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Sheshi "Avni Rustemi", Nr.24, Tirana

Tel.: + 355 4 2419301/2/3; + 355 4 2419409/10/11

Fax: + 355 4 2419408

E-mail: public@bankofalbania.org

www.bankofalbania.org

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FOREWORD

Dear reader,

Since 1998, you have been receiving a quarterly Economic Bulletin of the Bank of Albania. Through its analysis and assessments, this Bulletin has helped you be informed on the latest developments in world and domestic economy, impact on inflation and the monetary policy applied by the Bank of Albania to keep it under control. Moreover, the Economic Bulletin has featured a variety of documents reflecting the work and research of our central bank experts over the years.

In the framework of its public information policy, the Bank of Albania continuously and heedfully reviews and improves its publications. As of 2010, another publication is added to our list: Bank of Albania Bulletin, a half-early publication. This Bulletin comes to you following the restructuring of our Economic Bulletin, with the Monetary Policy Statement now published as a separate quarterly report.

At the beginning of the Bank of Albania Bulletin, you will find an "Editorial" with information on the biggest project, activity or engagement during the reporting period. Topics may range from monetary policy to bank supervision, from payments systems to European integration, from public education to national currency issue, depending on the multitude of duties and functions of the central bank.

Other rubrics in this publication inform the public on the activities, projects and aspirations of the Bank of Albania to develop and consolidate into a transparent and professional institution as it strives to achieve its goals.

We invite you to welcome and appreciate this publication!

EDITORIAL

GENERAL INFORMATION ON THE BANK OF ALBANIA'S CONTRIBUTION TO ANSWERS TO THE EUROPEAN COMMISSION QUESTIONNAIRE

1. GENERAL OVERVIEW

- After its ratification by the 25 Member States of the European Union (EU), the Stabilisation and Association Agreement (SAA) entered into force on 1 April 2009, thus paving the way for Albania to submit its application to the EU for the status of a candidate country.
- The application for EU membership was submitted on 28 April 2009 and, in accordance with procedures specified in the Treaty of the European Union, the EU Commission shall present an Opinion on Albania's capacity to fulfil membership requirements.
- The Commission formulates its Opinion based on the answers to the Questionnaire¹. The filling out of this Questionnaire avails the European Commission to understand and assess the country's current situation in terms of fulfilment of obligations in certain areas as well as its perspective towards meeting membership standards.
- Provided the Commission presents a positive Opinion to the Council and that the Council agrees unanimously on a negotiating mandate, negotiations may be formally opened between the candidate country and all the EU Member States. At this point, the applicant country is entitled to the status of a candidate country for membership into the EU.

On 16 December 2009, Mr. Helmuth Lohan, the Head of Delegation of the European Union in Albania, presented the Questionnaire to the Albanian Prime Minister, Mr. Sali Berisha. The answers formulated by Albanian authorities are the basis for the Opinion of the European Commission on Albania's membership application submitted in April 2009.

2. PREPARATION PHASES

Phase one of preparations for the European Commission's Questionnaire includes a number of activities, as summarised below:

- a) Establishment of the legal framework for filling out the European Commission's Questionnaire including the following:

¹ The Questionnaire consists of 2,284 questions, which relate to all segments of the European legal framework and Copenhagen criteria for EU membership.

- Order of the Prime Minister No.183, dated 11.12.2009 “On establishment of Inter-institutional Working Groups”; and
 - Decision of the Council of Ministers No.1193, dated 03.12.2009 “On translation procedures of the European Commission’s Questionnaire”.
- b) With the legal framework in place, special organisational structures were established to formulate answers and assure their quality.
- The ultimate decision-making body for the approval and delivery of answers to the European Commission was the Council of Ministers. The Council of Ministers approved all the answers to the European Commission Questionnaire and their English translation.
 - An Inter-ministerial Committee for European Integration (ICEI) was the leading body of the entire process in relation to quality assurance and harmonisation of answers. ICEI was established following an Order of the Prime Minister No. 46, dated 01.04.2009 “On establishment, composition and functioning of inter-ministerial coordination structures for the realisation of commitments in the framework of the Stabilisation and Association Agreement” and was responsible for:
 - Following continually the entire process of formulating answers to the European Commission Questionnaire;
 - Assuring quality of answers;
 - Scrutinising and approving answers in Albanian and English, as well as submitting them to the Council of Ministers for approval.
 - An Inter-institutional Coordination Committee for European Integration (ICCEI) was established, in addition to these two bodies, with the responsibility to guide the daily work, coordinate the work of institutions for formulating answers, and assure their quality. ICCEI was established following an Order of the Prime Minister No. 46, dated 1 April 2009 “On establishment, composition and functioning of inter-ministerial coordination structures for the realisation of commitments in the framework of the Stabilisation and Association Agreement” and was responsible for:
 - Following continually the entire process of formulating answers to the European Commission Questionnaire;
 - Monitoring and complying with the answers formulation timelines;
 - Reporting to the ICEI on the progress of the process;
 - Assuring the quality of answers to each Chapter of the European Commission Questionnaire and requesting improvement to answers;
 - Scrutinising and submitting the answers to each Chapter and the entire Questionnaire in Albanian and English to the ICEI.

- Inter-institutional Working Groups (IWGs) were established as bodies responsible for the answers formulation and quality assurance for each Chapter of the Questionnaire. An IWG was established for each Chapter of the Acquis Communautaire upon an Order of the Prime Minister. The functioning of the IWG follows:
 - The Inter-institutional Working Group Coordinator appointed a vice coordinator and a vice secretary to the Inter-institutional Working Group. The Inter-institutional Working Group was composed of one or more than one representative from each ministry or a central or independent institution that was part of formulating answers to a Questionnaire Chapter;
 - A representative of the Ministry of European Integration was a member of the Inter-institutional Working Group, tasked exclusively with the monitoring and coordination of the Inter-institutional Working Group activities;

The Inter-institutional Working Group was responsible for:

- Following the process of formulating answers to the assigned Chapter;
 - Assuring quality of answers formulated by working groups of ministries and other institutions as well as improving answers and issuing relevant instructions in this regard;
 - Ensuring and observing rules specified in the relevant instruction;
 - Ensuring and complying with ICCEI timelines on formulation of answers;
 - Scrutinising and submitting Chapter's answers for approval in compliance with the outlined procedures.
- The Working Group (WG) was another structure, under each ministry or institution, responsible for formulating answers and assuring their quality. The respective WG of the Bank of Albania was established upon an Order of the Governor. It was chaired by the Head of Governor's Office and consisted of an adequate number of senior officials for a successful completion of its tasks. The Working Group was responsible for:
 - Organising the work for formulating answers;
 - Assuring the quality of the answers in compliance with the rules specified in the instruction as well as ensuring consistency of answers provided by the ministry or institution;
 - Complying with the timelines;
 - Improving and harmonising answers formulated by working teams;
 - Proposing to the minister or the head of the institution to sign the answers of the ministry or a central or independent

institution as well as their English translation.

The answers by the Working Group were approved by the head of the institution. Signing was not necessary, when the relevant institution coordinated the Inter-institutional Working Group, to which the answers of the ministry or the institution working group were sent.

- The last but not the least, Working Teams (WT) were responsible for formulating one or more answers to the Questionnaire. The working team consisted of civil servants of a ministry or a central or independent institution. The working team was responsible for:
 - Formulating answers in compliance with the rules laid down in the relevant instruction;
 - Improving answers in line with the Working Group instructions of the ministry or a central or independent institution.

The team leader was responsible for a successful completion of the above-listed tasks.

The organisational structure includes institutions and working groups listed below:

Organisational Structure
Council of Ministers
Inter-ministerial Committee for European Integration (ICEI)
Inter-institutional Coordination Committee for European Integration (ICCEI)
Ministry of European Integration
Inter-Institutional Working Groups (IWG)
Ministry/Institution Working Groups
Working Teams

- c) During phase two of preparations, Inter-Institutional Working Groups (IWGs), which were composed of high ranking representatives of Albanian institutions, allotted responsibilities for formulating answers and issued instructions on questions understanding. Furthermore, the ministries and central institutions were provided with a brief methodology to study the Questionnaire for Montenegro. All institutions were also provided with the questions and answers to the Questionnaire from the Republic of Macedonia and the questions of the Questionnaire for the Republic of Croatia.

Procedures for the formulation and approval of the answers were as follows:

1. Answers formulated by the institution's working team were submitted to the working group of the ministry or a central or independent institution;

2. The working group of the ministry or a central or independent institution discussed and approved the answers;
3. Merging of answers for sub-questions of a question was done by the working group of the ministry or a central or independent institution that coordinated the Inter-institutional Working Group for that Chapter.
4. Answers formulated by the working group of the ministry or a central or independent institution were signed by the minister or the head of a central or independent institution and were submitted to the Inter-institutional Working Group;
5. The Inter-institutional Working Group analysed the answers formulated by the working groups of the ministries or central or independent institutions;
6. When the Inter-institutional Working Group found inaccuracies or inadequacies in the answers, it made a decision to send the answer back to the original ministry or central or independent institution responsible for formulating the answer, along with instructions to correct the inaccuracy or complete the answer;
7. The Inter-institutional Working Group submitted these approved answers to the minister or the head of a central or independent institution coordinating that Chapter for their approval (signature);
8. The minister or the head of the coordinating institution, following the approval of the answers, submitted them to the ICCEI for approval;
9. ICCEI scrutinised the answers for each Chapter. In some cases, the ICCEI would ask for improvements to answers by the Institutional Working Group;
10. ICCEI approved the answers to the European Commission Questionnaire and submitted them to the ICEI for approval;
11. ICEI scrutinised the answers and, when it found mistakes or insufficiencies, sent them back to the Inter-institutional Working Group for correction or completion, together with relevant remarks;
12. ICEI approved the answers to the European Commission Questionnaire and submitted them to the Council of Ministers for approval;
13. The Council of Ministers approved the final answers.

The Ministry of European Integration identified a leading ministry/institution for each Chapter of the Questionnaire (one ministry/institution for one Chapter). Division of Chapters as per ministry or a central institution follows:

Chapter of EC Questionnaire	Coordinating Ministry/Institution
Political Criteria	Ministry of Justice
Economic Criteria	Ministry of Finance
Chapter 1- Free movement of goods	Ministry of Economy, Trade and Energy (METE)
Chapter 2- Free movement of workers	Mission of the Ministry of Labour, Social Affairs and Equal Opportunities (MLSAEO)
Chapter 3- Right of establishment and freedom to provide services	METE
Chapter 4- Free movement of capital	Bank of Albania
Chapter 5- Public Procurement	Public Procurement Agency
Chapter 6- Company Law	METE
Chapter 7- Intellectual property law	METE
Chapter 8- Competition policy	National Competition Authority
Chapter 9- Financial services	Financial Supervisory Authority
Chapter 10- Information society and media	Minister for Innovation and Information and Communication Technology
Chapter 11- Agriculture and rural development	Ministry of Agriculture, Food and Consumer Protection (MAFCP)
Chapter 12- Food safety, veterinary and phytosanitary policy	MAFCP
Chapter 13- Fisheries	Ministry of Environment, Forestry, and Waters Administration (MEFWA)
Chapter 14- Transport	Ministry of Public Works and Transport (MPWT)
Chapter 15- Energy	METE
Chapter 16- Taxation	Ministry of Finance
Chapter 17- Monetary Policy	Bank of Albania
Chapter 18- Statistics	Institute of Statistics (INSTAT)
Chapter 19- Social Policy and Employment	MLSAEO
Chapter 20- Enterprise and industrial policy	METE
Chapter 21- Trans-European networks	MPWT
Chapter 22- Regional policy & coordination of structural instruments	Ministry of European Integration
Chapter 23- Judiciary and fundamental rights	Ministry of Justice
Chapter 24- Justice, freedom and security	Ministry of Interior
Chapter 25- Science and research	Ministry of Education and Science (MES)
Chapter 26- Education and culture	MES
Chapter 27- Environment	MEFWA
Chapter 28- Consumer and public health protection	METE
Chapter 29- Customs	Ministry of Finance
Chapter 30- External relations	METE
Chapter 31- Foreign, security and defence policy	Ministry of Foreign Affairs (MFA)
Chapter 32- Financial control	Ministry of Finance
Chapter 33- Financial and budgetary provisions	Ministry of Finance

3. ROLE AND TASKS OF THE BANK OF ALBANIA

Bank of Albania was a contributing institution for formulating answers to the Questionnaire on the following Chapters:

- Economic criteria (27 questions)
- Consumer and public health protection (6 questions)
- Financial services (9 questions)
- Enterprise and industrial policy (5 questions)
- Financial control (8 questions)
- Right of establishment and freedom to provide services (7 questions)
- Employment and social policy (9 questions)

It was also a leading institution for the coordination of answers on the following Chapters:

Chapter 4 - Free movement of capital, and
Chapter 17- Economic and monetary policy

During the formulation of answers to the Questionnaire, the Bank of Albania discharged the following functions:

- Support to the assignation of questions to institutions in accordance with the fields of operation of the Bank of Albania as well as representation of the institution in the Inter-institutional Working Groups;
- Support to the scrutiny and interpretation of the questions, in cooperation with relevant departments;
- Identification of the Acquis content on questions related to free movement of capital;
- Analysis of gaps between obligations of the Bank according to the Acquis and the actual legal and administrative situation.

Contribution to formulate answers to Chapter 4 – Free movement of capital – focused on the following:

- Regulation “On Foreign Exchange Activities”, with regard to transfers and transactions between residents and non-residents;
- Strategy for the liberalisation of short-term capital movements;
- Relations of this strategy to other economic developments; and
- Potential problems for the implementation of the monetary policy or the exchange rate in the case of significant capital inflows, other than foreign direct investments.

Concerning Chapter 17 – Economic and monetary policy, answers formulated by the Bank of Albania mainly focused on:

- Necessary reforms in the national legislation (legislation on the central bank and legislation on the banking system) targeting EU membership requirements;

- Democratic accountability and transparency of the central bank; and
- Issues related to the institutional, functional and personal independence.

At the conclusion of the formulation of answers to the Questionnaire, the Bank of Albania had contributed with formulating directly 120 answers to it.

On 14 April 2010, the Prime Minister of Albania Mr. Sali Berisha, handed over the Questionnaire to Mr. Štefan Füle, the EU Commissioner for Enlargement and Neighbourhood Policy. The European Commission has not specified a standard timeline for publishing an opinion on Albania's membership application.

4. ADDITIONAL QUESTIONS PHASE

Similar to procedures employed for other countries that have applied for the candidate status, on 15 May 2010, the European Commission sent 180 additional questions, which, along with their sub-questions and respective explanations, addressed a total of 480 issues on the Albanian administration.

The Bank of Albania was involved in formulating answers to additional questions for issues related to its activities. Namely, additional questions by the European Commission dealt with:

- Chapter 4 – Free movement of capital
- Chapter 9 - Financial services

Regarding Chapter 9 – Financial services, the answers addressed issues related to:

- Alignment of the legislation on banking system with the EU Directive on Capital Requirements and identification of provisions that need further alignment;
- Assessment of administrative capacities in the area of supervision to align the banking system legislation with the EU Directive.

Answers to additional questions for Chapter 4 – Free movement of capital addressed issues related to:

- Liberalisation of long-term capital movement; and
- Alignment extent of the current Albanian legislation on payments with the EU legislation.

During all the phases of answering the Questionnaire, the Bank of Albania maintained and developed close cooperation relations with the Ministry of European Integration as the coordinating, monitoring and administrating institution of the process.

Moreover, close institutional cooperation relations were established with the following institutions:

- Ministry of Finance for the preparation and coordination of Chapters on “Economic Criteria” and “Financial Control”;
- Ministry of Economy, Trade and Energy for the preparation of the Chapters on “Consumer protection” and “Enterprise and industrial policy”;
- Financial Supervisory Authority for coordination on the Chapter on “Financial services”;
- Ministry of Labour, Social Affairs and Equal Opportunities for preparation and coordination on the Chapter on “Employment and social policy”.

To answer the questions appropriately and realistically as well as present the vision of this government, some 1,200 highly committed and responsible officials of all ranks, from the specialist to the head of the institution or agency of the Albanian administration, were involved, 27 experts from amicable countries and international institutions were engaged, and tens of agencies from amicable countries and international institutions were consulted. In total, there were 2,284 questions and about 2,000 sub-questions, in 35 Chapters in the Questionnaire.

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

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

At the Press Conference on the Monetary Policy Decision-Making of the Supervisory Council of the Bank of Albania
January 27, 2010

The Supervisory Council of the Bank of Albania, at its meeting of January 27, 2010, dwelt with the Monetary Policy Statement for the second half of 2009, analysing in detail the performance of monetary and economic indicators for the second half of 2009, as well as the macroeconomic projections and the balance of risks that may associate them in the coming month. At the end of the analysis, the Supervisory Council of the Bank of Albania decided to keep the key interest rate of repurchase and reverse repurchase agreements unchanged at 5.25 percent. The Supervisory Council assessed that this interest rate is in line with Bank of Albania's goal to keep inflation close to the medium-term target.

The Albanian economy has just left behind a difficult year. The deep global economic crisis was soon felt even in Albania, testing the foundations of the economy: the financial stability and the macroeconomic balances. However, the good initial state of our economy and the proper response of macroeconomic policies helped to successfully cope with this test. During the first three quarters of the year, the Albanian economy ensured a positive growth, thus preserving the financial stability and the key indicators of macroeconomic stability: price stability, public debt level and balance of payments sustainability.

The global economic and financial crisis, which intensified significantly during the first half of the year, put in question the financial system sustainability, the macroeconomic stability and the long-term development prospects of the world economy. The determined response of public authorities, increased coordination of economic policies and keeping open the world trade channels, helped preventing any negative economic spirals. The latest data on the global economy indicate a recovery of economic activity in the third quarter onwards. The monetary and fiscal stimulus packages resulted successful in terms of stabilizing the global economy.

However, the sustainability of global economic growth will remain fragile, as long as the economic activity continues to rely on significant monetary and fiscal stimulus. In particular, the public debt sustainability, which is burdened by fiscal stimulus bill to exit the crisis, is becoming a more and more aggravated problem for many countries. In this complex situation, choosing the right moment for withdrawing the economic stimulus will have a decisive importance in the future economic performance.

In a more structural aspect, the recent crisis is expected to leave visible traces in the economic development. In a long-term horizon, it seems that new economic and strategic balances are being determined, thus re-dimensioning the poles

of global economic growth. In a medium-term horizon, the global economic growth rate is expected to converge in a lower balance than the one that has prevailed over the last two decades. This slowdown may be accompanied by economic and social problems for those countries, which would not know how to figure out their relevant implications. In a short-term horizon, discussions on the state's role in the economy, on economic development and growth patterns, on the philosophy and appropriate practices regulating the financial markets, will dominate the political round-table debates. In particular, the economic growth model will be a sensitive topic for economies significantly affected by the crisis, including many Eastern European countries. Promoting competitive advantage and increasing competitiveness in global markets will be the subject of discussions and intended reforms.

Turning to domestic economic developments, the analysis of available indicators shows that the Albanian economy has had a positive economic growth during the first nine months of the year. However, these indicators suggest that the growth rate was characterized by a progressive slowdown during 2009. Such performance was conditioned by reduced foreign demand and slowed domestic demand, in the presence of a tight liquidity situation, financing restriction and increased uncertainty.

According to preliminary data from INSTAT, the economic growth for the first nine-month period of the year was 4.9 percent, against 7.8 percent recorded for the same period of the previous year. In sectoral terms, the sectors that benefited most from the economic growth are the services and construction ones, while the industry sector underwent a more problematic performance.

The positive growth rate has been supported by the fiscal stimulus, while consumer demand and the contribution of external sector to the economy have been relatively stable. At the same time, private investments have declined. Consumer demand has been supported by a slight rise in employment and wages, while the mortgage and consumer credit contraction, as well as reduction of remittances have given the reverse effect. Private investments have been contracted, as a consequence of limited financing resources, reduced lending support by the banking system and limited access to international capital markets. Increased uncertainty, slowed progress of the final demand for their products and reduced capacity utilization rate have impacted on such performance.

Effects of domestic economic slowdown and the global economic crisis have appeared even in the foreign trade. Foreign economic activity is characterized by a simultaneous decline in both exports and imports of goods and services, thus impacting significantly on the economic growth for 2009. On the other hand, fiscal stimulus, injected mainly during the first half of the year, has contributed to rapid increase of budget spending and public debt.

The economic growth below the potential has created an environment of generally reduced inflationary pressures. The annual inflation for December

recorded 3.5 percent, while the average annual inflation rate was 2.2 percent. Both these indicators are in line with Bank of Albania's target on price stability. The economic activity slowdown, low main products prices in the world markets, low monetary expansion in the economy and controlled inflationary expectations offset the inflationary pressures arising from exchange rate depreciation during 2009.

The upward inflation trend during the last quarter of 2009 was expected by the Bank of Albania. It was formed mostly by transitory factors, which are not expected to generate steady inflationary pressures. In particular, this performance was influenced by rising food prices, which reflect the lagging effect of exchange rate depreciation, international markets conjunctures and structural problems of the Albanian market.

These factors are expected to exert inflationary pressures during the first half of 2010, possibly added by expected reduction of agricultural products supply, as a result of the flooding that has lately occurred. However, stable core inflation trend and low inflation rate of non-traded goods confirm that inflationary pressures exerted by domestic demand are moderate.

In the absence of other supply shocks, the slow progress of domestic demand, low growth of monetary supply and anchored inflationary expectations, are premises for keeping inflation within the target in the medium run.

The Bank of Albania pursued a prudent monetary policy during 2009, creating a suitable environment for a balanced development of the economy and for keeping inflationary pressures under check. In the presence of downward inflationary pressures and steady expectations, the hints for slow domestic demand in the next period have motivated the progressive growth of monetary stimulus during 2009. The Bank of Albania cut the key interest rate by one percentage point, down to 5.25 per cent during this period. It also steadily increased liquidity injection, according to banking system needs for liquidity and the economy demand for funding. Concerning liquidity injection, the Bank of Albania has made use of the entire range of monetary policy injecting instruments, facilitating at the same time the access to and easing the cost of operation of the banking system with the central bank.

Also, in the presence of the exchange rate depreciation, such policy has brought about easing monetary conditions, serving the promotion of the economic activity. However, the pass-through of easing monitoring policy on interest rates of banking products has been limited, due to liquidity constraints of the banking system and weakened demand of the public sector for funds. On the other hand, the banking system itself has been reserved with regards to lending, as a result of the increased risk in the economy and performance of loan portfolio quality. The alleviation of these problems would help to transmit the monetary policy more fully and enhance its effectiveness.

The country's external position continues to be characterized by a high and upward current account deficit. During the first three quarters of the year, the

deficit was fully covered by capital and financial account inflows, resulting in increased foreign exchange reserves of the Bank of Albania. However, the inflows have been significantly favoured by privatization receipts and by public sector borrowing. Both these items are limited in time and size, making necessary a steadier correction of the external position of our economy. This correction should aim at covering the trade deficit with stable funding resources, in the form of foreign direct investments and promoting export industries in branches that may constitute a competitive advantage for Albania.

However, short-term developments in foreign trade for October to November show a somewhat different performance compared with the first nine months of the year, testifying a modification of the trends observed earlier. Thus, the country's exports fell in annual average terms by about 7.4 percent, recording a slowdown in comparison with the average decline by about 19 percent during the first nine months of the year. On the other hand, imports recorded an annual average decline of 17 per cent over these two months, compared with the average annual decline of 7 percent recorded in 2009. These developments contain encouraging signs for the sustainability of the balance of payments in the short run.

Fiscal policy had an expansionary nature during most of the year, being materialized in a budget deficit of 6 percent of GDP. The increase of budget deficit reflects both the action of automatic stabilizer in the form of decreased revenues, and the intended countercyclical character of fiscal policy, through increased wages and capital expenditures. The country's economic activity slowdown has dictated a slow pace in budget revenue growth, especially after the first quarter of the year.

In late November, the annual growth of budget revenues was only 2 percent, almost entirely reflecting the low pace of generating the tax revenues. On the other hand, public expenditures have maintained high growth rates, accounting for 16.4 percent in November. The budget deficit reached ALL 65 billion in November. The deficit has been mostly financed through foreign borrowing and privatization receipts, dampening the pressures in the domestic financial market.

The rapid growth of expenditure and budget deficit during 2009 has further increased the public debt level, accounting for 58 percent of GDP at the end of November. The Bank of Albania deems that the future budget policy orientation towards fiscal consolidation, aiming at reducing the public debt, is now a prerequisite for the macroeconomic stability in the country. As we have constantly stated, the public debt reduction will mitigate the pressure of the public sector on the financial markets, creating more room for the private sector. Consolidation of public finances will also lower the risk premium in the economy and will raise the monetary policy effectiveness.

Money supply slowed down further in the second half, reflecting to a great extent, the ever lower credit growth. Annual growth of private sector loan portfolio slowed down to 10 percent in November. Unlike the first six months

of 2009, when credit growth curbing was more affected by the tightened supply, in the second half of the year the credit performance was dictated by decreased demand for loans.

The economic activity slowdown and uncertainty about the future, in the face of still tightening lending terms by banks, have guided the economic agents' decisions to postpone the investment plans and to less finance consumption from borrowing.

However, monetary developments confirm an improved situation of deposits during the second half of 2009. The change in depositors' behaviour, in the context of measures taken to prevent the spread of global crisis effects, and the foreign currency inflows in the form of remittances during summer, have contributed to stabilizing the liquidity situation of the banking system.

Financial markets were characterized by a more relaxed situation during the second half of the year. The banking system continued to be featured by liquidity constraints, which were remedied by central bank liquidity injections. Improved liquidity situation due to increased deposits in the system and fostered certainty in the market created a suitable environment for transmitting the monetary policy signal to the interbank market. The key interest rate cut at the end of October was followed by reduced yields on government securities, after the upward trend characterizing them throughout the year. In the meantime, the Bank of Albania, in accordance with time lags that characterize the monetary policy transmission mechanism, expects and requires that the key interest rate cut be transmitted to credit markets.

The Supervisory Council's decision on keeping the key interest rate unchanged aims to further maintain and consolidate the macroeconomic balances, considering them as a necessary prerequisite for a sustainable and long-term growth. It also guarantees the proper monetary support for the economy under this stage of development. In the future, the Bank of Albania remains willing to operate in line with the actual and expected performance of the economic indicators and in accordance with its principal objective.

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

At the Inauguration Ceremony of the Research Centre in Berat,
February 10, 2010

Dear friends, guests, colleagues and collaborators,

I have a special pleasure today to cut the red tape for the inauguration of one of the newest buildings of the old city of Berat, the Research Centre of the Bank of Albania. By building this Centre, the Bank of Albania aimed at joining the Berat citizens in telling a valuable story. To this end, we have adhered to the architectural values of Manghalem museum vicinage, believing that the architectonic quality and originality are irreplaceable values, which make the city of Berat an important part of the country's cultural heritage. Therefore, I am convinced that we have contributed to the charm of this city, through this new building, which is in perfect harmony with the one above one windows picturesque ensemble.

When it comes to the cultural heritage of Albania, there is an admirable understanding in our institution. That is why, during the last two years, we have taken concrete steps in terms of its documentation, preservation and dissemination. Let me remind you that at the end of each year the Bank of Albania has been very prudent in disseminating cultural values through the next-year calendar. I would highlight here the last BoA calendar, where we managed to produce, through a devoted work, a very special publication, reflecting the country's 12 ancient sites, where ancient coins dating back to B.C. have been discovered.

At first glance, cultural heritage and central banking may seem disconnected, detached from each-other. Personally, I believe the opposite. Central banks are carriers of a nation's culture. They carry within themselves the treasures of a nation, the toil and sweat of generations and put them in view of the future. Central banks, as successors of commercial banks, since their origin, relate with art and culture of a country, show the degree of civilization and its long path towards prosperity. The discovery of numbers, letters, figures, created the foundation of culture and art of a nation, being widely reflected in coins, icons, codex and monuments. The relationship between art, culture and money, has always made me believe that they have lived together and are destined to resist time, because they have preserved their identity. As the form, goal, idea, content of an icon resemble to those of a coin, similarly, its separate elements may be in concert with a monument, a score, a costume or an old song. In the above sense, they are treasures; they are reserves; they are investment. In the course of centuries, they have denoted the spirit, faith, strength, wealth and culture of a nation. They are traded and have passed on to new generations, spreading knowledge and civilization, gaining new values and bringing us prosperity. These values have passed from one mind

to another, making history; the caution for this historical legacy is the best investment, the added value for the next generation.

The culture and coins inherited in centuries belong to all of us and with these values we will enter Europe. Faith in language, customs, art, coins and culture has brought progress to our society, keeping the Albanian identity alive.

The Bank of Albania, as the sole monetary authority of the country, takes care of the country's currency and financial health. In communicating with other central banks and important international institutions, it is essential that the Bank conveys, in addition to professional achievements, the country's national identity highlighting the outstanding values of the national cultural heritage. This image makes the central bank a more reliable and dignified partner.

A country's currency itself, with its history, represents a unique value in the cultural heritage of each nation. The currency is another element that creates an essential bridge between a country's central bank and cultural heritage.

Another factor is related to the buildings, where central banks conduct their activity. In most cases, central banks own entire complexes as properties, which from the viewpoint of historical and architectural values reflect the most mature parts of heritage in this area.

Choosing such central bank buildings is not a coincidence. They should convey to the public the message of independence, stability, prosperity, vision and trust. I believe that the Bank of Albania's building located in the Scanderbeg Square and the one we are inaugurating today are as such.

Our legal mandate for price stability or financial stability, *inter alia*, implies an overall political, social and cultural environment that rightly interprets the role of money in the economy:

- The way money is created and the way to preserve its value;
- The way it finances our needs, including our heritage properties;
- The way it finances the safeguarding of our tangible or intangible assets;
- The way it finances the absorption of foreign experience and the way the foreigners use it to visit our heritage.

Dear friends,

Today's inauguration marks a return of the lost values. Notwithstanding the important function that the previous object has carried out for the city and for our country in general, a typical deed of socialist realism, it was in contrast with the ensemble of historical houses, spoiling the appearance of the area. Today, the Bank of Albania is proud to offer the city and every visitor, an architectural symbol that embodies prominent hospitable values and features,

accepted to a great extent by citizens, local authorities and everyone that has seen it.

My personal ambition for the future is the use of this building to liven up the city of Berat. If we had offered only a numismatic museum, I believe that our success would have been incomplete. Aiming right from the start at the economic and social revival of the city, the Bank of Albania is offering a genuine centre of research and training, where stories of modern visitors will be interwoven with stories, places and dates of human drama that has taken place in this 2400-year old city.

Our aspirations are as desirable as feasible. I will do my best to turn this centre into a regional one, whose regular visitors will be our colleagues from the region and beyond.

I am convinced that with the establishment of this Research Centre, the Bank of Albania will give new impetus to its scientific work, better determining the causality that characterizes the interaction of economic and financial indicators in Albania. I am also convinced that our experience, through this investment, will gain a new dimension vis-à-vis international experience, being further completed with an excellent infrastructure. Finally, I am also convinced that we have already created a functional logistical support to pass on contemporary knowledge to the new generation of professionals and beyond, in the field of banking, money and finance.

Our projections for the near future constitute programs for dealing with regional themes on Balkan civilization or its various categories, such as art, literature, culture, architecture and why not, the banking industry during respective stages of this civilization.

We believe that such a cooperation will not only raise the promotion of our region with common and diverse traditions, but will also contribute to making an efficient use of existing resources and generating ideas, projects and additional resources from our regional partners.

Dear friends,

I believe that I am not saying anything new, when emphasizing that the pride of each nation is rooted in the culture and that no nation can be mature without an outstanding past in its culture and tradition. Every nation is a legacy of beliefs, habits and knowledge collected, arranged and processed gradually in the course of centuries.

Believing in the significance of this statement, I hope that our contribution to the city of Berat will serve the whole community of this city, further preserving and enriching it, in order to leave it as inheritance to future generations. Only in this way, with the passing of years, the ancient and medieval heritage of this city will be enriched with new values of tomorrow.

Kasem Aga, the architect of the Sultan, wrote about the tap he donated to the city: ... "I did this act of charity to arouse envy to the beholders ...", and today, on behalf of the Bank of Albania, we bring this deed to the benefit of this city.

Thanking you wholeheartedly, I invite you to visit the interior premises of the Centre.

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

At the Press Conference on the Monetary Policy Decision-Making of the Supervisory Council of the Bank of Albania
February 24, 2010

At its meeting of February 24, 2010, the Supervisory Council of the Bank of Albania analyzed and approved the Monetary Policy Monthly Report. After being introduced to the latest economic and financial developments at home, to their projections for the future and the expected balance of risks, at the end of discussions, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 5.25 percent.

