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C O N T E N T S

<i>Editorial</i>	
- <i>Twinning Project of the Bank of Albania with Banca d'Italia and Banque de France</i>	5
<i>Addresses and Presentations by Bank of Albania's Administrators in Activities in Albania and Abroad</i>	10
<i>Periodic Analyses</i>	
<i>Information on Selected Economic and Monetary Indicators in the Central, Eastern and South Eastern European Countries</i> <i>Doriana Lama, Priam Ramaj and Medvin Shehu</i>	87
<i>Financial Intermediation Analysis</i> <i>Erjona Suljoti and Sofika Note</i>	102
<i>Analysis of Developments in the External Sector of the Economy, 2011 Q1</i> <i>Eglent Kika and Merita Boka</i>	113
<i>Papers</i>	
<i>Actual to Potential Trade between Albania and its Main Trading Partners</i> <i>Alban Pllaha</i>	120
<i>Evaluating the Volatility of Reserve Holdings and the Deviation from the Optimal Level: The Case of Albania</i> <i>Gerti Shijaku</i>	126
<i>Remittances in Albania over the Period 1996-2010 and their Key Determinants</i> <i>Esida Abazaj</i>	136
<i>Microcredit in Albania</i> <i>Alma Nako and Jonida Prifti</i>	143
<i>Bank of Albania Bulletin News, January-June 2011</i>	150
<i>Legal Events, January-June 2011</i>	160
<i>Bank of Albania Management, 30 June 2011</i>	170
<i>Banks and branches of Foreign Banks Licensed by the Bank of Albania, as at 30 June 2011</i>	171
<i>Publications Issued by the Bank of Albania over 2011 H1</i>	175

EDITORIAL

TWINNING PROJECT OF THE BANK OF ALBANIA WITH BANCA D'ITALIA AND BANQUE DE FRANCE

I. BACKGROUND

Diplomatic relations between Albania and the EU were established in 1991 and were developed further with the signing of the Trade and Co-operation Agreement in 1992. The Thessaloniki EC Summit in June 2003 clearly confirmed the EU perspective of the Western Balkan countries, and recognized Albania as a potential candidate country for EU accession.

The several-year relations progressed a step further with the signature of the Stabilization and Association Agreement (SAA) on 12 June 2006. The ratification process was concluded in less than three years and the SAA came into force on 1 April 2009. This paved the way for Albania to submit an application for EU candidate country status.

The SAA is an instrument of the European Union's Pre-Accession Strategy towards countries aspiring to join the EU. Its implementation represents a challenge for the country as it has to prove that it is equipped with the necessary capacities required to implement the obligations under the SAA. Worth noting is that the central and local administration, the independent institutions and the judiciary play a key role in the implementation of the SAA.

The Bank of Albania is the institution responsible to implement the SAA provisions on the right of establishment and freedom to provide services/banks; free movement of capital, current payments and transfers; safeguarding macroeconomic stability (Copenhagen economic criteria); and approximation of the Albanian legislation with the EU *acquis communautaire* on the above listed areas.

European Union's Pre-Accession Strategy represents a good starting point for the Albanian institutions in terms of the adoption of the European standards in the fields of their interest, and further approximation to the EU legal framework. In order to successfully carry out this duty, the EU supports the Albanian institutions by providing financial assistance through the Instrument for Pre-Accession Assistance (IPA), and more specifically, through the Transition Assistance and Institution Building component (IPA-I).

The Bank of Albania is one of the beneficiary institutions of IPA funds through the Twinning Project "Strengthening the institutional capacity of the Albanian Central Bank, particularly in the areas of banking supervision, statistics, payment systems and the implementation of monetary policy", which is an EU-funded project to the amount of EUR 1 million. Worth noting is that

the Bank of Albania is a first-time recipient of the financial assistance provided by the EU under the Instrument for Pre-Accession Assistance (IPA).

The Twinning Project entered its implementation phase after the selection of the twinning banks, Banca d'Italia in partnership with Banque de France, and the preparatory meetings of foreign experts with Bank of Albania experts and representatives of the Albanian banking system.

II. LAUNCHING OF PROJECT

The launching ceremony of the Twinning Project was held on 23 March 2011. It was attended by representatives of the diplomatic corps accredited to Albania, as well as representatives from Banca d'Italia, Banque de France, Bank of Albania and the Albanian banking system. The Ambassador of the EU Delegation to Albania Ettore Sequi and Director General of Banca d'Italia Fabrizio Saccomanni were present at the ceremony as special guests.

III. OBJECTIVES OF THE TWINNING PROJECT

The primary objective of this project is to assist the Bank of Albania in the process of approximating the legal and regulatory framework with the EU *acquis*, and alignment of its practices to the standards of the European System of Central Banks. This project is widely based on the priorities arising from the SAA, which aim at safeguarding macroeconomic stability, strengthening the banking sector's legal and regulatory framework, overall monitoring of the financial sector and improving and developing different economic statistics further.

The activities envisaged in the Twinning Project will be implemented through periodic study visits of Bank of Albania experts to Banca d'Italia and Banque de France, and visits of foreign experts to the Bank of Albania. In addition, during the 18-month period of the implementation of the Twinning Project, a Banca d'Italia representative has been appointed at the Bank of Albania, in the capacity of the Resident Twinning Advisor.

The following provides an overview of the respective modules of the project and the main activities they cover.

IV. TWINNING PROJECT MODULES

1. Supervision and Financial Stability

Banking supervision, being one of the most important activities of the Bank of Albania, will be one of the benefiting areas. The banking market is ever-growing in response to the domestic changes and launching of new products and services into the market. Therefore, continuous improvements are required to be made in the banking supervision sector in order to progress in line with the latest global developments. The review of the regulatory framework and the improvement of the supervisory capacities will be at the focus of this

project. In addition, it will also aim at the continuous improvement of the analytical forecast in the area of financial stability.

The Twinning Project activities in this module will focus on the training of Supervision and Financial Stability Departments staff, and on the provision of technical assistance in view of developing the instruments or manuals necessary to banking supervision.

The training activities deal with issues related to the supervision of banking risks, namely liquidity management, operational risk, internal assessment models; key IFRS issues (such as assessment of IAS 39, financial instruments) and advanced supervisory reporting systems, Basel regulatory framework and Capital Adequacy Directive criteria (Pillar I, II and III), the latest guidelines on stress-tests and the early warning system.

The technical assistance and advisory programme also aims at developing eight products necessary for the progress of banking supervision in the areas of banking supervision examination systems; review of regulations and reporting forms, macro-prudential supervision and support with technological infrastructure.

The successful implementation of the activities in this module will bring about success in the further approximation to the international supervision standards and meeting of EU accession criteria, contributing thus to the evolution of the Bank of Albania's supervisory system into a more qualitative, integrated and informative model of the banking system. This improvement will consist in the review of the regulatory framework and the application of the best practices.

2. Financial Literacy

The objective of the Financial Literacy module is to develop the research work activities in the area of financial literacy based on the best international practices and European experience.

In view of achieving this objective, surveys will be carried out to measure the overall financial literacy of the Albanian population and the efficiency of Bank of Albania's educational activities intended for high-school level education. Given the increasing importance of financial literacy global-wide, this module also envisages the organization of a high-level conference, in order to bring to Albania the best international experience and different initiatives in this regard.

3. Statistics

The Bank of Albania is the responsible institution for the collection, processing and dissemination of external sector data and monetary and financial statistics. The objective of the module on statistics is to enable the

establishment of a modern infrastructure for the compilation of different macroeconomic statistics at the Bank of Albania, particularly in the balance of payments area.

The activities under this module will be trainings, technical assistance and advice related to BoP/PIN statistics, with special focus on Direct and Portfolio Investment, and more specific on-the-job trainings on the data collection methods, questionnaires, business register of enterprises, information technology solution for data collection etc. A model will be developed to improve the quality of BoP/PIN statistical systems in line with the European standards. In addition, this model will deal with issues related to Financial Statistics, in order to facilitate the reporting process and ensure full coverage of the reporting of transactions in the banking system.

The expected results from the implementation of these envisaged activities are, among others, the enhancement of human capacities in terms of the adoption of new data collection methods, drafting of questionnaires, and application of stringent measures in relation to the observance of the deadline for the compilation and release of BoP/PIN data, enhancement of co-operation with INSTAT, and greater coverage of financial statistics and their use in the economic policy decision-making process.

4. Payment Systems

For the payment systems module, the Twinning Project envisages the review of the regulatory framework, in order to improve and comply it fully with the EU directives and actual practices in this area, and enhance the human capacities in the area of payment systems oversight.

The activities in this module will concentrate on the development of instruments and methodology to perform oversight activities with regard to payment systems, enhancement of human capacities in the management of payment settlement systems and gradual use of ESCB methods and procedures.

The expected results from the implementation of these envisaged activities are the drafting and review of the regulatory framework, particularly with regard to the oversight of payment systems, respective operational manuals and transposition of Payment Services Directive. In addition, they will seek to strengthen the collateral management and securities settlement procedure in compliance with the ESCB standards; implementation of an automatic securities settlement system and the application of new procedures.

5. Interbank Market

The further development of the interbank market is an important objective in view of the improvement of the monetary policy transmission mechanism in the country's economy.

Therefore, the activities under this module aim at achieving three main objectives. The first objective relates to the further promotion of the interbank money market through the identification of the possible strategies and initiatives to achieve the commitment of the money market operators, development of the Government bond secondary market and the establishment of information technology solutions as a trading platform in the interbank market. The second objective relates to the enhancement of human capacities with regard to the development of the collateralized money market, with special focus on the operational tasks of the Bank of Albania in this market, its surveillance, and the collateral evaluation methodologies. The third objective relates to the drafting of fundamental principles of internal manuals on the activity of interbank money market surveillance.

The implementation of this module will lay the foundations for the establishment of a liquid interbank money market and responsive to monetary policy decisions, which is a major objective that requires further co-operation with other Albanian institutions.

6. Coordination of the EU Integration Process

The objective of the module on the Coordination of the EU Integration Process will be entirely implemented by Banque de France. It consists in the development and possession of necessary coordinative instruments in the EU integration process, in order to prepare for the representation at European level meetings and coordinate Albania's EU accession process. Banque de France will provide its experience in the representation at European level meetings and management of the harmonization process of banking legislation with the *acquis communautaire*.

The implementation of activities under this model will focus on enhancing Bank of Albania's staff qualification, having also under consideration the further steps of the EU integration process arising from the implementation of the SAA, approximation to the ESCB, recognition of Albania as a potential candidate country for EU accession and opening of negotiations on Albania's EU accession. It will also aim at enhancing the efficiency of coordinative activities related to the successful representation of the Bank of Albania at the ESCB and ECB, and the development of relevant coordinative instruments.

V. TERMINATION OF THE PROJECT

The implementation period of the Twinning Project will take 18 months and it will terminate within the first half of 2012. As it was stated by the Ambassador of the EU Delegation to Albania Ettore Sequi, the Bank of Albania will be assisted by the central banks of Italy and France to prepare for economic EU integration, for this project is precisely a step towards economic integration between the EU Member States.

After the implementation of the Twinning Project, the Bank of Albania will have improved the organizational and operational framework of its main departments, hence approaching its European counterparts.

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 Regional Meeting with Representatives of the Local Government,
Banking Sector, Business Community of Shkodra District and Academic Staff
of "Luigj Gurakuqi" University
20 January 2011

Ladies and Gentlemen,

The Bank of Albania considers its communication with the public a key element to an effective communication of its decision-making. To serve this purpose, it makes use of all forms and types of communication. However, direct contact with the people provides us with a real perception and interpretation of their position and expectations and supports a more effective decision-making process. Therefore, I am pleased to be again in your city, the centre of a region of well-known intellectual, cultural and patriotic heritage, which also gives significant contribution to the country's gross economic product.

I would like to start this direct communication with you with a summarized analysis of domestic economic developments and, after that, dwell in more details on a number of concrete issues that affect the strength of relations between households and businesses on one side, and the financial system and the banking sector on the other. During 2010, the Albanian economy is expected to have recorded satisfactory growth. For the third quarter, annual economic growth is estimated at 4.9%.

The economic growth rate has been stable for the last two years, thus proving a good level of resilience to the effects of the international economic crisis. Other macroeconomic indicators have ranged within acceptable and expected levels. It is worth mentioning that this macroeconomic stability is a reflection of the successful combination of key economic policies, that is to say of the monetary and fiscal policies, during the last year.

More specifically, the fiscal policy aimed and succeeded to realise the necessary consolidation process following the fiscal expansion that accompanied economic developments in 2009. Fiscal consolidation was accomplished through better control over public expenditures and collection of revenues close to projected levels.

The exchange rate for the national currency, regardless of its depreciation in 2009, less so in 2010, has been much more stable than the currencies of other countries in South Eastern Europe, which implement a free floating exchange rate policy. A gradual depreciation of the Albanian Lek is deemed to have had a positive effect on the reduction of trade and current account deficits through establishing a more favourable dynamic for our economy's exports and imports.

Eventually, it is fully proven that the adoption of a flexible exchange rate regime has been one of the most outstanding choices of economic and financial policies over the past two decades.

The annual increase of consumer prices has been almost all the time within the tolerance band set by the Bank of Albania, namely 2-4%. Under moderate inflationary pressures, the Bank of Albania has pursued an accommodative monetary policy, injecting liquidity into the inter-bank market and lowering the key interest rate to the level of 5%. For 2011, macroeconomic indicators are expected to follow a trend similar to that of 2010. The Bank of Albania holds that last year's successful harmonisation of the monetary policy with the fiscal policy should continue even further in 2011. Fiscal and monetary policies should aim at the stability of these indicators, in addition to supporting economic growth. The influence of supply and demand-side factors over the exchange rate of the national currency is expected to be balanced. Inflationary pressures are expected to be moderate this year, although prices of imported goods are an apparent risk.

The Bank of Albania will maintain its monetary policy flexibility to prevent any undesired inflation developments.

Distinguished guests,

Next, I would like to dwell in more details on the banking sector situation and some issues that the Bank of Albania considers pivotal to the role of this sector in financial intermediation and public relations, with a mutual benefit. In recent years, the banking sector, a driving force in the financial system, has been a powerful supporter of the country's economic growth through an active role in financial intermediation. Certainly, banking activities involve risks, but the international financial crisis of the last three years proved that the banking sector in our country was stable and did not need public assistance to overcome the situation. Last year, the financial situation of the banking sector is assessed, generally, better than that of the preceding year. Regardless of the growing value of non-performing loans, the banking sector's profit was several times higher than that of 2009.

Liquidity situation has clearly improved with a stable growth in deposits. For that reason, the need of the banking sector for liquidity by the Bank of Albania has substantially reduced.

The banking sector is well-capitalised thanks to the cautiousness in expanding activities and increase of capital by shareholders. In spite of this good progress of the banking sector, rapid improvement is needed in some areas on which the Bank of Albania has focused its supervisory activity.

The first area relates to the need for crediting expansion and loan quality improvement. Both elements may support each-other, if careful actions are taken.

Crediting expansion will be better supported during 2011 due to two important developments, namely a substantial improvement of the liquidity situation and a falling tendency of interest rates for bank loans in Lek. The first signs of a more positive trend were noticed during the last two months of 2010, with the annual crediting pace significantly accelerating.

On the other hand, loan quality remains problematic, although a gradual improvement is expected during the current year.

I take this opportunity to reiterate our call on banks to be more active in handling non-performing loans and their collection. Concerning loans considered not to have any hope of collection, in conformity with the legal and regulatory framework, banks need to take actions for the execution of the collateral.

In this process, there is a need for further legal improvements in order to reduce the risk of banks in crediting as well as costs for the client. This process is indispensable to clean bank balances from investments that are burdensome and release funds that would be used for new credits.

In this context, monitoring of loan quality and behaviour or difficulties that banks face in this process lays at the very centre of the supervisory activity.

The second area concerns the cost of banking services for clients. On this issue, the Bank of Albania has conducted necessary analyses, which led to the conclusion that costs for a number of bank products and services, including payments and transfers, debit and credit cards, as well as some other forms of crediting, could be lower.

In relation to this issue, we are focused on two aspects:

First, promoting transparency in the banking sector on its relations with the clients regarding these services. For this issue, we have implemented requirements for the establishment of methodologies to determine effective crediting costs and clearly define contractual obligations vis-à-vis the clients. Banks are asked to provide all the information and explanations to the interested clients. In addition, following the same logic, we would ask from banks to establish methodologies to define their costs for bank services, mainly related to payments and transfers.

Therefore, it will be easier for clients to compare between a variety of offers by banking institutions and, hence, be able to make their choice according to the most favourable alternative.

For this to happen in the best possible way, customers themselves need to pay due attention and obtain accurate information on bank products and services. When necessary in this process, more specialised external expertise may be requested.

Secondly, the Bank of Albania aims to offer a concrete incentive in this process for commercial banks, by further reducing their costs for the use of AIPS and AECH payment systems during their transactions in Lek, on their own or their clients' behalf.

We believe that through a more competitive policy in products pricing by the banking sector, clients get more benefits and we may see an increase in their number and, subsequently, generate an increase in the revenues of the banking sector.

The third area of our focus relates to the requirements to increase accountability in banking institutions management, asking repeatedly that professionalism, dedication and accountability be transformed into a work culture for all banking institutions' staff.

For that matter, we are continuously reviewing the processes through which the banks carry out their decision-making, ensure control of certain activities and reporting chain within their institutions, as well as their interaction with the public.

Internal control systems define, mostly, the capacity of an institution to operate securely. These are necessary to avoid any gaps that may be abused to the disadvantage of the institution.

Hence, in its regular communication with banks, the Bank of Albania has requested that they undertake all necessary measures; in terms of money, human resources and technology; to guarantee the security of all banking operations.

Concluding, I would like to underline that the Bank of Albania will always be at the position the public expects it to be, in order to satisfy, at any given time, its legal responsibilities for price level and banking sector stability. In this process, state authorities, in particular the judiciary, would be needed to offer their indispensable cooperation and consider banking system issues a high priority, with the knowledge that a stable economic development of the country depends on it. The Bank of Albania calls on all relevant factors to accelerate their structural reforms on property title and execution of the collateral, as well as to undertake a number of other administrative and bureaucratic regulations, which affect banking system costs.

Inviting you to openly discuss on these issues, I 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
26 January 2011

At its meeting of 26 January 2011, the Supervisory Council of the Bank of Albania reviewed and approved the Monetary Policy Report for the second half of 2010.

Following a thorough analysis of Albania's latest economic and financial developments and discussions on performance outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 5.00%. The Council holds that current monetary conditions are appropriate for meeting the medium-term inflation target.

I will proceed with a brief overview of economic developments and key issues discussed at today's meeting that led to this decision.

The Albanian economy recorded a positive development during the second half of 2010. The economic activity continued to mark growth, while the main macroeconomic balances improved and the risk premium and interest rates in financial markets decreased. The economic growth during 2010 was mainly driven by foreign demand for Albanian goods and services, while domestic consumption and investments remained at low, albeit positive, developments. Inflation pressures remain controlled as a result of the existence of free capacities in the economy and anchored inflation expectations. The rapid expansion of exports and moderate increase of imports led to improved trade and current account deficits, contributing to foreign currency demand and supply balancing and increased exchange rate stability.

Monetary and fiscal policies have conveyed a careful macroeconomic stimulus. The withdrawal of the fiscal stimulus during the second half of the year led to a more stimulating monetary policy, by reducing the key interest rate in July and allowing its fuller transmission into the financial markets during the following period.

Financial markets were characterised by an improvement of liquidity indicators and a decline in interest rates in almost all financial instruments. Furthermore, a prudent fiscal policy rendered budget deficit and public debt in line with 2010 projections.

These developments are expected to be brought forward, in broad terms, in 2011 as well. Economic growth is expected to remain comparable to the levels of 2010. However, it is expected to be driven by domestic demand to a large extent. The banking system is in a much better position compared

with the previous two years in terms of supporting the increase of domestic consumption and investment with funds.

Moreover, inflation pressures are forecasted to be under control, budget deficit and public debt are expected to be further consolidated, and external position of the economy is expected to be more stable. Respecting this picture has important implications, which I will address later in more details, for policymakers and economic agents.

The latest developments in global economy are characterised by continued economic growth in most developed countries and emerging economies. In developed countries, economic growth was lower as a result of measures taken to consolidate public finances and the withdrawal of fiscal stimulus. On the other hand, emerging economies maintained higher growth rates, expanding their demand for raw materials and consumer goods, thus adding global inflation pressures.

Economic growth is expected to continue in 2011, but uncertainties remain high. Global macroeconomic misbalances, which appeared in high levels of trade deficit for some of the developed countries, may materialise in shocks to main currencies exchange rate and free trade exchanges worldwide.

In addition, concerns over public debt and fiscal sustainability for some of the euro area countries continue to affect the sensitivity of financial markets and their tolerance to risk. Regardless of the latest growing tendencies, the balance of inflation pressures is considered to be in check for the current year as well, as a result of continued existence of non-utilised capacities.

Keeping free movement of people and capital at world levels, taking timely corrective measures on public debt situation, as well as creating effective mechanisms to prevent and buffer financial crisis effects at local level, will be important challenges for policymakers. On the other hand, the monetary policy of the main central banks will continue to be cautious, introducing an appropriate monetary stimulus into the economy in order to promote economic activity without affecting the actual and projected inflation levels.

The Albanian economy recorded a positive growth during the third quarter. According to data reported from INSTAT, real annual growth of the GDP was 4.9%, that is, higher than figures recorded during the first two quarters of the year. Economic activity improvement relied mostly on trade, tourism and other services. The industry sector maintained the same contribution to the economic growth, while construction sector activities continued to shrink for the fourth consecutive quarter. Developments in demand components follow the tendencies of the beginning of the year and are in line with our previous assessments. Available data suggest that economic growth continued to be stimulated to a large extent by foreign demand; meanwhile fiscal consolidation during the second half of the year predictably yielded a slowing effect to the economic activity. Private consumption and investment remained low during the second half as well, despite the improvement of financing conditions

for the activity. Private consumption continues to be subject to a hesitating approach by consumers to spend and a low support by banks. Increased salaries, employment and remittances in the economy were not fully factorised in making individuals optimistic about the future, as proven by the low levels of consumer confidence index for the third quarter of 2010.

In addition, the sluggish consumer demand and non-utilised capacities in the economy did not encourage businesses for new investments. However, with the improvement of financing conditions and further increase of demand, contrary to the first two quarters, private investments are considered to have given a positive contribution during the third quarter.

Fiscal policy followed a cautious line during 2010, aiming to keep budget deficit and public debt in check. Budget deficit until November of this year was ALL 23.1 billion, marking a reduction of 64%, year-on-year. Reduction of the budget deficit by 4 percentage points of the GDP during 2010 demonstrated a fiscal consolidation both in public revenues, which increased by 9.6% until November, and budget spending, which reduced by 4.8% during the same period. In particular, budget deficit reduction and public borrowing control in domestic financial markets contributed to improved banking system liquidity and reduced interest rates in the financial market. The continuation of this tendency during 2011 would be a welcomed development for the Albanian economy. The Bank of Albania deems that the philosophy of caution pursued in 2010 in budget expenditures and public borrowing should be present for the current year as well.

Foreign demand continued to support economic growth even during the third and fourth quarters. January – November 2010 recorded a narrowing of the trade deficit by about 9.2% in annual terms, which came as a result of growth in exports by about 58%. On the other hand, imports marked a more moderate growth – around 6.4% – during the first eleven months. Improvement of trade deficit was favoured by a depreciation tendency of the exchange rate, moderate growth of domestic demand as well as climate and global market structures supporting Albanian exports.

Nevertheless, the contribution of net foreign demand to the economic growth of the third quarter is considered to be lower compared with the first half of the year. The annual improvement of trade deficit by 10.7% in the third quarter was lower than the one recorded in the first two quarters of 2010. Furthermore, trade of goods in the first two months of the fourth quarter proves a lower contribution of the external economy for the last quarter of 2010. The growing tendency of imports and an expected slowdown of exports growth may halt the process of correcting foreign trade balance and reduce its influence on the economic growth for 2011. In the aspect of macroeconomic policies, these developments suggest that strong stimulating policies for the economy may be buffered by a rapid increase in imports that accompanies the increase in domestic demand. In the structural aspect, these developments reiterate the need to continue with structural reforms, which should orientate the Albanian economy towards a more stable development model and a

higher competitiveness in global markets. Among other things, these reforms, should aim at establishing a favourable climate to attract stable capital flows as in foreign direct investments or other long-term capital inflows.

A further increase of aggregate demand enabled the Albanian economy to move closer to its potential output, yet remaining clearly below it. Consequently, decreasing pressures on inflation continued to be present even during the second half of the year. Average annual inflation was 3.1% in the first quarter of the year, dropping by 0.4 percentage points from its average level of the third quarter and getting closer to Bank of Albania's target. During 2010, inflation was influenced by increased administered prices, rising trend of basic goods prices, food products and oil prices in international markets, and depreciation tendencies of the exchange rate.

Annual inflation increase to 3.4% in December was due to increased agricultural products prices, as a reflection of their increase in the global markets. Yet, anchored expectations on price stability and disinflation pressures by the real economy balanced the action of the above-mentioned supply-side factors on inflation, halting their transition to second-round effects and stable inflation pressures.

The Bank of Albania considers that the inflation rate is expected to range within our target of 3%, during the entire year. The increasing effect on the inflation of supply-side factors will be balanced by the negative output gap and existence of non-utilised capacities in the economy.

Controlled inflation pressures and fiscal policy created room for a gradual increase of the monetary stimulus in the economy during 2010. The Supervisory Council of the Bank of Albania decided to reduce the key interest rate by 0.25 percentage points in July, taking it to the lowest historical level of 5.0%. In parallel with this move, the Bank of Albania supplied the interbank market with the necessary liquidity for a proper functioning of financial markets.

In the operational aspect, a change in the form of our objective in June served to a better orientation of banking system refinancing operations with liquidity, resulting in a liquidity premium reduction in the system and a better orientation of interest rates in the inter-bank market. Financial markets were more relaxed with their risk premium gradually falling. Interest rates in the primary market have continued their dropping tendency since a year ago, as a reflection of the moderate demand of the fiscal sector for funding and the good liquidity situation of the banking system. Moreover, the reduction of the key rate was followed, to a satisfactory degree, by interest rates in deposits and loans in Lek, hence enabling a good transmission of monetary policy decisions into the economy.

Beyond a better transmission of monetary policy decisions on interest rates of financial markets during the second half, the Bank of Albania deems that their transmission into the real economy remains incomplete. Referring to developments in lending to the economy during the second half, loans to the

private sector, on average, increased at the same pace as during the first half. Annual lending growth in November was 10.1%, almost commensurate with the level at the end of the first half. Slower increase of loans to the private sector gave a low contribution to money supply expansion in the economy, reconfirming controlled inflation pressures from the domestic economy. Broad money (M3) growth came close to its long-term historic average during the fourth quarter of the year, marking 11.9% and mainly in time deposits in the banking system.

Although banks did not tighten their lending terms and conditions - on the contrary, during the second half of the year there were signs of their easing - demand for bank lending by the private sector was low. This was due to the existence of spare capacities in businesses and the growing consumer tendency to save under a perceived added uncertainty about the future and a more cautious behaviour towards actual consumption. Reduction of risk premia in financial markets, maintenance of positive rates in economic growth, employment and wages, as well as a clearer short- and medium-term perspective of the economy are expected to contribute to an increased demand for bank loans in the coming period. The banking system meets the prerequisites, in terms of liquidity, capitalisation and more favourable financing conditions to respond to this demand.

Our outlook for the future supports keeping a positive progress of the economy for 2011. The growing demand is expected to be subject to the comparatively better progress of the domestic demand during this year. Private consumption and investments are expected to rise further, while, after the slowdown in 2010, the fiscal sector is expected to contribute positively to the economic growth. In spite of this, the growing demand is considered to be below the potential of our economy even for 2011. This will generate downward inflation pressures from the domestic economy, expected to balance the effect of import and administered prices increase.

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
23 February 2011

Today, on 23 February 2011, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on a thorough analysis of Albania's latest economic and monetary developments and discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to leave the key interest rate unchanged at 5.00%. The Supervisory Council confirmed that the actual monetary conditions remain appropriate for meeting the medium-term inflation target and for supporting the domestic economic activity.

I would like to proceed with a brief overview of economic developments and main issues discussed at today's meeting of the Supervisory Council.

Recent data from the global economy confirm the positive underlying momentum of the economic activity in developed and developing economies. Despite the gradual withdrawal of fiscal and monetary stimulus, economic growth has been stable, as a result of the recovery in the private sector demand in developing countries.

On the other hand, the higher demand has triggered a price increase in commodities, basic products and food items, thus impacting the shift of the inflationary pressures upward. Nevertheless, globally, consumer price inflation remains still contained, as long as the major economies continue to be characterised by below-potential economic growth. Global financial markets are improving, but they are still fairly sensitive to fiscal perspectives of certain economies and to tensions in the Euro area. Additionally, these markets show relatively little interest in South Eastern Europe countries, including Albania.

Overall, world economic growth is expected to remain high for the upcoming period as well, contributing also to the triggering of inflationary pressures and drawing more attention of monetary authorities to macroeconomic balances.

Domestic economic and monetary developments continued to generate an environment of contained inflationary pressures. Annual inflation for January 2011 was 3.3%, dropping by 0.1 p.p. compared to December 2010. This decline of inflation in January is totally due to the statistical effect of neutralising the increasing impact of some administered prices on inflation. On the other hand, food items and oil prices increased significantly, as a result of rising prices in world markets. These factors contributed by about 80% to the formation of the inflation figure. Increased agricultural products prices affected mostly the low-income segments of the Albanian society.

