. This change was due to higher investments in the form of currency and deposits. In quantitative terms, the banking system invested about EUR 278.5 million in the form of currency and deposits. Private and public borrowing registered a negative balance of EUR 3.7 million in Q3 (the negative value shows that repayments exceeded new borrowing in Q3), from the positive value of EUR 28.5 million in the same period a year earlier. The decline in total borrowing was determined by higher private sector principal payments. Overall, debt payments (both private and public) lowered Albania's liabilities by about EUR 30.6 million in 2013 Q3.

International reserve assets increased by about EUR 34.5 million at the end of 2013 Q3. As of end-September 2013, the international reserve stock was EUR 2,030.2 million, sufficient to cover 4.7 months of imports of goods and services.

GROSS EXTERNAL DEBT ANALYSIS 2013 Q3

EGLENT KIKA, MERITA BOKA, OLTİ MITRE
MONETARY POLICY DEPARTMENT, FEBRUARY 2014

EXECUTIVE SUMMARY

- At the end of the third quarter of 2013, the stock of gross external debt was estimated at 5.5 billion Euros, around 56.8% of nominal GDP.
- The sectoral allocation of the external debt stock depicts a stable profile, where the general government accounts for about 42.5%, the banking system 20.3%, other sectors 18.6%, FDIs 17.1% and the monetary authority 1.5%.
- Distributed by investment instruments, "other investments" dominate the stock of external debt (about 70.9% of the total stock).
- By maturity, long-term debt represents about 78.6% of the stock of external debt.
- By currency, 56% of the external debt is denominated in euro and 13% of the total stock of debt is denominated in US dollar.
- External debt sustainability, measured by various indicators of long-term repayment capacity, indicates a weakened position since 2008.
- Since the fourth quarter of 2011, the ratio of the performance of long-term gross external debt to the export of goods and services is higher than the optimal hypothetical threshold of 150%.
- Indicators of liquidity adequacy necessary to fulfil immediate external debt obligations delineate that a low and stable level of financial resources is allocated to the amortization of short-term external debt.
- Neither net foreign debt, nor the ratio of foreign currency reserves to short-term external debt, indicate pressures originating from expected payments used to service foreign debt.
- However, an upward trend is observed in the necessary funds used to meet external debt servicing obligations.

1. DETAILED ANALYSIS OF THE GROSS EXTERNAL DEBT

At the end 2013 Q3, Albania's stock of gross external debt was EUR 5,472.6 million. In value, it increased by about EUR 59.7 million compared to the previous quarter and EUR 230 million compared to the stock registered at the end of 2012 Q3. This performance represents an annual expansion of about 4.4%, reaching a ratio of around 56.8% to nominal GDP. This ratio was about 1.3 percentage points higher than that recorded during the same period of a year earlier.¹

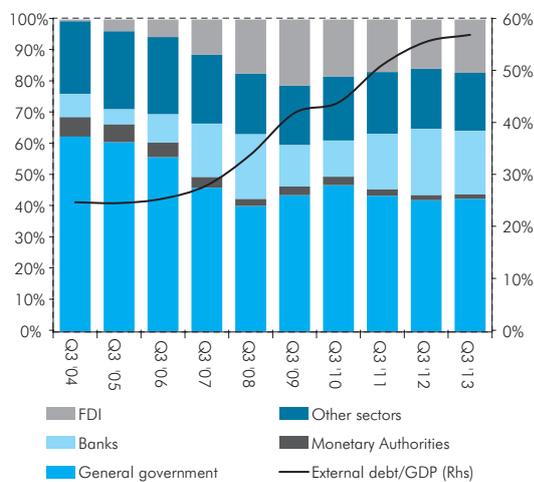
¹ Four quarters rolling sum of Nominal Gross Domestic Product.

The sector with the largest share in the total stock of external debt is the general government. At the end of 2013 Q3, the stock of general government debt was estimated at EUR 2,327.6 million, approximately 24.2% of the nominal GDP. Compared to 2012 Q3, the share of general government debt to the total external debt stock rose by 0.5 percentage points.

The gross external debt stock of the banking system at the end of 2013 Q3 amounted to EUR 1.11 billion, up by 1.4 million compared to 2012 Q3. External debt of other sectors summed up to about EUR 1.02 billion, increasing approximately EUR 5.0 million from 2012 Q3. Finally, the stock of external debt accumulated as a result of foreign direct investment during the considered period was estimated at around EUR 937.3 million Euros, up by EUR 57.4 million compared to 2012 Q3.

For the period under analysis, approximately 61.5% of the stock of external debt (excluding direct investments - loans among companies) is estimated to be long-term debt mainly in the form of loans. Short-term debt is estimated at about 21.4% of the total stock, mainly taken in the form of currency and deposits of the banking sector. The general government sector and the monetary authority only hold long-term debt, whereas the banking sector and other sectors possess a diversified portfolio consisting of long and short-term debt.

Chart 1 Total gross external debt breakdown by sectors



Source: Bank of Albania.

a) Gross External Debt by Economic Sectors²

The stock of external debt represents a largely consistent profile, where the general government has historically occupied the largest share. At the end of 2013 Q3, the general government³ held approximately 42.5% of the total outstanding external debt. The rest was distributed between: the banking system⁴ 20.3%, other sectors of the economy⁵ 18.6%, FDIs⁶ 17.1% and the monetary authority⁷ 1.5%.

The sector with the largest share to the total stock of external debt is the general government. During the past three years, the share of general

² Sectors of the economy refer to the general government, banking sector, other sectors of the economy, foreign direct investments, and monetary authority.

³ General government includes both central and local government

⁴ It includes liabilities of the banking system.

⁵ Included in the stock of debt classified under other sectors are obligations of other private companies or of public non-financial corporations (which include debt guaranteed by the government), non-bank financial institutions and obligations of individuals.

⁶ According to the international methodology, debt obligations associated with direct investments should be separated from other debt obligations. The table of gross external debt of Albania depicts these obligations separately, consisting in obligations of domestic banks with foreign capital to their parent banks. Foreign direct investment debt in other sectors is not yet possible to collect.

⁷ According to the international standard classification, data on external debt of this group include external liabilities of the Bank of Albania. In accordance with the BPM5, the stock of liabilities and loans from IMF are also included in this sector

government debt to total debt stock was estimated to be 44.0% on average, fluctuating within the range of 42.0%-47.6%. At the end of 2013 Q3, the stock of external debt of the general government recorded a value of EUR 2.3 billion, up by about 123.3 million compared to 2012 Q3. The general government owns only long-term debt, mainly in the form of long-term loans, notes and bonds.

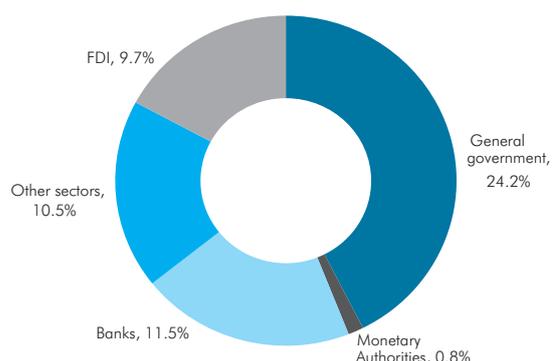
The sector with the second largest share of the total debt stock is the banking system. After a significant rise in the stock of debt of the banking system during 2011 and 2012, the first three quarters of 2013 marked a significant slowdown of its growth rate. At the end of 2013 Q3, the external debt of the banking system resulted in about 20.3% of the total debt stock, amounting to 11.5% of nominal GDP. The maturity breakdown in the banking sector depicted a clear orientation towards short-term debt. At the end of 2013 Q3, short-term debt held by the banking system represented about 90.9% of total outstanding debt of the whole sector.

At the end of 2013 Q3, the debt stock of other sectors of the economy amounted to about 18.6% of the total stock of gross external debt. After significantly increasing during the previous two years, these sectors' debt slowed down markedly in 2013. The debt stock of other sectors of the economy remains at around 10.5% of nominal GDP. By maturity, the other sectors debt stock was split into 84.1% long-term debt and 15.9% short-term debt.

The stock of foreign debt in the form of foreign direct investments- intercompany loans represented approximately 17.1% of the total external debt stock and a ratio of 9.7% to the nominal GDP at the end of 2013 Q3.

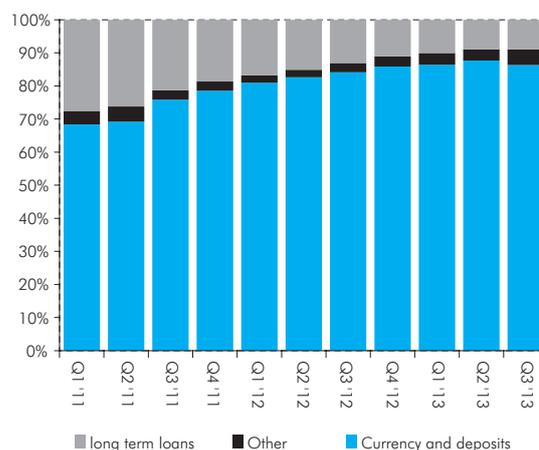
The stock of gross foreign debt of the monetary authority accounted for the smallest share of the total stock compared to other sectors. Over the years, obligations in the form of debt of the monetary authority continued to contract and at the end 2013 Q3, they represented about 1.5% of the total stock or approximately 0.8% of the nominal GDP. The monetary authority holds only long-term debt, mainly in the form of debt obligations and other long-term loans.

Chart 2 Gross external debt by sector, % of GDP at the end of 2013 Q3



Source: Bank of Albania.

Chart 3 Banking system's external debt by instruments

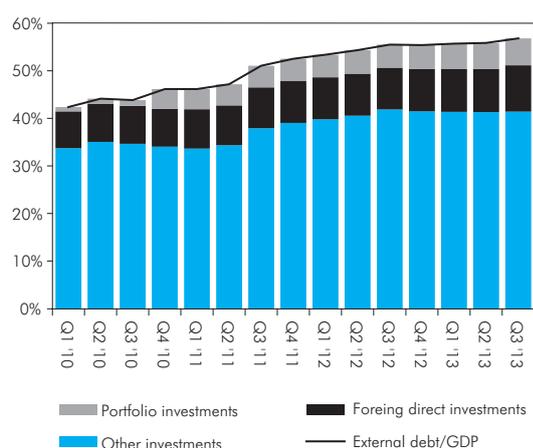


Source: Bank of Albania.

b) Gross external debt stock by instrument breakdown

Gross external debt stock by instrument breakdown presents a stable profile with slight changes over time. Investments classified under other investments⁸ amount to about 72.9% of total external debt stock. Long-term and short-term loans represent the highest share under this classification (about 70.9%). Starting from 2011, the share of this investment instrument has followed a slightly downward trend, as other investment instruments have been favoured,

Chart 4 Debt stock classification by investment instruments



Source: Bank of Albania.

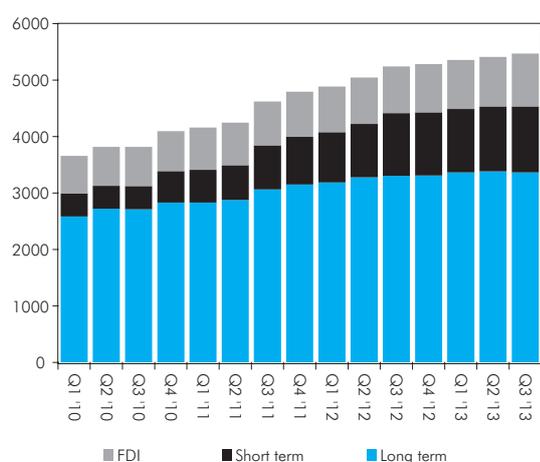
stabilizing at an average of 71.3% during 2013. The share of investments under currency and deposits instrument increased at an accelerated rate starting from the second half of 2010. Other investment instruments like trade credits and other debt liabilities continue to represent a small share of the total stock of other investments.

Over years, the stock of foreign direct investments has increased moderately. At the end of 2013 Q3, the stock of foreign direct investments – intercompany loans represented about 17.1% of the total debt stock or about 9.7% to nominal GDP.

Portfolio investments have followed an upward trend over time. At the end of 2013 Q3, portfolio investments accounted for about 9.9% of the total stock of gross external debt and are estimated at about 5.7% of nominal GDP.

c) Gross external debt stock by maturity breakdown

Chart 5 Gross external debt stock by maturity breakdown



Source: Bank of Albania.

According to its maturity breakdown, the stock of external debt largely consists of long-term debt. At the end of 2013 Q3, the long-term debt stock (which methodologically includes foreign direct investments) represented about 78.6% of the total stock of gross external debt and was estimated at about 44.7% of nominal GDP. Long-term debt, excluding FDIs, accounts for about 61.5% of the total external debt stock.

Short-term debt amounted to about EUR 1.2 billion at the end of 2013 Q3, increasing from about EUR 1.1 billion at the end of the same period the previous year. Over the last year, the share of short-term debt to total external debt increased and currently represents about 21.2% of the total. General government and the monetary

⁸ It includes: long and short-term loans, currency and deposits, trade credits and other debt liabilities.

authority own solely long-term debt. The banking sector and other sectors of the economy have a diversified portfolio containing both long and short-term debt.

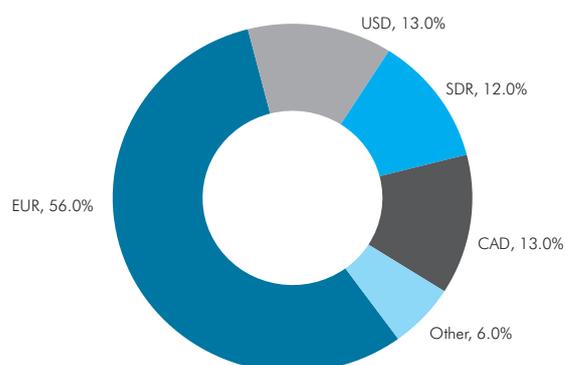
d) Gross external debt by currency breakdown

Albanian gross external debt stock is largely denominated in the European common currency, euro, representing about 56.0% of the total debt stock at the end of 2013 Q3. The share of debt stock denominated in SDR⁹ decreased progressively over the last three years. Meanwhile, over the first nine months of 2013, a sharp increase in the USD-denominated debt is observed, starting from 5% at the end of 2012 Q3 to 13.0% at the end of 2013 Q3.

e) Gross external debt service by sectoral breakdown

Total gross external debt service (principal and interest repayments) from all sectors of the economy amounted to about EUR 41.4 million, during 2013 Q3. The total debt service over the considered period was divided into approximately 82.6% in principal repayments and in about 17.4% in interest repayments. The bulk of payments to service the external debt according to sectoral breakdown, are largely composed of principal repayments.

Chart 6 Gross external debt by currency breakdown, 2013 Q3



Source: Bank of Albania.

Table 1 Total debt service by sectoral breakdown

	Q1 '13	Q2 '13	Q3 '13
General government			
Principal repayments	11.7	33.6	13.9
Interest repayments	6.1	9.0	6.5
Drawings	58.5	66.5	57.7
Private (long term and short term)			
Principal repayments	27.0	15.0	11.0
Interest repayments	0.1	1.3	0.3
Drawings	14.0	6.0	1.3
Banks (long term and short term)			
Principal repayments	13.5	16.8	5.7
Interest repayments	0.5	0.4	0.4
Drawings	3.0	4.4	7.0
Total debt service	62.9	76.3	41.4
Total drawings	74.7	95.2	26.9

Source: Bank of Albania

Over the third quarter of 2013, total new debt drawings contracted across all the sectors and amounted to about EUR 26.9 million, the lowest level since 2010. General government drawings (including guaranteed public debt)

⁹ Special Drawing Rights (SDR) represent reserve assets, constituted by the International Monetary Fund to satisfy other reserve assets allocated periodically to IMF member countries, proportionally to their respective quotas.

represented about 69.2% of the total disbursement of new debt over the considered period. Long-term debt drawings by the private sector contracted and were considerably lower compared to the past three years' registered mean levels. Drawings of the banking system increased over 2013 Q3 and amounted to about EUR 7 million.

2. INDICATORS OF EXTERNAL DEBT SUSTAINABILITY

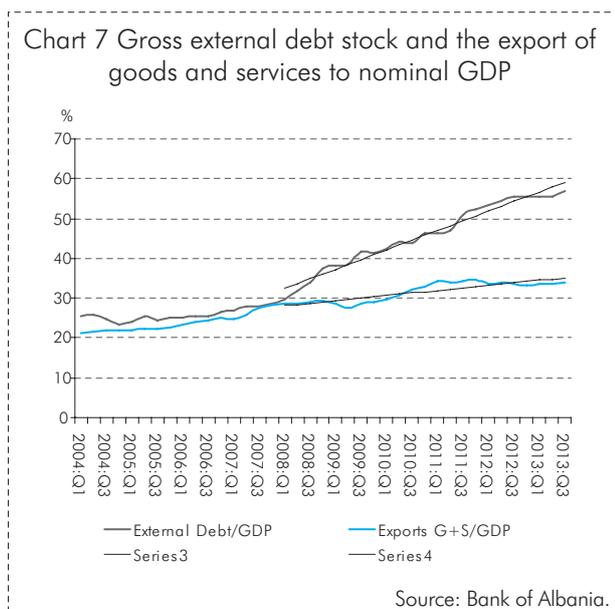
Gross external debt analysis focused on the performance of its sectoral sub-items. The instrument and maturity breakdown provides a dynamic overview of its current outlook and evolution, without attempting, however, an evaluation of or insight onto its sustainability over time. To facilitate the said analysis, it is paramount to use trend comparisons of gross external debt vis-à-vis other economic variables or scrutinise resultant indicators derived through manipulating gross external debt data. Indicators used to evaluate external debt sustainability are generally classified into two categories: indicators measuring the continuous and uninterrupted repayment capacity of a country to its creditors, and indicators assessing the liquidity adequacy for fulfilling immediate external debt obligations.

a) Indicators of repayment capacity

The export of goods and services is considered as a primary and a direct source of external revenue denominated in foreign currency. Concurrently, if approached comparatively vis-à-vis the gross external debt, also denominated in foreign currency, it can be conceptualised as an analytical tool that approximates the long-term repayment potential and capacity of a country. Since both indicators are expressed in a common foreign currency, it helps

to isolate the denominator effect from exchange rate fluctuations. The faster expansion of the gross external debt, compared to the export of goods and services, signals a deterioration of the repayment capacity of a country. In the longer term, it could complicate the fulfilment of the external debt's contractual obligations.

Until 2008 Q1, data on the share of Albania's gross external debt in nominal GDP shows a concomitant trend at a largely equivalent magnitude with minimal deviations vis-à-vis the export of goods and services¹⁰. Beyond this quarter, the stock of gross external debt to GDP has been subject to a more accelerated growth that has affected the divergent long-term paths of the two indicators depicted in the chart below.

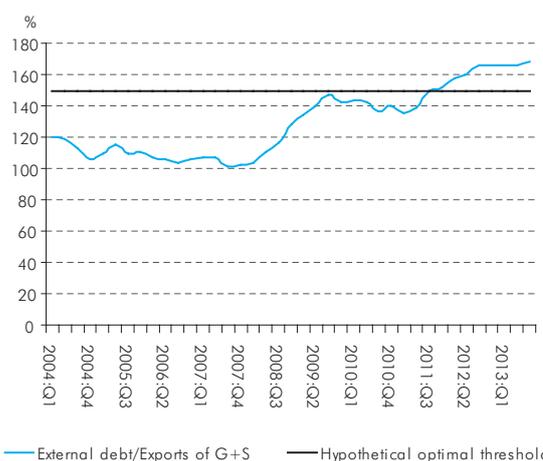


¹⁰ Exports of goods and services and quarterly nominal GDP have been annualised to make sure that they are comparable and consistent with the end-of-period external debt stock. The three variables are expressed in euro.

The divergence between the long-term evolution of the gross external debt and the export of goods and services is also underpinned by a deterioration of the ratio between the two. This indicator fluctuates around the 100% threshold until 2008 Q1, thus signalling the adequacy of primary foreign currency inflows from the annual exports of the country.

Subsequently, the gross external debt follows a more accelerated growth path compared to the export of goods and services, with 2008 Q1 and 2011 Q1 representing shifts towards the structural worsening of this indicator. The ratio of the gross external debt stock to the export of goods and services reached 168% in 2013 Q3. When put in perspective, according to readily available rule-of-thumb thresholds proposed by international organisations that vary according to institutional quality and development, this ratio is estimated to be relatively higher to a hypothetical optimal threshold that Albania would fall into.¹¹ In a regional context, this indicator positions Albania near the region-wide average registered during 2012, where the ratio of gross external debt to the export of goods and services ranged from 142.4% in Bulgaria to 235.2% in Croatia.

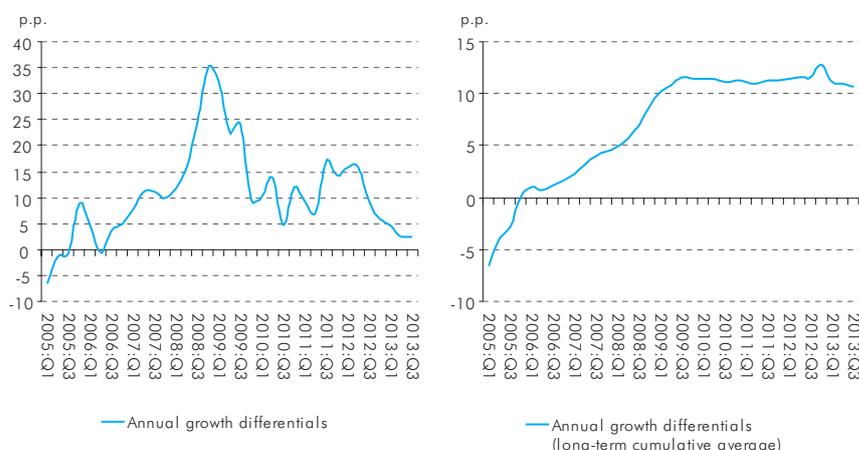
Chart 8 Gross external debt to exports of goods and services



Source: Bank of Albania.

Despite the above-mentioned divergence, in a second period, the previous accumulation of external debt could be accompanied with accelerated economic growth rates if its flows are optimally channelled into efficient investments or if they contribute to an added value in the economy. Until 2013 Q3, the indicator of the differential between the annual growth of gross

Chart 9 Difference between the annual change of the gross external debt and nominal GDP, by quarters (left) and its long-term cumulative average (right)



Source: Bank of Albania.

¹¹ According to the IMF and World Bank.

external debt and of nominal GDP does not yet point to the materialisation of such an occurrence. After excluding year 2005 and 2006 Q2, it can be concluded that the stock of gross external debt has expanded at a more accelerated rate compared to nominal GDP. At the same time, the long-run cumulative average¹² of the difference between the annual change in the gross external debt and the nominal GDP is estimated at around 10.7 percentage points at the end 2013 Q3.

The above indicators provide a dynamic outlook into the long-term repayment capacity of Albania. Despite a slight deterioration observed since 2008, the subsequent evolution of the external debt's sustainability is closely interlinked with the domestic economic performance in the future as well as with the time distribution of the external debt service.¹³ In an optimal scenario, the external debt service should not have direct repercussions in economic performance, stemming principally from reallocation of financial resources towards meeting external debt obligations. Similarly, in order to avoid short-term economic distress and financial panic, an economy should be able to meet its immediate principal and interest obligations linked to the gross external debt. Accumulation of external debt service arrears and frequent debt obligation rescheduling could lead to higher risk premia in the economy and hamper production activity. Therefore, the economy necessitates the availability of sufficient finances to meet external debt immediate contractual obligations or to create a buffer against external negative economic shocks.

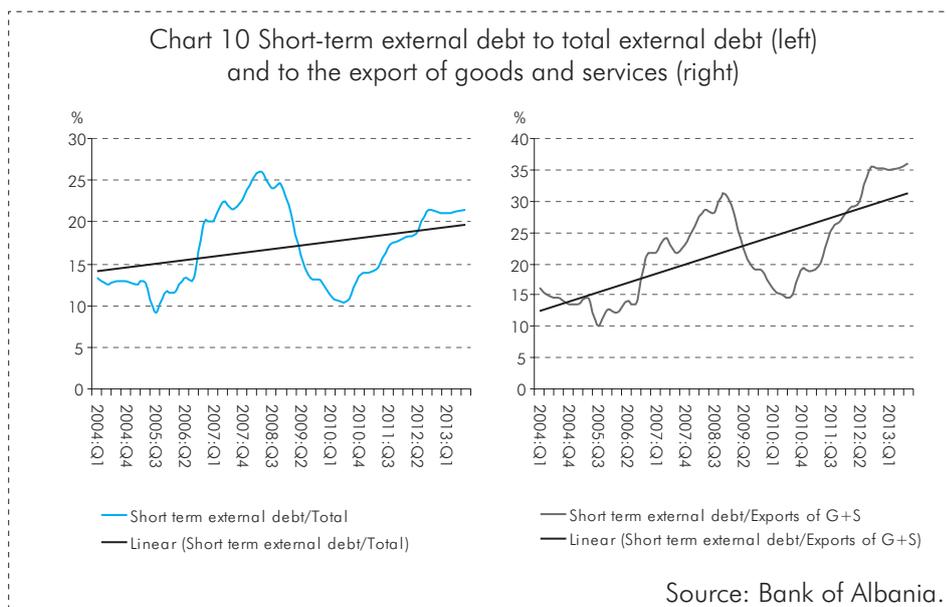
b) Indicators of liquidity adequacy

Liquidity adequacy as a function of the economy's short-term repayment capacity is largely influenced by its dependency on short-term external financing. Therefore, if consumption is supported by foreign financing with a maximum maturity period of one year, immediate obligations of the external debt are inevitably higher for the one year ahead. Albania's foreign financing has characteristically favoured long-term debt. Meanwhile, short-term debt has fluctuated between minimal levels of 9% to maximal levels of 26% to the total of external debt stock. At the same time, annual inflows of foreign currency income from the export of goods and services have managed to finance entirely the stock of short-term external debt.

One of the many important indicators of liquidity adequacy in relation to the short-term external debt is its ratio to the stock of foreign currency reserves. When a country has limited accessibility into international capital markets, the availability of an adequate foreign reserve stock could aid in meeting external short-term debt obligations in periods of distress. This indicator's importance

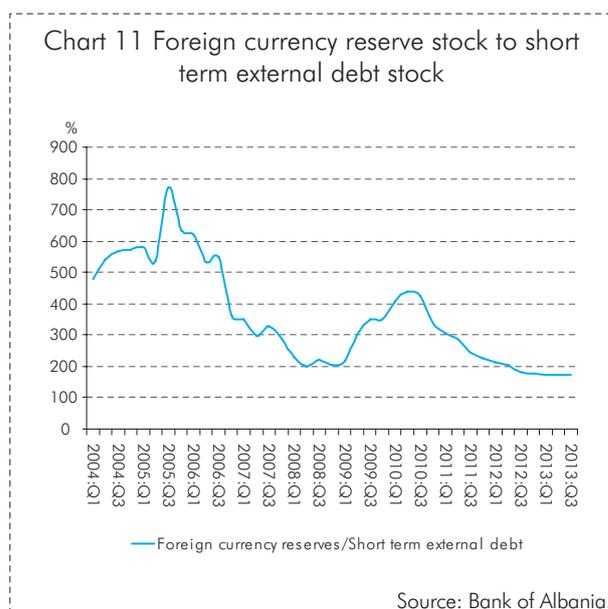
¹² This indicator is constructed by using the cumulative annual growth for every period realised in time 'T' and prior to it. Suppose then in period T_{12} there are 12 time periods. Their average reveals the realised cumulative average for T_{12} . The average for the next period is computed by adding the T_{13} value and averaging again.

¹³ If, in the future, economic growth accelerates and the time distribution of the external debt service is uniform, the long-term repayment capacity of a country is improved. In an analogous case, the indicators of the repayment capacity deteriorate.



is amplified in situations of perverse foreign financial conditions that could increase the probability of negative external shocks and erode the normal repayment capacity of short-term debt. Albania’s stock of foreign exchange reserves is assessed as sufficient to counteract such situations. The critical threshold of the ratio between the stock of foreign reserves and the short-term debt suggested by international organisations is 100%¹⁴ with levels below this threshold deemed unsustainable and indicating external vulnerabilities. In Albania, despite being volatile, this indicator has never fallen below the 100% threshold. As of the third quarter of 2013, the stock of foreign reserves covered around 173% of the short-term external debt stock.

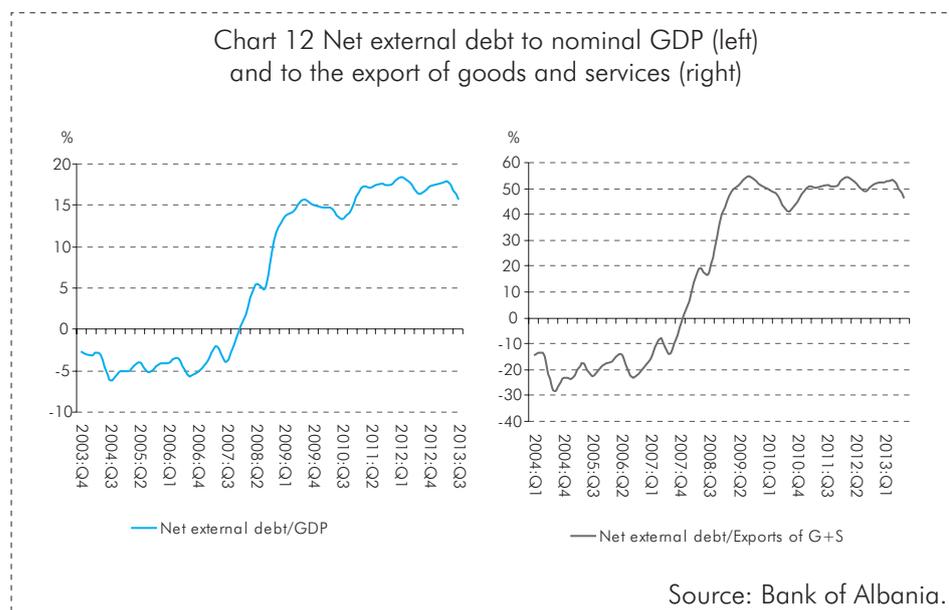
External debt measurements to identify short-term pressures stemming from expected obligations are contemplated with the derivation and the analytical insight of the net external debt. Thus, in its crude interpretation, the stocks of net foreign assets and of foreign currency reserves, which can serve as readily available short-term foreign currency cushions in case of financial distress, are subtracted from the stock of gross external debt. The Albanian net external debt is relatively low and it fluctuates around 20% to GDP.¹⁵ This level has been made possible through continuous growth in net foreign assets and foreign currency reserves despite an accelerated growth in the gross external debt stock.