The performance of global economy attests to the ongoing improvement of economic activity. The majority of advanced and emerging economies experienced economic growth over the course of the second half of 2009.

The growth in global trade activity, the undisturbed financial markets' developments and the improved confidence indices reflect and bring about more optimistic future expectations. In particular, the financial system stability and the progressive improvement of its balance sheets are promising signs for greater support to the economic activity. The improved global economy was coupled with an upward inflation rate trend, owing mainly to the recovery of demand and higher primary commodity prices.

However, the low capacity utilization at a global level is projected to rein in the inflationary pressures in the medium run. The frail economic growth over 2010 will be at the forefront of policymakers' agenda. Moreover, it will condition the preservation of monetary and fiscal incentives during this period, albeit at more moderate rates.

As far as the Albanian economy is concerned, the latest available information suggests that domestic demand contracted further in the last quarter of 2009.

Private investments contracted over the course of the year 2009, owing to the slower domestic and foreign demand, the low capacity utilization, the deteriorated business confidence and the tight lending conditions. In addition, consumer confidence indices, retail sales and consumer goods' imports signal the further slowdown of private consumption in the last quarter of 2009. This slowdown reflects a more moderate increase of disposable income, lower support by the banking system for consumer and mortgage loans and increased public uncertainty over the future. Consumer expectations for the future suggest that the contribution of private consumption to economic growth will be low over the next two quarters. Economic activity at home has been sustained by high fiscal stimulus during 2009; however, budget projections suggest that the fiscal stimulus will fall off in 2010. Foreign demand posted

positive performance for the last quarter of 2009, featuring lower trade deficit during this period. However, given its relatively small share to the GDP, the impact of this correction to the economic growth of 2010 is projected to be moderate.

Annual inflation marked 3.6 percent in January while average annual inflation rate increased to 2.4 percent. The annual increase in consumer prices was in line with the Bank of Albania's target for inflation in January, standing at the upper limit of the tolerance band. The upward inflation trend in January owes mainly to the higher food prices following the latter's rise in the global markets and the lagged effect of the exchange rate depreciation. The contribution of other consumer price basket items to inflation, albeit upward, was still low. The latest energy price rise effect on February's inflation is expected to contribute by 0.5 percentage points to the annual inflation rate.

The Bank of Albania assesses that the performance of the Albanian economy has yielded balanced inflationary pressures. This is also confirmed by the performance of core and non-traded inflation, whose rates marked 1.4 and 1.7 percent, respectively, in January. These trends suggest that the inflationary pressures exerted by domestic demand are weak, while the increase of inflation over the last months owes mainly to supply-side factors.

The Bank of Albania considers that these factors will only affect temporarily and their pressures on inflation are expected to gradually dampen in 2010. The same performance seems to be also expected by the main economic agents, whose inflation expectations remain anchored close to the Bank of Albania's target.

The Bank of Albania has been pursuing a prudent monetary policy over this period. The increase of monetary stimulus in economy, without prejudice to macroeconomic stability and keeping the economic agents' expectations stable, was the major focus of our policy. Our decisions have in particular aimed at providing adequate monetary conditions for the observance of the inflation target in the medium run and smoothing out the Albanian economy's way to more stable economic and financial balances. This philosophy will continue to guide our decision-making in the period to follow.

The latest data on Albania's external position cover only foreign trade. The analysis attests to the annual narrowing of trade deficit by about 17 percent in December. In annual terms, exports of goods increased 27 percent, while imports declined 10 percent. The relative coverage ratio of imports with exports increased to 23 percent. Despite this performance, the external position of the Albanian economy remains a concern as long as it is characterized by a high current account deficit. The shift of deficit to more stable levels will be at the forefront of the country's economic policies in the medium and long run.

As we have continuously stated, fiscal policy was counter-cyclical throughout 2009, underpinning the trend that began in 2007-2008. Budget

deficit amounted to ALL 79.9 billion in 2009, reflecting at the same time the accelerated increase of budget expenditure and slowdown of fiscal revenues. Budget expenditure increased 8 percent in 2009, while revenues grew only 2.7 percent, in part owing to the gradual contraction of economic activity.

The Bank of Albania considers that fiscal policy should prioritize the measures required to guarantee the sustainability of public debt. The increase of the latter during 2009 and the higher sensitivity of the financial markets to this indicator, call for the reliable commitment of fiscal policy with respect to its long-term sustainability. Therefore it is crucial to reach the projected fiscal balance by conditioning fiscal expenditure based on the budget revenues' collection rates. On the one hand, this policy implies a smaller fiscal stimulus for 2010, but on the other it will lower the risk premiums in economy and provide more room for borrowing in the domestic financial markets of the private sector of the economy.

The latest monetary developments attest to the low growth of broad money and lower banking intermediation in lending to the public and private sector. However, the banking system's liquidity indicators seem to have become more stable. In annual nominal terms, money growth was 7 percent, similar to November's growth rate. Deposits grew for the second consecutive month, owing to a large extent to the increase of time deposits.

Relative to the previous year, private sector lending grew 11 percent in nominal terms. In real terms, it grew by only 4 percent. The growth of lending owes mainly to the higher lending to business for liquidity purposes. By contrast, household loans continued to contract in annual terms. Despite the improved lending activity in December, its annual growth rate remains low. The slow lending performance owes to the high risk premium materialized in tight lending conditions, and to the economic agents' uncertainty for the future, materialized in low demand for private sector credit.

The exchange rate depreciated further in January, albeit at lower paces than in the previous month. In nominal effective annual terms, it depreciated 8 percent in January. Monthly developments attest to the slight depreciation of the ALL vis-à-vis the Euro and the USD. The Bank of Albania considers that the balance of factors affecting the exchange rate seems more stable for 2010.

The Bank of Albania continued to inject the required liquidity in January in order to buttress its interest rate cut move and relax the monetary conditions in October 2009. These injections were followed by the decline of interest rates in the interbank market, the decline of the Government T-bill yields and the downward tendency of ALL loans and deposits' interest rates.

The interbank market attested to the further increase of trading volumes signalling the efforts for a more effective liquidity management by the banking system.

The recovery of lending will substantially condition the performance of the Albanian economy over the following period. Its recovery will push the demand for borrowing by the economic agents and at the same time will provide more favourable bank lending conditions. The Bank of Albania has taken the proper measures in this regard, supplying the banking system with appropriate liquidity and taking the necessary measures to lower the borrowing cost. However, it expects a more complete reflection of these measures by the banking system. We believe that, without prejudice to the best and prudent lending practices, there is room for a more encouraging behaviour of the banking system in terms of boosting consumption and private investments in economy.

After discussing the current and expected economic performance, the Supervisory Council of the Bank of Albania concluded that the inflationary pressures will mount in the short term; however they are expected to quickly fall in the medium term.

The slower money growth, the low domestic demand, the moderate growth rates of economic activity, the low capacity utilization by businesses and the stable inflation expectations will balance the pressures exerted by the exchange rate and higher administered and foreign prices.

The Bank of Albania has been carefully monitoring the economic and financial situation in the regional countries and their future outlook. The possible implications for the Albanian economy through the trade and financial channels remain at the focus of our analysis.

Considering the economic situation and political realities in the Euro area's economy, we conclude that the transmission of these concerns to other economies will be contained. Moreover, the Bank of Albania believes that the Albanian economy enjoys firm macroeconomic balances, sufficient to cope with all potential shocks over our economy.

In conclusion, the Supervisory Council decided to keep the key interest rate unchanged at 5.25 percent. This decision helps to maintain and consolidate the macroeconomic balances further, considering macroeconomic stability key precondition for a stable and long-term growth. It also serves to anchor the inflation expectations and guarantee the adequate monetary support to the economy at this stage of development.

The Bank of Albania remains committed to act in concordance with the actual and expected performance of economic indicators. The shift of the inflationary risk balance downward, the strengthening of financial stability and inflation expectations in economy will be carefully factored in the future decision-making of the Bank of Albania.

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

At the Seminar "Albania - Sustaining Macroeconomic Stability in a Challenging External Environment",
Hotel Tirana International, March 4, 2010

Dear Mr. Bell, Dear Minister,

Dear participants,

It is a great pleasure for me to welcome you to this seminar and to attend its proceedings.

This seminar and its topics are very coherent and dwell upon very important issues for the economic development of Albania and of all developing economies. They explicate the topics that the economic authorities are faced with, as a consequence of macro and microeconomic side effects of the global financial crisis of the financial markets and the real economy.

Generally, the policies undertaken by authorities in the light of the country-specific conditions proved to be successful. Fiscal expansion and easing of monetary conditions according to respective needs turned out to be successful in avoiding the turning of the crisis into depression, like that of 1930. In Albania's case, these stimuli helped preventing the economic events that characterize the financial crisis and mitigated the adverse effects of the global economy on the Albanian economy.

Though the crisis effects continue to exert their impact on the world-wide economy, it's time to reassess the situation and the economic policies. Generally, the current period in the world economy coincides with the correction stage, which is reflected in lower economic growth and new balances in production, trade, services, financial intermediation, exchange rate and household budgets. These new balances do not represent a new stage or evolution of the crisis. They represent a sustainable equilibrium under new circumstances. Distortions in financial markets and lack of rationality in consumer behaviour are assessed as the main triggers of the crisis, because their level during the bubble blowing were not in line with the long-term sustainable equilibrium of the economy.

Consequently, the idea to continue the economic stimulus to speed up production, consumption and financial intermediation at the same rates and with the same instruments would be similar to the financial markets stimuli during the pre-crisis period. In other words, pursuing the same policies under current conditions and the new equilibrium would cause major economic and financial imbalances over the medium run, which would damage the economy rather than help it.

Precisely from this viewpoint, it is important that we now start to think about and cooperate for finding and implementing policies that would guarantee macroeconomic and financial stability at home.

From the above viewpoint, the nature of stimulating policies at present and in the future should aim at minimizing the costs of side effects that the expansionary policies have caused in the course of years. A very important place in this direction is occupied by the reduction of debt created during the fiscal expansion, and reduction of its cost. In this framework, all the fiscal authorities should work not only for avoiding the creation of new debt, but also for settling the debts in arrears with maximum efficiency. Debt exit strategies, including also the replacing of the expensive debt in arrears with a new cheaper debt, are very important and welcomed.

In current conditions, when there is a high probability for further debt growth, the policies to sustain the economy through expenditures is restricted from the incapability of the economy to generate economic growth.

Shifting the focus of discussion to the reality of our economy, in order to maintain the debt level and the macro-financial stability, it is necessary to restrict expenditures in accordance with revenues. The latter depends directly on Albanian economy revenues. Therefore, it is very important to encourage the economic development and to direct the financial resources to those directions where the Albanian economy provides its competitive advantages. This would enable the substitution of imported consumer goods with domestic products whenever possible and efficient. The purpose is to encourage production not only for domestic consumption but also for exports in traditional and new markets and products. This objective is a necessity, not only from the short-term and mid-term perspective, but also from the long-term one.

Debt management and reduction (debt restructuring) strategies are not only part of the macroeconomic policies. They should be extended to every cell of the economy, whenever the microeconomic balance sheets have been burdened by debt. The restructuring and the resumption of lending activity cannot take place without leaving aside the sick and bad part of the balance sheets. Currently, we are confronted with exchange rate correction. This automatic adjustment of consumer and producer behaviour, in terms of consumption, savings and investments, has been an indispensable process in line with the new equilibrium. However, it is insufficient; therefore, it should be coupled with the correction of fixed asset prices in accordance with the new wealth balances. I would like to emphasize that the equilibriums of a balance sheet, either fiscal, private or household ones, are guaranteed by simultaneous and equal changes on its both sides.

Banks and businesses should work together to identify and separate the sound parts from the problematic ones. If the current restructuring strategies lack the potential for improving the sick part, then perhaps it is the due time to pass to a new strategy that treats both parts of the business as separate

from each other. This would enable an optimal solution in each specific case versus a unified refinancing strategy that has been implemented so far. Clearing the lending activity would shift the new credit from inefficient refinancing to new development opportunities and economic growth, where the savings-investment balance is in equilibrium. This issue relates not only to the performance of the banking system and the financial stability of the country, but also to the ability of the economy to grow in the future.

As I have also mentioned in other events, both the macro and micro factors that have encouraged rapid economic growth in the recent years, are no longer present in the global and national economy. The new equilibriums we are living with show that the rapid consumption-driven growth models and credit-based growth models will no longer be present in our economy. This is true owing to supply and demand factors, since the rapid consumption and credit-driven growth has aggravated the savings-investments balance sheets of agents in the economy.

Consequently, there should be found a new long-term economic growth model, capable of absorbing the financial resources, particularly the foreign ones, and generating an economic growth. The first step in this regard is the identification of the competitive advantages that the Albanian economy generates and the acceleration of structural reforms in the Albanian economy in the light of these priorities.

It is a pleasure that our timely discussion topics and activities are in line with the agenda of this activity. Thus the IMF provides a valuable contribution to our economy through the discussion of these topics. Furthermore, through this activity, the IMF enhances the transparency throughout the Albanian economy regarding the economic development vulnerabilities from the IMF viewpoint, thus participating in the country's economic debate.

I would like to emphasize the latter, because I find it particularly important with regard to the difference between scientific contribution and that of political economy. The IMF comes to Albania as a participant in this debate with four scientific papers, whose results are based on available and reliable statistics, identified economic models and conclusions based on well-grounded assumptions and analyses. Each of these elements is clearly explained in the working papers that will be discussed today. These elements altogether make the work replicable (controllable), open for discussion, and assign credibility to the results and inferences. These materials represent good grounds for discussing issues of great importance to the Albanian economy. In contrast, today the bulk of economic discussions and analyses in Albania are based on a different criterion: that of listening and discussing.

Analysts and economists focus mainly on the transmission of conclusions of their economic thought. They neglect the important discussion of data sources, the identification of theory references (by author or by year), or the assumptions made while applying the models on whose bases the results are obtained.

This working model of “speak and listen” has dominated the economic analysis outside institutions. This model lacks two essential elements, the “read and write” ones. Economic comeback focuses only on television media, while all the economic policies of the Bank of Albania are based on the analysis and research papers with theoretical and empirical character and on economic indicators database.

All these elements of decision-making are transparent to the public because they are published in electronic formats on the Bank of Albania’s website, and are simultaneously available in print as separate working papers or summarized in volume forms. All this information is free of charge and is made available to the public as a public good. Consequently, analysis and comments on the nature, direction and speed of economic policies should start from and address to these studies in order to discuss them.

It is true that any analysis and critique starts from an economic hypothesis, but before the discussion becomes public, it is necessary that the validity of the null hypothesis is tested. This process should be documented in a working paper or article, because if the hypothesis or the model or data used is not appropriate in the analysis in question, then the conclusions are partial in the best case or make no sense in the worst case. Honestly, I hope that today’s activity will help establish a model or a culture of debate or analysis from the perspective of a third party. Everyone can benefit from the discussion, which is a necessary good for any institution that designs and implements policies of economic, environmental, social or any other nature. And this happens only when the content and the form of discussion is not determined by individual definition of the phenomenon, but by its detailed theoretical and empirical explication as required by the economic science standards.

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

At the Joint Press Conference of the IMF mission, the Ministry of Finance and the Bank of Albania
March 9, 2010

Dear Mr. Minister of Finance,

Dear Mr. Bell,

Dear participants,

During the last two weeks we have had an intensive dialogue with the IMF Mission, which visited Tirana in the framework of periodic consultations in terms of the observance of Article IV. During these discussions there is appraised the good performance of the Albanian economy during the past year and there is also emphasized the need for pursuing prudent economic policies, designed and implemented in the context of strengthening the macroeconomic and financial stability. Also, special attention has been paid to the need for ongoing structural reform that will support our long-term economic growth.

The Albanian economy has recorded a positive economic growth during the past year and has successfully tackled the direct and indirect shocks of the global economic crisis. Moreover, the Albanian economy has passed the test, by maintaining the domestic economic and financial balances, which serve as a prerequisite for a sustainable and long-term growth. Inflation rate fluctuated around 2 to 3 percent during 2009; the country's external balances have shown correction signs, while the Albanian banking system remains robust and well-capitalized.

However, the economic growth rate slowed down significantly during 2009. The global economic crisis, which deeply affected all countries of the region, was accompanied by slower exports, reduced remittances and other foreign currency inflows, increased uncertainty and slower credit growth. Although 2010 is expected to be accompanied by a gradual improvement in the world economic environment, many of the factors that negatively affected the Albanian economy will continue to be present during this year as well.

The stimulating fiscal and monetary policy helped support the economic activity during 2009. However, fiscal trajectories and the need for long-term stability suggest that the Albanian economy cannot rely on fiscal stimulus for a long time. Against this background, in 2010 a more conservative fiscal policy is necessary and is welcomed by the Bank of Albania. In a medium- and long-term horizon, we are of the opinion that fiscal sustainability should be ensured through a clear and prudent fiscal rule.

Under new circumstances, the economic growth should be based more on boosting the private sector of the economy and bank credit plays a key role in this regard. The good financial soundness of our banking system and the progressive improvement of liquidity conditions and risk premiums in domestic and foreign financial markets are encouraging developments. The easing of monetary conditions and the liquidity injections by the Bank of Albania have supported and will further support this process. However, the resumption of credit activity remains a challenging goal, which will require the encouragement of final demand and the generation of business plans valid for bank financing, lowering of real and perceived risk in the economy, review of development strategies and commercial banks' lending policies, as well as the reduction of cost and non-cost elements in lending. All these factors are envisaged to gradually improve throughout the year; however, they will remain far from the pre-crisis levels.

Bank of Albania's monetary policy will continue to be prudent, chiefly oriented towards the achievement of the inflation target. The recent upward inflation trend might have been motivated by temporary and limitedly-intensive supply factors. The Bank of Albania has envisaged that the excess of the 4 percent inflation rate will be for a short period of time and not followed by steady inflationary pressures. Our projections show that consumer price inflation will fall gradually towards the 3 percent targeted rate during 2010. However, we remain committed to taking all appropriate steps to ensure this performance and meet our legal mandate for price stability in the economy.

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

At the International Conference “Responsible Finance in Albania”, jointly organized by the Bank of Albania, KfW Entwicklungsbank and EFSE, March 23, 2010

It is with great pleasure that I open the proceedings of this important forum entitled “Responsible Finance”. This concept is being ever-increasingly mentioned in the discussion topics and macro finance debates, in particular following the 2008 events. Participation in this forum pushed me to find an accurate definition for this concept. “Responsible Finance” can be summarized as practices that are designed to create a fair balance of interests between a finance institution and other stakeholders. In fact, my search made me realize that this concept may perhaps best describe in a single designation the wide-ranging efforts of the Bank of Albania in the last 3-4 years with respect to banking and financial supervision, monetary policy and public education.

Responsible finance is an encompassing topic that affects and should be applied by all financial market players. It implies a phenomenon that goes beyond prudential supervision since it is a necessity to guarantee both the financial and macroeconomic soundness of an economy.

This philosophy cannot be reduced merely to the best business principles and practices but it also summarizes the desire and goal to assist the poor groups of the population and remove poverty by providing more affordable borrowing and prudence that guarantees their economic success. Responsible finance focuses on guaranteeing the system’s customers’ rights, however the requirements and practices of responsible finance are first and foremost a guarantee for the soundness of financial institutions and therefore of the entire financial system.

Responsible finance at the Bank of Albania has focused on three main directions:

- Banking supervision,
- Transparency and accountability, and
- Education.

First, responsible finance cannot be understood as a phenomenon and responsibility to be left to the market players’ own initiative. It should be grasped not merely as a right but also as an obligation of all market players.

If you agree to this principle, then you should be an advocate and promoter – indeed, this is the position of the Bank of Albania as far as this is concerned.

From a central bank’s point of view, responsible finance begins with sound supervision of the banking and financial system. It constitutes an obligation for

the central bank to provide the savers with the right of having financially strong financial institutions and to ensure that the latter conduct their operations in line with the best business principles. The Bank of Albania has paid particular attention to financial stability by exerting an effective risk-oriented supervision on the institutions it licences and supervises. Moreover, effective supervision also encompasses the importance given to the promotion of competition and protection of customer interests.

And last, but not least, the principle of responsible finance has been applied through prudential banking supervision and preservation of financial stability, harmonizing monetary and fiscal policy. This principle has been considered as an integral and essential part in the monetary policy decision-making and harmonization with fiscal policy.

Hence, the Bank of Albania guarantees that its monetary policy does not impair the financial soundness of banking and non-banking institutions and that of individuals; by contrast, it supports these financial market players by making them part of the decision-making process.

Allow me now to dwell upon the process of monetary policy decision-making transmission to the public. This process is crucial to guaranteeing the maintenance of macro finance balances in an economy. In view of this, the Bank of Albania has committed to the economic and financial education of the public, viewing the undertaking of some concrete initiatives for the establishment of financial literacy in the Albanian society as a necessity. However, this task cannot be performed alone; guaranteeing the balances requires the co-operation of the financial system, the private sector and the public at large in order for them to respond to the decision-making efficiently and rationally. The last two years' events have pushed many people to discuss the consistency of efficient market theories and the ability of economic agents to be rational. Although it is yet too soon (and more time is needed) to make a full analysis of the causes behind the crisis, I have to bring to your attention some key elements that impaired the individuals' ability and later on the markets' ability to be efficient and rational. This is not to analyse the crisis but to understand the implications for responsible finance.

It holds true that all stakeholders failed in terms of their decision-making and they made wrong, irrational and inefficient choices. But it also holds true that almost all borrowers did not have complete information on the types of credit they were borrowing or the financial instruments they were purchasing, or they were unable to understand the financial implications of their financial and monetary commitments. They were also pushed to believe that the housing prices were going up and that financial risk had ceased to exist. Unfortunately, it cannot be said the same for banks, which pushed people to borrow these types of loans. Did they explain to their customers that the interest rates were only extended in time and they were not forgiven, that prices swing and that they do not remain stable? Did they provide all the necessary information? If the answer to a few of these questions is "no", then the agents did not have the entire information available to make rational

choices. And when this happens, the entire economy and the financial system along with it are severely hit. Against this backdrop, transparency does not only represent an obligation to the customer's right to know each and every detail of a transaction, but also an obligation to the soundness of the entire financial system.

Lack of transparency encumbers the transmission of information and consequently, it does not guarantee the proper conditions for the agents to be rational in their decision-making. Therefore, transparency and responsibility are needed.

In order to enhance banks' transparency to their customers in Albania, the Bank of Albania has approved the Regulations "On the minimum requirements for disclosure of information by banks and branches of foreign banks" and "On the transparency of banking and financial products and services".

I would like to note that the lack of transparency does not only appear in the form of intentional concealing of information or simply as a result of negligence, but also as a result of wrong selection of tools and means of communication. The disclosure of information in the most prompt, the best, the most efficient and the most comprehensible way is a responsibility for all market players, both for the institution to the customer and the customer to the institution. In this regard, it is with pity that I note that microcredit advertisements may be only found on the mileage boards or the amateur graffiti that smudge the national roads' borders – the largest part of this information being the name of the institution.

These institutions should build a clear communication strategy with the public with respect to the products they offer, the lending terms these products are offered, and –what is particularly important– their objectives. Transparency should entail their competitive advantages against universal banks as regards the lending terms and the assistance they are able to provide considering their loan portfolio well-management. Responsible finance means that the donors should choose the best and most skilful partners to be involved in this activity, and exert their pressure so that the institutions they allocate their funds in guarantee the transparency and information required not only in memos and reports, but in the market, where it is evident and transparent for the target groups.

Efficient market decision-making also needs the central bank's transparency and responsibility, therefore the Bank of Albania has paid a great deal of attention in this respect. However, we are well-aware that transparency in information and decision-making represents a necessary but insufficient condition to guarantee an efficient response in economy.

It often occurs –in particular in our economies– that financial illiteracy becomes a significant hindrance to market efficiency, since the economic agents may not be able to accurately interpret the information and communication of the decision-making authorities and may respond to these decisions

unpredictably. This situation is similar to giving the people the appropriate tools to carry out a certain job without showing them first their function or how to operate with them.

Consequently, there is no responsible finance without education. Using this reasoning, we perceive education as an obligation of governmental and academic institutions to respond to the public right to educate. Market efficiency and rationality may be guaranteed only if the entire economy (not only the economists) enjoys a minimum level of economic education.

Being educated implies comprehending and interpreting the information and responding to it, however this does not necessarily mean being able to resolve every economic and financial problem by yourself. Being financially educated means knowing when it is necessary to address to the expert (the economist) in order to make better choices, after being convinced of his transparency and responsibility.

This means financial responsibility in the form of an obligation to personal and social right for a long-term economic and financial prosperity. This education should not be only limited to the institutions (universities or financial system) because we do not need only economists. Economic and financial education should be addressed to the entire public in the form of a public good for all the economic agents in all possible ways. As I noted above, we have tried to educate our public through some concrete initiatives such as the publication of educational booklets, the launch of educational programmes for students and training seminars for journalists, high school teachers of Economics and social workers.

In this regard, the Bank of Albania has always been active not only as regards the public education, but also in its search for partners, because when it comes to financial education there is room for everyone, in particular for the academia. It is for this purpose that we have recently established the Banking Research Institute as an opportunity for co-operation with the academia.

The Albanian public lacks the weekly economic-related columns in the press, the educational classes, the public lectures, the professional assistance to the public and other similar.

These are normal activities of the academia and the educational institutions in a developed world, since their primary purpose is to create public goods for the society. Social return or the social impact have now become an ever-increasingly important objective for profit-seeking financial institutions, while in our economy education is only limited to the strict and traditional classroom teaching. Analyses and comments almost always approach the criticism, and very rarely –not to say hardly ever– they approach explaining and interpreting a certain economic phenomenon. Against this backdrop, responsible finance goes beyond the financial system's boundaries; it stretches to all the players that can and have the responsibility to guarantee it in all possible ways.

I invite all the interested players to co-operate in order to guarantee financial responsibility, providing an active contribution according to their role in economy.

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

At the Press Conference on the Monetary Policy Decision-Making of the Supervisory Council of the Bank of Albania
March 24, 2010

At its meeting of 24 March 2010, the Supervisory Council of the Bank of Albania analyzed and adopted the Monetary Policy Monthly Report. After discussing the latest economic and monetary developments at home, their projections for the future and after assessing the balance of expected risks, at the end of discussions, the Supervisory Council of the Bank of Albania, decided to keep the key interest rate unchanged at 5.25%.

After the heavy shock in 2008 and the first six months of 2009, the world economy entered the recovery stage of economic activity, stimulated by the expansionary monetary and fiscal policy. The main central banks continued to pursue easing monetary policies with the purpose to sustain the credit market and guarantee the sustainability of economic growth. The end of economic recession was accompanied by rising inflationary pressures, as a reflection of both the statistical impact related to the performance of primary commodity prices, and the growth of demand in the world economy. The performance of financial markets was stable and the main risk indicators have stabilized at lower rates. However, in the last weeks, the financial markets have shown heightened uncertainties about the fiscal sustainability of some Euro area countries. This is reflected in the increase of Government security yields of these countries, and the heightened sensitivity of investors to fiscal developments.

Economic activity is assessed to have recorded a progressive slowdown in its growth rate in the last six months. The latest indicators of real economy, like sales' indicators and the monetary and confidence indicators signal further curbing of economic growth in the last quarter of 2009 and the early 2010. The lower investments by the majority of businesses, the low capacity utilization, the decline in capital goods' import and the low growth of investment loans attest to slow private investments in the early months of the present year. On the other hand, the more moderate growth rates in employment and wages, the contraction of consumer loans, the poor performance of retail sales and higher consumer's propensity to save show the curbing of the current and expected consumption in the short run.

External sector of economy manifested positive signals in January, featuring an export growth by 30 percent and narrowing of the trade deficit by 13 percent. This welcomed development remains however insufficient to set the Albanian economy on the path of sustainable economic growth.

The high fiscal incentive provided in the first three quarters of 2009 gave rise to the increase of public debt to 59.5 percent of GDP. The upsurge in

current and capital expenses over this period, financed by the widening of the budget deficit and the growth of public borrowing, provided considerable, albeit short-term, impact on economic activity. By cutting the key interest rate twice and constantly injecting liquidity, the monetary policy pursued by the Bank of Albania was stimulating in 2009 and the early 2010. Against a background of exchange rate depreciation, monetary conditions at home have ever-increasingly favoured aggregate demand. However, monetary conditions in economy have been and remain in line with the medium and long-term price stability, thus serving to the well-functioning of financial markets and the maintenance of the financial system's stability.

In response to the easing monetary policy and the lower risk premium in economy, monetary indicators showed signs of improvement in the first two months of 2010. Currency outside banks declined and there was a corresponding increase of deposits in the system. The improved liquidity indicators of the banking system and the lower public sector demand for funds gave rise to lower Government security yields. The exchange rate is relatively stable, reflecting the slight correction of foreign trade and current deficit in the last two quarters. This correction has also contributed to setting more stable balances of demand and supply with foreign currency.

Despite these encouraging developments, lending activity at home remains far from its potential in response to the lower demand for banking loans and the tight bank lending conditions. Private sector credit grew by 4 percent y-o-y in real terms, thus contributing by 7.8 percent to money supply in January.

ALL denominated credit continues to dominate the lending activity, which mainly covers the business needs for working capital. In January, the improved level of foreign assets in the banking system began to be reflected in the growth of foreign currency lending. However, the stable growth of lending should be assisted by the recovery of demand for loans and the parallel easing of lending conditions applied by the banking system. The Bank of Albania considers that the banking system should be more visionary in identifying the potential sectors of economic growth and take a more active role in boosting economic activity.

Annual inflation marked 4.4 percent in February 2010, exceeding the upper limit of the Bank of Albania target range by 0.4 pp. Average annual inflation marked 2.6 percent. The recent developments in inflation have reflected the statistical effect of the relatively low comparison base of prices in 2009, the more complete exchange rate depreciation pass-through to consumer prices and the administrative price rise of energy starting from January 2010.

The latter contributed by about 0.5 pp to inflation, being the main reason of its 4 percent target excess. On the other hand, the increasing tendency of food inflation owes to the global conjuncture of merchandise prices, which has been showing a gradual monthly increase since mid-2009.

Our analyses recommend that the increasing tendency of inflation owes mainly to supply-side factors, which are considered as being transitory and

short-term. The Bank of Albania expected these developments, being factored in our inflation forecast and communicated to the public transparently and timely. In the medium run, below-potential economic growth as a result of the slow domestic and foreign demand shall create an environment of low inflationary pressures, which are expected to balance the supply-side pressures. This assessment is also supported by the stable developments and the low historical rates of the long-term component of inflation and non-traded inflation, the latter being the most direct and indicative components of inflationary pressures generated from domestic demand in economy.

Core and non-traded inflation in February marked 1.1 and 2.3 percent, respectively.

In the discussions on the current and expected economic developments, the Supervisory Council of the Bank of Albania concluded that the inflationary pressures balance in the medium run is consistent with the central bank's inflation target, despite the latest tendencies of CPI inflation. The assessments regarding the slowdown of demand and the widening of the negative output gap, the more contained exchange rate and the stable expectations of economic agents about inflation, are factors that will condition the performance of inflation in line with the central bank's target.

At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged at 5.25 percent. This decision guarantees appropriate monetary conditions for meeting the inflation target in the medium run. The Bank of Albania remains willing to act in line with the actual and expected performance of economic indicators. In view of preserving and firming up the macroeconomic balances further, its decisions will particularly factor the maintenance of inflationary expectations anchored around the Bank of Albania's target for inflation and the financial system's stability at home.

The Bank of Albania concludes that the recent correcting tendencies of the balance of payments indicators are encouraging for the long-term sustainability of Albania's financial indicators. On the other hand, the Bank of Albania considers that this sustainability would be assisted by a prudent fiscal policy, which must factor the long-term soundness of fiscal parameters in its decision-making.

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

At the Presentation of the Bank of Albania's Annual Report 2009 to the
Parliamentary Commission of Economy and Finance
April 7, 2010

*Dear Chairman of the Commission,
Dear honourable Members of the Parliamentary Commission of Economy
and Finance,*

It is a privilege to present to you today the Bank of Albania's Annual Report for 2009. This Report, the key conclusions of which will be briefly reviewed in my speech today, makes a thorough and transparent analysis of economic and financial developments in Albania, and provides an overview of the Bank of Albania's work to meet its legal obligations and institutional commitments.

*Dear Chairman of the Commission,
Dear honourable Members of the Parliamentary Commission of Economy
and Finance,*

Let me begin my presentation by briefly outlining the key topics and messages of the Annual Report.

The year 2009 was a challenging year for the Albanian economy in all its dimensions. In response to the global economic and financial crisis, the following were put to the test during this year:

- The country's macroeconomic balances;
- Our financial system's stability;
- The business models and the private sector's financial sustainability; and
- The analytical and responsive capacities of macroeconomic policies.