As stated above, domestic inflationary pressures are characterised by short-term supply shocks, while the generated inflation by domestic demand is low, as reflected in the relatively stable situation of core inflation. This performance is conditioned by the existence of free capacities in the Albanian economy as well as contained monetary expansion and anchored inflationary expectations of consumers, businesses and agents in the financial market. The Bank of Albania deems that, in general terms, these factors will continue to be present during 2011.

On the other hand, the Bank of Albania, in its inflation outlook, has factored the projections on the situation of fuel and food items made so far by the IMF and FAO. In the absence of added and unpredictable supply-side shocks, or second-round chain phenomena, inflation rate is expected to be in line with the Bank of Albania target.

I would like to continue with a more detailed analysis of current and expected developments in the Albanian economy and financial markets, also assessing their implications on the expected consumer price inflation.

Economic Activity

In the absence of direct data and based on a number of indirect indicators, the Bank of Albania assesses that the Albanian economy continued to grow during the fourth quarter of 2010. The economic growth was mainly driven by the external demand for Albanian exports.

However, domestic demand has shown lately signs of recovery, as evidenced by the positive trend of bank lending, indirect consumption indicators and improved Economic Sentiment Indicator of the Albanian businesses and consumers.

Consumption and private investment, the two most important components of aggregate demand, experienced a slow progress during 2010. While disposable income of the Albanian consumers is considered to have increased in real terms, the high uncertainty and tightened lending terms and conditions by the banking system deterred the domestic consumption. On the other hand, the Albanian businesses encountered insufficient demand for them to use their full capacities and higher financing costs. This situation has most affected sectors of the economy such as construction, which relies totally on domestic demand and, at a lower extent, other sectors such as industry, which generates most of its activity from external demand. Under these circumstances, investments pace was relatively lower, compared with previous years. The Bank of Albania considers that domestic consumption and investments will have a better performance during the current year.

Conditions for funding the private sector demand appear improved, while risk premia in financial markets appear lower. Uncertainty for the future should gradually decrease. Additionally, the expected positive influence of external demand and fiscal policy during 2011 are expected to stimulate domestic demand.

Correction of fiscal conduct is followed by a lower contribution to the economic growth during 2010. Public expenditure reduced by about 5% year-on-year, while the budget deficit reduced by about 4 p.p. of the GDP. The Bank of Albania has always highlighted that fiscal stability is a fundamental precondition for a long-term economic growth. In this context, we deem that respecting objectives on budget deficit and public borrowing during 2011 will yield a positive contribution to the country's economic development. Maintaining relative levels in budget deficit will eliminate a direct negative effect on economic growth, while relatively low levels of public borrowing will have an impact on the control of long-term interest rates and reduction of risk premia in financial markets.

These developments were manifested during the second half of 2010 and are expected to stimulate domestic demand during 2011, as well.

The external sector of the economy continued to be characterised by a positive, though falling, contribution of foreign demand to economic growth. The correction pace of the trade deficit was slower in this quarter. Trade deficit reduced by 1.2% compared to the two-digit correction rates recorded in the first half of 2010. This situation of the trade deficit is determined mainly by the acceleration of imports, which marked a year-on-year increase of 10.8% in the fourth quarter of 2010, recording growth for the third consecutive quarter. On the other hand, Albanian exports increased by 48.8% year-on-year, maintaining high rising rates.

The Bank of Albania holds that the Albanian economy will find it difficult to maintain the same growing rates of exports during 2011; among other things, this projection reflects temporary factors that influenced on 2010 growth and is in line with the global economy situation and basic statistical effects. Nevertheless, external demand is expected to generate positive contribution to the economic growth during 2011, as well.

Monetary Indicators, Financial Markets and Inflation

The performance of monetary indicators continues to generate controlled monetary inflationary pressures on the domestic economy. Money supply increased by 12.5% in December 2010, reflecting a good performance of deposits in the banking sector during the second half of the same year. Our assessments indicate that monetary expansion is in line with the private sector demand for real money. A good progress of the economic activity and falling risk premia are also reflected on the upsurge of demand for loans by the private sector. Satisfactory parameters of the banking system in terms of liquidity and capitalisation have enabled additional support to the private sector with bank loans. In December, the growth rate of loans to the private sector reached 10.6% year-on-year. In addition to private businesses, which were the main users of credit funding during 2010, positive signals come from household consumers, whose demand for loans increased during the last quarter of 2010.

Financial markets are characterised by dropping risk premia and liquidity, reflected in a further decline of yields in the primary market and interest rates in Albanian Lek deposits and loans. In the inter-bank market, short-term interest rates remained close to the key interest rate and showed low volatility. Foreign exchange trading in the domestic market was also calm. The Albanian Lek continued to depreciate in annual nominal terms against foreign currencies, although more slowly compared to 2010.

Taking into account the information summarised above, the Supervisory Council deemed that inflationary pressures for the medium-term horizon remain contained. Consumer price situation is expected to be under the pressure of price increases in world markets, but, in the absence of second-round effects, their impact is expected to be transitional. On the other hand, the actual insufficient demand will continue to condition levels below the potential domestic capacity utilisation, exercising downward pressures on inflation.

Inflationary expectations continue to be anchored around the inflation target of the Bank of Albania. In the absence of unexpected shocks to the economy, inflation is expected to be close to the Bank of Albania mid-term target. The Bank of Albania will continue to monitor the nature of these external shocks and their impact on prices in the domestic context, for a timely reaction in order to eliminate stable inflationary pressures.

After the discussions, the Supervisory Council concluded that the monetary conditions remain appropriate for meeting the medium-term inflation target and decided to leave the key interest rate unchanged at 5.00%.

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
23 March 2011

Today, on 23 March 2011, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on a thorough analysis of Albania's latest economic and monetary developments and discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to raise the key interest rate by 0.25 percentage points to 5.25%.

I would like to proceed with a brief overview of economic developments and main issues discussed at today's meeting of the Supervisory Council.

The global economy was characterized by clear signs of growth in the first quarter of 2011. Emerging economies continued to lead the global growth, whilst economic expansion in advanced economies remained fragile. The Euro Area economy, the member states of which are our main trading partners, continued to expand over the course of this period. It also continued to experience increased financial tensions and low economic growth in its peripheral countries. The outlook shows further strengthening of the global economy, which will be markedly conditioned by the process of fiscal correction undertaken in several countries and the upward inflation trends.

On the other hand, the global demand recovery, structural supply-side problems and weather disturbances or geopolitical developments in certain regions have led to price rise in raw materials and primary commodities. It has been more pronounced for agricultural and agro-industrial products, bringing their indices back to 2008 historical records. Consequently, inflationary pressures are higher and consumer prices have picked up.

These developments were also reflected in the Albanian economy. Driven by the strong impact of climbing prices in the global markets, annual inflation rate edged up to 4.5% in February, signalling a greater pass-through of inflationary pressures into the domestic market. While the upward inflation rate was expected and announced by the Bank of Albania, the speed of its increase was unknown. From the viewpoint of basket composition, inflation rate rise in February derived from an increase in food and energy prices. In particular, processed and unprocessed food inflation has made a 70% contribution to headline inflation, whereas administered price rise has contributed about 0.4%. The impact of food price rise on inflation is more pronounced in emerging economies, such as Albania's, where foodstuffs have a considerable weight in the basket. On the other hand, this considerable weight makes possible the pass-through of such price rise into core inflation

rate, which edged up to 3.2% in February, shifting inflationary expectations upward. Other basket items have made a marginal contribution to inflation. However, the contribution of several other items has been upward.

In the macroeconomic context, inflation rate pickup in February is attributed almost entirely to added inflationary pressures originating from the external economy, while domestic inflationary pressures have remained in check. Real economy developments continue to result in unused production capacity for both labour and capital markets, as well as in a still negative output gap.

Concerning the assessment of the domestic economy, it should be stressed that our judgement on the real economy performance remains, in general, similar to that of the previous months. Real economy data coverage over the first months of the year remains low; however, indirect available data suggest that the positive growth rates were carried on the first quarter of this year as well. The latest data from foreign trade and the fiscal sector have confirmed our expectations for a higher contribution of the domestic demand to economic growth. This contribution owes mostly to increased public spending and budget deficit during the first quarter, reflecting and preceding a more stimulating position of fiscal policy to 2011 aggregate demand.

In quantitative terms, year-over-year budget spending increased by 14% in January, thanks to about 8% growth of current expenditure and 40% growth of capital expenditure. Consumption and private investments have increased at contained rates, providing a lower contribution to domestic demand. The latest data on the external sector of the economy show a downward contribution of foreign demand to aggregate demand over the fourth quarter of the past year. The deficit of net exports has increased by 2.3%, due to higher import growth over the course of this quarter. Data on foreign trade for January also show the same line. Merchandise exports have maintained high growth rates, up by 53.8% y-o-y, whereas y-o-y increase of imports is 19.3%. These developments have resulted in enlarged trade deficit by about 3.0% y-o-y.

The analysis of monetary developments confirms the so-far assessments for controlled pressures of monetary nature over the medium run. Nominal money supply growth rates decelerated to 11.5%, down about 1 percentage point from December. Banking system deposit growth has remained stable and liquidity conditions have improved.

On the other hand, regardless of the recovery signs highlighted recently, the growth of lending to the economy is decelerating. Year-over-year credit growth marked 9.8% in January, reflecting simultaneously the moderate demand for loan and its seasonal behaviour over the first months of the year. Information obtained from financial markets also attests to low liquidity and risk premium. Interbank market interest rates have approached the key interest rate and have exhibited low volatility. Primary market yields have increased slightly, reflecting the fiscal sector's higher demand for funding and hence offsetting a part of the sharp decline they had exhibited in the last two months

of 2010. Foreign exchange market was also relaxed and the exchange rate performance was characterized by a very low year-over-year depreciation.

Further in the meeting, the Bank of Albania's Supervisory Council proceeded with discussions on the actual and expected inflation rate. In the Council's opinion, the rapid rise in February's inflation rate suggests that imported inflation pressures appear higher than expected and their effect is being passed-through fully.

Inflationary pressures are generally of foreign origin and have the nature of supply-side shocks. However, the importing size of external inflationary pressures and their rapid pass-through into consumer prices at home indicates the increased ability of traders and businesses to dictate the final prices to the economy. This development might have been helped by the recovery of the domestic demand. It may also reveal an upward shift of inflationary expectations in the economy or likely second-round effects, given the expanded base of items contributing to inflation.

Taking into consideration the information summarised above, the Supervisory Council deemed that the inflationary pressures for the medium-term horizon appear elevated. Consumer prices are expected to be under the pressure of rising prices in the global markets. On account of projections for high prices of oil and agricultural products in those markets, the baseline projection of inflation is elevated compared to the previous months. However, the anchoring of public inflationary expectations and the presence of significant second-round effects are key drivers to actual inflation rate.

Concluding the discussions, the Supervisory Council decided to raise the key interest rate by 0.25 percentage points, to 5.25%. The key interest rate rise is intended to create appropriate monetary conditions for preserving price stability over the medium run. It restores the actual real interest rate in line with its historical trends, following the sharp decline as a consequence of elevated inflation and its projections. It also reflects the expected impact of fiscal policy on the economy, preserving the stimulating position of macroeconomic policies, and making them more prudent in the light of new reality. In line with the long-term horizon of monetary policy stance, anchoring inflation expectations of the public at the Bank of Albania's 3% target remains the final objective of this movement, aiming to prevent and minimize the second-round effects.

The Bank of Albania deems that this timely step would contribute to curbing the overall or speculative price rise, without impeding the economic growth sustainability.

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

At the Ceremony Launching the Bank of Albania's Twinning Project
23 March 2011

Ladies and Gentlemen,
Distinguished guests,

It is my pleasure to be with you today at this ceremony launching this important project.

This event is exciting for me and many colleagues among us, because we see today that a proposal, a brilliant idea has come to life, which I am convinced will be turned into a useful and very successful product in the months ahead.

In my first speech to the public, about 7 years ago, I stressed that: "The Bank of Albania regards the European Central Bank as an institution that represents not only the model of organization and operation we intend to rapidly approximate to, but also the possibility for concrete cooperation in specific areas of Bank of Albania's functioning and the strategic objectives of the Albanian economy".

From this viewpoint, it is my pleasure to ascertain that today's simple ceremony is a proof of:

- Accomplishment of the ambition I had at the beginning of my mandate;
- Maturity of our institution;
- Rapid approximation to the standards of the European System of Central Banks;
- Increased public confidence in the Bank and its improved image in the international arena.

I am convinced that the twinning project we are gathered today for will further foster the cooperation and communication between our institutions, not only in the professional area but also in the personal one, an element I strongly believe in. We live in a global society, where developments in the banking and financial world take place at alarming steps and, therefore, central banks should have internal, strong and reliable mechanisms of coordination and communication, which would prepare our institutions to cope with such situations.

In the light of this outlook, the twinning project is a priority element that would assist our Bank in its path, but not only that. By cautiously analyzing the overall scope of the project, we observe that it is focused on providing

assistance to the Bank of Albania to fulfil the economic criteria in view of our country's integration to the EU, hence contributing to the improvement of working practices on banking supervision, statistics, payment systems, interbank market, coordination of EU integration process and financial education.

I would also like to stress that this twinning project aims, *inter alia*, at approximating the standards of our institution to those of the European System of Central Banks (ESCB) and the legal and regulatory framework of our bank to the *acquis communautaire* affecting the banking and financial area.

A proverb says: "When planning for a year, plant corn. When planning for a decade, plant trees. When planning for life, train and educate people". This is a philosophy that is exemplified even today through this twinning project, which, alongside the assistance for developing the aforementioned areas, will also help raise awareness of the need for information and training our institution's staff in the respective areas. Harmonization of tasks and standards of our work with those of the European Union is one of the priorities of the Stabilisation and Association Agreement, and also of our institution, as an essential part of this process of nation-wide importance.

On this occasion, I would like to express my gratitude for the excellent cooperation we have had with the Banca d'Italia and the Banque de France during the preparation and implementation of the first stage of the twinning project. Also, my thanks go to the Delegation of the European Union for the ongoing assistance and caution shown throughout the progress of the twinning project. I express my strong conviction that these are only the first steps of a closer cooperation between our institutions.

I commend your endeavours and also hope that the successful implementation of this project will serve as an example for all of us to be more committed to initiatives of this kind.

I conclude, strongly convinced that this project and this cooperation are the cornerstones for a better future, and a significant step towards the European integration of our institution. Let us build on our hopes and above all, accept our responsibilities. Let this be our European future.

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

At the Opening of the Exhibition Marking the 85th Anniversary of the National Currency, National Historical Museum
31 March 2011

It is my pleasure to open the proceedings of the activities that the Bank of Albania has organized to commemorate the 85th anniversary of the national currency issue. When we decided to open today's exhibition, I was personally attracted by another dimension: the history of the Albanian monetary system development. The first Albanian coins found date back to the 2nd century B.C. All these bronze coins feature on one side the portrait of King Gent, the last ruler of Illyria. As in all other countries of the ancient Mediterranean, in Illyria, this powerful man set an unbreakable link between money and the state, not only to promote economic activity at home, but also gain its benefits.

Today's activity aims to capture and convey to the visitors the artistic and numismatic values, and the historical development of our national currency. Whilst viewing the evolution of nominal values, we are able to create a vision of:

- the performance of the national economy over the course of years;
- the purchasing power of money; and
- the history of the Albanian people through the portrayed entities and the depicted themes; the cultural and social sensations through artistic elements of design.

A country's monetary and financial system does not only put across the sovereignty of the state economic policies, but it also enables the country's economic and social development.

The issue of the national currency in the form of banknotes and coins undoubtedly plays a unique role in this regard. Historically, money was born as a response to the social needs for economic development and progress. Its three functions as a medium of exchange, store of value and unit of account, allow for greater economic sophistication.

These three roles were soon grasped by the ancient rulers, who were the first issuers of money in its classical forms. By acknowledging the role and power of money, these princes, kings and emperors sealed them with their portraits as a final expression of political and economic power.

This is very well described by Mayer Rothschild, the founder of the famous Rothschild dynasty, when he quotes: "...Give me control of a nation's money and I care not who makes the laws...". Indeed, even a surreal world as that of the famous Harry Potter cannot exist without Gringotts Bank, which J. K. Rowling describes as a multiple story white building with underground vaults that stretch to an unknown depth below the earth.

Economic and social development has constantly introduced innovations in the area of monetary systems, and also of banknotes and coins. The first banknotes were born as identical counter-values of the amounts of precious metals, mainly of gold, and they were explicitly guaranteed by the states and sovereigns for their gold parity. This characteristic is also found in the banknotes of the first period of the Albanian state. The banknotes issued during this period are designated as “gold franc” implying their coverage with physical gold at a fixed and invariable rate.

The further evolution of human societies and their economic and political systems introduced great innovations in the monetary area. The development of commercial banks, the credit system and central banks were crucial moments in the economic progress.

Central banks, as public institutions mandated to issue and circulate the currency, originate from earlier times. The first examples of central banks, closer to today’s perception of the central bank, date back to the 17th century in England or Sweden.

These institutions, originally with a clear commerce orientation, were responsible for the issue of currency and servicing the state needs with loans or lending for different purposes. The modern central bank originates from the 20th century, and the US Fed served as a model for a number of other central banks.

The attribution of the supervisory and regulatory functions of the banking system and the orientation of the central banks’ mission in terms of economic objectives, like low inflation or stable economic growth, marks the starting point of central banks at their present form. The latter have played a primary role in the further progress of monetary systems.

Fixed-rate convertibility to physical metals was found problematic in the economic and monetary management. The great economic depression of 1929-1932 clearly showed that monetary policy, designed as an opportunity for public authorities to affect the amount of money in circulation and its price, or the interest rates, is a valuable instrument to mitigate economic fluctuations.

Beginning from the 20th century, the issued banknotes and coins lost their convertibility into gold at fixed and invariable rates. The issued currency, from this moment on also referred to as fiat money, derives its value from the state’s obligatory force.

However, this is only half of the picture. The most important aspect determining the value of the currency is now on public confidence in it. The preservation of such confidence requires above all accountable institutions and transparent and reliable economic governance.

The modern role of central banks as independent institutions, exclusively in charge of issuing the currency and legally mandated to control its value in time, or in other words its purchasing power, or put even simpler, price

stability, originates under the same context.

The development of monetary systems has not had its final say yet; by contrast, the last decades have marked its highest rapid period. The origination of accounting currency in the form of savings deposits, current accounts, cheques and bills of exchange have stretched the classical definition of money further.

Electronic money in the form of debit and credit cards, payment orders initiated via the internet or mobile phone, or the movement of funds through electronic platforms of international financial markets, are great innovations. Important challenges for central bankers and other supervisory institutions lie ahead in terms of their management.

The foregoing developments, with some clear deviation during the communist regime, have also been reflected in the history of the Albanian monetary system. In what follows, I would like to point out the main stages our monetary system has been through. I will try to be brief and provide the essence of each stage in few lines.

When Albania gained its independence from the Ottoman Empire in 1912, the currencies of France, Italy, Greece, Austria-Hungary and the Kingdom of Serbs, Croats and Slovenians began to circulate in place of the Ottoman Lira. Albania did not possess a national monetary system.

The most widely used currency in Albania was that of the Latin Monetary Union – the gold franc –, which constituted Albania's *de facto* currency. Having no possession of any legal tender currencies, Albania applied the gold standard at which the silver and paper money values were fixed.

Albania was thus one of the few European countries to have a stable currency as a medium of exchange and treasury. The main duty for the Albanian authorities was to codify the monetary system by declaring the gold franc as the national monetary unit. This brought about the need to set up an issuing bank, one that would be able to fix the legal exchange rate for the issued banknotes, thus gradually removing the foreign paper money from circulation.

In 1922, Prof. Albert Calmes, Member of the League of Nations Commission of Inquiry into Albanian Affairs, noted that: "... as the Albanian lives very simply, in many cases under conditions of great poverty, he is able to save, despite the small output produced by his methods of working, and he does save, for he is very thrifty. Capital is hoarded in gold. As a result, Albania possesses a large stock of precious metals valued at 100 million gold francs. But this capital, which, if put to use, would suffice to place economic life in Albania on the road to progress, is hidden.

Credit and credit organizations do not exist in Albania. Rates of interest at 30% are by no means rare. The reason for this is the lack of confidence. The Albanian's belief in the stability of the Government is not firm enough for him

to risk his money in financial enterprises. In order to bring capital forth out of the hiding places in which it lies unproductive, confidence must be created...”

The best means to this end was the establishment of a national bank, an institution that Albania needed greatly at that period. Its establishment was urgently needed, for it alone could awaken Albania to the conditions of modern economic life. Its principal mission was to create confidence, and hence credit and the spirit of enterprise in Albanians.

The Albanian National Bank was established in 1925 as an Albanian-Italian joint-stock bank. It had the exclusive right of issuing the currency – in metallic coins (gold, silver and bronze) and banknotes – and determining its legal tender. The amount of banknotes the Bank put in circulation had gold or silver coverage.

The Bank gave Albania the first national currency – the gold franc – thus, going back to the gold-banknote monetary parity. The Bank’s greatest achievement was the establishment of a sound monetary system that successfully weathered the difficulties of the global monetary system during the 1930s’ global economic crisis. The Albanian currency remained faithful to the gold-banknote parity until April 1939.

Being based on gold bars, the Albanian banknotes were accepted at sight in all main bank counters globally. The Albanian franc was one of the strongest European currencies in the period between the two world wars.

The period between 1926 and 1939 corresponds to the establishment of a genuine banking system according to the market economy-based system and the banking traditions of that period. In the philosophy characterizing that system and time, which is basically similar to the current one, money played the main functions of the medium of exchange, store of value and unit of account.

This is clearly evidenced in the press of that time. In his inauguration speech as the President of the National Bank, Mr. Mosconi noted that: “Our wish is to bring here the same value of money as in the neighbouring Italy, and many big steps have been taken in this regard. So we are reaching our goal, as during our short period of existence, the official discount rate, which forms the underlying rate, has decreased from 12 to 6%.” (An excerpt from the speech of the President of the Albanian National Bank, Mr. Mosconi, held on the occasion of the inauguration of the Bank’s headquarters, published in *Drita Newspaper* on 1 November 1938).

In the aftermath of war, Albania entered the orbit of countries with centrally planned economies and the Albanian National Bank changed into the State Bank of Albania.

The first attempts to discipline monetary circulation to some extent affected the stabilization of the value of the Albanian currency, as now on termed the Lek.

Originally designed to operate as a capitalistically organized central bank, the Bank soon transformed into an ordinary state administration institution, lacking all prerogatives required for a central bank, hence losing all its autonomy. The Bank lost the traditional right of conducting monetary policy, thus transforming into the state's cash office. The communist monetary and financial system, adopted in practice during 1945-1991, recognized the three main functions of money, but it did not entirely acknowledge the role and importance of the credit system. Furthermore, the analysis of banknotes and coins of that time provides evidence for a clearly socialist realism-oriented artistic spirit.

Only after 1992, the State Bank of Albania transformed into a modern central bank having as a primary mission the maintenance of Lek's purchasing power.

In achieving this mission, our compass remains oriented towards the membership into the European Union through an unstoppable progress towards economic and legal EU convergence. To this end, strengthening Bank of Albania's functional, institutional, personal and financial independence, and particularly, ensuring price stability as the primary objective of monetary policy, will remain the main focus of our activity.

Money and sovereignty are destined to be interwoven. Just as the Illyrian coins used the sovereign's portrait as a means to encourage public confidence, the best way for the Bank of Albania to accomplish its mission to the public is to acknowledge and have confidence in the national currency. A strong and sound currency will be an inseparable companion along our path towards Brussels and Frankfurt gates.

Let me conclude this opening address with some personal anticipation.

The banknote and coin, as classical symbols of the medium of exchange, but also as objects that stylishly represent the historical and artistic values of the time, will continue to be part of economic reality for the future generations as well. The Albanian people have written poems about money. In his "Autobiography of the People in Verses", Kadare writes: "Holding the horse reins/breastfeeding the son/the gold pouring over the forehead. Holding the mule rein/breastfeeding the daughter, the gold pouring over the neck." The currency museum we are initiating today will not only preserve this historical memory, but it will continue to enrich in the future as well. This is the beginning of the national museum of monetary and numismatic values that the Bank of Albania will soon offer to the public in its reconstructed headquarters, and present the added historical values of our nation.

In conclusion, let me thank the Albanian and foreign collectors and the National Historical Museum for their cooperation in organizing this exhibition.

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

At the 24th Conference of Banking Supervisors from
Central and Eastern Europe
12 April 2011

Distinguished ladies and gentlemen,

Allow me to first wish you a warm welcome to the 24th Conference of Banking Supervisors from Central and Eastern Europe, which this time is taking place in Tirana. The Bank of Albania considers this forum as very important and a platform where participant institutions may exchange their experiences with each-other. This forum is a modern highway that allows for a rapid convergence of our supervisory practices to the best standards.

Let me now continue with a summarised analysis of economic and financial developments in Albania over the last two years, focusing on some concrete issues requiring more attention by the banking industry and the supervisory authority in the future.

The Albanian economy was characterised by positive developments during the pre-crisis period. Annual economic growth was on average 6%, with admirable and stable core macroeconomic indicators. Growth relied on a firm strengthening of domestic demand components while funded by internal resources, mainly through rapidly increasing loans to the private sector and loans for investments.

The banking sector, which dominates the domestic financial system, has also undergone a significant transformation in recent years. This is due to the entrance in the market of renowned European banking groups, expansion of banking infrastructure and upgrade of customer services. Financial performance has been good, recording average levels of return on equity and on assets, respectively over 20% and 1.5%. Over the years, the banking system has chosen to capitalise the majority of its profit in order to best support its activity with liquidity and capital.

During this period of a rapid and qualitatively better expansion of the banking activity, the Bank of Albania found it necessary to revise the supervision philosophy. The main ambition was its orientation towards sources of risk, in other words to strengthen control over banking activity. For that reason, at the end of 2006 a new law "On Banks in the Republic of Albania" was adopted. This law imposed, on the banking industry, more contemporary standards as regards operation, management, and control of the banking activity.

The main concerns consisted in high crediting levels, significant concentration of crediting in foreign currency, and the absence of sectorial diversification.

Consequently, at the end of 2006, the Bank of Albania introduced a number of regulatory amendments aiming at slowing down crediting growth levels, through imposing higher capital requirements on more aggressive banks.

These measures were further supplemented in 2008, targeting more directly cases when borrowers had no income in foreign currency.

Another strategic move during this period was the integration of banking supervision and financial stability with monetary policy decision-making. This action is as bold as it is innovative in establishing more optimal equilibriums between our function of formulating and implementing the monetary policy and that of maintaining the system's financial stability. From that moment on, the Financial Stability Report would not be merely another book in the library shelves of the Bank of Albania, but a valuable input to policy decision-making. Therefore, information becomes more complete, including the assessment of banking activity risks performance. This would mean that our philosophy becomes more preventive and more farsighted, because the collected information is used to minimise future risks.

We believe that these actions were the right therapy to buffer the effects of the global economic and financial crisis on the domestic banking sector and economy that appeared at the end of 2008. The turmoil in the global financial system generated uncertainties across the Albanian public and, subsequently, a part of deposits were withdrawn from the banking system.

Additional need for liquidity and the contraction of crediting during this period had a negative effect on the situation of financial resources, revenues and capital of the banking sector.

Under these circumstances, public authorities undertook a series of actions to support the banking sector, in particular the following:

- Approval of a law, which increased the insured amount of public deposits;
- Decisions of the Supervisory Council of the Bank of Albania to limit bank exposure against their bank holding groups and suspend the distribution of dividend for banks during 2008 and 2009;
- Implementation of a number of other decisions taken by the Bank of Albania in relation to the establishment of more easing conditions to provide liquidity in the inter-bank market; and
- Further improvement of the regulatory and supervisory framework, aiming at maintaining banking activity stability.

Overall, during this stage, the Bank of Albania has played an essential role for the identification of short-term problems of the banking sector and their immediate addressing. This process was necessary to identify later longer-term implications on the banking activity performance and further alignment of the supervisory framework.

Banking activity performance over the past two years has shown that these measures proved to be effective and the Albanian banking system successfully coped with the global crisis effects. The withdrawal of public deposits from the banking sector terminated at the end of 2009 Q1 and, from that moment, their return to the banks continues consistently. The current financial situation continues to be stable overall compared with previous periods, with a firm public confidence and satisfactory conditions of liquidity and capitalisation. The stress tests of the banking sector against assumed unfavourable scenarios – economic and financial ones – indicate that the banking system is capable of coping with them.

Banking activity performance during this period has reflected the overall performance of the economy. During the last two years, despite the negative output gap, the country's economy has continued its positive growth in the range of 3.5-4.5%. Other macroeconomic indicators have ranged within admissible and expectable values.

We believe that this financial and macroeconomic stability reflects the commitment and coordination of core economic policies, the monetary and fiscal policies, over the time. They will continue to support the solid economic growth further on, in light of the world's economy resurgence.

Dear guests,

The world's financial system faced an extraordinary crisis. Equally extraordinary were the measures that were taken. Naturally, its effects will continue to be present in the global economy, while decision-makers, experts and scholars will continue to analyse the causes and lessons that may be drawn from it. Taking advantage of being present in this panel of supervisors, I would like to list some of our conclusions:

- Macroprudential supervision policies constitute an essential argument of recent discussions. The role of the central bank is a part of them, especially in terms of its preventive role. Randall Kroszner, in his recent document "Challenges for Macro-Prudential Supervision" notes: "... central banks should move from their traditional role of the fire extinguisher (which means that if something goes wrong, central banks will intervene in the market and provide liquidity to extinguish the fire or prevent its expansion) to the role of the smoke detector (which means to try and prevent the fire)...". More specifically, this implies the identification and construction of a group of measurable indicators, which together create warning systems for macro prudential problems. Stress tests are necessary and they should be more frequent, real, and transparent and shared with supervisory authorities of other countries. Equally indispensable are integrity, professionalism and independence that should characterise the activity of each banking supervisor.
- Macroprudential supervisory policies, post-crisis, despite the progress made recently, need further regulation. For that purpose, specialised

international institutions need to concentrate on a more detailed definition and unification in order to adapt them continuously with markets development. Taking into consideration regional, demographic, historic and cultural specific characteristics is also important.