¹⁴ IMF (2000), 'Debt- and Reserve-Related Indicators of External Vulnerability', International Monetary Fund, Washington D.C.

¹⁵ Until the end of 2012, the net external debt of Albania, estimated at around 17.2% to GDP, was below the regional realised average. The average net external debt to GDP for all regional countries was around 30.4% and it ranged from minimal values of -13% and 11.5% in Kosovo and FYROM, to maximal values of 59.8% and 50.6% in Croatia and Montenegro.

This indicator has remained in positive territory since 2008 Q1 and as of 2013 Q3 it is estimated to be at around 15.6% to nominal GDP.

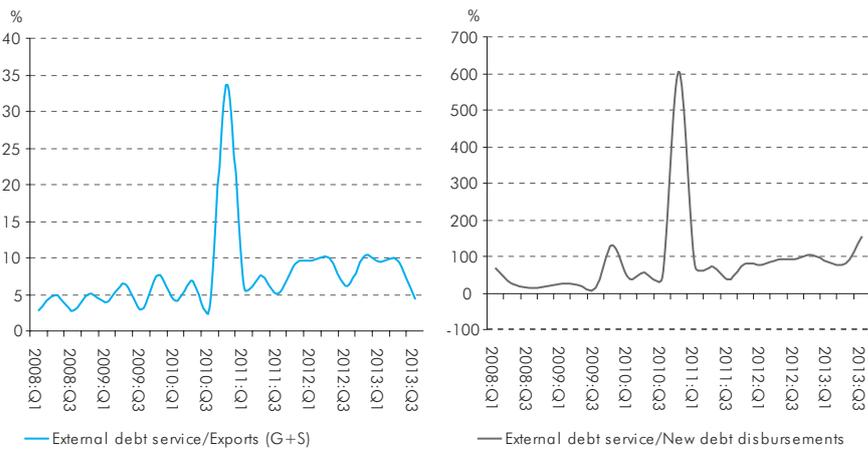


Principal and interest payment based indicators serve as an analytical tool to determine the financial resources of the economy regularly devoted to servicing the gross external debt. Since these indicators can isolate explicitly the magnitude of the external debt's immediate obligations, they are important both for monitoring short-term pressures originating from its servicing and for avoiding unexpected reallocation of financial resources from productive activities towards fulfilling due payments on external debt amortisation. Albania's external debt service ranges within 5% to 10% to exports of goods and services, excluding the outlier 2010 Q4. The high level registered for this quarter, that can be conveniently categorised as an isolated case, is linked to a higher-than-usual principal payment from the general government. The levels registered so far, bar the aforementioned quarter, remain below the critical value of 20% suggested by international organisations.¹⁶

The ratio between external debt amortisation and new debt disbursement measures the debt rollover or the fraction of repaid debt that is substituted by new debt. A ratio below 100% indicates a faster external debt disbursement to external debt amortisation. In Albania, the share of debt amortization to new disbursements until the last quarter of 2010 fluctuated within the 40% to 60% band. Beyond this period, this ratio increased to an average of 80% but it technically delineates a higher debt service rather than lower disbursements. Overall, this indicator portrays a more active new external debt disbursement activity when compared to repayments of accumulated obligations, which, in turn, could hint to higher external debt service obligations in the future.

¹⁶ IMF(2003), "External Debt Statistics: Guide for Compilers and Users", International Monetary Fund, Washington D.C.

Chart 13 External debt service to exports of goods and services (left) and to new debt disbursements (right)



Source: Bank of Albania.

RESEARCH PAPERS*

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

CONSTRUCTION ACTIVITY AND REAL ESTATE MARKET TREND: EVIDENCE FROM ALBANIA

DELINA IBRAHIMAJ, GIANLUCA MATTAROCCHI
MONETARY POLICY DEPARTMENT

ABSTRACT

Construction is an important sector in the national accounts of a country. The importance of this sector is not only related to its size and weight in GDP but also to its role in generating economic growth. The aim is to identify the main macro-economic drivers of construction in Albania. Using a proprietary database provided by the Bank of Albania, the article evaluates the relationship between macro-economic determinants and a set of macro-economic drivers using the Granger Causality Test and the impulse response function. Results show that, in Albania, as in other newly developed economies, the credit market and remittances are the main sources of construction changes. Real estate sector characteristics are more relevant in explaining the construction development in the short and in the long run. The obtained results are useful for policy market and macro-economists interested in evaluating the dynamics of the construction sector and the effect of any macro-economic change on the size and growth of the sector.

1. INTRODUCTION

The construction sector produces a heterogeneous asset that is offered to both individuals and firms in the private sector and to the public sector. Literature demonstrates that one of the key drivers of the construction sector output is due to the fact that private and public demand is positively related to the GDP and the public support to the real estate sector development is normally higher when more resources are available for the economy (Grebler and Burns, 1982). The role of the GDP in explaining the construction sector dynamics is higher for undeveloped economies. As the stage of development increases, this role could be lower or even negative (Crosthwaite, 2000).

Real estate is a long-term investment and constructors define the production of the new asset on the basis of the public demand and the new orders from the private sectors (Nicholson and Tebbut, 1979). The volume of orders is strictly affected by the real estate market dynamics. Better market condition can explain a change in the construction sector dynamics and more profitable conditions for the real estate investment (related to production efficiency or profitability) are expected to lead to an increase of the construction sector output. The paper tries to analyze this gap introducing variables on the efficiency and profitability of the real estate sector and evaluating their contribution to the construction industry.

The paper analyzes the relationship between the construction sector and the main macroeconomic determinants as suggested by the literature and the real estate market features. In more detail, it will try to analyze the possible effects of Real GDP, excluding construction (GDP) weighted average interest rate on domestic currency deposits (INT), credit to individuals (CRE), rent price index (RPI), house price index (HPI) number of approved licenses (No LICENSES), remittances (REM) and Tobin Q on the construction sector production in the economy (CONS). Initially, we will try to understand the direction of the relationships by testing the variables through the granger causality tests. We use the VAR model impulse response to analyze the effect of these macroeconomic variables in the construction sector. We will trace out the time path of the effect in the construction activity of structural shocks on the macroeconomic variables. Then we will employ the forecast error variance decomposition (FEVD) to understand how much of a change in a variable is due to its own shock and how much due to shocks to other variables.

Section two presents a detailed literature review on the macro-economic determinants of growth and size of the construction sector considering evidence for both developing and developed countries. Section 3 describes the sample characteristics (section 3.1), the methodology adopted (section 3.2) and results achieved (section 3.3). The last section summarizes results and implications.

2. LITERATURE REVIEW

The size of the construction sector is significantly affected by the overall trend of the economy as the increase of wealth available for citizens would increase the demand for real estate investments. The increase is not linearly related to the increase of the GDP per capita and literature demonstrates that the shape is approximated by an S shape: a positive relationship when the economy is still developing (LDE), an inelasticity of construction sector with respect to the GDP per capita for newly industrialized countries (NIE) and a negative relationship for advanced industrialized countries (AIE) (Crosthwaite, 2000). The different relevance of the construction sector for different levels of economic development is linked to the demand of housing and real estate in the main cities, that is, at the maximum for LDE, almost stable for NIE and even decreasing for AIE due to land and construction constraint applied to the sector (Bon, 1992)

The growth of the construction sector can be affected differently by different economic sectors. Normally, for both new and restructured building, the higher demand is related to the retail and the wholesale industry (Bon and Pietroforte, 1993). The interrelation between construction and other sectors have also a different degree of sensitivity to the GDP in the short or in the longer time horizon: services react in the shorter time horizon while manufacturing, transportation and communication will be affected by the construction sector only in the long-term horizon (Lean, 2001).

Even if each type of real estate asset is unique and costs related to realizing a type of real estate investment depend on the skills and standardization of the production process (Ball, 1965), construction sector dynamics can be explained on the basis of the differences between current prices and construction costs. The difference is normally summarized as a Tobin Q, computed as the ratio between an index of market prices and an index of the construction prices. Normally, values higher than 1 justify a short-run increase of the construction sector supply (Barot and Yang, 2002) while in the medium and long term, the supply is not significantly affected by the building cost that is seen as an avoidable cost (Dorward, Akintoye and Hardcastle, 1998).

The supply of real estate for investment purposes is affected by the rent market dynamics due to the better (worse) expected returns related to the real estate investment. So, a higher (lower) level of occupancy and/or an higher (lower) average rent will have a positive (negative) impact on the construction sector development. Results are clearer for some type of real estate investments (like office) for which the rented accommodation is the main form of tenancy (McGough and Tsolacos, 1999).

Real estate investment is normally done by using loans, and any change in the lending rate would affect the development of the construction sector. If demand is elastic, the increase of the interest applied to real estate developers will have a negative impact on the sector development due to the fact that real estate prices cannot increase enough to cover the extra-costs related to financing cost. If, on the other hand, demand is inelastic, the impact of the interest rate is absorbed by the price that will increase to cover extra costs related to increase of the lending rate (Lewis, 2004). The increase (decrease) of the lending rate to individual or (more generally) real estate investors will have a negative (positive) impact on the demand of the real estate and will be considered by the construction industry in order to evaluate investment opportunities for upcoming years (Ng, Fan and Wong, 2011). In spite of the cost of lending, an excess supply of credit (and lower credit constraints for lending) will have a positive effect on the construction sector development (Ozcelebi, 2011). Governments are interested to support the development of the construction industry because the sector is almost always a human capital intensive sector that contributes to reducing unemployment significantly (Ramsaran and Hosein, 2006). In less developed countries, another factor that could affect construction demand is the amount of remittances by citizens that are working in a foreign country and send home money for supporting durable investments (like houses) (Osili, 2004).

3 EMPIRICAL ANALYSES

3.1 SAMPLE

Empirical analysis will be computed by using data from the first quarter of 2004 to the second quarter of 2013. The choice of the timeframe was

conditioned by the availability of the real GDP series, which start in 2004 Q1. Quarterly data from INSTAT and Bank of Albania will be used. Variables selected are presented in Table 1.

Table 1 Descriptive Statistics

Variable	Label	Obs.	Mean	Median	Max	Min	St.Dev.
Construction	CONS	38	10.24	10.26	10.69	9.69	0.24
GDP	GDP	38	12.09	12.09	12.33	11.75	0.15
Interest on deposits	INT	38	1.77	1.77	2.02	1.52	0.12
Credit to individuals	CRE	38	11.37	11.84	11.95	9.65	0.73
Housing Price Index	HPI	38	4.91	4.94	5.11	4.54	0.16
Construction licenses	No_Lic	38	5.03	5.65	6.78	0.01	1.76
Remittances	REM	38	5.24	5.29	5.69	4.66	0.25
Rent Price Index	RPI	38	4.93	5.01	5.20	4.42	0.22
Tobin Q	T_Q	38	0.33	0.34	0.52	0.01	0.12

Source: INSTAT – Bank of Albania data processed by the authors

where:

CONS is the production in construction series published quarterly by the Albanian Institute of Statistics (INSTAT), expressed in real terms and seasonally adjusted.

GDP is the real gross domestic product (excluding the construction sector) that is published quarterly by INSTAT. It is expressed in real terms and is seasonally adjusted.

INT is the weighted average interest rate on domestic currency deposits published monthly by the Bank of Albania. For our study, we have used the quarterly average.

CRE is the credit to households and refers to the stock of the credit published monthly by the Bank of Albania. For the quarterly series, we have used the last month of the quarter value.

RPI is the Rent Price Index published quarterly by the Bank of Albania, computed using the Hedonic method.

HPI is the Housing Price Index published quarterly by the Bank of Albania, computed using the Hedonic method.

No_Lic is the number of approved licenses published quarterly by INSTAT. It is the number of building licenses approved by the municipalities.

REM is the Remittances series published quarterly by the Bank of Albania.

T_Q is the Tobin Q computed as the ratio of House Price Index over the Cost of Building Materials Index, calculated by the authors.

All variables are expressed as natural logarithms in order to analyze their elasticity (except for interest rate).

Before using the available data, we perform a unit root test using an Augmented Dickey Fuller Test. The null hypothesis is tested for validity interval 1%, 5% and 10% and results are summarized in Table 2.

Table 2 Unit root test

Variable	Label	No. of unit root	t stat	Prob
Construction	CONS	2 Differences	-24.19	0.00
GDP	GDP	1 Difference	-3.59	0.01
Interest on deposits	INT	1 Difference	-3.59	0.01
Credit to households	CRE	2 Differences	-10.69	0.00
Housing price index	HPI	1 Difference	-6.05	0.00
Construction licenses	No_Lic	Level	-5.66	0.00
Remittances	REM	1 Difference	-10.18	0.00
Rent Price index	RPI	1 Difference	-6.35	0.00
Tobin Q	TQ	1 Difference	-6.12	0.00

Source: INSTAT – Bank of Albania, data processed by the authors.

ADF test suggests that the indicators are integrated in different orders. There is a common agreement in academia¹ that stationary data should be used in econometric analysis because non-stationary data may cause spurious regressions. Although literature argues against differentiating time series (even if they may contain unit roots) because differentiating opposes co-integrating relationships (e.g. Sims et al 2000, Enders 1995, Doan 2004, Cooley and Leroy 1985), Enders (1995) explains that a VAR in differences may cause loss of information on the co-movement among the variables. Our data series are integrated in different orders and, following the approach proposed by Ozcelebi (2011), we will estimate the VAR model in levels.

3.2 METHODOLOGY

The causal relationship analysis is realized considering the bi-lateral causality between each explaining variable and the production in the construction sector. The causality is tested using the Granger Causality Approach (Granger, 1969), in formulas:

$$CONS_t = \alpha + \sum_{k=1}^n \beta_{i1} CONS_{t-k} + \sum_{k=1}^n \beta_{i2} Factor_{t-k} + u \quad (1)$$

$$Factor_t = \alpha + \sum_{k=1}^n \gamma_{i1} Factor_{t-k} + \sum_{k=1}^n \gamma_{i2} CONS_{t-k} + v \quad (2)$$

where CONS is the output of the construction sector and Factor is alternatively the Gross Domestic Product (GDP), interest on deposits (INT), Credit to households (CRE), Housing Price Index (HPI), Construction Licences (No_Lic),

¹ Granger and Newbold 1974, Phillips 1986

Remittances (REM), Rent Price Index (RPI) or the Tobin Q (TQ). If β_{i2} statistically is significant, while γ_{i2} is not significant, the Factor used in the Granger formula causes Production in the Construction sector. If both β_{i2} and γ_{i2} are statistically significant, the Granger Causality Test does not allow identifying the sign and strength of the causal relationship because both factors influence each other.

In order to consider the interrelationship between explaining variables, we perform also a Vector Auto-regression Analysis treating every endogenous variable in the system as a function of the lagged values and uncorrelated with all the other variables.

$$\begin{array}{lll}
 \text{CONS}_t & \text{CONS}_{t-1} & \text{CONS}_{t-p} \\
 \text{GDP}_t & \text{GDP}_{t-1} & \text{GDP}_{t-p} \\
 \text{INT}_t & \text{INT}_{t-1} & \text{INT}_{t-p} \\
 \text{CRE}_t & \text{CRE}_{t-1} & \text{CRE}_{t-p} \\
 \text{HPI}_t = \alpha + \varphi_1 & \text{HPI}_{t-1} + \dots + \varphi_p & \text{HPI}_{t-p} + \epsilon_t \\
 \text{No_Lic}_t & \text{No_Lic}_{t-1} & \text{No_Lic}_{t-p} \\
 \text{REM}_t & \text{REM}_{t-1} & \text{REM}_{t-p} \\
 \text{RPI}_t & \text{RPI}_{t-1} & \text{RPI}_{t-p} \\
 \text{TQ}_t & \text{TQ}_{t-1} & \text{TQ}_{t-p}
 \end{array} \quad (3)$$

Starting from that framework, we perform an impulse response analysis for tracing the effect of a shock to one endogenous variable on the other variables. A shock to the i -th variable not only directly affects the i -th variable but is also transmitted to all other endogenous variables through a dynamic lag structure of the VAR. An impulse response function traces the effect of a one-time shock to one of the innovations on current and future values of the endogenous variables. We focus our attention only on the effect on the construction sector of a shock of any factor analyzed. Starting from the VAR framework, we use impulse response functions for tracing the effects of a shock to one endogenous variable on the other variables in VAR and we identify the difference in the time necessary for the construction sector for absorbing a shock in one of the determinants. We also use the Variance Decomposition (FVED) in order to measure the different degree of importance of different variables in influencing the construction sector activity in a 10-quarters time horizon.

3.3 RESULTS

A preliminary analysis on the construction production drivers is realized using the Granger Causality Test in order to identify whether there is a univariate causal relationship among each driver and the construction sector. The results of the test of causality between the series with a lag of 4 quarters are shown in the Table. We choose 4 lags because a preliminary test demonstrates that the best results are related to the choice of that time lag.

Table 3 Results of Granger Causality

	Observations	H ₀ : CONS caused by the factor		H ₀ : Factor caused by the CONS	
		F-statistic	Prob	F-statistic	Prob
GDP	34	6.92	0.00	7.63	0.06
INT	34	1.18	0.34	7.65	0.00
CRE	34	6.14	0.00	1.45	0.25
HPI	34	3.71	0.01	1.57	0.21
No_Lic	34	1.37	0.27	3.21	0.03
REM	34	4.42	0.01	0.37	0.83
RPI	34	1.65	0.19	2.62	0.06
TQ	34	1.75	0.17	3.74	0.02

Source: INSTAT – Bank of Albania data processed by the authors.

Results demonstrate that the Gross Domestic Product (GDP) and the Construction sector (CONS) mutually Granger cause each other and so the Albanian economy dynamics are not coherent with the scenario for an undeveloped economy.

The (Granger) causes of the Construction sector dynamics are the credit to households and amount of remittances. The role of the credit to households on the construction sector could be explained on the basis of demand-side theory that relates the increase of the credit to an increase of production in the construction sector, due to the profits related to the higher expected prices for selling real estate assets (Elíasson and Pétursson, 2009). Similarly to other developing countries, remittances affect positively the investment in durable assets, and the construction sector will be positively affected by inflows of remittances (Kagochi and Kiambigi, 2012).

The construction sector Granger causes changes to the interest rate on deposits, the number of licenses, the Tobin Q and the Rent Price Index. The impact on the interest rate is related to a demand-side effect in the credit markets; as demand for construction drops, demand of credit by households will also drop. If the construction sector development halts, the new construction permits will drop, the Tobin Q will drop due to the increase of the cost per unit of buildings realized (lower amount of construction implies lower economies of scale and higher fraction of fixed costs for each building) and could have a positive impact on the rent price, due to the lower amount of housing available.

Results of the Granger causality test could be biased by the correlation among explaining factors that does not allow identifying correctly the relationship among variables, assuming a simple bilateral relationship between Construction and each determinant. Table 4 presents a correlation matrix among variables.

Table 4 Correlation Matrix

	CONS	GDP	INT	CRE	HPI	No_Lic	REM	RPI	TQ
CONS	1.00								
GDP	0.33	1.00							
INT	0.25	-0.05	1.00						
CRE	0.41	0.82**	0.14	1.00					
HPI	0.47	0.73**	0.19	0.92**	1.00				
No_Lic	0.02	-0.06	0.19	-0.07	-0.05	1.00			
REM	0.39	-0.29	-0.05	-0.16	-0.12	0.14	1.00		
RPI	0.35	0.82**	0.13	0.96**	0.97**	-0.09	-0.26	1.00	
TQ	0.48	0.68	0.19	0.87*	0.99**	-0.05	-0.09	0.94**	1.00

Notes: * Pairwise correlation significant at 95% ** Pairwise correlation significant at 99%
 Source: INSTAT – Bank of Albania data processed by the authors

The results of the correlation analysis show that no variable is highly correlated to the construction activity. The most correlated variables with each other are credit to households with GDP and real estate indicators (HPI, RPI and Tobin Q). The real estate variables are calculated for capital city (Tirana) that represents the reference market for the country. The high degree of correlation is partly due to the fact that the fast growth in GDP and in credit to households in the pre-crisis years is in line with a big demographic boom in Tirana, and the slowdown of these indicators is in line with the end of the demographic movements.

The results of the impulse response are shown in Chart 1. The variables included in the VAR model are the ones that showed robustness and significance. We first tested for significance. The variables whose shock gave a significant response to the production in construction were then tested for robustness. The robustness of the results has been tested by changing the order of the inclusion in the model. The indicators that passed the robustness test are only "Credit to households", "Number of building" licenses approved, "Remittances" and "Rent Price Index". For each of them, through the impulse response function, we study the impact of a shock on these variables on the construction sector (Chart 1).

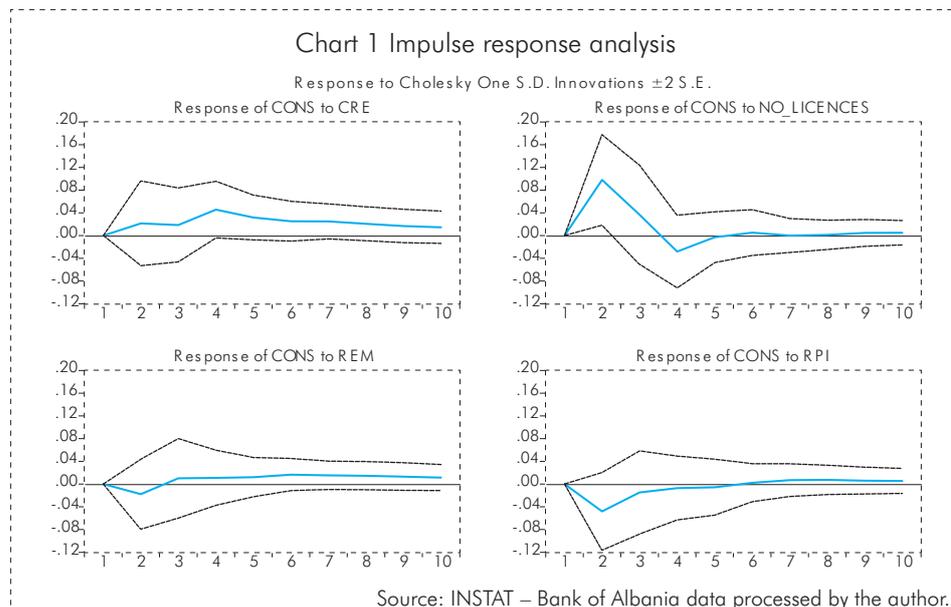


Chart 1 shows that the positive one standard deviation shock to CRE leads to an increase in the construction activity after the second quarter till the fourth quarter. We can consider that the shock to Credit to households has a permanent effect on construction since, in the longer run, this indicator finds a new (higher) equilibrium. This means that, in the medium to long term, the increase in credit to households affects positively the production in construction. Likewise, as expected, a higher amount of money available implies a higher level of the construction supply.

A positive one standard deviation shock to the number of licenses approved by municipalities gives a high positive shock to the construction activity, but the effect is only temporary because, in the long term, the model reaches the same equilibrium identified before the shock.

The response of the construction sector activity to a positive one standard deviation shock to remittances is negative in the second quarter, but, in the long run, reaction to this shock is positive and leads to a new equilibrium. The strange results related to the short term could be partially explained on the basis of the purpose of remittance that, especially for low income families, sometimes could be directed to support consumption expenditures.

A positive one standard deviation shock to Rent Price Index leads to a decrease of construction activity after two quarters. In the long run, the indicator tends to reach the equilibrium. The sign of this reaction is the expected one. An increase in rent prices may come from the increased demand for rents, which indicates that the demand for buying is dropping, hence no demand for new constructions. This is a demand effect, which may change with the changing of the business cycle phase. That is why the shock is not permanent and, in the long run, the variable tends to reach the equilibrium.

Shock to variables like Gross Domestic Product (GDP), interest rates (INT), real estate prices (HPI) and efficiency (TOBIN_Q) do not show a clear reaction to a construction sector output shock. Albania's transition has been characterized by high informality. The low quality of the data series that this informality has produced may be the major cause of the missing economic significance of the relations between these major macroeconomic analyses. One other drawback of the data is that their series are short. The lag length of the endogenous variables is usually determined using the Schwarz information criteria. Like Afonso et al in 2011, we used two lags given the low number of observations. A higher number of observations would allow estimating the VAR model with four lags suggested by the tests, and give, therefore, a better reaction of the construction sector to the shock in the above-mentioned macro variables. Another deficiency of the data is that they suffer from structural breaks; the literature suggests that the series before the structural breaks should not be taken in consideration. In this case, the low number of observations does not allow us to take any action, either.

The analysis of the role of the four variables to explain the "Construction sector" variability is analyzed more in detail considering the "Variance decomposition

approach" (FVED). The FVED analysis shows the degree of importance of Credit to households, Number of Licenses, Remittances and Rent Price Index influencing the construction sector activity in a time horizon of 10 quarters. The variance of "Construction" is decomposed in 10 future quarters (Table 5).

Table 5 FVED Results

	Period									
	1	2	3	4	5	6	7	8	9	10
CONS	100	75.58	72.79	69.09	67.79	66.80	65.93	65.30	68.47	64.55
CRE	0.00	0.89	1.49	5.03	6.63	7.56	8.44	9.00	9.35	9.61
No_Lic	0.00	18.48	20.27	20.45	19.99	19.68	19.32	19.03	18.86	18.74
REM	0.00	0.61	0.77	0.93	1.16	1.60	1.96	2.28	2.53	2.71
RPI	0.00	4.44	4.67	4.48	4.43	4.36	4.36	4.38	4.39	4.40

Source: INSTAT – Bank of Albania data processed by the authors

The FVED shows how much of this variance of ND is determined by each of the macroeconomic variables. The table shows that construction explains nearly 65% of the forecast error variance and of itself so it has the highest explanatory power over itself. The results in the table show that shocks to Number of Licenses and Rent Price Index explain nearly 20% and 5% of the variation in the construction sector. The results also show that the importance of the credit to households increases gradually so the impact should be analyzed in the longer term. FEVD analysis implies that "Remittances" gain importance in the variance forecasting power in the long run. However, compared to the other variables, its influence is low.

4. CONCLUSIONS

This study analyzed the effects of some macroeconomic variables on the construction sector, including variables related to the real estate sector like construction licenses, real estate and rent prices looking at a new industrialized economy in which the construction sector is not driven only by the GDP growth. In this study, empirical tests were conducted on the relationship between the construction sector and Real GDP excluding construction, 12 month average interest rate on domestic currency deposits and credit to households, house and rent price indexes, number of approved construction permits, remittances and Tobin Q. The purpose of this study was to analyze the effects of these macroeconomic variables on the construction activity.

The analysis of the main drivers of the construction sector demonstrates that the credit market and the amount of remittances are the main drivers of construction changes. The results are not surprising because real estate investment is capital intensive and financing may come from the standard lending channel (i.e. banks) or from informal credit market (remittances from family members) (Jarvis, 2000). Looking at real estate sector's specific determinants, the main drivers identified by the analysis are the number of construction permits and the real estate rent index. The increase of the

construction permits has a direct positive impact on the supply, because the market is still characterized by unsaturated demand that developers try to satisfy taking advantage of any new regulatory change (number of permits). The relevance of the rent index has to be ascribed more to the institutional/firms with respect to individuals: in fact, in the housing sector, the percentage of rented apartments or houses is increased, but it is still low (Kalia, 2013) while the retail and office sector has been growing due to the domestic and external demand (Colliers, 2012).

The real estate price is not a key driver for explaining the construction development, which could be partially explained on the basis of the source of the data constructed according to the database of announcement newspapers, which do not reflect the real value of the transactions. On the other hand, any other index constructed on public data would be inaccurate due to the high degree of informality. Furthermore, any index constructed on public data related to real estate transaction could be biased by criteria adopted for defining the expected price by the Government. The lower the frequency of updating the reference price the more significant the bias. (Thanasi and Hysi, 2013).

The paper provides evidence that a construction sector is significantly affected by credit market variable; also real estate dynamics matters. In a not- fully-developed economy the growth of the market is also related to the opportunity of creating real estate market conditions that support the demand for investing in that asset class.

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EXPORT PERFORMANCE IN ALBANIA 2005-2012: CMS APPROACH

OLTI MITRE
MONETARY POLICY DEPARTMENT

1. INTRODUCTION

Export performance is an important factor to be taken into consideration in economic policy decision making, particularly in the background of an unfavourable situation for our trading partners and world economy. Economic and financial crisis has affected the sustainability of trade deficits (current account) of the region by reducing sustainable sources of external financing. At least two sources - FDI and remittances - are slowing down. The study of export performance, mainly for countries like Albania, can be crucial for selecting appropriate policies aimed at addressing imbalances in the external sector.

This study attempts to evaluate the performance of Albanian exports during the period 2005-2012. By analysing the competition that Albanian exports and exports of other developing countries face in foreign markets, the performance of Albanian exports can be considered satisfactory for the period under analysis. During the second half of 2000, the geographic structure of exports underwent a gradual change marked by an increase in the market share of exports to China, Switzerland, Turkey and CEFTA member countries. In addition, this period was characterized by a different specialization in commodities as compared to exports of other Eastern European countries. At the same time, the structure of exports in terms of variety and quality was a key factor in their performance.

This study is organized as follows. The degree of exposure of the Albanian economy to international trade and especially the structure of exports by commodity and destination are analysed in the second section. The third part uses the Constant Market Share (CMS) method to find the key factors in the change of total exports. The fourth section summarizes the results and conclusions of this study.