In a broader setting, the shock that hit the Albanian economy in 2009 put the flexibility of Albania's economic development model and its capacity to respond to a thoroughly transformed global environment to test.

The global crisis provided a quick impact on economic activity at home. It was soon followed by the reduction of current and capital account foreign inflows, an abrupt fall of foreign demand and slowdown of domestic demand for goods and services.

In response to these developments, the economic growth rate marked a progressive slowdown during the last year, but still remained positive. Albania's balance of payments was characterized by imbalances in foreign currency inflows and outflows. The imbalances were reflected in the swinging of demand and supply ratios of foreign currency, yielding the depreciation

of the exchange rate in response to new balances that dominated the foreign exchange market. Fiscal policy became more expansionary in 2009, supporting economic activity in the country but also increasing the pressures on the financial markets.

The shock that hit the financial system gave rise to the establishment of a challenging environment for the monetary policy to be transmitted completely and timely. Against this challenging background, the Bank of Albania accomplished its legal mandate to maintain price stability in economy successfully: CPI annual inflation remained within our 3 +/- 1 percent target in 2009.

The Bank of Albania's easing monetary policy established the proper monetary conditions required to maintain price stability. In addition, the supply of the economy with the necessary liquidity and at a declining cost stabilized the financial markets and created the proper conditions for the support of economic activity during 2009.

The performance of the Albanian financial system was affected by the wavering of confidence in our financial system during the first half of the year and the withdrawal of a portion of deposits. This performance, coupled with another group of factors, yielded less support, and at higher cost, to the Albanian economy with banking loans.

Among the factors worth noting are:

- Higher economic agents' uncertainty and liquidity premiums;
- The correction of the business model in particular financial market segments;
- Increased exchange rate volatility; and
- Contracted demand for loans in the second half of 2009.

The wavering of public confidence underscored the prime importance of financial stability in Albania's economic life. Within its area of responsibility, the Bank of Albania undertook a number of comprehensive and co-ordinated measures, which aimed at maintaining financial stability at a systemic and institutional level.

These measures, *inter alia*, consisted in:

- Reviewing the regulatory base in terms of increasing the supervisory prudence;
- Strengthening on-site supervision;
- Increasing the analysis of banks' balance sheets at an individual and systemic level; and
- Enhancing the co-operation with the national and foreign counterpart institutions.

Our endeavours to preserve financial stability were also coordinated with other public, executive and legislative authorities. Worth noting is the

improvement of the public deposit insurance scheme and the increase of the deposit insurance level by the Deposit Insurance Agency. These measures proved successful in curtailing the negative consequences and in fully restoring confidence in the banking system.

Subsequently, the Albanian banking system maintained sound balance sheets and was in full capacity to carry out its function as a financial intermediary and supplier of the economy with payment instruments.

In what follows, I would like to dwell on the aforementioned topics.

1. BANK OF ALBANIA'S MONETARY POLICY AND PRICE STABILITY

(PERFORMANCE OF ECONOMIC ACTIVITY, MAIN MONETARY HIGHLIGHTS, MONETARY POLICY AND ACHIEVEMENT OF THE INFLATION TARGET)

In accordance with its legal mandate, the Bank of Albania's monetary policy has been designed and implemented in order to achieve and maintain price stability. During 2009, the main risks to price stability have arisen from the slowdown of economic activity, wavering of economic agents' confidence, imbalanced external position of the Albanian economy and the exchange rate depreciation. Despite these challenges, the Bank of Albania managed to keep the CPI inflation within the target. Let us dwell on these elements further.

1.1 WORLD ECONOMY

The global context that accompanied Albania's economic and financial performance over the past year was not at all favourable. The year 2009 featured contracted global economic activity as a result of the economic downturn in advanced economies and considerable economic slowdown in emerging countries. Global economy posted the first negative growth rate of the last 50 years. Following the problems first shown in 2008, the global financial system went through a difficult period. The attention of regulators and financial institutions focused on fixing the impaired balance sheets of the financial system. The contracted economic activity and the higher uncertainty in financial markets were followed by the reduction of trade and financial flows worldwide. Economic recession also triggered the increase in unemployment and decline in the use of capacities, hence creating a low-inflation environment.

This environment enabled the adoption of strong stimulating fiscal and monetary policies to encourage the growth of demand and production in the economy.

These stimulating policies resulted successful in the majority of countries. Economic activity, the growth of which was mostly negative in the first half of the year, marked a slight improvement in the second half. The recovery in worldwide demand led to the revival of economy and the growth of trade, improvement of confidence indices and formation of more optimistic future expectations. In addition, the decisive intervention of the authorities to support the financial system helped lower the pressures arising from the crisis. This normalization of the situation was reflected in the reduction of risk premium, the downward performance of interest rates and in their more moderate volatility. However, the recovery of global economic activity remains fragile.

Public debt, which has increased substantially as a result of high fiscal deficits, stands at the forefront of the financial markets and policymakers' agenda. The Governments' capacity to refinance and service this debt in the future will determine the risk premium in the financial markets and macroeconomic stability in individual countries.

1.2 ECONOMIC GROWTH AND FACTORS AFFECTING IT

The increasing integration of the Albanian economy and the financial system in particular caused the global crisis to be reflected early in our country. The main channels the Albanian economy was exposed to were:

- Decline of exports;
- Decline of remittances and other foreign currency inflows;
- Increased uncertainty in the financial institutions; and, in response to the latter,
- Review of almost all economic agents' business plans.

This impact was reflected in low growth rates and shaking of some macroeconomic balances in 2009. In the first nine months, GDP grew 4.9 percent in annual terms. Its annual growth rates were characterized by a progressive decline from 5.4 percent in the first quarter to 4.1 per cent in the third one.

Indirect data and other qualitative information suggest that the economy continued to slow further in the last quarter of 2009. In anticipation of INSTAT's official statistics, preliminary estimates indicate that the economy grew about 3 percent in 2009. The slowdown of GDP growth reflected the contraction of activity in industry and construction, while the services sector's value added remained the key contributor to economic growth.

Given the difficult circumstances in which economic activity took place and compared with other regional countries' experiences, the preservation of the economic growth rate at positive levels is an encouraging development. However, its slowdown and the new macroeconomic balances need due attention by all economic agents in their projections for the future. Albania's

economic development outlook also requires greater support from the private sector, while the contribution of the public sector to economic growth is expected to decline.

The data on aggregate demand show that the contraction of private consumption and the fall in investment were determining factors in the slower growth of demand at home. Net exports continued to provide a negative contribution to aggregate demand in 2009, however at more moderate rates than in 2008. In addition to easing monetary conditions, the fiscal stimulus supported the economy in generating positive growth rates during 2009. Private consumption is the key component of aggregate demand accounting for about 80 percent of GDP. The slow growth rates in wages, the decline of remittances and the contraction of consumer loans contributed to the slowdown of consumption in 2009.

Private investments are assessed to have been affected more by the global financial and economic crisis than the other components of aggregate demand. The contracted domestic and foreign demand and the uncertainties regarding the economic situation at home and abroad, and the tight lending conditions triggered the contraction of private investment in 2009.

FISCAL POLICY AND FISCAL INDICATORS

The slowdown of Albanian economy affected the performance of fiscal policy and fiscal indicators. Fiscal policy was expansionary being reflected in the deepening of budget deficit particularly during the first half of 2009. Budget deficit for 2009 is estimated at about 7 percent of GDP. The main sources of deficit financing were privatization receipts and syndicated loan, which reduced the need to borrow in the domestic market.

Budget revenues posted an annual increase of 2.7 percent, largely due to the slow increase in tax revenue. On the other hand, public spending grew by about 8 percent, led by the high rate of current expenditure.

The expansionary fiscal policy provided the economic activity with the necessary impulse over the course of the year; however, it was also accompanied by higher public debt and upward pressures on Government T-bill yields. The deepening of budget deficit resulted in substantial public debt growth, which as at year-end 2009 accounted for about 59.5 percent of GDP. The Bank of Albania considers that it will be challenging to cope with the expansionary fiscal policy in the medium-term and it will likely yield negative consequences in the long run.

In this respect, we encourage measures to reduce the budget deficit and public debt. Lower budget deficit and public debt levels in the long run will provide more room in accessing funds from the private sector and boost confidence in Albania's macroeconomic stability. In addition, these measures

will help create appropriate conditions for attracting foreign capital in the form of private loans or foreign direct investment.

MONETARY DEVELOPMENTS AND FINANCIAL MARKETS

Financial intermediation in economy was conditioned by the contraction of financial resources, wavering of confidence in financial institutions and the decline of demand for banking loans in 2009. At the end of March, deposits fell to 55 percent of GDP compared to 63 percent in September 2008. The withdrawal of deposits during the first quarter of the year brought about the slowdown of money growth in economy.

Banking activity recovered slowly during the following three quarters. Money supply grew by an average of 6 percent this year or about twice less than the previous year.

The growth of money supply mainly attributes to the growth of its ALL component, while foreign currency loans and deposits contracted in 2009. The creation of money in ALL has been based on the fiscal sector's domestic borrowing and the preservation of the private sector's ALL credit rates.

In addition to the higher banks' sensitivity to their liquidity indicators, private sector credit activity was carried out under the conditions of a more conservative behaviour of banks' lending in 2009. As I mentioned at the beginning of my speech, this conservative behaviour owes also to an increased caution of banks to certain banking products, such as foreign currency loans to certain segments of the economy exposed to exchange rate fluctuations, and consumer loans.

In the second half of the year, demand for loans declined as a result of the tight lending standards and the slowdown of economic activity. Despite the easy monetary policy of the Bank of Albania, private sector credit maintained a uniform slowdown trend during 2009.

As at year-end 2009, credit annual growth rate marked 12 percent versus 33 percent in 2008. The growth of credit has been triggered by the business demand to finance the liquidity needs, while the households' loan portfolio contracted over the same year.

1.3 BALANCE OF PAYMENTS AND THE EXCHANGE RATE

In the presence of slow domestic demand and reflecting the difficult situation of the global economy, current account deficit narrowed by about 3 percent in 2009, standing at 15.3 percent of GDP. Despite the slight correction during the year, current account deficit remains high and one of the weaknesses of the Albanian economy.

As we have constantly stated, the Bank of Albania considers that the prioritized handling of the current account deficit requires the formulation of

policies supportive to the long-term growth of savings in Albania, as well as measures to encourage production in those branches or industries that result competitive in the international markets.

Trade balance narrowing was affected by the concurrent annual decline of exports and imports by 18 and 9 percent, respectively. The difficult situation in our neighbouring countries has been also reflected in the decline of remittances, which contracted 6.5 percent in annual terms, while their share to GDP was 9 percent. Capital and financial account surplus reduced substantially over the course of 2009, dropping by 35.6 percent compared to 2008. This performance owes to a large extent to the low increase in foreign direct investment and the reduction of private foreign borrowing.

Unlike the previous two years when capital and financial account covered over 100 percent of the current deficit, in 2009 it financed only 77 percent. Total foreign inflows, albeit downward, were almost sufficient to cover this deficit in 2009. The country's foreign reserve remained at similar levels as in 2008, sufficient to cover 4.2 months of imports of goods and services.

The contraction of foreign inflows exerted depreciation pressure on the exchange rate, particularly in the first half of 2009. In the domestic foreign exchange market, average annual depreciation of ALL against the EUR and the USD was 7.6 and 13.2 percent, respectively. The depreciation tendency of the ALL exchange rate was more moderate in the second half of the year, after a more stable balance between supply and demand for foreign currency had been restored. The rebalancing of supply and demand owes substantially to the trade balance correction and the more moderate psychological effects.

1.4 INFLATION AND BANK OF ALBANIA'S MONETARY POLICY

PERFORMANCE OF CPI INFLATION

Consumer prices rose 2.2 percent on average in 2009, which is in line with the Bank of Albania's target for inflation. As a result of the reduced inflationary pressures worldwide, annual inflation marked low rates – 1.8 percent on average – during the first quarter of 2009. In the following two quarters, inflation rates stabilized close to the lower limit of the Bank of Albania's target – 2.0 percent. Annual inflation displayed an upward tendency in the last quarter, when it marked 2.9 percent in average terms and converging to the inflation target. The highest inflation rate of 3.5 percent was marked in December. The increase of inflation in the last part of the year was mainly triggered by the more complete transmission of the exchange rate depreciation to consumer prices, in the presence of upward primary commodity prices in the global markets.

The slowdown of economic activity at home and the low inflationary pressures from the global economy yielded an environment of relatively low inflationary pressures. Core and non-traded inflation marked average rates

of 1.3 and 1.6 percent, respectively, in 2009 attesting to the low inflationary pressures on domestic economy. These factors offset the depreciation effect of the national currency, which led to higher prices of imported goods and a part of products that are still indexed to the exchange rate. Traded goods' inflation – a portion of which are imported and the rest are directly affected by global prices – increased substantially compared to the previous two years. Its contribution to headline inflation was about 73 percent in 2009.

BANK OF ALBANIA'S MONETARY POLICY

The weakening of economic activity and domestic inflationary pressures, our forecast for a contained inflation in the future and the anchored expectations of economic agents provided room for pursuing an easy monetary policy in 2009. This policy was materialized in two interest rate cuts by 0.5 percentage points each in January and October 2009 to 5.25 percent, and in the continuous injection of liquidity required by the market and the economy. By means of this prudent monetary policy, the Bank of Albania aimed at creating appropriate monetary conditions for a balanced and long-term development of the country.

The key interest rate cuts were instantly passed through to the short-term interest rates in the interbank market, which declined and were less volatile than in 2008. On the other hand, these movements were not fully and instantly transmitted to the interest rates on banking loans and deposits. As in all other countries, the increase of the liquidity premium, the higher uncertainty and the deterioration of the banking system's profit were amortizing factors for the easy monetary authorities' measures. However, our monetary policy and our interbank market operations managed to successfully avoid a detrimental contraction of banks' balance sheets, something that many developing countries had to go through.

The 1.00 percentage point cut in 2009 relaxed the financial burden of the banking system's intermediation activity. The Bank of Albania has consistently supported the banking system with the required liquidity. In addition to cutting the key interest rate, the Bank of Albania has helped Albania's banking system activity through: the change of the refinancing auction form from fixed-amount auction to unlimited-amount auction; up to 3-month extension of the maturity term of injected liquidity; the expansion of the range of collateral in our refinancing operations; the increase of the use of required reserve; and the reduction of the overnight loan interest rate. We have employed almost all of our range of instruments for implementing monetary policy. The amount of liquidity injected by the Bank of Albania peaked in summer with ALL 40 billion. As a result of the deposits entering the banking system, this amount reduced gradually to about ALL 28 billion at the end of 2009.

2. BANKING SUPERVISION AND FINANCIAL STABILITY

The banking system performance was significantly conditioned by the economic slowdown and wavering of confidence, aspects that were elaborated

at length in my speech. Consequently, there was higher uncertainty, higher bank sensitivity to liquidity, a more cautious lending behaviour, and an increase in non-performing loans. These are the main highlights of the banking system performance during 2009. Despite the downward profitability, capitalization indicators remain at satisfactory levels. The banking system remains sound, a fact that also attributes to the effective carrying out of the regulatory and supervisory function of the Bank of Albania. In what follows I would like to elaborate more on these aspects.

2.1 BANKING SYSTEM PERFORMANCE

The Albanian banking system's total assets increased in 2009, but at a rate about twice lower than in 2008. This decrease reflects fully the lower expansion of lending. Our banking system continues to be mainly financed by public deposits and be concentrated on business lending.

The banking system's deposits and loans grew at a lower rate than in the previous years. Loans to total deposits increased by nearly 3 percentage points, from 62 to 65 percent. On the other hand, the increase of deposits as a result of the restored public confidence has improved the liquidity situation in the banking system.

Non-performing loans increased in 2009 owing to the economic slowdown and the exchange rate depreciation. Loan portfolio quality index expressed as "non-performing loans to total outstanding loans" rose to 10.48 percent as at end 2009 from 6.64 percent at the end of 2008.

The Bank of Albania has monitored the situation closely being aware of the pro-cyclical effects that these developments may have on the loan portfolio. From our assessments and proactive approach we have noted that although this level of the loan portfolio deterioration was not tested before, capital adequacy and quality not only to carry out the banking operations but in particular to support the extension and expansion of lending, have remained almost intact. In this context, we can mention the fact that although the loan portfolio did not grow at similar rates as in the previous years, probably due to the large accrual basis but also as a result of banks' reluctance for prudence-related reasons, the growth was satisfactory and at higher levels than in the region.

Based on the periodical stress-tests, the Bank of Albania has managed to make a preliminary assessment of banks' needs for capital, thereby enabling a rapid increase of the capital by banks when necessary. Thus, the increase of non-performing loans was associated with the increase of the banking system's capital.

Total regulatory capital of the banking system increased 37.7 percent, being dominated by the core capital, providing evidence for a qualitatively good and sustainable regulatory capital. Despite the difficult economic and financial environment, the adequacy of the regulatory capital to the level

of risks, mainly the credit risk, has generally remained satisfactory and the banking system's capitalization level was significantly above the regulatory minimum required by our regulations and international practices.

Efficiency indicator shows almost the same level as at year-end 2008, attesting to prudential and stable growth of banking activity in general. On the other hand, shareholder's equity is estimated to have increased 18.7 percent in 2009 versus 2008. Financial leverage reduced gradually during 2009. The decline of the financial leverage from 11.7 to 10.4 percent over a year implies that the system has relied less on debt to finance assets. Compared with the European Union countries, the Albanian banking system's financial leverage remains low attesting to a low degree of the system's borrowing practice.

The network expansion of banking branches and agencies in the territory of Albania persisted in 2009 but at lower rates compared to the previous years. As at year-end 2009, the total number of branches and agencies amounted to 530 from 517 at the year-end 2008. 17 new bank branches were opened while 4 existing branches/agencies were closed. This fact confirms that banks and branches of foreign banks operating in Albania continued to expand their activity in 2009, being at the same time more cautious in their investments.

2.2 BANKING SYSTEM SUPERVISION

In order to ensure the banking system's stability and exercise its supervisory function, the Bank of Albania has been engaged in a process of a more prudential and deeper analysis and supervision of the legal and regulatory framework compliance and enforcement from the licensed entities. This process has been achieved through on-site inspections, which in 2009 were more frequent and rigorous, particularly in terms of the banking system's needs for liquidity. Besides the observance of the supervisory cycle, banks were constantly contacted for phenomena that have represented a concern during the year, taking appropriate measures to address potential problems in due time. Overall, the banking system has acted with caution in conducting the operational processes of their activities and in compliance with the regulatory framework of the Bank of Albania.

On the other hand, the Bank of Albania has cooperated closely with other supervisory institutions at home, which monitor specific activities of the financial market, namely the Financial Supervisory Authority, the General Directorate for the Prevention of Money Laundering, the Deposit Insurance Agency, the Competition Authority. Cooperation in terms of supervision has been extended to international institutions as well, counterparts of the Bank of Albania. With the initiative of the European Central Bank colleges of supervisors have been established to coordinate the work, exchange of information and joint supervision of large banking and financial European institutions with some supervisory authorities these institutions originate from.

In this context, we have become part of the group in some of these colleges, being closer to the monitoring of activities of foreign-owned banks operating in Albania.

2.3 STRENGTHENING THE REGULATORY AND SUPERVISORY FRAMEWORK

The strengthening of the banking supervision regulatory framework was one of the main priorities of the Bank of Albania in 2009. The design of strong and appropriate rules and their rigorous monitoring constitutes a guarantee for the preservation of financial stability. The Law "On Banks in the Republic of Albania" and the continuous meeting of medium and long-term objectives of the Bank of Albania consolidated the work for the revision of the supervisory regulatory framework for the compliance with the law provisions, the interweaving with the revised principles of the Basel Committee for an effective supervision and the New Capital Accord concepts, the European Council directives and the best practices in the area of regulation and supervision of financial institutions licensed by the Bank of Albania.

In 2009 the Bank of Albania finalized the drafting of several new regulations and amendments to some other banking supervision regulations. This process has aimed at preceding the prevention of negative phenomena in the system and it has often been triggered by the developments in the global financial markets, particularly the last financial crisis. The main objective remains the adaptation of the best practices in the area of internal control; responsible and effective governance; strengthening of risk management capacities and increase of banks' transparency to the public. With respect to the latter, the Bank of Albania has required higher and improved communication of the banking system with the public about the products and services being provided, the promotional campaigns for new products and the provision of information on their real financial situation and risk profile.

3. OTHER BANK OF ALBANIA ACTIVITIES

I elaborated at length on the description and analysis of two aspects of the Bank of Albania work: the design and implementation of monetary policy and banking supervision, since these are two key functions of the institution I chair and are rather sensitive for the public. However, allow me to elaborate on some other aspects of the Bank of Albania's work that help develop the financial system and market economy in Albania. More concretely, I will focus on the performance of the payments system, support of the European integration process; improvement of the Bank of Albania's communication with the public; performance of monetary statistics and the balance of payments; and the enhancement of research capacities.

3.1 PAYMENTS SYSTEM

The payments system reflected security and efficiency in 2009. On average, 225 transactions a day were processed and settled in the AIPS system, with an average daily value of ALL 19 billion. The AIPS is the real time gross settlement system and it is managed by the Bank of Albania. Participants in this system are all licensed banks in Albania. Total liquidities settled in the AIPS system during 2009 is about 4.3 times higher than the GDP. In addition to this system, the Bank of Albania operates the AECH system, which processes and clears low value customers' payments. On average, 413 payments a day were processed in the AECH system, with an average daily value of ALL 62.3 million.

The year 2009 marked the expansion of the range of payment instruments used by the public, reflecting the increase in the use of the banking network by individuals and the higher confidence in the banking system. Debit and credit cards are among the instruments that are being ever-increasingly used in Albania. The number of cards in circulation increased 11 percent in 2009 relative to the year-end 2008. On the other hand, the number of ATMs and POSs for the use of cards has increased by 15 and 48 percent, respectively, versus the end of 2008. However, cash withdrawals from the ATMs account for 96 percent of total transactions, providing evidence for the high use of cash in the Albanian economy.

Developing and maintaining an efficient and safe payments system is one of the Bank of Albania priorities. An effective and developed payments system promotes the well-functioning of the financial markets and strengthens the financial stability at home. In this context, our work in 2009 focused on these main directions: strengthening the legal framework in view of overseeing the payments systems, and improving and encouraging changes in the national payments system in view of our role as a reformer of the payments system.

With respect to the first objective, the Bank of Albania is very close to finalizing the draft law "On the Payments Systems in the Republic of Albania", which aims at regulating, overseeing and protecting the payments systems. With respect to the second objective, the Bank of Albania has in co-operation with other entities, carried out projects that aim at providing the technical and regulatory infrastructure for setting up payment platforms and projects that aim at reducing the use of cash in economy.

3.2 PROMOTION OF THE INTEGRATION PROCESS

The Bank of Albania, in the capacity of the central bank in the Republic of Albania, plays a key role in the European integration process. In line with the SAA implementation process, the Bank of Albania has contributed to revising the National Plan for the Implementation of the SAA (NPISAA) for the period 2009-2014, identifying and updating the priorities and measures taken in the areas of macroeconomic stability, free movement of capital, freedom of

establishment and freedom to provide services, in addition to the provision of legal initiatives, implementing activities, the required technical assistance and the expected costs during the process of approximation of the national legislation to the *acquis communautaire*. The Bank of Albania has kept regular contacts with the Ministry of European Integration, submitting monthly progress reports that reflect the achievements in terms of the accomplishment of the legal measures and implementing activities, and a description of the level of compliance of judicial acts approved by the Bank of Albania with the *acquis communautaire*.

3.3 PUBLIC COMMUNICATION AND INSTITUTIONAL TRANSPARENCY

The Bank of Albania has for many years paid an increasing attention to public communication. This has aimed not only at enhancing public transparency, as an important institutional pillar of the Bank of Albania activity, but also in view of enhancing the efficiency of its operations. In this way, the Bank of Albania acknowledges and addresses the importance of having a well-informed and well-educated public in the transmission of monetary policy to the economy, by taking timely, right and rational decisions.

In this context, our activities in the area of public financial education have intensified further through the qualitative enhancement and greater geographical coverage. University and high school students and professors were at the focus of our educational trainings and educational activities.

Journalists and the media, being important players in the intermediation of dialogue between the Bank of Albania and the public at large, have also been at the centre of our educational activities. In addition, our educational publications have increased in number and diversification, hence addressing better to the various stakeholders. Lastly, the redesign of the Bank of Albania website in the beginning of 2009 provides a more efficient portal for the provision of information, making it efficient, re-arranged and user-friendly.

3.4 IMPROVEMENT OF STATISTICS AT THE BANK OF ALBANIA

The formulation of economic and monetary policies cannot be comprehended without relying on timely and reliable figures and statistics. The Bank of Albania plays a key role in the national statistical system, as an institution responsible for the production and dissemination of monetary statistics and external sector statistics.

In view of carrying out its statistical functions, the Bank of Albania is guided by the basic principles of official statistics in the Republic of Albania, which are: unbiasedness, reliability, professional independence, relevance, cost effectiveness, statistical confidentiality and transparency. In 2009, the Bank of Albania continued to develop and disseminate monetary statistics and external sector statistics, aiming at the improvement of the statistical service.

The purpose of this commitment is to approximate the methodology with the recommendations and the best international practices, enhance the quality of data through the improvement and automation of control processes, and increase the number of released indicators and detailing of aggregate indicators.

3.5 STRENGTHENING RESEARCH CAPACITIES AT THE BANK OF ALBANIA

The Bank of Albania has been ever-increasingly paying special attention to enhancing the research capacities in the field of economics and finance, through the strengthening of the human resource capacities, modernization of technical and research infrastructure and the establishment of bridges for the exchange of experience and knowledge with research-engaged institutions and authorities. Some of the main aspects the Bank of Albania's research focused on in 2009 are: forecasts and development of econometric models; the analysis of monetary policy transmission channels; the external sector, financial stability, economic growth etc. The study of different economic phenomena is now based on complete or partial econometric models that allow the drawing of conclusions and reliable forecasts. Our internal challenge in the future will be to further refine these models and make greater use of them in the Bank of Albania decision-making.

*Dear Chairman of the Commission,
Dear honourable Members of the Parliamentary Commission of Economy and Finance,*

In conclusion, I would like to emphasize that the Bank of Albania's financial statements and the balance sheet for 2009 have been submitted according to the legal requirements. The entire financial activity of the Bank of Albania for 2009 has been certified by prominent accounting firms.

Thank you very much for your attention and I am open to any questions, comments or suggestions regarding the activities of the Bank of Albania in 2009 and onwards.

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

At the 4th Bank of Albania Forum with the Albanian Banking System,
April 14, 2010

*Dear commercial bank managing directors,
Dear guests,*

I would like to welcome you to this periodic meeting, which aims at providing a platform for the exchange of ideas and presentation of viewpoints related to the developments affecting banking and financial activity in general, and which are focal to the financial system's stability.

Yesterday, the Supervisory Council of the Bank of Albania approved the Financial Stability Report for the year 2009. This is the third issue of this Report and it is my pleasure to state today that now we do have a consolidated product, which aims at being in full compliance with the best standards. The conclusions derived from this Report confirm that the Albanian banking system experienced an unusual liquidity situation in 2009 and has now entered a period of full recovery.

The satisfactory growth rate of deposits, in particular over the recent months, attests to the restoring of public confidence in the banking system. Moreover, the conclusions of this scientific research confirm that the Albanian banking system is sound and stable and provides full guarantee for the mobilization of public savings and their channelling into boosting economic activity at home. I avail myself of this opportunity to invite all participants in this meeting, the decision-making and governmental authorities, the media and the public at large to address to this Report. Only in this way you will better understand the current situation, the achievements made so far and the challenges to be faced in the future.

In what follows, I would like to provide an overview of the economic situation at home, and later dwell upon the banking sector's present situation and outlook for 2010. Credit quality and banks' transparency to their customers are two issues I particularly chose to focus on.

According to INSTAT's preliminary assessments, Albania posted a positive economic growth of 3.3 percent during 2009, despite the impact of the international financial and economic crisis. The financial system, dominated by the banking sector, was stable and the fiscal and monetary stimulus mitigated the difficulties of the real sector of the economy. This growth rate is very close to the early 2009 projections made public by the Bank of Albania.

Among the factors that boosted economic growth over the course of 2009 we can mention the public authorities' measures to rapidly restore public

confidence in the financial system and the banking sector, and the monetary and fiscal stimulus provided through the cut of the key interest rate, the injection of liquidity and the increase of public expenditure.

Among the factors that led to lower economic growth rate we can mention:

- the trade balance deficit sustainability;
- harder times for the entrepreneurship due to lower foreign demand and contraction of banking sector lending; and
- lower dynamics in household consumption.

Banking sector's assets grew to ALL 886.3 billion, posting an annual growth of 6.3 percent relative to year-end 2008. The performance of the financial system's financial resources, revenue and capital was affected by the international financial crisis and its impact on Albania's real economy. As far as the banking sector is concerned, the decline of public deposits terminated at the end of the first quarter, and their return to banks progressed at stable rates during the rest of 2009.

However, the changes in the liquidity situation, the exchange rate depreciation and the difficulties encountered by the real sector of the economy gave rise to slower lending and deteriorated loan quality. As at end 2009, lending, including the accrued interests, accounted for about 50.8 percent of total banking sector's assets or as much as 40 percent of GDP. In the meantime, the ratio of non-performing loans to total loan portfolio rose to 10.5 percent. The need to increase the reserve funds for coping with the credit risk from banks led to the decline of the banking sector's profit, which however ended positive for about ALL 3.5 billion. Business capitalization was adequate during 2009, as a result of lower high-risk bank investments, injection of new capital by the shareholders and the preservation of a net positive profit. As at end 2009, capital adequacy ratio was 16.2 percent.

The public authorities took several measures in 2009 to support the financial system and the banking sector in particular. Among these measures, I could mention the approval of the law which increased the insurance amount of public deposits, and the decisions of the Supervisory Council of the Bank of Albania to limit banks' exposure to foreign banking groups and to suspend the allocation of banks' profit in 2008 and 2009. Along with these decisions, during 2009 a number of other Bank of Albania decisions taken since the last quarter of 2008 continued to be implemented. These decisions related to the establishment of more facilitating conditions as far as the provision of liquidity in the interbank market is concerned. The Bank of Albania decisions in January and October, which cut the key interest rate by 1 percentage point to 5.25 percent, contributed further to increasing the banking sector's opportunities to provide liquidity at a lower cost.

Economic development at home during 2010 will be supported by a more favourable global economic situation, which will provide a better setting for

foreign investments and will better boost the demand for the Albanian exports. In the domestic economy, the developments noted during 2009 as regards the increase of budget deficit and domestic debt, the lower banking sector lending, and a more rigid situation in production and consumption, need to be addressed through quick and decisive actions and in the course of an adequate time span.

It is therefore indispensable to keep the budget deficit for 2010 under check and at levels that guarantee the observance of the targets outlined in the Medium-Term Macroeconomic Framework as regards budget deficit and public debt level. The consolidation of public finances, reflected through the restoring of budget deficit's downward trend is of great importance in terms of the decline of its financing cost.

It will also lead to improved liquidity situation in the financial market, releasing more financial resources into the system, the use of which will boost the private sector lending. The entrepreneurship and households need to assess the expected outlook of the Albanian economy for 2010 realistically. This period should be used by the entrepreneurship to control the costs and take the necessary measures for restructuring the activity in order to enhance the efficiency. In general, these actions of the fiscal authority and the private economic agents are in the short-term necessary to provide a more adequate environment that will enable the undertaking of other measures for increasing the contribution of production to economic growth and increasing the domestic savings in a longer-term.

During 2010, the banking sector will expand its activity at higher rates than in 2009, however less than the average long-term annual growth. The expansion of activity will likely be more rapid in the second half of the year. As regards the financial resources, the banking sector will benefit from the stable growth of public deposits. The growth of ALL deposits will continue to be supported by the more stable savers' flows, the positive real return and the expectation for greater exchange rate stability. The growth of foreign currency deposits will reflect the seasonal performance, hence being higher during summer.

The maturity structure of deposits is not expected to display any significant changes from the present situation; however the average maturity term of deposits is expected to be higher in 2010 relative to 2009. The extent of this change will be determined by the performance of depositors' income and the stimulus set by banks to orient the structure of savings.

The Bank of Albania will continue to provide the necessary liquidity to the interbank market. As far as the financing lines and shareholders' equity are concerned, the Bank of Albania will continue to require from banks that they maintain the necessary liquidity not only in order to carry out a normal banking business and comply with the regulatory framework requirements, but also in order to support the recovery of banking business at well-controlled risks. With regard to bank investments, the Bank of Albania expects higher bank

lending in 2010 relative to 2009, with the largest part of growth expected to take place in the second half of the year.