- The banking system needs to embrace a culture based on the best values of ethics, service and integrity. This should be the primary objective of all banking system managing structures, which will in turn lead to enhanced accountability in banking institutions management. Bank managing structures are responsible for a balanced management of their institution, where the objective for profit should serve to identify, analyse and professionally assess risks that accompany relevant actions. In addition, banking institutions and their staff need to reflect, in their public relations, the highest standards of security, communication and transparency, care and support so that this relationship of trust and confidence becomes a characteristic of mutual progress. The supervisory and regulatory framework is being completed with a view to take these developments even further.
- Banking supervisors, in turn, need to pay more attention to examinations and reports they prepare, integrity and behaviour that characterises the work of each bank.
- Another great lesson we may draw from the crisis is to avoid at any cost huge concentrations and dependency on short-term financial funds. A top priority remains the adoption of prudential practices of risk management.
- Composition and capacities of banks' managing structures represent another challenge for the banking industry in the future. The last crisis showed that in many cases, board members represented only the short-term interests of shareholders, at the expense of other interests of the group. Likewise, their expertise and know-how should be closely connected to specific activities of the bank.
- The market and innovation move faster than the supervisor does. Therefore, any innovation or new banking product, prior to being marketed, needs to be tested responsibly, assessing carefully all potential accompanying risks.

In a more national context, it is necessary and actually completely possible for the banking sector to accelerate the process of crediting revitalisation, a development that supports not only the economy and the clients, but also the banks.

Crediting should be supported better through a solid growth of funding sources, especially deposits. In crediting, it is necessary to have a better sectorial distribution and a more reasonable balance between public and private investment projects, Albanian Lek or foreign currency-denominated credits, therefore orienting crediting towards supporting the national economy.

In this context, there is sufficient room for banks to support more crediting to small and medium-sized enterprises and provide more opportunities in Lek crediting. In any case, the process of analysis, assessment, follow up and evidencing the credit quality should be pivotal to relevant structures in banks and should be carried out with maximum seriousness and commitment, conform to supervisory requirements.

In this process, cooperation is needed with clients that are facing temporary difficulties. However, in the case of non-performing loans, it is necessary to undertake envisaged and timely actions to execute the guarantees and other forms of collateral, in order to recover maximum values.

These actions are important while the Bank of Albania deems that the crediting activity of the banking sector will continue to face a challenging environment and targeted improvements for the credit quality will require more time to be made.

In conclusion, let me underline that, movement in the above-mentioned directions make a complex process, which requires a two-way commitment and cooperation. It is with pleasure that I find that cooperation between us and the banking sector is seeing progress, both in the field of supervision and monetary policy implementation.

I believe this cooperation will grow among supervisors in the South Eastern Europe. On behalf of the Bank of Albania, I would like to assure you that we will offer full cooperation in this regard.

Taking advantage of this opportunity, I would like to underscore that the Bank of Albania will always respect the public expectations and will fulfil, on time, its legal responsibilities in terms of maintaining the banking system and price stability.

I thank you for your attention and wish you success!

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
27 April 2011

Today, on 27 April 2011, the Supervisory Council of the Bank of Albania reviewed and approved the quarterly Monetary Policy Report. Based on a thorough analysis of Albania's latest economic and financial developments, and following discussions on their future outlook, the Supervisory Council of the Bank of Albania decided to leave the key interest rate unchanged at 5.25%. The Supervisory Council holds that the actual monetary conditions are appropriate for meeting the inflation target and for continuing to stimulate the economic activity.

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

The Albanian economy is deemed to have had a positive performance during 2011 Q1. Economic activity increased, main macroeconomic balances improved, and risk premiums and interest rates in financial markets dropped. Economic growth during 2011 relies on foreign demand for Albanian goods as well as on domestic demand. Consumption and investments in the country remain slow, beyond the seasonal effect that characterises the first quarter. Rapid expansion of exports and moderate growth of imports have led to an improvement in trade deficit, contributing to the balancing of demand and supply for foreign currency and retaining the national currency value.

Demand-generated inflationary pressures remain contained, due to the existence of free capacities in the economy and controlled consumption, while import prices increase was a principal contributor to the price rise in the country.

In March 2011, inflation pointed to 4.3%. During the first quarter of 2011, inflation averaged 4.0%, i.e., one percentage point above the mid-term inflation target. The country's economy continued to grow during the fourth quarter of 2010, and indirect available data suggest that even the first quarter of 2011 was positive. On average, this growth is estimated to have been lower than the potential growth of the economy, suggesting that domestic demand-side inflationary pressures have been weak. The rapid upsurge in prices over the last two months is mainly due to the effect of food and oil prices increase in international markets, thus leading to the light increase of inflationary pressures and initial emergence of second-round effects, in February. In response to this phenomenon, the Bank of Albania increased the key interest rate by 0.25 percentage points at the end of March 2011. Inflationary expectations remain anchored close to the mid-term target of the

Bank of Albania. In addition to the domestic demand, the relative stability of the exchange rate contributed to preventing further inflation increase.

More specifically, during 2011 Q1, inflation reflected a hike in prices of some food items, further increase of oil prices as well as an upturn in medication prices. With the warmer season approaching, domestic agricultural output is expected to contribute to an upward domestic supply, thus buffering high pressures from import prices.

The Bank of Albania deems that policies to encourage domestic production, which reduce the exposure of the Albanian economy to external shocks, are necessary.

Annual inflation of tradable goods sector in 2011 Q1 was 4.9%, accounting for about 75% of the headline inflation. Primary reasons for this conduct were the actual and expected aggravated conjunctures of commodity prices, unusual geo-political situation in large economies producing oil and agro-industrial products, as well as unfavourable weather conditions that have damaged agricultural production. Inflation of non-tradable goods of the CPI basket, which reflect the domestic pressures, in the first quarter of 2011, reached 2%. This value is close to that of the previous year and comparable to its historic average.

Inflation trend, without counting temporary effects on it, that is core inflation, was close to 3.0%, reaching high historical values. This long-term inflation component shows that inflationary expectations in the economy, though reflecting a value that is relatively higher, remain well anchored with the Bank of Albania target.

In the future, inflationary pressures along the time span of the monetary policy action are forecasted to be high, but their intensity will be falling over the course of the year. I would like now to address, in more details, the factors that determine inflation developments and relevant risks.

During 2011 Q1, the world economy demonstrated growth, while unemployment remains high. Economic growth is expected to intensify, mainly owing to the private sector, hence providing the conditions for the withdrawal of the public sector.

As a result of high divergences among countries, authorities have to deal with diverse challenges. In advanced economies, the focus is on reducing public debt and adjusting economic agents' financial balance sheets, while in emerging economies the main risk appears to be about the overheated economy and rapid credit growth. Inflationary pressures are considered upward, due to supply-side shocks in the oil and other commodity markets. On the other hand, as a result of a rapid increase of demand in some developing countries, prices of factors of production, such as energy, raw materials and labour, increased. The forecasts reveal a heightened level of uncertainty, as a result of social and political turmoil and natural disasters in some countries

of the world. Price increases worldwide and the extent of their transmission to various economies have affected the decisions on interest rates applied by some central banks. Therefore, as a result of the expectations for an inflation rate above the targeted level, the European Central Bank decided to increase the key interest rate by 0.25 percentage points. Likewise, a slight increase of interest rates has been noted in the international financial markets, thus factoring into the expectations for a higher inflation rate.

Domestic economic activity over the fourth quarter recorded a growth of 5.4% year-on-year, significantly narrowing the negative output gap. Economic growth was supported by the external demand and was boosted in positive terms by a consistent recovery of the global economy. An acceleration of the annual growth rate of real GDP during the fourth quarter was triggered by a higher positive contribution of the industry sector. Meanwhile, the value added of the services and agriculture sectors contributed positively, albeit at a lower level, to annual real GDP growth.

The latest data on 2011 Q1 obtained from the business confidence surveys, the external trade performance, and monetary and fiscal indicators support a continued domestic economy recovery, mainly due to the positive contribution of the production sector.

Partial data available on private consumption suggest a rapid rise y-o-y during 2010 Q4. In the meantime, partial data for the first quarter suggest a moderate contribution of consumption to the aggregate demand. 2011 Q1 surveys show that uncertainty for the future is considered high by consumers, thus affecting the stability of consumption for upcoming periods. The Bank of Albania considers that in the short run, there is room for the Albanian consumer to adopt a more rational behaviour towards expanding consumption. As regards investments, their performance is assessed to have been more stable over the last two quarters. The increase of the external demand for producing businesses, the positive expectations for demand in some producing sectors, as well as easing of funding terms and conditions during the last quarter of 2010 signal a continuation of the positive contribution of private investments during the current year. Nonetheless, production capacity utilization remains low and the internal consumption situation remains unclear, suggesting that the economy continues to operate below its potential.

In 2011 Q1, government expenditures are estimated to have given an important contribution to keeping demand at positive levels, in contrast to the trend of the preceding year. At the end of 2011 Q1, budget deficit reached ALL 11.8 billion, against the surplus of ALL 0.7 billion recorded in the same quarter of the previous year.

During this period, budget expenditure increased in nominal terms by 16.8% year-on-year, mainly due to increased current expenditures. Maintaining similar growth rates over the rest of the quarters is expected to be translated into a higher contribution of expenditures to the aggregate demand, as compared to 2010. Developments observed both on revenues and expenditures side

have led to a drop of the primary balance to negative values during 2011 Q1, after an apparent improvement in the last quarter of 2010.

In 2010 Q4, the net position of the current account was estimated in a deficit of EUR 373.6 million or 16.4% of nominal GDP. In contrast to the first three quarters of the year, which recorded a narrowing of the annual current account deficit, in the fourth quarter of 2010, this deficit widened by 15.1% in annual terms. The main factor for the widening of the current account deficit was the widening of the trade deficit, despite the high rise in exports of goods and services by 20.7% year-on-year. Foreign demand continued to support economic growth in the first two months of 2011. The good performance of exports contributed to a narrowing of the trade deficit by 5.9% y-o-y for this period. The average ratio of imports' coverage by exports was 47.3%, recording its highest historic peak. Trade annual growth was 30.4% during the first two months of the year. Exports' value continued its accelerating upward trend, which had started in the first quarter of 2010, and expanded by 66% in annual terms.

The three-digit annual growth in the electric energy exports was a key contributor to this performance, while processed metal exports and textile re-exports continued to contribute positively to the value of annual export performance.

In the post-global-crisis period, domestic economy is adapting to a new growth model, which requires significant structural changes. During this process of reallocating resources to the most efficient sectors of the economy, as well as a more conservative behaviour of Albanian households towards consumption, its potential output is expected to be lower for the mid-term horizon. According to the demand components analysis, the improvement of the growth rates in the last two quarters may have significantly narrowed the negative output gap, but the existence of spare capacities in the economy even during 2011 suggests that the Albanian economy will continue to operate below its potential, generating weak domestic demand-side inflationary pressures.

On the supply side, increasing productivity during 2010 Q4 and a slower rise in unit labour cost generate lower inflationary pressures from the labour factor. Inflationary pressures over the level of domestic prices, which arise from the fluctuations in the prices of oil and food items in international conjunctures, are assessed to be present during the current year, but with a continuous downward trend. Due to the aggravated geo-political situation in the world, the uncertainty surrounding these expectations remains high. The absorbing capacity of the domestic economy to these shocks and avoidance of steady pressures on inflation will condition the future performance of the Albanian economy and the control of agents' inflationary expectations.

Monetary indicators performance has reflected a slowdown of the money supply over the first two months of the current year, hence confirming contained monetary inflation pressures. The M3 aggregate marked an average annual

increase by 11.2%. The foreign currency component of the money supply provided a downward contribution to the broad money growth; however, the high use of foreign currency in the banking system and the economy remains one of the weaknesses of the Albanian economy. As an expression of its interest in addressing this issue, in today's meeting, the Supervisory Council of the Bank of Albania decided to waive the remuneration of the required foreign reserve. This measure will encourage commercial banks effectively to reduce the deposit collection costs and will favour the intermediation in the national currency. The level of the demand for money by private and public economic agents has increased. Our assessments indicate that monetary expansion is in conformity with the private sector demand for real money. The performance of loans to the private sector has been in line with its seasonal behaviour at this period of the year, increasing on average by 10.1% in annual terms. Although insofar credit developments have been slow, there are encouraging signs for a better performance of lending in the future. Private sector's demand for loans, whose low levels have been a primary obstacle for the revitalisation of lending, increased during the first quarter of the year and is expected to grow in the next quarter as well. The banking system is sound and it enjoys good liquidity conditions for supporting a growing demand for loans, with even better lending conditions. The Bank of Albania supports the banks' initiative to clean up their balance sheets, aiming at increasing transparency and creating free funds to support lending.

The overall performance of financial markets for the first quarter of 2011 has been positive.

In light of its primary objective to maintain price stability, the Bank of Albania decided to increase the key interest rate at the end of March. This decision was reflected in higher interest rates in the inter-bank market, while it is expected to be transmitted into other markets during the upcoming period. In parallel with this move, the Bank of Albania has supplied the inter-bank market with the necessary liquidity for a normal functioning. In the meantime, in the deposit market, the downward tendency of interest rates continued. Interest rates in the credit market varied; they increased for lek and decreased for euro. This performance, however, is deemed to represent special bank policies for certain segments of the economy. Lastly, the nominal effective exchange rate reduced its depreciation trend for the seventh consecutive quarter. Our analyses indicate that, overall, the fundamental factors of the economy support a new equilibrium of the exchange rate, which, albeit higher than three years ago, is adjusting to domestic financial and economic equilibriums, hence supporting the strengthening of the competitiveness of the Albanian economy in international markets. The stable performance of the exchange rate has contributed to a further consolidation of the domestic financial stability, without exercising pressure on the banks' activity and conduct of economic agents.

Our future projections support the maintenance of a positive performance of the Albanian economy even in 2011. Consumption and private investment are expected to grow further, while the fiscal sector is expected to provide

a positive contribution to the economic growth, after a slowdown in 2010. Notwithstanding this, demand growth is expected to be below the potential of our economy even in 2011.

This will condition downward pressures on inflation from the domestic economy, which are expected to balance the effect of rising import prices. The Bank of Albania is determined to take all the necessary measures in due time to comply with its inflation target in the mid-term horizon.

Taking into consideration the information set out above, the Supervisory Council concluded that there are added inflationary pressures for the medium-term horizon, which however, remain subdued. Consumer price performance is expected to be under the pressure of price increase in international markets. On the other hand, insufficient demand will continue to condition below-potential domestic capacity utilization rates, exercising downward pressures on inflation. Inflationary expectations continue to be anchored around the inflation target of the Bank of Albania.

At the end of its discussions, the Supervisory Council concluded that the monetary conditions are appropriate for compliance with the mid-term inflation target and decided to keep the key interest rate unchanged at 5.25%.

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

At the Presentation of the 2010 Annual Report to the Parliamentary
Committee on Economy and Finance
24 April 2011

Dear Chair,
Dear Committee Members,

It is a pleasure and privilege for me to present to you today the Bank of Albania's 2010 Annual Report key conclusions.

Pursuant to the legal requirements and our institutional commitments for enhanced central bank's independence, transparency and accountability, this year's Annual Report contains a comprehensive analysis of economic and financial developments and reflects faithfully the activity of the Bank of Albania during 2010. This activity, in its entire spectrum, aimed to fulfil our mission and legal obligations, and reflect the Assembly's recommendations for 2010.

Let me begin my presentation with a brief outline of the key issues addressed in this Report.

The Albanian economy experienced an overall positive performance during 2010. On the other hand, this year's economic developments underlined the need to continue and intensify structural reforms, which are pre-requisites for stable and long-term economic growth.

Last year, the economy grew reflecting the sound foundations of the Albanian economy, dynamism of the private sector, and maintenance and consolidation of macroeconomic stability. Owing to developments in the financial and real sectors of the economy, as well as the Bank of Albania's monetary policy, consumer price inflation remained in line with our 2010 target. In this year:

- Inflation was within the target band of the Bank of Albania;
- Budget deficit and public debt dropped in relative terms;
- Financial stability consolidated; and
- Financial intermediation expanded further.

In addition, the economy's external position improved, and interest rates and risk premiums in financial markets dropped.

According to INSTAT data, the Albanian economy is estimated to have grown by 3.9% this year. Compared to 2009, economic growth is more balanced in terms of sectorial distribution and demand components.

During 2010, economic growth was mostly driven by foreign demand, as reflected in the rapid growth of Albanian exports and reduction of trade deficit. It has also relied on the increased domestic demand. The significant reduction of the fiscal stimulus, especially in H2, was compensated by the positive tendencies in private consumption and investments over this period.

Albeit growing, the Albanian economy was characterised clearly by the existence of free capacities in both the labour and capital market.

Free capacities in the economy, anchored inflationary expectations of economic agents, as well as controlled monetary expansion in response to a prudent policy of the Bank of Albania, had a downward impact on inflation.

These factors compensated the inflationary effects from increased administered prices, depreciated exchange rate, and global markets' prices. Consequently, consumer price inflation averaged 3.6% during 2010, fully compliant with the Bank of Albania's policy on price stability.

The above-mentioned developments were supported by a prudent combination of monetary, macroprudential and fiscal policies. In the presence of controlled actual and expected inflationary pressures, negative output gap, and reestablishment of the public trust in the financial system, during 2010, macro-economic policies maintained their stimulating trend. The welcomed shift of attention of the fiscal policy towards retaining debt indicators long-term sustainability was accompanied by the reduction of budget deficit and fiscal stimulus.

This development led to the pursue of a more stimulating monetary policy by the Bank of Albania and paved the way for it to reduce the key interest rate by 0.25 percentage points in July 2010.

In response to the continuous liquidity injections by the monetary authority, the easing side of monetary policy was reflected in reduced interest rates for deposits in lek, government bond yields, and, to a lesser extent, lending in lek. Financial markets experienced a quieter year with growing liquidity and downward interest rates. In addition, banking system liquidity and capitalisation indicators improved.

Lending terms applied during 2010 by the banking system eased gradually. It was a reflection of not only the Bank of Albania's monetary policy, but also of liquidity indicators improvement, risk premium decline, and public borrowing reduction in the domestic market. The easing of lending terms and increase of credit demand was followed by a rapid surge of crediting in 2010.

In the regional context, financial intermediation expansion during the past year constitutes a prominent development, in contrast to the experience of many other countries witnessing a decline of this indicator. Crediting supported primarily additional investments in services and industry sectors, while consumer credit was subject to moderate growth rates.

At the conclusion of this brief summary, I would like to draw your attention to the key topics presented in this Report. Economic developments in 2010 are an illustration of economic challenges faced by the Albanian economy.

First, the economic development model pursued until now has room for further improvement. The new agenda of structural reforms should aim to establish the requisites for more balanced and stable growth in the long run.

Greater orientation of Albania's economy on exporting and overall higher competitiveness of our products in international and domestic markets dictate the need for continued structural reforms at macro- and microeconomic levels.

Second, macroeconomic stability consolidation requires more efforts and work in the future.

Maintaining the country's internal and external balances requires the further development of decision-making architecture and macroeconomic coordination, as well as economy and market supervisory and regulatory mechanisms. Analytical forecasting and decision-making capacities of public and private economic agents need to be improved further. Lessons drawn from the last global crisis should be analysed and implemented with determination by all of us.

Third, ensuring the country's financial stability requires coordinated action by all supervisory and regulatory institutions, and market's private agents. Financial stability serves to channel savings into the most competitive sectors of the economy in the long-term horizon.

Following, I would like to address the above-listed topics in more details, focusing on the key points of the Bank of Albania's work.

1. ECONOMIC AND FINANCIAL DEVELOPMENTS DURING 2010

During 2010, the Albanian economy was characterised by the gradual improvement of the aggregate demand and further consolidation of the macroeconomic stability. Economic development was followed by price stability, while the public debt, budget deficit and current account deficit narrowed.

Economic growth relied mainly on foreign demand and increased exports, while domestic demand was sluggish. It was decelerated by public finances consolidation and state deficit reduction in 2010, while consumer spending and private investment were affected by uncertainty for the future and unutilised capacities.

Private consumption was slow during 2010, as a consequence of the overall economic and financial situation uncertainty and future employment expectations. This was reflected in consumers' increased preference for saving, while aggregate data suggest increased disposable income.

As in many other economies, boosting private consumption will be one of the main economic growth determinants and one of the future challenges we may face over the course of the current year.

Private investments provided a low contribution to the 2010 economic growth. Albanian businesses hesitated to make new investments under the impact of low production capacity utilisation and more prudent crediting attitude by banks.

Fiscal policy focused on fiscal consolidation in 2010, subsequent to a countercyclical nature in 2009. Fiscal consolidation accelerated especially during 2010 H2, following the approval of the revised budget. This consolidation was present both on the side of revenues and expenditures. Budget revenues increased by 8.4% y-o-y due to economic growth, expansion of taxpayers' base, and income from privatisations. On the other hand, budgetary expenditures reduced by 4.5%, attributable to the reduction of government capital expenditures.

Budget deficit for 2010 settled to around 3.0% of the GDP, reducing by 52% compared to a year earlier. This deficit was funded mainly through the issue of domestic debt ordinary instruments. However, deficit financing experienced a novelty in 2010 with the issue of the first Albanian Eurobond. Its issue, at EUR 300 million, met a part of the public sector need for foreign currency and was accompanied by the reduction of domestic borrowing. It eased pressures on the national currency, increased the room for private sector borrowing and led to its financing terms improvement.

Current account deficit narrowed by 21.5% in 2010, settling at 11.9% of the GDP. This was reflected in augmented private and public sectors' savings. Increased exports as a result of invigorated foreign demand, depreciated exchange rate and improvement of trade terms at this period also contributed to it. Notwithstanding the improvement recorded in 2010, current account deficit remains high. As we have continuously stated, the Bank of Albania deems that the formulation of structural policies to dampen the external economy misbalances should be a priority.

The significant narrowing of the trade deficit in goods and services came as a result of the accelerated increase in goods and services exports by about 16.4%, annually. On the other hand, goods and services imports reflected a moderate growth rate by 2.6% on average, with an upward trend in the last months. The difficult economic situation in our neighbouring countries is reflected in the annual drop of net remittances by 11.7%, while their share to the GDP was estimated at 7.8%.

Net flows in the capital and financial account recorded a decline by 11.2% in 2010, leading to the financing of the current account deficit to 87.5%. Excluding privatisations, foreign direct investments were estimated at 9.3% of the GDP and constituted the main source of foreign financing of the Albanian economy. Foreign reserve increased by about EUR 178.8 million and its stock of EUR 1.9 billion may cover 4.8 months of goods and services import.

The positive developments in the external sector of the economy, primarily owing to the expansion of exports and foreign currency income from the Eurobond, contributed to the generation of contained pressures in the foreign exchange market this year. In the macroeconomic perspective, the relative stability of the exchange rate during the year reflected a new equilibrium in foreign currency demand and supply.

In sectorial terms, the Albanian economy development relied chiefly on the industry and services sectors growth, which benefited, largely, by the foreign demand and the structural shift of domestic demand to short-term consumer goods.

In the short- and mid-term horizon, the industry and service sectors are expected to remain the main supporting pillars of the Albanian economy. The construction sector continued to shrink during 2010, reflecting a contraction of public investments, more tightened lending terms, more cautious consumer behaviour vis-à-vis immovable properties, and concerns arising from the relatively high stock of inherited inventory.

Overcoming these problems and correction of price tendencies in some segments of residential markets will open the way for a more stable development of this sector. On the other hand, the agricultural sector is deemed to have grown as a consequence of better weather conditions and favourable price conjunctures that characterises and will characterise this sector.

Money and Financial Markets

Broad money was on average up by 10.6% in 2010, as a reflection of the economic activity performance and restoration of economic agents trust in the banking system. The expansion of monetary stock complied with the economy's demand for money and did not trigger inflationary tendencies in the economy. Deposit to GDP ratio was 64.2% at end-year, higher than its level prior to deposits withdrawal. In addition, the profile of deposits' time structure reflected a higher preference for saving, characterised by a shift to longer maturity-term deposits.

The eased lending terms during 2010 H2, the stimulating measures by the Bank of Albania, the higher interest of the banking system to support domestic consumption and investment, as well as the reduced uncertainty and risk premiums were followed by a gradual crediting growth during the year. Credit portfolio for the private sector expanded by 10% in 2010, principally due to foreign currency crediting. Nevertheless, crediting continues to suffer from the lack of demand and realistic, qualitative and worth crediting business plans.

Restoration of trust in the financial system, stabilised macroeconomic situation, and regulatory and supervisory measures taken by the Bank of Albania led to the stabilisation and improvement of banking system capitalisation, liquidity and profitability indicators.

2. INFLATION AND MONETARY POLICY

Annual consumer price inflation was on average 3.6% in 2010, remaining within the target band of the Bank of Albania. Inflationary pressures were more concentrated during 2010 H1, mostly because of a rise in some administered prices. Average annual inflation in 2010 H1 was 3.9%. In the following two quarters, the relative stabilisation of the exchange rate and low domestic demand-side inflationary pressures contributed to the average inflation rate convergence around the Bank of Albania's target. The generated negative output gap contained the inflationary pressures over the entire 2010, thus balancing the depreciation effect of the national currency and international markets' price increase.

During 2010, the Bank of Albania's monetary policy was implemented in a macroeconomic environment characterized by positive growth rates, anchored inflationary expectations and contained inflationary pressures. As I highlighted earlier, this environment led to retaining the expansionary monetary policy that had emerged since 2009.

This policy triggered downward interest rates and completed even further the stimulating effects from the exchange rate depreciation. Low interest rates favoured domestic consumption and investment increase, while the depreciated exchange rate supported the Albanian exports increase during 2010.

The reduction of the fiscal stimulus expanded even further the room for a stimulating monetary policy. In July 2010, the Bank of Albania reduced the key interest rate by 0.25 percentage points, to its all-time low of 5.0%. Banking system liquidity improvement and public sector's weak demand for monetary assets supported the transmission of a facilitating policy to all financial markets segments during the last months of 2010.

In parallel, the Bank of Albania supplied the financial market with the required liquidity to support financial intermediation. With a view to adopt the most advanced models of central banking, particularly, convergence with Euro-system practices, the Bank of Albania changed the form of its operations objective.

Since June 2010, our liquidity management operations are oriented on targeting short-term interest rates in the inter-bank market and minimisation of their volatility. This remodelling of our money market interventions boosts the monetary policy effectiveness and promotes the inter-bank market development. Similarly, it marks another step towards the completion of our technical preparations to adopt the inflation targeting regime.

Another important aspect of the central bank duties is the banking system supervision.

3. BANKING SUPERVISION AND FINANCIAL STABILITY

The improvement of Albania's economic activity is reflected also in the performance of the banking activity. Year 2010 was characterised by higher banks assets, improved banking soundness and profitability indicators, as well as system's well-capitalisation. On the other hand, the banking system was characterised by a larger non-performing loans portfolio, reflecting also the active policy of the Bank of Albania on enhancing the transparency of banks' balance sheets. The organisational change of banking supervision, in conformity with the challenges of the time, contributed to the further improvement of the regulatory and supervisory framework and, consequently, strengthening of the financial stability in the country.

Banking System

The banking system continues to remain the main actor of financial intermediation in Albania. At present, this sector consists of 16 banks, two of which are branches of foreign banks. At the end of 2010, banking system assets doubled their growth rates compared to a year earlier, accounting for about 81% of the GDP. Overall, this ratio expanded by 3.5 percentage points, year-on-year.

The structure of the banking system assets continued to be financed primarily by the public deposits and focused on lending, mainly to the private sector. Banking system investment in lending increased in 2010, but its growth rates continued to be moderate. This performance reflects banks' prudent policies on their loan portfolio quality and the moderate demand for loans by economic agents. The sluggish lending growth and below-potential performance of the economy led to increased non-performing loans indicator to 14%. However, this indicator's growth rate decelerated in 2010.

Capital adequacy ratio remains at satisfactory levels. The system's shareholders' equity increased by 10% in 2010. Albanian banking system is considered as well capitalised, which is also confirmed by the high capital adequacy ratio at 15.4%, clearly higher than the 12% established in the regulatory framework.

Financial leverage ratio settled at 10.6%, almost unchanged compared to 2009. This performance demonstrates a stable support to the banking system intermediation, at similar debt levels during the two above-mentioned years. Credit risk remains the banking sector's main risk. In response to it, the banking sector has created its own reserve funds to tackle potential losses. At end-2010, credit risk reserve funds (provisions) for lending to residents were about 33% higher than at end-2009.

Our stress test analyses confirm that, in our banking system, capital is adequate to absorb large shocks, which may lead to reduced borrowers' payment capacity or market misbalancing. The Bank of Albania has clearly improved its stress test analysis supported by ever-growing cooperation

with the IMF, World Bank, European Central Bank and other central banks. Concerning bank supervision, the Bank of Albania has concluded a number of cooperation agreements with central banks of the region and other European countries, where parent banks have their head offices.

Information exchange both at the licensing phase and on potential financial stability risks to institutions that they supervise, as well as cooperation for controlling financial institutions operating in the country and abroad will help the Bank of Albania to ensure banking system stability.

In addition to the banking sector, 2010 was a positive year for non-bank financial institutions as well, witnessing increased diversity and completion of the financial infrastructure. At end-year, there were 17 non-bank financial institutions in the financial system compared to 12 a year earlier. Overall, their financial and lending activities reflected a good performance and were mainly in compliance with the regulatory framework established by the Bank of Albania.

Banking System Supervision

As stated above, at the offset of 2010, the Bank of Albania changed its banking supervision organisational framework, refocusing and connecting it directly to risks that accompany the financial activity.