2. EXPORT STRUCTURE AND EXPOSURE TO INTERNATIONAL TRADE

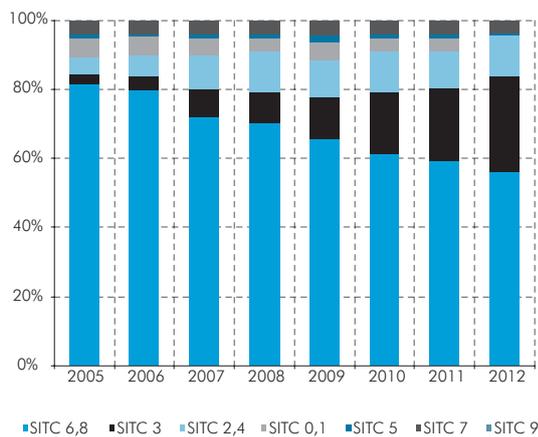
2.1 EXPORT STRUCTURE BY CATEGORY AND GEOGRAPHIC ORIENTATION

A significant change in the structure of Albanian exports by commodity and destination has been observed during the period 2005-2012. In addition to the positive contribution of manufactured goods and other goods, exports of fuels and lubricants played a role in the overall increase of total exports. At

the same time, Albanian exports began to move from their main destination, the EU-27 markets, towards CEFTA countries and other developed markets.

The structure of exports by product (Standard International Trade Classification, SITC) shows that the combined weight of “fuel and lubricants” (mainly crude oil) and “manufactured goods and other manufactured goods” (products of iron & steel and textile products for re-exporting) has remained on average around 80% of overall exports. Meanwhile, the structure of exports to Eastern European countries shows a specialization in other categories, slightly different from the ones above. Although the common factor remains the high weight of the category “manufactured goods and other manufactured goods”, countries such as Serbia, Croatia and Bosnia and Herzegovina have shown an increase in the weight of the category of “machinery and equipment” during the period 2005-2012.

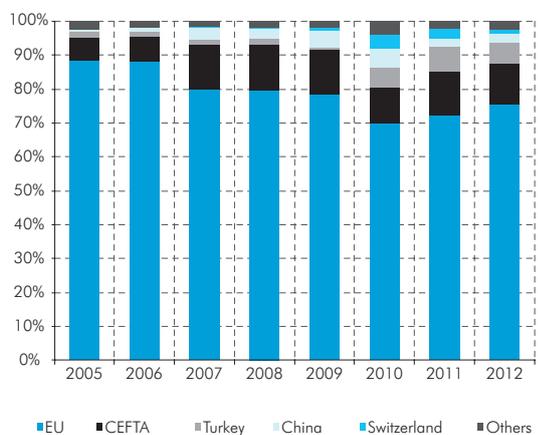
Chart 1 The structure of total Albanian exports



Source: Bank of Albania.

The EU-27 market continues to be the main destination of exports of Albanian products although its market share in exports fell from 89% in 2005 to 76% in 2012. The process of changing the geographic structure of exports was characterized by increased weights of CEFTA member countries and countries such as China, Switzerland and Turkey, respectively from 7% and 2.3% in 2005 to 12% and 9.8% in 2012. Markets of the EU-27 remained the main destination for the region, accounting for 50-60% of total exports of countries like Bosnia and Herzegovina, Serbia and Croatia.

Chart 2 Geographical orientation of Albanian exports



Source: Bank of Albania.

The key factors in the re-orientation of the destination of Albanian exports are estimated to have been:

- Increased competition in the markets of the EU-27 during the period 2005-2012 by exports of other countries;
- Impact of the financial crisis on the euro area declining domestic demand of EU markets for foreign products;
- Intensification of integration processes in the framework of CEFTA 2006.

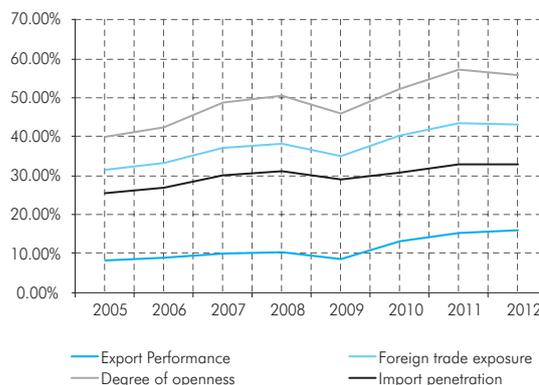
2.2 FOREIGN TRADE INDICATORS

During the past two decades, various Eastern European countries have gradually expanded the exposure of their economies to foreign trade, under the influence of several factors. Foreign trade liberalization, increasing

consumer demand for product variety, lower transportation costs and shorter distances between markets, contributed to accelerated increase in commodities trading in these countries. Positive links between economic growth rates and exposure to foreign trade are supported by a number of empirical studies, including (Mckinnon (1973), Balassa (1985), Proudman et al., (1997), Vamvakidis (2002)). However, foreign trade indicators for Albania’s total exports show a mixed picture during the period 2005-2012.

Described in Chart 3, the performance of Albanian exports of goods during the period 2005-2012 is estimated to have increased from 8% in 2005 to around 16% in 2012. Nevertheless, these values are low compared to other countries in the region such as Macedonia, Serbia & Croatia, which recorded respectively a ratio of 43%, 27% and 19% during the same period. The degree of openness to foreign trade is estimated to have had a slight increase in recent years, but still below the average of countries in the region. In addition, the import penetration indicator is important to understand to what extent domestic demand - the difference between GDP and net exports - is satisfied by imports. For our economy, this ratio is estimated to have been approximately 30% during the period under analysis and in line with other countries in the region. At the same time, the indicator of exposure to foreign trade increased from 31.6% in 2005 to 42.95% in 2012.

Chart 3 Foreign trade indicators for total exports*



Source: Bank of Albania.

*Indicators used:
 Export performance = $X/Y * 100$ where X – exports of goods and Y – Nominal GDP
 Degree of Openness to foreign trade = $(Exp + Imp) / GDP\ nominal * 100$
 Import penetration = $Imp / (GDP - Net\ Exp) * 100$
 Exposure to foreign trade = $Exp\ performance + (1 - Exp\ performance) * Imp\ penetration.$

3. CMS METHOD (CONSTANT MARKET SHARE)

3.1 METHOD

Constant Market Share (CMS) is a decomposition method based on the assumption that exports of a country might increase faster than the global average for three reasons: a) the demand for commodities exported is growing faster than the world’s average b) exports can go to the markets of the regions that display high growth rates c) exports of the country in question may (or may not) have been able to compete successfully with the other exports going towards foreign markets.

The following part will describe the CMS method as presented by Leamer and Stern (1970). The symbols used are:

- V_i – Value of Albania’s exports of good i in period 1
- V_i' – Value of Albania’s exports of good i in period 2
- $V_{.j}$ – Value of Albania’s exports to country j in period 1
- $V'.j$ – Value of Albania’s exports to country j in period 1
- V_{ij} – Value of Albania’s exports of good i to country j in period 1

r – % increase in world exports from period 1 to 2

r_i – % increase in world export of good i from period 1 to 2

r_{ij} – % increase in world export of good i to country j from period 1 to 2

Value of exports of country A in period 1 is:

$$\sum_i \sum_j V_{ij} = \sum_i V_i = \sum_j V_j = V.. \quad (a)$$

If exports were considered as a single good to a single market, equation (b) could be written and one could interpret that if Albania maintained its market share in the world market, then the exports would increase by ($rV..$).

$$V'.. - V.. \equiv rV.. + (V'.. - V.. - rV..) \quad (b)$$

Taking into consideration the fact that Albania's exports are a set of different goods, the equation (c) can be written as:

$$\begin{aligned} V'_i - V_i &\equiv r_i V_i + (V'_i - V_i - r_i V_i) V'.. - V.. \\ &\equiv \sum_i r_i V_i + \sum_i (V'_i - V_i - r_i V_i) \\ &\equiv \underbrace{(rV..)}_{(1)} + \underbrace{\sum_i (r_i - r) V_i}_{(2)} + \underbrace{\sum_i (V'_i - V_i - r_i V_i)}_{(3)} \quad (c) \end{aligned}$$

Distinguishing for different goods to different regions we can reach the fourth level of CMS analysis shown in equation (d):

$$\begin{aligned} V'_{ij} - V_{ij} &\equiv r_{ij} V_{ij} + (V'_{ij} - V_{ij} - r_{ij} V_{ij}) V'.. - V.. \\ &\equiv \sum_i \sum_j r_{ij} V_{ij} + \sum_i \sum_j (V'_{ij} - V_{ij} - r_{ij} V_{ij}) \\ &\equiv \underbrace{(rV..)}_{(1)} + \underbrace{\sum_i (r_i - r) V_i}_{(2)} + \underbrace{\sum_i \sum_j r_{ij} V_{ij}}_{(3)} + \underbrace{\sum_i \sum_j (V'_{ij} - V_{ij} - r_{ij} V_{ij})}_{(4)} \quad (d) \end{aligned}$$

The last level of this analysis stipulates that Albania's exports might grow from the following: (1) increase in world overall exports (2) commodity composition (3) geographic distribution and (4) unexplained residual, due to increased competitiveness.

3.2 LIMITATIONS OF CMS METHOD

The application of CMS method has certain limitations¹:

- Exports composition and geographic orientation:

The change in the structure of goods exported is mainly related to consumer preferences and competition faced from third countries in the country of

¹ Richardson (1971)

destination. In addition, changes in the geographic distribution mainly reflect changes of the demand side, such as consumer preferences and traditional relations between the two countries (exporter and destination)². In the case of Albania, the above factors are reflected in the increased weights of CEFTA member countries and in the increased market share of “fuel and lubricants” (mainly crude oil). On the supply side, the geographic structure is related to productivity, and to the monetary and fiscal policies pursued by the exporting country. To analyse this effect, indicators such as NEER, REER and labour productivity are taken into consideration. (See Chart 4.)

- Definition of the periods: We assume that time in the above equations of CMS method is continuous and not discrete. If time were discrete, then it would not be feasible to assume that the goods composition and geographic orientation would remain the same for a long period of time.

3.3 REMARKS

The four components of identity (d) were calculated for the period 2005-2008, 2008-2010, 2011 and 2012 using the weights of the categories of exports based on reported values for them. Calculations are based on average annual change during the review period to avoid the problem of discrete time. The distribution of Albanian exports was broken down into the main SITC categories (Standard Classification of Foreign Trade) and also by two destinations: EU-27 market and others. The latter category includes CEFTA member countries, China, Switzerland, Turkey and others.

RESULTS

The CMS results are summarized in Table 1. The overall increase of total exports came mainly as a result of the increase due to world exports and increased competitiveness. The commodity composition had a negative effect during 2005-2008, but switched to positive in 2008-2010 and during 2011. A small negative effect of commodity composition was recorded during 2012. The geographic orientation of exports showed a negative contribution to growth during the aforementioned periods. At the same time, the three main categories of exports (SITC 3,6,8) gave the same results as total exports, being positively influenced mainly by the world growth of exports and the residual effects of competition. Meanwhile, 2011 brought a number of positive effects and the export growth this year was estimated to be positively influenced by all components of the analysis, except the geographic orientation. The poor economic performance in our trading partners during 2011 and 2012 is estimated to have brought a negative effect on the geographic orientation. The weight of the positive effect due to competition fell during 2011 and 2012, which shows an increased competition faced by Albanian commodities in foreign markets. The improved effect due to the commodity structure of Albanian exports can be explained by the increased commodity diversity in

² Athanasoglou, P.P. et al (2010)

recent years. Nevertheless, the abovementioned effect turned negative again in 2012. The increase in weight of the category “Raw materials, minerals” and “Fuel and Lubricants” helped to mitigate the effects of the financial crisis during 2008-2009 on the exporting activity of our country. The increasing weights of the abovementioned categories of exports are estimated to have contributed positively to overall export growth in 2011.

Table 1 CMS results for Albanian exported goods

	Total exports							
	2005-2008		2008-2010		2011		2012	
	Mil €	% total	Mil €	% total	Mil €	%total	Mil €	%total
Due to world export	55.60	14.4%	52.22	20.4%	164.53	70.3%	121.39	101.1%
Due to goods composition	-3.97	(1.0%)	9.54	3.7%	49.50	21.2%	-2.83	(2.4%)
Due to geographic orientation	-1.78	(0.5%)	-29.24	(11.4%)	-19.32	(8.3%)	-38.43	(-32.0%)
Due to competitiveness	335.83	87.1%	223.12	87.3%	39.32	16.8%	39.96	33.3%
Total change	385.68	100%	255.64	100%	234.02	100%	120.09	100%

Source: Bank of Albania, EuroStat, World Trade Organization, UN comtrade and author's calculations.

In addition, the negative effect due to geographic orientation shows the huge impact that foreign demand has on export commodities in Albania. The recent economic and financial crisis affected developed markets and our main partner, the EU. In 2009, the GDP growth rate of EU member countries fell by about 4% and the recession brought a decline in foreign trade by 20%. Consequently, the Eastern European countries were faced with a reduction in foreign demand for domestic goods exported. Also, the share of total Albanian exports to EU-27 markets remains relatively low, around 0.03% of total EU imports from the world. This indicates that our export performance will continue to be affected by the economic performance of our main trading partners, such as Italy and Greece.

Another indicator that helps in assessing the geographic orientation of exports is the Trade Complementarity Index (TCI), which answers the question of whether an exporting country should start to produce new goods to export to a given country or it should expand in the existing export markets. This index measures the extent to which a country's exports model is consistent with the pattern of imports from another country. A high degree of complementarity is supposed to show the most favourable opportunities for a successful trade agreement. The index performance over time can indicate whether the trade profiles of these countries are becoming more or less compatible. The index is constructed as follows and takes values from 0-100:

$$C^{AB} = 100 \left[1 - \sum_k |m_k^A - x_k^B| / 2 \right]$$

m_k^A - k's market share in EU-27 total

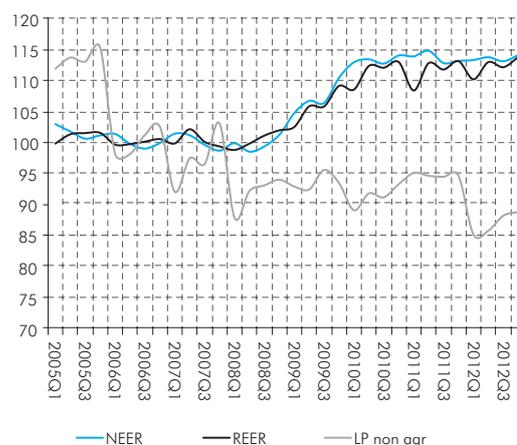
x_k^B - k's market share in Albania's total

For Albania, as an exporting country to the EU-27, this index showed an increase from 41.7 in 2005 to 54.5 in 2012, stipulating a growing complementarity of the Albanian exports structure with the structure of imports

of EU markets. These increased values of the index indicate a possibility of efficiently expanding the foreign trade between Albania and the EU member countries.

The positive effect which comes due to the increased competitiveness of our exports in foreign markets is estimated as a result of several factors. These factors may be associated with the price levels or with the labour productivity of the economy. The NEER and REER indices show increasing values during the period under analysis, implying a depreciating trend for the local currency. This trend may have increased the demand for “cheap” Albanian exports in the foreign markets. In addition, Celiku and Metani (2011) estimated labour productivity values for Albania during the period 2003-2010 and concluded that the index showed a downward trend. When dividing the economy into two sectors, tradable and non-tradable, the latter registered the highest weight, affecting the labour productivity (LP) index downward during the period under analysis. Whereas the tradable sector, even though having the lowest weight, did show an upward trend in its LP index, leading to a plausible explanation of the positive effect due to increased competitiveness of exports.

Graph 4. NEER, REER and Labor productivity index for Albania (2006=100)



Source: Bank of Albania.

The Revealed Comparative Advantage (RCA) index, computed in Balassa (1965), might also help determining the comparative advantage of different export categories of Albania. The index is formulated as:

$$B_{ij} = \frac{x_{ij}/x_{wj}}{x_i/x_w}$$

where X_{ij} – commodity j exports of Albania, X_{wj} world exports of commodity j , X_i – total exports of Albania and X_w – world total exports.

This index shows that Albania has a comparative advantage in exports of product j if $x_{ij}/x_{wj} > x_i/x_w$, evaluating a country’s international specialisation on the basis of its market share in the overall world exports of product j against the weight of the country’s total exports in world exports. It should be noted that if a country remains focused on exports categories with high market shares in its profile but little market share in the global context (as frequently happens in the case of small economies), the result will be an index value greater than 1. To correct for this effect, an index is built with symmetrical distribution³.

$$BL_{ij} = \frac{B_{ij}-1}{B_{ij}+1}$$

This index has a range of values from -1 to 1 and stipulates that if $0 \leq BL_{ij} \leq 1$, then country i (in this case Albania) has a comparative advantage

³ Laursen (1998)

in commodity or category j of exports. Table 2 describes the values that this index takes for certain export categories in Albania and in other countries in the region, which are becoming candidates for EU accession.

Table 2 Descriptive statistics for Bij index (Albania, Serbia, and Croatia)

Balassa 1965	2007	2008	2009	2010	2011	2012
SITC 3	0.6	0.5	0.8	1.2	1.2	1.4
SITC 6,8	2.7	2.8	2.6	2.4	2.3	2.1
Balassa 1965	Serbia					
SITC 3	0.2	0.2	0.3	0.3	0.2	0.2
SITC 6,8	1.9	1.9	1.6	1.7	1.7	1.5
Balassa 1965	Croatia					
SITC 3	0.9	0.7	0.9	0.8	0.7	0.7
SITC 6,8	1.3	1.2	1.2	1.2	1.3	1.3
Laursen 1998	Albania					
SITC 3	-0.3	-0.3	-0.1	0.1	0.1	0.2
SITC 6,8	0.5	0.5	0.4	0.4	0.4	0.4

Source: Bank of Albania, WTO.

The abovementioned results show the existence of comparative advantage in three main SITC categories (SITC 3, 6, 8) for Albania as a result of both calculated indexes. In addition, it is observed that the values of Balassa (1965) index for the three main export categories are most of the time higher than those indexes of Serbia and Croatia, therefore providing arguments for comparative advantages in the region.

4. CONCLUSION

This study aimed to estimate the performance of Albanian exports during the period 2005-2012. Starting with the structure of goods and their geographic orientation and continuing with the analysis of the exposure of the Albanian economy to foreign trade, an overall view was created on the key trends of Albanian exports. To identify the key factors affecting the framework of overall exports, Constant Market Share (CMS) method was used.

Given the ever increasing level of competition in international markets, the small share of total exports of Albania in EU markets, the increased level of exposure to foreign trade and the effects of the economic and financial crisis, the performance of Albanian exports are estimated to have been satisfactory for the period under analysis. The structure of goods exported during the period 2005-2008 and 2012 was estimated to bring a negative effect on the growth of total exports. Although the reorientation of Albanian exports to CEFTA member countries is estimated to have been positive, the effect of the decline in the domestic demand for foreign goods in the EU-27 countries had a higher weight in the equation, therefore adversely affecting the performance of Albanian exports during the period under analysis.

In addition, the positive effect due to increased competition indicates a satisfactory performance of our exports in foreign markets. Based on the above results and highlighting the important weight of re-export textile products and

the weight of minerals and fuels in Albanian exports, these industries are estimated to possess the potential to attract foreign investment from the region and from other developed countries. Nevertheless, it should be stressed that the economic performance of our international partners remains crucial, since foreign demand will play a key role in the performance of exports.

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THE CARRY-OVER EFFECT ON ANNUAL GROSS DOMESTIC PRODUCT DEVELOPMENTS

IRIS METANI

MONETARY POLICY DEPARTMENT

The annual growth rates of the gross domestic product are determined by both economic developments during a given year and GDP growth in the previous year. In other words, the annual average growth rate depends not only on the quarterly growth rates during the year under analysis, but also on growth dynamics recorded a year before. This is known as the carry – over effect. Estimating the carry – over effect is important as it differences out the growth generated in a specific year from the mechanical statistical effect recorded the previous year. The carry – over effect adds information to the cyclical analysis of GDP and should be considered when analysing the annual forecasted GDP growth rates. This article provides an explanation of the carry – over effect concept, describes how it is computed and analyses its importance for the dynamics of GDP growth over time.

The theoretical dimension of the carry – over effect

The carry – over effect is measured as the annual average GDP growth rate that results when the level of GDP during the fourth quarter of the first year remains constant throughout the second year. In terms of quarterly growth rates, this means that quarterly GDP growth rates during the second year are zero. The concept of the carry – over effect is, however, relevant for quarterly or monthly time series, like in this case, when it is applied for quarterly real GDP series. The following formula shows how to compute the carry – over effect and breaks down the annual GDP growth rate in the carry – over effect and growth dynamics.

$$\frac{\text{GDP}_t}{\text{GDP}_{t-1}} = \frac{\sum_{i=1}^4 \text{GDP}_t^{(i)}}{\sum_{i=1}^4 \text{GDP}_{t-1}^{(i)}} = \frac{\text{GDP}_{t-1}^{(4)}}{\sum_{i=1}^4 \text{GDP}_{t-1}^{(i)}/4} \times \frac{\sum_{i=1}^4 \text{GDP}_t^{(i)}/4}{\text{GDP}_{t-1}^{(4)}}$$

where GDP is the level of real GDP (flow data)¹ and seasonally adjusted during quarter i of year t.

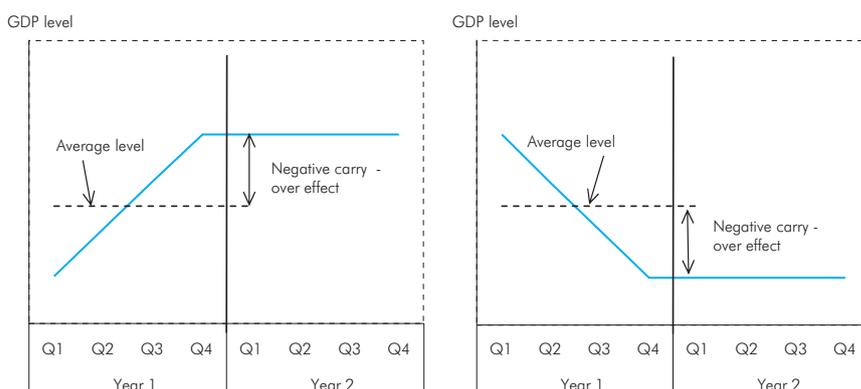
The formula shows that the annual index² can be decomposed in two

¹ The analysis in this article is based on quarterly series of real GDP, as flow data and seasonally adjusted over the period 2005 Q1 – 2013 Q3. The GDP series are seasonally adjusted according to the indirect method by INSTAT. Initially, the direct method is applied to seasonally adjust value added series by economic activities, choosing between working day adjustment for certain branches of economic activity and trading day adjustment for others. Then seasonally adjusted GDP for the economy is computed as the sum of each seasonally adjusted value added series by economic activities.

² It must be highlighted that annual GDP growth rates differ marginally when computed over annual series generated as the sum of seasonally adjusted from when calculated on quarterly GDP series not seasonally adjusted.

components. The first term estimates the carry – over effect, which is computed as the difference in percentage between the GDP level during the fourth quarter of the previous year and the average level of GDP recorded in the referred year. The second term shows by how much the average level of GDP has grown in the second year compared to the previous year. Growth dynamics during the second year can be computed also as the difference between the annual average GDP growth and the carry – over effect.

Chart 1 Theoretical illustration of a positive and a negative carry – over effect



The carry – over effect on annual GDP growth might be positive or negative. If the value of GDP during the fourth quarter of the first year is higher compared to the average GDP value during that year, the carry – over effect has a positive impact on annual average GDP growth during the second year. By contrast, the carry – over effect is negative when GDP level during the last quarter of the first year is lower than the average level during that year. As regards the size of the carry – over effect, the higher the quarterly GDP growth rate in the fourth quarter of the first year, the larger is the carry – over effect. The assumption that conditions in the economy remain unchanged implies that the annual average growth rate might also be higher during the second year.

However, the analysis of the relationship between the annual growth rate and the quarterly growth rates clarifies the importance of quarterly developments. The approach followed is the one developed by Patton and Timmermann (2011), and Todter (2010). Mainly referring to the approach of Todter, represents the annual growth rate of GDP during year t and is the quarterly growth rate of GDP during quarter i of year t . Annual growth rate can be computed using the following formula:

$$G_t \approx \frac{1}{4} * (g_{t-1,2} + 2 * g_{t-1,3} + 3 * g_{t-1,4}) + \frac{1}{4} * (4 * g_{t,1} + 3 * g_{t,2} + 2 * g_{t,3} + g_{t,4}) \quad (1)$$

As the carry – over effect implies that quarterly rates during year t are 0, due to the assumption that the GDP level in year t remains that of the last quarter of year t – 1, according to the formula shown above the effect is calculated as:

$$U_t \approx \frac{1}{4} * (g_{t-1,2} + 2 * g_{t-1,3} + 3 * g_{t-1,4})$$

While the growth dynamic during year t is computed based on the formula:

$$D_t \approx \frac{1}{4} * (4 * g_{t,1} + 3 * g_{t,2} + 2 * g_{t,3} + g_{t,4})$$

The formula used for the calculation of the annual growth rate shows that different weights are attributed to quarterly changes. The quarterly growth rate of the last quarter of year t – 1 accounts for the largest weight in the computation of the carry – over effect, whereas the quarterly change in the first quarter of year t has more importance for growth dynamics during year t.

The above breakdown of the annual growth rate shows also that available information up to the fourth quarter of a year contributes to the forecasting of the annual growth rate in the successive year, at a relatively high credibility. The error carried in the forecasted annual growth rate of GDP is strongly related to developments in the fourth quarter of the previous year and those in the first quarter of the forecasted year. If the last quarter of year t – 1 and the first quarter of year t are accurately forecasted, and if the data during the second and third quarter of year t – 1 are known and are not revised largely, then we have about 62.5%³ of the information required to forecast, at a relatively high precision, the annual growth rate during year t.

Applying the carry – over effect in the annual growth rate of domestic GDP

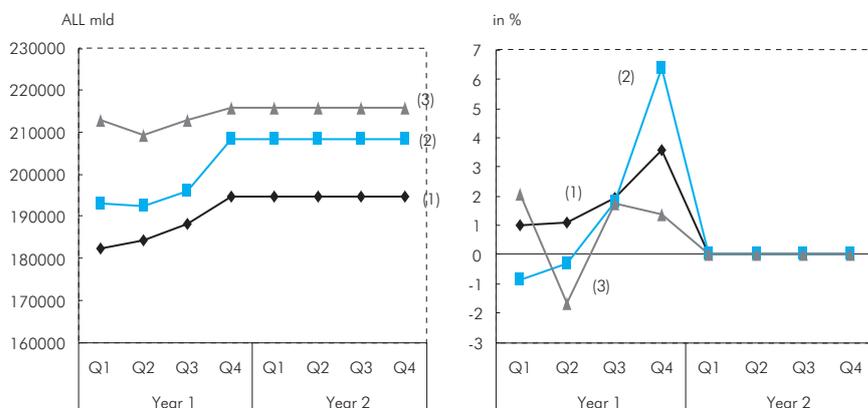
In order to understand the importance of growth dynamics during the first year to the carry – over effect during the second year, the effect is computed over quarterly data for domestic GDP covering the period 2006 – 2009. This is illustrated by Chart 2 that reflects GDP developments in levels and in quarterly changes during 2006 – 2007 (1), 2007 – 2008 (2) and 2008 – 2009 (3). The size of the carry – over effect results differ depending on the recorded GDP developments in the first year of each period. The carry – over effect accounts for a minimum value of 1.5% during period (3), when quarterly GDP growth fluctuated around low rates in 2008, to a maximum value of 5.5% during period (2), with the highest quarterly growth rate, in 2007.

The decomposition of annual GDP growth rate in the carry – over effect and growth dynamics is calculated during the period 2011 Q1 – 2013 Q3 in order to get an illustration of the breakdown. Lines A and C in Chart 3 represent average GDP levels during 2011 and 2012, respectively. Lines B and D correspond to average GDP levels during 2012 and 2013 assuming

³ This value is computed as the ratio of respective weights attributed to the above specified quarterly rates with the weights of quarterly rates used to calculate the annual growth rate,

$$\frac{\frac{1}{4} * (1 + 2 + 3 + 4)}{\frac{1}{4} * (1 + 2 + 3 + 4 + 3 + 2 + 1)}$$

Chart 2 GDP in levels and its quarterly growth rates during 2006 - 2007 (1), 2007 - 2008 (2) and 2008 - 2009 (3)

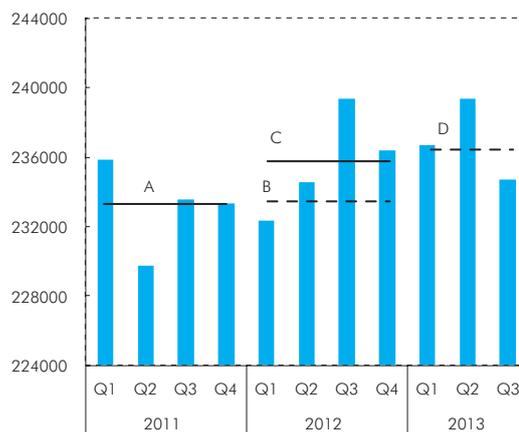


Source: INSTAT.

that these levels would equal GDP recorded flows in the fourth quarters of 2011 and 2012, respectively. The difference in percentage between A and C is the annual average growth rate during 2012 (1.1%), whereas the difference in percentage between A and B, and between C and D shows the carry – over effect in 2012 (0.1%) and in 2013 (0.3%). Meanwhile, the difference in percentage between B and C represents the growth dynamics during 2012 (1.0%).

Based on the calculations reflected in Chart 4, about 62% of the annual average GDP growth rate, which fluctuated around 4.2% during 2006 – 2012, is explained by the growth dynamics over time, whereas 38% of this rate is attributed to the carry – over effect. Also, the availability of quarterly GDP data up to 2013 Q3 allows for the computation of the carry – over effect during 2013 that accounts for 0.3%. This value might again be subject of estimation as long as the forthcoming publications of GDP for the following quarters include not only new data, but also revisions of the series during the previous quarters. The availability of the series up to 2013 Q3 ensures around 93.75%⁴ of the indispensable information to forecast the annual GDP growth rate during 2013. More concretely, by applying data up to the third quarter of 2013 to formula (1), GDP in 2013 is estimated to fluctuate around the average annual growth rate of 0.35%. This value does not account for the quarterly growth rate during the fourth quarter

Chart 3 GDP in levels during 2011, 2012 and 2013

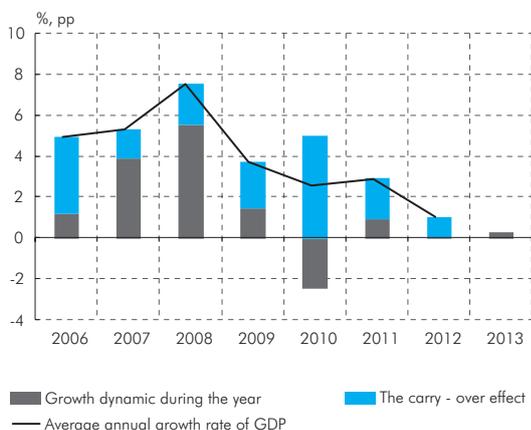


Source: INSTAT.