In terms of risk assessment, in the short-term, the banking sector's financial situation has benefited positively from the following developments:

- a) Substantial improvement of liquidity situation against a background of public confidence recovery and stable deposit growth. It is assessed that during 2009, the annual growth of public deposits was 7.6 percent, rising to ALL 694.3 billion. Presently speaking, the deposit level has exceeded that of end September 2008, prior to the beginning of the deposit withdrawal. The growth rate of public deposits would have been higher if the situation in the real sector of the economy had improved and the banking sector lending had recovered.
- b) Lower growth rate of the banking sector's risk-weighted assets. During 2009, the growth of the banking sector's risk-weighted assets reduced substantially, owing mainly to the much lower growth rate of lending and the lower expansion of banking business in general. In fact, during 2009 the banking sector increased lending by about 13.2 percent, compared to the growth by about 35.7 percent in 2008. It is assessed that ALL loans grew about 23 percent, while foreign currency loans grew about 9 percent. However, in real terms, the real growth of foreign currency lending was negative.
- c) The depreciation of the national currency exchange rate during 2009 is assessed to have been at a reasonable rate and extent, providing the banking sector and other economic agents the necessary time to take adequate and protective measures. There are great expectations for a stable exchange rate during 2010. However, the movements in the exchange rate against a background of a flexible regime are normal and should be an expected phenomenon by the economic agents and which they should be prepared for.

In the medium term, the banking sector should cope with the impact that the loan quality performance has on its activity. Lending grew by about 13.2 percent in 2009. ALL lending provided the major contribution to the overall growth, supported by the gradual increase in public deposits and the injection of liquidity by the Bank of Albania.

Lending in foreign currency was stagnant, against a background of reduced availability of free foreign currency funds by banks and limited demand for loans as a result of the exchange rate depreciation. Another reason for the slowdown in lending owes to the more cautious lending policies adopted by banks against a background of higher credit risk resulting from the higher difficulties in the real sector of the economy. More specifically, the ratio of non-performing loans rose to 10.5 per cent at year-end. Its rise persisted in the early months of the present year though at a slower rate. As a result of the deteriorated loan quality, the entire banking sector has doubled the respective

reserve funds, hence providing a negative contribution to the banking sector's profit. The latter was in 2009 half as much as in 2008 and had a greater concentration.

The Bank of Albania has for long been vocal as regards the recovery of lending, which will not only boost the economy and customers, but also the banks themselves. The economic setting definitely remains challenging and the return to the 2008 lending growth rates is unrealistic, indeed undesirable. But we do believe that there exist opportunities -particularly in terms of the deposit growth performance- that the growth of lending will be better in 2010 relative to the previous year. Based on the early months' survey carried out by the Bank of Albania for this purpose, the same expectation seems to be supported by you as well. However, though the recovery of lending is a desirable development, it should be carried out on the basis of a prudential analysis, monitoring carefully the loan quality performance. In more practical terms, it is necessary that banks fully reflect the size of non-performing loans for the existing loans and create appropriate reserves for covering the risk of loan losses.

As far as non-performing loans are concerned, banks must identify customers with temporary and surmountable problems, and should set up policies that provide support to these customers in exchange to additional elements that hedge the bank against such credit risk in the future. As regards the customers assessed as having low creditworthiness, banks should without hesitation follow the procedures for the execution of the collateral and other forms of collateral, in order to recover as large as possible amount of credit. The entire decision-making in this process should be clear and documented, and should be based on the analysis of specialized bank structures. Without carrying out this process first, the implementation of general regulatory measures for a temporary sorting out of this problem would result premature and indeed counterproductive.

With respect to new loans, taking into account the experience of banks faced with loan portfolio problems, there should be a better sectoral distribution and a more reasonable balance between public and private investment projects, between customers representing business or household undertaking, between the forms of lending in ALL or in foreign currency, etc., orienting lending in order to reduce the exposure to more problematic forms and the concentration of lending. Assessing first of all the borrowers' creditworthiness and lending safety, the Bank of Albania considers that there is sufficient room for commercial banks -depending on their size and opportunities- to support SMEs with more lending and provide greater funding opportunities in ALL. In addition, the monitoring of the loan quality performance will necessarily require the prudential monitoring of the situation at individual banks, which may display a different performance from the average of the sector.

The performance of loan portfolio quality will continue to exert pressure on banks' profit. In this context, the prudential monitoring of banking activity capitalization rates is of great importance, despite its current sufficient levels.

I would like to note that this is another process that puts to test the capability of banks' managing structures in managing the situation carefully, with integrity and professionalism. Moreover, this process requires from banks' shareholders, who increased their investment and profit during the credit boom, to stand by banks in order to meet their eventual needs for capital or other forms of financing.

Allow me now to touch upon another issue, which I consider paramount and that relates to banks' transparency to customers. Despite the overall improvements in this regard I would like to focus on banking service-related issues.

The Bank of Albania has received frequent complaints from citizens, regular or casual users of banking services, in relation to the costs that banks apply for the services they provide. It comes out that in many cases citizens are left with no options as regards the obligations to the bank for the service provided to them, without first being notified of the reason and size of obligation. In other cases, the user of the service cannot find the necessary and convincing explanation from the bank about the "why" of the obligation and the way the latter is calculated. I cannot exclude here the cases when the problem stands in the limited financial understanding of the citizen himself; however it seems that the work of the banks' staff to ensure transparency to the customer is superficial and at times deficient. In a broader and technical concept, the method the costs are determined by banks for the services they provide remains unclear.

Based on a recent analysis made by the Bank of Albania on the level of various commissions applied by the banking sector, it results that the banks have not made any documented cost analysis for the services they provide to the customers and have not set up any methodologies for setting the respective commissions/fees. Moreover, there are not any standards of the form, composition and designation of the commissions for similar services in different banks, hence making it difficult for the customers to make any interbank comparison and raising the confusion among the public. In addition, the transactions between customers of different banks are penalized by the relatively high commissions, hence burdening the making of payments through banks and providing undesirable consequences for the performance of cash in economy.

Regarding the way the commissions are set, banks are guided by the competitive institutions in the market and there does not seem to be any active and visionary banking services development policies, supportive to the increase of the number of users that may easily become potential bank customers. It is not accidental that the income from banking service commissions accounts for only 5.5 percent of their total income. According to us, it shows that banks are not active in using all their potential for raising their income through competitive policies in this area. I avail myself of the opportunity to require your utmost commitment to address this issue aiming at making a thorough improvement in this regard. The Bank of Albania will examine the possibility to require through the regulatory framework the setting up and implementation

of documented methodologies for banking service commissions, as well as to encourage the establishment of a standard for the presentation/disclosure of commissions and the way they are monitored.

Dear commercial bank managing directors,

The Bank of Albania has constantly shown that it is a responsible and visionary institution. Withstanding the difficult situation was not merely casual. Our measures and actions of the last four years, pre- and post-crisis, were paramount. We are evaluating the measures and actions that will characterize the months to follow at the same level of responsibility. I refer, *inter alia*, to the so-called exit strategy, which refers to the gradual withdrawal of extraordinary political and regulatory measures established in order to withstand the effects of the crisis.

Noting that the liquidity situation in the banking system has improved and public confidence has restored, the Bank of Albania has started to implement the exit strategy.

More concretely, in the beginning of the present year, the Bank of Albania changed the form of its main refinancing instrument auction from fixed price to limited amount auction. It is with pleasure that I inform you that this change has been comprehended well by the market, given the stable interest rates in the interbank market. Similarly, the securities' market responded positively with the 12-month T-bill interest rates going down by about 1 percentage point in 2010.

As part of this strategy, the Bank of Albania has restored the relationships of bank investors with the profit on their investment in Albania to normal levels. Resetting the free movement of capital regime, besides being an obligation for Albania in the framework of the international conventions, provides a positive impact on Albania's perception as a reliable destination of investment and on pushing the entry of foreign direct investments into our financial system.

Moreover, along with the development of the banking system, the increase of the interbank market's role and the enhancement of our political and analytical institutional capacities, the Bank of Albania is planning to improve our system's refinancing operations. We are assessing the possibility of changing the operational objectives from quantitative to qualitative ones, expressed in the form of short-term interbank market interest rates.

In my speech I tried to touch upon the issues that the Bank of Albania considers that constitute our near and distant future objectives. However, I would like to highlight once again what I consider as constituting our major challenge for 2010. The economy needs to be financed in order to ensure a stable development. Financial intermediation is the purpose of banking activity. To this purpose, I once more draw your attention to be more active in this regard. The return of deposits has now provided room for the recovery of lending to the economy.

The motto of the banking system for 2010 will be: every added deposit in ALL should be converted into a new ALL-denominated loan to the economy.

In conclusion, taking advantage of this forum with the banking system, I would like to address to the Albanian public at large as well.

The last crisis that hit the world economy highlighted an important element of the philosophy that characterizes the day-to-day life of every nation. Regardless of the similar recipes applied by individual nations, what is noticeable was the appeal on public's national awareness and the patriotic response of the latter. I avail myself of this opportunity to make this appeal to the Albanian public, which with the rational behaviour shown so far, has shown that it is prudent and responsible.

What I would appeal once again is simple. We should have:

- more confidence in our currency;
- more confidence in our banking system;
- more confidence in our analysis and conclusions;
- more deposits mean more loans;
- more loans mean more prosperity.

After all, this is the real convergence with the European Union.

In conclusion, I would like to note that the year 2009 was a relatively hard one for the banking sector. Although the year 2010 is expected to be a better one, some banking activity-related issues such as loan quality, its recovery, the shareholders' commitment to providing more support to the banking activity and the strengthening of risk management structures require your utmost attention.

The Bank of Albania remains committed to acting in full compliance with the legal and regulatory framework requirements that establish the norms for the conduct of banking activity. Therefore, your co-operation and professionalism are particularly important to this process.

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

At the High Level Regional Policy Dialogue “Strengthening Domestic Anchors to Assist with Crisis Exit Strategies”
Washington D.C., April 23, 2010

Dear participants,

It is a great pleasure to come back to Washington and continue our dialogue. Previous meetings confirmed and clarified the value of building up stronger domestic fiscal anchors. In my discussion I hope to show the extent to which domestic and foreign anchors are related, and that capacity building needs to be considered for foreign anchors too. It is even more interesting that the issues discussed today are at the very heart of the problem, not only in economies of the region but also for the entire world economy. I believe that this is the best way to serve the anchoring policies.

The points we discuss today are not different from what Blanchard and co-authors (2010) talk about recently in the perspective of developed economies. Capacity building in the area of policy coordination is becoming increasingly important because fiscal policy implications are imposing serious threats on other policies, especially on monetary policy.

One of the lessons we have learned is that in any case fiscal policy does matter. Not only in the context of problem making but also in the context of problem solving. Recent developments did in fact show that under certain circumstances, monetary policy might have limited room for maneuvers; therefore fiscal policy must take over. Yet when this taking over happens, the situation can get very unstable as the budget and debt are getting larger.

Differently from the monetary policy – which puts in place correction mechanism to eliminate collateral damage to final objective – fiscal policy leaves the economy with considerable debt at the end of the crisis. Therefore the most imperative macro task today is to put the fiscal sector back in order.

WHAT ANCHORS CAN BE USED IN THIS RESPECT? A FISCAL RULE MIGHT BE A SOLUTION.

A fiscal rule which ensures a long rung macro fiscal stability, is definitively a good domestic anchor. A fiscal rule does not imply a simple quantitative restriction. It is a dynamic and complex issue. It incorporates all other economic and social policies. It is developed and implemented in full compliance with objectives of other major economic and social policies of a given country.

This is to make sure that it fits with EU compliance under the stability and growth pact or any other political arrangements according to specific countries circumstances.

I would like to discuss the EU compliance and several related issues later as part of the discussion of external anchors, and rather focus here on another important issue: that of independent fiscal agencies, like a fiscal council. This discussion logically follows the arguments on the fiscal rule.

The core issue of the rule is to decide, to agree or to build a consensus on what is considered sustainable in the long run. The general proposal here in the form of policy coordination capacity building is to establish an independent agency that will, in fact, play the role of the referee between the fiscal agent and the other involved parties that share interests into or with fiscal policy.

Now before answering the question of whether we need these agencies let's explore the following issue:

To announce a new agency is like admitting a problem. What sort of problem? Was this a problem of behavior of the political system or a problem of institution and capacity building?

There is no easy answer to this question. It bears important implications for the nature of the therapy. Assuming that this is a problem of political behavior, establishing a new institution from the same political (democratic) system will not likely be a solution.

This is because the new institution will exhibit the same political behavior problem as the existing constitutional bodies. It is hard to believe that such institution can solve the adverse selection and moral hazard problems in fiscal policy. We all know that fiscal problems do not rest within specific institutions. Those are always product of the domestic political system.

Under such circumstances, new state agency will have the capacity to diminish the independence of the central bank. Therefore, if the solution to such behavioral problems is a new constitutional "independent" agency then the solution has the potential to become worse than the problem itself.

It is worth mentioning the latest right wing victory in Hungary. If a clear majority will be confirmed what is going to happen with the Fiscal Council and its Policy? There is under big potential threats. The chair of the Council might be removed, their financial status might change or their salaries might be affected, and so on. It is not possible to equip the Council with the same central bank style of independence – like financial independence, objective independence and tradition.

NEED FOR CAPACITY BUILDING

If the problem rests with institutions than there is need for capacity building, and probably institution building.

Our experience evidences two important shortcomings regarding fiscal rule, which indicate direction for reform and capacity building. This applies

in the field of setting fiscal goals. The evidence points not only to technical inadequacies e.g. revenue elasticity, but also to a certain lack of prudence and realism in assessing risks and trade-offs. The rule is a ratio which measures the government behavior relative to GDP. Hence if one doesn't have a good, reliable and timely GDP figure it is almost impossible to have a useful fiscal rule. As it can be seen, the fiscal rule requires a tremendous push in policy and capacity building in statistics. Without a satisfactory level of transparency, integrity and devotion, the rule becomes a meaningless mathematical exercise.

TAKE THE CASE OF GREECE: WHAT COULD BE A BETTER EXAMPLE TO ILLUSTRATE THIS POINT?

Another key element has to do with the need for coordination amongst main policy decision makers. At this point I recall one of my answers to journalists: Isolation is loneliness.

This brings me to another issue: Independence versus isolation. The way Bank of Albania has approached the anchor issue, in particular after the IMF agreement ended, is "be independent but do not isolate yourself". We have invited the Minister of Finance along with his staff to participate in joint meetings where we share and discuss our views on economic developments and the arguments behind them. In fact these meetings have been a learning process for both sides, and I can firmly state that this was definitively capacity building in the policy coordination area.

Among others, another lesson we understood is that sometimes differences emerge not from policy objectives but predominantly from different opinions on current and expected economic developments – statistics that in fact must have been readily available for policy analysis. It is hard to discuss the issue of capacity building and domestic anchors separately since they are so interrelated with each other. In my opinion I believe that the best domestic anchor is a technician who is an independent thinker, proud of what he does, and who understands the consequences of his actions and results.

THE REAL QUESTION IS HOW TO BUILD SUCH AN ANCHOR?

First is to educate, then to make him independent politically and financially, and then to educate further in those areas where his actions and results play an important role with immediate implications. On the other hand, capacity building is not a persons' issue; it is an institutions' issue; it is in fact a process invariant from the human being.

That is because capacities must be build in "processes" and not in people in order to be long lasting. From this point of view, every one can realize that institutions are part of the government payroll even under political influence. In fact much is said in regard to central bank independence but not much is said in regard to other independent agencies, for example statistical office.

Good anchors are not supposed to be used only by institutions which relate their policy to the anchor. They must become a strong argument at the hand of the public to pressure government agencies to design and implement sustainable policies. This brings me to the point that the public itself must be able to understand and use the anchor. Thus there is need for capacity building in our societies beyond institutions.

Let me illustrate the point with a funny but sad story from my own experience. After one public speech on TV a friend of mine called me to congratulate. He told me every single word was properly placed. Even my wife, who is a medical doctor, did understand everything – he told me. However, at the end she asked him to explain what GDP means? His answer was: Mathematics was never one of my strongest skills.

CAPACITY BUILDING AND THE ROLE OF FOREIGN ANCHORS

In the developed Europe there are natural poles where researchers converge naturally to discuss such issues from the critical point of view. Forums like policy think tanks or universities whose respected opinions play an important role in public perception in the context of credibility of public institutions.

The real question is why such institutions are not as strong in our economies as they are in EU?

In this regard I strongly believe that European values can play a decisive role, by strengthening and supporting the establishment of reputable institutions where the critique can develop independently of political process and political objectives.

From a general prospective the support of EU policies have targeted political process and consolidation of government institutions. In the meantime our societies are evolving fast in several other important ways and dimensions, which so far are not part of European convergence initiatives. Just to give few examples, I would like to mention the fast extension of universities, academic programs and academic institutions.

These examples are in fact the natural poles that are supposed to establish, shape and strengthen domestic anchors, as discussed above. Neglecting the process of capacity building is the same as to neglect the creation of important domestic anchors.

In other words, all those institutions which are capable to bring together groups of individuals and philosophies which regardless of their professions, ideas, interests, political and social affiliation, will be able to stage the critique for unsustainable fiscal policies.

With regard to other issues like Economic Fiscal Program (EFP) and Precessions Economic Program (PEP), I have expressed my views in the significant contribution of both programs. However I believe that EU can play

a bigger role as a foreign anchor. EU guideline refers to the budget or debt situation at any point in time. Therefore if it is a conditional criteria current policies under normal circumstances must leave room for emergency fiscal intervention that does not break the limit. The recent crises show that EFP and PEPs are somehow rigid and might not perform well under stressed economic conditions. Some of the key goals would be to develop more reliable baseline and risk scenarios for the economy and public finances; and create adequate fiscal space to deal with adverse shocks. Therefore it will be advisory that EU requires that all aspiring countries of the region have functional IMF agreement during the entire road to EU accession.

This is not only to check but also to guarantee immediate intervention in case of crisis; and better integrating structural reforms including adoption of the *acquis communautaire*. It will be too optimistic to expect that aspiring economies of the region can resist as long as Greece while EU considers the options. After all under current legal arrangements EU does not have or assume any responsibility for the solution of potential crisis in our countries. In this respect, EU alone is hard pressed as a foreign policy anchor and surveillance institution along with the other political, legal and intuitional role.

While this more or less summarizes in general my opinion (expressed last year), I would like to add few notes on this discussion. The most important aspect of these two arrangements is that they are unique for all countries and therefore do not account for country specific needs or situations.

The fiscal rules that we are discussing today might and need to be different for different countries, tailored to country specific needs, based on individual economic needs and priorities in structural reforms.

In fact, all such specific needs, have received detailed attention under IMF programs. Structural benchmarks of these programs have played a similar role as fiscal rules, however they have been different across countries and across periods. In this respect they have allowed for temporary adjustments without compromising long run sustainability of macro fiscal balances. Our countries have also gained substantial experience in the negotiation and execution of such agreements. In the absence of these agreements or arrangements, the countries can not make use of this accumulated experience, simply because the counterpart in the new arrangement does not follow the same setup as the IMF.

Therefore it might be a responsible and wise choice for all aspiring countries including new members, during the EU integration process until full economic convergence is achieved, that the macro fiscal framework should be designed, and implemented under a three party agreement, respectively the Country, European Commission and IMF.

I believe this will be beneficiary on both sides: EU and the country. They both will gain the experience of the IMF in the area of policy harmonization, capacity building and implementation of economic policies.

Although now most countries in the region qualify for “emerging market economies”, we need to keep in mind that, economically wise the threshold between transition and emerging market is very thin. Advancement to “emerging market economies” carries greater responsibilities and more vulnerability. Getting out of transition does not mean the end of economic troubles, nor does it automatically provide confidence in the markets.

As such, I believe that these countries are not yet capable of pursuing aggressive economic and financial policies entirely on their own without relying on international expertise. Such expertise would provide additional guarantee for markets. That will bring greater confidence, higher FDIs, a faster convergence, and of course sustainable economic growth.

Dear participants, this initiative proved to be useful and I take this opportunity to thank Centre for Excellence in Finance for their contribution. I am confident that Centre for Excellence in Finance has helped a lot to flag and prioritize capacity building efforts in the region. Several methods or approaches to capacity building need to be explored in the future; and I see CEF as an active leading agency. At the end I would like to conclude by considering the experience sharing, more diagnostic workshops, focused technical assistance, learning networks and the enhancement of human resource skills as complements not as alternatives.

Thank you for your attention.

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

At the Press Conference on the Monetary Policy Decision-Making of the Supervisory Council of the Bank of Albania
April 28, 2010

At its meeting of 28 April 2010, the Supervisory Council of the Bank of Albania analysed and approved the Monetary Policy Report of the first quarter of 2010. In the light of the latest economic and financial developments, the future outlook and the expected risk balances, at the end of discussions, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 5.25%.

The world economy continued to show signs of improvement during the first quarter of this year. The economic activity, trade activities and capital flows are upward. Low capacity utilisation has generated inflationary pressures at low levels, but with a clear upward trend due to the recovery in demand. Central banks continue to pursue an easing monetary policy, while the first movements of the withdrawal from unconventional policies undertaken at the onset of and during the global recession have been made.

Financial markets have been characterised by declining interest rates, low risk levels and increased trade. However, the expectations for low lending levels during 2010, in terms of withdrawal of monetary and fiscal stimulus in most of the countries and the high levels of unemployment, will condition the performance of global aggregate demand.

Statistical information, which provides figures on the Albanian economy performance, was partial. However, the analysis of fiscal and monetary developments, inflation and external sector's performance and the quality of information obtained from the Bank of Albania through its surveys, provide an overview of economic developments. According to INSTAT, the Albanian economy recorded a positive growth of 3.3% in 2009. After the positive growth rates recorded during the first nine months, the economic activity contracted in the last quarter of 2009. Based on preliminary data, gross domestic product fell by 0.8% in annual terms during this quarter. This performance is determined by the shrinkage of private and public investments, and the significant slowdown of private consumption. Low growing rates of wages and employment, the greater tendency of consumers to save, triggered a slower pace of consumption in the last quarter of the past year. Private investments contracted during this quarter, against the backdrop of slower domestic and external demand and low capacity utilisation rate. Also, the reduction of fiscal stimulus during the last months of 2009 was reflected in a lower contribution of public investments to economic growth during the last quarter. As shown by the performance of fiscal and monetary indicators and by consumer and business expectations, the domestic economy performance is assessed as slow even during the first months of this year.

Average annual inflation pointed to 4.1% in the first quarter of 2010, slightly above the upper tolerance band of the Bank of Albania's inflation target. During this quarter, the rise in administered energy price has contributed by 0.5 percentage points to the formation of annual inflation, thus determining the exceeding of this limit. Meanwhile, inflation marked 3.9% in March, returning to within the Bank of Albania's targeted band. The upsurge of inflation during the first months of the year is considerably conditioned by the supply-side factors. Besides electricity price rise, the limited supply of domestic agricultural output and the upward trend of raw material prices in the world market, in the presence of the national currency's depreciation effect, have exerted upward pressures on inflation. However, it is considered that these factors influence inflation temporarily. The performance of core and non-traded inflation rates, which are close to their long-term historical average, attest to low demand-induced inflationary pressures. Over the medium run, the slower domestic demand and below-potential economic growth are expected to impede the creation of any sustainable inflationary pressures, thus balancing the direct effect of supply-side factors.

Developments in the external sector of the economy during the first two months of this year are characterised by a narrowing trade deficit at home. Trade deficit has narrowed by about 20% in annual terms, reflecting an annual increase in exports and an annual decline in imports, respectively by 31% and 7%. This positive performance has also led to establishing more balanced ratios of demand and supply of foreign currency, resulting in steadier exchange rate levels. Although trade deficit correction over this period is an encouraging development, its long-term sustainability requires ongoing structural reforms in the economy. In particular, the growth of savings in the economy should be encouraged through deepening and implementation of the pension system reform. It will support the long-term sustainability of this system and will create appropriate conditions for increasing domestic financial funds, thus serving the correction of the current account deficit at home.

During the first months of 2010, the fiscal policy pursued the refraining trend of fiscal expansion that appeared in the last quarter of 2009. Budget expenditures increased at a restrained pace of around 4% in annual terms. On the other hand, the demand slowdown continues to dictate low growth paces of budget revenues. The pursuit of a prudent fiscal policy, notwithstanding with a lower contribution to the economic growth of this year, will help the consolidation of fiscal indicators at sound levels, thus better serving the economic growth sustainability and the maintaining of macroeconomic balances in the long run.

The first two months of year featured an ongoing positive performance of monetary indicators. Money supply grew on an average by 8.3% in annual terms, supported mainly by the increase of foreign currency-denominated deposits. The low intermediation of banking system has created little room for the growth of broad money in the economy. Lending to economy, though increased at higher rates in the last quarter of 2009, remains at low record levels in the recent years.

Annual growth of credit to the private sector, excluding exchange rate effect, resulted 5.4% in February. Credit to businesses reflected a better performance in the first months of this year, as a result of the improved foreign currency liquidity and easing credit terms and conditions. On the other hand, households' credit continues to shrink at similar rates to those of last year-end. Despite these developments, credit demand remains low, due to slower economic activity in the country and more prudent stance of economic agents in terms of borrowing.

The Bank of Albania has pursued a prudent monetary policy, in view of meeting our inflation target and the needs of the economy for liquidity. Bank of Albania has been present in the interbank market, providing the necessary liquidity for a normal development of the financial markets. The latter have been characterised by lower risk premium, higher transactions volume and falling interest rates.

Upon the improvement of the banking system's liquidity position and normalisation of the risk premium, in January of this year, the Bank of Albania decided to re-apply standardised repurchase agreement auctions: weekly injecting operations at a competitive interest rate. Performing these auctions at a fixed interest rate and unlimited amount from November 2008 to December 2009 was one of the measures taken by the Bank of Albania against the tightened liquidity position and rising risk premium and increased uncertainty during that period. Returning to standardised auctions of the main instrument of the Bank of Albania marks the beginning of the withdrawal of these measures in response to the normalized situation in financial markets at home.

The Supervisory Council of the Bank of Albania concluded that inflationary pressures on economy are expected to be balanced in the medium term.

Assessments for a slowdown of domestic demand and the widening of the negative output gap are expected to balance the short-term inflationary pressures from the supply-side. At the same time, inflationary expectations are well-anchored close to the Bank of Albania's target.

At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged at 5.25%. This decision serves to meeting the inflation target in the medium run. The Bank of Albania remains willing to operate in line with the current and expected performance of economic indicators. In particular, its decisions will continue to be oriented towards maintaining price stability and further consolidation of macroeconomic balances.

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

At the Presentation of the Bank of Albania's Annual Report 2009 to the
Albanian Parliament
April 29, 2010

*Honourable Madam Speaker of the Parliament,
Dear deputies,*

It is a privilege to present to you today the Bank of Albania's Annual Report for 2009. This Report, the key conclusions of which will be briefly reviewed in my speech today, makes a thorough and transparent analysis of economic and financial developments in Albania, and provides an overview of the Bank of Albania's work to meet its legal obligations and institutional commitments.

The year 2009 was a challenging year for the Albanian economy in all its dimensions. In response to the global economic and financial crisis, the following were put to the test during this year:

- The country's macroeconomic balances;
- Our financial system's stability;
- The business models and the private sector's financial sustainability; and
- The analytical and responsive capacities of macroeconomic policies.

In a broader setting, the shock that hit the Albanian economy in 2009 put the flexibility of Albania's economic development model and its capacity to respond to a thoroughly transformed global environment to test.

The global crisis provided a quick impact on economic activity at home. It was soon followed by the reduction of current and capital account foreign inflows, an abrupt fall of foreign demand and slowdown of domestic demand for goods and services. In response to these developments, the economic growth rate marked a progressive slowdown during the last year, but still remained positive. Albania's balance of payments was characterized by imbalances in foreign currency inflows and outflows. The imbalances were reflected in the swinging of demand and supply ratios of foreign currency, yielding the depreciation of the exchange rate in response to new balances that dominated the foreign exchange market. Fiscal policy became more expansionary in 2009, supporting economic activity in the country but also increasing the pressures on the financial markets.

The shock that hit the financial system gave rise to the establishment of a challenging environment for the monetary policy to be transmitted completely and timely. Against this challenging background, the Bank of Albania accomplished its legal mandate to maintain price stability in economy successfully: CPI annual inflation remained within our 3 +/- 1 percent target in 2009.

The Bank of Albania's easing monetary policy established the proper monetary conditions required to maintain price stability. In addition, the supply of the economy with the necessary liquidity and at a declining cost stabilized the financial markets and created the proper conditions for the support of economic activity during 2009.

The performance of the Albanian financial system was affected by the wavering of confidence in our financial system during the first half of the year and the withdrawal of a portion of deposits. This performance, coupled with another group of factors, yielded less support, and at higher cost, to the Albanian economy with banking loans.

Among the factors worth noting are:

- Higher economic agents' uncertainty and liquidity premiums;
- The correction of the business model in particular financial market segments;
- Increased exchange rate volatility; and
- Contracted demand for loans in the second half of 2009.

The wavering of public confidence underscored the prime importance of financial stability in Albania's economic life. Within its area of responsibility, the Bank of Albania undertook a number of comprehensive and co-ordinated measures, which aimed at maintaining financial stability at a systemic and institutional level.

These measures, *inter alia*, consisted in:

- Reviewing the regulatory base in terms of increasing the supervisory prudence;
- Strengthening on-site supervision;
- Increasing the analysis of banks' balance sheets at an individual and systemic level; and
- Enhancing the co-operation with the national and foreign counterpart institutions.

Our endeavours to preserve financial stability were also coordinated with other public, executive and legislative authorities. Worth noting is the improvement of the public deposit insurance scheme and the increase of the deposit insurance level by the Deposit Insurance Agency. These measures proved successful in curtailing the negative consequences and in fully restoring confidence in the banking system.

Subsequently, the Albanian banking system maintained sound balance sheets and was in full capacity to carry out its function as a financial intermediary and supplier of the economy with payment instruments. The developments of the first quarter of 2010 attest to the full restoring of public confidence in the banking system. Currently, the level of deposits has exceeded that of end September 2008, prior to the beginning of the withdrawal of deposits.

In what follows, I would like to dwell on the aforementioned topics.

1. MONETARY POLICY AND PRICE STABILITY

In accordance with its legal mandate, the Bank of Albania's monetary policy has been designed and implemented in order to achieve and maintain price stability. During 2009, the main risks to price stability have arisen from the slowdown of economic activity, wavering of economic agents' confidence, imbalanced external position of the Albanian economy and the exchange rate depreciation. Despite these challenges, the Bank of Albania managed to keep the CPI inflation within the target. Let us dwell on these elements further.

1.1 ECONOMIC GROWTH

The global context that accompanied Albania's economic and financial performance over the past year was not at all favourable. The year 2009 featured contracted global economic activity as a result of the economic downturn in advanced economies and considerable economic slowdown in emerging countries. Global economy posted the first negative growth rate of the last 50 years.

The increasing integration of the Albanian economy and the financial system in particular caused the global crisis to be reflected early in our country. The main channels the Albanian economy was exposed to were:

- Decline of exports;
- Decline of remittances and other foreign currency inflows;
- Increased uncertainty in the financial institutions; and, in response to the latter,
- Review of almost all economic agents' business plans.

This impact was reflected in low growth rates and shaking of some macroeconomic balances in 2009. According to the Statistics Institute, GDP grew 3.1 percent in annual terms in 2009. The slowdown of GDP growth reflected the contraction of activity in industry and construction, while the services sector's value added remained the key contributor to economic growth.

Given the difficult circumstances in which economic activity took place and compared with other regional countries' experiences, the preservation of the economic growth rate at positive levels is an encouraging development. However, its slowdown and the new macroeconomic balances need due attention by all economic agents in their projections for the future. Albania's economic development outlook also requires greater support from the private sector, while the contribution of the public sector to economic growth is expected to decline. The data on aggregate demand show that the contraction of private consumption and the fall in investment were determining factors in the slower growth of demand at home.

Net exports continued to provide a negative contribution to aggregate demand in 2009, however at more moderate rates than in 2008. In addition to easing monetary conditions, the fiscal stimulus supported the economy in generating positive growth rates during 2009.

Private consumption is the key component of aggregate demand accounting for about 80 percent of GDP. The slow growth rate in wages, the decline of remittances and the contraction of consumer loans contributed to the slowdown of consumption in 2009.

Private investments are assessed to have been affected more by the global financial and economic crisis than the other components of aggregate demand. The contracted domestic and foreign demand and the tight lending conditions triggered the contraction of private investment in 2009.

1.2 FISCAL POLICY AND FISCAL INDICATORS

The slowdown of the Albanian economy affected the performance of fiscal policy and fiscal indicators. Fiscal policy was expansionary being reflected in the deepening of budget deficit. Budget deficit for 2009 is estimated at 7.1 percent of GDP. The main sources of deficit financing were privatization receipts and syndicated loan, which reduced the need to borrow in the domestic market.