Moreover, the Bank of Albania re-conceptualised its supervision focus and strategy in accordance with risks faced by the banking and financial system in Albania.

Transparency and disclosure of information for banking and financial products and services were also at the focus of supervision in 2010. Since 2010, the Bank of Albania has provided, on a half-yearly basis, an orientation to compile business plans both for the public and financial agents through publishing detailed analysis of system-level financial soundness. On the other hand, promotion of private financial agents' transparency is reflected in this year's amendments to the regulatory framework. The high commission fees for banking products and services were a sensitive issue addressed in 2010 and will continue to be a priority in the upcoming period. The Bank of Albania, through its analyses, has played a key role in discussions on this matter, aiming to tackle it in a timely and efficient fashion.

Issues on anti-money laundering, transparency and compliance with supervisory rules were equally important in financial institutions supervision during 2010. Hence, full on-site inspections were carried out in two banks and four non-bank financial institutions, as well as two targeted inspections. Following these inspections, these institutions drafted internal regulations and developed their payment systems, which enable the identification of daily cash transactions.

Strengthening of the Supervisory and Regulatory Framework

In 2010, the Bank of Albania finalised some new regulations and amended some other regulations on banking supervision. This process aimed at compliance with Basel Committee standards and EU Directives, taking into account the best international practices and developments in the Albanian banking system developments.

New regulatory acts and key amendments to actual acts on banking supervision approved during this year include:

- Regulation “On management of risk from open foreign exchange positions”, which sets out the rules and criteria for the calculation, reporting and supervision of bank’s open foreign exchange positions for exchange rate risk management.
- Regulation “On risk management in the activity of non-bank financial institutions”, whose scope is to set out rules on risk management in the activity of non-bank financial institutions, especially with reference to rules on risk management in the activity of micro-credit and financial leasing institutions.
- Guideline “On conservatorship and liquidation of banks”, which sets out the procedures and actions for conservatorship and liquidation, finalising the authority’s action framework in cases of conservatorship/liquidation of a bank or a branch of a foreign bank.

Besides some central aspects of the Bank of Albania’s work, such as monetary policy and banking sector supervision and regulation, in my presentation I would like to dwell on some other aspects of our work. These activities are compliant to our legal obligations and contribute to the financial system and market economy development in Albania.

4. OTHER ACTIVITIES OF THE BANK OF ALBANIA

Next, I would like to present a summary of the Bank of Albania’s role in the payment systems development, support to the European integration process, public education and communication, statistics, and research capacity building at the Bank of Albania.

Payment Systems

In 2010, the payment systems infrastructure improved even further, their security and efficiency increased, by processing a high number and volume of payments. The volume of transactions in the real time gross settlement system (AIPS) increased by 44% compared to 2009.

This year marked a further expansion of payment instruments use, reflecting, *inter alia*, increased public trust and confidence in the banking system.

The sound operation of the financial markets and strengthening of financial stability in the country may not be realised without effective and developed payment systems. In this regard, the Bank of Albania is working to adopt the best practices of other central banks. The Twinning Project with the Bank of Italy and the Bank of France, among other things, will focus on capacity building and approximation of the payment systems regulatory and operational framework in Albania with that of the European Union.

In 2010, we focused on two main aspects: strengthening of the legal framework for the payment systems' supervisory role; and, improvement and promotion of changes to the national payment system in the context of the Bank of Albania's reformatory role. As concerns improvements to the regulatory framework, in 2010, the draft-law "On payment systems" was finalised.

This draft-law constitutes a further step that is crucial to the process of ongoing approximation of the Albanian legislation with the EU banking and financial legislation, as envisaged in Articles 70 and 89 of the Stabilisation and Association Agreement (SAA).

In its reformatory capacity, in March 2010, the Bank of Albania realised live communication between the interface of the Treasury System of the Ministry of Finance and the payment systems at the Bank of Albania. This new scheme enables the Ministry of Finance to monitor in real time its accounts activity at the Bank of Albania, contributing to a more efficient funds administration. Moreover, in this year, our work focused on the improvement and extension of the necessary infrastructure to settle electronic payment instruments in the Albanian lek for various international cards (MasterCard, Visa) and other projects aiming to reduce the use of cash in the economy.

Support to European Integration Process

In light of the SAA implementation, the Bank of Albania has contributed to the review of the National Plan for the Implementation of the SAA for 2010-2014, identifying and updating priorities and measures taken in the field of macroeconomic stability, free movement of capital, freedom of establishment, and freedom to provide services.

For the European Commission's questionnaire, the Bank of Albania had a coordinating role for some chapters, and participated actively in further EC fact-finding missions.

During 2010, the Bank of Albania continued to keep regular and fruitful contacts with key financial institutions such as the IMF, World Bank, European Bank for Reconstruction and Development (EBRD), Bank for International Settlements (BIS), and enhanced the bilateral relations with other central banks.

In 2010, the Bank of Albania continued its work to review the legal and regulatory framework vis-à-vis the EU legislation and the latest developments in the country by drafting important banking legal, sub-legal and regulatory acts.

Public Communication and Institutional Transparency

Communication with the general public and individual institutions is considered to be one of the most important elements in our work, to which the Bank of Albania dedicates a significant amount of its resources. During 2010, the work of the Bank of Albania focused mainly on restructuring the existing instruments and establishing new communication methods, which contribute to establishing an environment where actors are well-informed and capable to understand the central bank's decision-making and make rational decisions on economic and financial issues. In the past year, additional contacts were established with various public groups, targeting especially those that have an impact on the public's educational processes.

Other activities consist in direct communication, periodic and non-periodic publications, presentations and meetings, which have made information on the Bank of Albania's work and decision-making available to the public. Moreover, the official website provides real time and user-friendly information on the Bank of Albania's activities, decisions and statistics.

Improvement of Statistics at the Bank of Albania

The Bank of Albania's aim was not only to successfully compile and publish statistical indicators, but also to improve continuously its public services by expanding the range of indicators, aligning its methodology with the best international practices and standards, and providing information in the best way. The main development in 2010, in terms of the statistical production, included the first time release of gross external debt statistics, international investment position statistics and economy crediting detailed statistics, thus concluding the statistics series on the external sector.

With respect to the monetary and financial statistics, the Bank of Albania has worked to improve the methodology, computerize the control processes and increase the number of published indicators.

Strengthening of Research Capacities

The Bank of Albania has long considered economic, financial and social research as a key element in its decision-making assessments and analysis.

Research capacities were strengthened through ongoing staff training, research infrastructure modernisation and establishment of bridges for experience and expertise exchange with various research institutions. Key research aspects in 2010 include monetary and fiscal policies, financial stability issues, new economic growth model, and the external sector of the economy. Support and application of econometric models in studying various economic phenomena led to reliable conclusions and forecasts.

Our internal future challenge is to improve these models even further and use them in the Bank of Albania's decision-making.

In conclusion, I would like to point out that, in addition to the Bank of Albania's Annual Report 2010, financial statements and the balance sheet, certified by auditors, are submitted.

Thanking you for your attention, I remain open to any questions and comments on the activities of the Bank of Albania in 2010.

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
25 May 2011

Today, on 25 May 2011, the Bank of Albania's Supervisory Council reviewed and approved the monthly Monetary Policy Report. Based on a thorough analysis of Albania's latest economic and monetary developments and discussions on their outlook, the Supervisory Council decided to maintain the key interest rate unchanged, at 5.25%. The Supervisory Council judges that the current monetary conditions are appropriate to meet the inflation target and continue the economic activity stimulus.

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

The Albanian economy continues to maintain a positive development trend. Recovery in domestic demand over the first four months of the year and the positive contribution of external demand have impacted on the positive growth of the Albanian economy. Also, the major macroeconomic balances have remained stable and the financial system indicators appear to have generally improved.

Following the shock of February, CPI inflation has followed a downward trajectory, reflecting the subdued inflationary pressures on the economy and Albanian financial markets. Available data on 2011 Q1 show that the economic activity has registered growth; however, the persistence of some spare capacity suggests that this growth remains below the potential. The negative output gap implies the existence of low domestic demand-induced inflationary pressures; however, persistent shocks to import prices caused inflation expectations to move up slightly. On the other hand, relative exchange rate stability and increased domestic food supply are factors that have made a positive contribution to lowering the inflation rate. Aiming at stabilizing inflation expectations in the medium term, the Bank of Albania raised the key interest rate by 0.25 percentage points at end-March. This move has been transmitted to financial markets, in line with the time lags of monetary policy transmission mechanism.

Inflation rate rose to 4.1% in April 2011, falling back gradually towards the Bank of Albania's target. Its performance has reflected the high rise in food prices, in the excise tax of some goods, and to some extent, the administered price inflation. Higher supply of agricultural products, as in March, made a positive contribution to lowering the annual inflation rate. Compared to the previous month, consumer price index fell by 0.6%, hitting the lowest monthly inflation rate of April in the last decade.

Processed foods and non-food consumer goods, including oil and pharmaceuticals, have been the main drivers of inflation. The first item, following the increase in primary commodity prices in global markets, has determined and will continue to determine the annual inflation rate throughout 2011. The second item has registered positive upward values as a result of the global conjuncture of this item's commodity prices, particularly oil prices.

Besides the increase in basic food prices, April's inflation rate has also reflected the second-round effects, being materialised in higher prices of several services. The Bank of Albania judges that the Albanian economy should find room to face the external supply shocks or international price fluctuations by promoting domestic production in some key sectors.

Annual inflation of tradable goods sector resulted 4.9% in April, accounting for about 73% of the headline inflation rate. The high inflation rate of this sector of the Consumer Price Index (CPI) basket continued to be affected by high primary commodity prices in global markets, non-optimistic mid-term forecasts related to them, and depreciated exchange rate pass-through. On the other hand, the decline in this item's share in determining the headline inflation was an outcome of the entry of domestic agricultural supply into the market. Non-tradable goods inflation, which reflects the domestic inflationary pressures better, settled at 2.5% in April, attesting to a slight upward trend. April's core inflation, which strips out the temporary effects, was close to 3.3%, reaching historical highs.

The monthly paces of inflation rise, which are a better signal about inflation expectations trend, were lower than in the previous months. Core inflation shows that the economy's inflation expectations, although reflecting a relatively higher rate, remain well-anchored at the Bank of Albania's target.

The Bank of Albania judges that in the period ahead, inflationary pressures along the time horizon of monetary policy stance will remain relatively high, but their intensity will decrease during the year. In the following, I will analyse in detail the factors determining inflation developments and related risks.

During the first months of 2011, global economic activity continued to grow, although the signals coming from confidence indicators suggest that risks associated with these positive developments are in place. Global inflationary pressures have increased as a consequence of a higher demand and persistent supply-side shocks. In advanced economies, fiscal consolidation and public debt reduction remain the major concerns, whereas inflation pickup has left little room for monetary stimulus.

In advanced economies, the positive global demand momentum has led to increased aggregate demand, while the upward inflationary pressures have made the central banks respond by tightening the monetary policy. In financial markets, the soundness of public balance sheets has determined the yield performance in several countries, while the political tensions have elevated the demand for safer instruments. The outlook remains highly uncertain, as a

consequence of higher global prices, fiscal consolidation in some euro-area countries and less room for fiscal and monetary stimulus.

Returning to the Albanian economy, the latest data on 2011 Q1, obtained from business confidence surveys, the performance of external trade activity, and monetary and fiscal indicators, support the continued recovery of the domestic economic activity, primarily due to the positive contribution of the production sector. External demand and fiscal stimulus are factors of major influence on this growth. The data analyzed by the Supervisory Council show that Q1's budget spending rose by 16.8%, sustained in part by ALL 12.5 billion budget deficit increase, compared to the same period a year earlier.

April's data show a decelerated growth of budget revenues over this period, underlining the necessity of taking measures to observe the budget deficit projection. Real economy data suggest slow consumption growth, due to uncertainties about employment outlook. On the other hand, the better performance of business credit and increase in capital goods imports suggest that investments have been positive, reinforcing the grounds for a sustainable economic growth in the future. Continued business investments in turn require the response of consumer demand, about which the Bank of Albania judges that there is room for recovery. On the other hand, long-term investment growth will be conditioned by the ability of the Albanian economy to attract foreign capital. In this context, responsible institutions at macro and microeconomic level should further strengthen the work for structural reforms, which develop the comparative advantages of the Albanian economy and enhance our economic competitiveness in goods, labour and capital markets. The Bank of Albania judges that preserving the macroeconomic stability parameters is an indispensable precondition to orient its work towards maintaining price stability and safeguarding financial stability at home.

2011 Q1's data on trade activity performance at home show a slight trade deficit narrowing, due to increased imports and decelerated export growth over March. Merchandise trade deficit shrank by roughly 0.3% y-o-y, accounting for 22.1% of GDP. Import coverage by exports ratio averaged 44.5%, or up 9 percentage points from the same quarter of the previous year. During the period under analysis, exports in value continued their upward trend having started since 2010 Q1 and expanded by 45.4% y-o-y. However, following a speeded-up growth over the first two months of the year, our export growth rates were significantly mitigated in March. During the same period, imports grew by 15.9% y-o-y. The division of imports according to their final use highlights the rapid growth of imports of intermediate and capital goods. The outlook of these trends may be associated with expanded current account and trade deficits in the country. The Bank of Albania is very attentive to this development, since it significantly conditions the external balances of the Albanian economy and the foreign exchange market.

Monetary expansion during 2011 Q1 was in line with economic agents' money demand, marking a steady year-over-year growth of roughly 11%. The 6.2% y-o-y growth of real money supply remained close to historical lows. The

moderate growth rates of M3 aggregate and other monetary indicators are in line with so-far assessments for the existence of contained monetary inflation pressures. This trend is also supported by the developments of currency outside banks. This indicator continued to fall y-o-y and, together with the shift of the deposit structure to longer maturity terms, it indicates economic agents' lower preference for liquidity.

In March, the annual broad money expansion was supported by increased private sector credit, which rebounded in line with its seasonal trend path. The upward contribution of private sector's demand for money has offset the gradual decline in net foreign assets. Public sector's demand for money has been upward, supportive to the government's more active stance over the first quarter of the year. In annual terms, the private sector loan portfolio grew by 11.5% from 10.3% in February.

Business loans remain the main contributor to the private sector credit growth. In the meantime, in March, household loans also showed positive signs.

Overall, financial markets performed positively during the first four months of 2011. The information transmitted from financial markets shows agents' anchored inflation expectations. The key interest rate rise at end-March was passed-through to short-term money market interest rates, leading to a slight flattening of T-bill yield slope. In the deposit market, interest rates continued to fall, reflecting also the correction of their high rates since end-2008. The foreign exchange market has operated smoothly and the exchange rate has continued to depreciate at low annual paces. The Bank of Albania has supplied the interbank market with the necessary liquidity for their normal functioning.

To sum up, the Bank of Albania judges that the relatively high inflationary pressures over the first quarter of the year generally resemble transitory shocks. Other factors affecting inflation, such as current and expected economic performance against the potential rate of development, the expansion of monetary assets in the economy, and the public and financial markets' expectations, exert inflation-restraining impact.

Our projections for the rest of the year support the maintenance of a positive performance of the Albanian economy. Consumption and private investments are expected to grow further, whereas following the 2010 slowdown, the fiscal sector is expected to provide a positive contribution to economic growth. However, the demand growth is likely to be below our economy's potential even for 2011. This will condition the downward inflation pressures from the domestic economy, which are expected to offset the import price rise effect. On the other hand, the Bank of Albania is determined to take appropriate measures to meet its inflation target in the medium term.

The Supervisory Council judges that, based on the above overview, medium-term inflationary pressures are in check. Inflation expectations remain anchored around the Bank of Albania's inflation target. In the absence of any

unexpected shocks, inflation is expected to be within the Bank of Albania's target over the medium term. Also, the risks around this baseline scenario appear to be balanced.

At the end of the discussions, the Supervisory Council concluded that monetary conditions appear suitable for meeting the inflation target in the medium term and decided to maintain the key interest rate unchanged, at 5.25%.

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

At the Annual Meeting of the European Fund for Southeast Europe
7 June 2011

Honourable Mr. Prime Minister,

Dear Governors,

Distinguished EFSE Board Members,

Ladies and Gentlemen,

It is a great pleasure and privilege for me to be here today, in this distinguished panel, to greet the start of the 2011 annual meeting of the European Fund for Southeast Europe, or EFSE as we are used to call it. More than four years ago, I was invited to the launching ceremony of this wonderful initiative here in Tirana. Two years ago, at its annual meeting that took place in Novi Sad, the Albanian government became a shareholder to the Fund. Today, we are gathered here again, in the capital city of Albania, to make the balance of this institution's work.

I avail myself of this opportunity to thank the European Fund for Southeast Europe, for its contribution to our region, for its financial support and expertise provided for the financial market development, without leaving behind specifically the EFSE's assistance to Albania through funding business projects at competitive terms, at a time when bank lending has posted slow paces of recovery.

The grave financial crisis of modern times has induced much volatility in the global economy. Today, the situation is assessed as more improved. In theoretical and scientific debate round-tables, efforts have been focused on identifying the causes and taking measures to prevent the recurrence of such events in the future. A new financial infrastructure is being designed. This is the context of this annual meeting, at the focus of which is the identification of post-crisis challenges our region is faced with.

Allow me to briefly address two or three of my personal opinions about this situation.

Before the impact of the international financial crisis, all countries in the region were involved in important reforms aimed at increasing the economic growth. At this stage, through necessary legal improvements and prudent development policies, we witnessed the opening of economies and the development of trade, increase in domestic and foreign investments, overall

liberalization of markets and promotion of financial market development to provide more qualitative and sustainable financial services to businesses and households.

From the macroeconomic viewpoint, fiscal policies in the region have aimed at fiscal consolidation through revenue growth and greater investment-oriented public spending. Monetary policies, thanks to different exchange rate regimes, have generally kept consumer price rise on track and interest rates have followed a downward trend. However, the global financial crisis has affected the countries in our region, due to some weaknesses that were present during the growth phase.

First, the closeness of our countries and the concentration of trade with the European Union area, as well as migratory movements, have brought about a large use of the euro in the regional economies. Economic growth has been financed, to a significant extent, by foreign resources, in the form of foreign currency borrowing by the public sector, financial sector, businesses and households. A substantial share of the banks' liabilities and the loan portfolio is in foreign currency. Foreign currency lending has been dominant and preferable by parties.

This was due to a combination of factors, such as positive exchange rate trend, lower interest rates and good opportunities of the banking sector to fund these loans in the wholesale markets. Foreign currency lending to the private sector and households was used to a considerable extent for consumption.

Foreign investments in the tradable goods sectors, which would contribute positively to trade balance, were less than those in the non-tradable goods sectors. This is the case of Albania, Bosnia and Herzegovina or Serbia. It is estimated that in terms of the stock of foreign investments, at end-2008, the share of investments in the tradable goods sector ranged from 15% in Albania to 35% in Serbia. Therefore, in the pre-crisis period, some of the countries posted steady and even upward trade balance deficits.

Second, notwithstanding the efforts to develop the financial market, the banking sector continued to dominate the financial system of the countries in our region. This is a phenomenon of developing economies, which shows the great dependence of economic development on the banking sector conditions.

The banking sector in some countries in the region is mostly owned by European banking groups. The financial crisis showed that the entry of foreign banking groups into a domestic market, besides advantages, is also associated with elements of risk, which must be addressed duly and timely.

Third, the countries in our region have different needs for investments, highlighting those in road infrastructure, energy and health care. Also, demographic developments, including migration, and slowing population growth trend, have brought about increased costs of public pension schemes and other elements of social protection. Therefore, despite fiscal consolidation

efforts, budget deficits have been present and steady all the time.

During the financial crisis period, public authorities were committed to overcoming the situation. Almost all governments of the countries in the region were committed to implementing fiscal stimulus policies, aimed at increasing the support to the real economy and the financial system. Monetary policy followed an easing trend, cutting the interest rates and satisfying the interbank market needs for liquidity.

Back to Albania's case, I would like to emphasize that our experience in absorbing the impacts of the crisis proved successful.

Albania, I think, is one of the countries that:

- Did not experience any bank failure or capital injection by the state;
- Courageously withstood the crisis of confidence in the banking system, where financial intermediation was never interrupted;
- The economy continued to grow in positive terms, albeit at a slower pace;
- Inflationary expectations remained anchored throughout all time.

During this period, the Albanian banking sector continued to increase its lending to the economy, albeit at lower paces. Difficulties added to the real sector of the economy and the exchange rate depreciation by about 12% in 2009 were followed by decreased credit quality and increased bank provisions to face the credit risk.

Distinguished participants,

The pre-crisis phenomena, and those that occurred in 2008-2010, offer a valuable experience to economic actors and public authorities of each country in our region. Not to mention all, I would like to dwell only on some of them, which I consider important for enhancing the sustainability of our economy and of the financial system in the future.

First, the region needs a better balance in the factors supporting the sustainable economic growth. I think that the public authorities should assign priority to the increase in investments and implementation of stimulus policies for developing the competitive sectors. In this way, the country's export capacity would grow by creating better conditions for a sustainable improvement of the external balance of our economy.

Second, closely related to the first issue, I would highlight the need for undertaking and deepening the structural reforms. This strategic objective remains a constant priority for each of our economy. Their focus should be comprehensive, meaning further adaptation of legislation, improvement of infrastructure, full privatization of public assets, improvement of the business climate, deepening and broadening of the financial market, comprehensive reform in pensions, as well as a number of other actions which I cannot

mention here because of objective reasons. I think that foreign direct investments remain our major target. Without them, the region would remain small, fragmented, with a low social and economic development potential, with sporadic exports, with premature markets and high costs, or in other words, with a low productivity. Personally, I am of the opinion that each foreign investment means faster convergence to Europe.

Third, the financial market should develop to create other alternatives for savings, financing and risk management of economic entities, as well as for improving the conditions of these activities. Besides the banking sector, the share of non-bank financial institutions should also be rapidly developed, to enable greater involvement and access to financial services for entities that cannot benefit enough from banking services.

Furthermore, I think that it is important to pay more attention to the development of capital markets, particularly those issuing and trading debt securities and equities by private entities.

Fourth, the regulatory framework and supervisory practices should be completed with some important elements in terms of prudential measures and emergency financial situation management. The prudential measures framework should cautiously treat capital and liquidity requirements from banks, especially in the case of foreign currency. Simultaneously, it is necessary to assess the systemic risk in both the financial system and the banking sector, by constructing special indices and implementing the best practices in stress-testing. In terms of completing the framework on the management of emergency financial situations, importance should be given to the legal and regulatory reviewing and improvement process, the cooperation between public authorities and timely identification of various problems, particularly in systemically important institutions. The Bank of Albania has already entered in this reviewing and improvement process of the regulatory framework, on the basis of several pre-set objectives.

Concluding, I would like to emphasize that the countries in our region have successfully overcome a difficult period as a consequence of the international financial crisis. However, there are numerous challenges ahead. They require an ongoing commitment of all the factors of the country's economic and political life. The need for coordinated actions, both locally and regionally, is an absolute priority.

I think there are in place all the prerogatives for making this cooperation effective, honest and of mutual benefits to each country in the region. To this end, I think that the European Fund for Southeast Europe will continue to play an important role. Once again, I take this opportunity to congratulate for the work it has done and the commitments it has taken for the future.

Thank you.

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

At the Presentation of the 2010 Annual Report to the
Albanian Parliament
9 June 2011

Dear Madam Speaker,
Dear Members of Parliament,

It is a pleasure for me to be here today to present the Bank of Albania's opinion on economic and monetary developments of the past year.

Pursuant to the legal requirements and our institutional commitments to enhancing the central bank's independence, transparency and responsibility, in this presentation I will share with you the main highlights on Bank of Albania's activity over 2010. This activity, in its entire spectrum, aimed to fulfil our mission and legal obligations, and reflect the Parliament's recommendations for 2010.

Let me begin my presentation with a brief overview of our conclusions.

During 2010, the Albanian economy experienced an overall positive performance. The economic activity posted growth, while the macroeconomic stability and financial soundness indicators improved.

Economic growth reflected mainly the foreign demand for Albanian products and services, affirming, above all, the dynamism of our private sector. It was also supported by a sustained macroeconomic environment, with downward risk premia and improved liquidity indicators.

In particular, reflecting the developments in the financial and real sector of the economy, as well as our monetary policy, consumer price inflation remained in line with our 2010 target.

Also, during this year:

- The economy's external position improved;
- The ratios of budget deficit and public debt to GDP dropped;
- Financial stability consolidated;
- Financial intermediation expanded further; and
- Interest rates and risk premiums in financial markets decreased.

On the other hand, 2010's developments underlined the need to continue and intensify structural reforms, which are pre-requisites for a sustainable and long-term economic growth.

First, the new agenda of structural reforms should aim at establishing the requisites for a more balanced and sustainable growth in the long run.

Greater orientation of Albania's economy to export and overall higher competitiveness of our products in international and domestic markets dictate the need for continued structural reforms at macro- and microeconomic levels.

Second, macroeconomic stability consolidation requires more work in the future. The greatest lesson that the recent global financial crisis taught us is that prevention is better than cure.

Maintaining the country's internal and external balances requires further development of decision-making architecture and macroeconomic coordination, as well as economy and market supervisory and regulatory mechanisms. Analytical, forecasting and decision-making capacities of public and private economic agents should also be further improved.

Third, ensuring the country's financial stability requires coordinated action by all supervisory and regulatory institutions, and greater attention by private agents of the market.

A sustainable financial system, oriented to long-term horizons and prudential to risks, serves to channel savings into the most competitive sectors of the economy.

In the following, I would like to address the above-listed topics in more details, focusing on the key points of the Bank of Albania's work.

1. Economic and Financial Developments in 2010

According to INSTAT data, the Albanian economy is estimated to have grown by 3.9% this year. Compared to 2009, economic growth is more balanced in terms of sectorial distribution and demand components.

During 2010, the Albanian economy was characterised by the gradual improvement of the aggregate demand and further consolidation of the macroeconomic stability. Economic development was followed by price stability, while the public debt, budget deficit and current account deficit narrowed.

Economic growth relied mainly on foreign demand and increased Albanian exports, while domestic demand was sluggish. The latter decelerated due to public finances consolidation and budget deficit reduction in 2010, while consumer spending and private investments were affected by the uncertainty about the future and presence of spare capacities.

Fiscal policy was oriented towards fiscal consolidation in 2010, following the stimulating nature in 2009. Fiscal consolidation accelerated especially in

2010 H2, following the approval of the revised budget. This consolidation was present on both revenue and expenditure sides. Budget revenues increased by 8.4% y-o-y, reflecting the economic growth, expansion of taxpayers' base, and privatisation receipts. On the other hand, budget expenditures decreased by 4.5%, attributable to the reduction of government capital expenditures.

Budget deficit for 2010 settled to around 3.0% of GDP, reducing by 52% compared to a year earlier. This deficit was funded mainly through the issue of domestic debt instruments. However, deficit financing experienced a novelty in 2010, with the issue of the first Albanian Eurobond. Its issue, at EUR 300 million, met a part of the public sector's need for foreign currency and was accompanied by the reduction in domestic borrowing.

Current account deficit narrowed by 21.5% in 2010, to 11.9% of GDP. This was reflected in augmented private and public sectors savings. Increased exports as a result of invigorated foreign demand, depreciated exchange rate and improvement of trade terms over this period also contributed to it. Notwithstanding the improvement recorded in 2010, current account deficit remains high. As we have continuously stated, the Bank of Albania deems that the formulation of structural policies to dampen the external economy misbalances should be a priority.

Net flows in the capital and financial account recorded a decline by 11.2% in 2010, leading to current account deficit financing to 87.5%. Excluding privatisations, foreign direct investments were estimated at 9.3% of GDP and constituted the main source of foreign financing of the Albanian economy. Foreign reserve increased by about EUR 178.8 million and its stock of EUR 1.9 billion may cover 4.8 months of goods and services import.

The positive developments in the external sector of the economy, primarily owing to the expansion of exports and foreign currency inflows from the Eurobond, contributed to the generation of contained pressures in the foreign exchange market. From the macroeconomic viewpoint, the relative exchange rate stability during the year reflected a new equilibrium in foreign currency demand and supply.

In sectorial terms, the Albanian economy development relied chiefly on the growth of industry and services sectors, while the construction sector continued to contract in 2010. Industry and services sectors benefited, to a great extent, respectively, from foreign demand and the structural shift of the domestic demand to short-term consumer goods.

In the short- and mid-term horizon, both sectors are expected to remain the main supporting pillars of the Albanian economy. Agriculture, the other important sector of the Albanian economy, marked a positive performance in 2010. Even so, based on the broader concentration of the country's population and the great potential for development, the increase in this sector's productivity remains a long-term priority.

Money and Financial Markets

Monetary developments in the past year were in line with the performance of the real sector of the economy, reflecting simultaneously the fully restored confidence in the financial system, improved supply and demand ratios in the financial markets and prudent liquidity management policy of the Bank of Albania.

The expansion of monetary stock by 10.6% on average complied with the economy's demand for money and did not trigger any inflationary tendencies in the economy. Deposit to GDP ratio was 64.2% at end-year, higher than its level prior to deposits withdrawal. In addition, the profile of deposit time structure reflected a higher preference for saving, characterised by a shift to longer maturity-term deposits.

Easing lending terms during 2010 H2, stimulating measures taken by the Bank of Albania, and decreasing uncertainty and risk premiums were followed by a gradual credit growth. Private sector loan portfolio expanded by 10% in 2010, principally influenced by foreign currency credit growth. This performance reflects the prudential bank policies on the loan portfolio quality and economic agents' moderate demand for loan.

In general, lending continues to suffer from the lack of demand and realistic, qualitative and valuable business plans for crediting.

Restoration of confidence in the financial system, macroeconomic consolidation, and regulatory and supervisory measures taken by the Bank of Albania led to the stabilisation and improvement of banking system capitalisation, liquidity and profitability indicators.