⁴ This is computed as the ratio of respective weights attributed to quarterly growth rates during 2012 and those that are disposable during 2013 with the weights of quarterly rates used to calculate the annual growth rate, $\frac{\frac{1}{4} \cdot (1 + 2 + 3 + 4 + 3 + 2)}{\frac{1}{4} \cdot (1 + 2 + 3 + 4 + 3 + 2 + 1)}$

to which a small weight of 25% it is attributed, and might as well be subject of revaluation due to GDP series revisions.

Chart 4 The annual average GDP growth rate decomposed in the carry - over effect and the growth dynamic during the year



Source: INSTAT and author's calculations.

The breakdown of annual average GDP growth rate in the carry – over component and economic developments ameliorates the analysis process of economic growth and does enhance the understanding of the annual forecasted growth rates. The analysis shows that, depending on the growth performance, the carry – over effect might fluctuate considerably from year to year. However, it is important to understand and examine the amount of information the carry – over effect contains for the forecasting of annual average GDP growth rate, the extent it may reduce the uncertainty surrounding the forecasting process and how effective the carry – over effect is for short – term forecasts.

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ABOUT ECAI RECOGNITION

LINDITA VRIONI
RESEARCH DEPARTMENT

1 INTRODUCTION

Basel II represents a major innovation in approaches to regulation that, when implemented to its full potential, will result in a stronger, more resilient banking system. Recently, the new regulation of the Bank of Albania “On Capital adequacy ratio” (CAR) was published and will enter in force on 31.12.2014. The new capital standards increase capital charges and require banks to use credit ratings from approved rating agencies (called external credit assessment institutions, or ECAIs) when calculating their net capital requirements under the Standardized Approach.

Taking in account the significance of such regulation and the impact of those changes on the banking system, as the regulation is in a transitory period, this analysis will address some concerns related to the implementation of the new capital requirement, especially for the credit risk.

At the heart of the Basel Framework is the idea that regulatory capital requirements should be determined by the risks profiles. In Europe, the Basel is being implemented in the form of the Capital Requirement Directive (CRD), which was adopted by the EU Commission in July 2004, and BoA’s CAR regulation is in alignment with the CRD. The BoA approach, the Standardized Approach, employed to calculate the capital requirement for the credit, is a simple one. Nevertheless, references to credit ratings in the regulation have augmented the reliance on ratings, increasing therefore the responsibility of the regulator to ensure adherence to minimum standards.

The CRD¹, as well as BoA’s CAR Regulation Nr. 48, of 31.07.2013, provide that, in order to calculate their counterparty’s credit quality, banks may use external credit ratings, as provided by external credit assessment institutions (ECAIs). The ECAIs that produce those assessments have to be recognized as eligible for that purpose by the regulatory authority. This recognition is granted only if the supervisory authority determines that an ECAI has met the recognition criteria laid down in the CAR Regulation.

¹ Article 80 of the CRD provides that: “To calculate risk-weighted exposure amounts, risk weights shall be applied to all exposures, unless deducted from own funds (...). The application of risk weights shall be based on the exposure class to which the exposure is assigned and (...) its credit quality. Credit quality may be determined by reference to the credit assessments of external credit assessment institutions (ECAIs) in accordance with the provisions of Articles 81 to 83 or the credit assessments of Export Credit Agencies

Taking in consideration the present activity of the rating agencies in the Albanian market, the use of their ratings for regulatory purposes, considered in this approach, faces some obstacles. Those obstacles are related to factors necessary for assessing the credit quality accurately. Anyhow, in order to implement the above-mentioned regulatory provisions, some preparatory research and work must be done. This will help to organize and prepare the data to be supplied to the rating agencies to perform their task.

The external ratings have to bring more accuracy into the credit quality and, therefore, improve the quality of the regulatory capital requirements under the Standardized Approach; however, this depends on the availability and quality of and sufficient quantity of necessary data.

2. CREDIT RATING AND ECAIs

2.1 DEFINITION OF CREDIT RATING

The emphasis to the importance of credit rating agencies (CRAs) according to Basel II asks for a reaction from the authorities' side in knowing the work and functioning of CRAs.

The credit rating characteristics have been summarized by Ong (2002). A credit rating is:

- a judgmental process of ranking and classifying loans into different risk categories. Each of these categories represents a clear and precise statement of the creditworthiness of the rated firm;
- a predictive process using observable and current information to project potential future outcomes (e.g. future loss);
- key ingredients include both quantitative analyses (e.g. ratios, cash flow, industry, sector, macroeconomic) and qualitative analyses (e.g. financial strength, management and corporate governance).

The term ECAI is coined by Basel II. Credit Rating Agency (CRA) is used for agencies that conform to the IOSCO (International Organization of Securities Commissions) definition, which includes:

- those entities whose primary business is the issuance of credit ratings for the purposes of evaluating the credit risk of issuers or debt and debt-like securities; or
- any organization whose ratings are recognized for regulatory purposes by a financial regulatory authority.

The IOSCO (2004) defines a "credit rating" as an "opinion forecasting the creditworthiness of an entity, a credit commitment, a debt or debt-like security or an issuer of such obligations, expressed using an established and defined ranking system".

From consulting the web of rating agencies, we may conclude that Rating Agencies use different approaches in forming and publishing their opinions

about credit risk. Some agencies use analysis, some use mathematical models, and some use a combination of the two. As rating agency models differ with regards to their criteria, processes, and ratings definitions, users of ratings should consider such differences if they are using credit ratings as benchmarks.

The two main approaches are Analyst-Driven Credit Rating and Model-Driven Credit Ratings.

Standard & Poor's use the Analyst-Driven approach and employs analysts to evaluate and express an opinion on the relative creditworthiness of issuers and the relative credit quality of debt issues. In rating an issuer, analysts review the financial performance, policies, and risk management strategies of that issuer as well as the business and economic environment in which the issuer operates. In addition to evaluating financial data, credit analysts typically weigh qualitative information, such as long-term strategies, as they assess the issuer's ability and willingness to meet its financial obligations in a timely manner. Many analysts also bring their expertise in specific industry segments and transaction structures in evaluating credit risks attributes.

Model-Driven Credit Ratings

A small number of rating agencies use the model-driven approach, focusing more exclusively on quantitative data that they incorporate into a mathematical model to produce their ratings, which are generally point-in-time assessments. This approach assesses the creditworthiness of a bank or financial institution and evaluates that entity's asset quality, funding, and profitability based on figures that appear in that entity's financial statements and regulatory filings. The mathematical formulas used to measure creditworthiness are often proprietary and highly complex.

Considering the availability of historical data for the Albanian market, we expect that credit rating applicable for eligibility for the purpose of capital requirement in Albania will be the Analyst-Driven Credit Ratings.

CRA's have their own ratings definitions, for instance:

Standard & Poor's

A credit rating is an "opinion of the general creditworthiness of an obligor, or the creditworthiness of an obligor with respect to a particular debt security or other financial obligation, based on relevant risk factors. It does not constitute any recommendation (to purchase, sell or hold a particular security) and does not comment on the suitability of any particular investment".

Moody's

A Moody's rating is an "opinion of future relative creditworthiness, derived by fundamental credit analysis and expressed through the AAA–C symbol system. Fundamental credit analysis incorporates an evaluation of franchise value, financial statement analysis and management quality".

Moody's definition of default includes three types of default events, namely:

- a) disbursement of interest and/or principal is missed or delayed, including delayed payments made within a grace period,
- b) an issuer files for bankruptcy, or legal receivership occurs, or
- c) a distressed exchange occurs.

According to these definitions, we might conclude that CRAs issue opinions on the credit worthiness of a particular issuer or financial instrument as of a given date. As such, being an opinion (which in itself does not imply a responsibility) they do not constitute a recommendation within the meaning of the [CAR] directive; moreover they are confined to a determined time.

While the credit ratings are only an assessment, an "opinion", they are eventually used and relied upon in this context as if they were completely objective indicators of credit risk. In this case, the fact that they may not be reliable does not directly impact the CRA's credibility and reputation, as more consequences are borne mainly by third parties.

In order to arrive at a conclusion for a particular credit rating, CRAs analyze public financial, accounting and other information about the issuer, as well as current and prospective macro- economic and market factors that may affect the issuer's or the debt instrument's credit risk, which is composed of both financial risk (financial policy, profitability, liquidity and debt management) and industrial/commercial risk (sector risk, competitive position, strategy, industrial and restructuring projects, etc). In most cases, the CRAs communicate with the issuer's management and also base their ratings on non-public information. However, CRAs do not verify the accuracy of accounting, financial or other information.

Each CRA uses its own credit risk assessment methodology, which is made public on its website, where the CRA explains the quantitative and qualitative factors used to determine credit ratings for each category of debt (depending on the economic sector, whether the issuer is a sovereign, municipal or corporate entity, the type of debt instrument or structured finance vehicles, etc). Even though the appreciation of certain factors taken into account in the rating process is essentially subjective, the publication of a CRA's methodology may help the issuer and investors to better understand the rating process.

2.2 Debates on regulating the Credit Rating Agencies after the crisis.

The trend: increasing reliability of and decreasing reliance on credit ratings

Before the financial crisis, the credit rating activities relied only on the "comply or explain" model of industry self-regulation. Self-regulation is explained by the IOSCO CRA Code of Conduct, first published in December 2004. The Code was revised in 2008 to address concerns about (i) CRA transparency and market perceptions; (ii) independence and avoidance of conflicts of interest, and (iii) CRA competition and the interaction of this competition on CRA

independence. The Code relies upon disclosure as a compliance mechanism, with individual CRAs publishing their own codes of conduct so that market participants could evaluate the degree to which a CRA had incorporated the Code within its own internal requirements. Most CRAs have adopted the code and IOSCO will monitor its implementation.

Proposed policy recommendations focus mostly on the regulation of CRAs using a “be supervised” model. The proposed regulations aim at reducing conflicts of interest and promote increased competition in the CRA industry. These goals are consistent with two of the key objectives of financial regulation, namely (1) protecting investors from opportunistic behavior; and (2) enhancing the efficiency of the financial system. For instance, the G20 Leaders’ Statement (London Summit, 2 April 2009) proposes “to extend regulatory oversight and registration to CRAs to ensure they meet the international code of good practice, particularly to prevent unacceptable conflicts of interest.”

Currently, CRAs are not regulated but the crisis has urged them to be registered and supervised.

De Larosière Group (2009) recommends a fundamental review of CRA’s business model, its financing, and the separation of the rating and advisory activities. It also recommends the reduction of the use of ratings in financial regulations. The Group stresses that the regulatory changes should be accompanied by increased due diligence and judgment by investors and improved banking supervision.

While some regulators are making efforts to reduce references to ratings in legislation and regulation, still the fact is that credit ratings are an important market mechanism and they are well integrated into today’s financial framework. Perhaps, some effort is needed to educate the Albanian market as to the purpose and limitations of ratings.

As the summary of the debates we may say:

Opinions, per se, cannot be “accurate”, but that does not mean they might be random or unreasonable and that CRAs should not be responsible for the process through which they are assigned and published. In fact, we have an unregulated entity that has the right to give delicate and important “opinions” for regulated entities. What’s needed by the regulatory authority is to ensure credit rating reliability.

2.3 CONCERNS ABOUT CREDIT RATINGS

CRAs produce not only credit ratings, but their own definition of what credit risk means in the context of a particular entity, which in fact might be different from that of the regulatory authority. Having no consensus on the definition and measurement of credit risk, regulating the credit ratings industry substantively seems difficult at this stage.

Obviously, credit rating agencies tend to raise the credit ratings of borrowers in economic boom times and lower the credit ratings in times of economic difficulty. That allows banks to lower their capital requirements in economic expansion, but requires an increase in capital requirements in economic downturns. This is precisely the opposite of what financial economists suggest to be the optimal approach for capital standards.

Eventually, banks might include rating triggers in loan agreements and obtain automatic enforcement rights in case of borrower default, on the sole basis of the rating, neglecting the close monitoring of the borrower's credit risk and other risks.

But CRAs do not have the same incentive as banks to monitor borrowers, since they do not incur a financial risk in the case of borrower default. Therefore, irrespective of the accuracy of credit ratings, the banks' unique function in assessing, closely and on a permanent basis, a borrower's overall financial structure and risks may, in some cases, no longer be fulfilled.

Moreover, when banks will use credit ratings in order to calculate capital requirements, they might be motivated to select highly-rated borrowers, because it mechanically lowers their capital requirements. If credit ratings do not adequately reflect credit risk, the banks' capital structure might give the illusory impression that it constitutes a sufficient "cushion" against risk, which could threaten the safety and soundness of the banking system.

Despite those concerns, it has been widely established that investors, banks and regulators rely on credit ratings for an increasing variety of purposes: i) determining capital requirements; (ii) identifying or classifying assets, usually in the context of eligible investments or permissible asset concentrations; (iii) providing a credible evaluation of the credit risk associated with assets purchased as part of a securitization offering or a covered bond offering; (iv) determining disclosure requirements' and (v) determining prospectus eligibility.

3. ECAI RECOGNITION

Basel II sets six eligibility criteria for ECAs, (almost the same are set out in the BoA regulation, which transposes the CRD).

Although the criteria in some cases have different names, they are essentially identical. The differences between Basel II and the Directive consist in adding four criteria concerning ECAI methodology.

The Directive, unlike Basel II, omits the following provisions:

- assessment based on a combination of quantitative and qualitative approaches
- specification of CRD benchmarks
- some details on disclosure: definition of default, time horizon and meaning of each assessment category, transition matrix.

These additional provisions generally make the assessment of ECAs more direct and explicitly stated. By setting criteria for approving the list of recognized ECAs, the competent authorities undoubtedly influence ECAs, but this is not equivalent to regulation.

Two models of supervisory recognition are set out in the CRD: direct and indirect recognition. Both modes are agreed procedures for the application and assessment process in the new regulation of BoA. In the direct recognition, supervisors make their own evaluation of an ECA's compliance with the recognition criteria. In the indirect recognition, supervisors recognize an ECA based on recognition in any Member State of EU, without carrying out their own evaluation process.

The key purpose of the recognition criteria is to identify ECAs that produce external credit assessments of sufficiently high quality and consistency that may be used by institutions for regulatory capital purposes under the Standardized Approach.

The recognition process beings when:

- applications are initiated by an ECA
- applications are initiated by financial institutions
- applications are initiated by the BoA itself actively seeking entities that meet ECA recognition conditions.

The recognition process can stem into three parts for the purposes of the recognition process:

- a) the requirements/expectations of supervision authority
- b) the documents that must be submitted in order for the authority to be able to assess whether the requirement have been met
- c) key questions for the ECA's representatives.

Following a successful assessment of an ECA, the authority includes the ECA in its List of Eligible ECAs for the relevant market segment(s). The authority will notify the applicant and the relevant ECA of the outcome of the process.

3.1 MARKET PENETRATION OF CRA

The ECA runs its activities even without the recognition of the competent authorities. The approval of an ECA by a competent authority for capital adequacy purposes may be taken as a widening of the scope of application of its ratings.

Currently, there are only three major international credit rating agencies: Moody's, Standard & Poor's (S&P) and Fitch. They cover many individual assessments (tens of thousands) and include long default histories. They also have experienced and sufficient teams of analysts assuring ongoing review. But, primarily, they are recognized by market participants.

The penetration of CRAs in Albania is limited to rating only some subsidiaries of foreign banks and local banks such as:

- ProCredit Bank Albania, rated by “Fitch Ratings”;
- National Commercial Bank (BKT), rated by JCR-ER;
- Societe Generale Bank rated by Moody’s;
- Credins Bank rated by Moody’s;
- Also Moody’s has rated all the Greek banks operating in Albania: Alpha Bank, Emporiki Bank, National Bank of Greece SA, Tirana Bank.
- Standard & Poor’s rates Vienna Insurance Group.

The Albanian market for rating agencies is recently established and lacks even the short history of rating. Obviously, the process of recognizing agencies as eligible ECAIs would be relatively easy, as it will be mostly an indirect recognition (CRAs are already recognized in EU). In addition, there are some specialized smaller rating agencies, which, in many cases, provide ratings in addition to other consultancy services.

3.2 IS ECAIS RECOGNITION ENOUGH FOR A RELIABLY CREDIT ASSESSMENT?

The requirements that a CRA must comply for ECAI recognition should be of comfort to regulatory authorities, when they allow financial institutions to use these ratings for the purpose of calculating regulatory capital.

The regulation “On Capital Adequacy” is approved and is in accordance with the EU directive. Despite the will to be implemented, the legal mandate is restricted to several technical criteria, such as specification of the (quantitative and qualitative) factors, the benchmark and the ‘mappings’.

In trying to illustrate the criteria to the practical implementation, I would like to explain in more details those criteria starting with the ‘mappings’.

For the purpose of capital requirement, the regulators are very keen in requesting that the definition of the rating category, as shown in the relevant article of the CRD, should be compared with the meaning of the credit quality steps assigned by the authority.

Article 11 - Meaning and relative position of a rating category

1. The meaning of a rating category established by the ECAI shall be defined according to the following characteristics of the capacity of financial commitments as reflected in the items assigned such rating category, being honored, and more in particular by:

- (a) its degree of sensitivity to the economic environment;*
- (b) its degree of proximity to the default situation.*

2. The meaning of a rating category shall be compared to the one established for each credit quality step, as specified in Article 16.

3. The meaning of a rating category shall be considered in combination with its relative position within the rating scale established by the ECAI.

Subsequently, for the process of ECAs recognition to be completed, it is necessary for the meaning of the credit quality steps to be established by the BoA, as provided in the regulation below. "Bank of Albania, taking into account the technical criteria set out in this Subchapter on the recognition of ECAs, shall determine the mapping process with which are to be associated the credit quality steps set out in Subchapter I of this Chapter and the relevant credit assessments of an eligible ECAI".

The subchapter describes the credit quality steps and corresponding weighted risk; but, as the regulation requires, the meaning of the credit quality steps is necessary, as well.

The regulation determines that: *Bank of Albania shall compare default rates for each credit risk assessment carried out by an ECAI with a benchmark built on the basis of the experience with default rates by other ECAs, for a category of issuers that present an equivalent level of credit risk.*

This means that, for calculating default rates, the historic data on credit rating for a period of time and the default of ratings are needed. Maybe, in this respect, a central repository of credit ratings is also necessary for the implementation of this regulation.

When assessing the level of risk behind each credit assessment, the ECAs are asked by the regulator to provide all necessary and relevant information. Also, they should have systems in place to capture relevant data as they become available. The data will show whether, in practice, the rating agencies' predictions were accurate (did companies, which received higher ratings, default less frequently than those receiving lower ratings?). The question pops up: can the credit rating agencies find relevant data on bankruptcy filing for each segment of credit market in Albania?

It looks like the main costs of compliance with this regulation would be faced by ECAs as they have to provide the data, which are scarce for Albanian markets. Those data are necessary inputs for the ECAs methodology for assigning credit assessments. The methodology is based on a combination of quantitative and qualitative factors to determine credit ratings for each category of credits. Such a quantitative factor is the "cumulative default rates" (CDRs) over a three-year period: that is, the sum of all defaults that have occurred in a given three-year period for all rated items belonging to the same bucket and qualitative factors, such as general risk drivers of the items assigned a rating category, should also be taken into account.

After all, intensive data are needed (and only the credit risk) such as those in the list below: borrower data, guarantor data, asset-specific data, default data, data on recoveries, data on rating and migration, industry data, macro data, correlation data.

For banks, the costs of complying with this Regulation are negligible, since the individual mapping tables for each ECAI will be made publicly available

and would be easily incorporated into the calculation process for capital requirements.

Efforts should be made in order to limit as much as possible the burden on the ECAs; otherwise they might not be interested to be involved in the process, from the economic point of view. These efforts are important not only for the costs of complying with this Regulation but, most importantly, for avoiding unwanted bank incentives such as the preference to lend to unrated corporates. The reason is that, under the Standardized Approach, the unrated corporates are expected to face the same risk charges as in the Basel I Accord.

CONCLUSIONS

The ECAs have a more important role under the Basel II framework, in particular for banks using the Standardized Approach.

In order for the process of ECAs recognition to be completed as the regulation provides, some additional technical criteria are needed. Those criteria are important. For the practical implementation of the credit assessment under the Standardized Approach, intensive data are necessary (borrower data, guarantor data, asset-specific data, default data, data on recoveries, data on rating and migration, industry data, macro data, correlation data).

This approach delivers risk sensitivity only if all corporates are rated and if their ratings properly reflect their risk profiles.

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REAL EFFECTIVE EXCHANGE RATE FOR COUNTRIES IN OUR REGION: BUILDING A DATABASE

JONIDA BOLLANO AND DELINA IBRAHIMAJ
MONETARY POLICY DEPARTMENT

INTRODUCTION

Albania is considered as a small and open economy, where the exchange rate plays a significant role on price levels and on the balance of payments.

The Real Effective Exchange Rate (REER), which measures developments in the real value of the currency relative to a basket of currencies of major trade partners for the given country, has been broadly used both in theoretic and practical research. This index has been used to evaluate misalignment from the “equilibrium” and underlying factors of trade flows, and analyse the dynamics of competitiveness based on cost prices.

The primary aim of this paper is to propose creating a database on the performance of the real effective exchange rate for Albania and some Balkan and SEE countries based on a unified methodology. Employing the same methodology provides an additional opportunity to explain the trade performance of various countries and to compare the international competitiveness of the countries under review. The indices on labour productivity and exports performance over the years, for the countries under review, constitute added value for this study. Measuring prices and cost of production are among the standard factors used to evaluate the competitiveness profile of a country.

While we do not seek to make a comprehensive analysis of the competitiveness profile of the countries under review, we do present some preliminary conclusions about: a) role of the exchange rate regime in the REER performance and absorption of foreign shocks; and b) positioning of Albania versus countries in the region and more advanced CESEE countries in terms of REER.

LITERATURE

Literature suggests that the determinants of a country’s international competitiveness may be classified as structural factors that may be related or unrelated to prices/costs. Price-related structural factors are necessary to measure competitiveness, although the significance of such factors depends on the elasticity of demand in relation to prices. Leichter et al, in 2010, says that price-related structural factors are usually conditioned by the following: efficiency in production, distribution, and sale; exchange rate between two exporting

countries and importing countries and the strategies that the companies apply in international markets. The first factor may be measured by productivity. Durand et al in 1992 states that the primary and secondary factors are combined to create an aggregated competitiveness index, such as the REER. The latter factor may be measured by relative disaggregated export prices.

On the other hand, non-price-related factors are difficult to evaluate as they are mainly based on qualitative data. However, according to OECD 2008, all productivity indicators, measured by input factors, and the total factor productivity are relevant for the competitiveness. Labour productivity may be measured by considering various factors of production: GDP, disposable income, NDP evaluated on the hours of work or number of employed persons.

In the case of Albania, Celiku and Metani in 2011 studied the competitiveness profile of the domestic economy through the relative indicators of the LP and CPU. According to them, the differences between the CPUs of an economy against other economies may arise from a series of factors, which are oftentimes difficult to identify, measure and analyse. This study supports the fragile competitive advantages of our economy in relation to the panel of other economies under review. Competitive disadvantages arise mainly from large differences between the LB of domestic economies and those of comparative economies, as well as by the small share of the tradable sector in the economy.

Differences in the productivities of countries provide useful information on competitiveness. It is crucial for the competitiveness analysis, however, to analyse the exchange rate, which is usually measured by REER. To measure REER an ample dataset is needed, such as: number of countries to compare competitiveness; indices of costs/prices; nominal exchange rate; weights for data aggregation.

The study of REER and its impact on the Albanian economy has stirred the interest of many researchers.

The first attempt to measure REER in Albania was made by Vika (2006), who has established REER taking into consideration the main trading partners, to see the appreciation or depreciation trend, in real terms, of the Albanian lek and the volatility. Vika constructed REER based on the consumer price index and the ratio of relative prices tradable to non-tradable goods and services. He built two indices according to these two baskets against 5 and 16 countries. The outcome of the study revealed that these two indices are closely related to each other and that choosing between them does not constitute a significant problem.

For 2006, Shtylla and Sojli combined the effects of relative prices and exchange rate on trade flows in one single variable of the real exchange rate, and did not distinguish between their elasticity. They found that the long-term impact of the real effective exchange rate on imports volume is somewhat higher than that of the domestic GDP.

Hoda in 2012, in his study on the role of the exchange rate on trade exchanges in Albania found that while income constitute a main promoter of trade flows in Albania, the exchange rate plays a significant role to boost export growth and replace imports.

Pllaha in 2012 studied the effect of exchange rate on bilateral trade flows between Albania and its main trading partners, namely: euro area, Italy, Greece, Germany, Kosovo, and Turkey. One of the main findings is that the hypothesis of the "J-curve" is endorsed only in the case of trade with Italy and Turkey.

Economic literature proposes some theories which may argument REER changes, such as the Balassa-Samuleson effect, price level convergence, changes to productivity of countries based on various business cycle stages, stable changes of productivity, optimum distribution of resources among production sectors.

MEASURING REER

REER index is constructed based on the computation of the nominal effective exchange rate and a second index, which states the price or relative cost between the country under review and its trading partners. In practice, there is a number of prices that may be used to measure the real exchange rate: consumer price index (CPI), exports price index (EPI), producer price index (PPI), GDP deflator (GDPD), and the unit labour cost index (ULC) (Chinn, 2002). In this paper, we have opted to use the consumer price index (CPI). Although this index measures the purchasing power better than the competitiveness one, it is widely use to compute the real exchange rate, because it is easily available for all the countries.

The real effective exchange rate (REER) is computed as the weighted geometric average of prices in Albania relative to the prices in trading partners:

$$REER = \prod \left[\frac{C_h \times K_n}{C} \right]^{W_n}$$

where C and C_h are domestic price indices, W_n is the share of the relevant trading partner n in domestic trade, and K_n is the nominal exchange rate for the national and foreign currency expressed as the price of a foreign currency unit to the national currency. According to this definition, a decrease in the index represents an appreciation in real terms, whereas increase would point to depreciation in real terms of the the national currency.

The weights used to construct the REER index are based on bilateral trade flows¹, which are calculated according to the following formula:

¹ A disadvantage of the selected method is that it does not take into account the competitiveness of two countries in third markets. This methodology has also been applied by the IMF to compute the weights of competition for 35 "new" members of the Fund from Eastern Europe, including Albania, and former Soviet Union countries (Zanello & Desruelle, 1997).

$$W_{ij} = \frac{M_i}{M_i + X_i} m_j^i + \frac{M_i}{M_i + X_i} x_i^j$$

Where M_i and X_i represent imports and exports of country i ; m_j^i is the share of imports of country i originating from country j ; and x_j^i is the share of exports of country i to country j (Zanella & Desruelle, 1997). In the above computations, we should pay attention to the change of relative weight of bilateral trade in different periods. Volatility of import-export flows may alter the weight of trading partner countries, hence leading to the need for timely update. For this reason, Ellis (2001) proposes that the construction of the REER index for time t should be computed as the product of REER for the period before the introduction of the new weights $W(\tau-B)$, with the ratio of bilateral real exchange rates BRER, for countries i , measured by the geometric average for the base period B and current one t , using current weights τ :

$$REER_t = REER_{\tau-B} \times \frac{\prod_i BRER_{i,\tau}^{w(i,\tau)}}{\prod_i BRER_{i,\tau-B}^{w(i,\tau)}} \quad \text{ku } t \geq \tau.$$

DATA

Based on the criteria of similarities between the economies, we decided to study the performance of the real exchange rate for Albania, Bosnia and Herzegovina, Bulgaria, Hungary, the Czech Republic, Macedonia, Croatia, Poland, Romania, Serbia and Turkey.

Romania, Serbia, Poland, Turkey, the Czech Republic and Hungary, similarly to Albania, have a free floating regime, whereas the other economies, despite having a fixed exchange rate regime, are considered as structurally similar to the economy of Albania.

Monthly CPI data are taken from Eurostat and Global Economic Monitor² and national statistics institutions. The base year for all the data is year 2005. In the case of Montenegro, given the lack of data for 2005-2007, the CPI is approximated with the retail trade index. In the case of Serbia, given the lack of data for 2005, the CPI is equalised to 100 for all the months.

The average values of the exchange rate for the countries under review are taken from ACIFIC Exchange Rate Service and Global Economic Monitor. For constructing exchange rates, we have assumed that trade exchanges with European trading partners are in euro, whereas trade exchanges with non-European trading partners (including Turkey) are in US dollars.

For all the countries under review, the most significant 15 trading partners have been selected, accounting for over 75% of their total trade exchanges. To construct the weights we have used data from <http://www.trademap.org/> Data are in annual terms. The weights have been kept unchanged throughout the year. For 2013, we have used the weights of 2012, as data for 2013 are not published, yet.

² World Bank database.

In this study, labour productivity (LP) is computed as a ratio of the real GDP to the number of persons employed in an economy (Morgese et.al. 2008). Certainly, construction of LP computed as a unit produced to total hours worked would be useful, as it would express the difference in work hours between the countries (taking into account also the difference of hours worked based on a full-time or part-time contract). However, in the absence of data for countries subject to comparison, the analysis is made based on the number of employed persons. For constructing the LP, for all the countries subject to comparison The Conference Board Total Economy Database, published in January 2014, has been used. For all the countries under review, the real GDP is in USD millions to price level in 2013, adjusted by the purchasing power parity (PPP) for 2005, constructed according to the model developed by Elteto, Koves and Schultz³.

RESULTS

Performance evaluation of prices and cost of production are among the standard factors used to evaluate the competitiveness profile of a country. In general, the appreciation of the national currency, or the rapid rise of prices is considered to lead to declining capacities of a country to compete in foreign markets. In this study, the REER increase is considered as a real depreciation of the national currency, whereas its contraction is considered as appreciation.