Budget revenues posted an annual increase of 2.7 percent, largely due to the slow increase in tax revenue. On the other hand, public spending grew by about 8 percent, led by the high rate of current expenditure. The expansionary fiscal policy provided the economic activity with the necessary impulse over the course of the year; however, it was also accompanied by higher public debt and upward pressures on Government T-bill yields.

The deepening of budget deficit resulted in substantial public debt increase, which as at year-end 2009 accounted for about 59.5 percent of GDP.

The Bank of Albania encourages measures to reduce the budget deficit and public debt in the medium run. Lower budget deficit and public debt levels will provide more room in accessing funds from the private sector and boost confidence in Albania's macroeconomic stability. In addition, these measures will help create appropriate conditions for attracting foreign capital in the form of private loans or foreign direct investment.

1.3 MONETARY DEVELOPMENTS AND FINANCIAL MARKETS

Financial intermediation in economy was conditioned by the contraction of financial resources, wavering of confidence in financial institutions and the decline of demand for banking loans in 2009. At the end of March, deposits fell to 55 percent of GDP compared to 63 percent in September 2008. The withdrawal of deposits during the first quarter of the year brought about the slowdown of money growth in economy.

Banking activity recovered slowly during the following three quarters. Money supply grew by an average of 6 percent this year or about twice less than the previous year. The growth of money supply mainly attributes to the growth of its ALL component, while foreign currency loans and deposits contracted in 2009. The creation of money in ALL has been based on the fiscal sector's domestic borrowing and the preservation of the private sector's ALL credit rates.

In addition to the higher banks' sensitivity to their liquidity indicators, private sector credit activity was carried out under the conditions of a more conservative behaviour of banks' lending in 2009. This conservative behaviour owes also to an increased caution of banks to certain banking products, such as:

- foreign currency loans to certain segments of the economy exposed to exchange rate fluctuations, and
- consumer loans.

In the second half of the year, demand for loans declined as a result of the tight lending standards and the slowdown of economic activity. Despite the easy monetary policy of the Bank of Albania, private sector credit maintained a uniform slowdown trend during 2009.

As at year-end 2009, credit annual growth rate marked 12 percent versus 33 percent in 2008. The growth of credit has been triggered by the business demand to finance the liquidity needs, while the households' loan portfolio contracted over the same year.

1.4 BALANCE OF PAYMENTS AND THE EXCHANGE RATE

In the presence of slow domestic demand and reflecting the difficult situation of the global economy, current account deficit narrowed by about 3 percent in 2009, standing at 15.3 percent of GDP.

Despite the slight correction during the year, current account deficit remains high and one of the weaknesses of the Albanian economy. The Bank of Albania considers that the prioritized handling of the current account deficit requires the formulation of policies supportive to the long-term growth of savings in Albania, as well as measures to encourage production in those branches or industries that result competitive in the international markets.

Trade balance narrowing was affected by the concurrent annual decline of exports and imports by 18 and 9 percent, respectively. The difficult situation in our neighbouring countries has been also reflected in the decline of remittances, which contracted 6.5 percent in annual terms, while their share to GDP was 9 percent. Capital and financial account surplus reduced substantially over the course of 2009, dropping by 35.6 percent compared to 2008. This performance owes to a large extent to the low increase in foreign direct investment and the reduction of private foreign borrowing.

Unlike the previous two years when capital and financial account covered over 100 percent of the current deficit, in 2009 it financed only 77 percent. Total foreign inflows, albeit downward, were almost sufficient to cover this deficit in 2009. The country's foreign reserve remained at similar levels as in 2008, sufficient to cover 4.2 months of imports of goods and services.

The contraction of foreign inflows exerted depreciating pressure on the exchange rate, particularly in the first half of 2009. In the domestic foreign exchange market, average annual depreciation of ALL against the EUR and the USD was 7.6 and 13.2 percent, respectively.

1.5 INFLATION AND MONETARY POLICY

1.5.1 CPI Inflation

Consumer prices rose 2.2 percent on average in 2009, which is in line with the Bank of Albania's target for inflation. As a result of the reduced inflationary pressures worldwide, annual inflation marked low rates – 1.8 percent on average – during the first quarter of 2009. In the following two quarters, inflation rates stabilized close to the lower limit of the Bank of Albania's target, 2.0 percent. Annual inflation displayed an upward tendency in the last quarter, when it marked 2.9 percent in average terms and converging to the inflation target. The highest inflation rate of 3.5 percent was marked in December. The increase of inflation in the last part of the year was mainly triggered by the more complete exchange rate depreciation pass-through to consumer prices, in the presence of upward primary commodity prices in the global markets.

The slowdown of economic activity at home and the low inflationary pressures from the global economy yielded an environment of relatively low inflationary pressures. Core and non-traded inflation marked average rates of 1.3 and 1.6 percent, respectively, in 2009 attesting to the low inflationary pressures of the domestic economy. These factors offset the depreciation effect of the national currency, which led to higher prices of imported goods and a part of products that are still indexed to the exchange rate. Traded goods' inflation – a portion of which are imported and the rest are directly affected by global prices – increased substantially compared to the previous two years. Its contribution to headline inflation was about 73 percent in 2009.

1.5.2 Bank of Albania's Monetary Policy

The weakening of economic activity and domestic inflationary pressures, our forecast for a contained inflation in the future and the anchored expectations of economic agents provided room for pursuing an easing monetary policy in 2009. This policy was materialized in two interest rate cuts by 0.5 percentage points each in January and October 2009 to 5.25 percent, and in the continuous injection of liquidity required by the market and the economy. By means of this prudent monetary policy, the Bank of Albania aimed at creating appropriate monetary conditions for a balanced and long-term development of the country.

The key interest rate cuts were instantly passed through to the short-term interest rates in the interbank market, which declined and were less volatile than in 2008. On the other hand, these movements were not fully and instantly transmitted to the interest rates on banking loans and deposits. As in all other countries, the increase of the liquidity premium, the higher uncertainty and the deterioration of the banking system's profit were amortizing factors for the easy monetary authorities' measures. However, our monetary policy and our interbank market operations managed to successfully avoid a detrimental contraction of banks' balance sheets, something that many developing countries had to go through.

The 1.00 percentage point cut in 2009 relaxed the financial burden of the banking system's intermediation activity. The Bank of Albania has consistently supported the banking system with the required liquidity. In addition to cutting the key interest rate, the Bank of Albania has helped Albania's banking system activity through:

- the change of the refinancing auction form from fixed-amount auction to unlimited-amount auction;
- up to 3-month extension of the maturity term of injected liquidity;
- the expansion of the range of collateral in our refinancing operations;
- the increase in the use of required reserve; and the reduction of the overnight loan interest rate.

We have employed almost all of our range of instruments for implementing monetary policy. The amount of liquidity injected by the Bank of Albania peaked in summer with ALL 40 billion. As a result of the deposits entering the banking system, this amount reduced gradually to about ALL 28 billion at the end of 2009.

2. BANKING SUPERVISION AND FINANCIAL STABILITY

The banking system performance was significantly conditioned by the economic slowdown and wavering of confidence, aspects that were elaborated at length in my speech. Consequently, there was higher uncertainty, higher bank sensitivity to liquidity, a more cautious lending behaviour, and an increase in non-performing loans. These are the main highlights of the banking system performance during 2009.

Despite the downward profitability, capitalization indicators remain at satisfactory levels. The banking system remains sound, a fact that also attributes to the effective carrying out of the regulatory and supervisory function of the Bank of Albania. In what follows I would like to elaborate more on these aspects.

2.1 BANKING SYSTEM PERFORMANCE

The Albanian banking system's total assets increased in 2009, but at a rate about twice lower than in 2008. This decrease reflects fully the lower

expansion of lending. Our banking system continues to be mainly financed by public deposits and be concentrated on business lending.

The banking system's deposits and loans grew at a lower rate than in the previous years. Loans to total deposits increased by nearly 3 percentage points, from 62 to 65 percent. On the other hand, the increase of deposits as a result of the restored public confidence has improved the liquidity situation in the banking system.

Non-performing loans increased in 2009 owing to the economic slowdown and the exchange rate depreciation. Loan portfolio quality index expressed as "non-performing loans to total outstanding loans" rose to 10.48 percent as at end 2009 from 6.64 percent at the end of 2008. On net basis, that is by deducting total provision fund, the same figure is only 6.3 percent.

The Bank of Albania has monitored the situation closely being aware of the pro-cyclical effects that these developments may have on the loan portfolio. Despite the loan portfolio deterioration, capital adequacy and quality to carry out the banking operations, to extend and expand lending, have remained almost intact. Although the loan portfolio growth is below the previous years' levels, it is satisfactory and at higher levels than in the region.

Based on the periodical stress-tests, the Bank of Albania has identified all banks' needs for capital, thereby enabling a rapid increase of the capital when necessary. Banks' responses were instantaneous bringing in new capital.

Total regulatory capital of the banking system increased 37.7 percent, being dominated by the core capital providing evidence for a qualitatively good and sustainable regulatory capital. The banking system's capitalization level was significantly above the regulatory minimum required by our regulations and international practices.

Efficiency indicator shows almost the same level as at year-end 2008, attesting to a prudential and stable growth of banking activity in general. On the other hand, shareholder's equity is estimated to have increased 18.7 percent in 2009 versus 2008. Financial leverage reduced gradually during 2009. The decline of the financial leverage from 11.7 to 10.4 percent over a year implies that the system has relied less on debt to finance assets. Compared with the European Union countries, the Albanian banking system's financial leverage remains low attesting to a low degree of the system's borrowing practice. This indicator provides further evidence for the sound situation of the banking system.

The network expansion of banking branches and agencies in the territory of Albania persisted in 2009 but at lower rates compared to the previous years. As at year-end 2009, the total number of branches and agencies amounted to 530 from 517 at the year-end 2008. 17 new bank branches were opened while 4 existing branches were closed.

2.2 BANKING SYSTEM SUPERVISION

The medium-term strategy for banking supervision was approved in 2009. The main pillar of this strategy is the adoption of a new philosophy: risk-oriented supervision.

The main highlights of this new supervisory policy are:

- further interaction and harmonization among monetary policy, financial stability and supervision;
- harmonization of our supervisory framework with the acquis communautaire;
- interaction between the domestic and foreign supervisory authorities and the Financial Supervisory Authority;
- harmonization with the third pillar of Basel II, encouraging the process of self-regulation and consumer protection.

The Bank of Albania has been constantly engaged in a process of deep analysis and supervision of the legal and regulatory framework compliance and enforcement from the licensed entities. This process has been achieved through on-site inspections, which in 2009 were more frequent and rigorous. Besides the observance of the supervisory cycle, banks were constantly contacted for phenomena that have represented a concern during the year, taking appropriate measures to address potential problems in due time. Overall, the banking system has acted with caution in conducting the operational processes of their activities and in compliance with the regulatory framework of the Bank of Albania.

2.3 STRENGTHENING THE REGULATORY AND SUPERVISORY FRAMEWORK

The design of strong and appropriate rules and their rigorous monitoring constitutes a guarantee for the preservation of financial stability.

The Bank of Albania has been active in improving the regulatory framework, consolidating it further in compliance with the legal provisions and the Basel Committee principles, the European Council directives and the best practices in the area of regulation and supervision of financial institutions licensed by the Bank of Albania.

The main objective was the harmonization of the best practices in:

- strengthening internal control;
- improving banking institutions' governance;
- strengthening the risk management capacities; and
- increasing the level of banks' transparency to the public.

With respect to the latter, the Bank of Albania has required higher and improved communication of the banking system with the public about the products and

services being provided, the promotional campaigns for new products and the provision of information on their real financial situation and risk profile.

3. OTHER BANK OF ALBANIA ACTIVITIES

After the analysis of the two key functions of the Bank of Albania, I would like to elaborate on some other aspects of the central bank's work.

3.1 PAYMENTS' SYSTEM

The payments' system reflected security and efficiency in 2009. On average, 225 transactions a day were processed and settled in the AIPS system, with an average daily value of ALL 19 billion. Total liquidities settled in the AIPS system during 2009 is about 4.3 times higher than the GDP.

3.2 EUROPEAN INTEGRATION

The Bank of Albania plays a key role in the European integration process. The Bank of Albania has been active in revising the National Plan for the Implementation of the SAA for the period 2009-2014.

The Bank of Albania has prepared monthly progress reports that reflect the achievements in terms of the accomplishment of the legal measures and implementing activities, and a description of the level of compliance of judicial acts approved by the Bank of Albania with the *acquis communautaire*.

3.3 COMMUNICATION AND TRANSPARENCY

Public communication was one of the major priorities of the Bank of Albania in 2009. We have aimed at transmitting the Bank of Albania's decision-making to the financial market, other decision-making institutions, media, other economic agents and the public at large, timely and efficiently.

The Bank of Albania's communication has been materialized through added transparency in:

- our analyses of economic and financial developments at home,
- the risk balance and potential implications for the economy,
- the entire regulatory and supervisory activity of the banking system.

With the belief that higher transparency is translated into higher integrity and independence, the Bank of Albania has been paying an increasing attention to public education as well.

The Bank of Albania acknowledges and appreciates the importance of having a well-informed and well-educated public in the transmission of monetary policy to the economy, by taking timely, right and rational decisions.

In this context, our activities in the area of public's financial education intensified further in 2009 through the expansion of age groups and greater geographical coverage.

In figures, for the period 2008-2009:

- were distributed a total of 21 000 educational leaflets;
- were held training seminars for around 170 teachers teaching Economics in Tirana, Vlorë, Korçë, Shkodër, Gjirokastra and Elbasan;
- were held 20 meetings with different stakeholders in Tirana, Vlorë, Korçë, Gjirokastra and Shkodër;
- the competition "The Real Value of Money" was organized in Tirana, Vlorë, Shkodër, Korçë and Gjirokastra, with a total of 100 high schools taking part;
- were held seminars for 60 social workers in Tirana;
- were held full cycles of training seminars and lectures for the journalists;
- the Governor held 7 lectures for students in Albania and abroad;
- Bank of Albania Day was organized in four universities.

Lastly, the redesign of the Bank of Albania website in the beginning of 2009 provides a more efficient portal for the provision of information, making it efficient, re-arranged and user-friendly.

3.4 MONETARY AND FINANCIAL STATISTICS

The Bank of Albania plays a key role in the national statistical system, as an institution responsible for the production and dissemination of monetary statistics and external sector statistics.

In 2009, the Bank of Albania continued to develop and disseminate monetary statistics and external sector statistics, aiming at:

- the further approximation of the methodology with the recommendations and best international practices,
- enhancing the quality of data through the improvement and automation of control processes, and
- increasing the number of released indicators and detailing aggregate indicators.

3.5 STRENGTHENING THE RESEARCH CAPACITIES

Based on the tradition of the best international models, the Bank of Albania has been ever-increasingly paying special attention to enhancing the research capacities in the field of economics and finance.

Our guiding philosophy has been the improvement of the Bank of Albania decision-making, basing it on scientific conclusions and empirical results. The study of different economic phenomena is now based on complete or partial econometric models that allow the drawing of conclusions and reliable

forecasts. Our future challenge will be to further refine these models and make greater use of them in the Bank of Albania decision-making.

4. BANK OF ALBANIA'S FINANCIAL STATEMENTS

The financial statements of 2009 were audited by an Independent Auditor and they give a true and fair view of the Bank of Albania's financial position for 2009.

Bank of Albania's financial position has improved further. Total assets have amounted to ALL 353,6 billion, whilst liabilities have amounted to ALL 321 billion. Realized profit totalled about ALL 10 (9,993) billion, the highest in the last three years. This result has increased the Bank of Albania's capital.

Pursuant to the obligations of Law No. 8269, dated 23 December 1997, Article 9, 25 percent, about ALL 2,5 (2,479) billion, of the net profit was capitalized, causing the general reserve to amount to ALL 10 (9.994) billion.

Similarly, the Bank of Albania has observed the obligation of transferring the net profit to the State Budget pursuant to Article 10 of the same Law, and paid to the State Budget about ALL 6,74 billion for the year 2009.

Pursuant to Article 10, in March 2010 the balance of 2009 net profit amounting to ALL 2,4 (2,436) billion was paid to the State Budget.

*Honourable Madam Speaker of the Parliament,
Dear deputies,*

Thanking you for your attention, on behalf of the Supervisory Council of the Bank of Albania, I want to guarantee the Parliament of the Republic of Albania that the central bank will remain a responsible decision-making institution in 2010.

Our decision-making will:

- remain transparent for both the financial market and the public at large;
- consider all possible information in and out of Albania;
- rely on qualified human resources, and
- improve its policy and operational framework, considering the best contemporary and international practices.

The focus of monetary policy will remain oriented to consumer price stability, whilst endeavouring to accomplish successfully all the other legal objectives.

Albania's financial stability remains another major priority for the period to follow. To this purpose, the Bank of Albania is fully committed to monitoring the situation and designing and implementing proper measures timely and at the right intensity.

Lastly, in the capacity of the Governor of the Bank of Albania, I guarantee that the central bank will continue to provide a responsible, accountable and transparent reporting to the Albanian Parliament without hesitancy to meet the constitutional and legal obligations.

In addition, in full observance of the legal obligation to preserve the autonomy of the institution I preside, I assure you that I will make any ethical, legal and constitutional endeavours to ensure that our accountability before you and the public at large is unbiased and true.

Expressing my highest considerations on my behalf, on behalf of the Supervisory Council and the Bank of Albania staff, I avail myself of this opportunity to thank the Albanian Parliament for the contribution and continuous support provided to our institution.

Thank you.

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

At the Press Conference on the Monetary Policy Decision-Making of the Supervisory Council of the Bank of Albania
May 26, 2010

At its meeting of 26 May 2010, the Supervisory Council of the Bank of Albania reviewed and approved the Monetary Policy Monthly Report. Taking into account all the latest economic and financial developments at home and their projections for the future, at the end of discussions, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 5.25 percent.

The first months of 2010 featured improved economic activity on a global level, as evidenced by the sharp growth of developing economies and the moderate growth in some developed countries. Economic recovery was coupled with the increase in trade activity, whilst central banks and fiscal authorities have continued to support aggregate demand through easing policies.

Despite the upward tendency of primary commodity prices, the inflationary pressures remain low owing to the negative output gap. However, the last couple of weeks' events have shown that both the Euro area and world economies remain highly uncertain about the future. Fiscal situation has particularly become the focus of economic and political discussions. Taking immediate and concrete measures, which guarantee the long-term sustainability of public debt, seems to condition the future developments considerably. Global financial markets have responded tensely to these developments, showing high volatility and higher risk premium in all the range of instruments, markets and financial agents.

Turning to the Albanian economy, the latest qualitative and quantitative indicators show a slow performance of the economy in the early months of 2010. The deceleration of domestic demand has been offset by the positive and growing Albanian exports.

Domestic inflationary pressures have been low and CPI inflation has been declining. Monetary markets were calmer, featuring downward interest rates, improved liquidity in the banking system and a more stable exchange rate. However, lending to economy continues to maintain low growth rates.

Indirect and preliminary information suggests that private consumption growth rates have been contained, owing to the limited financing resources and the greater consumers' propensity to save. The low capacity utilisation in economy, the low growth rate of investment loans and the lower capital and intermediate goods' import signal the contraction of private investment in the first quarter of the present year. Private sector's demand for money remains low as a reflection of the contracted economic activity.

Excluding the exchange rate effect, the annual growth rate of private sector credit slowed down further to 4.8 percent in March. Business demand for loans remains the only source for credit growth, while household loans continue to contract in annual terms for the fifth consecutive month. The first signals of easier bank lending standards were shown during this period but only on large-sized businesses.

Fiscal stimulus was more contained in the first four months, providing a lower contribution to economic activity during this period. Fiscal policy was stimulating but at a lower extent than in the same period of the previous year. Budget deficit amounted to ALL 5.3 billion, down by 47 percent in annual terms. The low economic activity is reflected on the low growth of budget revenue by about 3 percent in the first four months of 2010.

On the other side, budget spending contracted by about 2 percent from the previous year. The Bank of Albania continues to draw the attention that despite the short-term positive impact the fiscal stimulus may generate, the long-term sustainability of the public sector should be the main guide of fiscal policy. The lesson drawn from the current problematic situation involving many European Union countries is the necessity to consolidate public finances, and for that purpose, taking important and timely correcting measures is highly important.

Balancing the aforementioned developments, the accelerated growth of exports has provided a positive contribution to total demand and economic growth. In the first quarter of 2010, exports increased by 45.1 percent y-o-y, while imports declined by about 2.3 percent y-o-y.

The rapid increase in exports and the more moderate decline of imports gave rise to the contraction of trade deficit by about 17.1 percent, hence maintaining the trend shown in the second half of 2009. The ratio of import coverage by export was 35.4 percent, about 11.6 pp higher than in the previous year. These external sector developments have established a more stable balance of supply and demand for foreign currency, thereby contributing to higher stability of domestic currency in the last months. This positive moment should become durable over the medium term through rapid implementation of supporting economic policies.

Economic background and monetary developments have created an environment of moderate inflationary pressures. In April, annual inflation marked 3.5 percent, down by 0.4 pp from March 2010. The recovery of inflation to within the Bank of Albania's target was expected and forecasted.

CPI inflation in Albania owes mostly to the rise in administered prices, the upward tendency of global prices and the exchange rate depreciation effect on inflation. In the absence of second round effects on inflation, the impact of these factors is, as expected, transitory. Domestic inflationary pressures remain low as shown by the performance of core and non-traded inflation. In April, they marked 1.2 and 2.4 percent, respectively. This tendency is expected to

persist in the near future, as long as the Albanian economy will continue to be characterized by low capacity utilization rates, contained growth of monetary indicators and anchored inflationary expectations.

In view of meeting its inflation target, the Bank of Albania has pursued a prudent monetary policy, supplying the market with the required liquidity. Financial markets were more stable; the interest rates were downward and showed low volatility; and the risk premium was lower. Monetary developments in March confirmed the further growth of money supply in economy, which rose by 10.2 percent in annual nominal terms. This performance has been sustained by the decline of currency outside banks and the stable growth of deposits in the banking system.

The Supervisory Council of the Bank of Albania concluded that the inflationary pressures on the domestic economy are expected to be balanced over the medium term.

Against a background when the temporary effect of supply-side pressures is expected to terminate, the non-inflationary pressures as a result of the demand-side negative output gap are expected to determine the inflation rate moving around the Bank of Albania's target. In addition, the economic agents' expectations for inflation remain anchored over the medium run.

At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged at 5.25 percent. This decision complies with the achievement of the inflation target in the medium run and at the same time, ensures the appropriate monetary conditions to support the sound development of the economy. The Bank of Albania will continue to monitor the performance of inflation and other economic development indicators cautiously and will analyze the need and room for monetary policy response.

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

At the Forum "Interbank Market Development and Improvement of Operational Policy at the Bank of Albania",
Sheraton Hotel, 21 June 2010

*Dear bank managers,
Dear colleagues,*

We are gathered here today to discuss an essential issue concerning the performance of our financial market and the Albanian economy on the whole: interbank market development and strengthening.

I do believe that the role and importance of the interbank market is clear to all attendees. It represents the first link of liquidity trading in economy and the most transparent price setting mechanism.

By providing the appropriate instruments and partners for liquidity trading, the interbank market allows the refinancing of short and medium-term positions and facilitates the mitigation of your business liquidity risk.

The banking system and the interbank market represent the exclusive setting monetary policy operates in. A developed, active and efficient interbank market enhances the efficiency of central bank's monetary policy, transmitting its impulses into the economy best. Thus, the development of the interbank market smoothes the progress of financial intermediation and boosts lending to economy, hence improving the country's economic and social welfare.

The deepening and broadening of the financial market is one of the key structural reforms in economy. It should be ceaseless and it requires the commitment of domestic and external factors. It naturally adapts to the different economic development stages the country and the state go through. I do believe that there cannot be a developed and well-integrated economy without open, integrated, efficient, transparent and well-regulated markets.

Therefore, it comes out clearly that the development of the interbank market is in all stakeholders' interests: the banking system itself, the Bank of Albania and the economy on the whole.

Being fully aware of this, the Bank of Albania has built a clear strategy in terms of:

1. Deepening and broadening the money market in Albania further;
2. Creating relevant market instruments;
3. Establishing a close and rational cooperation with the banking system and the financial market in general;
4. Ensuring a clear and constant communication with the market operators

- and the public at large;
5. Providing modern technological solutions.

As a result of these initiatives, our monetary policy is now entirely based on indirect instruments of monetary management, which operate in line with the open market logic. Our operational framework allows the banking system to manage the liquidity effectively, being a counterparty of the last resort to meet the system's aggregate needs for liquidity or invest it.

Via the required reserve, the Bank of Albania has provided you with enough room to cover your unexpected liquidity needs, at a remuneration rate close to the market interest rates that avoid the distortions the required reserve may yield to your banking business. Our regulations, which restrain the banking business operational, liquidity or market risks, are in full compliance with the international standards, providing at the same time enough room for the development of the interbank market. We have also taken major steps in terms of the institutional development of this market, through the establishment and maintenance of TRIBOR and TRIBID reference rates, through constant communication with the dealers' association and promotion of new interbank market instruments.

I would like to inform you today of the last Bank of Albania's step in this regard, and also ask for your greater attention in terms of taking prompt actions that will boost the activity and role of the interbank market.

CHANGE OF THE BANK OF ALBANIA'S OPERATIONAL TARGET FRAMEWORK

The Bank of Albania is in the final phase of reviewing its operational targets. The latter will soon change their form, shifting from the quantitative targeting of the Bank of Albania's balance sheet to the targeting of interbank market interest rates.

The operational targets of monetary policy play a key role in the formulation and conduct of monetary policy. In a theoretical background, these targets serve as a link between the monetary authority's interventions in the interbank market and the intermediate target of monetary policy. Thus, the operational targets serve as the starting point of the monetary policy transmission mechanism. In practice, these targets serve to steer and discipline the monetary authority's interventions in the money market quantitatively. The rapid transformation of economic structure and the development of interbank markets and economic agents were coupled with fundamental changes in the monetary policy transmission mechanism. The latter has now become more complex, involving more players whose sophistication is ever-increasing, and incorporating more instruments and financial contracts that are timely structured and indexed to different indicators. The Albanian economy is now economically and financially integrated into the global economy, having the characteristics of a market economy but at the same time featuring the typical challenges of economic management that such an economy entails.

These changes have called for the constant monitoring by the monetary authority in order to make the necessary changes in the monetary policy regime and the operational aspects of its implementation.

Against this background, the Bank of Albania has been committed to a process of constant evaluation of the interbank market performance and at the same time fine-tune its monetary policy regime.

The Monetary Policy Document for the 2009-2011 Period was a major step in this regard. In this Document, the role of monetary aggregates as indicators of inflationary pressures in economy and as intermediate targets of monetary policy was complemented with a wide range of information provided by the real sector of the economy, which is systemized and finalized in the inflation forecast performance. This change was entirely based on the Albanian experience.

The development of money markets and progress in financial innovation, the rapid growth of lending and dollarization of the economy, and the increasing role of real estate in the investment opportunities caused the functioning of the Albanian economy to become even more complex. They were supplemented with unstable velocity of money circulation, hence toning down the short and medium-term link between monetary aggregates and inflation.

This change materializes the modernization of monetary policy decision-making based on a more complete information analysis that aims at managing the market operators' expectations.

One of the directions the Bank of Albania's work has been focusing on during the past year, as we have transparently stated in our Monetary Policy Document, was the assessment of the suitability of operational targets and the adoption of more advanced forms. The quantitative targeting of the Bank of Albania's balance sheet, in the form of a ceiling on the net domestic assets and a floor on the net international reserves, has for quite a long time acted as a guide to our interventions in the interbank market.

In spite of that, the abovementioned developments suggest that there is plenty of room for improvement in this philosophy and practice. Targeting the interbank market interest rates seems a practical option that finds ample theoretical support and whose application has proved successful in a number of advanced economies.

Broadly speaking, this operational philosophy is guided by the need to steer the short-term interest rates in the interbank market close to the key interest rate set by the monetary authority. As such, it serves better to keeping the short-term horizon of the interest rates' curve under check, making the conduct of monetary policy more transparent and providing clearer signals for economic activity. Steering our operations to the stability of interbank market interest rates will serve to a more relaxed functioning of the interbank market and lowering of risk premium. In addition, this operational target is well-framed in

our medium-term steering and commitment to adopting the inflation targeting regime, making up an important link of its successful adoption.

Concluding my theoretical discussion of this change, I would like to underline that our long-term commitment to keeping our foreign reserve at optimal levels to cope with the shocks Albania may be faced with remains an unquestionable objective of our monetary policy.

In an institutional aspect, I would like to note that such a move does not only attest to the level of maturity of our interbank market. It also crowns our constant efforts in achieving its utmost efficient management.

In this context, the Bank of Albania has made utmost efforts to develop liquidity forecast models, to dampen the impact of fiscal flows into the money markets and to develop optimal procedures and modalities of interbank market interventions. I do strongly believe that our efforts will persist in the future as well, enabling a smooth shift of the operational target and optimal functioning of their new form.

INTERBANK MARKET DEVELOPMENT

Dear colleagues,

Bank of Albania's role in promoting the interbank market is indisputable. However, we are fully aware that the development of this market mostly reflects the results of the banking system's own development and efforts.

Therefore, the Bank of Albania requires your utmost attention in this regard. More precisely, in our discussion today we would like to have your opinion on the three steps we consider will boost the development of the interbank market. First, setting the prime rates in the functioning of commercial banks. These rates can and should serve as a guide to setting prices on banking products, both on the assets and liabilities' side. Second, the functioning of the collateralized market through repo or reverse repo contracts. Although in its classical concept the interbank market is an uncollateralized market, its enhancement with the abovementioned instruments would open the way to its thorough development, ensuring a more efficient distribution of liquidity among the market operators. Third, banks can and should be active in quoting the liquidity in the Albanian lek, keeping the same stance as in the foreign exchange market. The constant quotation will encourage a more active liquidity management and it will enable its continuous price setting.

Dear bank managers,

The Bank of Albania considers the development of the interbank and financial market as a process that requires our constant commitment but which provides tangible benefits to all of us. I invite you now to an open and fruitful discussion to share our opinions on the right paths that will encourage this market further.

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

At the Press Conference on the Monetary Policy Decision-Making of the Supervisory Council of the Bank of Albania
June 30, 2010

At its meeting of 30 June 2010, the Supervisory Council of the Bank of Albania analyzed and approved the Monetary Policy Monthly Report. After being introduced to the latest economic and financial developments at home and their projections for the future, at the end of discussion, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 5.25 percent.

Global economy attested to higher economic activity in the early months of 2010 fuelled by the recovery of demand in developing countries, stimulating policies pursued by advanced economies and higher foreign trade. The prospects for global economy suggest that the recovery will persist in most economies. However, unemployment remains high, reflecting the low business confidence and scarce investments in expanding production capacities. Inflation pressures, albeit low, maintained their upward trend in 2010 owing to the recovery of global demand. The financial markets were highly volatile in response to the key market players' concerns over the public debt-related issues in some Euro area countries. The need for budget consolidation in most of these countries due to the deteriorated fiscal indicators is expected to affect the future economic developments on a large scale.

The last G20 meeting, which represents the world's premier forum for discussing economic policies, came up with a clear message about the need for fiscal consolidation and immediate efforts to rein in public debt.

Concerning the Albanian economy, the available data attest to slow economic performance in the first four months of 2010. The poor performance of domestic demand components was offset by the higher contribution of foreign demand due to the considerable growth in exports. However, in line with our expectations, the Bank of Albania considers that economic activity has recovered gradually during this period. The recovery is expected to persist in the second half of 2010 as well. Inflation has maintained downward rates due to the low inflation pressures generated by the domestic economic environment.

The financial markets have been stable, featuring downward interest rates, an improved liquidity situation in the banking system and a more relaxed exchange rate.

Consumer spending continued to be affected by the restrained financial resources and low consumer confidence in the first half of 2010.

Indirect indicators like:

- the low growth of retail sales;
- the decline of remittances and consumer loans; and
- the slower employment indicators

attest to slower private consumption in the early months of 2010.

Private investments have provided a negative contribution to economic growth. The historical low free capacity utilization rate, the worsened figures of business confidence, the contraction of the import of intermediate and capital goods and the slowdown in credit suggest that investments were low during this period.

On the other hand, the slight recovery of credit for investment purposes and the increase in the imports of intermediate goods in the first months of the second quarter of 2010 may signal a possible shift of this aggregate demand component in the second quarter of the present year.