2. Inflation and Monetary Policy

Annual consumer price inflation was on average 3.6% in 2010, remaining within the Bank of Albania's targeted band. Inflationary pressures were more concentrated in 2010 H1, mostly triggered by a rise in some administered prices. Average annual inflation in 2010 H1 was 3.9%. In the following two quarters, the relative stabilisation of the exchange rate and low inflationary pressures from the domestic demand contributed to the average inflation rate convergence around the Bank of Albania's target.

The negative output gap generated contained inflationary pressures throughout 2010, thus balancing the national currency depreciation effect and the international market price rise. The prospects for the future show that the Albanian economy is expected to operate below its potential even in the medium-term, putting downward pressures on inflation.

As I highlighted earlier, in 2010, the Bank of Albania's monetary policy was implemented in a macroeconomic environment with positive growth

rates, contained inflationary pressures and anchored inflation expectations. This environment led to retaining the stimulating monetary policy stance that has been conducted since 2009. It triggered downward interest rates and completed even further the stimulating effects from the exchange rate depreciation. The low interest rates favoured the rise in domestic consumption and investments, whereas the depreciated exchange rate supported growth in Albanian exports.

The reduction of the fiscal stimulus in 2010 H2 expanded the room for monetary policy conduct. In July 2010, the Bank of Albania lowered the key interest rate by 0.25 percentage points, to its historic low of 5.0%. The improvement of banking system liquidity conditions and weak public sector demand for money supported the transmission of an easing policy to all segments of the financial markets in the last months of 2010.

In parallel, the Bank of Albania supplied the financial market with the required liquidity to support financial intermediation. Aiming at adopting the most advanced models of central banking, and particularly, convergence with Euro-system practices, the Bank of Albania changed the form of its operational objective.

Since June 2010, our liquidity management operations are oriented to targeting short-term interbank interest rates and minimizing their volatility.

The banking system supervision function is another important aspect of central bank duties.

3. Banking Supervision and Financial Stability

Year 2010 was characterised by increased banking system activity, improved banking soundness and profitability indicators, as well as a good capitalisation of the system. On the other hand, the banking system suffered the increase in non-performing loan portfolio, reflecting also the active policy of the Bank of Albania in terms of enhancing the transparency of bank balance sheets.

Banking System Developments

The banking sector continues to remain the main actor of financial intermediation in Albania. At end-2010, banking system assets doubled their growth rates compared to a year earlier, accounting for about 81% of GDP. The banking system continued to be financed mainly by public deposits and focused on lending to the private sector.

On the other hand, the economy's below-potential growth and the depreciated exchange rate contributed to increasing non-performing loans to 14% of total loans. However, this indicator's growth rates decelerated in 2010.

Capital adequacy ratio remained at satisfactory levels, at 15.4%, clearly higher than the 12% benchmark set forth under the regulatory framework. The system's shareholder equity increased by 10% in 2010.

Credit risk remains the main risk to the banking sector. In response to this risk, the banking sector has created adequate provisions to weather big shocks to borrowers' solvency and market equilibriums.

Banking System Supervision

In early 2010, the Bank of Albania changed its banking supervision organisational framework, orienting and relating it directly to risks associated with the financial activity. In parallel, the Bank of Albania re-conceptualised its supervision focus and strategy in accordance with risks posed to Albania's banking and financial system.

Transparency and disclosure of information on banking and financial products and services were in focus of supervision in 2010. Encouraging the enhancement of private financial agents' transparency has been also reflected in the amendments made to the regulatory framework during the year. The high commission fees on banking products and services were a sensitive issue that was addressed over the past year and will constitute a priority in the upcoming period. The Bank of Albania, through its analyses, played a key role in discussions about this matter, aiming to tackle it timely and duly.

Also, issues related to anti-money laundering and compliance with prudential regulations were an important part of the supervisory process in 2010.

In view of strengthening the supervisory process on banking institutions, the Bank of Albania has signed a number of cooperation agreements with central banks in the region and with European ones, where parent banks have their headquarters.

Strengthening of the Supervisory and Regulatory Framework

In 2010, the Bank of Albania finalised the drafting of several new regulations and amended some other regulations on banking supervision. This process aimed at compliance with Basel Committee standards and EU Directives, taking into account the best international practices in the area of regulation, and the Albanian banking system developments.

The new regulatory acts and key amendments to actual acts on banking supervision approved during 2010 are:

- Regulation "On management of risk from open foreign exchange positions";
- Regulation "On risk management in the activity of non-bank financial institutions"; and
- Guideline "On conservatorship and liquidation of banks".

Besides the main aspects of the Bank of Albania's work, such as monetary policy and banking supervision and regulation, the Bank of Albania's activity also focused on the fulfilment of its other legal obligations and institutional commitments.

Sparing the details, I would like to emphasize that the Bank of Albania has done a great job in 2010 for:

- Developing and sophisticating the payment system;
- Supporting the integration processes of the country, in accordance with our scope of activity;
- Enhancing our communication with the public, as an essential instrument to foster transparency and central bank independence;
- Further developing the monetary statistics and those of the external sector of the economy;
- Strengthening research capacity to support our analysis and decision-making.

All these activities serve the financial system development and support the free market economy in Albania. A detailed analysis on them can be found in our Annual Report.

Dear Madam Speaker,
Dear Members of Parliament,

Turning back to our analysis on economic and financial developments in the country, before, during and after the crisis, I would like to highlight a structural weakness of the Albanian economy that has accompanied it throughout the transition: the high current account deficit and the still low degree of our economy's competitiveness in global markets.

Today we live in a global world, with integrated capital, product and labour markets. As a developing country, Albania is facing (and will continue to face) a rising competition, not only in the region but also beyond it.

In our opinion, the long-term and sustained development of the country and reduction of our structural weaknesses, imply necessarily the increase of competitiveness of the Albanian economy. The ongoing structural reforms should be driven by ambitious goals and a realistic time horizon.

Structural reforms should aim at creating a more attractive climate for foreign and domestic investments, encouraging employment and growing welfare further, by providing:

- A sustainable macroeconomic environment;
- An efficient and reliable financial system;
- A functional, complete and transparent legal framework;
- A modern infrastructure;

- A qualified and competitive workforce in terms of cost; and
- A clear perspective for a faster integration into the European Union, which will open the way to convergence funds.

The fulfilment of all these criteria requires a joint commitment, and the Bank of Albania will play its role. Personally, I remain convinced that increasing the effectiveness of these reforms in light of this would enable Albania to make a qualitative step towards its integration.

In conclusion, allow me to remind you that, besides the Bank of Albania's Annual Report, the Bank of Albania's financial statements and balance sheet, as certified by auditors, are submitted.

Thank you for your attention.

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

At a Meeting Held by Raiffeisen Bank with Business Representatives
and its Major Clients
14 June 2011

Dear Minister of Finance,

Dear Mr. Lennkh and Mr. Hodell,

Dear Mr. Canacaris,

Dear Ladies and Gentlemen,

Today's meeting organised by the Raiffeisen Bank with the business community is very significant. Firstly, it shows a well-defined strategy of the Raiffeisen group to increase its market share in Albania through dialogue with business partners. Secondly, such forums serve also as a platform to generate development ideas and projects of national, and why not, regional importance. Thirdly, I think that today's meeting is indicative of the maturity and rising awareness of the banking system and the business community. Personally, I would wish that such meetings be intensified in the future: they should also be more structured, oriented towards a constructive debate, and involve the entire system and all sectors of the economy. In short, banks and businesses need to sit together for the best.

Dear Ladies and Gentlemen,

We are almost in mid-2011 now, which is a complex year in terms of its challenges for objective reasons owing to the international financial dynamics of the past 3-4 years. Whilst our economy has posted positive growth, it continues to operate below its potential.

The international setting is filled with uncertainty for a group of advanced economies, while agricultural products and raw material prices remain high. Despite last year's narrowing current account deficit, Albania's external position remains a constant structural weakness.

The Albanian banking system is considered to have adapted commendably to this complex situation. I would like to underline that we have done an immense amount of work so far. Therefore, I take this opportunity to congratulate all central and local managing units of banks operating in Albania. During this period, the Albanian banking system has continued to expand its activity and lending to the economy. Financial soundness and profitability indicators have improved and system's activity capitalization is in a good position. The banking sector remains the main actor of financial intermediation in Albania, whose financing continues to rely mainly on public deposits.

The main problem of the banking system has been the growing non-performing loans share, which has also reflected the active policy of the Bank of Albania to enhance the transparency of banks' balance sheets. Credit risk remains the primary risk to our banking sector. In response, the banking sector has established adequate reserve funds to buffer major shocks on the borrowers' repayment capacity and market equilibriums. Stress tests support our conclusion on banking system stability.

The presence in this room of both the business community and the banking system suggests me to refer once again to the need for sincere cooperation of mutual benefit. With a few exceptions, I think this cooperation has been present and operational and has certainly supported in particular the country's economic activity over the past years. The global financial crisis that erupted in late 2008 had its influence on our economy by stiffening this cooperation. On the one hand, the system found itself in a difficult liquidity situation, while on the other hand, businesses found it difficult to access markets. With some additional subjective reasons, the outcome of this was a deterioration of the system's loan portfolio and companies' liquidating capacity. Consequently, 2009-2010 marked a slowdown of lending growth to the economy, reflecting the increased prudence, fully justified by the system, and business inability to earn a meritable new loan. The period corresponded to a review of balance sheets and portfolio restructuring, when possible with provisions, directly affecting the system's profit.

The Bank of Albania has played a major role as a guardian of the country's macroeconomic and financial stability. Macroprudence has been the prevalent word in our communication with the market, authorities and the public. We have translated macroprudence as a need for more capital and liquidity, and increased banking system payment capacity. Consequently, the Albanian banking sector did not experience any crunches. The Bank of Albania has provided and continues to provide the necessary liquidity to the banking system, to stimulate not only the market but also the entire economy. Prudent policies and timely legal regulations guaranteed effective banking supervision and enabled satisfactory businesses' access to bank loans. Actually, I would like to point out that the Albanian banking system left the crisis in healthy condition and that it guarantees growing stability.

Our banking system, during this period, has carried out a considerable amount of work, which has served to consolidate each bank's position prior, during and after the crisis. Hence, the banks are now able to use again their full lending potential. For the truth's sake, it must be underlined that the latest figures speak of growth by 10% in annual terms, a figure which should not go unnoticed or be considered as inadequate. I would suggest the same philosophy to the business community. For objective reasons, the concept of free money seems to belong to the past. By that I mean that a bank loan should be earned, which means unconditional and honest cooperation within the legal and regulatory framework approved by the country's authorities. Of course, banks are established to lend money, but first and foremost we need to bear in mind that the public deposits' stability is more important than an

individual business loan or bank portfolio. Moreover, the business community needs to recalibrate its position in relation to the recent developments both in the national and global economy context. It must aim at higher productivity, primarily through identifying comparative advantages in the framework of the global changes.

In that regard, it is necessary to adopt new business administration philosophies on capacity building and investment in human resources, governance, internal control, financial and legal expertise, and risk management. Besides a legal relation, the bank-client relation is a human relation, one of trust. When a business delays the payment of a bank loan instalment, it should consider its judgement on the bank if the bank delayed the payment of the matured interest rate on the deposit of that business.

Dear ladies and gentlemen,

On behalf of the Bank of Albania, I would like to invite the communities present in this event to strengthen their communication bridges, which is of benefit not only to them but also to the economy in general.

SPEECH BY THE FIRST DEPUTY GOVERNOR OF THE BANK OF ALBANIA, MR. FATOS IBRAHIMI

At the Annual Meeting and the Business Forum of the Board of Governors
of the Black Sea Trade and Development Bank
19 June 2011

Distinguished participants,

It is a great pleasure for me to take the floor at this forum organized by the Black Sea Trade and Development Bank, which this time has on focus the promotion of development opportunities in Albania. Allow me to say that the time of holding this forum coincides with the need to ensure the economy's revival at home, after weathering the direct impacts of the global economic and financial crisis. The economy's revival needs to become more sustainable, promoting the development of sectors that provide a competitive advantage by developing specific public policies and taking the public-private investment partnership to a new level.

Allow me to dwell in more details on the contribution that the financial system and the banking sector can provide to support valuable business projects.

The development and good financial position of the financial system in general and the banking sector in particular is a prerequisite for carrying out a successful financial intermediation activity. In fact, over the last decade, the banking sector has experienced a rapid development. Well-known European banking groups have entered the market, bringing about the best know-how and technology, as well as enhancing competition in the interbank market. Also, the banks with Albanian capital have expanded their network and have properly utilized the advantages of better recognition of the domestic market. As a result of active business development policies, the banking sector has experienced a steady growth of deposits and credit expansion. It suffices to say that at end-2004, total loans accounted for only 7% of GDP, while today they account for approximately 40%. About two-thirds of loans are extended to the private sector, while the rest to households and individuals. In the business sector, loans are extended to the most important and fast-growing sectors, such as trade, other services, transport and construction. Almost all business loans are extended to the private sector, though recently an increase in loans for public sector's projects/investments is registered.

On the other hand, the expanded banking network and better use of new technologies have enabled the pursuit of more competitive policies, attracting a high number of depositors and providing valuable services to citizens. Deposits continue to represent the main source of banking sector financing, an element that highlights its stability. Interest rates on loans and deposits have reflected the banks' targets on financial indicators, the monetary

policy at home and in the countries of the major currencies, as well as the country risk margin. We deem that over this period, these interest rates have been appropriate for a sustainable development of the banking financial intermediation.

During the last 2-3 years, the country's economy was affected by the global economic and financial crisis. The public authorities at home were committed to supporting the domestic economic development by pursuing stimulus fiscal and monetary policies. In the banking sector, the global financial crisis appeared mainly in the form of contracted paces of lending to the economy. Throughout this period, the Bank of Albania has aimed at preventing the deepening of the impact of this crisis by conducting an easy monetary policy and supplying the interbank market with necessary liquidity. During 2009 and 2010, the Bank of Albania lowered the key interest rate by 1.25 percentage points, to 5%. Also, during the major part of 2009, banks benefited unlimited liquidity, at an interest rate equal to the key policy rate. In the meantime, before the impact of the crisis, through special regulatory acts initiated since 2006, the Bank of Albania has aimed at limiting some risks arising from banking activity, such as rapid and foreign currency lending, by setting higher capital requirements for more exposed banks. Throughout this period, we have communicated regularly with the public at large, businesses and the banking industry, to explain our actions and discuss the challenges posed to economic actors. We believe that as a result of these actions taken by the public authorities and the cooperation with the financial industry, the banking sector has successfully withstood the impact of the global financial crisis, remaining sustainable and maintaining positive indicators of financial intermediation. Thus, during 2010, the banking sector credit growth, albeit lower than in the pre-crisis period, was considerable, around 9%, while in some Central and South-Eastern European countries, it was negative. The deceleration of credit growth, which was initially driven by supply-side factors, is mostly a phenomenon attributed to the decline in the demand for loans. As a consequence of weaker expectations for activity development, businesses decreased their production capacity utilization, lowering investment objectives and the demand for loan.

In spite of weathering the direct impact of the crisis, important challenges lie ahead of the banking sector and the Bank of Albania. First, the performance of credit quality should be monitored prudentially, aiming to timely identify non-performing loans, assess them correctly according to their possibilities for repayment, and pursue proper policies, in order to recover the loan value within an appropriate time. Second, during this phase, it is necessary to strengthen the banks' internal audit systems, not only related to credit risk but also to provide a higher standard of management. Third, banks should assess their expectations about the performance of their activity and take measures to strengthen their capital position in advance, in case of need.

The Bank of Albania deems that in the periods ahead the Albanian banking sector and the economy need to determine and pursue more suitable development policies, which for the banking sector should include: setting

realistic development objectives; setting more competitive prices for banking products and services; and increasing lending in the national currency. About the overall economy, a more sustainable development should be ensured, relating mainly to better control on trade deficit, supporting the sectors that actually contribute or may contribute to increasing exports in the country. Public authorities should strengthen their commitment to developing the non-bank financial market, which gradually leads to the reduction of economic dependence on the banking sector conditions and improves access to financing of a higher number of private entities. In this way, greater opportunity would be provided to the financial system to finance projects in the agricultural sector, which has a high potential for ensuring competitive advantages in the Albanian economy.

Allow me to conclude by emphasizing the Bank of Albania's willingness to contribute, through its policies on monetary and financial stability, to maintaining a better climate of sound development of the financial and banking activity, as a condition for greater financial support to business development in the country. I think that this forum will make a valuable contribution to setting some concrete development policies and projects, about which, I believe that the Black Sea Trade and Development Bank will offer its own support and expertise.

Wishing success to the proceedings of this forum, I thank you for your attention.

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

At the Joint Press Conference with the Albanian Minister of Finance
and the IMF Mission Chief for Albania
22 June 2011

Dear media representatives,

In the last two weeks, a team of the International Monetary Fund (IMF) led by Mr. Gerwin Bell, Mission Chief, visited Albania. During this visit, we had intensive discussions on the current economic developments, the economy's expected performance and appropriate orientation of macroeconomic policies. This visit in the framework of Article 4 Consultation focused also on structural issues of the Albanian economy, highlighting the steps to be made for ensuring sustainable long-term growth.

Brief overview of key issues discussed

First, the 2010 and early 2011 economic and financial developments showed that, overall, the Albanian economy overcame the global crisis effects with success and has the pre-requisites to generate economic growth in the period ahead. Foreign demand was the main contributor to the 2010 economic growth, while the current year is expected to be characterised by a resurgence of domestic demand and slower growth rates of Albanian exports. Overall, the macroeconomic situation is balanced, characterised by low and controlled inflation; safe, liquid and well-capitalised financial system; improving financial markets; and improved current account position. These developments reflect, *inter alia*, the relevant policies, which have proven effective in buffering large shocks from the global crisis. I take this opportunity to point out that the Bank of Albania's efforts to keep inflation in check and anchor inflationary expectations, as well as its regulatory and supervisory measures to guarantee financial system stability managed to reduce shock-buffering costs and prevented undesirable consequences.

Second, as regards the economy's expected performance in the medium and long run, the conclusion reached after the two-week long consultations was that the Albanian economy is expected to remain in positive territory of economic growth. However, the growth rates will clearly depend on the resurgence of the domestic demand, which is suffering from uncertainty related to national and international developments. Consumption and investments continue to suffer from added prudence by economic agents, while financial conditions and banking system capacity to credit the economy have improved. Furthermore, the higher inflation rates, noted during the first months of 2011, are expected to drop in the upcoming period. This reveals the foreign origin of shocks that have led to increased prices and reflects internal economic and financial conditions as well as our monetary policy.

The joint examination of the Albanian economy found that the fiscal and external sectors are the two main ones that would require our attention and our work in the future.

The Bank of Albania has long held that public finances' long-term stability is a precondition for sustainable economic growth. The daily world press illustrates channels through which indicators such as budget deficit and public debt affect financial markets, and in turn the real economy. Convinced that the Albanian economy would benefit in the medium and long run from lower public debt, we have encouraged and supported all measures taken in this regard. We deem that this philosophy should lay at the foundation of the expected 2011 mid-year budget revision, as well as other medium and long-term public finances projects.

The external sector is another structural weakness of the Albanian economy. Partially also in response to this concern, the Bank of Albania has underlined constantly the need for deepened structural reforms to support a new economic growth and development model for Albania. This model should inevitably materialise through increased efficiency and competitiveness of our products and services in domestic and international markets.

On the other hand, it requires a more rational attitude of the private sector towards the current economic context, as well as a more careful management of underlying financial risks. What is more, the Albanian economy needs to become more attractive to foreign investors by continuously improving the business climate, the legal framework and its implementation, as well as by providing educated and cost-attractive labour force.

Thirdly, seen in the above-mentioned setting, our policies should remain prudent to guarantee the country's macroeconomic equilibriums. As the crisis showed, prevention is better than cure. In this regard, political and structural measures that contribute to stability have a positive impact in the long-term horizon.

During the consultations, I found that we share the same views with the IMF and the Ministry of Finance on the need to maintain and further strengthen macroeconomic stability. Moreover, there is a modern and functional consensus on the division of duties between the two central institutions of macroeconomic administration (central bank and Ministry of Finance), as well as a concrete commitment to continue this co-ordination in the future. In conclusion, I would like to reiterate that the Bank of Albania remains fully committed to observe the inflation target of 3%, and continue to orient its monetary policy exclusively to this function.

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
29 June 2011

Today, on 29 June 2011, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on an analysis of Albania's latest economic and financial developments and following discussions on their future outlook, the Supervisory Council of the Bank of Albania decided to leave the key interest rate unchanged at 5.25%. The Supervisory Council holds that the actual monetary conditions are appropriate for meeting the inflation target and for continuing to stimulate the economic activity.

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

Annual inflation pointed to 4.2% in May, remaining close to preceding months levels. Under higher import prices pressure, the prices of "processed foods" and "non-food consumer goods", including oil, were the main contributors to the inflation rate. In the meantime, the seasonal effect of increased domestic supply of fruits and vegetables is reflected in a lower contribution of "unprocessed foods" to inflation. The rise of some administered prices and the effect of higher excise tax rates for some goods continued to provide a constant, but positive, contribution to annual inflation.

Inflation's performance over the recent months was consequent to the balance of two main factors' opposite actions. On the upside, the high primary commodity and raw material prices in world markets were transmitted to the domestic inflation in the form of higher imported inflation. In the short run, this phenomenon also contributed to core inflation, which was up compared with last year. The higher net inflation rate of non-tradable goods showed that a part of higher commodity prices materialised in second-round effects on inflation.

The latest developments in inflation affected also the economic agents' inflation expectation, which, however, remain within the target band of the Bank of Albania.

On the downside, domestic economy developments continued to produce an environment with contained inflationary pressures. Our assessments on economic activity suggest positive growth rates for the first quarter, although below the potential. Under these circumstances, the Albanian economy continued to be characterised by spare production capacities – labour and

capital – and negative output gap, which continues to exercise downward pressures on inflation. Similarly, the monetary development analysis confirmed the presence of contained monetary pressures on the domestic economy.

Following, I would like to address the economic factors that determined inflation developments and their expected performance.

Albania's economic activity, during the first months of the year, took place in the context of a growing global economy, but amid increasing inflation pressures and added uncertainty in financial markets.

Global economic activity continued to grow during the first half of 2011, led by the rapid expansion of demand in emerging economies. On the other hand, the high demand and geopolitical tensions were reflected in higher raw materials and primary commodity prices, thus increasing the inflationary pressures at global level. Developments in financial markets reflected the concern over the fiscal position sustainability in the euro area peripheral countries, hence increasing the risk premiums on a wide scale. On a balance, risks on the future performance of global economy were expanded, while the room for a response of fiscal and monetary policies narrowed.

Against this setting of international economic developments, the Albanian economy is assessed to have grown over the first months of 2011. Foreign demand contributed positively to the aggregate demand, but, as expected, Albanian exports contribution to economic growth was lower than in 2010. Moreover, the public sector demand supported the economic activity growth. On the other hand, consumption and private investments performance was considered as slow.

Indirect indicators of these domestic demand components signal their weak performance, despite improved financing conditions and a more appropriate climate for private sector development. Uncertainties for the future, as stated in the low consumer confidence, dictated a conservative behaviour of individuals towards consumption and a higher preference towards saving. Given the under-utilised production capacities, the business need for new investment was low.

The positive momentum of global economy continued to boost our exports, although to a lesser degree compared to last year. In April, exports' annual growth was 10.8% while imports expanded further, reaching an annual growth of 16.7% in this month. These foreign trade developments materialised in deepened trade deficit during this period, resulting in 19.5% year-on-year. Overall, balance of payments developments confirm the frailty of Albanian economy's external position.

Current account deficit, estimated at 11.8% of the GDP in the first quarter, remains high. The Bank of Albania has constantly underlined the need for taking measures to reduce it and ensuring sustainable funding sources by attracting capital inflows in the form of foreign direct investments.

Balance of payments developments were reflected in a relatively relaxed exchange rate. Under the conditions of a balancing demand and supply, the domestic currency demonstrated stability, slightly depreciating in effective and nominal terms in May. Future exchange rate performance will be conditioned significantly by external economy balances and individuals' preferences for their financial asset portfolio structure.

Public sector expenditures were an important stimulus of economic activity during the first months of the year. In January-May, these expenditures were up by 10.3% year-on-year, while decelerated fiscal revenues reflected the private sector's low demand. These developments were reflected in the budget deficit of about 1.7 times higher compared to a year earlier. Expenditure growth slowed down during the second quarter.

This behaviour is expected to continue for the rest of the year, conditioned by the commitment to observe the 2011 deficit and public debt target. This fiscal policy approach is expected to be formalised in the July budget revision, which should take into consideration the public debt's long-term sustainability.

Against the above-mentioned developments, monetary indicators' analysis confirms controlled inflationary pressures originating from the domestic economy. Money supply annual growth was 12.2% in April, remaining close to its historic trend. Monetary expansion reflected the accumulation of liquidity in the banking system, revealing the households' preferential behaviour towards saving. Our assessments point out that monetary expansion is compliant with the private sector's demand for real money, thus indicating controlled monetary-related inflationary pressures.

The contained behaviour of the private sector about spending and investing is reflected also in a low demand for bank lending.

The annual growth rates of lending to the private sector ranged 10%-12% in the first four months of the year, on average, only 2 percentage points higher than a year earlier. The business demand to cover liquidity needs was their main driver for loans, while lending to households increased at low rates.

Developments in financial markets speak of low risk and liquidity premiums. Short-term interest rates in the inter-bank market remained close to the key interest rate and demonstrated contained volatility. In the primary market, government security yields surged in the last three months, in response to a higher demand of the public sector for funding. Nevertheless, their curve remains lower in comparison with a year earlier, pointing to more favourable financial conditions in the economy.

Looking ahead, assessments and projections of the Bank of Albania suggest the continuation of positive growth in the upcoming period. In a longer-term horizon, under diminishing external impulses to the aggregate demand and a more contained fiscal behaviour, growth rates acceleration will be conditioned by the resurgence of the private sector.

In this regard, the Bank of Albania deems that the economic climate provides the conditions and room for even higher consumption and private investment growth.

Despite the positive growth rates, the Albanian economy is expected to remain and operate below its potential, hence conditioning the continuation of the negative output gap and contained demand-side inflationary pressures. On the other hand, inflation performance will continue to be under import prices pressure for the upcoming period as well. In the absence of unexpected developments, the effect of shocks from import prices is expected to fade away, while the effect of administered prices increase is expected to be neutralised during the third quarter of the year. Therefore, inflation is forecasted to return to within the Bank of Albania's target band by the year-end. Although risks about this baseline scenario are added as a consequence of uncertainties surrounding the global economy, they remain balanced.

Drawing on the information above, the Supervisory Council of the Bank of Albania deemed that the inflationary pressures are, in the short term, high, but with a downward trajectory; while in the medium term, they remain controlled.

In the absence of unexpected shocks, inflation is expected to be within the target band of the Bank of Albania along the time horizon of monetary policy action. Inflationary expectations of economic agents continue to be within the target range, which is essential under the conditions of the simultaneous presence of the negative output gap and high import prices. The Bank of Albania is fully committed to anchoring inflationary expectations in compliance with its inflation target and willing to accomplish its mandate, by preventing the materialisation of constant pressures on inflation.

Following the discussions, the Supervisory Council concluded that the monetary conditions remain appropriate for meeting the medium-term inflation target and decided to leave the key interest rate unchanged at 5.25%.

PERIODIC ANALYSES*

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

INFORMATION ON SELECTED ECONOMIC AND MONETARY INDICATORS IN THE CENTRAL, EASTERN AND SOUTH EASTERN EUROPEAN COUNTRIES

DORIANA LAMA, PRIAM RAMAJ, MEDVIN SHEHU,
MONETARY POLICY DEPARTMENT, JULY 2011

Global economic activity continued to record positive growth rates in 2011 Q1, showing at the same time self-financing capacity and shift from the support of fiscal policies. However, indirect data and conjectural indicators released over the recent months signal a lower economic growth rate in 2011 Q2. The overall global setting during this period continues to confirm different performances across individual countries and regions. However, it is evident that the positive economic performance is gradually detaching from the public element and is being distributed to different sectors of the economy. Inflation has been to the upside, reflecting the rise in energy and primary commodity prices. Euro area's economy posted positive and upward growth rates throughout 2010 and 2011 Q1. Preliminary estimates provide evidence for the growth of euro area's GDP in 2011 Q2 as well, primarily driven by the growth of foreign demand and recovery of domestic demand against a background of improved business confidence figures. The sensitive financial situation and the concerns about the public debt sustainability in some euro area countries (Greece, Ireland, Portugal and Spain) contributed to elevated uncertainties in the global financial markets, which is expressed in the re-dimensioning of the overall economic climate and the upward interest rates in the money market and the higher bond yields.

Key interest rates and use of instruments in advanced economies

	Euro area (ECB)	USA (Fed)	UK	Japan
Inflation target	2%	n.a.	2%	1% ^{1 2}
Key interest rate changes	5 May 2011 (+0.25) 9 June 2011 (0.00) 7 July 2011 (+0.25)	15 March 2011 (0.00) 27 April 2011 (0,00) 22 June 2011 (0.00)	5 May 2011 (0,00) 9 June 2011 (0,00) 7 July 2011 (0,00)	28 April 2011 (0.00) 20 May 2011 (0,00) 14 June 2011 (0,00)
Current key interest rate	1.50%	0-0.25%	0.50%	0-0.1%
Latest inflation ³	2.7%	3.6%	4.2%	0,30%
Expected MPC meetings	21 July 2011 4 August 2011 8 September 2011	9 August 2011 20 September 2011 2 November 2011	4 August 2011 8 September 2011 6 October 2011	5 August 2011 7 September 2011 7 October 2011
Expected events	11 August 2011 15 September 2011 Monthly Bulletin	27 August 2011 7 September 2011 Beige book	10 August 2011 Inflation Report	14 July 2011 Monthly Report

¹ Selected Economy Figures, Inflation and Monetary Policy Orientation in Advanced Economies

² Source: "Understanding of Medium- to Long-Term Price Stability", Bank of Japan

³ June 2011.