It must be noted, however, that a deterioration of price indexes and of cost may be an element that accompanies the convergence process (conform to the Balassa-Samuelson effect). On the other hand, it may be followed by the improvement of non-price competitiveness.⁴ Despite this aspect, which requires a more thorough analysis, the following analysis seeks to introduce a unified performance of the real exchange rate and labour productivity for some countries of the Balkans and Central and South-Eastern Europe.

As the charts show, in almost all EU candidate countries⁵, except Albania, the REER index has fallen in the period before the crisis (before 2008), showing a considerable appreciation in real terms of their currencies. Similar performance is also noted in EU member countries.⁶

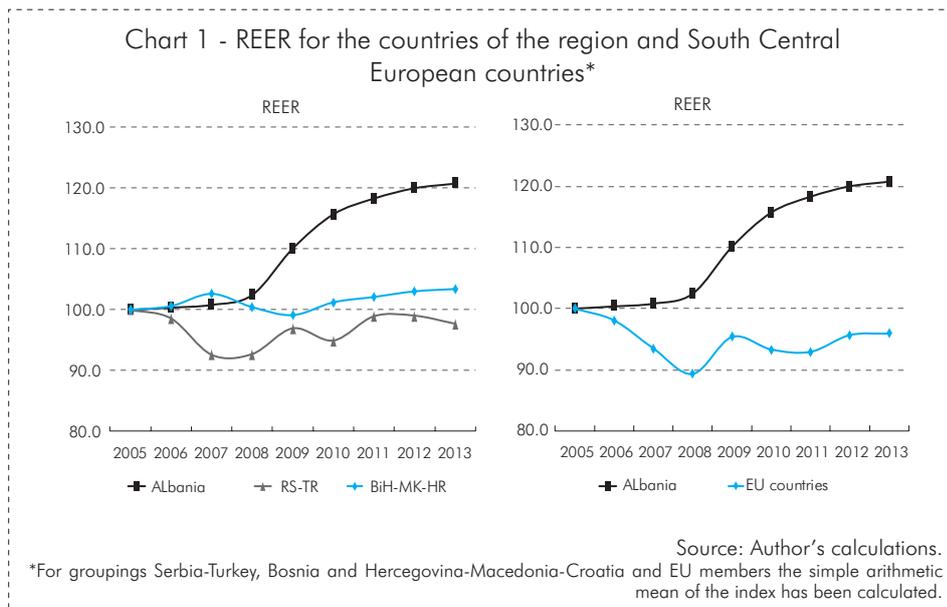
During 2005-2008, Albania's REER stood at steady rates, to increase significantly in 2009.

³ The same methodology is applied by the OECD and Eurostat.

⁴ Balassa, B. (1965), "Trade liberalisation and revealed comparative advantage", *The Manchester School*, Vol. 33:2, pp. 99-123.

⁵ As candidate countries, we refer to countries that are in the process of membership in the European Union: Albania, Bosnia and Herzegovina, Serbia, Macedonia, Turkey and Croatia.

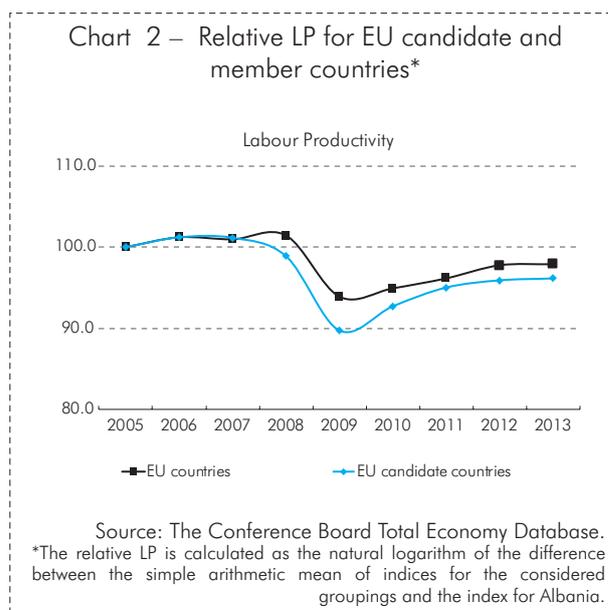
⁶ In this study, as EU member countries we refer to countries in our region: Poland, Romania, Hungary, Bulgaria, and the Czech Republic. Croatia is considered as a candidate country, as it joined the EU only in July 2013.



From the onset of the global crisis (2008 and/or 2009), the currencies of EU candidate countries applying a floating exchange rate regime were significantly depreciated compared to the currencies of EU candidate countries applying a fixed exchange rate (such as Bosnia and Herzegovina and Macedonia) hence, raising their competitiveness profile against these countries. Over the same period, the currencies of EU member countries fluctuated in real terms, but at a lower amplitude.

This development was particularly notable in the case of Albania and Serbia, where REER was up by 13% and 9%, respectively, during 2008-2010, due to the real-term depreciation of their national currencies 12% and 18%, respectively. Similarly, in the case of Turkey, the REER expanded by 9.6% in 2011 from 2008, reflecting mainly the depreciation of the national currency by 16% for the same period. From this perspective, the floating exchange rate regime has apparently been a buffer to the financial crisis in the recent years.

Overall, as an outcome of this study, we may say that before the start of the financial crisis, EU candidate countries seemed to have lost their competitiveness vis-a-vis Central European countries. After 2009, the competitiveness of these countries, in terms of REER, apparently improved, especially in those countries that apply a floating exchange rate.



The graphic presentation of the labour productivity (LP) shows that the values for Albania are lower than for EU candidate countries and already EU member countries.⁷

⁷ The results are in line with the results found by Çeliku and Metani, 2011.

In spite of this, the LP has increased across all the EU candidate countries during the period under review. Labour productivity has constantly increased in these countries, since the onset of the crisis, more due to the lower employment than to the higher GDP, which has outpaced employment. Therefore, in the countries of our region, such as Serbia and Macedonia, the LP has improved, mainly thanks to low employment rates. On the contrary, the increasing LP in the case of Turkey owes mainly to the increase in the real GDP, which stood above the increase in employment in 2010 and 2011. The same behaviour, though at slower rates, was noticed in Albania during 2010-2011.

The comparison of these indices with the unit labour cost would provide a more thorough and comprehensive analysis of the competitiveness profile of the countries under review. Future research will focus on this issue as well as on broadening the base of the relevant data.

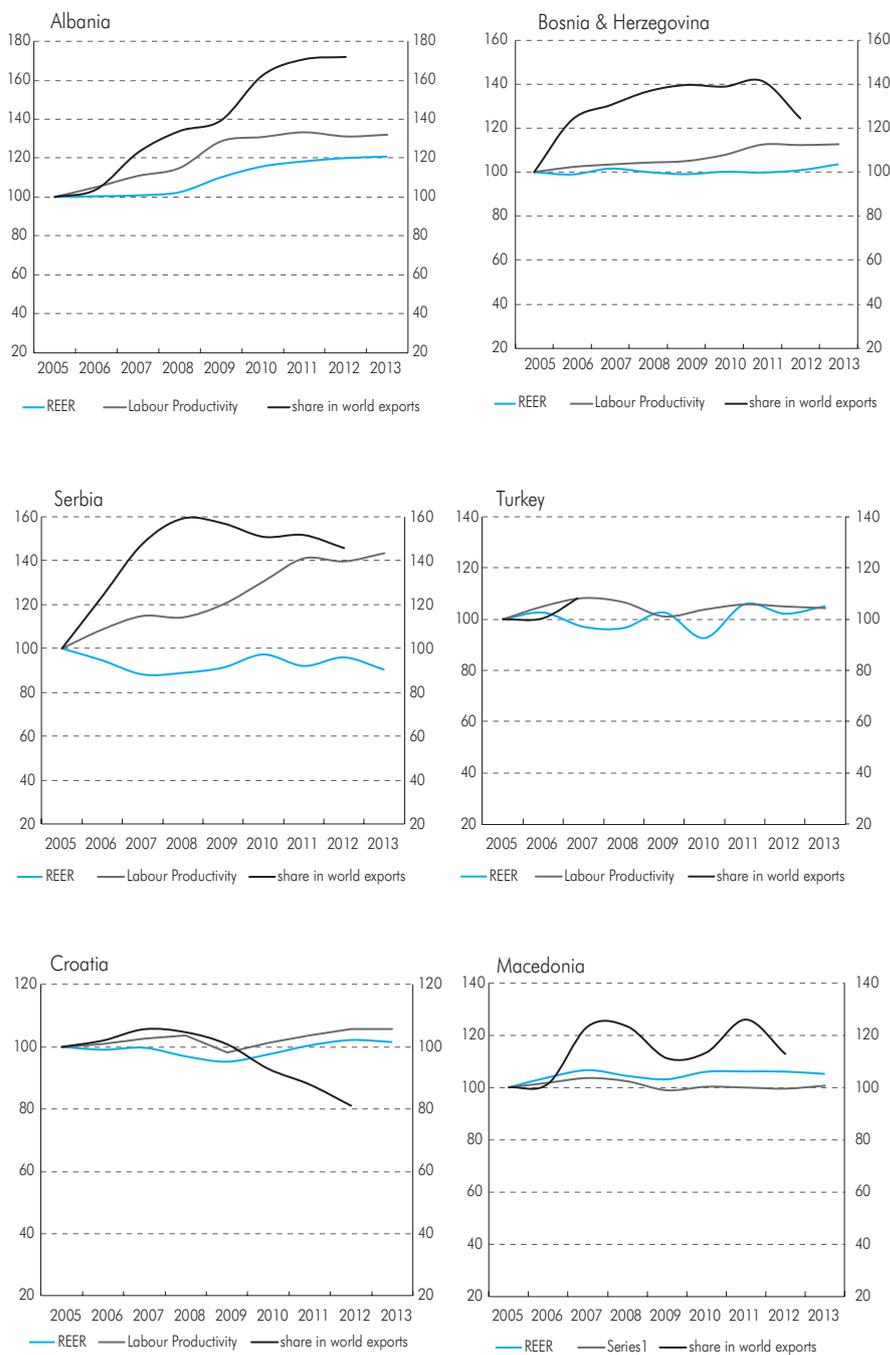
1. CONCLUSIONS

A database on the performance of the real effective exchange rate for Albania and some countries of our region, based on a unified methodology, would be useful not only for the timely study of competitiveness trends, but also for a comparison of the countries under review.

The results show that, after 2009, the currencies of EU candidate countries applying a floating exchange rate regime depreciated significantly compared to candidate countries applying a fixed exchange rate, hence being buffers to the recent financial crisis.

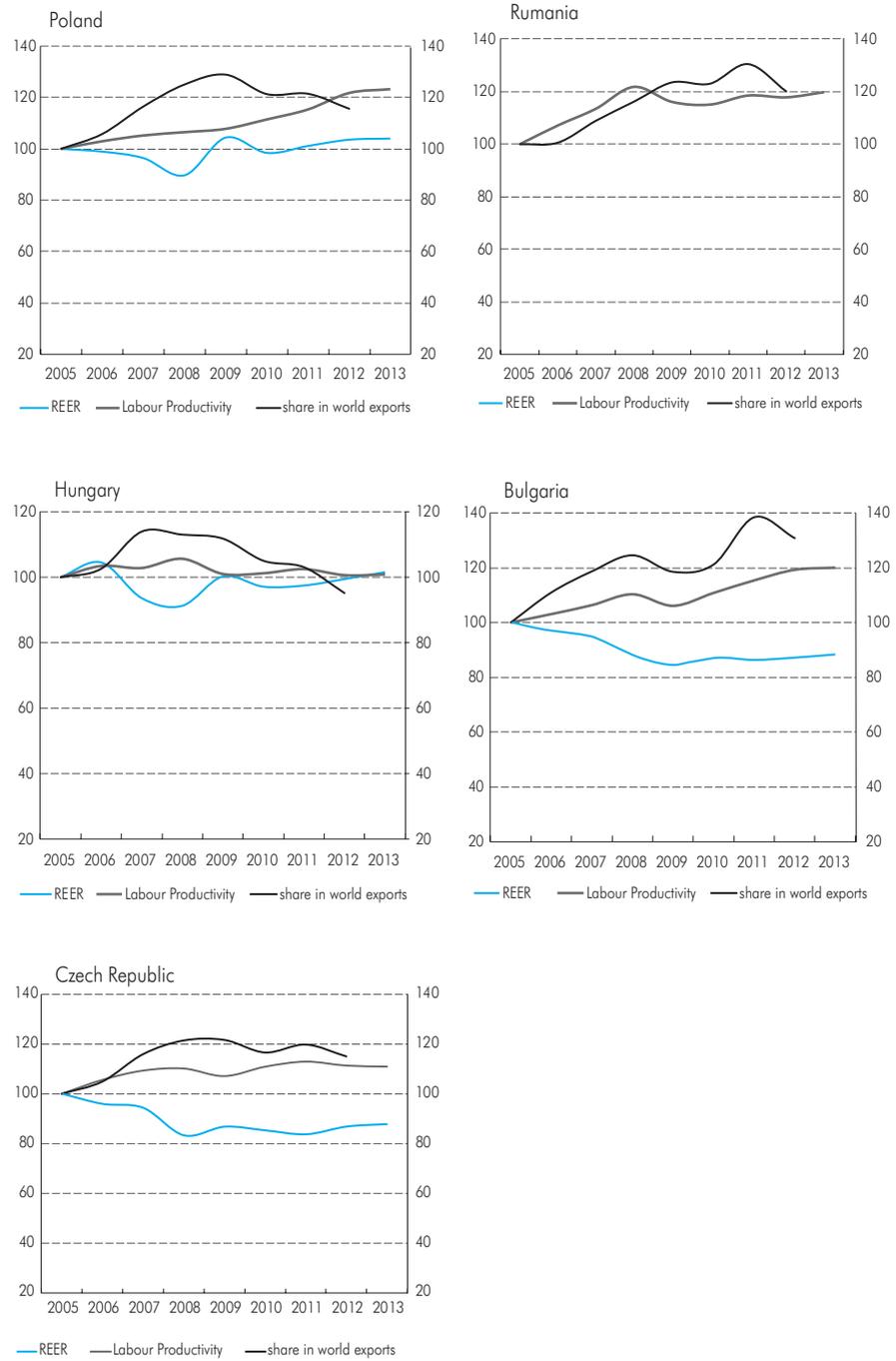
Labour productivity, from the onset of the crisis, has increased steadily across all the countries under review. This has resulted mainly because of lower employment and not because of higher GDP, which has outpaced employment.

Chart 3 – EU candidate countries (2005=100)*



Source: Author's calculations and The Conference Board Total Economy Database.
 *Data for 2013 refer to the average until September.

Chart 4 – EU candidate countries (2005=100)



Source: Author's calculations and The Conference Board Total Economy Database.

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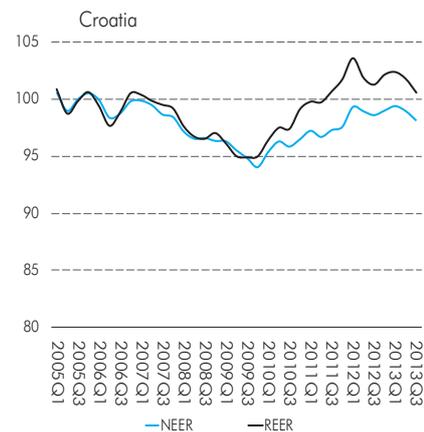
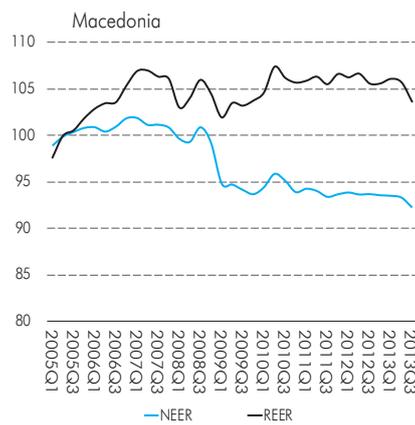
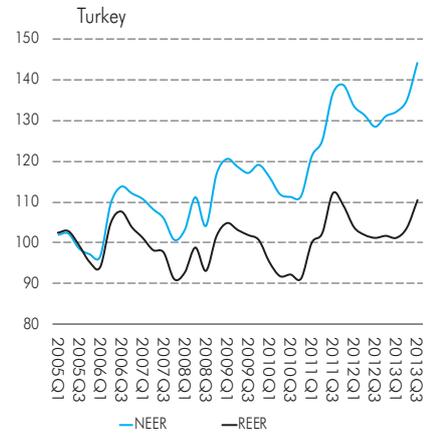
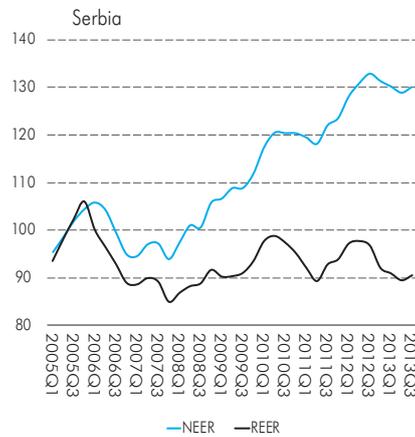
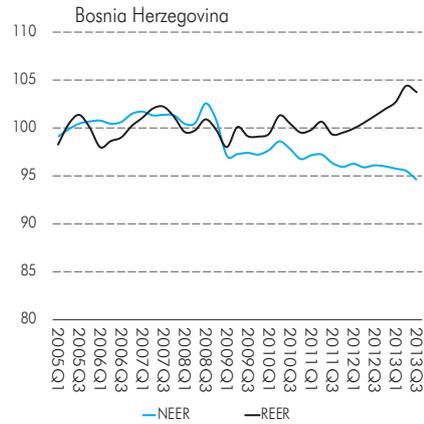
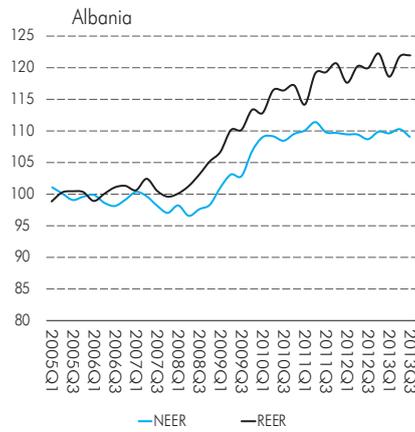
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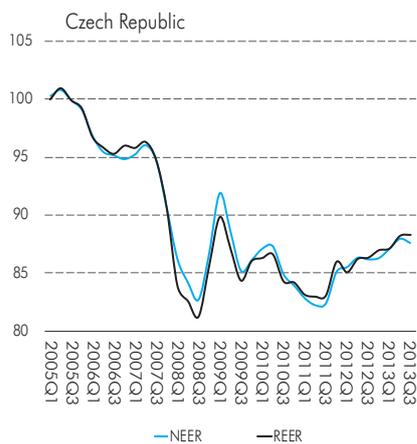
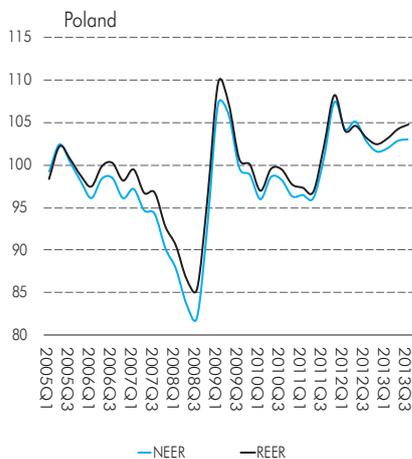
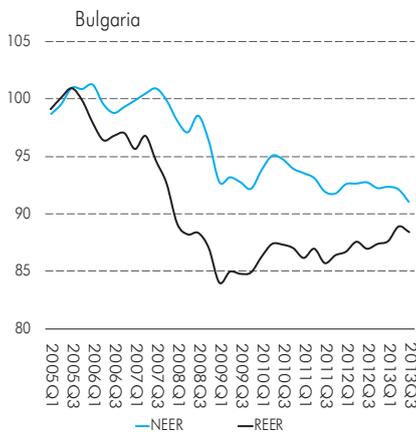
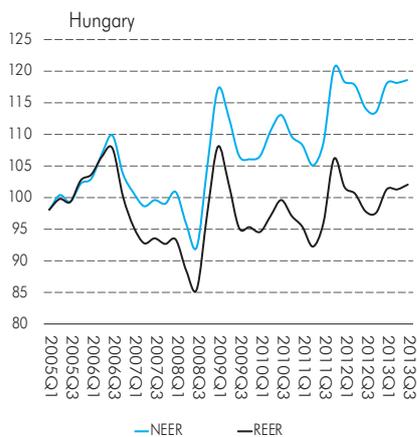
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Appendix 1 –NEER and REER, quarterly (2005=100)



Source: Author's calculations.

Appendix 1 –NEER and REER, quarterly (2005=100)



Source: Author's calculations.

EXTRAPOLATING PRIVATE CONSUMPTION AND INVESTMENTS IN ALBANIA: WHERE ARE WE NOW?

ILIR VIKA AND ESIDA ABAZAJ
RESEARCH DEPARTMENT

INTRODUCTION

This material aims to help the process of re-evaluating the macro-econometric model of the Albanian economy (MEAM), which is used in Bank of Albania's monetary policy decision-making. Enriching the model's database on a quarterly basis is a necessary condition in this process. Currently, the model simulations cover the period 1996 Q1 – 2009 Q4, while the model parameters are estimated for the period until 2006. Database update with the latest quarterly data is a challenging task, considering that some of aggregate demand indicators according to the expenditure approach are available from INSTAT till 2008 and at annual frequency. There is, therefore, a 20-quarter lag in the release of data on economic activity measured using the expenditure approach. The lack of data makes it impossible to re-evaluate behavioural equations for private consumption and investments, which are in the demand block of the MEAM macro model and, consequently, do not allow the closure of the model as a whole.

The MEAM has been used since 2007 mainly to develop different scenarios or simulations accompanying economic projections, by developing different risk-bearing scenarios in a central projection. The MEAM has also contributed to developing conditional projections for the main macroeconomic indicators. However, these projections cannot be generated directly since the model uses quarterly data until end-2009. The results obtained from the macro model, expressed as the deviation in percent from the baseline, are applied to the latest values of the indicator under consideration to generate its forecast. While we expect the macro model to generate genuine and direct forecasts in the future, it is important for all time series in the model to possibly extend until the current period.

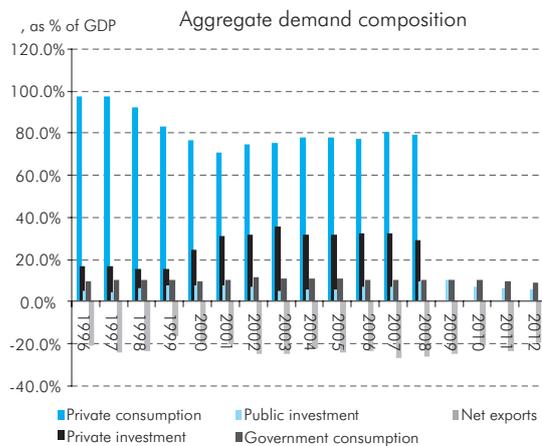
Despite the initial purpose of the macro model, measuring consumption and investments is also important for monetary policy reports, which make frequent assumptions of developments in private consumption and investments based on the performance of some economic and financial indicators.

The graphical representation of aggregate demand components over the 1996-2008 period shows that private consumption accounted for a major share at around 81%, whereas private investments accounted for 26% on average (see Chart 1).

Private consumption and investments are generally analysed together and derived as residuals by from the expenditure approach used to measure GDP. Over the 1996-2008 period, consumption accounted for 3/4 of the total of the two indicators. However, such ratio has not been constant throughout the period. In 1996, the ratio of private consumption to the sum of private consumption and investments was around 85.6%, whereas in 2008, it dropped to 73.4% (see Chart 2). At present, the tendency of the performance of private consumption and investments in the periodic reports of the Bank of Albania is based on a number of indirect indicators, which are available sooner and at a higher frequency. These reports, however, do not provide a point estimation of these two indicators for the post-2008 period. In addition, they do not identify the most important indirect indicator establishing the performance of private consumption or investments. This material, therefore, does not only aim to provide point estimations of the performance of private consumption and investments for the post-2008 period, but also to identify which of the indirect indicators is the most (least) significant in explaining the performance of C and I.

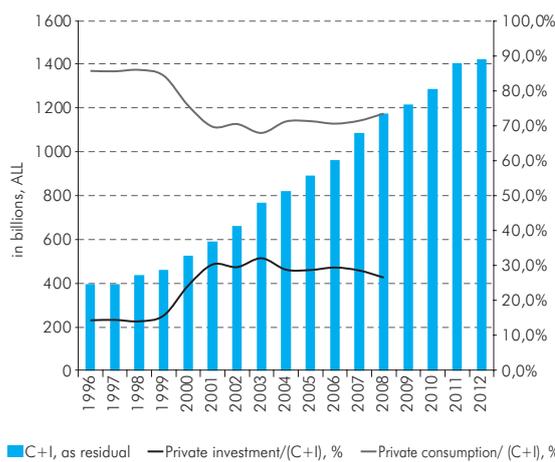
The rest of the material is organised as follows: Section 2 describes the methodology used and lists the indirect indicators that may be potential candidates for determining the performance of private consumption and investments for the post-2008 period. Section 3 shows the results derived from the empirical assessment, emphasizes the empirical issues encountered during the assessment and the last section provides some final remarks.

Chart 1 Aggregate demand components as a percentage of GDP: 1996-2012



Source: INSTAT, MoF and calculations of Macroeconomic Modelling Division, Research Department.

Chart 2 Total Consumption plus Investment



Source: INSTAT, MoF and authors' calculations.

METHODOLOGY AND INDIRECT INDICATORS

Time series released on an irregular basis and with considerable lags are a concern for most developing countries. Different methodologies are used to address the lack of data, such as autoregressive models, "bridge" models, bivariate VAR, principal components analysis, Bayesian VAR or dynamic factor models (Liu et al., 2011).

In this study, we use the bivariate Autoregressive Distributed Lag methodology, where Y_t is the indicator we want to forecast (private consumption or investment); and Z_t is one of the indirect indicators selected to provide a possible explanation for the performance of private consumption or investments.

We use six different specifications of the Autoregressive Distributed Lag model, which are grouped into two categories: specifications that include the lagged values of dependent variable and specifications that do not include lags (see Table 1).

Table 1 Autoregressive Distributed Lag specifications

Type of model	Equation
Specifications that do include the lagged values of dependent variable	
Autoregressive Distributed Lag (ADL)	$y_t = \alpha_0 + \sum_{i=1}^p \beta_y y_{t-i} + \sum_{i=0}^q \beta_z z_{t-i} + \varepsilon_t$
Reduced Form / Dead Start (RF)	$y_t = \alpha_0 + \sum_{i=1}^p \beta_y y_{t-i} + \sum_{i=1}^q \beta_z z_{t-i} + \varepsilon_t$
Partial Adjustment (PA)	$y_t = \alpha_0 + \sum_{i=1}^p \beta_y y_{t-i} + \beta_z z_t + \varepsilon_t$
Specifications that do not include the lagged values of dependent variable	
Distributed Lag (DL)	$y_t = \alpha_0 + \sum_{i=0}^q \beta_z z_{t-i} + \varepsilon_t$
Leading Indicator (LI)	$y_t = \alpha_0 + \sum_{i=1}^q \beta_z z_{t-i} + \varepsilon_t$
Static Regression (SR)	$y_t = \alpha_0 + z_t + \varepsilon_t$

The preliminary selection of proxies for real-time forecast of private consumption and investments series is made based on economic intuition, descriptive statistics or expert judgement. See Table 2 for a complete list of selected proxies.

Table 2 Proxies for private consumption and investments

PROXIES FOR PRIVATE CONSUMPTION	Period/Frequency	Source
(+) Import of consumer goods	2004-2012/Monthly	BoA
(+) Retail trade volume index	1999-2012/Monthly	INSTAT
(+) Value added tax	1996-2012/Monthly	INSTAT
(+) Consumer confidence index	2003-2012/Quarterly	BoA
(+) Remittance inflows	1993-2012/Monthly	BoA
(+) Lending for consumer purposes	2006-2012/Monthly	BoA
PROXIES FOR PRIVATE INVESTMENTS		
(+) Value of new constructions	2004-2012/Quarterly	INSTAT
(+) Foreign direct investments	1993-2012/Monthly	BoA
(+) Lending for investment purposes	2006-2012/Monthly	BoA
(+) Import of machinery and equipment	1993-2012/Monthly	INSTAT
(+) Import of capital goods	2004-2012/Monthly	BoA
(+) Investment expenditure of sectors of the economy	2006-2011/Annual	INSTAT
(+) Profit income tax	1996-2012/Monthly	MoF
(-) Monetary conditions index	1996-2012/Monthly	BoA
(+) Business confidence index	2002-2012/Quarterly	BoA
(+) Remittance inflows	1993-2012/Monthly	BoA

*The proxies in bold are the ones included in the empirical assessment.

The main criteria used for the selection of final proxies in the empirical assessment according to Table 1 include: first, their time series should cover a time period sufficient enough to run a regression; second, the time series should be on a monthly or quarterly basis; and third, the indicators should show a considerable level of association with private consumption or investment, and such association should show result with the expected sign.

As shown in Table 2, remittances have been selected as a proxy for the two aggregate demand series. This selection is not only due to the availability of the remittance data series for a long period of time and on a quarterly basis, but also due to the importance of remittances in supporting private consumption or investment, as pointed out in different surveys. According to Gëdeshi (2009) and Bank of Albania's survey conducted in 2008¹, a considerable portion of remittances (around 65-70%) is channelled into satisfying the basic daily needs (food or clothing), improving the living conditions (buying furniture or constructing/repairing homes), investing in real estate and business investments.

Retail trade volume index is considered a good proxy for consumption given the way it is constructed. According to INSTAT, retail trade volume index measures the change in turnover figure through time. The turnover figure consists of enterprise proceeds from the sale of own goods, products and services, excluding value added tax, over a month.

Foreign direct investments have also been selected as an appropriate proxy for the performance of private investments. According to the FDIs report (2011), FDI inflows do not necessarily add to capital formation; consequently, only the portion used for investment (capital formation) is recorded as investment.² In addition, profit tax is believed to be a good proxy for the performance of private investments, considering that the main source of financing for private investment companies in Albania is domestic (Enterprise Survey, IFC, 2007).