The public sector continued to pursue a stimulating fiscal policy in the first five months of 2010. Budget deficit amounted to ALL 11.6 billion, owing to the annual growth of budget revenue by 4 percent and the annual contraction of public spending by 3 percent.

After careful monitoring of the current and expected economic performance and its implications for fiscal indicators, the Bank of Albania considers that fiscal policy should be watchful at keeping the budget deficit and public debt levels in check.

Keeping the budget deficit within sound parameters increases confidence in the long-term sustainability of public debt, hence lowering the risk premium in the financial markets. In addition, the lowering of pressures in the domestic financial markets helps keep the long-term interest rates in check, hence facilitating the private sector access to the credit market. Therefore, the projected revision to the 2010 state budget needs to be based on a realistic budget revenue plan, making at the same time projections of the required correction measures for the reduction of public spending and control of budget deficit.

Net exports increased their positive contribution to aggregate demand in the first four months of 2010. This performance was triggered by the annual increase of exports by 47 percent, while imports were comparable to the previous year. Hence, in the first four months of the present year, trade deficit narrowed further by 14 percent y-o-y. In addition to the positive impact on economic growth, this necessary correction aided the stability of the national currency. Lek's exchange rate was more stable and less volatile during this period.

The performance of other balance of payments items in the first quarter of the present year attests to the significant reduction of foreign financing.

Remittances declined 6.7 percent, hence financing only 40.6 percent of the trade deficit.

Despite the positive performance of foreign direct investments, posting an annual growth of 26 percent, the surplus in capital and financial account financed only 41.2 percent of the current deficit. The surplus was 63 percent lower than the previous year.

The long-term stability of the external position of our economy remains a weakness that requires constant consideration in terms of the formulation and implementation of economic policies.

The slow growth rates of domestic demand were reflected in the low demand for money. In April, money supply posted an annual nominal growth of 7.5 percent. The creation of money in economy continues to be primarily sustained by the growth of the banking system's net foreign assets. In April, private sector credit posted an annual growth of 7 percent.

Banking loan data show a positive dynamics for the last two months, displaying higher monthly growth rates of loans and particularly of investment loans. However, the lending growth rates are still low owing to the economic agents' moderate demand for loans and the tight lending standards applied by the banking system as a result of its increased prudence.

The growth of deposits improved the banking system's balance sheet and its liquidity and capitalization indicators. This positive performance needs to be reflected in a more active role of the banking system in terms of lending.

The improved liquidity indicators, the contained public sector borrowing in the domestic financial market, the lower risk premium and the anchored inflation expectations have led to lower interest rates in the financial market. The latter appears more relaxed and the trading volumes have increased. The decrease of interest rates on deposits, loans and Government securities persisted in the last two months; hence providing appropriate conditions for boosting economic activity. The Bank of Albania considers that the same tendency should continue to be sustained by the contribution of all abovementioned factors.

This year's economic developments have yielded low inflation pressures. CPI annual inflation marked 3.1 percent in May, close to the Bank of Albania's target. Annual inflation rate was downward for the third consecutive month, confirming our expectations and forecast for the transitory supply-side shock effects. On the other hand, domestic demand-side pressures have been downward; this has been attested by the historical lows of core and non-traded inflation, 1.2 and 1.3 percent, respectively.

The Bank of Albania has pursued a prudent monetary policy. In full observance of the inflation target, the Bank of Albania continued to be present in the market through the provision of the required liquidity to the banking system.

At its meeting today, the Supervisory Council approved the change of its monetary policy operational objective, which as from today will be steering the short-term interest rates in the interbank market close to the Bank of Albania's key interest rate.

This change enhances the efficiency and transparency of monetary policy and promotes the further development of the interbank market. The Bank of Albania has taken all the necessary measures to successfully implement this project.

In its discussions today, the Supervisory Council of the Bank of Albania concluded that in absence of unanticipated shocks, CPI inflation will be in line with the Bank of Albania's target in the medium-term. In addition, the Supervisory Council concluded that the monetary conditions are fully adequate to observe this target. In conclusion, the Supervisory Council decided to keep the key interest rate unchanged at 5.25 percent.

This decision is considered appropriate for the situation the Albanian economy is in, providing at the same time the necessary monetary conditions for sustaining its sound development.

Concerning the future, the Bank of Albania remains fully committed to consider and follow up the actual and expected performance of economic indicators in view of maintaining price stability and firming up macroeconomic balances at home.

The Bank of Albania invites all economic stakeholders to join this philosophy and provide their contribution to the stable and long-term growth of Albania.

PAPERS

AN ANALYSIS OF RISK AND RETURN FOR THE ALBANIAN BANKING SYSTEM*

IRINI KALLUCI

The banking sector, as the most important element of the Albanian financial system, requires particular attention when it comes to its risk and return analyses. This material makes a brief presentation of an analysis of risk and return for the Albanian banking sector, measured in a novel way, differently from what has been seen so far in periodic reports. The aim of this material is not simply to analyze the financial ratios or measures of risk and return, but also to suggest some indicators and an index that may be used by supervisors during their work.

1. PERFORMANCE ANALYSIS OF THE ALBANIAN BANKING SYSTEM, USING THE MODIFIED DUPONT MODEL

The starting point for the measurement and the analysis of financial indicators of an enterprise (or industry) is the rate of return on equity (ROE), which shows the profitability provided over a certain period from the shareholders' point of view. DuPont model (equation) is the base model used in the literature for the decomposition of ROE into several components, for every kind of industry.

Cole (1972) was the first to adapt and apply the DuPont model for banks. The banking system operates like any other industry in a regulated, supervised and competitive market. It has its own products and services that distinguish it from other industries. The financial statements of the banking system also differ from those of other sectors, with regard to the peculiarities that characterize banking activity. As a consequence, the financial or economic ratios of efficiency and performance of banking operations take on another meaning when they are calculated for this sector.

This material makes a more detailed analysis of return on equity and assets, by using a combination of two models; the one suggested by Koch and MacDonald (2002), and the other suggested by Vensel et al. (2004). Both models are extensions and modifications of the DuPont model. The analysis provided by these authors incorporates more indicators than in the DuPont model and they provide a more comprehensive framework of the factors that affect the banking system's profitability¹.

* This analysis is based on the methodology presented in the Working Paper "Analysis of Albanian banking system in a risk-performance framework", (Kalluci, I., forthcoming in the Bank of Albania's Working Paper Series).

The Albanian banking system, in the period prior to the global financial crisis, was characterized by high returns on equity, thus attesting to high

¹ Refer to Table 1 and the list of abbreviations in the Annex for the method of calculation of ROE and ROA indicators.

efficiency in its use. This was due to investment in high profitability assets, but also due to the prudence shown by the banks themselves and the supervisors for a safe and stable activity. However, in the last two years, the indicators of return on equity and assets slumped.

The changes that occurred in the Albanian banking system in the recent years (the privatization of banks, the acquisition of some domestic banks by big foreign banks, the merger of two banks, the regulatory changes and the strengthening of supervision via stricter regulatory requirements, the broadening of the range of products and services, the increased competitiveness, etc.) have undoubtedly also affected the indicators that are analyzed further to this material. Another factor that affected the following indicators is the global financial crisis, which although did not affect the Albanian banking sector directly, was accompanied by a slowdown in lending activity and by deposits withdrawal. The latter lasted only a few months and deposits returned into the system and kept their normal trend. In the meantime, the annual credit growth kept going down during 2009 as well.

Table 1 shows the decomposition of return on equity and assets indicators, initially according to DuPont model and thereafter according to the models suggested by Koch and MacDonald (2002) and Vensel et al. (2004). The data are obtained from the financial statements of the Albanian banking system. The balance sheet items (total assets, shareholders' equity, earning assets, paying liabilities) are averaged, while the profit and loss statement items are on a cumulative basis for the whole year.

Table 1 ROE components through years 2001-2009

Financial ratios	2001	2002	2003	2004	2005	2006	2007	2008	2009
Return on Equity (in %), $ROE = EAT/BVE$	23.45	19.2	19.53	21.1	22.43	20.17	20.32	11.35	4.58
Return on Assets (in %), $ROA = EAT/TA$	1.58	1.20	1.24	1.28	1.41	1.36	1.48	0.91	0.42
Components of ROE, $ROE = PM * AU * EM$									
Profit Margin (in %), $PM = EAT/TOI$	15.99	14.23	14.29	15.8	17.24	17.67	17.95	10.43	3.26
Asset Utilization (in %), $AU = TOI/TA$	9.90	8.46	8.66	8.08	8.15	7.70	8.24	8.76	12.79
Equity Multiplier (in times), $EM = TA/BVE$	14.81	15.94	15.78	16.54	15.96	14.82	13.74	12.42	10.99
Components of ROA, $ROA = AU * ER$									
Asset Utilization (in %), $AU = TOI/TA$	9.90	8.46	8.66	8.08	8.15	7.70	8.24	8.76	12.79
Expenses Ratio (in %), $ER = TOE/TA$	8.32	7.26	7.42	6.80	6.75	6.34	6.76	7.85	12.37
Components of ROA, $ROA = NIM * EAR + B * LLP/TA - T/TA$									
Net Interest Margin (in %), $NIM = NII/EA$	3.35	2.91	3.23	3.08	3.75	4.22	4.35	4.13	4.04
Earning Assets Ratio (in %), $EAR = EA/TA$	91.00	94.21	95.85	94.80	93.33	93.19	93.34	92.95	91.30
Banks Burden (in %), $B = NNII/TA$	-0.77	-0.85	-1.11	-0.93	-1.45	-1.69	-1.62	-1.68	-1.75
Loan Loss Provisions to Total Assets ratio (in %), LLP/TA	0.23	0.33	0.25	0.26	0.19	0.48	0.53	1.05	1.39
Taxes to Total Assets ratio (in %), T/TA	0.47	0.35	0.50	0.45	0.46	0.41	0.44	0.18	0.12
Components of NIM, $NIM = REA - COL * LEA$									
Return on Earning Assets (in %), $REA = II/EA$	8.39	7.73	8.07	6.96	6.84	7.05	7.72	8.06	8.10
Cost of Liabilities (in %), $COL = IE/PL$	5.33	5.17	5.23	4.14	3.28	3.05	3.70	4.30	4.43
Liabilities to Earning Assets ratio (in %), $LEA = PL/EA$	94.65	93.26	92.47	93.80	94.36	92.90	91.15	91.59	91.71

Source: Bank of Albania, author's own calculations

- The rate of return on equity (ROE) fluctuated over the analyzed period, but it generally remained at the 19-23% levels (in 2001-2007). We may, however, observe a sharp decline in this indicator in 2008-2009. This drop, if we simply look at the base formula of its calculation, is affected by the decrease in net income generated by the banking system during the last two years. The earnings after taxes of the system in 2008 were 7.3 billion leks, representing an annual decline of 26.5 per cent. While in 2009, this result reached 3.5 billion leks, declining by 51.7% compared to 2008. By contrast, average shareholders' equity has increased, but its growth rate has varied through the years, with an average of 19% in the period 2002-2009. The annual increase in shareholders' equity was 19.8% at the end of 2009. Apparently, these two phenomena have affected the ROE decline.

However, let us look in more details at the components that produced the decline in the ROE:

- The profit margin tracked almost the same trend of ROE. It pursued a growing trend in 2003-2007, but in 2008-2009 there was a notable decrease in this indicator, making it one of the main factors to have caused the ROE decline. The factors contributing to this deterioration were, on one side, the annual fall in earnings after taxes by 51.7%, and, on the other side, the annual increase by the same rate (54.6%) in total income. A decline in the profit margin implies that a smaller part of total income (after the deduction of expenses) remains at the shareholders' disposal (to be distributed in the form of dividends) or at the bank's disposal (to be re-invested).
- Meanwhile, during 2009 a considerable increase in asset utilization from 8.76% (in 2008) to 12.79% (in 2009), is noted; this ratio fluctuated between 8 and 9% in 2002-2008. Since it experienced a sudden increase in 2009, it affected positively the return on equity.
- The equity multiplier² (EM) continued to decrease in 2009, a trend that started in 2005. This phenomenon has been induced by the faster annual increase in the shareholders' equity averaging 26.3% over 2005-2009, compared to a lower average annual increase in assets by 16.4% over the same period. The value of the equity multiplier at the end of 2009 shows that assets cover the invested capital nearly 11 times. The annual increase in shareholders' equity slowed down during 2009, while a higher growth was recorded in 2008. This evidenced the measures undertaken by banks to increase the capitalization in order to better cope with the financial crisis.

Up to now, we may draw the conclusion that the decrease of ROE in 2009 was mainly caused by the marked fall in the profit margin and the equity

² In the Annual Reports of the Supervision Department of the Bank of Albania, this concept is referred to as "Financial Leverage".

multiplier, whereas the increase in asset utilization did not counterbalance this effect.

Next, we proceed with the decomposition of the return on assets to identify the components that determine it and, notably, its decline in the recent two years.

- The rate of return on assets (ROA) for the Albanian banking system has been satisfactory and generally, this indicator has remained within the interval of 1.2-1.6% in 2001-2007; however, in 2008-2009 it dropped significantly to 0.9% and 0.4%, respectively. As regards the performance of total revenue and expenditure as a percentage of total assets, we note that they have moved in the same direction but not to the same degree. In 2009, there was an increase in both total revenue and expenditure of the banking system, but apparently expenditure has increased more than the revenue, thus causing both net income and the return on assets to decline.
- The net interest margin (NIM) is an indicator of the efficiency with which banks conduct financial intermediation. During the period under analysis, this indicator has generally displayed a positive trend, which shows that the Albanian banking system has ever-increasingly generated higher net interest income as a proportion of earning assets. But in 2008-2009, the banking system evidenced a fall in net interest margin (which however is not significant). While for the years 2005-2007, the annual increase of net interest income was higher than that of earning assets (which resulted in higher net interest margins), these trends overturned in 2009, and the net interest income increased by only 1.9%, whereas the annual change in earning assets was 4.1%, thus resulting in lower levels of the NIM rate.
- The Albanian banking system has been efficient in the investment of its assets, as on average, its earning assets accounted for more than 90% of its total assets in the years 2001-2009. The EAR decreased by 1.6 pp during 2009, providing evidence for its impact on the decline in the return on assets, and, indirectly, the return on equity.
- As expected, the banking system burden is negative. Banks have not been able to generate sufficient non-interest revenues to cover the non-interest expenses. Furthermore, net non-interest income³, which has been negative, has continuously worsened due to a range of factors. First, the net income from other activities has continuously increased, with the revenue and expenses from commissions and foreign exchange activities being the main items of revenue and expenses from this category. Thus, it may be said that this item has positively affected net non-interest income. On the other side, operating expenses have also been increasing and contributing to the worsening of the

³ Calculated as follows: *Net income from other activities + Net extraordinary income – Operating expenses. Another way of calculation is: Non-interest income – Non-interest expenses.*

already negative net income from non-interest activities. It should be mentioned that operating expenses and personnel expenses (as the item that accounts for about 40% of operating expenses) increased less in 2009 (less than 9%), providing evidence for the slowdown in the broadening of the range of activities and of the geographical expansion of the banking system during this year.

- The ratio of loan loss provisions to total assets was low (less than 0.5%) between 2001 and 2007, but in 2008-2009 there was a sharp increase to 1.05 and 1.4%, respectively, a consequence of the fast increase in non-performing loans. The high growth of loan loss provisions over 2008 (they increased by nearly 140% in 2008, but the increase decelerated to 40% in 2009), as a result of the loan portfolio deterioration and the measures taken by the banking system to put aside reserves under circumstances of increasing uncertainty, exceeded the increase in the average total assets of the system (6% in 2009), thus negatively affecting the return on assets.
- Tax paid by banks accounted for an average of only 0.5% of total assets, and fell in 2009 to 0.1%, thus positively affecting the return on assets. The drop in the absolute value of this expense was caused by the fall in earnings before taxes.

To explain the trend of net interest margin, its components are analyzed below:

- The return on earning assets (REA) is a way of measuring the average interest earned on profitable assets by the banking system. This indicator has increased in the recent years, which shows that the banks of the Albanian banking system have started to invest in higher return (but also riskier, e.g. lending) activities.
- The cost of borrowed funds (COL) also increased in the last years of the sample. The major share of interest expenses goes to interest paid to customers (for time deposits). These expenses increased over the period in question, not only as a consequence of the rise in the absolute value of liabilities, but also because interest rates increased notably in the later years (either because of a gradual raise of the policy rate since 2005 up to the beginning of 2009⁴, and/or the policy of banks to call the attention of their depositors to seasonal offers).
- The ratio of paying liabilities to earning assets (LEA) experienced a slight increase in 2008-2009, but generally, during the period analyzed, more than 90% of interest bearing assets was financed by liabilities that pay interest.

⁴ During 2009, the key interest rate decreased twice by 0.5 pp.

2. MATRIX ANALYSIS OF THE BANKING SYSTEM PERFORMANCE

An alternative way of analyzing financial ratios is through the matrix approach presented by Vensel et al. (2004). These authors state that starting from n quantitative indicators Y_i ($i=1,2,\dots,n$), it is possible to define n^2-n qualitative indicators x_{ij} (financial ratios).

$$x_{ij} = \frac{Y_i}{Y_j} \quad (i, j = 1, 2, \dots, n; i \neq j) \quad (1)$$

Once the matrix is created and a range of financial ratios is calculated, we may judge the performance of the banking system. Unlike the modified DuPont model, by using the matrix, we may create more financial ratios and present them in a tabloid way, thus making the comparison simpler.

The following matrix presents 28 financial indicators (ratios) for the years 2001, 2005 and 2009. Thus, a range of matrices may be formed with indicators for different years, and based on the interrelations expressed in the matrix, we may identify the factors that affect a certain element of the matrix (or that affect its increase or decrease compared to a prior period).

For illustration, we consider an important indicator, PM (profit margin), which may be expressed as a combination of several other factors:

$$PM = NENII * NIIR * INIR * NIRTIR = \frac{EAT}{NII} * \frac{NII}{IR} * \frac{IR}{NIR} * \frac{NIR}{TOI} = \frac{EAT}{TOI} \quad (2)$$

For instance, if $PM_{09} / PM_{01} = 0.204$, this may be expressed as a combination of the growth rates of each PM component during the period 2001-2009 (refer to formula 3 and the subsequent matrix), respectively:

$$\frac{PM_{09}}{PM_{01}} = \frac{NENII_{09}}{NENII_{01}} * \frac{NIIR_{09}}{NIIR_{01}} * \frac{INIR_{09}}{INIR_{01}} * \frac{NIRTIR_{09}}{NIRTIR_{01}} = 0.218 * 1.249 * 0.407 * 1.842 = 0.204 \quad (3)$$

Here we see that the element that accounts for most of the decline in the PM over 2001-2009 is the NENII indicator. Subsequently, we may proceed with the decomposition of the latter into its components for a detailed analysis of the situation and of the motives that may have caused it.

Another indicator that may be analyzed is EAER (earning asset to equity ratio), which may be written as a combination of two other indicators:

$$EAER = EAR * EM = \frac{EA}{TA} * \frac{TA}{BVE} = \frac{EA}{BVE} \quad (4)$$

Similarly, we can analyze the factors that affect the decrease in EAER (over 2001-2009) to discover that the leading cause of this drop was the equity multiplier (EM).

Finally, we can make the matrix analysis of the factors that affect ROE (return on equity), which may be written as a combination of:

$$\begin{aligned}
 \text{ROE} &= \text{NENII} * \text{NIIR} * \text{INIR} * \text{NIRTIR} * \text{TIEA} * \text{EAR} * \text{EM} = \\
 &= \frac{\text{EAT}}{\text{NII}} * \frac{\text{NII}}{\text{IR}} * \frac{\text{IR}}{\text{NIR}} * \frac{\text{NIR}}{\text{TOI}} * \frac{\text{TOI}}{\text{EA}} * \frac{\text{EA}}{\text{TA}} * \frac{\text{TA}}{\text{BVE}} = \frac{\text{EAT}}{\text{BVE}}
 \end{aligned} \tag{5}$$

Again, the elements that have produced the ROE's fall may be identified as follows:

$$\begin{aligned}
 \frac{\text{ROE}_{09}}{\text{ROE}_{01}} &= \frac{\text{NENII}_{09}}{\text{NENII}_{01}} * \frac{\text{NIIR}_{09}}{\text{NIIR}_{01}} * \frac{\text{INIR}_{09}}{\text{INIR}_{01}} * \frac{\text{NIRTIR}_{09}}{\text{NIRTIR}_{01}} * \frac{\text{TIEA}_{09}}{\text{TIEA}_{01}} * \frac{\text{EAR}_{09}}{\text{EAR}_{01}} * \frac{\text{EM}_{09}}{\text{EM}_{01}} = \\
 &= 0.218 * 1.249 * 0.407 * 1.842 * 1.287 * 1.003 * 0.742 = 0.195
 \end{aligned} \tag{6}$$

As noted above, the decrease in NENII has been the most important factor causing the ROE ratio to decline in 2009 compared to 2001. Other factors that have also affected the ROE negatively are the INIR and EM declines.

In the same way, we may continue to analyze the reasons behind the changes in the indicators over the years.

	Earnings after taxes (EAT) Y_1	Net interest income (NII) Y_2	Interest revenues (IR) Y_3	Non-interest revenues (NIR) Y_4	Total operating income (TOI) Y_5	Earning assets (EA) Y_6	Total assets (TA) Y_7
Net interest income (NII) Y_2	$NENII = Y_1 / Y_2$ 51.9% (2001) 40.2% (2005) 11.3% (2009)						
Interest revenues (IR) Y_3	$NEIR = Y_1 / Y_3$ 20.7% (2001) 22.0% (2005) 5.6% (2009)	$NIIR = Y_2 / Y_3$ 39.9% (2001) 54.8% (2005) 49.9% (2009)					
Non-interest revenues (NIR) Y_4	$NENIR = Y_1 / Y_4$ 69.9% (2001) 79.4% (2005) 7.7% (2009)	$NIIR = Y_2 / Y_4$ 134.5% (2001) 197.5% (2005) 68.4% (2009)	$INIR = Y_3 / Y_4$ 336.9% (2001) 360.5% (2005) 137.2% (2009)				
Total operating income (TOI) Y_5	$PM = Y_1 / Y_5$ 16.0% (2001) 17.2% (2005) 3.3% (2009)	$NITIR = Y_2 / Y_5$ 30.8% (2001) 42.9% (2005) 28.8% (2009)	$ITIR = Y_3 / Y_5$ 77.1% (2001) 78.3% (2005) 57.8% (2009)	$NIRTIR = Y_4 / Y_5$ 22.9% (2001) 21.7% (2005) 42.2% (2009)			
Earning assets (EA) Y_6	$NREA = Y_1 / Y_6$ 1.7% (2001) 1.5% (2005) 0.5% (2009)	$NIM_1^* = Y_2 / Y_6$ 3.4% (2001) 3.7% (2005) 4.0% (2009)	$REA = Y_3 / Y_6$ 8.4% (2001) 6.8% (2005) 8.1% (2009)	$NIEA = Y_4 / Y_6$ 2.5% (2001) 1.9% (2005) 5.9% (2009)	$TIEA = Y_5 / Y_6$ 10.9% (2001) 8.7% (2005) 14.0% (2009)		
Total assets (TA) Y_7	$ROA = Y_1 / Y_7$ 1.6% (2001) 1.4% (2005) 0.4% (2009)	$NIM_2^* = Y_2 / Y_7$ 3.0% (2001) 3.5% (2005) 3.7% (2009)	$IOA = Y_3 / Y_7$ 7.6% (2001) 6.4% (2005) 7.4% (2009)	$NIOA = Y_4 / Y_7$ 2.3% (2001) 1.8% (2005) 5.4% (2009)	$AU = Y_5 / Y_7$ 9.9% (2001) 8.2% (2005) 12.8% (2009)	$EAR = Y_6 / Y_7$ 91.0% (2001) 93.3% (2005) 91.3% (2009)	
Book value of equity (BVE) Y_8	$ROE = Y_1 / Y_8$ 23.4% (2001) 22.4% (2005) 4.6% (2009)	$NIIOE = Y_2 / Y_8$ 45.1% (2001) 55.8% (2005) 40.5% (2009)	$IOE = Y_3 / Y_8$ 113.1% (2001) 101.9% (2005) 81.3% (2009)	$NIOE = Y_4 / Y_8$ 33.6% (2001) 28.3% (2005) 59.3% (2009)	$TIOE = Y_5 / Y_8$ 146.6% (2001) 130.1% (2005) 140.5% (2009)	$EAER = Y_6 / Y_8$ 13.47 (2001) 14.89 (2005) 10.03 (2009)	$EM = Y_7 / Y_8$ 14.81 (2001) 15.96 (2005) 10.99 (2009)

* The net interest margin may be measured in two ways: Net interest income to Earning assets (x_{26}) or Net interest income to Total assets (x_{27}). (Kalluci, 2010).

3. RISK INDEX

Generally, financial theory views returns as being related to risk, as higher risk needs to be compensated by higher returns in order to be undertaken by risk-averse shareholders. Banks face risks that are characteristic to banking activity, such as credit risk, interest rate risk, liquidity risk, exchange rate risk, operational risk, etc. Aside from developing specific indicators to measure each of the above risks, a "Risk Index" can also be created that incorporates all these risks into a single index (also known in the literature as the Z-statistic, Z-index or Z-score).

The calculation of this index was first performed by Hannan and Hanweck (1988)⁵, who derived the probability of book value insolvency (the probability that the bank's losses in a certain period exceed the book value of the bank's equity, or the probability that the assets value of the bank becomes lower than the value of its liabilities) in their paper.

The Risk Index is provided by a combination of the return on assets (ROA), the inverse ratio of the equity multiplier (EM) and the standard deviation of ROA. "The risk index (Z-score) shows the number of standard deviations below the mean by which the bank's (or banking system's) profit would have to decline in order to eliminate equity" (Eisenberg and Kwast, 1991); so it expresses the ability of the bank to absorb losses.

Its empirical form is:

$$RI = \frac{E(ROA) + CAP}{\sigma_{ROA}} \quad (7)$$

where:

- RI - is the Risk Index (also called the Z-statistic, Z-index or Z-score);
- E(ROA) - is the average (expected) return on assets;
- CAP = EM⁻¹ - is the equity to asset ratio;
- σ_{ROA} - ROA's standard deviation.

While the probability of book value insolvency (Π) is measured as:

$$\Pi = \frac{1}{2 * RI^2} \quad (8)$$

It should be noted that a value or interval that serves as a benchmark for the risk index (i.e. for understanding if a banking system (bank) is in a safer or riskier situation) does not exist. Generally, the index is observed for its trend; where an increasing trend indicates a positive development, and a decrease shows a negative development. Thus, a lower value of the index implies a riskier bank, and a high value, a safer bank. Since the index value is inversely related to the probability of book value insolvency, a higher value means a lower probability that a bank faces solvency difficulties.

⁵ This index is inversely related to the probability of book value insolvency of banks.

If a bank (banking system) is characterized by a high return on assets, a high level of capitalization and a low volatility of ROA, then the bank (banking system) is considered safer (it has a higher risk index).

3.1 COMPUTATION OF THE RISK INDEX FOR THE ALBANIAN BANKING SYSTEM

Next, it is calculated the risk index for the Albanian banking system for the December 2001-September 2010 period. The data are quarterly and initially they were considered separately for each bank. Then, in order to calculate the required indicators that are components of the index, the data were aggregated for the whole system as weighted averages of the individual data (the share of each bank's assets to total system assets were used as the weighting factors).

The expected value of ROA of the system for each quarter is calculated as a weighted average of each bank's ROA⁶ at the end of the quarter, weighted by the share of each bank's assets to the system assets, at the end of the respective period (formula 9).

$$E(ROA)_t = \sum(ROA_{it} * w_{it}) \quad (9)$$

where:

$E(ROA)_t$ – is the banking system's average (expected) return on assets at quarter t ;

ROA_{it} – is the return on assets of bank i at quarter t -th, on an annual basis;

w_{it} – is the share of bank i assets to the banking system's total assets, at quarter t ;
 i stands for the i -th bank and t for the t -th quarter.

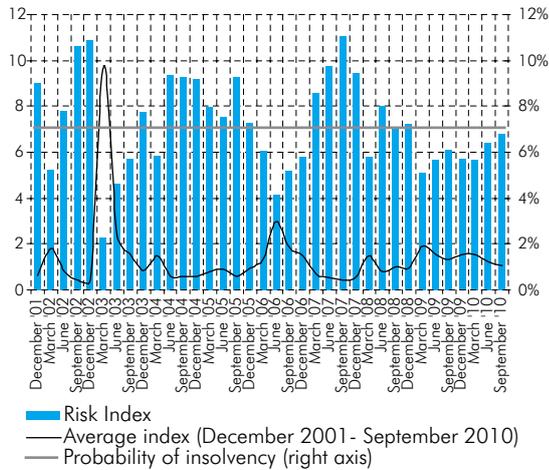
The standard deviation is calculated according to formula (10):

$$\sigma_{(ROA)_t} = \sqrt{\sum[ROA_{it} - E(ROA)_t]^2 * w_{it}} \quad (10)$$

The risk index for the Albanian banking system has fluctuated through time, but its average value in the December 2001-September 2010 period reached 7.2 units. From the moment when the financial markets were hit by the global financial crisis, its values have been lower than the average. In the first quarter of 2009, the index fell notably. The banking system perceived more risk, hence the risk index declined (which is an unfavorable situation). However, in 2010 there is an improvement in the index values, which shows a more optimistic

⁶ Usually, in calculating the expected value, the probabilities of a specific situation occurring are used as weighting factors. Since the probability distribution of future (predicted) values is missing, it is supposed that the expected value of the system's ROA may be approximated by the weighted average of all current ROAs for each bank.

Chart 1 Albanian banking system's Risk Index and Probability of book value insolvency

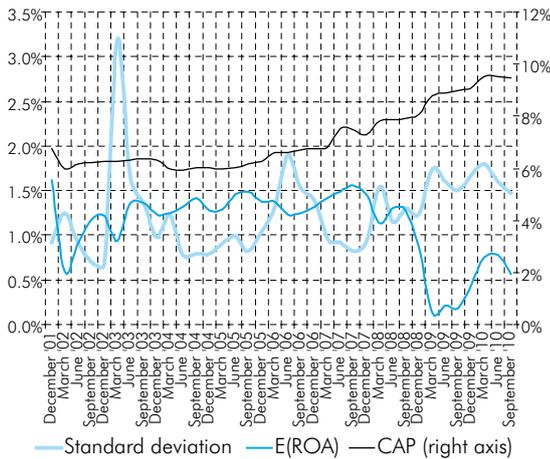


Source: Bank of Albania, author's own calculations

situation. This is in line with the expectations of commercial banks for an upturn in their activity and with the recovery of public confidence in the banking system.

When the financial crisis reached its peak, ROA's weighted average of the system fell notably, but it has been recovering during the last quarters. The equity/asset ratio has been increasing over time (i.e. it has positively affected the value of the risk index) due to measures taken by banks to increase their capital, but also due to strong supervisory requirements for a better risk management. The increase in ROA's volatility (standard deviation) at the end of 2008, but also in some of the quarters of 2009, contributed to the deterioration of the risk index. While during 2010, the standard deviation decreased, thus affecting positively the risk index⁷.

Chart 2 Components of Risk Index for the Albanian banking system



Source: Bank of Albania, author's own calculations

On the other hand, the probability that the banking system's equity would turn negative was low, fluctuating between 1 and 3% over the period under consideration.

⁷ The negative effect of the decrease in the weighted average ROA is exceeded by the positive effect of the increase in ROA's volatility.