Source: Respective central banks

1. SELECTED ECONOMY FIGURES, INFLATION AND MONETARY POLICY ORIENTATION IN ADVANCED ECONOMIES

EURO AREA

In 2011 Q1, the euro area recorded positive GDP growth of 0.8% q-o-q and 2.5% y-o-y. The growth, however, was not uniform across the euro area countries. The growth was driven by the increase in private consumption and investment. Preliminary indicators, such as retail sales and capacity utilization, signal that the economy continued to grow in 2011 Q2 as well. The debt crisis in Europe has entered a new phase. The European Central Bank (ECB), European Union (EU) and the International Monetary Fund (IMF) have held a series of meetings to discuss the possibilities to further finance the Greek debt and the performance of the fiscal adjustment plan undertaken by the Greek Government. In these meetings, they have re-emphasized the need for deeper consolidation measures. The concerns about the public balance sheets of the euro area countries were also reflected in the performance of the yields on debt instruments, which have reached high levels in the recent months. The inflationary pressures have mounted due to the rise in oil and primary commodity prices in the international markets. At its meetings of April and July, the ECB decided to raise its policy rate by 0.25 pp each to 1.50%. In addition, at its last meeting held in June, the ECB confirmed that it would continue to conduct its main refinancing operations as fixed rate tender procedures with full allotment, and also the one-month and three-month refinancing operations, at least until October. The financial markets in the euro area reflected the heightened uncertainties reigning in the recent months. This setting was also reflected in the money markets, which recorded continuous increases.

Euro area	GDP growth projection ¹		Inflation forecast ¹	
	2011	2012	2011	2012
IMF	1.6	1.8	2.3	1.7
OECD	2.0	2.0	2.6	1.6
European Commission	1.6	1.8	2.6	1.8
ECB	1.5-2.3	0.6-2.8	2.5-2.7	1.1-2.3

¹ Obtained from the respective institutions.

There are heightened uncertainties about the euro area's economic outlook, which mainly relate to the contagion effects from the Greek debt crisis and the primary commodity prices. Against a background of tight fiscal policies, these two are expected to dampen consumption and investment.

USA

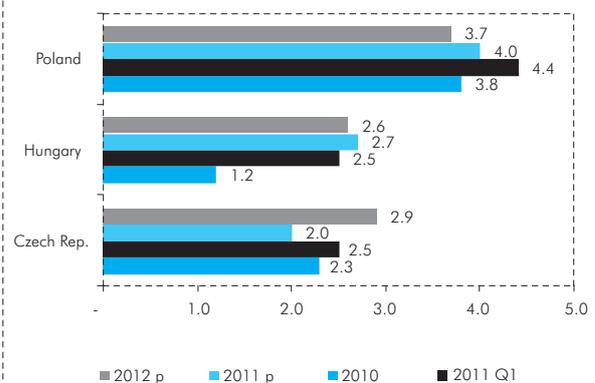
The latest data on USA show that the economy has recovered. U.S. GDP growth rates were close to market agents' expectations for 2011 Q1. According to the U.S. Department of Commerce, the GDP grew 1.9% q-o-q

and 2.3% y-o-y. GDP growth rates in 2011 Q1, albeit positive, were lower than in the previous quarter, thus providing evidence for a slight deceleration of the positive performance that the U.S. has been displaying since 2010. This deceleration was driven by the lower consumer spending, higher imports, lower public spending and contracted investment. Preliminary data show that the U.S. GDP will record positive, albeit lower, rates in 2011 Q2 and the entire 2011. The improved employment figures, the more favourable lending standards and the accommodating monetary policy are some of the factors believed to contribute positively to the U.S. economic performance. The current account deficit continued to increase in 2011 Q1, primarily as a reflection of the higher trade deficit. Despite showing upward signs due to the rise in energy and food prices, the inflationary pressures were generally contained as evidenced by the performance of the core inflation. U.S. monetary policy continued to be accommodative and the reference rate did not change over these months. At the same time, the Fed continued to conduct operations in the U.S. government securities market, by implementing the so-called “quantitative easing” announced in November 2010. During these months, the U.S. financial markets have reflected the re-dimensioning of expectations for a rapid economic growth, which in turn has also triggered a moderate increase of the yields in these markets.

2. SELECTED ECONOMIC FIGURES, INFLATION AND MONETARY POLICY ORIENTATION IN SELECTED CEE COUNTRIES¹

The economic performance of the Czech Republic, Hungary and Poland has been relatively satisfactory. In 2011 Q1, the economic growth in these countries was higher than the euro area’s average and above the expectations. Along the same line, the projections point to a high economic growth in 2011-2012. Economic growth was driven by foreign demand, while the recovery of domestic demand was sluggish. All CEE countries are operating under spare capacities and below their economic potential. This setting is less uniform in terms of the performance of inflation. In the Czech Republic, the inflation rate was low and in line with the inflation target, hence pushing the central bank to keep the key interest rate at historic lows. In Poland and Hungary, the inflation rate has jumped to above the target. The National Bank of Poland responded by raising the reference rate three times within 2011 Q2 by 25 basis points each (from 3.75% in March to 4.50% in June). The monetary policy changes took place amidst highly stable currencies of these two countries in 2011 Q2. For the same stated period, the inflationary pressures were lower as a result of the curbed rise in primary commodity prices.

Chart 1 Economic growth in CEE countries was high in 2011



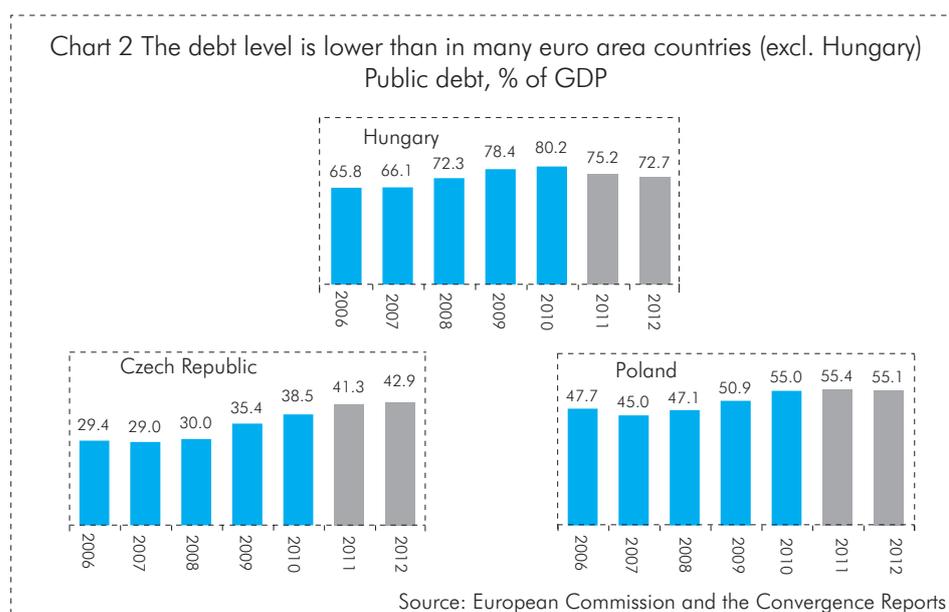
Source: European Commission and the Convergence Reports

¹ This region includes the Czech Republic, Hungary and Poland.

The performance of public debt figures in the euro area countries pushed these countries to tighten their fiscal policies. Hungary was the most aggressive in this regard. In general, the risks facing these countries are similar to those of the euro area countries, due to their close economic and financial ties with this area.

2.1 ECONOMIC ACTIVITY

The Czech Republic recorded the soundest macroeconomic indicators in the region.



In 2011 Q1, the Czech Republic's GDP (y-o-y and seasonally adjusted) was 2.8%, about 0.5 pp higher than the central bank's forecast. Other indicators, such as employment and wages, have increased higher than the forecast. Employment increased by 0.7% in Q1, while wages rose by 2.1%. Exports were the main driver of this growth, while the domestic demand is still low. This development profile generated lower inflationary pressures. Judging from the figures, manufacturing is expected to record a lower growth rate in Q2. Fiscal balances are sound to the point that they enable the Government to undertake reforms in the tax and pension systems, which imply less budget revenues.

Rating CZECH REPUBLIC

A1 (stable)
(Moody's)

A (positive)
(S&P)

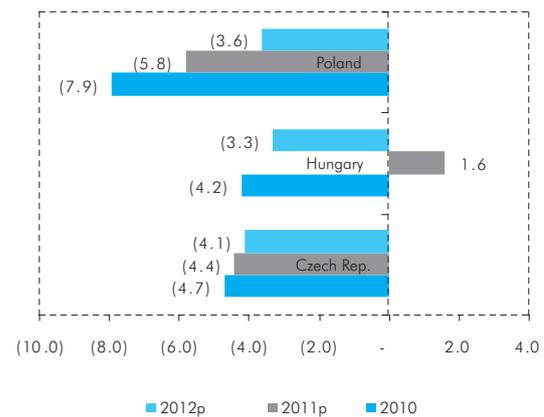
A+ (positive)
(Fitch)

The Czech currency has been the most stable currency in the CEE countries. The exchange rate has been stable since early-2011, a little higher than 24 Czech koruna per 1 Euro. The long-term appreciation trend of the Czech

koruna seems to be unwavering, although it may be affected by the widening of the spreads in the key interest rates. The central bank expects the exchange rate to average 24.1 CZK/EUR in 2011 and 23.4 CZK/EUR in 2012. This expectation is based on the balance of payments approach, with net exports projected to increase in the future, hence implying an appreciation of the Czech currency.

Hungary's growth rate was 2.5% (y-o-y) in 2011 Q1, primarily driven by foreign demand. Industrial output has recorded continuous growth, while the services sector has been sluggish. The economic growth did not reflect in the increase of employment. Domestic consumption remains weak despite the assessments for the increase in disposable income (as a result of the reduction in some taxes). The Hungarian people have the propensity to save and the level of new credit is low. The economy continues to be characterized by the adjustment of the private sector balance sheets in the post-crisis period, which is also reflected in the low level of investment. According to the central bank, the output has fallen short of its potential level by 3 percent. On the other hand, Hungary is perhaps the only country in Europe expected to record a budget surplus. This is explained by the pension system reforms, which are expected to have effect only for the fiscal year 2011. In the meantime, the severe fiscal measures set forth in the Convergence Programme of the Hungarian Government expect the budget deficit to decrease to about 3% in 2012, and the public debt to about 70%.

Chart 3 Budget deficit (% of GDP) is expected to narrow



Source: European Commission and the Convergence Reports

Rating HUNGARY		
Baa3 (negative) (Moody's)	BBB- (negative) (S&P)	BBB- (stable) (Fitch)

The HUF/EUR exchange rate has followed an appreciation tendency in the recent months. Hungary's equilibriums are considered vulnerable. However, given the country's stable fiscal position, the risk of contagion of the debt crisis is moderate. The point estimate for the Hungarian currency at the end of the year is 270 HUF/EUR, which implies a stable exchange rate against the Euro. The Hungarian Government's solvency and the accomplishment of fiscal consolidation measures will play a primary role in the developments of this currency.

The data on Poland's economic performance in 2011 Q1 were highly positive (the highest in this region) and reflected the increase in consumption and investment. The Polish economy expanded by 4.4% in Q1, compared to 4.5% in 2010 Q4, primarily driven by the growth of domestic demand. Private

consumption grew 3.9% y-o-y, while investments expanded by 6.0%, reflecting partly the preparations for the 2012 European Football Championship. Economic growth is expected to be relatively high in the period ahead, as shown by the improved labour market figures, the growth of investment and mortgage loans, and the higher foreign investment. On the other hand, the projection for the deceleration of the euro area’s economy and the monetary policy tightening in Q2 may lead to the downward revision of Poland’s GDP for 2011.

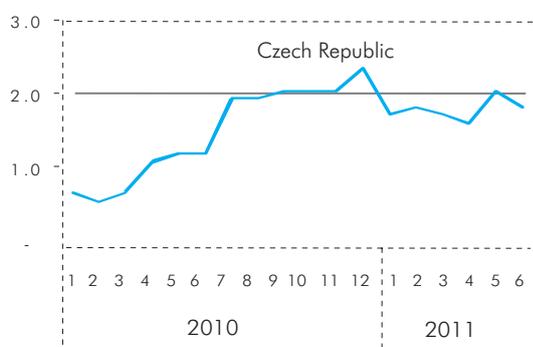
Rating POLAND		
A2 (stable) (Moody's)	A (stable) (S&P)	A- (stable) (Fitch)

The Polish Zloty’s exchange rate against the Euro has been stable and close to 4 PLN/EUR for the entire Q2. The forecast for the Polish currency relies on the growth of exports, expecting a possible appreciation in the long run, but with little room for change in the months ahead. The positive performance of the Polish Zloty has been affected by the positive macroeconomic developments, which seem to have encouraged the channelling of investment funds into this economy.

2.2 INFLATION AND MONETARY POLICY

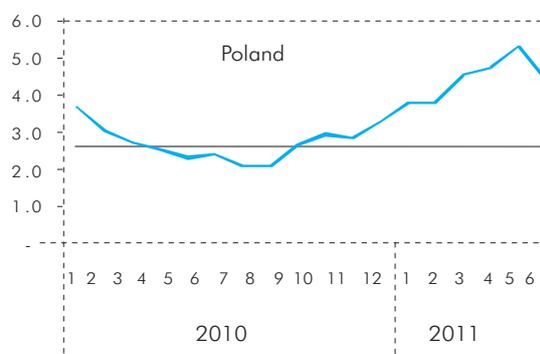
Compared to the other countries in the CEE region, inflation in the Czech Republic is low and below the 2% target of the central bank and the euro area. In June, it dropped to 1.8% from 2% in May. According to the central bank, the inflationary pressures remain balanced; thereby no monetary policy changes were required to be made. The reference rate has been at its record low of 0.75% since May 2010. There are two main risk factors to this positive performance of inflation: the relatively high inflationary expectations and an abrupt acceleration of domestic demand. The inflationary expectations point

Chart 4/a Inflationary pressures are downward



Source: Respective central banks

Chart 4/b Inflationary pressures are downward



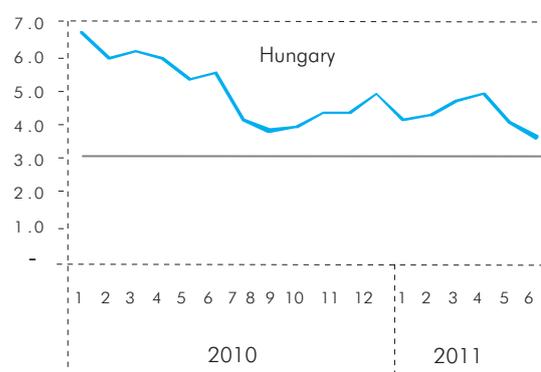
Source: Respective central banks

to 2.5%, above the target but within the tolerance band (+/-1%). In the meantime, the developments in the euro area (an escalation of the sovereign debt concern of some countries) give rise to low inflationary pressures.

In Hungary, the inflation rate was above the central bank's target; however, the latter did not respond considering the inflationary pressures to be transitory. They arise from the rise in administered (energy) and primary commodity prices in the international market, and they are not believed to have any chain effects as long as there are no pressures from the labour market. Inflation marked 3.5% in June, compared to 3.9% in May. However, the central bank's forecast shows that, in the absence of changes in the base rate, inflation will fall back to the 3% target in 2012. This forecast assumes that prices in the international market will drop and, in the presence of a weak domestic demand, potential second-round effects will subside.

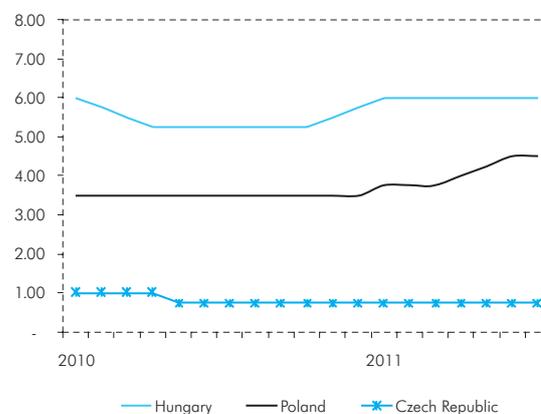
The continuous increase of inflation in Poland to 5% in May – 2.5 pp above the target – pushed the central bank to increase the key interest rate three times in 2011 Q2. Inflation has primarily reflected the rise in food and energy prices. The higher core inflation and public's inflation expectations have been of great concern. In view of this, given that domestic demand has been the main driver of economic growth, the central bank addressed the increase of inflation by raising the key interest rate three times by 25 basis points each in 2011 Q2, from 3.75% to 4.50%. At its last monetary policy meeting in July, it decided to keep the key rate unchanged, hence signalling the continuation of this monetary policy stance. Combined with the desired fiscal policy tightening, the tighter monetary conditions will push inflation down close to the target in the medium run.

Chart 4/c Inflationary pressures are downward



Source: Respective central banks

Chart 5 Monetary policy has remained unchanged/tight



Source: Respective central banks

3. SELECTED ECONOMIC FIGURES, INFLATION AND MONETARY POLICY ORIENTATION IN SELECTED SEE COUNTRIES (+TURKEY)¹

Following the stabilization of the SEE economies during the past year, these countries recorded fast growth rates in 2011, particularly Turkey, which recorded the highest GDP growth in Q1, 11%. In addition, the inflation rates were relatively high due to the rise of prices in the international markets. The

¹ This region includes Bulgaria, Macedonia, Romania and Serbia, and for study purposes, Turkey as well.

positive economic developments did not translate into marked improvements in the labour market or into the decrease of non-performing loans, hence providing evidence for the vulnerability of these economies. Another risk to these countries arises from the effect that the prolongation or the crunch for the solution of the public debt crisis in countries they are financially related to (Greece, Italy), may have on them.

	GDP growth expectations ¹				
	2009	2010	2011 Q1	2011p	2012p
Serbia	(3.5)	1.8	3.4	3.0	5.0
Romania	(7.1)	(1.3)	1.7	1.5	3.7
Croatia	(6.0)	(1.2)		1.1	2.0
Bulgaria	(5.5)	0.2	1.5	2.8	3.7
Turkey	(4.8)	8.9	11.0	8.7 ²	2.5 ³
Macedonia	(0.9)	0.7	5.1	2.5	3.3
Albania ⁴	3.3	3.9	3.4	3.5	6.1

¹ Preliminary data for GDP in 2011 Q1. European Commission's projections for 2011-2012.

² Revised IMF's projection after the release of the GDP for Q1.

³ Revised IMF's projection after the release of the GDP for Q1.

⁴ BoA's and MoF's projections for Albania.

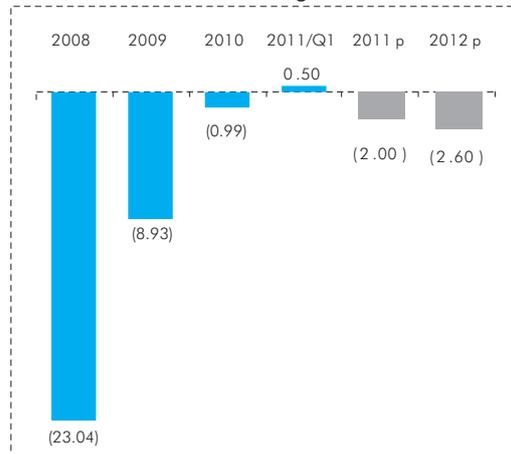
In order to address the increase of inflation, the central bank of Serbia raised the key interest rate, while that of Turkey increased the level of the required reserve. The other central banks did not change the key interest rate, despite being above the target. The rationale behind this decision was that they viewed this trend as temporary and that the inflationary pressures will mitigate in the medium run. The inflationary expectations were closely monitored during this period, due to their upward tendency (as reported by confidence and bank experts' surveys). Once the inflationary pressures decelerated, the central bank of Serbia cut the key interest rate. The fall of inflation is expected to persist, thus bringing it down to within the respective central banks' target in the medium run.

3.1 ECONOMIC ACTIVITY

Bulgaria's real GDP expanded by 1.5% y-o-y in 2011 Q1, compared to 3.1% in 2010 Q4. Except for agriculture, almost all the economic sectors recorded growth. Exports were the main driver of the economic growth. The increase of exports (22%) and the relative decrease of imports (+4%) brought about marked improvement in Bulgaria's external balance. The current account narrowed from -23% of GDP in 2008 to -1% in 2010, and recorded a surplus in 2011 Q1. Domestic consumption continues to grow in negative (but more moderate) terms, against a background of a high unemployment rate, lower confidence indices and higher propensity to save. In the post-crisis period, in view of restructuring the fiscal indicators, the Bulgarian Government approved the decision to freeze wages and pensions (the contributions for the latter have increased). The accumulated budget surpluses in the past helped overcome the crisis, while the tight fiscal measures continue to be effective,

in order to bring the budget deficit down to 3% of GDP and keep the public debt at very low levels. Considering the sound fiscal indicators and their future outlook, the Fitch rating agency revised its rating for Bulgaria from negative to positive.

Chart 6 Current account deficit as a percentage of GDP, Bulgaria



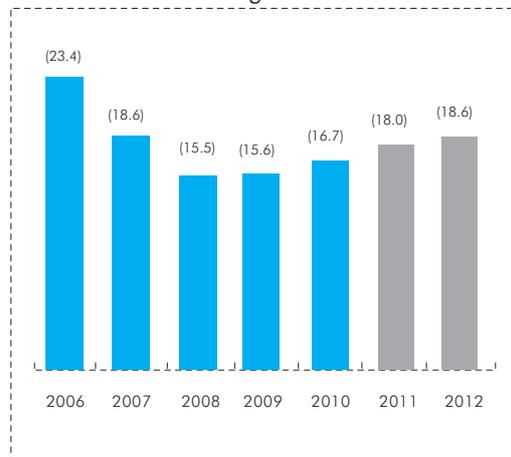
Source: European Commission and the Convergence Reports

Chart 7 Fiscal deficit as a percentage of GDP, Bulgaria



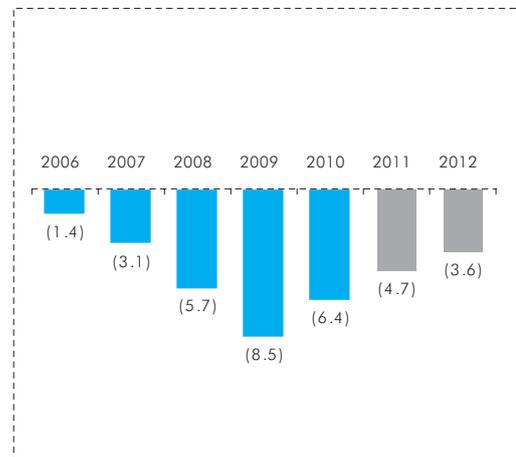
Source: European Commission and the Convergence Reports

Chart 8 Public debt as a percentage of GDP, Bulgaria



Source: European Commission and the Convergence Reports

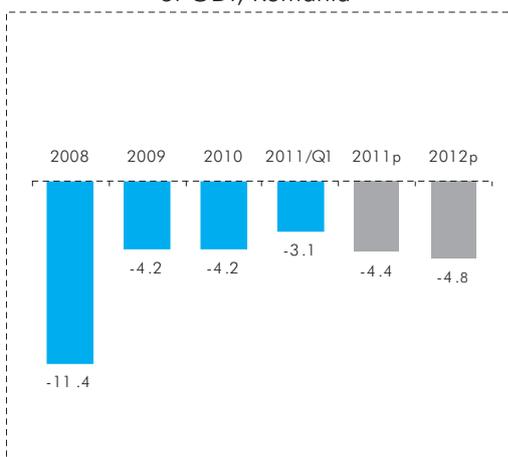
Chart 9 Budget deficit as a percentage of GDP, Romania



Source: European Commission and the Convergence Reports

Macedonia has progressed at slow, albeit positive, growth rates. Its GDP expanded by 5.1% in 2011 Q1, the peak rate since 2008 (but this mainly owes to the base effect). Exports and investments in industry, trade and construction are the main drivers of this growth. On the demand-side, private sector lending improved as a result of the higher employment (up 5% y-o-y in Q1) and the improved consumer confidence. In addition, foreign direct investment (FDI) increased by 2.7% in 2010 Q1, compared to 1.2% in 2010 Q4. The budget deficit remained at a similar level to 2010, accounting for 2.5% of GDP.

Chart 10 Current account deficit as a percentage of GDP, Romania



Source: European Commission and the Convergence Reports

For the first time since 2008, Romania registered positive economic growth rates in 2011 Q1, hence officially exiting the recession. Romania's GDP expanded by 1.7% in 2011 Q1, compared to -0.6% in 2010 Q4. The delayed recovery reflected the impact of the tight fiscal policy that became effective in July 2010. In the meantime, domestic demand remains subdued due to the still tight lending standards and the fall of capital inflows. Worth noting is that exports increased by 24.4% in Q1, compared to 18.0% in 2010 Q4. The current account deficit improved to 3.1% of GDP in 2011 H1, compared to 4.1% at end-2010.

The Romanian Leu appreciated slightly in 2011 Q1 as a result of the improved investors' perception of Romania and the authorities' decision

to conclude a Stand-By Arrangement. In 2011 Q2, the Romanian currency managed to enter and stand at the range of over 4.1 RON/EUR until mid-June, when it shifted towards its depreciation.

Rating ROMANIA

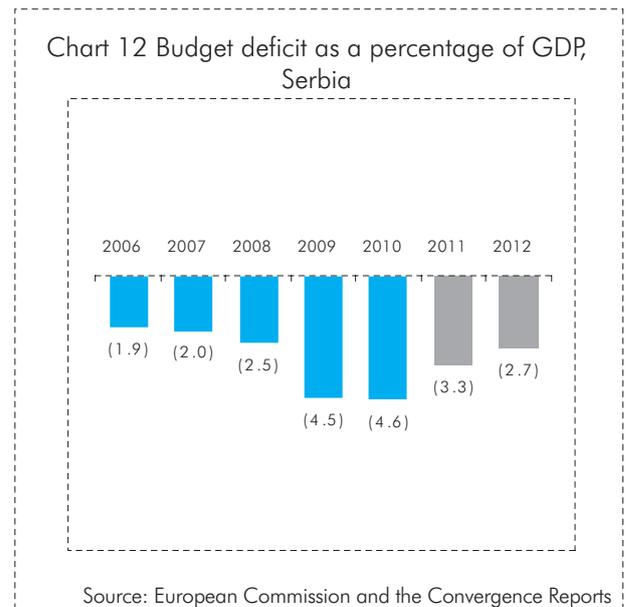
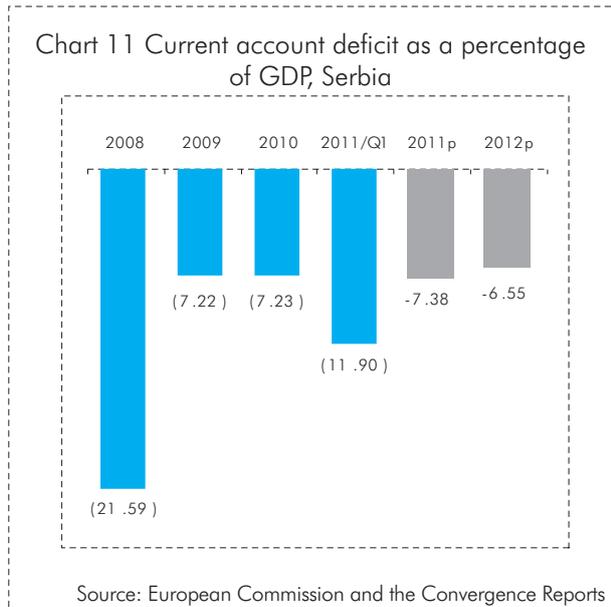
Baa3 (stable)
(Moody's)BB+ (stable)
(S&P)BBB- (stable)
(Fitch)

Serbia's economic growth in 2011 Q1 was driven by the fast and positive development of the industry sector. Industrial production grew at considerable rates (6.0% y-o-y) due to the higher foreign demand and improved competitiveness in Serbia. Private investments provided substantial contribution to the economic growth. They were fostered by the foreign inflows in the form of FDI, growth of corporate credit, improved construction sector figures and the decline in spare capacities. Serbia's GDP is expected to continue to grow by about 3% in 2011, driven by the growth of domestic demand. The decline of inflation and the improved labour market figures are expected to contribute in this regard.

Rating SERBIA

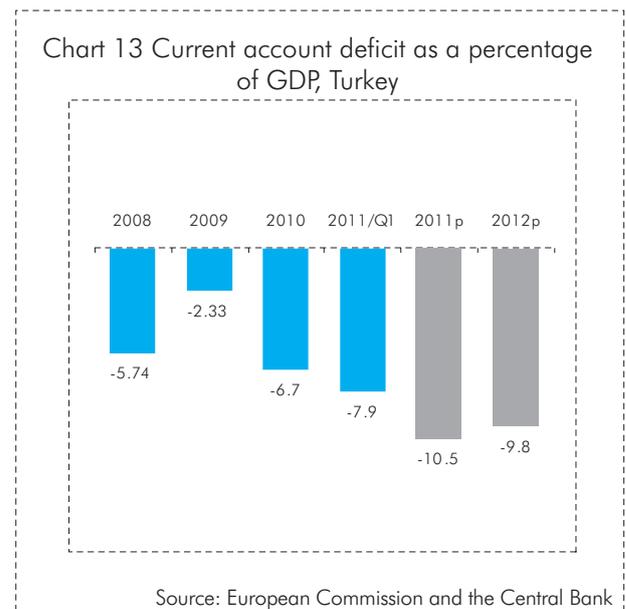
Unrated
(Moody's)BB (stable)
(S&P)BB- (stable)
(Fitch)

Due to the high spread between Serbia's and euro area's interest rate, Dinar's exchange rate against the Euro maintained its upward trend commenced since 2010 Q4. In nominal terms, the Dinar appreciated by more than 5%, and considering the high spread between Serbia's and euro area's inflation, the appreciation of the Dinar in real terms is even more



significant. It is evident that a strong Dinar is useful in the fight against inflation, but its persistent appreciation would jeopardize Serbia's exports. The latest developments in the exchange rate (in July) have reflected the uncertainties originating from the euro area, bringing in turn the depreciation of the Serbian Dinar.