The methodology used to assess private consumption and investments in real time consists of several steps. First, private consumption and investment series for the 1996-2008 period, published by INSTAT on an annual basis, are interpolated to quarterly frequency. This is done by taking their observed annual shares in GDP and applying them to the quarterly summation of consumption and investment, which is derived as a residual in the GDP identity (output minus government expenditure minus net exports). Applying the general-to-specific approach, each ADL method specification is estimated by including up to 12-quarter lags, which is incrementally reduced by one unit, while we check for the coefficient sign before the explanatory variable, Schwarz and Akaike information criteria, diagnostic tests for correlation and heteroskedasticity, and the quality of in-sample forecast in a three-year period covering 2006-2008 (RMSE, MAPE, Theil, Bias, Variance, and Cov. Proportion). The same procedure is repeated for the six different ADL specifications for each explanatory variable Z_t (four for private consumption and six for private investments). Judging on all diagnostic tests, we choose the best ADL specification from each group: the group of specifications that include the lagged values of the dependent variable, and the ones that do not include the lagged values of the dependent variable.

¹ See *Economic Bulletin, Bank of Albania, Volume 12, No. 3*.

² In INSTAT's report: "Gross domestic product by expenditure approach", gross capital formation is measured based on enterprise surveying, but it is not reported whether it is domestic or foreign.

After having selected the best ADL specifications, we derive the forecasts for private consumption and investments from each specification for year 2009 on a quarterly basis. These forecasts are further weighed on the basis of the RMSE (Root Mean Square Error) of each specification to derive one single forecast. After weighing and deriving one single value for private consumption and investments, their sum is compared to the actual sum derived as a residual using the expenditure approach. The forecasted values for private consumption and investments are adjusted in a way that their sum equals the actual values. This process is repeated for each following period.

To check for the robustness of results derived from the methodological approach as explained above, we also test other combinations of ADL specifications, such as selecting the best ADL specification (1 per each explanatory variable) or selecting all estimated specifications.

RESULTS AND SOME EMPIRICAL ISSUES

Before carrying out the empirical evaluation, the time series of private consumption and investments and other explanatory variables are tested whether they are stationary or not using three tests: Augmented Dickey Fuller (ADF), Phillips Perron (PP) and Kwiatkowski-Phillips-Schmidt-Shin (KPSS) for the 2000-08 period. Most specifications are evaluated for this period, except for those where the explanatory variable is available for a shorter period of time. The pre-2000 period is generally not included in the sample due to the highly unstable regressions observed during the evaluation testing.

Unit root tests show that the time series taken into consideration are generally integrated of order $I(1)$ (Table A in the Appendix), that is, they are required to be made stationary to enter regression.

Table 3 shows the final specifications for consumption and investment evaluation equations. The results for some of the equations are not presented as the association between variables resulted to have an opposite sign compared to expectations. In the case of regressions which do not include lagged values of dependent variable (eq. 1-3), it results that the most acceptable specification according to the above criteria is that of a distributed lag form for consumption and leading indicator form for investments. Whereas for the group of regressions which include the lagged values of dependent variables (eq. 4-6), the full ADL form seems to be the most appropriate, particularly for investments.

Table 3A. Private consumption: specifications of selected ADL models (p, q)

Type of model	CCI	Remittances	Retail trade	VAT
1. Static regression	-	SR(0,0)	SR(0,0)	SR(0,0)
2. Distributed lag	DL(0,1)	DL(0,1)	-	DL(0,10)
3. Leading indicator	-	-	-	-
4. Partial adjustment	-	PA(3,0)	PA(5,0)	PA(7,0)
5. Reduced form	RF(1,1)	-	-	-
6. Autoregressive Distributed Lag (ADL)	ADL(1,1)	ADL(1,1)	ADL(9,9)	ADL(4,4)

Note: The highlighted specifications indicate the best equations in terms of the forecasting ability for each specification group, including and excluding the lagged values of dependent variable.

Table 3B. Private investments: specifications of selected ADL models (p, q)

Type of model	FDI	BCI	Imp. of Machinery	Remittances	Profit tax
1. Static regression	SR(0,0)	-	SR(0,0)	SR(0,0)	SR(0,0)
2. Distributed lag	DL(0,2)	DL(0,1)	DL(0,2)	DL(0,3)	DL(0,11)
3. Leading indicator	LI(0,2)	LI(0,1)	LI(0,7)	-	LI(0,11)
4. Partial adjustment	PA(1,0)	-	PA(1,0)	PA(1,0)	PA(1,0)
5. Reduced form	RF(11,11)	RF(6,6)	RF(12,12)	RF(12,12)	RF(11,11)
6. Autoreg. distributed lag	ADL(11,11)	ADL(6,6)	ADL(12,12)	ADL(12,12)	ADL(11,11)

Note: The highlighted specifications indicate the best equations in terms of the forecasting ability for each specification group, including and excluding the lagged values of dependent variable.

The main selection criterion for these specifications, both in the case of private consumption and investments, relates to the performance of forecast during the 2006-2008 period. The LM test for autocorrelation suggests a strong presence of this issue in the selected equations for the two variables, C and I (see Tables B and C in the Appendix), which makes their forecast inefficient. However, a considerable number of equations, by construction, preserve the consistency and unbiasedness of results. In addition, judging from the numerous tests, we consider that in most cases, autocorrelation could have been a result of “not well-specified dynamics” rather due to the inclusion of the lagged values of dependent variable as an explanatory variable, than of any internal error term characteristic. The efforts to correct the serial correlation by using statistical evaluation procedures lead to imposing non-linear restrictions on the “true” model. In fact, our efforts concluded by stating what most econometric literature suggests, that cure is almost always worse than the disease. Moreover, the LM test for autocorrelation may not be very convincing as a diagnostic test for our estimated regressions (short time series and many coefficients) since it is a test used for large samples and requires at least three degrees of freedom to make sense (Yin-Feng Gau, 2002).

Taking into account the share of each explanatory variable based on the relevant RMSE, it seems that the retail trade volume index is the most significant indicator in explaining the performance of private consumption (accounting for a total of 29%); while the three other variables, consumer confidence index, remittances and value added tax are almost equally significant in terms of the information we obtain on the performance of consumption (sharing a total weight of 24% each). While in the case of private investments, the results show that the best explanatory variable is the business confidence index (total share of 26%), followed by profit tax (23%), remittances (21%), import of machinery and appliances (17%), and foreign direct investments (13%) (see Tables B and C in the Appendix).

Table 4 shows the forecast of total consumption and investments (C+I) for the 2009-11 period.³ It is measured through the Mean Percentage Error, MPE, which examines the size of forecast deviations expressed in percent, and reflects their tendency to overshoot (undershoot) when the deviation is positive (negative). The forecasts are evaluated for two groups, where the first

³ INSTAT's GDP figures for 2012-13 have been subject to constant revisions, hence, affecting the performance of forecasts for this period. While the up-to-2011 data, albeit not final or preliminary, have generally been stable.

(column A) includes the best forecast models of the two groups, including and excluding the lagged values of dependent variable; and the second (column B) consists in the best models for each explanatory variable, that is, four in the case of consumption and five in the case of investments.

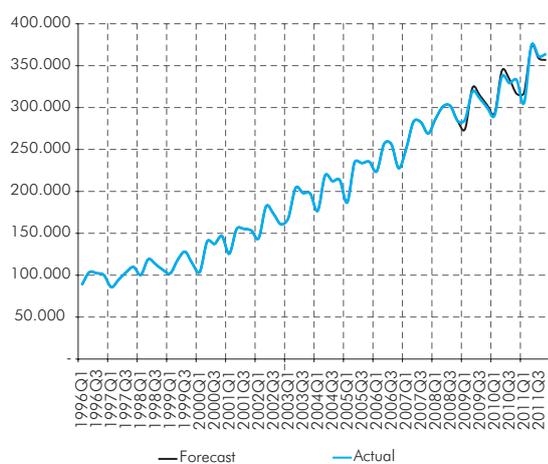
Table 4 Performance of forecasts of total consumption and investments (C plus I)

Period	Mean Percentage Error (MPE)	
	(A) Best models from each group	(B) Best models for each explanatory variable
2009	0.0	0.7
2010	-0.2	-1.0
2011	0.2	-1.0
MPE (2009-11)	0.0	-0.5

The evaluation of forecasts for the 2009-11 period shows that deviations in the case of column A with models from each group take values between the interval $[-0.2: 0.2]$, with a mean percentage error equal to 0% in these three years. While in the case of combination in column B, the size of deviations is larger and there is constant undershooting during 2010-11, resulting in an MPE of around -0.5% for the entire period. Based on the mean percentage error results, it results that the first combination, which includes the best models from each group, is the most satisfying evaluation for the forecast of private consumption and investments.

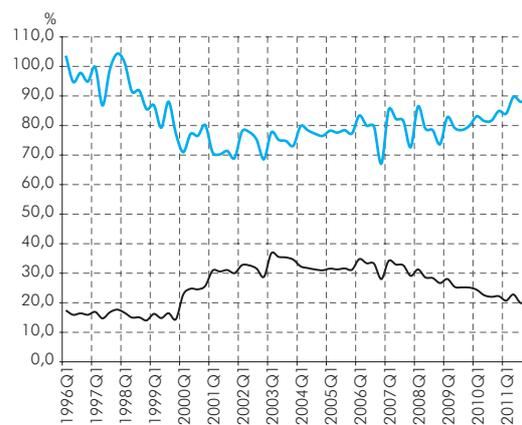
Chart 3 shows the current developments in the total of both variables, which appear quite close to the forecasts derived from the combination of equations in column A, Table 4. Chart 4 shows the performance of the final time series of private consumption and investments, as a percentage of GDP.⁴

Chart 3. Sum of private consumption and investment (C+I) nominal, in millions ALL



Source: Authors' calculations and INSTAT.

Chart 4. Private Consumption and Investment in percentage of GDP



Source: Authors' calculations, INSTAT, Ministry of Finance and World Bank.

⁴ Nominal GDP is made available by INSTAT for up to 2011, on annual basis. Its extension for the post-2011 period and interpolation have been calculated by Macroeconomic Modelling Division, Research Department.

Our estimates suggest that the ratio of private consumption to GDP during 2009-11 may have increased considerably from 79.4% in 2008 to 87.7% in 2011. While the share of private investments showed opposite performance to private consumption, shrinking by more than 7 percentage points during the period under review, to 21.2% of GDP.

A question raised about the adoption of the above measurement method is whether it would have been more accurate to estimate one of the components (let's say consumption) and derive the other (investment) as the residual sum. We can, therefore, infer whether the consumption forecast models perform better than investment forecast models, and vice versa. To answer this question, we refer to statistical indicators of variation, as the MPE (or any other forecast performance measure) cannot be estimated as a residual for estimates. Table 5 shows that the means and variations around them are quite close between two different approaches of estimation. This implies that the performance level of the models used to forecast private consumption does not distinguish from the one used to forecast private investments. This can allow selecting the estimate of only one of the variables, and derive the other as a residual.⁵ However, this form of estimation does not allow us to measure the ability of models to forecast, therefore, it is necessary to estimate the two variables, consumption and investments, individually.

Table 5 Main statistical variables of different forecasts, 2009-2011

	Consumption Estimated individually	Investments	Consumption Estimated as a residual	Investments
Mean	1,020,374.88	282,719.87	1,020,625.02	282,970.02
Standard deviation	107,374.65	12,522.92	106,891.54	12,428.98
Variation coefficient	0.11	0.04	0.10	0.04

Note: The forecasts for the best models in the two groups (including and excluding the lagged values of dependent variable).

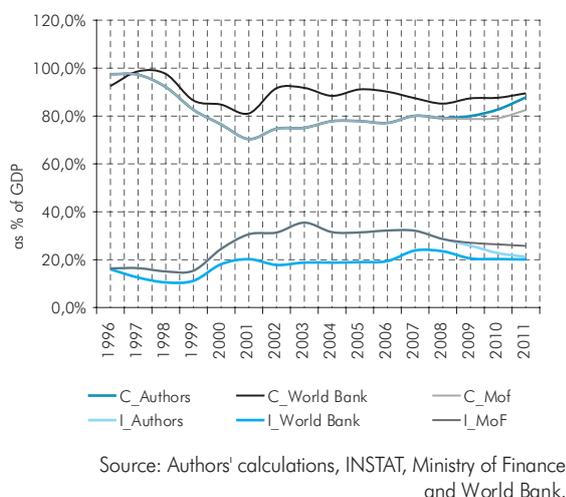
Lastly, our estimates for consumption and private investments during 2009-11 have been compared to those of the World Bank and Ministry of Finance⁶ (see Chart 5). We note that the tendency of the two indicators as a share of GDP is similar, but the magnitude of differences varies. According to the World Bank, the ratio of private consumption to GDP increased gradually from 85.2% in 2008 to 89.5% in 2011; while the ratio of private investments to GDP lowered from 23.5% in 2008 to 20.5% in 2009, to remain around the same level in the next two years.⁷ Similarly, Ministry of Finance's estimates suggest the increase in consumption-to-GDP ratio to 82.5% in 2011, and the decrease in private investments to 25.8%.

⁵ This is the approach adopted by INSTAT. For data up to 2008, various data are explored for private investment, while households' consumption is estimated as a residual.

⁶ World Bank's estimates have been generated from WB's database at <http://databank.worldbank.org/data/views/reports/tableview.aspx>, downloaded on 6 February 2014. Ministry of Finance's estimates have been obtained from the approved framework on economic indicators in "Medium-term Budget Program for 2014-16".

⁷ The ratios of the two indicators as measured by the World Bank differ from those as measured by the Albanian institutions for the entire period.

Chart 5 Comparison of estimates for private consumption and investments (in % of GDP), 2009 Q1- 2011 Q4



FINAL REMARKS

Our findings suggest that consumption as a percentage of GDP increased during 2009-11, while the share of private investments continued to fall. The ratio of consumption to GDP in 2011 increased by 8.7 percentage points from 2008, to 87.8%, whereas the ratio of private investments to GDP was around 21.2% in 2011, about 7.4 percentage points below the 2008 ratio. The same tendencies have been also noted in reports of World Bank and in Council of Ministers' Decisions estimates (2013), despite the magnitude of differences varying across the sources.

Although the evaluation of forecasts based on the Mean Percentage Error shows that the models display adequate capacity to forecast total private consumption and investments, their individual performance requires cautious consideration as long as the presence of autocorrelation in several equations suggests non-entirely efficient measurement.

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APPENDIX

Table A Unit root tests

Augmented Dickey Fuller test results						
Proxies	in level			in first difference		
	Constant	Constant & trend	None	Constant	Constant & trend	None
Retail trade volume index (2001 Q2 : 2008 Q4)	0.6471	0.0304	0.8692	0.0000	0.0053	0.0000
Value added tax (2000 Q3 : 2008 Q4)	0.3024	0.9996	0.9644	0.0000	0.0000	0.0000
Consumer Confidence Index (2003 Q4 : 2008 Q4)	0.1205	0.4814	0.3814	0.0007	0.0241	0.0000
Remittance inflows (2000 Q3 : 2008 Q4)	0.0005	0.0001	0.8719	0.0000	0.0000	0.0000
Foreign direct investments (2000 Q3 : 2008 Q4)	0.8222	0.0020	0.8990	0.0000	0.0000	0.0000
Import of machinery and appliances (2000 Q3 : 2008 Q4)	0.9726	0.5228	0.9913	0.0000	0.0000	0.0000
Profit income tax (2001 Q1 : 2008 Q4)	0.3839	0.9995	0.9472	0.0000	0.0000	0.0000
Monetary Conditions Index (2000 Q3 : 2008 Q4)	0.4717	0.4707	0.4448	0.0007	0.0040	0.0000
Business Confidence Index (2003 Q4 : 2008 Q4)	0.0341	0.0068	0.0114	0.0005	0.0252	0.0000
Phillips- Perron test results						
Proxies	in level			in first difference		
	Constant	Constant & trend	None	Constant	Constant & trend	None
Retail trade volume index	0.8052	0.0499	0.9902	0.0000	0.0000	0.0000
Value added tax	0.1647	0.4792	0.9836	0.0000	0.0000	0.0000
Consumer Confidence Index	0.1468	0.5857	0.4430	0.0005	0.0000	0.0000
Remittance inflows	0.0005	0.0000	0.7241	0.0001	0.0000	0.0000
Foreign direct investment	0.1015	0.0019	0.8911	0.0000	0.0000	0.0000
Import of machinery and appliances	0.6309	0.0002	0.9993	0.0001	0.0000	0.0000
Profit income tax	0.4828	0.6061	0.9759	0.0000	0.0000	0.0000
Monetary Conditions Index	0.0046	0.0074	0.3511	0.0000	0.0000	0.0000
Business Confidence Index	0.0341	0.0772	0.0013	0.0005	0.0029	0.0000
KPSS test results						
Proxies	in level			in first difference		
	Constant	Constant & trend	None	Constant	Constant & trend	None
Retail trade volume index	0.6593	0.1265		0.3448	0.2388	
Value added tax	0.5808	0.1906		0.5000	0.2273	
Consumer Confidence Index	0.3519	0.1884		0.3738	0.5000	
Remittance inflows	0.6387	0.2804		0.2383	0.2588	
Foreign direct investment	0.5970	0.2009		0.4076	0.5000	
Import of machinery and appliances	0.7829	0.1631		0.2391	0.2189	
Profit income tax	0.6084	0.1835		0.5000	0.2479	
Monetary Conditions Index	0.5825	0.0678		0.1588	0.0630	
Business Confidence Index	0.4051	0.0624		0.1002	0.0752	

Table B Private consumption: Diagnostic tests and shares for best models

Explanatory variable	CCI	Remittances	Retail trade	VAT	CCI	Remittances	Retail trade	VAT
	Lagged dependent variable models				Non-lagged dependent variable models			
Type of model	RF(1,1)	PA(3,0)	ADL(9,9)	ADL(4,4)	DL(0,1)	DL(0,1)	SR(0,0)	DL(0,10)
Sum of coeff.	0,597	0,062	0,217	0,497	0,766	0,134	0,078	0,803
Akaike criterion			-3,447				-2,689	-2,978
Schwarz criterion	-2,564	-2,717		-2,799	-2,039	-2,220		
Normal. JB testprob.	0,673	0,325	0,748	0,429	0,771	0,892	0,857	0,745
Autocorrel. LM test prob.	0,669	0,394	0,000	0,671	0,042	0,002	0,017	0,084
Heterosked. BPG test prob.	0,586	0,276	0,353	0,621	0,258	0,190	0,076	0,875
	Forecasting ability for 2006 Q1:2008 Q4 (12 obs.)							
RMSE	7852.0	7562.8	4304.1	6861.1	8947.9	11301.9	21244.0	10745.3
Theil	0,020	0,019	0,011	0,017	0,023	0,029	0,052	0,027
Shares, based on RMSE								
Best equations (8/14) per each group	0,130	0,135	0,238	0,149	0,114	0,090	0,048	0,095

Table C Private investments: Diagnostic tests and shares for best models

Explanatory variable	FDI	Lagged dependent variable models		Remittances		Profit tax	FDI	Non-lagged dependent variable models		Remittances	Profit tax
		BCI	Imp_Machinery	BCI	Imp_Machinery			BCI	Imp_Machinery		
Type of model	ADL(11,11)	RF(6,6)	ADL(12,12)	ADL(12,12)	ADL(11,11)	SR(0,0)	LI(0,1)	LI(0,7)	DL(0,3)	LI(11,11)	
Sum of coeff.	0,069	0,407	1,434	2,387	2,092	0,028	0,042	0,482	0,307	0,855	
Akaike criterion	-2,609	-2,518	-2,707	-3,553	-2,644	-2,348	-1,902	-2,359	-2,351	-2,278	
Schwarz criterion	0,412	0,907	0,715	0,526	0,966	0,347	0,831	0,846	0,631	0,550	
Normality JB testprob.	0,412	0,907	0,715	0,526	0,966	0,347	0,831	0,846	0,631	0,550	
Serial corr. LM test prob.	0,000	0,036	0,000	0,000	0,000	0,828	0,218	0,542	0,020	0,017	
Heterosked. BPG test prob.	0,583	0,236	0,746	0,577	0,439	0,057	0,091	0,315	0,144	0,121	
Forecasting ability for 2006 Q1:2008 Q4 (12 obs.)											
RMSE	5241.0	2791.2	4506.1	2831.7	4043.4	9393.5	3949.3	6044.7	7529.5	3411.5	
Theil	0,036	0,019	0,029	0,019	0,026	0,059	0,027	0,039	0,048	0,023	
Shares, based on RMSE											
Best equations (10/27) per each group	0,082	0,154	0,096	0,152	0,106	0,046	0,109	0,071	0,057	0,126	

DO ALBANIAN EXPORTS POSSESS COMPARATIVE ADVANTAGES? THE PERFORMANCE OF DOMESTIC EXPORTS IN RECENT YEARS; SHIFTS IN TRADE GROUPS CATEGORIES AND TRADING PARTNERS

ALBAN PLLAHA, FEBRUARY 2014

RESEARCH DEPARTMENT

Methodological Researches in Micro Data Unit

ABSTRACT

This article analyses the performance of Albanian export during recent years. The article analyzes the performance of exports at disaggregated levels: by partner countries and by categories of goods. Revealed Comparative Advantage Index and Export Specialisation Index are used to assess the competitiveness and advantages of domestic exports. The analyses reveal that in recent years, Albanian exports have shifted in structure and destination (finding also new trading partners alongside the historical ones). The indices show that three out of four main categories of goods exported by Albania possess revealed comparative advantage. Albania is also characterised by export specialisation in the category of “textiles and footwear” toward Italy.

1. INTRODUCTION

Foreign trade plays an important role in a small and open economy, as an important factor of a country's production capacity and its economic strength, affecting employment and the economic welfare. The share of 'exports' as an economic indicator becomes even more significant when considering cases of small developing economies, such as Albanian one. Therefore, a detailed analysis on Albanian exports toward its main trading partners would positively lead to accurate identification of specific export features and characteristics. Based on these findings we can point out specific sectors that constitute a priority for the Albanian economy or sectors whose level of international competitiveness is not good enough.

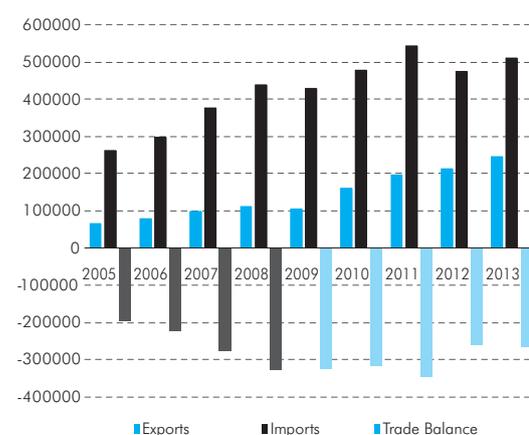
Similarly to other transition economies of countries in the Balkan region (from centralised economies to a free-market economy), during 2005 – 2013, the Albanian economy was characterised by a negative trade balance. The Albanian foreign trade was characterised by an on-going y-o-y growth in trade flows (imports and exports). However, trade was constantly predominated by imports, deteriorating further the negative trade balance until 2008 (Chart 1). In 2009, Albania's foreign trade, for the first time since 2005, shows signs of improvements of its trade deficit. During 2009 – 2013, the performance of Albanian imports – exports reflected an improving trend of its trade deficit, hence narrowing down the gap between imports and exports. The improvement

of the trade balance is generally because Albanian exports have notably accelerated the velocity of growth in recent years. We believe it is worth analysing in details this new tendency of Albanian exports, aiming thus the highlightment of specific sectors and trading partners that have contributed to this new orientation to foreign trade.

By constructing indices on external trade - a) Revealed Comparative Advantage Index (RCA Index) and b) Export Specialisation Index, this article aims to highlight the specific sectors of the Albanian economy, which have comparative advantages in exports of goods compared to other countries.

The structure of this article is as follows: Section 2 discusses the performance of Albanian exports by trading partners and by category of goods. Section 3 deals with competitive advantages, productivity and the impact on the economy. Section 4 summarises the main findings and concludes.

Chart 1 Trade Balance of Goods, 2005 – 2013 (in million Lek)



Source: INSTAT, 2014.

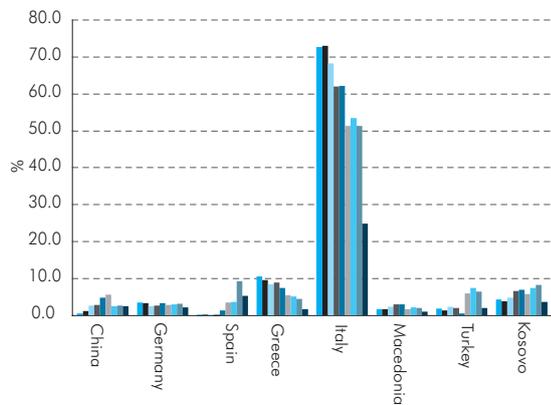
2. EXPORTS BY TRADING PARTNER AND BY CATEGORY OF GOODS

For a detailed analysis on Albanian exports in recent years, it is worth analyzing exports to our trading partners, in order to determine possible exports' shifts that may have taken place during the recent years.

Italy and Greece have been Albania's traditional main trading partners, accounting for more than 80% of total Albanian exports until 2006. However, by carefully analysing Chart 2, we notice that after 2006, exports to both these trading partners (as a percentage to total Albanian exports) have shown a deteriorating trend, year on year. Therefore, in 2006 exports to Italy accounted for about 72% of total exports, dropping sharply to about 51% of total exports in 2012, contracting by 20 percentage points in only six years. Exports to Greece indicate a similar trend. In 2005, Albanian exports to Greece counted for about 10% of total exports, whereas in 2012, they were down by more than 50%. Hence, during the last year, Albanian exporters found new markets for their products, in an effort to diversify their trade market. Chart 2 shows that the level of exports to Germany and Macedonia remained almost unchanged or were slightly volatile during 2005 – 2012.

On the other hand, when analysing trade partners such as Turkey, Kosovo, or Spain, we come across a completely different picture from the one analysed above. Therefore, exports to Turkey were mostly stable, though slightly volatile, during 2005 – 2009. However, Albanian exports to Turkey have sharply increased to around 6.5% of total exports, from around 1.6% of total exports in 2005 – 2009 (estimates show that this rising trend is continuing even

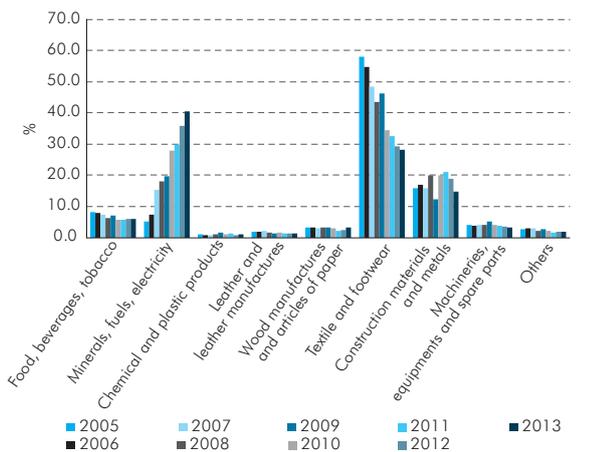
Chart 2 Exports according to trading partners as a % to total Exports (2005 – 2012)



Source: INSTAT, 2014.

during the second half of 2013). Exports to Kosovo have also shown an increasing trend, year on year, during these recent years. Thus in 2005, Albanian exports to Kosovo accounted for only 4.1% of total exports, while in 2012 they accounted for 8.2% of total exports. For about eight years, Albania has doubled its exports to Kosovo, becoming now one of the most important trading partners for the Albanian economy. Exports to Spain were almost inexistent during 2005 – 2008. However, since 2009 and further they have picked up sharply, showing up a continuous growing trend year on year. Thus, in 2012, exports to Spain accounted for 9.2% of total Albanian exports, hence becoming Albania’s second most important trading partner for domestic exports, after Italy.

Chart 3 Exports based on the 9 main categories of tradable goods weighted against total exports (2005 – 2013)



Source: INSTAT, 2014.

The above analysis helps us conclude that Albanian exports have recently undergone through some considerable changes in terms of both volumes and destinations. In recent years, (particularly since the onset of the global economic crisis), the share of exports to our traditional trading partners (Italy and Greece) has shrunk. It is also worth noting that these two specific economies have been severely stricken by the recent economic and financial crisis. The following analysis on exports by main trading partners and by export categories of goods offer a more complete picture on these developments.

Chart 3 shows developments of Albanian exports by nine main categories of goods during 2005 – 2013. Among the categories with the largest share in Albanian exports (above 80% of total exports),

listed by their importance for the period under consideration, we can list the following: ‘Textiles and footwear’ (about 43%), ‘Minerals, fuels and electricity’ (about 20%), ‘Construction materials and metals’ (about 17%), and ‘Foods and tobacco (about 7%)’.

However, when analysing them by their performance in years, we see that the share of certain categories of goods in total exports has performed differently. Thus ‘Textiles and footwear’, has dropped significantly, year on year, to under 30% in 2013, from about 60% of total Albanian exports in 2005. ‘Construction materials and metals’ and ‘Foods, beverages and tobacco’ has ranged at almost the same quotas during 2005 – 2013.

‘Minerals, fuels and electricity’ reveal a continuously positive growing trend during this specific period. This category of goods accounted for only 5.2% of

total Albanian exports in 2005, reaching 40% of total exports in 2013, thus becoming the main export category for the Albanian economy.

The following analysis focuses on exports performance by main trading partners and by the categories of goods exported to them. The above analysis on the performance of exports during 2005 - 2013, highlights three categories of main trading partners: a) partners, exports toward whom have shown a decreasing trend (the share of these partners averages 69% for 2005-2013), b) partners, where exports have increased (averaging 12% to total exports), and c) partners, where exports toward whom have not reflected any improving or deteriorating trends (averaging 8% to total exports for the period under review). Considering this categorisations, the following analysis will focus on the two first categories of trading partners, where Albanian exports have been considerably dynamic:

Chart 4 and Chart 5 below show the performance of exports toward two trading partners, respectively Italy and Greece, by nine main categories of goods for 2005 – 2013, in ALL million.