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ANNEX

LIST OF ABBREVIATIONS

Abbreviation	Meaning	Calculating formula (Source of data)
AU	Asset Utilization	$AU = \frac{TOI}{TA} = \frac{IR + NIR}{TA}$
B	Burden	$B = \frac{NNII}{TA} = \frac{NIR - NIE}{TA}$
BVE	Book Value of Equity	(taken by banks' balance sheet)
COL	Cost of Liabilities	$COL = \frac{IE}{PL}$
EA	Earning Assets	(taken by banks' balance sheet)
EAER	Earning Assets to Equity Ratio	$EAER = \frac{EA}{BVE}$
EAR	Earning Assets Ratio	$EAR = \frac{EA}{TA}$
EAT	Earnings After Taxes	(taken by banks' profit and loss statement)
EM	Equity Multiplier	$EM = \frac{TA}{BVE}$
ER	Expenses Ratio	$ER = \frac{TOE \cdot IE + NIE + LLP + T}{TA}$
IE	Interest Expenses	(taken by banks' profit and loss statement)
INIR	Interest to Non-Interest Ratio	$INIR = \frac{IR}{NIR}$
IOA	Interest on Assets	$IOA = \frac{IR}{TA}$
IOE	Interest on Equity	$IOE = \frac{IR}{BVE}$
IR	Interest Revenues	(taken by banks' profit and loss statement)
ITIR	Interest to Total Income Ratio	$ITIR = \frac{IR}{TOI}$
LEA	Liabilities to Earning Assets	$LEA = \frac{PL}{EA}$
LLP	Loan Loss Provisions	(taken by banks' profit and loss statement)
NEIR	Net Earnings to Interest Ratio	$NEIR = \frac{EAT}{IR}$
NENII	Net Earnings to Net Interest Income	$NENII = \frac{EAT}{NII}$
NENIR	Net Earnings to Non-Interest Ratio	$NENIR = \frac{EAT}{NIR}$
NIE	Non-Interest Expenses	(taken by banks' profit and loss statement)
NIEA	Non-Interest on Earning Assets	$NIEA = \frac{NIR}{EA}$
NII	Net Interest Income	(taken by banks' profit and loss statement)
NIIOE	Net Interest Income on Equity	$NIIOE = \frac{NII}{BVE}$
NIIR	Net Interest to Interest Ratio	$NIIR = \frac{NII}{IR}$
NIRTIR	Non-Interest Revenues to Total Income Ratio	$NIRTIR = \frac{NIR}{TOI}$
NIM	Net Interest Margin	$NIM = \frac{IR}{EA} - \frac{IE}{PL} * \frac{PL}{EA} = REA - COL * LEA$
NINIR	Net Interest to Non-Interest Ratio	$NINIR = \frac{NII}{NIR}$
NIOA	Non-Interest on Assets	$NIOA = \frac{NIR}{TA}$
NIOE	Non-Interest on Equity	$NIOE = \frac{NIR}{BVE}$
NIR	Non-Interest Revenues	(taken by banks' profit and loss statement)

NITIR	Net Interest to Total Income Ratio	$NITIR = \frac{NI}{TOI}$
NNII	Net Non-Interest Income	(taken by banks' profit and loss statement)
NOI	Net Operating Income	(taken by banks' profit and loss statement)
NREA	Net Return on Earning Assets	$NREA = \frac{EAT}{EA}$
PL	Paying Liabilities	(taken by banks' balance sheet)
PM	Profit Margin	$PM = \frac{EAT}{TOI}$
REA	Return on Earning Assets	$REA = \frac{IR}{EA}$
ROA	Return on Assets	$ROA = \frac{EAT}{TA} = AU - ER$
ROE	Return on Equity	$ROE = ROA * EM$
T	Taxes	(taken by banks' profit and loss statement)
TA	Total Assets	(taken by banks' balance sheet)
TIEA	Total Income on Earning Assets	$TIEA = \frac{TOI}{EA}$
TIOE	Total Income on Equity	$TIOE = \frac{TOI}{BVE}$
TOE	Total Operating Expenses	(taken by banks' profit and loss statement)
TOI	Total Operating Income	(taken by banks' profit and loss statement)

ECONOMIC BULLETIN NEWS, JANUARY – JUNE 2010

Lecture by Governor Fullani at POLIS University, Tirana

On 13 January 2010, the Governor of the Bank of Albania, Mr. Ardian Fullani, delivered a lecture at POLIS University in Tirana. In his lecture, the Governor introduced the professors and students to the project for the renovation of the Bank of Albania premises in Tirana. This project is conceptualised as an intertwining of the actual building's architecture with modern architecture, hence providing a multifunctional solution and architectural attributes.

The professors and students of the University were also interested in the developments of the Albanian economy and the role of the Bank of Albania to ensure a stable and sound macroeconomic and financial stability. Real estate global crisis, its effects and the role of the Bank of Albania was another topic of the Governor's lecture. At the conclusion of his lecture, he underlined the message that the Albanian banking system is sound and fully capable to accomplish its mission.

Research Centre of the Bank of Albania inaugurated in Berat

In the framework of its efforts to intensify scientific research and citizen education, the Bank of Albania finalised its initiative for establishing a modern research centre in Berat. On 10 February 2010, the Bank of Albania inaugurated its Research Centre in the city's old quarter of Mangalem. Officials from the Ministry of Culture, Tourism, Youth and Sports, local government, commercial banks operating in Berat as well as architects, historians and other guests attended the ceremony.

This Centre aims to conduct and expand scientific research in the field of economics, with a special focus on central banking and financial system. Furthermore, the architecture of the Centre fits well with Mangalem characteristic architecture and stands out as a concrete and tangible contribution of the Bank of Albania to preserve and promote architectural values of this ancient city.

On 11 February 2010, Governor Fullani had a meeting with high school teachers and students of Berat schools where he launched a challenging project on citizen education accessible through the Bank of Albania's webpage, referred to as "online education". The Bank of Albania will provide internet-based learning platforms not only to the students but also to their teachers on issues such as central bank, economics and personal finances.

Lecture by Governor Fullani at the SEE University of Tetovo, Macedonia

On 25 February 2010, the Governor of the Bank of Albania, Mr. Ardian Fullani, was invited by the South East European University (SEEU) in Tetovo, Macedonia and delivered a lecture on "Albania vis-à-vis challenges of the

time and European perspective". In his lecture, Governor Fullani informed the participants on measures taken by the Bank of Albania to ensure sustainable and sound development of macroeconomic and financial stability underlining that, regardless of the crisis effect, the Albanian banking system remains liquid, well-capitalised and capable to accomplish its mission. Governor Fullani dedicated a significant part of his lecture to the issue of global crisis and its effects. At the conclusion of his lecture, the Governor had a Q&A and discussion session with SEEU professors and students on special issues raised by them.

Moreover, Governor Fullani had a meeting with the Rector, Mr. Alajdin Abazi, and other SEEU functionaries and professors. They discussed the importance of educating the new generation. In this context, the Governor informed his interlocutors on Bank of Albania's initiatives on citizen education, with students being an important part of it. During the meeting they also discussed about cooperation between the SEEU and the Bank of Albania. The Governor told the SEEU that the Bank of Albania will assist their library with copies of BoA's publications.

During his visit in Macedonia, Governor Fullani met with the Governor of the National Bank of the Republic of Macedonia (NBRM), Mr. Petar Goshev, at the NBRM head office in Skopje. In this meeting, the two governors discussed about the macroeconomic situation in both countries and in the region. Furthermore, they discussed about the development of bilateral cooperation in areas of mutual interest.

On 15-16 March 2010, the Governor of the National Bank of Serbia, Mr. Radovan Jelašić paid a two-day official visit to Albania upon an invitation by the Governor of the Bank of Albania, Mr. Ardian Fullani. Discussions in their meeting focused on financial stability in the region, underlining that coordination of various macroeconomic policies would contribute to the promotion of regional and European integration. Ways to further cooperation was another important point of their discussion. An agreement between the two central banks was signed last year with an aim to exchange experiences in various fields of central banking. Implementation of this agreement on technical cooperation is ongoing.

Governor Radovan Jelašić of the National Bank of Serbia visits Bank of Albania

During his official visit, Governor Jelašić delivered a lecture on "The future will be different from the past! The case of Serbia". The lecture was delivered at the hall of the Bank of Albania to an audience of participants from the Bank of Albania, commercial banks, academic and research institutions as well as representatives of Serbian businesses in Albania.

On 23 March 2010, the Bank of Albania in cooperation with KfW Entwicklungsbank (the German Development Bank) and the European Fund for Southeast Europe (EFSE) organised a conference on "Responsible finance in Albania". The participants in the panel, representatives of the financial sector,

Conference: "Responsible Finance in Albania", co-organised by the Bank of Albania, KfW Entwicklungsbank and EFSE

Albanian government, donor agencies, international financial institutions as well as microfinance practitioners in Albania, called for bigger efforts to promote practices and principles of responsible finance in Albania.

During the past years, financial and microfinance sectors in South Eastern Europe, including Albania, have seen high rates of economic growth. Businesses and individuals now have better access to financial services. Nevertheless, in spite of positive effects, the growing trend has been accompanied by negative aspects also – non transparent lending practices, non transparent pricing for financial products and ambiguous publicity – putting many clients at risk for a higher debt. Panellists underlined the need for bigger attention to the exchange rate risk, which follows currency appreciation or depreciation and bank loans in foreign currencies. Especially in volatile settings, fluctuations of the exchange rate may increase the burden of foreign currency loans on borrowers.

Furthermore, the conference highlighted the importance of promoting financial education as a key component to ensure fair and equal access to financial and crediting services. To raise the public awareness on these issues, EFSE, in cooperation with the KfW and central banks in the region, organises regular workshops and conferences. The panel in Tirana was the fourth in line on responsible finance discussions supported by the EFSE. Other similar panels are organised in Serbia, Kosovo and Bosnia and Herzegovina.

Bank of Albania trains teachers of economics in high schools of Durrës, Berat and Fier

Under its “Central Bank in daily life” educational programme, the Bank of Albania organises training workshops for high school teachers of economics. These workshops aim to deepen and expand teachers’ knowledge on central banking and the Bank of Albania and its role in the economy. The training programme includes, but is not limited to, topics such as financial policy and state budget.

Bank of Albania’s workshops for teachers aim at building their professional capacities in the areas of economy and finance, for a better, improved and more comprehensive education of high school students. During the first half of 2010, workshops were organised for teachers of Durrës, Berat and Fier, as per the following schedule:

Date	Event description
29 March – 2 April 2010	Training workshop for high school teachers of Durrës
26 – 30 April 2010	Training workshop for high school teachers of Berat
24 – 28 May 2010	Training workshop for high school teachers of Fier

Bank of Albania holds its 4th Forum with the banking system

On 15 April 2010, the Bank of Albania organised its 4th Forum with the banking system. This periodic event provides a platform for exchanging ideas and introducing approaches to developments that affect banking and financial activities in the framework of financial system stability.

In his opening remarks, the Governor of the Bank of Albania, Mr. Ardian Fullani, after his welcoming words, informed the participants on the most important conclusions of the Financial Stability Report 2009, approved by the Supervisory Council of the Bank only the day before. After providing an assessment of the country's economic situation, the Governor continued with an assessment of the current situation for the banking system and the outlook for 2010. The Governor confirmed that the banking system in Albania is sound and stable and that it provides full guarantee to mobilise savings and channel them into support for the country's economic activity.

On 29 April 2010, the Governor of the Bank of Albania presented the Bank of Albania's Annual Report 2009 to the Assembly of Albania. This report is a comprehensive and transparent analysis of economic and financial developments in Albania as well as a report of the work of the Bank of Albania to accomplish its legal duties and institutional commitments.

Governor Fullani presents Annual Report 2009 to Parliament

While introducing 2009 as a challenging year for the Albanian economy, in all its dimensions, Governor Fullani briefed the Assembly on measures taken by the Bank of Albania in response to the global economic and financial crisis. Concluding, Governor Fullani revealed Bank of Albania objectives and commitments for 2010 and assured the Assembly that Bank of Albania will continue to report to it with seriousness, responsibility, accountability and transparency and that it will never cease nor hesitate to comply with its legal and constitutional obligations.

On 21 June 2010, the Bank of Albania organised a forum on: "Interbank market development and improvement of Bank of Albania operational policy". In this forum, the Bank of Albania introduced market operators to its operational policy review process. In the near future, these objectives will change their form shifting the target from quantitative indicators of the Bank of Albania balance sheet to interest rates of the interbank market. This shift aims to keep the range of short-term interest rates in the interbank market around similar lines with the key interest rate of the Bank of Albania.

Forum: "Interbank market development and improvement of BoA operational policy"

Governor Fullani told the forum that the operational objective conforms well to the mid-term orientation and commitment of the Bank of Albania to adopt an inflation targeting regime, making thus an important step towards its successful adoption. The change in the form of the operational objective is in line with decisions on monetary policy, which relies now on a more comprehensive information analysis that comes from the market economy and aims to administrate better the expectations of market operators.

The Research Department of the Bank of Albania organises a fortnightly "Friday Seminar". This initiative invites experts of the Bank of Albania, researchers from academic and other financial institutions to present and

Friday Seminar

discuss their theoretical/empirical research papers on Albania and application of most advanced research methods.

During the first half of 2010, in "Friday Seminar" series seven research papers were presented by representatives of the Bank of Albania, other central banks and academics. These papers addressed issues of monetary and financial stability, exchange rate, development policy, etc.

"Friday Seminar" for 2010 opened with a study by Oriela Kodra of BoA Research Department on "Monetary and Financial Conditions Indices – the case of Albania". This paper assesses relative weights of real interest rates and the real exchange rate in the case of Albania as well as calculates the monetary and financial conditions index. The Monetary Conditions Index (MCI) was first introduced by the Bank of Canada and has been used by many international banks and institutions as a mechanism to interpret the direction of monetary policy and related effects on the economy.

The MCI is a weighted average of real interest rates and real exchange rates and determines if monetary conditions in a given economy are "loosened" or "tightened." The result is displayed by a specific number that shows the grade of pressure that monetary policy exercises on economy and consequently on inflation. The methodology used to assess relative weights of real interest rates and real exchange rates is OLS (Ordinary Least Squares), the assessment covers the period 1998-2008 and data are quarterly. According to empirical results, the MCI for the case of Albania is 3.8, implying that the effect of a real effective exchange rate (REER) by 3.8 percentage points might be neutralised by a shift of 1 percentage point in real interest rates.

Another presentation was on "An investigation of the effects of exchange rate volatility on exports in East Asia" by Dilara Das, PhD, University of Southern Illinois. This paper addresses the estimation of the long term effect of exchange rate volatility on trade flows of Southeast Asian countries before and after 1997. The research elaborates also on the estimation of the persistence of exchange rate effect on export flows based on several volatility measures. The author uses ARCH (1) and GARCH (1, 1) models for estimation. Empirical results show that long term demand for exports depends on relative export prices, world income, exchange rate volatility, and real effective exchange rate. Results reveal a negative correlation between exchange rate volatility and export demand in the long run for countries like South Korea and Malaysia. This shows that risk-averse producers prefer to carry out their transactions in domestic versus international markets.

"The Equilibrium of the Real Lek-Euro Exchange Rate: How far from Equilibrium?" by Erjon Luçi, The World Bank and Ilir Vika, BoA Research Department, was another presentation at the Friday Seminar Series. This paper seeks to identify factors determining exchange rate developments, estimate an equilibrium exchange rate, and assess whether actual exchange rate deviates from the equilibrium rate.

Exchange rate determinants taken in consideration included productivity differential, net foreign assets, government expenditure, interest rate differential, degree of openness of the economy, remittances, and terms of trade.

The paper relies on the Autoregressive Distributed Lag (ARDL) methodology developed by Pesaran and Shin (1999). The authors conclude that the real exchange rate does not appear to be deviating from its medium term equilibrium.

Another paper presented was on "The Use of the Euro in Central, Eastern and Southeastern Europe: Extent, Causes and Impacts of the Global Financial Crisis" by Ms. Doris Ritzberger-Gruenwald, Head of the Foreign Research Division, Bank of Austria, Mr. Helmut Stix, Economist, Economic Research Division, Bank of Austria, and Mr. Thomas Scheiber, Economist, Foreign Research Division, Bank of Austria. This paper presents results of a survey carried out in ten European countries, five of which are EU members and the other five candidates for EU accession.

The central questions of the survey concerned cash holdings in foreign currency, number of deposits in foreign currency, and the amount of bank loans in foreign currency, among others. Some of the key findings of the survey showed that these countries have high degrees of euroization, that they suffer from a high persistence of euroization, and that the financial crisis has had an impact on each individual's portfolio.

"The Institutional Model of Socio-economic Development: The Role of Education and Training and Related Issues" by Mr. Oliver Deasy, EU CARD program representative in Albania, was the next presentation in line. This presentation introduces the institutional model of economic development, with special reference to the Irish model. Results show that the role of education and individual training is very important for a country's economic development and that education and training helps attract Foreign Direct Investments (FDI). Indeed, it is everybody's duty to promote public training and education through strategy development policies.

Mr. Krishna Kamath, economist at the Finance Department of the Wharton School of Business, presented a paper on "Match – Making and Rent – Seeking: An empirical analysis of mergers of Venture – Backed Companies".

This paper studies the rent-seeking behaviour accompanying the "keiretsu" effect of venture capital companies. Using examples from 750 mergers among venture-backed companies, the author concludes that deals where the acquiring company and the target company are backed by a common venture capital firm achieve lower announcement CAR and produce lower post-merger operational performance by the acquirer. In addition, venture backed acquirers pay more for the acquisition of companies backed by the same venture.

Lastly, stock as a method of payment is used more in the case of mergers between companies backed by the same venture. The results show that venture

capitalists facilitate the merger between companies by reducing information asymmetry and use their influence to extract rent from the stockholders of the acquiring company.

The last paper presented in the seminar for the first half of 2010 was “Bank Credit and GDP” by Mr. Arjan Kadareja, a member of the Supervisory Council of the Bank of Albania. This paper identifies the importance of bank credit transmission of monetary policy in the Euro Area, as well as the real effects of the 2007 global financial crisis on banks. The applied evaluation method is the instrumentalised panel method and the quarterly data covers the period 1999-2008.

The countries subject to the study are Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal and Spain.

The results reveal that in the Euro Area the bank credit transmission mechanism of monetary policy is important, in that changes in bank credit (in volumes and/or standards) have important effects on output, unlike the case of the US (Driscoll, 2004). This finding suggests that bank credit developments can be taken into consideration for monetary policymaking in the Euro Area. Moreover, the results of this study can be used to measure the real impact of negative shocks on banks in the context of the global financial crisis that started in the middle of 2007.

MONETARY POLICY DECISIONS

28 January 2009

The Supervisory Council of the Bank of Albania decides to decrease the key interest rate by 0.50 percentage points, to 5.75%.

25 February, 25 March, 29 April, 17 May, 24 June, 29 July, 26 August
and 30 September 2009

The Supervisory Council of the Bank of Albania decides to keep the key interest rate unchanged at 5.75%.

28 October 2009

The Supervisory Council of the Bank of Albania decides to decrease the key interest rate by 0.50 percentage points, to 5.25%.

25 November and 23 December 2009

The Supervisory Council of the Bank of Albania decides to keep the key interest rate unchanged at 5.25%.

27 January, 24 February, 24 March, 28 April, 26 May, 30 June 2010

The Supervisory Council of the Bank of Albania decides to keep the key interest rate unchanged at 5.25%.

LEGAL EVENTS OVER THE FIRST HALF OF 2010

MONETARY POLICY

On 27 January 2010, the Supervisory Council of the Bank of Albania approved by Decision No. 2 "The Monetary Policy Statement of the Bank of Albania for the Second Half of 2009". According to this Statement, the Albanian economy recorded positive growth, despite the progressively slower growth rate in the second half of 2009. This performance owes to the fall in foreign demand and the slower domestic demand against a background of tight liquidity conditions. Below-potential economic growth produced an environment of generally receding inflationary pressures. In October 2009, the Bank of Albania cut the key interest rate by 0.5 p.p. to 5.25%. In addition, the Bank of Albania increased the injection of liquidity into the banking system to meet the banking system's and the economy's demand for liquidity.

On 28 April 2010, the Supervisory Council of the Bank of Albania approved by Decision No. 29 "The Monetary Policy Report for the First Quarter of 2010". This Report provides a comprehensive overview of the latest macroeconomic developments of factors that have affected and are expected to affect consumer prices at home. According to this Report, economic activity in Albania was relatively sluggish in the first quarter of 2010, while exports grew at a rapid pace. The overall macroeconomic environment and monetary conditions did not fuel the creation of stable inflationary pressures. The performance of financial markets and monetary indicators was encouraging and the Bank of Albania's policy helped ease the inflationary expectations and reach a more balanced performance of the external sector of the economy.

On 30 June 2010, the Supervisory Council of the Bank of Albania adopted the Decision No. 43 "On some changes to "The Monetary Policy Document for the 2009-2011 Period"". The purpose of these changes is to reformulate the operational objective of the Bank of Albania. Subsequently, the operational objective of the Bank of Albania's monetary policy will be steering the short-term interest rates in the interbank market close to the central bank's key interest rate, set by the Supervisory Council, and curbing their movements.

BANKING SUPERVISION

On 24 February 2010, the Supervisory Council of the Bank of Albania adopted the Decision No. 10 "On the abrogation of Decision No. 28, dated 25 March 2009, of the Supervisory Council of the Bank of Albania". This Decision abrogates the suspension of the allocation of profit realized in 2008

and 2009, and the one carried over from previous periods, from banks and branches of foreign banks.

On 10 March 2010, the Supervisory Council of the Bank of Albania adopted the Decision No. 13 "On granting the First Investment Bank, Albania, sh.a., preliminary approval for conducting additional activity". Following this Decision, the First Investment Bank may conduct money broking activities of custodial, depository and trust services.

On 24 March 2010, the Supervisory Council of the Bank of Albania adopted the Decision No. 22 "On granting Intesa Sanpaolo Bank Albania, sh.a., preliminary approval for conducting additional activity". Following this Decision, Intesa Sanpaolo Bank Albania may conduct money broking activities of custodial, depository and trust services.

On 24 March 2010, the Supervisory Council of the Bank of Albania adopted the Decision No. 23 "On granting Tirana Bank, sh.a., preliminary approval for conducting additional activity". Following this Decision, Tirana Bank may conduct money broking activities of custodial, depository and trust services.

On 24 March 2010, the Supervisory Council of the Bank of Albania approved by Decision No. 25 the Regulation "On risk management in the activity of non-bank financial institutions". The purpose of this Regulation is to set out the rules for the management of risk in the activity of non-bank financial institutions. In addition to non-bank financial institutions, this Regulation shall also apply on micro-credit financial institutions, being granted a license to carry out financial activity in the Republic of Albania. Upon the approval of this Regulation, the Regulation "On the supervision norms of non-bank entities conducting financial activity" is abrogated.

On 14 April 2010, the Supervisory Council of the Bank of Albania adopted by Decision No. 27 "Supervision Operational Policy". The purpose of this Decision is to set out the criteria for an ongoing risk-oriented supervision; that is, the supervisory sources and capacities will orient towards the monitoring of banking institutions that pose higher risk. This Document sets out specific elements of the supervisory process, such as the regulatory and licensing framework, off-site supervision, on-site examination, supervisory process strategy and structure, electronic database, etc.

On 12 May 2010, the Supervisory Council of the Bank of Albania adopted the Decision No. 33 "On granting Alpha Bank-Albania preliminary approval for conducting additional activity". Following this Decision, Alpha Bank-Albania may conduct money broking activities of custodial, depository and trust services.

On 26 May 2010, the Supervisory Council of the Bank of Albania approved by Decision No. 36 the Regulation "On establishing the level of decision-making in the supervision of banking and financial activities". The purpose

of this Regulation is to establish the level of the exercise of competences by the Bank of Albania's governing structures in the decision-making process in relation to its supervisory function, through the implementation of the principle of competence delegation to the closest persons, who exercise the specific relevant functions.

On 16 June 2010, the Supervisory Council of the Bank of Albania adopted the Decision No. 37 "On granting Credins Bank, sh.a., preliminary approval for conducting additional activity". Following this Decision, Credins Bank, sh.a., may conduct money broking activities of custodial, depository and trust services.

FINANCIAL STABILITY

On 14 April 2010, the Supervisory Council of the Bank of Albania approved by Decision No. 24 "The Financial Stability Report for 2009". According to this Report, due to the extraordinary fiscal and monetary stimulus in 2009, the global economy has stabilized and its stable recovery is underway. The Albanian economy posted a positive growth, despite the impact of the global financial and economic crisis. The financial system, dominated by the banking sector, was stable and fiscal and monetary stimulus mitigated the difficulties of the real sector of the economy. By and large, the economic developments will exert pressure on private entrepreneurship and households' financial situation, at least in the first half of 2010. The banking sector should aim at a gradual recovery of lending through the monitoring of loan quality. It remains sensitive to highly volatile exchange rate movements.

MONETARY OPERATIONS

On 30 June 2010, the Supervisory Council of the Bank of Albania adopted the Decision No. 44 "On a change to the Regulation "On Overnight Deposit"". Following this Decision, Article 1 of this Regulation changes to: "Overnight deposit is a short-term investment instrument available to commercial banks. The purpose of the overnight facility is to manage the level of liquidity in the banking system and steer short-term interest rates in the money market in line with the operational objective of the Bank of Albania's monetary policy".

On 30 June 2010, the Supervisory Council of the Bank of Albania adopted the Decision No. 45 "On some changes to the Regulation "On Overnight Loan"". The purpose of this Decision is to reformulate the definition of overnight loan in Article 1 of the Regulation, while Article 5 sets out that the interest rate on overnight loan is 1.75%, on an annual basis, higher than the interest rate on repurchase agreements.

On 30 June 2010, the Supervisory Council of the Bank of Albania adopted the Decision No. 46 "On some changes to the Regulation "On Repurchase and Reverse Repurchase Agreements"". These changes affect, *inter alia*,

Article 3 of the Regulation, which sets out the objective of intervention through repurchase and reverse repurchase agreements. Following these changes, in addition to the short-term management of liquidity in the banking system, it will be aimed at meeting the operational objective of monetary policy by steering the short-term interest rates in this market.

On 30 June 2010, the Supervisory Council of the Bank of Albania approved by Decision No. 47 the Regulation "On Outright Transactions". The purpose of this Regulation is to set out the rules and ways of Bank of Albania's operations in the interbank money market through outright transactions. The purpose of these operations is to adjust the market liquidity structure, with possible impact on the short-term interest rates in this market. Following the approval of this Regulation, the Regulation "On Outright Transactions", approved by Decision No. 56, dated 13 July 2005, is abrogated.

ECONOMIC POLICY

On 7 January 2010, the Council of Ministers adopted the Decision No. 4 "On the approval of macroeconomic and fiscal framework for the 2011-2013 period". Through this Decision, the Council of Ministers approves the key macroeconomic indicators for this period and the fiscal indicators according to the consolidated budget.

On 13 January 2010, the Council of Ministers adopted the Instruction No. 1 "On the way of verifying or examining the legal validity of the creation of property titles on agricultural land of former agricultural enterprises and the development area with tourism as a priority". This Instruction authorizes the local commissions for the verification of property titles to take, on their own initiative, direct control on the activity of former land commissions at all levels in the process of agricultural land division. The control order for the land areas of former agricultural enterprises and the development areas with tourism as a priority will be formulated by these commissions and approved by the District Prefecture.

On 21 January 2010, the Albanian Parliament approved by Law No. 10214 the ratification of "The agreement between the Council of Ministers of the Republic of Albania and the Government of Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income". This Agreement shall apply to value added tax, corporate tax and capital gains tax, placed on behalf of one of the two countries or their respective local authorities.

On 21 January 2010, the Albanian Parliament approved the Law No. 10215 "On some changes and amendments to the Law No. 7928, dated 27 April 1995 "On value added tax, as amended"". This Law provides, *inter alia*, for changes in the articles that regulate the cases when the obligation for the registration and cancellation of registration of taxable persons is borne, the categories of supplies exempt from taxation, reimbursement, etc.

On 27 January 2010, the Council of Ministers adopted the Decision No. 43 "On some changes to the Decision No. 1140, dated 30 July 2008, of the Council of Ministers "On the approval of the inter-sectoral strategy of the fight against organized crime, traffics and terrorism". The changes provide for the establishment of the Inter-institutional Committee for Measures against Organized Crime, Traffics and Terrorism, which shall monitor the strategy and coordinate the activity of institutions engaged in its implementation. This Committee shall be chaired by the Prime Minister and shall convene every three months.

On 3 February 2010, the Council of Ministers adopted the Decision No. 55 "On the mandatory declaration of tax statements and other tax documentation only through electronic form". This Decision stipulates the declaration of VAT payment statement, tax on labour income payment, tax on profit and social and health insurance contributions only through electronic form.

On 3 February 2010, the Council of Ministers adopted by Decision No. 60 "The IDF Grant Agreement No. TF 094711 between the Republic of Albania and the International Bank for Reconstruction and Development (IBRD) for "The strengthening of Aarhus Convention Implementation Project"". The grant of USD 370,000 from the International Bank for Reconstruction and Development will be used to finance the Aarhus Convention Implementation "On access to information, participation to decision-making and access to justice". The purpose of this project is to strengthen the institutional capacity and the legal framework; access information and enhance transparency on issues relevant to Aarhus Convention.

On 3 February 2010, the Council of Ministers adopted the Decision No. 135 "On establishing the criteria for the allocation of the Regional Development Fund". According to this Decision, 20% of total Regional Development Fund shall be allocated to priority sectors and areas, 25% by the number of population in each district, 35% by the level of district poverty, and 20% to sectors according to investment in the last 4 years.

On 4 February 2010, the Albanian Parliament approved the Law No. 10219 "On some amendments to the Law No. 9482, dated 3 April 2006 "On the legalization, urbanization and integration of buildings without permits", as amended"". This Law provides, *inter alia*, that the owners of the buildings without permits built within and outside the yellow lines may pay up to 70% of the construction site value through privatization certificates.

On 4 February 2010, the Albanian Parliament approved the Law No. 10224 "On the adherence of the Republic of Albania to the international convention on civil liability for bunker oil pollution damage, 2001". Upon signature of this convention, the states parties aim at adopting uniform international rules and procedures for determining questions of liability and providing prompt and effective compensation for damage caused by pollution resulting from the escape or discharge of bunker oil from ships.

On 4 February 2010, the Ministry of Agriculture, Food and Consumer Protection and the Ministry of Finance adopted the Instruction No. 1 "On the implementation of the Council of Ministers' Decision No. 1290, dated 23 December 2009 "On establishing the basic criteria for the sectors to benefit and the extent of this benefit from the agriculture and rural development programme fund"". This Instruction establishes the criteria and the extent of benefit of different sectors from the agriculture and rural development programme fund of ALL 1,515,000,000 and aims at boosting bank lending to agriculture. Some of the agricultural sectors benefiting from this programme are: farming, bio products, watering technology, growing of vegetables in greenhouses, etc..

On 10 February 2010, the Council of Ministers adopted by Decision No. 81 "The additional protocol between the Council of Ministers of the Republic of Albania and the Government of the Republic of Croatia on amendments to the agreement "On the encouragement and reciprocal protection of investment"". This protocol provides for changes in the national treatment and most-favoured-nation treatment provisions. Hence, the provisions of the agreement shall not apply to advantages accorded by a contracting party pursuant to its obligations as a member of a customs, economic, or monetary union, a common market or a free trade area.

On 10 February 2010, the Council of Ministers adopted by Decision No. 82 "The agreement between the Council of Ministers of the Republic of Albania and the Government of the Republic of Croatia on changes in the bilateral economic agreement between the Government of the Republic of Albania and the Government of the Republic of Croatia". These changes stipulate that upon the adherence of the Republic of Croatia to the European Union, the agreement shall apply without prejudice to the obligations arising from this membership. Moreover, this agreement shall not invalidate or affect the obligations under the Treaty on European Union and the Stabilization and Association Agreement between the European Union and the Republic of Albania.

On 11 February 2010, the Albanian Parliament approved by Law No. 10229 the ratification of "The note exchange agreement between the Council of Ministers of the Republic of Albania and the Government of Japan on the project financing for the upgrade of medical equipment in regional emergency centres in the Republic of Albania". The grant of JPY 718,000,000 endorsed by the Japanese Government shall be used for the purchase of necessary products and services for the improvement of medical equipment in emergency centres.

On 11 February 2010, the Albanian Parliament approved by Law No. 10230 the ratification of "The loan and financing agreement between the Republic of Albania, Kreditanstalt für Wiederaufbau (KfW), Frankfurt am Main and FEFAD Foundation on the SMEs promotion project". The loan of EUR 2,600,000 along with the financial contribution of EUR 210,000 shall be used by the project implementation agency, in this case by FEFAD Foundation,

to promote large, small and medium-sized enterprises in urban and rural areas.

On 11 February 2010, the Albanian Parliament approved the Law No. 10231 "On the ratification of the statute of the International Renewable Energy Agency (IRENA)". IRENA was established in Bonn on 26 January 2009. Considering the national priorities and benefits, and the contribution of renewable energy in protecting the environment, IRENA promotes the widespread and increased adoption and sustainable use of all forms of renewable energy.

On 11 February 2010, the Albanian Parliament approved by Law No. 10232 the ratification of "The loan agreement between the Republic of Albania and the Saudi Fund for Development for the financing of "Construction of Durrës Bypass Road" project". The loan of SR 45,000,000, with a maturity term of 25 years, shall be used to finance the works and cost of goods that will be used for the construction of Durrës bypass road.

On 15 February 2010, the State Aid Commission adopted by Decision No. 32 the Guidelines "On state aid for environmental protection". The purpose of these Guidelines is to establish the terms and criteria that determine the state aid for environmental protection. The primary objective of state aid is to ensure that state aid measures will result in a higher level of environmental protection and to ensure that the positive effects of the aid outweigh its negative effects, taking account of the polluter pays principle.