Turkey's real GDP expanded by 11% y-o-y in 2011 Q1, driven by the rapid recovery of domestic demand and the increase in private consumption and public expenditure. On the expenditure side, private consumption grew 12.1% y-o-y. The increase in private investment remains very high, 38.3% y-o-y, albeit downward compared to 2010 Q4. Domestic demand expanded by 15.9% y-o-y, while net exports provided an adverse contribution. The increase in imports was fast, thus contributing to the considerable widening of the current account deficit and augmenting the pressures in the foreign exchange market.



Rating TURKEY		
Ba2 (Moody's)	BB (positive) (S&P)	BB+ (positive) (Fitch)

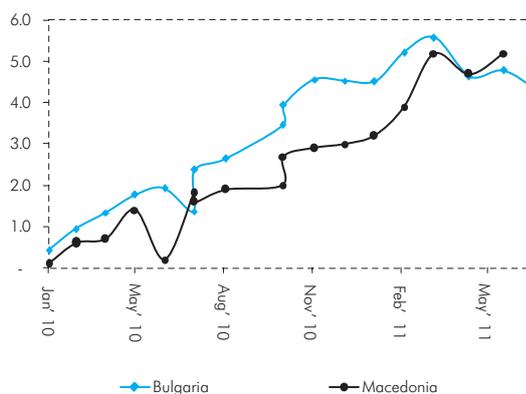
The Turkish Lira showed a depreciation tendency, due to the considerable increase in imports and the maintenance of the interest rate at a similar level. During the last nine months, it has depreciated by 10.9% against the U.S. dollar and 16.4% against the Euro. The central bank of Turkey has constantly

noted the persistence of weak capital flows into the emerging markets, which owe to the concerns about the debt sustainability in some euro area countries. Depending on the circumstances, it may revise the amount of foreign currency it purchases at daily auctions.

3.2 INFLATION AND MONETARY POLICY

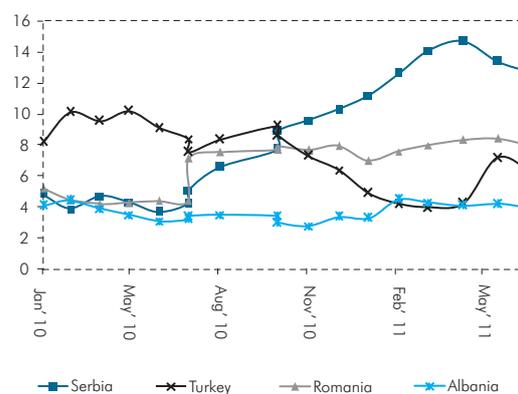
The inflation rate in Bulgaria marked 4.3% in June, compared to 4.8% in

Chart 14 Inflationary pressures



Source: Respective central banks

Chart 15 Inflationary pressures



Source: Respective central banks

May. The central bank assesses that the domestic inflationary pressures have been low and contained. The increase of inflation in early 2011 attributed to the rise of global prices, while the core inflation rose only slightly.

Annual inflation in Macedonia has been increasing continuously over 2011. In May, it marked 5.2%, while for the first half of 2011, it averaged 4.5%. Food and energy (mainly fuel) prices were the main drivers of this increase. Core inflation was stable, supporting in turn the assumptions that inflation will be stable in the range of 5-5.5% in the months ahead, hence assuming a neutral fiscal policy stance. The Macedonian Central Bank is likely to begin a tightening monetary policy cycle, in order to subdue the upward inflationary pressures and the widening of the current account deficit. The central bank is keeping the key interest rate at an all-time low of 4%.

Annual inflation in Romania marked 7.9% in June, compared to 8.4% in May 2011. This rate is, however, high compared to the central bank's target of $3\% \pm 1\%$. The rise in prices in the recent months owes mainly to the VAT rate hike³ by the Romanian Government and the higher agriculture food prices. Despite registering the highest inflation rate in the entire European Union, the

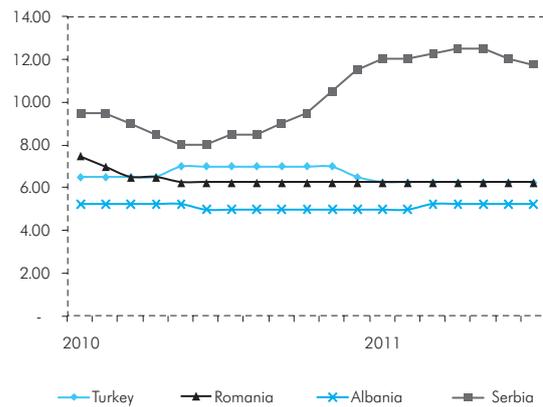
³ The VAT rate increased by 5 basis points (to 24%) in 2010, in order to reach the budget targets under the obligations of the IMF stand-by arrangement, in the context of the financial aid Romania has received from the IMF to overcome the crisis (USD 25 billion).

increase of inflation was factored into the central bank's forecasts, pushing the latter not to take any monetary policy measures as long as inflation is not monetary in nature. The Romanian Central Bank kept its key interest rate unchanged at 6.25% (it last changed on 4 May 2010). It has signalled that it will not change the benchmark rate as long as the output gap is negative. The performance of inflation will depend on the implementation of fiscal and structural reforms, such as the VAT rate hike and the absorption of EU and IMF funds. The effect of the VAT rate hike is expected to subside in 2011 H2, and the annual inflation rate is forecast to drop to 4.9% at end-2011.

Inflation in Serbia peaked in April (14.7%) due to the food price hikes. In order to maintain the inflationary expectations well-anchored, the Serbian Central Bank raised the key interest rate twice by 25 basis points each, to 12.50%. In June, inflation dropped to 12.7%, from 13.4% in May. The downward tendency of inflation in Serbia is assessed to have been driven by the seasonal fall of agricultural prices, the tighter monetary policy, the maintenance of fiscal indicators under check and the appreciation tendency of the Serbian Dinar. These assessments encouraged the central bank to begin a cycle of monetary policy easing, by cutting the key interest rate in June (-50 basis points) and in July (-25 basis) to 11.75%.

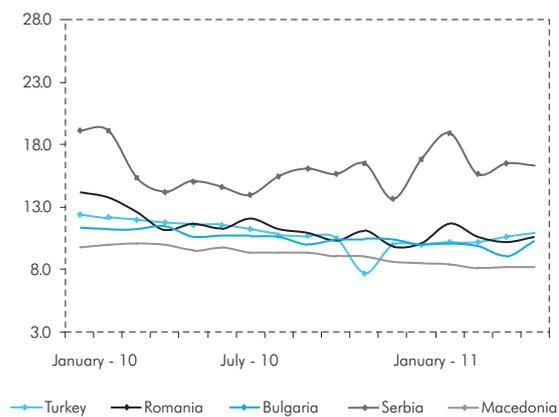
Inflation in Turkey marked 6.24% in June, compared to 7.17% in May. The fall in food prices by 6.4% was the main driver of the lower inflation. In the meantime, producer prices have almost remained unchanged m-o-m. Core inflation showed upward signs, due to the demand-side pressures and the downward exchange rate. The Turkish Central Bank has kept its benchmark one-week repo rate unchanged at 6.25% since January 2011. In early 2011, it employed the required reserve instrument as a tool to tighten the monetary conditions in the economy. In the meantime, the widening of the current account deficit, coupled with the growth of credit, may feed risks to financial stability, thus giving rise to the increase of the key interest rate.

Chart 16 Monetary policy has remained unchanged/tight



Source: Respective central banks

Chart 17 Interest rates on loans in the national currency



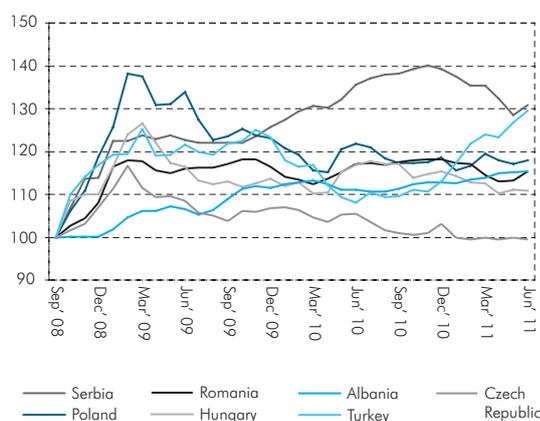
Source: Respective central banks

4. EXCHANGE RATE IN CENTRAL AND SEE COUNTRIES

The currencies of Central European countries – the Czech Republic, Poland and Hungary – were particularly stable during this period. The economies of these countries have been export-oriented. The increase of net exports (Czech

Republic) may factor into their appreciation in the long run. In addition, the higher spread between these countries' and euro area's interest rates (Poland) may bring about its slight appreciation. The Hungarian currency, despite its negative history, is considered stable as long as the Hungarian Government carries out its commitments made with regard to fiscal reforms.

Chart 18 Daily Euro/national currency exchange rate in CEE countries (base index: September 2008)



Source: Respective central banks and MPD estimates

The currencies of SEE countries remain vulnerable. Given the positive macroeconomic outlook, some of them (Serbia, Romania) appreciated slightly in the beginning of the quarter. At the end of June and in July, their currencies appreciated against the Euro due to the negative news in the euro area. The uncertainty surrounding the solution of the sovereign debt crisis in the euro area may generate a crisis of confidence and fear of investing in the national currencies.

In Turkey, the national currency has come under pressure from the increase in imports and the widening of the current account deficit. On the other hand, the Government authorities have declared that they see the weak currency as a way to push exports up and narrow the current account deficit.

Monthly average exchange rate and monthly changes in percent

Euro/national currency	Serbia	Turkey	Romania	Poland	Hungary	Czech Republic
March 2011	103.42	2.21	4.16	4.02	271.00	24.41
April 2011	101.15	2.20	4.10	3.97	265.34	24.28
May 2011	98.26	2.26	4.11	3.94	267.06	24.38
June 2011	99.98	2.31	4.19	3.97	266.61	24.28
Monthly change April 2011	-2.19%	-0.45%	-1.44%	-1.24%	-2.09%	-0.53%
Monthly change May 2011	-2.86%	2.73%	0.24%	-0.76%	0.65%	0.41%
Monthly change June 2011	1.75%	2.21%	1.95%	0.76%	-0.17%	-0.41%

Source: Respective central banks and MPD estimates

5. MISCELLANEOUS

- In May, an agreement was negotiated between Portugal, ECB, EC and IMF. This agreement set out the conditions to be met by the Portuguese Government in terms of consolidating the fiscal sector, recapitalizing the banking sector and undertaking structural reforms, in order to receive the financial aid from these institutions.
- In July, Moody's rating agency downgraded Portugal's sovereign credit rating from Baa1 to Ba2.

- On 29 June, the Governing Council of the European Central Bank (ECB) took a decision, in coordination with the Bank of Canada, the Bank of England and the Swiss National Bank, to extend the liquidity swap arrangements with the Federal Reserve up to 1 August 2012.
- In March, the Fed's Chairman Ben S. Bernanke announced that starting from March, the Fed will hold press briefings four times per year to present the Federal Open Market Committee's current economic projections and to provide additional context for the FOMC's policy decisions. The introduction of regular press briefings is intended to further enhance the clarity and timeliness of the Federal Reserve's monetary policy communication.
- The National Bank of Romania has successfully launched the first euro payment system in Romania (TARGET 2) with 23 participants. TARGET2-Romania is the national component of the TARGET2 euro payment system. The introduction of TARGET2-Romania is a step forward towards European integration and euro adoption. The National Bank of Romania is the 24th national central bank that connects to TARGET2 of the 28 central banks making up the European System of Central Banks.
- Fitch credit rating agency has improved its outlook on Bulgaria's currency ratings from negative to positive (BBB-). This decision reflects the country's solid macroeconomic indicators and prospects for their improvement. The credit rating agency has said that another upgrade is possible if Bulgaria's banking sector shows clearer evidence of stabilization, and the budget deficit and external debt are reduced further.
- Romania's sovereign rating was raised one step to BBB- by the Fitch rating agency. This upgrade reflects Romania's progress in narrowing the current account deficit and reducing the budget deficit.

FINANCIAL INTERMEDIATION ANALYSIS

ERJONA SULJOTI, SOFIKA NOTE
MONETARY POLICY DEPARTMENT, JULY 2011

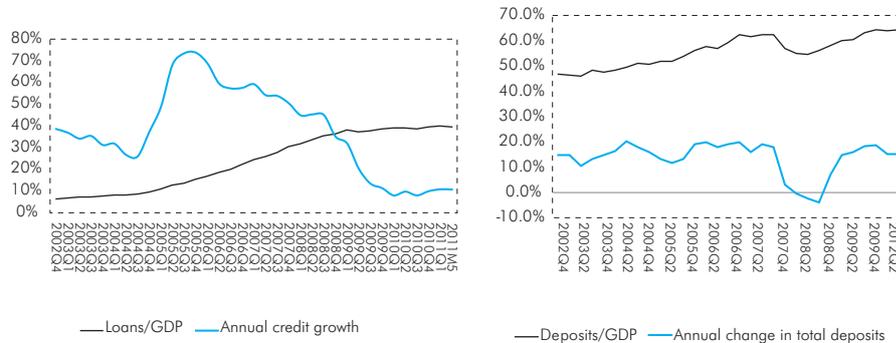
1. INTRODUCTION

At the end of 2011 H1, the Albanian banking system was composed of 16 private banks with a dominating foreign capital, which currently accounts for about 94% of the total banking system capital. As in many other countries in the region, the Albanian banking system represents the main segment of the financial sector providing private sector intermediation. Banks hold about 95% of the financial system's assets, and loans extended by them account for about 90% of the total loan portfolio extended to the economy. However, the segment of non-bank financial institutions in Albania has, since 2010, been increasing both in terms of their number and the loan portfolio. In June 2011, the number of non-bank financial institutions was similar to that at end-2010, more specifically 17 institutions or 5 more compared to 2009. These developments provide evidence for the wider range of the financial market products, in accordance with the needs of the economy and particularly, of the small and medium-sized businesses.

Financial intermediaries' participation in the increase of financial intermediation was cautious in 2011 H1. Loan-to-total deposit ratio stood at a similar level to the end of Q1, 61.1%. During this period, the banking system has been active and has increased the deposits held by the public with them, being also supported by individuals' propensity to save. In the meantime, private sector lending maintained moderate annual growth rates. In April and May, net lending flows were weaker than in Q1, owing to the absent seasonal growth of business lending over these two months. This performance is a reflection of the weaker business demand for credit and the tight lending standards over this period. The lower business demand for credit in 2011 Q2 is considered to attribute to the slow recovery of the Albanian economic activity – particularly consumption –, and the heightened uncertainties surrounding the future outlook following the election and post-election period in Albania.

As at the end of May, about 47.6% of the banking system assets was invested in the loan portfolio. Deposits, the main source of funds for banks, accounted for about 76.2% of liabilities, compared to 73.9% a year earlier. In the first five months of 2011, loan-to-GDP ratio increased slightly from the end-2010 level to 39.2%. In the meantime, the satisfactory performance of the collection of deposits contributed to the increase of monetisation in the economy, expressed in the increase of deposit-to-M3 ratio to 81.2%. At the end of May 2011, total deposits accounted for 64.1% of GDP.

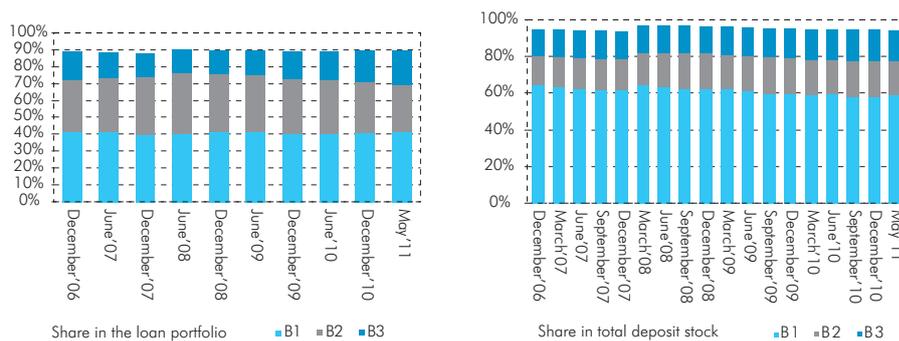
Chart 1 Loans and deposits as a percentage of GDP (in %)



Source: Bank of Albania

Intermediation by banking groups provides evidence for the better performance of small banks in the credit market. They have grown their loan portfolio further, thus offsetting the contraction of Greek banks' loan portfolio. The credit market share of small banks reached 20.1%, compared to 18.7% at the end of 2010. Greek banks' loan portfolio shrank considerably due to the change in these banks' strategies. The share of Greek banks in the system reached 28%, compared to 30% five months earlier. In the meantime, the steady growth of large banks' credit portfolio contributed to further consolidating their dominating position in the credit market to 41%.

Chart 2 Share of banking groups* in total banking system loans and deposits



* The analysis of banking groups is based on the intermediation activity of nine most active banks in the credit market, which account for about 91% of the banking system assets. The division of banks into groups is based on the size of bank balance sheets and the financing characteristics of their activity. More specifically, they represent: B1 – the three largest banks in the system; B2 - three Greek banks; B3 – the three smallest banks active in lending.

Source: Bank of Albania

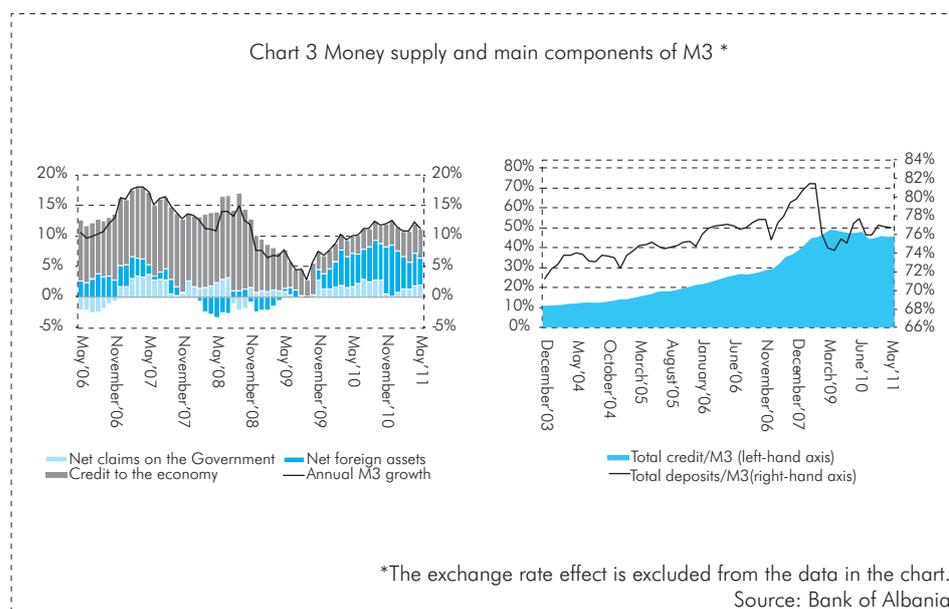
At the end of May, the deposit market did not undergo any significant changes compared to a year earlier. The group of large banks accounts for about 58.6% of this market, compared to 58% at the end of 2010 and 59%

in the corresponding period in 2010. Greek banks have managed to keep their market share unchanged for more than two years by providing attractive products for deposits. In the meantime, small banks have manifested a moderate growth of deposits compared to the end of 2010.

2. BANKING SYSTEM INTERMEDIATION

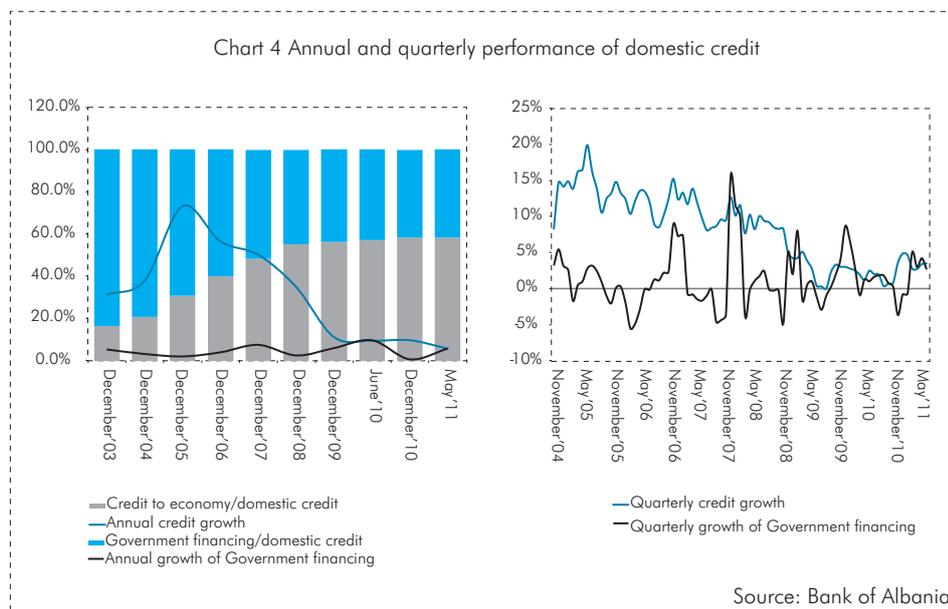
The recovery of economic activity in Albania was slow in 2011 H1. The positive impulse provided by the stimulating fiscal policy contributed to expanding the economic activity, particularly in Lek, and to a higher contribution of the fiscal component to the growth of demand. Surrounded by uncertainties about the future outlook, the private sector manifested a slow recovery of demand for money, as shown by the moderate demand for loans. In addition, the performance of prices in the economy materialized into a higher annual inflation rate, transmitting the added inflationary pressures of primary commodity prices in the international markets on the inflation of consumer goods in Albania.

Against this backdrop, at the end of March, the monetary authority raised the key interest rate by 0.25 percentage points, in order to manage and anchor the inflationary expectations around its target, as well as to discourage the further materialization of second-round effects on inflation. Following this decision, the key interest rate in the economy stands at 5.25% and remains close to historic lows. In 2011 Q2, the financial markets responded to the monetary policy signals by showing upward tendencies of the interest rates in almost all this market segments. For the same period, Lek's exchange rate against the major currencies showed a moderate annual depreciation, hence causing the overall monetary conditions in the economy to remain accommodative and support the recovery of economic activity. In the meantime, the real interest rate remains at historic lows, thus underpinning aggregate demand in the country.



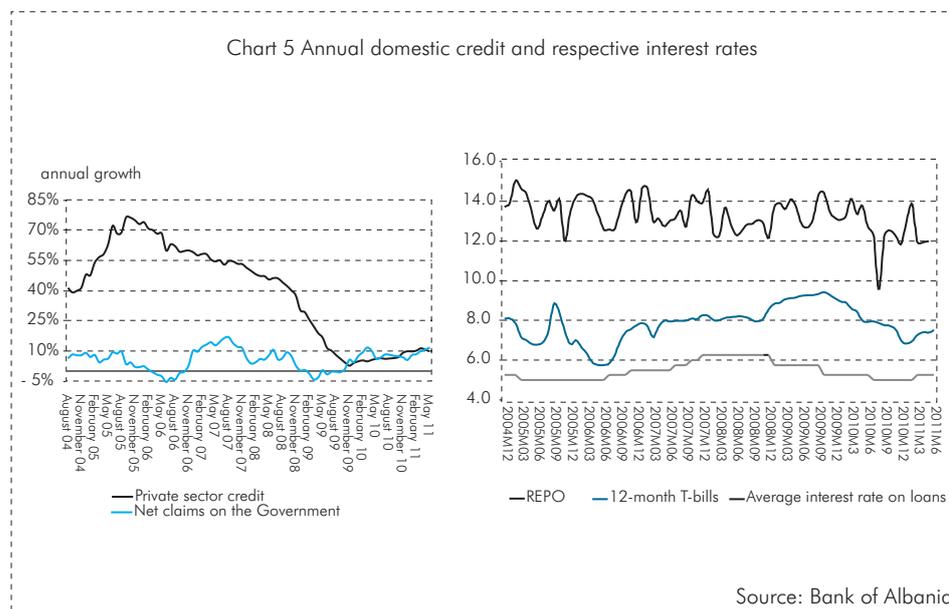
The performance of monetary indicators during January to May 2011 was affected by a steady contribution of the private sector demand and a higher demand for public sector lending, mainly in the Albanian Lek. This demand fuelled the stable growth of ALL-denominated deposits during this period, and consequently, the recovery of M2 aggregate growth rates, which grew on average by 6% y-o-y. In 2010, M2 aggregate manifested moderate annual growth rates throughout the year, in response to the low public and private sector demand for the Albanian Lek.

In 2011 Q2, M3 aggregate expanded at higher rates y-o-y than in Q1, due to a better performance of foreign currency-denominated deposits. In April and May, it grew on average by about 11.7%, compared to 11.0% in Q1. The foreign currency component continued to provide the major contribution to monetary expansion in Q2, albeit at lower levels than at end-2010.



The growth rates of credit to the economy remain moderate and below their historical average, thus reflecting not only the moderate demand for money but also the heightened uncertainty about the future outlook. In the meantime, the further deterioration of the loan portfolio quality discouraged banks to ease the lending standards further. The annual growth rate of credit to the economy averaged 10.8% in April and May, compared to the average growth of about 9.6% in Q1. Private sector credit grew relatively higher by about 11.4% on average over these two months. In absolute terms, private sector credit stock grew by about ALL 7.6 billion, driven by both credit to households and businesses. Excluding the exchange rate effect, however, the net monthly flow in April and May was about 40% less than that at end-Q1. Corporate credit demand was substantially lower than the high seasonal flows characterizing this period. Corporate lending was mainly denominated in foreign currency and for liquidity purposes. Data on Q2 confirmed the positive performance of credit to households, which grew 2.5% y-o-y. Credit to households amounted to ALL 1.7 billion in April and May, or about 3 times

higher than in Q1. The improved household credit portfolio reflects the easier lending standards and a more positive performance of demand for this type of credit.



In the first half of 2011, budget revenues increased at low rates, while budget expenditures, particularly capital ones, increased substantially. Fiscal expansion led to higher growth rates of public sector borrowing from the banking system in H1. During this period, net claims on the government increased on average by 4.5% y-o-y, compared to 3.4% in Q1. Government borrowing took place through the issue of short-term debt instruments, mainly of 12-month maturity, and long-term bonds of 2 and 5-year maturity. The growing demand of the Government for borrowing exerted pressure on the setting of prices in the primary market, which maintained an upward tendency throughout 2011. In addition to the higher demand, the performance of the yields in the primary market has also reflected the increase in the key interest rate at the end of Q1.

Banking system intermediation for the economy, represented by the ratio of total loan-to-deposit stock, remains relatively low. At the end of May, total loan-to-deposit ratio stood at 61.1%, similar to 2011 Q1, but lower than the peak of 69% in May 2009. In addition to the rapid growth of deposits due to their full return to the banking system since 2010 H1, the lower intermediation in the medium run is also a reflection of the moderate growth rate of credit to the economy in the recent years.

3. BANKING INTERMEDIATION ANALYSIS¹

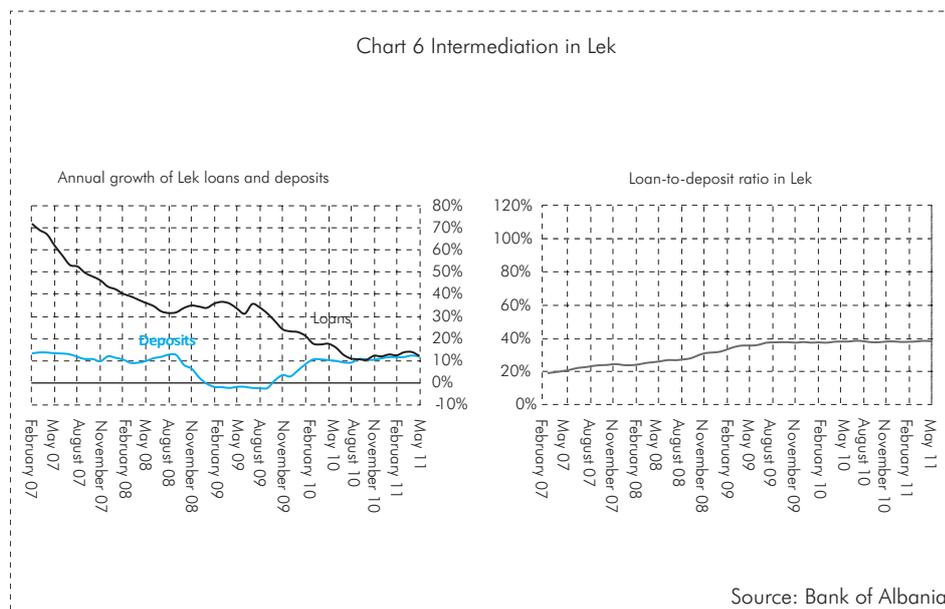
The performance of banking intermediation in April and May was in line with the developments in 2011 Q1. Intermediation figures remained almost unchanged at the 2011 Q1 level and showed little deviation from the previous 6-7 months' average. Beyond their monthly volatility, intermediation costs

¹ Banks' activity in Euro dominates their foreign currency activity, accounting for more than 80%.

were stable for the Euro and decreasing for the Albanian Lek. On the other hand, a considerable portion of non-price lending standards remain tight.