Chart 4 suggests that the gross value of exports to Italy, by nine main categories of goods, has been characterised by a positive growing trend for almost all the categories of goods. The increase in exports to Italy is noticeable in both gross values and volumes (net percentages). However, if we refer to the above analysis, chart 2., shows that the share of exports to Italy (the main trading partner) to total Albanian exports have contracted considerably, particularly after 2008 (from the onset of the global economic crisis). This contraction is explained by the fact that the domestic economy has recently boosted exports not only to Italy but also to new trading partners. After 2008, domestic exporters have aimed at finding new markets for domestic products, hence reducing their dependence on the traditional trading partners (Italy and Greece).

The analysis by category of goods shows that exports of 'Textiles and footwear' (around 59%), 'Minerals, fuels and electricity' (around 12%) and 'Construction materials and metals' (around 12%) are the main categories of goods dominating exports to Italy. The performance of 'Construction materials and metals' remained almost constant throughout the period under consideration. Meanwhile the category of 'Textiles and footwear', predominating exports to Italy, has been steadily upward during 2005 - 2013. It is worth noting that since 2008, exports of 'Minerals, fuels and electricity' have increased sharply.

Chart 5 shows that the category of goods dominating the Albanian exports to Greece (around 4.4% of total Albanian exports in 2013) for 2005 – 2013 are:

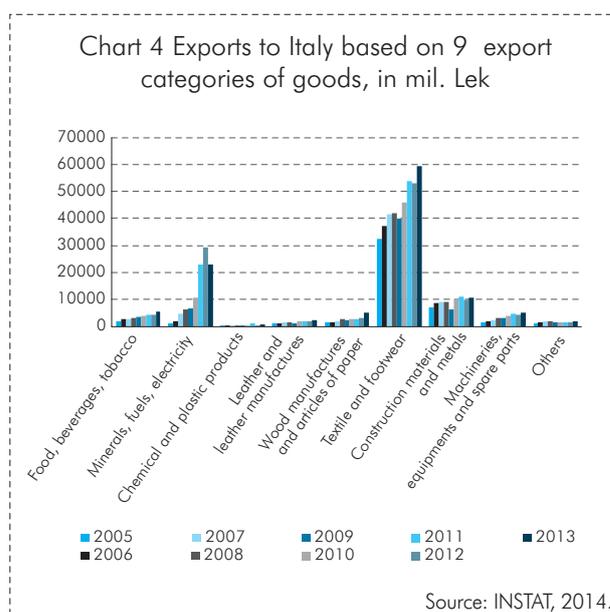
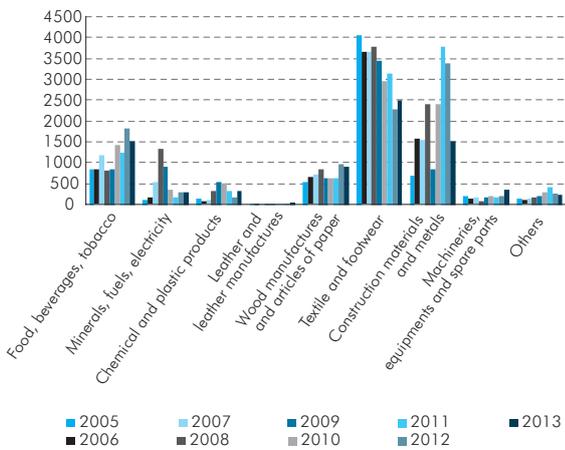
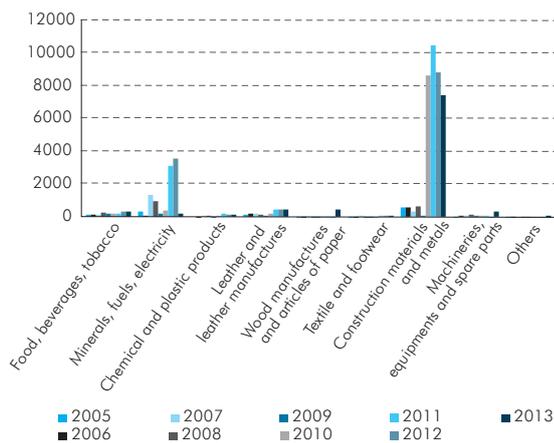


Chart 5 Exports to Greece based on 9 export categories of goods, in mil



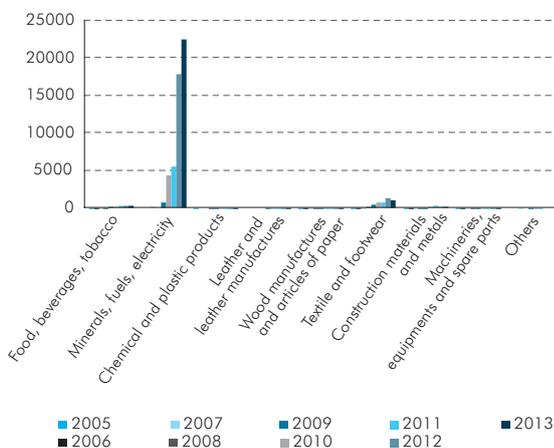
Source: INSTAT, 2014.

Chart 6 Exports to Turkey based on 9 export categories of goods, in mil. Lek



Source: INSTAT, 2014.

Chart 7 Exports to Spain based on 9 export categories of goods, in mil. Lek



Source: INSTAT, 2014.

'Textiles and footwear' (around 41%), 'Construction materials and metals' (around 23%), 'Foods and tobacco' (around 13%). 'Textiles and footwear', dominating Albanian exports to Greece, have shown a decreasing trend, particularly during the last years (to around 24% in 2013, from around 59% in 2005). Exports of 'Construction materials and metals' and 'Foods, beverage and tobacco' have shown a growing trend, averaged at around 35% and 19%, respectively, as a percentage of total exports to Greece in 2013.

Charts 6, 7 and 8 show the performance of exports by category of goods to new trading partners: Turkey, Kosovo and Spain. In Chart 2 we evidenced that exports to these new trading partners, as a percentage of total exports, were increasing during 2005 – 2013, particularly after 2008.

The analysis on exports by category of goods toward Turkey (around 6.3% of total Albanian exports in 2012) during 2005 – 2013, reveal that exports to Turkey are dominated by only two main categories of goods: 'Construction materials and metals' (around 49%) and 'Minerals, fuels and electricity' (around 28%). Exports of the other seven categories of goods to Turkey are almost inexistent, even though, in recent years, Albanian exports to Turkey account for around 6.5% of total exports.

Exports of categories of goods to Spain (around 9.2% of total Albanian exports in 2012) performed similarly to exports to Turkey. The only category dominating exports to Spain are 'Minerals, fuels and electricity', accounting for around 90% of Albanian exports to this trading partner. Exports of 'Textiles and footwear' show a slightly marginal growth, whereas, exports of other categories of goods to Spain are insignificant, though exports to this country for 2012 ranked Spain as Albania's second main trading partner. Trading of only one category of goods to this country suggests that exports to Spain should be analysed more in depth.

Exports to Kosovo (around 8.2% of total Albanian exports in 2012) reveal another situation. Unlike the cases Turkey and Spain, exports to Kosovo are dominated by some other categories of goods:

‘Minerals, fuels and electricity’, ‘Foods, beverages and tobacco’ and ‘Machinery, equipment and spare parts’. Overall, almost all categories of goods exported to Kosovo have shown an upward growing trend during 2005 – 2013. The above conclusions highlight that Kosovo is becoming an important trading partner for Albanian exports which are well diversified in almost all export categories of goods.

3. EXPORTS AND COMPETITIVE ADVANTAGES

3.1 COMPETITIVENESS AND COMPETITIVE ADVANTAGES

The above analysis leads to a question: Is the increase in Albanian exports during recent years as a result of the competitive advantages they offer, or is it influenced by other circumstances. To answer this important question, we should consider the assessment of the competitive advantages of Albanian exports by different sectors of the economy. Revealed Comparative Advantage Index (RCA Index) is one of the means applied mostly by researchers in international trade, when referring to the competitiveness of the economy’s sectors in the external trade. This index was initially suggested by the Balassa (1965), and has been largely applied ever since. This paper applies the export specialization index, which is a modified RCA index. It assesses the export specialisation, in which the denominator is usually measured by referring to specific markets or partners. It provides information on the specialisation in the export sector of a country to a specific trading partner. The specialisation index is calculated as the ratio of the share of an exported product in a country’s total exports to the share of this product in imports of the specific partner. In the form of an equation, this index may be expressed as follows:

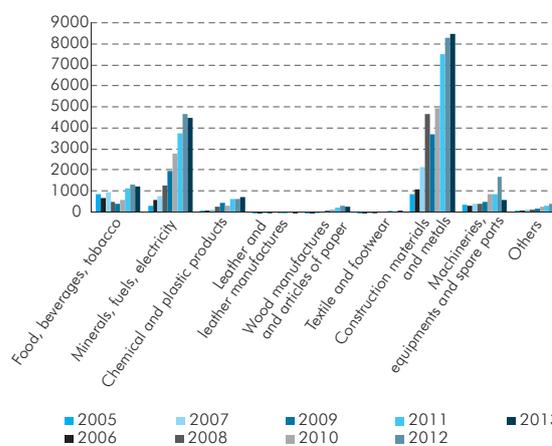
$$ES = (x_{ij}/X_{it}) / (m_{kj}/M_{kt})$$

Where x_{ij} are export values of country i in product j (in our case, Albania), X_{it} are total exports of a country I , m_{kj} are import values of product j in market k (the rest of the world) and M_{kt} are total imports in market k .

A specialisation index values above 1 for different sectors of the economy (Leromain & Orefice (2013) shows that in this specific sector of exports the economy is specialized, indicating a competitive advantage. The values of the specialisation index less than 1 show that this sector of the economy is not as specialised, and does not indicate a competitive advantage for exports to the specific partners.

Our analysis focuses on the export specialisation index for four main categories of goods of the Albanian economy exports: ‘Textiles and footwear’,

Chart 8 Exports to Kosovo based on 9 export categories of goods, in mil. Lek



Source: INSTAT, 2014.

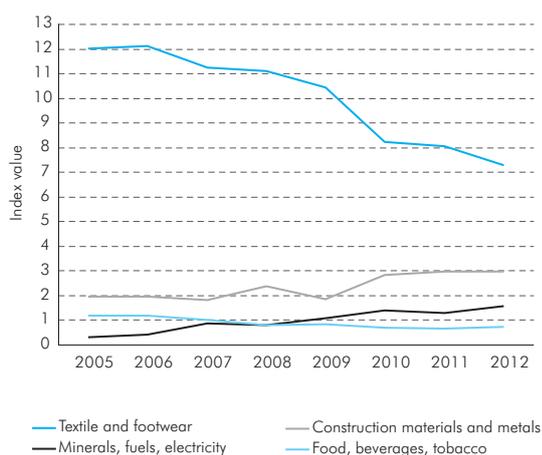
'Minerals, fuels and electricity', 'Construction materials and metals' and 'Food, beverages and tobacco'.

In recent years, 'Mineral fuels, oils and products of their distillation' has experienced the highest increase (accounting for around 27% of total exports for 2013, mainly to Italy and Spain, above 80%). This category of exports includes exports of crude oil and its sub-products. Other mineral sub-products, such as chromium, nickel, cast iron and steel (whose exports have increased in recent years), are also usually exported as unprocessed materials. These types of (unprocessed) exports are known as gross exports, which contribute only marginally to the value added of exports and productivity.

The category of 'Contract manufacturing', which, besides contributing employment, basic materials processing and total exports, increases also the value added and productivity, by transforming the basic materials into final consumer products. It is, therefore, this category of exports ('Textiles and footwear') that has contracted significantly in the recent years (from around 60% of total exports in 2005 to around 30% of total exports in 2013). The economic crisis has influenced a lot in this regard, affecting the historical trading partners of the Albanian economy: Italy and Greece (both EU economies most severely hit by the economic crisis).

The analysed time series (source: UN COMTRADE) of total import of these products display the total world imports as a trading partner. The aim is to analyse the comparative advantages revealed by the four main categories of Albanian exports to the world.

Chart 9 Revealed Comparative Advantages index of Albanian exports to the World



Source: INSTAT, 2014.

Revealed Comparative Advantage Index of Albanian exports to the world shows that Albanian exports of 'Textiles and footwear' have a competitive advantage compared to other countries. The index is above 1, indicating a comparative advantage of these exports. However, the values of this index for exports of 'Textiles and footwear' have shown a downward trend for the period 2006 - 2012. The export index for 'Minerals, fuels, and electricity' was below 1 till 2008, thus indicating no comparative advantage for this category of goods exported abroad. However, from 2009 onward, the index has been above 1, indicating a revealed comparative advantage of these exports to the world.

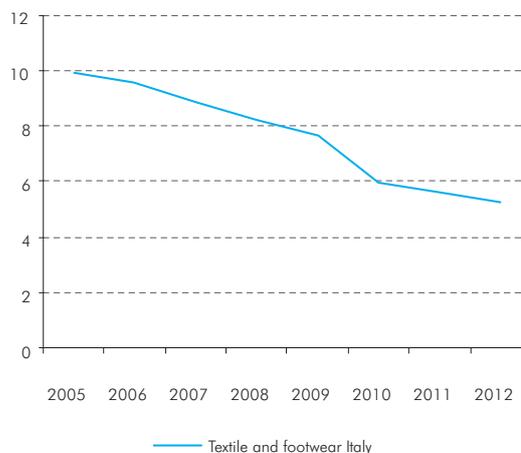
The index shows values above 1 during 2005 – 2012 even for exports of 'Construction materials and metals'. Again, the Albanian economy presents a comparative advantage in exporting construction materials and metals to the world.

The index shows the opposite as regards the comparative advantage of exports of 'Foods, beverages and tobacco' (the fourth category of goods

by importance of Albanian exports to the world). Even though the value of this index was above 1 for 2005 – 2006, it has dropped below 1 over the following years, revealing less comparative advantage for this category of exports to the world.

Considering that Italy is Albania's main trading partner and that 'Textiles and footwear' constitute the main category of exports to Italy, this paper has also analysed the specialisation of the Albanian economy in this sector of exports. As chart 10 shows, the Albanian economy is specialised in exports of 'Textiles and footwear', though the trend of this index has shown a downward trend.

Chart 10 Specialization index in Textiles and footwears to Italy, 2005 - 2012



Source: INSTAT, 2014.

4. SUMMARY AND CONCLUSIONS

During Albania's transition period, imports have dominated the trade balance. Since 2008, Albania's trade deficit has been improving steadily, influenced substantially by the increase in exports. Analyses reveal that after 2008, the Albanian exports have diversified their destination, finding new trading partners, such as Turkey, Kosovo and Spain, and reducing exports to Greece (which is severely hit by the economic crisis).

Exports to Turkey and Spain are concentrated only in one or two main export categories of 'Minerals, fuels and electricity' and 'Construction materials and metals', and do not display good distribution of exports to these trading partners. Exports to Kosovo appear well diversified across several categories of goods and show a steady upward growing trend.

Exports to Italy have continued to grow, and Italy remains Albania's main trading partner (although after 2008 the share of exports to Italy in total exports has dropped).

The increase in total exports was driven by the category of 'Minerals, fuels and electricity', which, in 2012, became the predominant category of Albanian exports.

The Revealed Comparative Advantage Index shows that the Albanian economy presents comparative advantages in at least three out of the four main categories of goods it exports.

Also, the Export Specialization Index suggests that Albania is specialized in the export of 'Textiles and footwear' to Italy, its main trading partner.

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BANK OF ALBANIA NEWS JULY-DECEMBER 2013

President of the Deutsche Bundesbank, Mr. Jens Weidmann, pays an official visit to the Bank of Albania

On 21 August 2013, on the invitation of the Governor of the Bank of Albania Mr. Ardian Fullani, the President of the Deutsche Bundesbank, Mr. Jens Weidmann, paid an official visit to the Bank of Albania.

Meeting with members of the Supervisory Council and heads of departments of the Bank of Albania, Mr. Weidman discussed the latest economic developments in Albania, the region and in the euro area at large.

Governor Fullani informed Mr. Weidmann on the situation of the Albanian economy and that of the banking system in particular. Moreover, Governor Fullani presented the measures taken by the Bank of Albania to strengthen macroeconomic conditions and guarantee the country's financial stability. He also informed Mr. Weidman on the work of the Bank of Albania towards fulfilling the legal and economic requirements in the framework of Albania's approximation with the European Union and the efforts to initiate and promote regional cooperation between the region's central banks.

President Weidmann commended the performance of the Bank of Albania and its efforts to maintain financial stability in Albania.

The Deutsche Bundesbank is a key provider of technical assistance to the Bank of Albania. President Weidmann affirmed the support for stronger bilateral cooperation between the two central banks.

This is the first official visit of the President of the Deutsche Bundesbank, Mr. Jens Weidmann, in Albania.

Bank of Albania launches new educational package "1, 2, 3... Çufo piggy learns to save"

The Bank of Albania has launched the educational package "1, 2, 3... Çufo piggy learns to save" for the 2013-14 school year. This package is dedicated to pupils attending class I, II and III of the nine-year school. It will be taught in the free teaching classes dedicated to school projects or as an inter-subject project.

The text of the educational package "1, 2, 3... Çufo piggy learns to save" was designed and developed in accordance with the best didactic practices for children aged 7 to 9 years.

The topics elaborated in this book were selected to comply with the daily experience of pupils with money and personal finance.

The materials included in this package were prepared by the Bank of Albania, in cooperation with Gaqo Bushaka, a distinguished children's book writer, who made the characters of his work "Çufo and Curly puppy" available to the Bank.

This educational package consists of the fairy tale book "1, 2, 3... Çufo piggy learns to save", the worksheets and the teacher's guide.

- The book "1, 2, 3... Çufo piglet is learning to save" consists of seven short tales, which cover in a simple language topics such as: the

difference between needs and wants; where the money comes from and what it serves for; and money management and saving.

- 22 completing worksheets, which help the pupils learn by having fun.
- The Teacher's Guide aims to help teachers better understand the package objectives and guide them during the elaboration of fairy tales and worksheets in class.

This educational package seeks to teach financial education to pupils of class I, II and III, and motivate them to save and take care of money, and push them into active thinking about money and prices.

The Ministry of Education and Science has decided to develop this project in 30 pilot nine-year schools, initially in Tirana, Vlora and Shkodra.

This educational package will be provided to all schools free of charge.

To ensure the successful implementation of this project, the Bank of Albania has held training seminars for teachers of the 30 pilot schools. These seminars seek to introduce teachers to the essential concepts of the package and the best ways to convey the information to the children.

The package launched today represents the first level of the financial education platform designed by the Bank of Albania. After successfully incorporating the elective module "Personal finance in your hands" into the high school curriculum in 2011 and launching the educational set "1, 2, 3... Çufo piglet is learning to save", the Bank of Albania is committed to design other educational programmes in the years ahead, dedicated to students at all education levels. In this regard, conveying educational information by age group through specialised applications for iOS and Android operating systems is one of the greatest ambitions. The widespread use of mobile devices operating through these systems creates a golden opportunity to easily reach most people.

On 19 September 2013, the Bank of Albania in cooperation with the University of Oxford hosted a conference on "Strengthening linkages in South East Europe. Policy anchors and business perspectives".

*Conference
"Strengthening linkages
in South East Europe.
Policy anchors and
business perspectives"*

This conference was attended by the Prime Minister of the Republic of Albania, Mr. Edi Rama, representatives of academic circles from Albania, the region and beyond, public institutions, international institutions in Albania, and the Bank of Albania. This conference was part of the cooperation agreement between the Bank of Albania and the University of Oxford.

The main topics discussed at the conference focused on recent economic-financial developments in the countries in the region and the challenges facing these economies. During the conference the Governor of the Bank of Albania, Mr. Fullani, signed a cooperation agreement with the representative of the University of Oxford, Mr. Othon Anastasakis, for the next three years.

The Bank of Albania signed the first cooperation agreement with the University of Oxford in September 2010.

This cooperation aims at carrying out scientific researches to promote and deepen knowledge on economic policies and challenges facing Albania and the region, as well as assessing the policies for promoting growth of economic sustainability in the region, and integration into the European Union.

Technical meeting to promote regional cooperation in the framework of Vienna Initiative 2.0

On 3 October 2013, the Bank of Albania hosted a technical meeting to promote regional cooperation in the framework of Vienna Initiative 2.0, with representatives from central banks of the SEE region and beyond.

This meeting was organised ahead of the Vienna Initiative Full Forum Meeting scheduled to take place shortly in Brussels.

In the meeting, participants discussed about the effects of deleveraging in the countries of our region, mechanisms to be employed to restore lending to our economies, as well as the role of European Union authorities and banking groups in this regard. Discussions focused also on the effects that the new supervisory framework of the European Union may have on our economies. In this respect, participants paid particular attention to fostering cooperation between host non-EU countries, and strengthening their negotiation powers vis-a-vis European Union authorities.

In early 2013, the Governor of the Bank of Albania, Mr. Ardian Fullani, was appointed as a Steering Committee member of Vienna Initiative 2.0.

As the only non-European Union member state having a seat in the Steering Committee of the Vienna Initiative 2.0, Albania is committed to represent the interests of other non-EU member states of Central Europe, especially of the South East Europe, in the Initiative.

The main goal of the meeting was to collect first-hand the participants' proposals, which would be brought up in the next forum of the Vienna Initiative 2.0.

The Vienna Initiative 2.0 follows the success of Vienna Initiative 1.0, launched at the height of the global financial crisis of 2008-09. It continues to use the public-private sector platform, which brings together major international financial institutions, the European Commission and other EU institutions, the largest international banking groups, and home and host country authorities, to complement other initiatives.

"...the bank, for Albania, is a second victory after freedom..." 100 years journey of central banking in Albania

This year, the Bank of Albania celebrates one of the most important events in Albania's central banking history: 100 years from the signing of the first concession agreement establishing the National Bank of Albania.

On 4 October 2013, the Bank of Albania opened an exhibition on: "...the bank, for Albania, is a second victory after freedom..."

100 years ago, on 4 October 1913, the founder of the modern Albanian state, Ismail Qemal Bey Vlora signed, on behalf of the Albanian government, the first concession agreement to establish a central bank in Albania. The concession agreement was also signed by representatives of two of the largest financial groups of the time, of Austria-Hungary and Italy. The concession is the corner stone for the establishment of central banking in Albania.

The exhibition commemorating this important historic date will inform the public on the journey of the currency across Albanian territories and the history of the establishment of the central bank in our country. The exhibition features coins and banknotes in circulation across Albanian territories from antiquity to modern days as well as unique items that testify pre-monetary exchanges in these territories.

In addition to historic documents on central banking and the variety of national banknotes, the exhibition highlights the most recent initiatives of the Bank of Albania on financial education.

The Governor of the Bank of Albania Mr. Ardian Fullani addressed the audience at the opening ceremony, in the presence of Mr. Ilir Meta, the Speaker of the Albanian Parliament, representatives of diplomatic missions accredited in Albania, banking sector senior officials, relevant scholars, media and members of the public.

On 16 October 2013, the Bank of Albania, further to a number of legal and regulatory initiatives to reduce non-performing loans and boost lending, held a round table on introducing a platform for addressing non-performing loans, which was attended by senior managers of the Albanian banking system and representatives of the Albanian Association of Banks.

On introducing a platform for addressing non-performing loans

The platform was designed by the Bank of Albania, in cooperation with the World Bank's Vienna-based Financial Sector Advisory Centre (FinSAC). This platform aimed at addressing the non-performing loan problem and improving the related ratio.

Close cooperation with FinSAC's experts aims to deeply and professionally restructure and improve the non-performing loan management.

The FinSAC was established by the World Bank with the purpose to provide technical assistance on the regulation and supervision of the financial sector to central banks and financial regulators in Europe and Central Asia.

Governor of the Bank of Albania, Mr. Ardian Fullani, addressed the end-of-year meeting with journalists, analysts and media executives

On 20 December 2013, on the occasion of the end of the year, the Governor of the Bank of Albania, Mr. Ardian Fullani, addressed a meeting with journalists of the print and electronic media, political/economic analysts and media executives in Albania.

Governor Fullani opened the meeting with his best wishes for a happy and successful New Year, and expressed his appreciation of the journalists' role in and contribution to implementation of Bank of Albania's primary mandate to achieve and maintain price stability.

During this meeting, Governor Fullani introduced Bank of Albania's calendar for 2014 dedicated to agriculture and its products, stressing the importance of this sector's development to the country's economy.

At the end of the activity, the Governor awarded three prizes to winners of the open contest on "Governor's award for the best diploma, 2013", as follows: The first prize was awarded to Ms. Eda Dokle, from the Charles University in the Czech Republic, for her Master's thesis on "Inflation Targeting in a Dollarized Economy".

The second prize was awarded to Mr. Minella Kalluci, from Bocconi University in Italy, for his diploma thesis on "Main critiques of the credit rating agencies and determinants of sovereign debt rating: Evidence from the euro area".

The third prize was awarded to Mr. Ergi Take, from the University of Tirana, Faculty of Economics, for his diploma thesis on "Validity of Okun's law in Albanian economy (1980-2012)".

This is an annual contest open to Albanian students graduating during the year in Albania or abroad, for scientific researches into issues related to monetary and international economics, price and financial stability, economic integration of Balkan countries to European Union, Bank of Albania's activity, Albanian financial system, banks' behaviour and role in the Albanian economy, and issues related to other macro and microeconomic aspects of the overall economy.

Friday Seminars

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 2013, the Friday Seminar welcomed six presentations by the Bank of Albania's experts and by other researchers from the academia in Albania and abroad.

Research papers presented in "Friday Seminar Series" addressed different issues regarding the impact of shocks on business cycles and the trend of economic growth, financial innovation, bidding behaviour in treasury

auctions, and imported inflation and its impact on the headline inflation. In the following sections, you may find a detailed description of the presented materials.

The Friday Seminar in the second half of 2013 opened with the working paper by Bledar Hoda, Research Department, on: "The impact of nominal shocks on business cycles and on the trend of economic growth". The volatility of output and the long-term trend in the income per capita have been recently the focus of policy decision making worldwide. Identification of the role of nominal, monetary or interest rate shocks in smoothing business cycles has become an area that draws much interest. This study focuses on the impact of monetary or interest rates shocks on output and other indicators of national accounts, as a means of stabilizing business cycles. The author aims to establish a system consisting in the consumption to output ratio and the investment to output ratio, as well as a function of money demand in a three-equation system. Monetary and real interest rates shocks are used as alternative potential factors explaining developments of the real sector. Findings identify the extent to which each nominal indicator is used to influence the latter.

The next paper introduced in the seminar was: "Financing innovation and innovation in finance", by Grid Thoma, Assistant Professor of Economics and Management at the University of Camerino, Camerino, Italy. This study analyses data obtained from the process of recording financial patents in Europe, whose number has increased in parallel with significant changes in the financial and payment systems. Drawing an analogy with non-financial patents, data are obtained from the European Patent Office (EPO) and the analysis follows the performance of the market value of financial patents in dynamic. The author finds that companies, which operate in non-financial sectors and have a diversified portfolio, own a large part of patents in EPO, while their evolution is similar to developments in the U.S patents market. The findings of the study provide valuable information for intellectual property managers on financial innovations and patents.

The next paper introduced in the seminar was: "On Bidding behaviour in Albanian treasury auctions", by Elisa Pazaj, Monetary Operations Department. This study aims to present empirical evidence on the response of investors to various developments in treasury auctions. Based on detailed data from submitted claims in auctions during January 2010– December 2012, this study reveals that uncertainty in the market is associated with higher yields for treasury bills. Also, results show that bidding behaviour varies depending on the form of auction

"Applicability of international financial reporting standards in developing countries, case of Albania" by PhD. Dritan Fino, Lecturer at "Marin Barleti" University. The aim of this paper is to analyse the applicability of international financial reporting standards in developing countries, and their role in the economic development of these countries. The material provides a description of the advantages and disadvantages of adopting such standards, along with the challenges that the accounting system faces in Albania. The

author concludes that financial reports prepared on the basis of international financial standards provide more reliable information, which facilitates the financial decision making. Consequently, our country should benefit from their implementation, while considering the environment and the current stage of the economic development. The adoption of international standards in Albania will increase the comparativeness, transparency and accountability of the reported financial information. Although, it is a difficult process and depends considerably on the ability of the national accounting authorities.

An other study presented was on: "Imported inflation of consumer goods and its contribution to the national inflation", by Lorena Skufi and Enian Çela, Reserach Department. As a small open economy, Albania is thought to be exposed to foreign inflationary influences, which then have an impact on the country's headline inflation. This paper seeks to quantify imported inflation for a selected sample of consumer goods representing 60% of the Consumer Price Index (CPI) basket. Also, the study tries to decompose the headline inflation into domestic and foreign contributions, while applying accounting techniques for the period 2008- 2012. Results show that the contribution of imported inflation is marginal.

The closing paper in the "Friday Seminar" series for the second half of 2013, addresses: "How to write and assess an academic paper", by Margerita Topalli, Reserach Department. This paper discusses, in general terms, the process of scientific research for each stage, and how to write a research paper. The focus of the presentation consisted in becoming familiar with procedures for publishing a paper, its publication and review process, which altogether might last from several months to about two or three years

MONETARY POLICY DECISIONS

31 July 2013

The Supervisory Council of the Bank of Albania decided to cut by 0.25 percentage points the interest rate for repurchase and reverse repurchase agreements. The new rate is 3.50 per cent (from 3.75 per cent).

28 August 2013

The Supervisory Council of the Bank of Albania decided to keep the interest rate on repurchase and reverse repurchase agreements (REPO and reverse REPO) unchanged at 3.50 per cent.

25 September 2013

The Supervisory Council of the Bank of Albania decided to keep the interest rate on repurchase and reverse repurchase agreements (REPO and reverse REPO) unchanged at 3.50 per cent.

30 October 2013

The Supervisory Council of the Bank of Albania decided to keep the interest rate on repurchase and reverse repurchase agreements (REPO and reverse REPO) unchanged at 3.50 per cent.

27 November 2013

The Supervisory Council of the Bank of Albania decided to cut by 0.25 percentage points the interest rate on repurchase and reverse repurchase agreements (REPO and reverse REPO). The new rate is 3.25 per cent (from 3.50 per cent).

16 December 2013

The Supervisory Council of the Bank of Albania decided to cut the interest rate on repurchase and reverse repurchase agreements (REPO and reverse REPO) by 0.25 percentage points. The new rate is 3.0 per cent (from 3.25 per cent).