On 17 February 2010, the Council of Ministers adopted the Decision No. 140 "On financing hospital services through the mandatory health insurance scheme". According to this decision, hospitals are public judicial entities; they have an independent budget and are responsible for realizing their public procurements. Hospital capital expenditure on investment is provided by the Ministry of Health; however, hospitals can also make investment through other investment sources like donations and other funds created from operating income.

On 18 February 2010, the Albanian Parliament approved the Law No. 10234 "On the adherence of the Republic of Albania to the protocol "On integrated management of coastal areas in the Mediterranean of the Barcelona Convention for the protection of the marine environment and the coastal region of the Mediterranean". The purpose of integrated management of coastal areas is to assist the sustainable development of these areas by ensuring the harmonization of environment with economic development and the sustainable use of their natural resources.

On 18 February 2010, the Albanian Parliament approved the Law No. 10236 "On the takeover of companies with public bids". The purpose of this Law is to set out the rules, conditions and procedures for the takeover of companies with public bids. The application of this Law covers the bids publicly announced for the takeover of securities issued by a public company

with legal seat in the territory of the Republic of Albania and accepted for trading in the organized national security market, and by foreign public companies listed on the Albanian stock exchange. This Law is not applicable to the securities issued by the Bank of Albania.

On 24 February 2010, the Ministry of Labour, Social Affairs and Equal Opportunities adopted the Instruction No. 423 "On the criteria for the allocation of social protection undistributed funds". According to this order, a commission, chaired by the Minister, shall be charged with the allocation of social protection undistributed funds. It shall be charged with the review of projects and proposals made by the local government units.

On 25 February 2010, the Albanian Parliament approved the Law No. 10239 "On the establishment of a special compensation fund for the property owners". The purpose of this Law is to specify the compensation fund for the properties, the fund sources and the implementation rules. This fund shall be used to compensate, in monetary value, the expropriated entities that have gained the right of compensation where physical restitution of their property is not possible. This fund shall be managed by the Property Restitution and Compensation Agency. The fund shall be provided by the state budget, the sale of state property at auction, and by income generated through the property transfer of construction sites.

On 3 March 2010, the Council of Ministers adopted the Decision No. 149 "On an amendment to the Decision No. 1058, dated 21 October 2009, of the Council of Ministers "On setting the minimum threshold of registration for value added tax"". This amendment sets the minimum threshold of registration for value added tax of no less than ALL 2 million for a calendar year on all taxpayers who conduct economic activity in professions like: lawyer, notary public, dentist, pharmacist, architect, engineer, designer, certified accountant, economist, etc..

On 11 March 2010, the Albanian Parliament approved by Law No. 10248 "The ratification of the loan and project agreement between the Republic of Albania, represented by the Ministry of Finance, the Transmission System Operator, sh.a., as the Project Executing Agency, and KfW Frankfurt am Main for financing the 400 kV Transmission Line Albania-Kosovo (Tirana-Prishtina) project through a loan of EUR 42 million". According to this agreement, the loan of EUR 42 million shall be entirely channelled through the Transmission System Operator, sh.a., which shall be responsible for drafting, executing, operating and maintaining the 400 kV Transmission Line Albania-Kosovo (Tirana-Prishtina) project. The loan shall be repaid within a 10-year period beginning from June 2013.

On 11 March 2010, the Albanian Parliament approved by Law No. 10249 "The ratification of the loan and project agreement between the Republic of Albania, represented by the Ministry of Finance, the Transmission System Operator, sh.a., as the Project Executing Agency, and KfW Frankfurt am Main for financing the 110 KV Circuit Line South Albania project through a

loan of EUR 37.75 million". According to this agreement, the loan of EUR 37.75 million shall be entirely channelled through the Transmission System Operator, sh.a., which shall be responsible for drafting, executing, operating and maintaining the 110 KV Circuit Line South Albania project. The loan shall be repaid within a 10-year period beginning from June 2010.

On 11 March 2010, the Albanian Parliament approved by Law No. 10250 "The ratification of the loan and project agreement between the Republic of Albania, represented by the Ministry of Finance, and the Transmission System Operator, sh.a., as the Project Executing Agency of the 110 KV Circuit Line South Albania through a loan of EUR 10.75 million". The loan of EUR 10.75 million extended through this agreement is part of a three-loan package that will be used to finance the 110 KV Circuit Line South Albania project. This loan shall be repaid within a 30-year period beginning from June 2020.

On 11 March 2010, the Albanian Parliament approved by Law No. 10251 "The ratification of the loan and project agreement between the Republic of Albania, represented by the Ministry of Finance, the Transmission System Operator, sh.a., as the Project Executing Agency, and KfW Frankfurt am Main for financing the 110 KV Circuit Line South Albania project through a loan of EUR 500 thousand". The loan of EUR 500 thousand is part of the package that will be used to finance the 110 KV Circuit Line South Albania project. This loan shall be repaid within a 20-year period beginning from June 2020.

On 15 March 2010, the Minister of Finance adopted the Instruction No. 9 "On the procedures and deadlines for the redistribution of privatization certificates invested in investment funds, created in accordance with the Law No. 7979, dated 26 July 1995, "On investment funds"". According to this Instruction, the redistribution of privatization certificates and political prisoners' papers invested in investment funds shall be made at commercial banks serving as deposit holders of the respective funds.

On 17 March 2010, the Council of Ministers adopted by Decision No. 184 the Regulation "On the organization and functioning of the Public Procurement Commission and on some changes and amendments to Decision No. 659, dated 3 October 2007, of the Council of Ministers "On the approval of public procurement rules with electronic means"". The purpose of this Regulation is to set out the rules and functions of the Public Procurement Commission and the procedures for the procurement procedure complaints.

On 24 March 2010, the Council of Ministers adopted the Decision No. 208 "On granting the Government of Kosovo financial aid to execute the projects proposed in Graçanica Municipality in Kosovo". The financial aid of EUR 400 thousand shall be provided by the 2010 state budget reserve fund. The Albanian Development Fund shall monitor the execution of the proposed projects.

On 1 April 2010, the Albanian Parliament approved the Law No. 10261 "On some changes and amendments to the Law No. 9920, dated 19 May

2008 "On tax procedures in the Republic of Albania", as amended". This Law stipulates the changes in the Articles that regulate the structure of central tax administration through the establishment of the Tax Council, as the advisory body, and the structure and functions of investigation units that have the right to complain through the Taxpayer Lawyer.

On 1 April 2010, the Minister of Finance adopted the Instruction No. 11 "On regional development fund". The regional development fund consists of different competitive grants, like the one for road infrastructure, education, health, water-supply and sanitation, cultural objects, etc. This Instruction stipulates the principles and procedures to be followed during the applications and their assessment.

On 7 April 2010, the Council of Ministers adopted the Decision No. 238 "On an amendment to Decision No. 565, dated 9 August 2006, of the Council of Ministers "On the protection of needy households from the rise in electrical energy price"". According to this Decision, each recipient is compensated with ALL 640 per month. The financial effect of the additional compensation shall be provided by the 2010 state budget funds allocated to the Ministry of Labour, Social Affairs and Equal Opportunities.

On 8 April 2010, the Albanian Parliament approved the Law No. 10263 "On the use of uncultivated agricultural land". The purpose of this Law is to set out the rules and procedures for the use of uncultivated agricultural land in order to ensure the economic function of the property, without prejudice to the property right, in view of achieving a sustainable agricultural and rural development. This Law shall apply to agricultural land under private ownership of the following cadastral items: "field", "vineyard", "arboriculture" and "olive grove".

On 12 April 2010, the Council of Ministers adopted the Instruction No. 116 "On the bonus procedures awarded for the registration of newly born children under the Law No. 10129, dated 11 May 2009 "On the civil status"". This Instruction sets out the procedures to be followed for being awarded the bonus amounting to ALL 5 thousand for the registration of newly born children within 60 days of birth for children born inside the territory of the Republic of Albania, and 90 days of birth for children born outside the territory of the Republic of Albania.

On 13 April 2010, the Council of Ministers adopted the Decision No. 246 "On some changes to Decision No. 1180, dated 5 August 2008, of the Council of Ministers "On setting the service tariff for the legalization, collection and management of legalization income", as amended". The changes stipulate that the service tariff for the legalization of buildings without permits or informal extensions in buildings with permits shall be ALL 4 thousand for each building floor. In the case of informal buildings for housing or mixed (housing and social-economic) purposes, the payment of the site value may be made in Albanian Lek, in full value, and/or in privatization certificates. In the case of informal buildings for social-economic purposes, the payment shall be made only in Albanian Lek and in full monetary value.

On 15 April 2010, the Albanian Parliament approved by Law No. 10267 the ratification of "The mandate agreement between the Republic of Albania and Deutsche Bank AG, London/J. P. Morgan Securities, LTD, as co-managers for the Eurobond transaction of up to EUR 400 million and the approval of other transaction documents". The purpose of this Law is to approve the texts of the documents that relate to the Eurobond transaction, like the subscription agreement, the fiscal agency agreement, the commitment agreement and the bond terms and conditions agreement. The Republic of Albania has engaged Deutsche Bank and JPM to act as co-managers and depositors for the issuance and provision of a minimum of unsecured bonds of EUR 300 million, with a maturity of 3 to 5 years.

On 21 April 2010, the Council of Ministers adopted by Decision No. 270 "On supplementing the 2010 budget planned for the Ministry of European Integration for the payment of funds held by the European Commission for some projects financed by CARDS with the Ministry of European Integration being the recipient". According to this Decision, an amount of ALL 25.25 million shall be supplemented to the budget planned for the Ministry of European Integration for 2010. This supplement shall be used for the payment of funds held by the European Commission for some projects financed by CARDS with the Ministry of European Integration being the recipient.

On 21 April 2010, the Council of Ministers adopted the Decision No. 282 "On the approval of the agreement in principle between the Council of Ministers of the Republic of Albania and the Swiss Confederation on AlbVET support programme for the Albanian vocational education and training (ATP), second phase, July 2009-June 2011". The overall purpose of this project is to contribute to the Albanian vocational education and training system that matches with the labour market requirements and strives towards European standards, and thus contributes to economic development and poverty reduction. For the implementation of this project, the Swiss Government provides a grant of CHF 2.6 million.

On 21 April 2010, the Council of Ministers adopted the Decision No. 283 "On the approval of the agreement in principle between the Council of Ministers of the Republic of Albania and the Swiss Confederation on alternated education and vocational training (CEFA), sixth phase, May 2009-June 2012". The goal of this project is to provide support to the Albanian institutions to contribute to the further enhancement of educational and social inclusion of Roma and Egyptian communities through formal education in public schools and vocational training. The grant of CHF 2.22 million provided by the Swiss Government shall be used to finance different parts of the project like: training of Roma language teachers, training of Roma NGOs to enhance their capacities, training of non-Roma teachers on human rights, etc..

On 22 April 2010, the Albanian Parliament approved by Law No. 10268 the ratification of "The agreement between the Republic of Albania and the Republic of Austria on mutual aid in cases of catastrophes or serious events".

This agreement sets out the conditions of voluntary aid in cases of catastrophes or serious events provided through the intervention of aid teams, individuals sent to provide the aid, materials or information.

On 22 April 2010, the Albanian Parliament approved by Law No. 10269 the ratification of "The loan agreement between the Republic of Albania and the European Bank for Reconstruction and Development for financing the regional and local road project". The loan of EUR 50 million shall be used for the rehabilitation of 500 km of the regional and local road network in Albania. The project is expected to be completed by the end of 2015 and it covers the preparation of engineering projects, civil works for the rehabilitation of roads, supervision of construction works, consultations about the improvement and upgrade of local roads, etc..

On 22 April 2010, the Albanian Parliament approved the Law No. 10270 "On the right of privatization of public land in use and tax on the right to use it". The purpose of this Law is to regulate and ensure the collection of income through the right of privatization and to set tax on the right to use public land, in use by individuals that have benefited from the privatization of buildings on public land. According to this Law, the tax on the right to use public land is annual and equals 10% of the value of public land in use. In accordance with the provisions of this Law, 75% of the income collected from the privatization or sale of public land shall be transferred to the state budget and 25% to the local government budget.

On 28 April 2010, the Council of Ministers adopted the Decision No. 278 "On establishing the financial amount in the 2010 state budget to be allocated to the religious communities that have entered into agreement with the Council of Ministers". According to this Decision, out of ALL 100 million, the Albanian Muslim Community shall be allocated ALL 28 million, while the Orthodox Autocephalous Church of Albania, the Catholic Church in Albania and World Headquarters of Bektashians shall be allocated ALL 24 million each.

On 6 May 2010, the Albanian Parliament approved by Law No. 10274 the ratification of "The agreement on military grant between the Council of Ministers of the Republic of Albania and the Government of the Republic of Turkey". The purpose of this agreement is to strengthen military cooperation for the restructuring of the Armed Forces of the Republic of Albania. According to this agreement, the grant of TL 727.5 thousand, equivalent to US dollars, shall be provided in the form of materials and services, and TL 60 thousand, equivalent to US dollars, shall be provided in the form of monetary value.

On 6 May 2010, the Albanian Parliament approved the Law No. 10275 "On some amendments to the Law No. 8691, dated 16 November 2000 "On the production and trading of tobacco and cigarettes", as amended". The purpose of these amendments is to stipulate the procedures to be followed on those tobacco products that have been used as means for being engaged in criminal acts, on which a categorical rule by the court has been issued for

the confiscation of tobacco products, whose packaging does not comply with the Law provisions.

On 6 May 2010, the Albanian Parliament approved the Law No. 10276 "On some changes to Law No. 10267, dated 15 April 2010 "On the ratification of the mandate agreement between the Republic of Albania and Deutsche Bank AG, London/J.P. Morgan Securities, Ltd, as co-managers for the Eurobond transaction of up to EUR 400 million and the approval of other transaction documents"". According to these changes, the document entitled "Indicative price", dated 30 March 2010, is substituted by the document entitled "Indicative price", dated 4 May 2010. The annex entitled "Indicative price" for the Eurobond to be issued by Albania provides the reference levels and the indicative price at current market conditions.

On 12 May 2010, the Council of Ministers adopted the Decision No. 334 "On the approval of the bilateral protocol on development cooperation between the Council of Ministers of the Republic of Albania and the Government of the Republic of Italy, 2010-2012". The Italian Development Cooperation will focus on three main sectors: private sector development; agriculture and rural development, and social development (education, health, employment policies). The Italian Development Cooperation will commit EUR 51 million, out of which EUR 28 million in the form of soft loans, EUR 3 million in the form of grants and EUR 20 million in the form of debt conversion.

On 19 May 2010, the Council of Ministers adopted the Decision No. 383 "On establishing the allocation procedures of the compensation to owners of private real estate affected by informal buildings". The purpose of the Decision is to establish the rules and procedures to be followed by the Property Restitution and Compensation Agency, pursuant to the Council of Ministers decisions, in the process of compensation to owners of private real estate affected by informal buildings.

On 19 May 2010, the Council of Ministers adopted the Decision No. 389 "On the compensation to owners of private real estate affected by informal buildings". The purpose of this decision is to establish the compensation to owners of private real estate occupied by informal buildings in the districts of Tirana, Elbasan, Fier, Berat, Shkodra, Gjirokastra, Dibra, Lezha and Durrës, in full value, for the land area of 48,849.90 m² amounting to ALL 757,664,073.8.

On 20 May 2010, the Albanian Parliament approved the Law No. 10280 "On some changes and amendments to Law No. 9975, dated 28 May 2008 "On national tax", as amended". These changes mainly relate to the tax applied to used transportation vehicles and its calculation; carbon tax on gas, gas oil and coal gas; annual circulation tax of vehicles and the method of calculation by levels, etc..

On 20 May 2010, the Albanian Parliament approved the Law No. 10281 "On the adoption of the normative act under Law No. 1, dated 5 May 2010,

of the Council of Ministers "On some changes and amendments to Law No. 9663, dated 18 December 2006 "On concessions", as amended". Based on this Law, the Albanian Parliament recommends that the Public Procurement Advocate consolidates the work further in 2010 in order to ensure adequate enforcement of legal procedures by the contracting authorities, the prevention of irregularities, and the protection of candidates, bidders and suppliers' interests. This institution shall focus on the improvement of the legal framework in order to ensure the functioning of the public procurement and concession system, and the increase in their audit.

On 26 May 2010, the Council of Ministers adopted the decision No. 398 "On some changes to Decision No. 1, dated 10 January 2007, of the Council of Ministers "On the adoption of public procurement rules", as amended". This Decision develops provisions which regulate, *inter alia*, the procurement of sectoral contracts and shall be implemented by the contracting authorities that conduct activity in the sectors of water, energy, transportation and postal service, regardless whether they carry out their activity on the basis of exclusive or special rights.

On 3 June 2010, the Albanian Parliament approved by Law No. 10285 "The ratification of Convention between the Council of Ministers of the Republic of Albania and the Government of the Republic of Estonia for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income". The purpose of this Convention is to develop and facilitate the economic relations between the two countries further. This Convention shall apply to tax on income in both countries and tax on small-sized business in Albania.

On 3 June 2010, the Albanian Parliament approved the Law No. 10286 "On some changes and amendments to Law No. 8976, dated 12 December 2002 "On excises", as amended". The changes mainly affect the article that regulates the confiscation procedures in cases of violation during the storage, transportation and sale of unstamped excise goods.

On 15 June 2010, the Minister of Public Works and Transportation and the Minister of Finance adopted the Joint Instruction No. 13 "On some changes and amendments to Instruction No. 6257, dated 2 September 2008 "On establishing the subsidized loan amount to households benefiting loans from the state", as amended". Among others, this Instruction includes in the categories benefiting 0% interest rate loans, the households residing in the houses of political and economic emigrants; tenant households living in former private properties and paying rent to the owner prior to 1992; tenant households that have been living in former private properties and continue to live in the same properties, but branching out on the family tree prior to 1992.

On 16 June 2010, the Council of Ministers adopted the Decision No. 450 "On some changes and amendments to Decision No. 681, dated 11 June 2009, of the Council of Ministers "On the recovery of loans transferred

from entirely state-owned commercial banks to the Loan Recovery Agency, the terms and conditions for the change in the loan agreement and the property procedures of real estate pledged or unpledged by the borrowers, the management, sale and lease or emphyteutic lease of real estate". Among others, this Decision stipulates that the debtors settling the entire transferred or remaining principal amount at once are forgiven 10% of all penalties, late payment penalties or interest rates. The debtors who decide to pay the remaining by instalments shall pay a part of interest rates and late payment penalties according to the rates specified in this Decision.

On 16 June 2010, the Council of Ministers adopted the Decision No. 478 "On the termination of employment relationships by the public administration bodies after meeting the retirement conditions". The purpose of this Decision is to regulate the procedures to be followed by public administration bodies, entirely or partially financed by the State Budget, in cases when the insured employees meet the retirement conditions.

On 17 June 2010, the Albanian Parliament approved the Law No. 10288 "On the ratification of the free trade agreement between the Republic of Albania and EFTA states and the agreements on agriculture between the Republic of Albania and the Swiss Confederation and Principality of Liechtenstein, the Republic of Albania and the Kingdom of Norway, and the Republic of Albania and Iceland, as integral parts of EFTA". By means of this agreement, Albania and EFTA States commit to establish a free trade area for agricultural products with a view to mutually increase investment opportunities and spurring prosperity and economic development in their territories.

On 23 June 2010, the Council of Ministers adopted the Decision No. 486 "On an amendment to Decision No. 41, dated 14 January 2009, of the Council of Ministers "On granting concession to ARMO sh.a. Tirana, to refine oil, gas and their by-products". According to this Decision, ARMO sh.a. shall be prohibited to sell semi-refined products to entities that do not have relevant trading permission or the relevant refining equipment for these semi-refined products.

On 30 June 2010, the Council of Ministers adopted the Decision No. 474 "On pension raise". After raising pensions for different categories by 4%, 6% and 10%, this Decision stipulates that the minimum retirement pension in cities shall be no less than ALL 12,840 per month, while the minimum retirement pension in villages shall be no less than ALL 7,870 per month. The financial effects of the implementation of this Decision shall amount to ALL 1,912 million and be provided by the contingency fund allocated in the 2010 state budget for the pension raise.

On 30 June 2010, the Council of Ministers adopted the Decision No. 476 "On raising the supplementary pension for militaries, State Police employees and the special financial treatment". This Decision raises the temporary or supplementary pension and the special financial treatment by 4% for the following categories: militaries, pilots, navy officers and sub-officers, naval

forces divers, mining workers, university and public research institutions employees in the Republic of Albania.

On 30 June 2010, the Council of Ministers adopted the Decision No. 477 "On some changes and amendments to Decision No. 1114, dated 30 July 2008, of the Council of Ministers "On some issues pursuant to Laws No. 7703, dated 11 May 1993 "On social insurance in the Republic of Albania", as amended, No. 9136, dated 11 September 2003 "On the collection of compulsory social and health insurance contributions in the Republic of Albania", as amended", and No. 7870, dated 13 October 1994 "On health insurance in the Republic of Albania", as amended". Among others, this Decision stipulates that the minimum monthly wage for the calculation of social and health insurance contributions shall be no less than ALL 16,820, while the maximum monthly wage shall be ALL 84,100.

BANK OF ALBANIA MANAGEMENT, 30 JUNE 2010

SUPERVISORY COUNCIL

ARDIAN FULLANI	Chairman
FATOS IBRAHIMI	Vice Chairman
TEFTA ÇUÇI	Member
LIMOS MALAJ	Member
KSENOFON KRISAFI	Member
ADRIAN CIVICI	Member
ARJAN KADAREJA	Member
HALIT XHAFA	Member
BENET BECI	Member

GOVERNOR

ARDIAN FULLANI

DEPUTY GOVERNORS

FATOS IBRAHIMI First Deputy Governor

GENERAL INSPECTOR

TEUTA BALETA

GOVERNOR'S OFFICE

GENC MAMANI

HEAD OF COORDINATION

GRAMOS KOLASI

DEPARTMENTS AND OTHER UNITS

HUMAN RESOURCES DEPARTMENT	Roden Pajaj
MONETARY POLICY DEPARTMENT	Erald Themeli
RESEARCH DEPARTMENT	Altin Tanku
MONETARY OPERATIONS DEPARTMENT	Marjan Gjermeni
SUPERVISION DEPARTMENT	Indrit Banka
FINANCIAL STABILITY DEPARTMENT	Klodion Shehu
INFORMATION TECHNOLOGY DEPARTMENT	Xhilda Kanini
STATISTICS DEPARTMENT	Diana Shtylla
ISSUE DEPARTMENT	Valer Miho
ACCOUNTING AND FINANCE DEPARTMENT	Artan Toro
PAYMENT SYSTEMS DEPARTMENT	Dashmir Halilaj
LEGAL DEPARTMENT	Toni Gogu
AUDIT DEPARTMENT	Teuta Baleta
FOREIGN RELATIONS, EUROPEAN INTEGRATION AND COMMUNICATION DEPARTMENT	Oneda Andoni
ADMINISTRATION DEPARTMENT	Agron Skënderaga
SECURITY AND PROTECTION DEPARTMENT	Eduard Sinani

BRANCHES

SHKODRA	Ermira Istrefi
ELBASANI	Valentina Dedja
GJIROKASTRA	Anila Thomaj
KORÇA	Liljana Zjarri
LUSHNJA	Shpresa Meço

LIST OF ENTITIES LICENSED BY THE BANK OF ALBANIA, JUNE 30, 2010

BANKS AND BRANCHES OF FOREIGN BANKS

1. RAIFFEISEN BANK (JOINT-STOCK COMPANY)

Licence No. 2/1998, dated 11.01.1999

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

Certificate No. 2 "On Deposit Insurance".

Director: Oliver WHITTLE
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 (JOINT-STOCK COMPANY)

Licence No. 3/1998, dated 11.01.1999

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

Certificate No. 3 "On Deposit Insurance".

Director: Hikmet GÜLER
Address: Rruga "Durrësit", sheshi "Rilindja" (Zogu i Zi), Godina Teknoprojekt, P.O. BOX 128, Tirana, Albania
Tel.: +355 4 2228 460 / 2223 873 / 2227 408
Fax: +355 4 2228 460 / 2228 387
E-mail: info@ubaal.com
Website: -

3. ITALIAN BANK OF DEVELOPMENT (BANCA ITALIANA DI SVILUPPO)

Licence No. 5/1998, dated 11.01.1999

Approved by the Supervisory Council Decision of the Bank of Albania No. 164, dated 11.12.1998. Certificate No.4 "On Deposit Insurance".

Director: Libero CATALANO
Address: Bulevardi "Dëshmorët e Kombit", Ndërtesa Kullat Binjake, Tirana
Tel.: +355 4 2280 555
Fax: +355 4 2280 356
E – mail: info@bisbanca.com
Website: www.bisbanca.com

4. NATIONAL COMMERCIAL BANK (JOINT-STOCK COMPANY)

Licence No. 6/1998, dated 11.01.1999

Approved by the Supervisory Council Decision of the Bank of Albania 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 (JOINT-STOCK COMPANY)

Licence No. 07, dated 12.09.1996

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

Certificate No. 6 "On Deposit Insurance".

Director: Dimitrios SANTIXIS

Address: Rruga "Dëshmorët e 4 Shkurtit", PO BOX 2400/1, Tirana, Albania

Tel.: +355 4 2269 616 / 7 / 8, +355 4 2233 441 / 42 / 43 / 44 / 45 / 46 / 47

Fax: +355 4 2233 417 / 2369 707

E – mail: info@tiranabank.al

Website: www.tiranabank.al

6. NATIONAL BANK OF GREECE (JOINT-STOCK COMPANY) – TIRANA BRANCH

Licence No. 08, dated 25.11.1996

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

Certificate No. 7 "On Deposit Insurance".

Director: Ioannis KOUGIONAS

Address: Rruga "Durrësit", Godina Comfort, Tirana, Albania

Tel.: +355 4 2274 802 / 2274 822

Fax: +355 4 2233 613

E – mail: nbgalbania@icc-al.org

Website: -

7. INTERNATIONAL COMMERCIAL BANK (JOINT-STOCK COMPANY)

Licence No.09, dated 20.02.1997

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

Certificate No. 8 "On Deposit Insurance".

Director: Mahendra Sing RAWAT

Address: Qendra e Biznesit, Rruga "Murat Toptani", Tirana, Albania

Tel.: +355 4 2254 372 / 2256 254

Fax: +355 4 2254 368

E – mail: info@icbank-albania.com

Website: -

8. ALPHA BANK (JOINT-STOCK COMPANY) – ALBANIA

Licence No.10, dated 07.01.1998

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

Certificate No. 9 "On Deposit Insurance".

Director: Andreas GALATOULAS

Address: Rruga e Kavajës, G – KAM Business Center, Kati II, Tirana, Albania

Tel.: +355 4 2278 500

Fax: +355 4 2232 102

E – mail: tiranabranh@alpha.gr

Website: -

9. INTESA SANPAOLO BANK ALBANIA (JOINT-STOCK COMPANY)

Licence No.11, dated 10.08.1998

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

Certificate No. 10 "On Deposit Insurance".

Director: Stefano FARABBI

Address: Rruga "Ismail Qemali", Nr. 27, P.O. Box 8319, Tirana, Albania

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

Fax: +355 4 2248 762

E – mail: helpdesk@intesasanpaolobank.al

Website: www.intesasanpaolobank.al

10. PROCREDIT BANK (JOINT-STOCK COMPANY)

Licence No. 12, dated 15.03.1999

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

Certificate No. 11 "On Deposit Insurance".

Director: Borislav KOSTADINOV

Address: Rruga "Durrësit", Laprakë, 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 OF ALBANIA (JOINT-STOCK COMPANY)

Licence No. 14, dated 28.10.1999

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

Certificate No. 13 "On Deposit Insurance".

Director: George CARACOSTAS

Address: Rruga "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 (JOINT-STOCK COMPANY)

Licence No. 15, dated 28.08.2002

Approved by the Supervisory Council Decision of the Bank of Albania 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

Website: -

13. CREDINS BANK (JOINT-STOCK COMPANY)

Licence No. 16, dated 31.03.2003

Approved by the Supervisory Council Decision of the Bank of Albania 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. POPULAR BANK (JOINT-STOCK COMPANY)

Licence No. 17, dated 16.02.2004

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

Certificate No.16 "On Deposit Insurance".

Director: Hubert de SAINT JEAN

Address: Bulevardi "Dëshmorët e Kombit", Ndërtesa Kullat Binjake, Kulla 1,
Kati 9, Tirana, Albania

Tel.: +355 4 2280 442 / 3

Fax: +355 4 2280 441

Mobile: 068 (69) 20 60 974

E-mail: bp.info@socgen.com

Website: www.bpopullore.com

15. UNION BANK (JOINT-STOCK COMPANY)

Licence No. 18, dated 09.01.2006

Approved by the Supervisory Council Decision of the Bank of Albania 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 (JOINT-STOCK COMPANY)

Licence No. 13, dated 16.04.1999

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

Certificate No. 12 "On Deposit Insurance", dated 18.07.2007.

Director: Bozhidar TODOROV

Address: Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Kulla 2, Kati 14,
Tirana, Albania

Tel.: +355 4 2276 702 / 3

Fax: +355 4 2280 210

E – mail: -

Website: www.fibank.al

In addition to banks and branches of foreign banks, the Bank of Albania has as of 30 June 2010 licensed the following entities:

NO.	ENTITIES
14	NON-BANK INSTITUTIONS
256	FOREIGN EXCHANGE BUREAUS
2	UNIONS OF SAVINGS AND CREDIT ASSOCIATIONS
137	SAVINGS AND CREDIT ASSOCIATIONS
1	REPRESENTATIVE OFFICE OF FOREIGN BANKS

PUBLICATIONS ISSUED BY THE BANK OF ALBANIA OVER 2010

This list was designed to inform readers about publications issued by the Bank of Albania over the first half of 2010. By visiting our website (www.bankofalbania.org) you can subscribe to our mailing list by submitting a written request either by e-mail at public@bankofalbania.org or sending a fax to + 355 4 2419408. You can also subscribe to updates by signing up to receive free e-mail notices when new series 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 2010. This list does not include periodical surveys carried out by the Bank of Albania as they are available only online (http://www.bankofalbania.org/web/survey_3405_2.php).

ANNUAL REPORT:

Annual Report 2009

FINANCIAL STABILITY REPORT:

Financial Stability Report 2009

SUPERVISION ANNUAL REPORT:

Supervision Annual Report 2009

MONETARY POLICY PERIODICAL REPORTS:

Monetary Policy Report for the First Quarter of 2010

Monetary Policy Report for the Second Quarter of 2010

Monetary Policy Document for the 2009 - 2011 Period, revised in June 2010

PUBLICATIONS ON STATISTICS:

Statistical Report (Published monthly)

Balance of Payments Bulletin 2009

BULETINI ZYRTAR:

Index of the Official Bulletin of the Bank of Albania (2009)

Official Bulletin - Volume 12, no.1 Year 2010

Official Bulletin - Volume 12, no.2 Year 2010

Official Bulletin - Volume 12, no.3 Year 2010

Official Bulletin - Volume 12, no.4 Year 2010

Official Bulletin - Volume 12, no.5 Year 2010

ECONOMIC BULLETIN:

Economic Bulletin - Volume 12, no.4 Year 2009

DOCUMENT:

Medium-Term Development Plan of the Bank of Albania for 2009 – 2011

PAPERS:

Monetary Policy Strategies for Small Economies - Editor, Ardian Fullani

Alternative Methods of Estimating Potential Output in Albania

Determinants of Net Interest Margin in the Albanian Banking System - Irini Kalluci

Modelling the Quarterly GDP - Role of Economic and Surveys Indicators - Evelina Çeliku, Ermelinda Kristo, Merita Boka

Monetary Transmission Mechanism in Albania - Gramoz Kolasi, Hilda Shijaku, Diana Shtylla

Measuring Inflation Expectations - Gent Hashorva, Elona Bollano, Elvana Troqe

Financial Development and Economic Growth: The Albanian Case - Elona Dushku

Monetary Policy: Institutional and Operational Framework Toward a Forward Looking Regime - Gramoz Kolasi, Bledar Hoda, Sofika Note

Macro Econometric Model of Albania: A Follow Up - Vasilika Kota, Elona Dushku

SCIENTIFIC NOVELTIES AT THE BANK OF ALBANIA:

Scientific Novelties at the Bank of Albania No.3

Scientific Novelties at the Bank of Albania No.4

EDUCATIONAL PUBLICATIONS:

Brochure "Why should we have a personal budget?" (Reprint, available only in Albanian)

Brochure "What is Price Stability for You?" (Reprint, available only in Albanian)

Brochure "The Story of Ice Cream" (Reprint, available only in Albanian)

Brochure "Knowing the Treasury Bills" (available only in Albanian)

Leaflet and poster "Withdrawal from circulation of 500 lekë banknote" (available only in Albanian)