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MONETARY POLICY

On 31 July 2013, 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 2013". The first months of 2013 confirmed Albania's slow economic growth and weak inflationary pressures. Albania's economic activity continues to suffer from sluggish aggregate demand. The second-quarter inflation averaged 2.2%, edging down relative to the first quarter. With regard to economic developments, INSTAT data show that the first-quarter economic growth was 1.7%, remaining similar to the previous year's figure. Bank of Albania's projections for the economic outlook support the assessment that the Albanian economic activity will grow slowly over the quarters ahead, at levels comparable with those of the first half of the year.

On 31 July 2013, the Supervisory Council of the Bank of Albania approved the Decision No. 47 "To cut the interest rate on repurchase and reverse repurchase agreements". According to this Decision, the Bank of Albania cuts by 0.25 percentage points the interest rate on repurchase and reverse repurchase agreements, from 3.75 per cent to 3.50 per cent.

On 30 October 2013, the Supervisory Council of the Bank of Albania approved by Decision No. 61 the "Monetary policy report on the third quarter of 2013". According to this report, the Albanian economy saw slow economic growth and weak inflationary pressures throughout 2013. Economic growth slowed down to 1.1% in the second quarter, while available information suggests weak economic activity during the third quarter. Consumption and private sector investments were weak, whereas external demand continued to curb due to the economic situation in Albania's trading partners. Private agents' uncertainty about the future was reflected in low tendency to spend and weak demand for loans. Moreover, banking system's conservative policies kept the lending standards tight, and prevented the normal functioning of the monetary policy transmission mechanism.

On 27 November 2013, the Supervisory Council of the Bank of Albania approved the Decision No. 78 "To cut the interest rate on repurchase and reverse repurchase agreements". According to this Decision, the Bank of Albania decided to cut by 0.25 percentage points the interest rate on repurchase and reverse repurchase agreements (REPO and reverse REPO), from 3.50 per cent to 3.25 per cent.

On 16 December 2013, the Supervisory Council of the Bank of Albania approved the Decision No. 81 "To cut the interest rate on repurchase and reverse repurchase agreements". According to this Decision, the Bank of Albania cuts by 0.25 percentage points the interest rate on repurchase and reverse repurchase agreements, from 3.25 per cent to 3.0 per cent.

BANKING SUPERVISION

On 31 July 2013, the Supervisory Council of the Bank of Albania approved by Decision No.48 the Regulation "On capital adequacy ratio". This Regulation lays down the criteria and rules for the calculation of the capital adequacy ratio, and the minimum of capital adequacy ratio. This Regulation shall apply to banks licensed to carry out the banking and financial activity in the Republic of Albania. In accordance with this Regulation, banks shall calculate the capital adequacy ratio between the amounts of regulatory capital to the amount of risk weighted exposures (assets), expressed in percentage, on individual and consolidated basis.

Banks shall ensure that the capital adequacy ratio, calculated according to the criteria laid down in this Regulation, shall not be less than 12%.

On 28 August 2013, the Supervisory Council of the Bank of Albania approved the Decision No. 55 "Amendments to the Regulation 'On the prevention of money laundering and terrorist financing'". These amendments consist in the articles that regulate the procedures and documentation for identifying clients for the purposes of preventing money laundering and terrorism financing, the responsible structures of entities, the reporting to the receptive authorities related to these kinds of activities, etc.

On 30 October 2013, the Supervisory Council of the Bank of Albania adopted the Decision No.63 "On granting the prior approval to Raiffeisen Bank sh.a. to conduct additional activity". According to this Decision, the Bank of Albania grants the prior approval to Raiffeisen Bank sh.a. to conduct the additional financial activity of intermediary in insurance and re-insurance.

On 30 October 2013, the Supervisory Council of the Bank of Albania approved the Decision No.64 "On granting the prior approval Intesa Sanpaolo Bank Albania sh.a. to conduct additional activity". According to this Decision, the Bank of Albania grants the prior approval to Intesa Sanpaolo Bank Albania sh.a. to conduct the additional financial activity of providing guarantees and taking commitments, as well as the trading activity for its own account or for the account of its clients, even in a foreign exchange, in a self-organised market, also known as transferable securities.

ISSUE

On 31 July 2013, the Supervisory Council of the Bank of Albania approved by Decision No. 49 the Regulation "On the suspected counterfeit euro and other foreign banknotes and coins". This Regulation lays down the rules and procedures for handling suspected counterfeit euro and other foreign banknotes and coins, to prevent and protect them against counterfeiting. This Regulation will be applied on the Bank of Albania, commercial banks, branches of foreign banks and other non-bank financial institutions, licensed to carry out banking and/or financial activities in the Republic of Albania.

On 31 July 2013, the Supervisory Council of the Bank of Albania approved the Decision No. 50 "On the approval of an amendment in the Regulation "On the export and import of Albanian banknotes and coins". The amendment to this Regulation concerns Article 6, which lays down the cases under which the export of Albanian banknotes and coins will be allowed outside the territory of the Republic of Albania.

On 11 September 2013, the Supervisory Council of the Bank of Albania approved by Decision No. 57 the Regulation "On exchanging damaged Albanian banknotes and coins". This Regulation lays down the criteria and procedures for the exchange of damaged Albanian banknotes and coins and their withdrawal from circulation. Entities, subject to this Regulation, shall be banks and branches of foreign banks licensed to exercise banking and/or financial activities in the Republic of Albania.

On 11 September 2013, the Supervisory Council of the Bank of Albania approved by Decision No. 58 the Regulation "On exchange of damaged banknotes and coins". This Regulation lays down the rules and procedures for the exchange of the damaged banknotes and coins at the Bank of Albania. The articles of this Regulation stipulate the general requirements to be met for the exchange, technical analysis, assessment and the commission.

On 25 September 2013, the Supervisory Council of the Bank of Albania approved the Decision No. 60 "On the exposure of precious metal coins in the exhibitions hosted by the Bank of Albania". According to this Decision, the exposure of numismatic values is approved, for coins from the golden and silver fund, in the exhibitions that Bank of Albania will host in the framework of celebrating the 100th Anniversary of the concession for the establishment of the National Bank of Albania, on 4 October 2013.

On 16 December 2013, the Supervisory Council of the Bank of Albania approved the Decision No. 82 "On an amendment in the Regulation 'On the authenticity checking and criteria for recirculation of Albanian lek banknotes'". The amendment consists in the adoption of banknotes handling machines installed prior to the entry into force of the Regulation on the meeting of the requirements stipulated herein. The adoption term is extended from no later than nine months from the entry into force of this Regulation to no later than 12 months.

FINANCIAL STABILITY

On 11 September 2013, the Supervisory Council of the Bank of Albania approved by Decision No. 56 the “Financial Stability Report for the first half of 2013”. The Albanian banking sector and financial system saw stable performance in H1 2013. Bank capital and liquidity indicators were adequate despite the lower profit figures. Banks’ activity volume continued to decelerate due to the lower deposit growth and poor credit growth. Loan portfolio quality continued to deteriorate and a considerable portion of banks’ operating income was channelled into reserve funds providing for protection against credit risk. The volume of financial institutions’ assets grew 2.1% from end-2012 and around 5.1% compared to the previous year. The banking sector remained the dominant segment of financial intermediation in Albania. Its assets accounted for about 92.6% of total financial system assets and around 88.9% of GDP.

MONETARY OPERATIONS

On 30 October 2013, the Supervisory Council of the Bank of Albania approved the Decision No. 66 “On an amendment in the Regulation “On the procedures for Bank of Albania intervention in the domestic foreign exchange market””. The amendment relates to Article 16 of the Regulation that regulates the announcement and publication of the Bank of Albania’s intervention in the foreign exchange market.

ECONOMIC POLICY

On 3 July 2013, the Council of Ministers approved the Decision No. 573 “On establishing the minimum wage”. The approval of this Decision lays down that the monthly minimum wage for the employees, at country level, obligatory to be implemented for each person, whether legal or natural, resident or non-resident, shall be ALL 22 000 (twenty-two thousand). This salary is granted for 174 (one hundred and seventy-four) working hours per month, carried out during the normal working time. The hourly minimum base salary shall be ALL 127 (one hundred and twenty-seven).

On 10 July 2013, the Council of Ministers approved the Decision No. 591 “On disciplining the use of budgetary expenditures for 2013”. This decision stipulates, among others, the reduction of operating expenses and maintenance of the central government units, at 20%, and the reduction of expenses for travelling and per diems abroad for the general government units, hence financing only the travelling of special importance.

On 17 July 2013, the Council of Ministers approved the Decision No. 583 “On the raise of pensions”. This decision stipulates the increase by 4% of pensions’ categories subject to the Law No 4171, dated 13.9.1966 “On social securities in the People’s Republic of Albania” and the Law No 7703,

dated 11.5.1993 "On social securities in the Republic of Albania". Also, an increase at the same level for the special state pensions and the relevant additions, monthly additions benefited by invalids of the national liberation war, pensions defined for the treatment of military personnel, special financial treatment for different categories of armed forces, etc.

On 17 July 2013, the Council of Ministers approved the Decision No. 663 "Inter-sectorial strategy of the war against organised crime, illegal traffics and terrorism, 2013-2020, and the action-plan for 2013-16". The purpose of the Strategy is to: consolidate the achieved performance in the fight against organised crime, illegal traffics and terrorism; lay down the policies, strategic priorities in this field, the objectives of public institutions engaged in it; and upgrade the inter-institutional coordination for achieving the strategic objectives for the period 2013-2020.

On 17 July 2013, the Council of Ministers approved the Decision No. 581 "On some amendments to the Decision No. 1114, dated 30.7.2008 of the Council of Ministers 'On some issues for the implementation of the laws No. 7703, dated 11.5.1993 'On social insurances in the Republic of Albania' as amended, No. 9136, dated 11.9.2003 'On the collection of the required social and health insurance in the Republic of Albania' as amended, and No.7870, dated 13.10.1994 'On health insurance in the Republic of Albania', as amended. This decision stipulates, among others, that the minimum monthly salary, for the effect of calculating the social and health insurance contributions, from August shall be ALL19 130 (nineteen thousand one hundred and thirty). The minimum monthly amount of contributions for all insurance branches, starting from this period, shall be ALL 5 308 (five thousand three hundred and eight).

On 17 July 2013, the Council of Ministers approved with Decision No. 600 the "Status of Mandatory Insurance Fund of Health Care in the Republic of Albania". According to this decision, the Mandatory Insurance Fund of Health Care is an independent public legal person, with the head office in Tirana and local offices across all the territory of the Republic of Albania. It provides and manages itself the mandatory insurance of health care in the Republic of Albania, being a specialised financial authority that manages the mandatory health insurance scheme, in compliance with the national health care policies of laid down by the Ministry of Health.

On 24 July 2013, the Council of Ministers approved by Decision No. 640 the annual report "On state aid 2012". This report presents detailed information and data of state aid related to the donor, beneficiary, and the value for each category of aid, excluding agriculture and fishing, which are not subject to the Law on state aid. The value of state aid granted to Albania, during 2007-2012, amounts ALL 83 523, 75 million (\approx EUR 631 million). State aid for 2012, including all sectors, amounts ALL 21 480, 77 million (EUR 154, 49 million), equal to 1.6% of the country's GDP. Also, the report provides data on the state aid granted in 2008, 2009, 2010 and 2011, to note the performance of different aid categories.

On 30 July 2013, the Ministry of Finance approved the Instruction No. 23 "On some amendments to Instruction No. 5, dated 30 June 2006 'On income tax', as amended". The amendments consist in the table of personal income tax from employment, and the article that regulates the income exempted from taxation. Thus, upon the approval of this decision, among other things, exempted income shall include: income from the insurance in the obligatory social and health insurances scheme, and the economic assistance for families and individuals with no income or with low income; pupils and students' scholarships, notwithstanding their financial resources, according to the specifications; benefits in case of diseases or calamities, etc.

On 31 July 2013, the Council of Ministers approved by Decision No. 636 "The Agreement on Swedish grant No. TF014255, between Albania and the International Bank for Reconstruction and Development (IBRD) acting as administrator of grant funds provided by Sweden, represented by Swedish International Development Cooperation Agency (SIDA), to assist in the co-financing of a Water Resources and Irrigation project". The IBRD, acting as administrator of grant funds provided by Sweden, represented by Swedish International Development Cooperation Agency (SIDA) ("Donor") proposes to extend to the Recipient a grant in an amount not exceeding US dollars 4,675,000 (four million six hundred and seventy-five thousand) to co-finance a Water Resources and Irrigation project.

On 31 July 2013, the Council of Ministers approved the Decision No. 712 "On the determination of public competition procedures for fishing rights in the internal waters of the Republic of Albania". The purpose of this decision is to provide a rational and responsible utilisation of biological sources of the internal waters in the Republic of Albania. It lays down the rules, criteria and procedures for the application of fishing permission, the way of handling the public competition and the correct implementation of terms for granting the permission.

On 28 August 2013, the Ministry of Finance approved by Instruction No. 8/2 "An amendment to Instruction No. 26, dated 4.9.2008 "On national taxes, as amended". This amendment stipulates that when the owner of the utilisation permit exports the mineral he has excavated from the underground, or the sub product produced by this mineral, he shall pay the tax on mining rent at the moment of providing the custom declaration. Also, in case the entity owner of the utilisation permit exports the mineral extracted by the mine or the sub product produced out of this mineral, through another sole exporting entity, the tax on mining rent shall be paid by both the owner of the utilisation permit and by the exporter.

On 18 September 2013, the Council of Ministers approved the Decision No. 833 "On determining the scope of state responsibility of the Ministry of Energy and Industry". According to this decision, the Ministry of Energy and Industry will compile and implement policies that aim at guaranteeing the energy supply to the country, utilisation of energetic and mineral resources for the sustainable economic development and public utility, and encouraging

industrial development by applying friendly standards to environment. It carries out its activity in areas that are under the state's responsibility, in electrical energy sector, hydrocarbons (oil and gas), mines and geology, and non-food industry.

On 18 September 2013, the Council of Ministers approved the Decision No. 835 "On determining the scope of state responsibility of the Ministry of Economic Development, Trade and Entrepreneurship". The Ministry of Economic Development, Trade and Entrepreneurship will prepare and implement the government policies on economy, trade and entrepreneurship to construct a new economic model, for high and sustainable economic growth in Albania. It compiles and implements integrated economic policies in primary sectors of economy, of economic and social convergence of the country's regions, improvement of the climate and services provided to business and enterprising.

On 27 September 2013, the Council of Ministers approved the Decision No. 841 "On determining the scope of state responsibility of the Ministry of Finance". This Decision lays down that the mission of the Ministry of Finance is to provide for economic stability through the effective and transparent management of public finances. It carries out the activity in public responsibility fields, such as: macro-economic and fiscal policy, management of state revenues and budget, public debt management, and financial management and control.

On 27 September 2013, the Council of Ministers approved the Decision No. 845 "On determining the scope of state responsibility of the Ministry of Social Welfare and Youth". According to this Decision, the mission of the Ministry of Social Welfare and Youth is to guarantee the constitutional rights for the social protection and inclusion, education and professional skills formation, adequate and insured employment, social insurance and equal opportunities, guarantee of freedom of religion and faith and equality of religious communities. The Ministry is responsible to develop public policies in the field of employment, education and vocational training, work relationships, inspection, insurance and health at work, etc.

On 30 September 2013, the Council of Ministers approved the Decision No. 880, "On an amendment to Decision No. 591, dated 10 July 2013 of the Council of Ministers "On disciplining the use of budgetary expenses, for the year 2013". This amendment stipulates that the Ministry of Defence, General Staff and structures of Armed Forces are excluded from some of the conditions laid down in the Decision No. 591. The decision specifies the activities of these institutions, which are not subject of disciplinary measures.

On 4 October 2013, the Council of Ministers approved the Normative Act No. 6 "On some amendments to the Law No. 119/2012 "On 2013 budget". The amendments to the Law, among others, lay down that the budget revenues for 2013 amount ALL 321,919 m (three hundred and twenty- one thousand nine hundred and nineteen million), expenditures ALL 405,408 m

(four hundred and five thousand four hundred and eight million), whereas the deficit amounts ALL 83,489 m (eighty-three thousand four hundred and eighty-nine million).

On 9 October 2013, the Council of Ministers approved the Decision No. 939 "On determining the scope of state responsibility of the Ministry of Agriculture, Rural Development and Waters Administration". This Decision stipulates that the mission of the Ministry of Agriculture, Rural Development and Waters is to implement the Council of Ministers political programme in the field of agriculture, rural development, alimentary industry and consumer protection, administration of waters, fishing and aquaculture. The Ministry is responsible, among others, to compile and implement the government policies and prepare the national strategies and plans of action related to the issues of above-mentioned fields.

On 9 October 2013, the Council of Ministers approved the Decision No. 944 "On determining the scope of public responsibility of the Ministry of Urban and Tourism". This Decision determines that the Ministry of Urban Development and Tourism compiles and implements policies aiming at modernising the implementation of legal framework in the field of urban planning and development, housing, legalisation and integration of informal constructions, and tourism. The ministry carries out its activity, among others, in the field of urban development planning, land administration and stable development of the control on territory, as well as in the field of tourism development.

On 10 October 2013, the Parliament of the Republic of Albania adopted the Law No. 157/2013 "On measures to combat financing of terrorism". This Law lays down the measures against terrorism financing, competences and relationships among the relevant authorities to propose, approve, control and implement them. The purpose of this Law is to prevent and fight terrorism actions and those who support and finance terrorism, or those against whom substantiated suspicions exist that they have carried out, or are carrying out or aim to carry out such actions. Measures include the sequestration of their funds and assets, in light of the implementation of international resolutions and agreements where the Republic of Albania is a party.

On 17 October 2013, the Parliament of the Republic of Albania approved the Law No. 162/2013 the "Agreement on the auditing service of government debts arrears to domestic and foreign private companies". The purpose of this Law is to issue the current and real results of the accumulated debt that ministries owe to private companies for the performed works, the services and purchased goods, and the processing of the management policies to pay this debt, by conducting deep and comprehensive audit procedures. This Law will apply on all public central institutions, that own data or that may use data related to the debt, subject of this Law, and the chartered auditor that will carry out the auditing service for the implementation of this Law.

On 25 October 2013, the Council of Ministers approved the Decision No. 976 "Funding Agreement between the Council of Ministers of the Republic of Albania, represented by the Ministry of Finance and the European Investment Bank, on the technical assistance for the secondary and local streets project No. 2 – Support to the implementation and stability". According to this Agreement, the European Investment Bank, on the secondary and local streets No. 2 – will support the implementation and stability, for the amount of EUR 1,250,000 (one million two hundred and fifty thousand).

On 31 October 2013, the Parliament of the Republic of Albania ratified by Law No. 167/2013 "The Agreement between the Council of Ministers of the Republic of Albania and the Government of the Republic of India for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital". This Agreement shall apply to persons who are residents of one or both of the Contracting States with regard to taxes on income and on capital imposed on behalf of a Contracting State or of its administrative subdivisions or local authorities.

On 14 November 2013, the Parliament of the Republic of Albania approved the Law No. 170/2013 "Agreement on the Albanian customs assistance". The purpose of this Law is to approve the agreement between the Council of Ministers of the Republic of Albania and "Crown Agent Limited" company. It aims at providing assistance to customs administration, in compliance with the European Union standards and the best regional practices, to improve performance, raise revenues and fight corruption in the customs administration of the Republic of Albania.

On 26 November 2013, the Parliament of the Republic of Albania approved by the Law No. 171/2013 the "Actual state budget for 2012". This Law lays down the state budget revenues at ALL 274,260 m (two hundred and seventy-four thousand two hundred and sixty million), whereas expenses at ALL 306,298 m (three hundred six thousand and two hundred and ninety-eight million).

On 2 December 2013, the Parliament of the Republic of Albania approved the Law No. 185/2013 "On 2014 budget". In accordance with this Law, the revenues for the 2014 budget will amount ALL 364,704 m (three hundred and sixty-four thousand seven hundred and four million), expenditures ALL 456,404 m (four hundred and fifty-six thousand four hundred and four million), while deficit ALL 91,700 m (ninety-one thousand and seven hundred million).

On 4 December 2013, the Council of Ministers approved the Decision No. 1039 "On the functioning of the National Employment Council and for the assignment of the representative of the Council of Ministers in this Council". This decision lays down out that the National Employment Council is a tripartite consultative authority, with representatives of the Council of Ministers and of the employees and employers organisations. It holds consultancies, takes consensual decisions and provides recommendations to the Council of Ministers, through the Minister of Social Welfare and Youth.

On 5 December 2013, the Parliament of the Republic of Albania approved the Law No.173/2013 "On the ratification of the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Council of Ministers of the Republic of Albania for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital". This Agreement shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its administrative subdivisions or local authorities, irrespective of the manner in which they are levied. This Agreement shall apply to persons who are residents of one or both of the Contracting States.

On 5 December 2013, the Parliament of the Republic of Albania ratified the Law No. 174/2013 "Assistance Agreement for developing objectives between the Council of Ministers of the Republic of Albania and the United States Government for strengthening the rule of law, good-governance and establishing the conditions for a sustainable, common and broad-based economic growth". The purpose of this Agreement is the common understanding between the contracting parties in undertaking a set of steps to fulfil its objectives. The USAID-estimated contribution to achieve the goals will amount to USD 28,544,000 (twenty-eight million four hundred and forty-four thousand), which will be granted increasingly and based on the availability of funds.

On 14 December 2013, the Council of Ministers approved the normative act No. 7 "On some amendments to the Law No. 119/2012 "On 2013 budget", as amended. The amendments to this Normative act, among others other, consist in amending the budget revenues for 2013 at the amount ALL 325,918 m (three hundred twenty-five thousand and nine hundred and eighteen million), the expenditure ALL 409,408 m (four hundred and nine thousand four hundred and eight million), whereas the deficit amounts ALL 83,490 m (eighty-three thousand four hundred and ninety million).

On 28 December 2013, the Parliament of the Republic of Albania adopted the Law No. 177/2013 "On some amendments to the Law No. 8438, dated 28 December 1998 "On income tax", as amended". The amendments to this Law consist in the articles that regulate the exempted income, the applicable fields of tax on profit, and special reserves for banks and insurances companies, tax levels and tax withholding, registration, declaration and payment. Upon the approval of this Law, tax on profit points at 15%.

On 28 December 2013, the Parliament of the Republic of Albania adopted the Law No. 178/2013 "On some amendments to Law No. 9975, dated 28.7.2008 "On national taxes", as amended". The amendments to this Law, among others, consist in the articles that regulate the levels of national taxes, the declaration for the payment of the mining rent, the transfer of income from national income to the tax regional tax directorate and the accounts of government units, and the commissions that tax agents benefit. Some of tax levels subject to these amendments are: tax for plastic packaging, tax for glass packaging and the vehicle circulation tax on benzene and gasoline.

On 28 December 2013, the Parliament of the Republic of Albania adopted the Law No. 179/2013 "On some amendments to Law No. 9920, dated 19.5.2008 "On taxation procedures in the Republic of Albania" as amended. The amendments to this Law consist in articles that regulate the scope of implementation, local government offices, taxation deregistration, cash payments, notification on the taxation assessment and request for the payment of taxation obligation, overpaid tax obligations, final report of the taxation control, reimbursement of taxation obligation, overdue and penalty payments, etc.

On 28 December 2013, the Parliament of the Republic of Albania adopted the Law No. 180/2013 "On some amendments to Law No. 61, dated 2012.1993 "On excises in the Republic of Albania" as amended. These amendments consist in articles that regulate excise on coffee and energy drinks, address the illegal production of tobacco and its sub-products, avoidance from verification from excise payment for tobacco, coffee and energy drinks, excesses or shortages in the premises of the registered receivers.

On 28 December 2013, the Parliament of the Republic of Albania adopted the Law No. 181/2013 "On some amendments to Law No. 9632, dated 30.10.2006 "On local taxation system", as amended. These amendments consist in articles that regulate the simplified tax on profit for small-sized business, tax levels, acknowledged and unacknowledged expenses, holding of registers, tax declaration, and management, tax on buildings, temporary taxes and local tariffs.

On 28 December 2013, the Parliament of the Republic of Albania adopted the Law No. 182/2013 "On some amendments to Law No. 7928, dated 27 April 1995 "On Valued Added Tax", as amended. The amendments to this Law consist in articles determining the regulation of tax levels, exempted supplies, medicines and health services and reimbursements.

On 31 December 2013, the Ministry of Finance approved the Instruction No. 32 "On simplified tax applied on small-sized business". The purpose of this instruction is to clarify the meaning of adjustments related to the profit of small-business to guarantee the correct and uniform implementation applied to all tax payers and to all regional taxation directorates. The simplified tax on profit shall be applied on those small-sized businesses, which realise throughout the year a turnover lower or equal to ALL 8 000 000 (eight million).

BANK OF ALBANIA MANAGEMENT, AS AT 31 DECEMBER 2013

SUPERVISORY COUNCIL

ARDIAN FULLANI	Chair
ELISABETA GJONI	Deputy Chair
ADRIAN CIVICI	Member
DHORI KULE	Member
ELA GOLEMI	Member
ERMELINDA MEKSI	Member
PETRAQ MILO	Member
ARJAN KADAREJA	Member (until 11.12.2013)
HALIT XHAFA	Member (until 11.12.2013)

GOVERNOR

ARDIAN FULLANI

DEPUTY GOVERNORS

ELISABETA GJONI First Deputy Governor

GENERAL INSPECTOR

ELIVAR GOLEMI

GOVERNOR'S OFFICE

GENC MAMANI Chief of Cabinet

HEAD OF COORDINATION AT GOVERNOR'S OFFICE

GRAMOZ KOLASI

SECRETARY OF SUPERVISORY COUNCIL

Elvis Çibuku

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 AND STATISTICS	Klodion Shehu
INFORMATION TECHNOLOGY DEPARTMENT	Mariglen Biti
ISSUE DEPARTMENT	Dorian Çollaku
PAYMENT SYSTEMS AND ACCOUNTING AND FINANCE	Anjeza Harizaj
LEGAL DEPARTMENT	Altin Naqe
AUDIT DEPARTMENT	Elivar Golemi
ADMINISTRATION DEPARTMENT	Agron Skënderaga
SECURITY AND PROTECTION DEPARTMENT	Eduard Sinani

BRANCHES

SHKODRA	Ermira Istrefi
ELBASANI	Thoma Rula
GJIROKASTRA	Anila Thomaj
KORÇA	Liljana Zjarri
LUSHNJA	Shpresa Meço

BANKS AND BRANCHES OF FOREIGN BANKS LICENSED BY THE BANK OF ALBANIA, AS AT 31 DECEMBER 2013

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: Emina ŠIŠIĆ

Address: Rruga e Durrësit, sheshi tek Zogu i Zi, Godina Teknoprojekt, P.O. BOX 128, Tirana, Albania

Tel: +355 4 2404 575

Fax: +355 4 2228 460, 2228 387

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: Savvas THALASSINOS

Address: Rruga "Ibrahim Rugova", Tirana, Albania.

Tel: +355 4 2269 616, 2233 441

Fax: +355 4 2233 417 / 2369 707

E – mail: info@tiranabank.al

Website: www.tiranabank.al

6. NATIONAL BANK OF GREECE – ALBANIA 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: tiranabbranch@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: Silvio PEDRAZZI

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 no. 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: Frederic BLANC

Address: Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Kulla 1, Kati 9, Tirana,
Albania

Tel: +355 4 2280 442 / 3

Faks: +355 4 2280 441

E-mail: info@societegenerale.al

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 2013 licensed the following entities:

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

PUBLICATIONS ISSUED BY THE BANK OF ALBANIA OVER 2013 H2

This list is designed to inform readers about publications issued by the Bank of Albania over the second half of 2013. 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 enroll in the mailing list for the publications of the Bank of Albania.

You can also subscribe to updates by signing up to receive free e-mail notices when new items are posted on the Bank of Albania website. You will receive e-mail notices each time we post new items of the series you selected.

Listed below you can find all the publications issued by the Bank of Albania over the second half of 2013. This list does not include surveys carried out by the Bank of Albania as they are available only online (http://www.bankofalbania.org/web/vrojtime_3405_1.php).

MONETARY POLICY PERIODICAL REPORTS:

Monetary Policy Report 2013 Q3

FINANCIAL STABILITY REPORT

Financial Stability Report- 2013 H1

PUBLICATIONS ON STATISTICS:

Statistical Report (Published monthly)

Statistical Report - May 2013

Statistical Report - June 2013

Statistical Report - July 2013

Statistical Report - August 2013

OFFICIAL BULLETIN

Official Bulletin – Volume 15, no. 5 Year 2013

Official Bulletin – Volume 15, no. 6 Year 2013

Official Bulletin – Volume 15, no. 7 Year 2013

Official Bulletin – Volume 15, no. 7 Year 2013

Official Bulletin – Volume 15, no. 9 Year 2013

Official Bulletin – Volume 15, no. 10 Year 2013

Official Bulletin – Volume 15, no. 11 Year 2013

BULLETIN OF THE BANK OF ALBANIA:

Bulletin of the Bank of Albania - 2013 H1

STRATEGICAL PUBLICATIONS OF THE BANK OF ALBANIA

Monetary policy, from the past to the present - Tenth International Conference of the Bank of Albania (26 October 2012)

RESEARCH PAPERS:

The impact of trade on growth: A gravity model-based instrument approach on post-communist Europe- Endrit Yzeiraj

Inflation Forecasting Performance and Monetary Policy Decision-Making during 2011-2012 – Evelina Celiku, Genti Hashorva

Determinants of bank credit to the private sector: The case of Albania - Gerti Shijaku, Irini Kalluci

Density estimation for economic variables – a genuine application – Altin Tanku, Kliti Ceca

Financial literacy in Albania: Survey results for measuring financial literacy of the population, 2011 – Kliti Ceca, Arlinda Koleniço, Egnis Isaku and Borana Haxhimusaj

The “J-curve” effect in bilateral trade: The impact of currency depreciation on trade balances between Albania and its main trading partners – Alban Pllaha

The Financial Model for Albania: A panel data approach – Elona Dushku, Vasilika Kota

SCIENTIFIC NOVELTIES AT THE BANK OF ALBANIA:

Scientific Novelties at the Bank of Albania No. 10

EDUCATIONAL PUBLICATIONS-INFORMATIVE

The educational package “1, 2, 3 ... Çufo piglet is learning to save”

The teacher's guide for the educational package “1, 2, 3 ... Çufo piglet is learning to save”

Leaflet “...the bank for Albania, is a second victory after the freedom ...”