3.1 Intermediation in Lek

In April and May, intermediation in the Albanian Lek maintained similar levels to the previous two quarters. Loan-to-deposit ratio rose slightly to 38.6% on average, compared to 38.2% in the previous two quarters. The stable intermediation indicator for more than a year is a consequence of the relatively balanced developments in Lek-denominated loans and deposits.

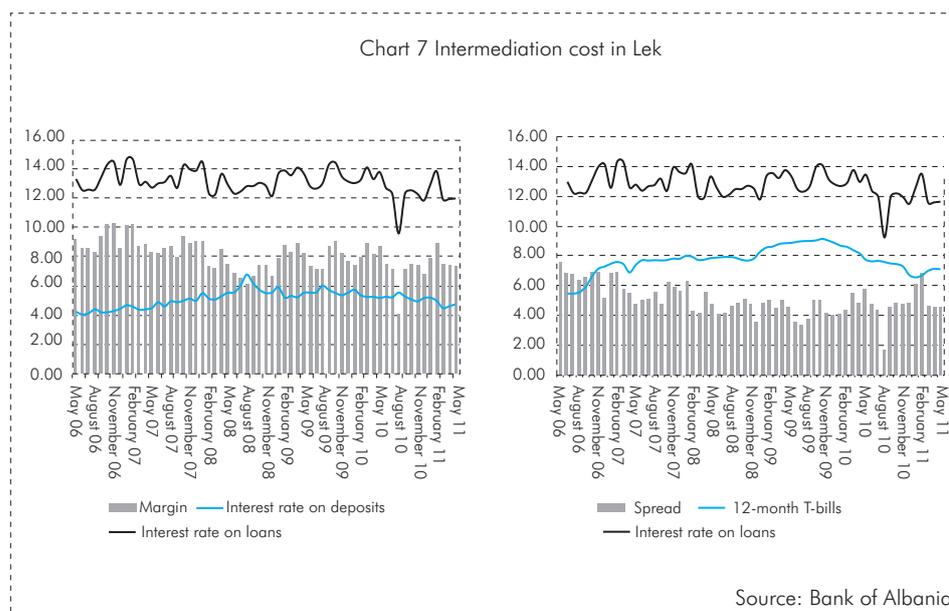


In April and May, the average annual growth rates of Lek-denominated credit were similar to the previous quarter, 12.9%. Corporate demand for working capital loans is the main source of the growth in Lek-denominated credit. In the recent months, however, Lek credit to households has increased in response to the recovery in household demand for credit. In April and May, Lek-denominated credit to households accounted for about 50% of the net flow of total credit in Lek. In addition to consumer loans, which are generally extended in Lek, the national currency is being increasingly used in mortgage loans, hence reflecting a greater consideration of the exchange rate risk in the borrower's solvency.

Lek-denominated deposits grew on average by 11.9% during April-May, which is comparable to the previous quarter's growth rate. Their net monthly flow amounted to ALL 3.7 billion, compared to ALL 4.7 billion in Q1. In a longer time horizon, however, the average monthly growth of deposits remains stable and comparable to the average flow noted since early-2010.

The intermediation cost in Lek dropped in April and May. It averaged 7.4% from 8.1% in 2011 Q1. The average interest rate on deposits recorded a

slight decrease compared to Q1, to 4.6%. The lower intermediation cost owes primarily to the decrease in the average interest rate on loans. It averaged 12.0% or about 0.9 pp less than in Q1. As in the previous months, its performance was mainly determined by the interest rates on corporate loans for liquidity purposes. The decrease in the interest rates on loans is due to the increase in the interest rate on 12-month T-bills, which in most cases serves as a reference rate in determining the cost of credit. The average spread was 4.6% over this period, down 1.3 pp from Q1.



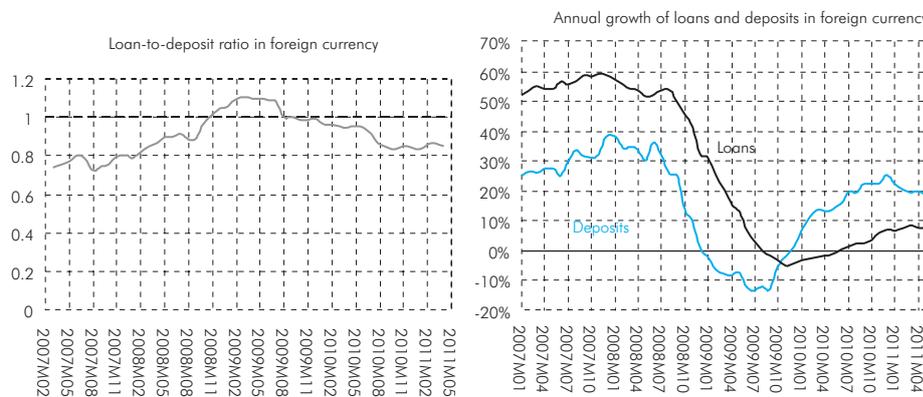
3.2 Intermediation in Foreign Currency (Euro)

In April and May, the performance of intermediation in foreign currency was in line with the developments in the previous months. Loan-to-deposit ratio increased slightly to an average of 85.9%, compared to 85.1% in 2011 Q1. This performance owes primarily to the deceleration in deposits, while loans maintained a stable growth rate.

The annual growth of foreign currency-denominated loans averaged 7.8% in April and May, up 0.4 pp from 2011 Q1. The increase in foreign currency lending during this period was mainly triggered by the higher corporate demand for working capital loans. In addition, for the same stated period, the demand of public enterprises for foreign currency-denominated credit was higher.

Unlike the first quarter of 2011, the average monthly flow of deposits denominated in foreign currency was positive in April and May. Despite this, it was as much as 50% of the monthly flow in 2010 H2. The deceleration in the growth of deposits denominated in foreign currency is also in line with the lower remittances and foreign inflows into the Albanian economy during this period. Deposits denominated in foreign currency grew 19.3% y-o-y, compared to 20.7% in 2011 Q1.

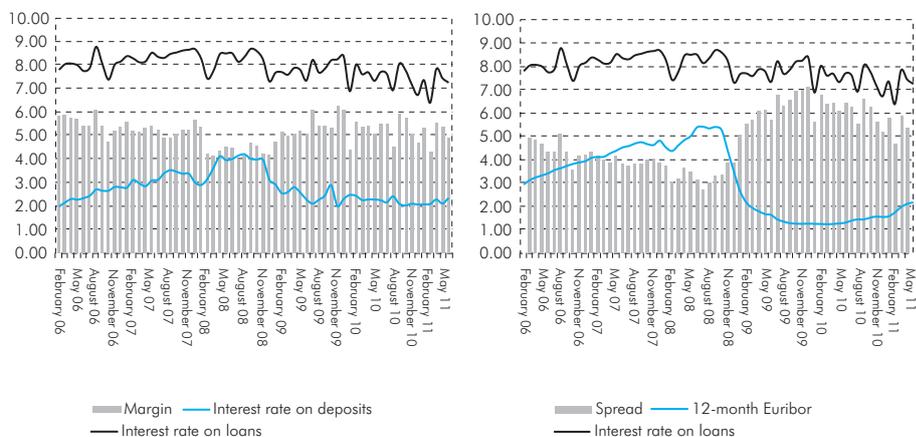
Chart 8 Intermediation in foreign currency



Source: Bank of Albania

The intermediation cost in Euro was stable in April and May. It maintained a similar level to 2011 Q1, 5.1%, as a result of the slight and simultaneous increase of the average interest rate on loans and deposits.

Chart 9 Intermediation cost in Euro

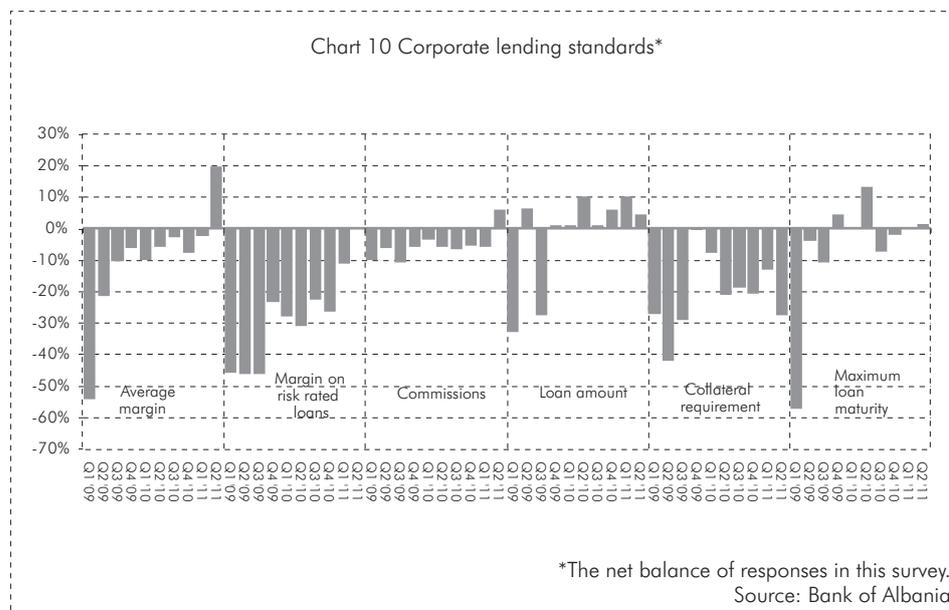


Source: Bank of Albania

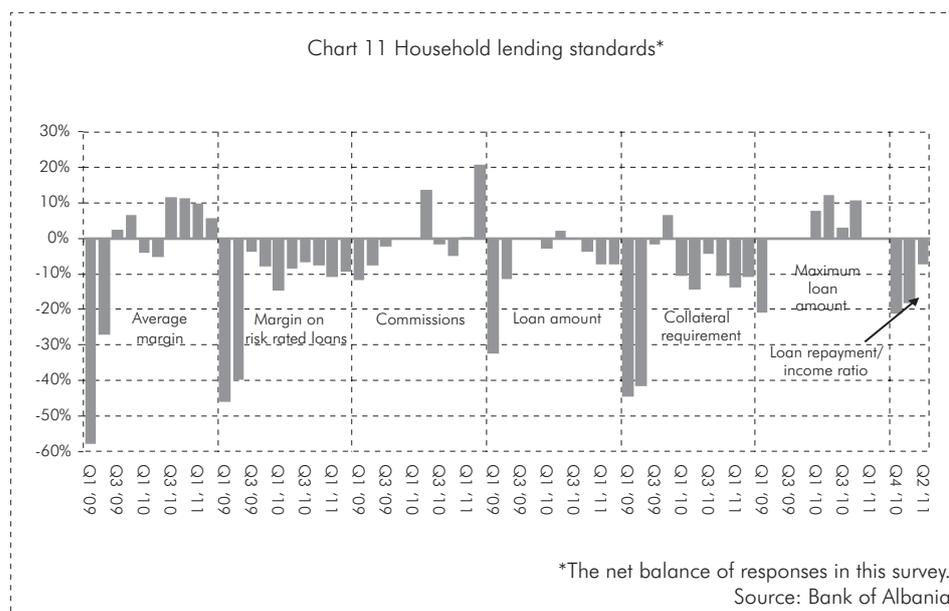
The cost of credit in Euro remains substantially higher than the reference rates of the Euro in the international interbank markets, hence reflecting the high cost of Euro deposits in Albania. However, following the improved liquidity situation in Albania and the increase of Euro interest rates in the international markets, the spread between the EUR deposits in Albania and Euribor rates has dropped considerably to below 1 pp. This has also been reflected in the decrease of the interest rate on EUR loans in Albania and the spread between them and Euribor rates. This spread currently stands at 5.2 pp, compared to 5.5 pp in 2011 Q1 and 6.3 pp in the corresponding period in 2010.

3.3 Non-Price Criteria in Intermediation

In addition to the interest rate, the performance of banking intermediation is also affected by non-price lending criteria, which determine the supply of credit. It is generally noticed that although the interest rates on loans have decreased, important criteria in determining potential borrowers' capacity to obtain loans still remain tight.



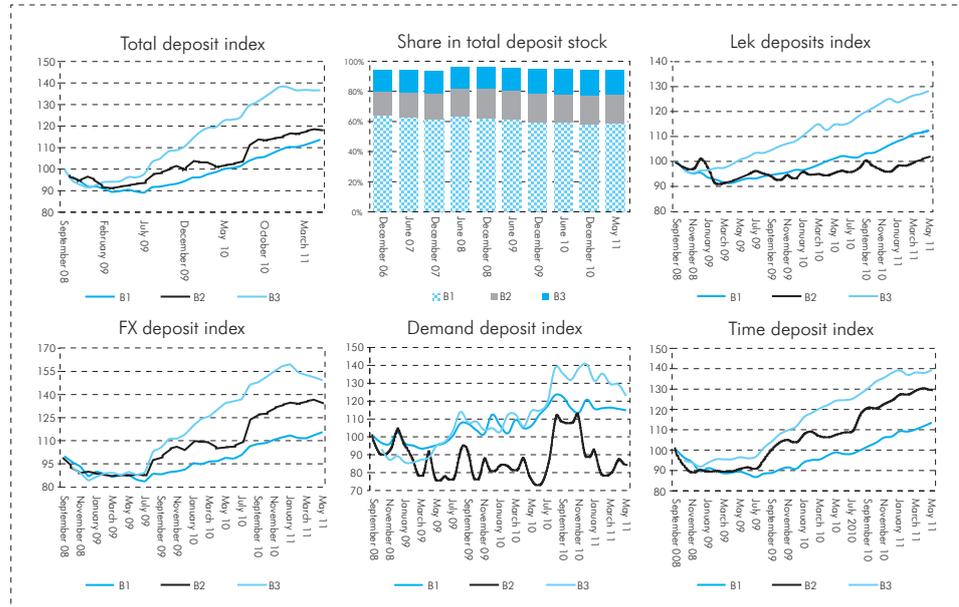
Corporate lending standards tightened in 2011 Q2. Lending price criteria – margin on normal risk rated loans and costs – eased for the first time in more than two years. The other two lending criteria – loan amount and maturity – also eased. On the other hand, the further increase in collateral requirements continues to restrain corporate borrowing capacity considerably.



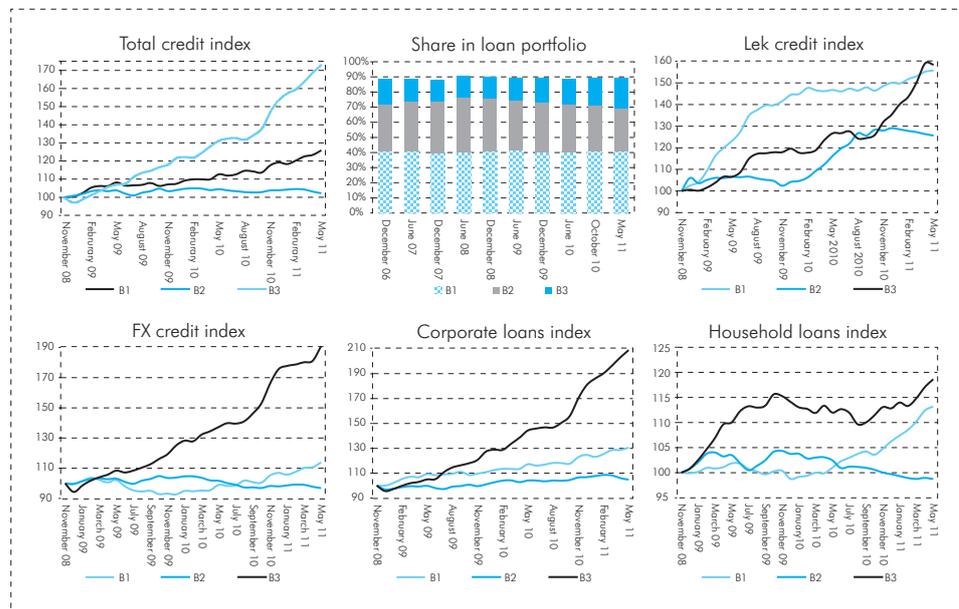
The lending standards applied to households continued to ease in 2011 Q2. In addition to easing the standards applied to the margin on normal risk rated loans, banks also applied easier lending policies by lowering the credit costs. Although the decrease of the main credit cost – the interest rate – is a key factor in lending, the latter is, to a great extent, also affected by other non-price criteria. More specifically, the tight lending standards applied to other criteria of household lending, such as the loan amount, collateral requirements and the rate of loan repayment/income, offset a good portion of the easing effect provided by the decrease of the interest rate.

ANNEX

DEPOSITS



LOAN PORTFOLIO



ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY 2011 Q1

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MONETARY POLICY DEPARTMENT, BANK OF ALBANIA, JULY 2011

BALANCE OF PAYMENTS DEVELOPMENTS, 2011 Q1

In 2011 Q1, the overall balance of payments recorded a decline in foreign assets by about EUR 77.1 million. The current account deficit widened by 4.7% y-o-y during this quarter, and accounted for about 11.7% of nominal GDP. Net foreign inflows in the capital and financial account amounted to about EUR 186.6 million, up 59.2% y-o-y. As a percentage of nominal GDP, net capital and financial flows are estimated at about 8.9% or 2.8 pp higher than in the corresponding quarter in 2010.

Table 1 Balance of Payments indicators

EUR million	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Merchandise	-601.34	-419.01	-482.93	-595.92	-584.85	-408.50
Export	205.51	254.91	340.47	270.29	305.86	370.59
Import	-806.85	-673.92	-823.40	-866.20	-890.71	-779.09
Services	34.47	-13.07	9.51	180.00	5.22	-46.04
Export	389.84	259.31	369.55	661.04	412.47	289.21
Import	-355.37	-272.38	-360.04	-481.04	-407.24	-335.25
Income	-30.53	-14.10	-11.21	-19.93	-31.61	11.74
Foreign Direct Investment	-70.64	-65.88	-56.08	-25.02	-73.71	-26.78
Current Transfers	272.76	210.86	282.46	190.62	237.69	196.43
Remittances (net)	226.84	170.05	219.47	135.15	165.10	153.14
Current Account	-324.63	-235.32	-202.18	-245.22	-373.55	-246.37
Capital and Financial Account	109.6	117.3	180.6	193.7	433.1	186.6
Capital Account	17.0	10.0	22.7	22.6	30.2	19.1
Financial Account	92.6	107.3	157.9	171.1	402.8	167.5
Foreign Direct Investment (inflows)	108.5	165.8	171.6	241.1	249.0	57.5
(a) shares and reinvested earnings	155.1	161.0	171.8	256.2	245.4	172.6
(b) other capital	-46.6	4.8	-0.2	-15.1	3.6	-115.1
Portfolio Investment (net)	4.1	-25.9	-25.0	-1.5	272.4	-20.9
Other Investment (net)	-14.9	-32.4	13.0	-78.9	-119.6	134.6
Errors and Omissions	128.3	100.6	31.9	111.7	66.2	-17.4
Overall Balance	-86.7	-17.4	10.3	60.2	125.7	-77.1

Source: Balance of Payments, Bank of Albania

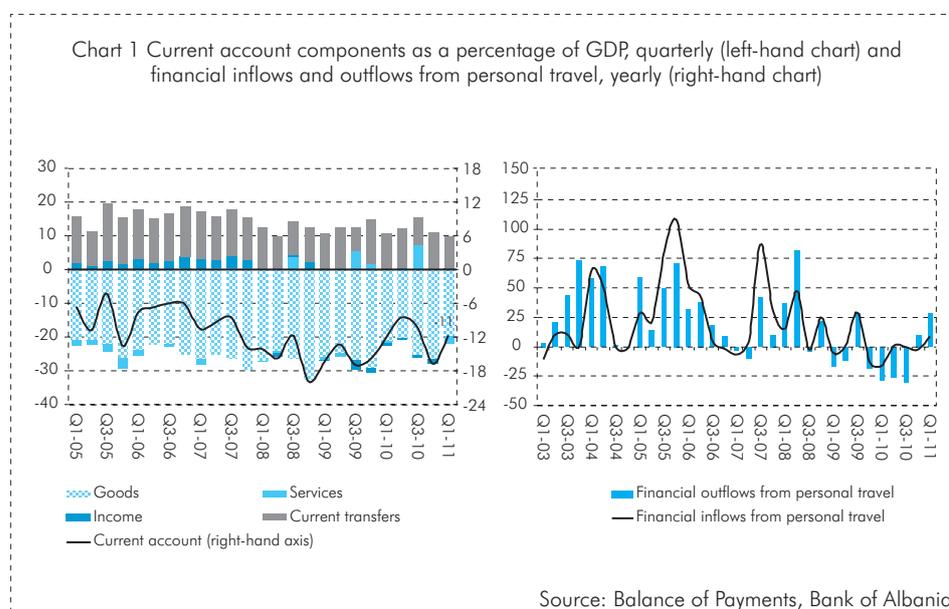
CURRENT ACCOUNT

Albania's net current account position recorded a deficit of EUR 246.4 million or about 11.7% of nominal GDP. In terms of value, this deficit continues to widen for the second consecutive quarter y-o-y. During the quarter

under review, it was 4.7% higher than in the corresponding quarter in 2010. However, as a percentage of GDP, in Q1, it was estimated at about 0.3 pp lower than the previous year. The deepening of the current account deficit in Q1 was broadly affected by the performance of the services and current transfers' account. Their combined net position deterioration compared to the same quarter in 2010 contributed to the deepening of the current account deficit. At the same time, the merchandise trade deficit widened by about 2.5% y-o-y. The contribution of net exports to the annual performance of aggregate demand was negative during 2011 Q1.

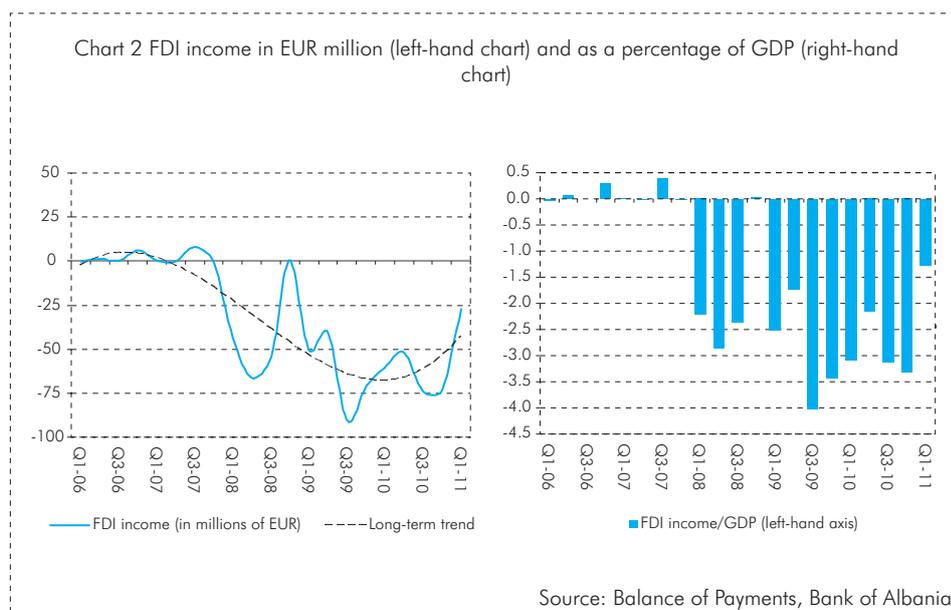
Services, Income and Current Transfers

Current account analysis by main items points out the widening of the net export deficit, as a key factor in the deterioration of this account position. Despite the slight annual narrowing of the merchandise trade deficit, the deepening of the net negative position of the services account conditioned the widening of the net export deficit by 5.2% y-o-y. The net position of the services account was negative in 2011 Q1 by about EUR 46 million, due to the increase in expenditures made by residents for personal travel, for tourism and business purposes. The application of the visa-free regime for Albanian residents has provided a significant effect, contributing to the increase in travel services' financial outflows by about 29% y-o-y. Although inflows from non-residents were higher in 2011 Q1 compared to the corresponding quarter in 2010, they could not offset the increase in expenditures of resident travellers abroad.

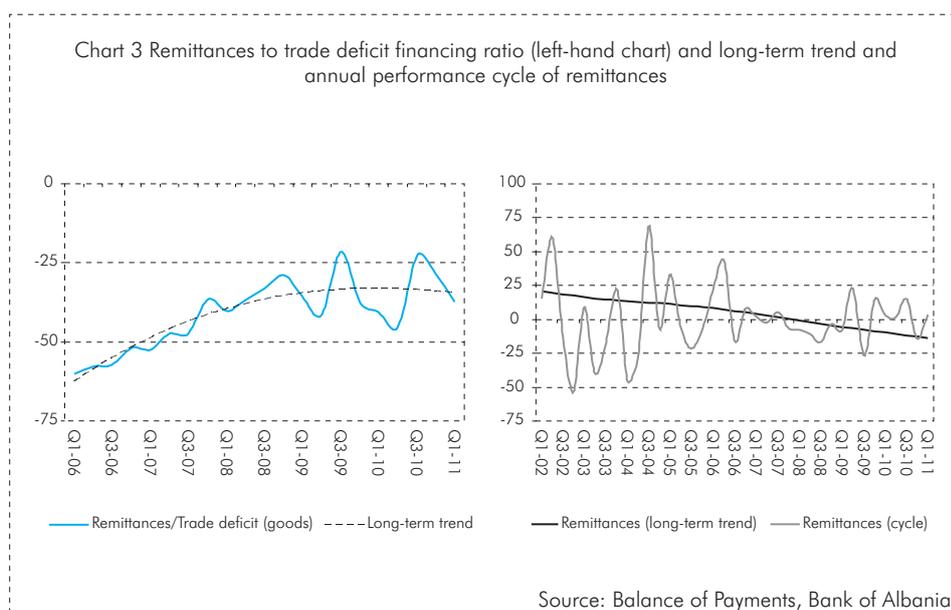


The net balance of the income account yielded a surplus of EUR 11.7 million in 2011 Q1, hence shifting from the trend in this account, after recording a net deficit for eight consecutive quarters. The decrease in profit repatriation on account of foreign direct investment (FDI) by about 55.9% y-o-y provided the major contribution to this performance. Although this decrease in profit

repatriation from foreign investors may imply implications for the profitability of their activity in Albania, its truthfulness may be confirmed by viewing the performance of this sub-item over the quarters ahead. However, judging from the trend of this sub-item over the last three years, its performance may be attributable to the reinvestment of their earnings in order to increase the production capacities. Net portfolio investment income increased by EUR 2.7 million, while income from net interest payments on debt increased by about EUR 10.9 million compared to the corresponding quarter in 2010.



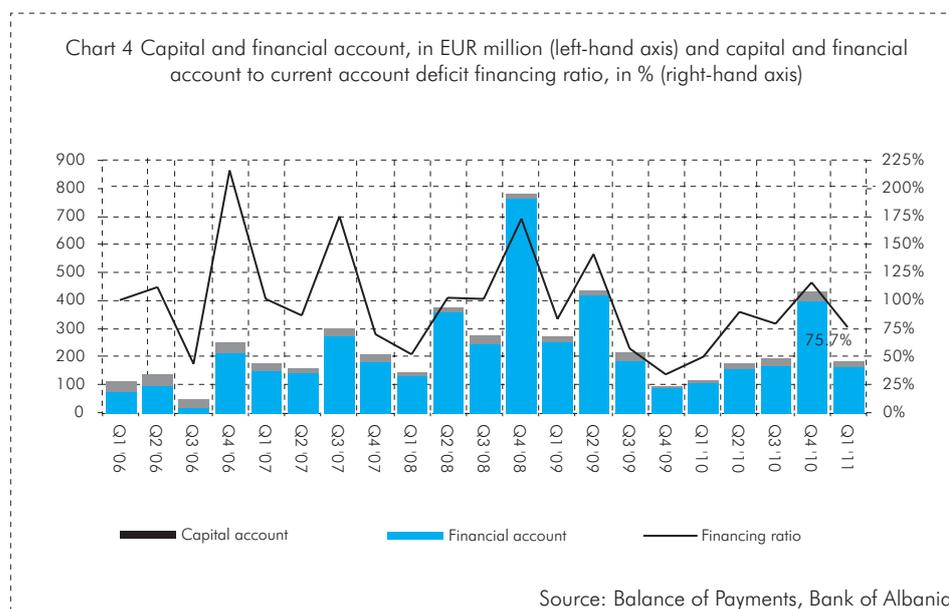
Current transfer surplus fell by 6.8% in 2011 Q1 compared to the corresponding quarter in 2010. Workers' remittances, the key sub-item in this account, maintained the annual downward tendency for the second consecutive quarter. In Q1, workers' remittances were about 10% lower y-o-y.



Statistical analyses provide evidence for their long-term downward trend, while short-term movements in remittances have been affected by external economic factors. More specifically, the high level of unemployment in Greece¹ is assessed to have provided a direct impact on workers' remittances to Albania. According to the latest data on 2011 Q1, workers' remittances sent from Albanian emigrants residing in Italy² are reported to have remained unchanged on a yearly basis. Remittances to trade deficit ratio is estimated at 37.5% or down 3.1 pp from the financing ratio in 2010 Q1. Trade deficit financing ratio has shown a declining trend since 2007.

Capital and Financial Account

In 2011 Q1, net foreign inflows in the capital and financial account amounted to about EUR 186.6 million, up about 59.2% y-o-y. As a percentage of nominal GDP, net capital and financial flows are estimated at about 8.9% or 2.8 pp higher than in the same quarter in 2010. Out of the total, EUR 19.1 million entered Albania in the form of capital investment grants and EUR 167.5 million in the form of financial flows. Despite the annual positive developments in this account, the surplus registered in 2011 Q1 was insufficient to fully finance the current account deficit. The latter's financing ratio was 75.7%, which, however, is about 25.9 pp higher than in the corresponding quarter in 2010.

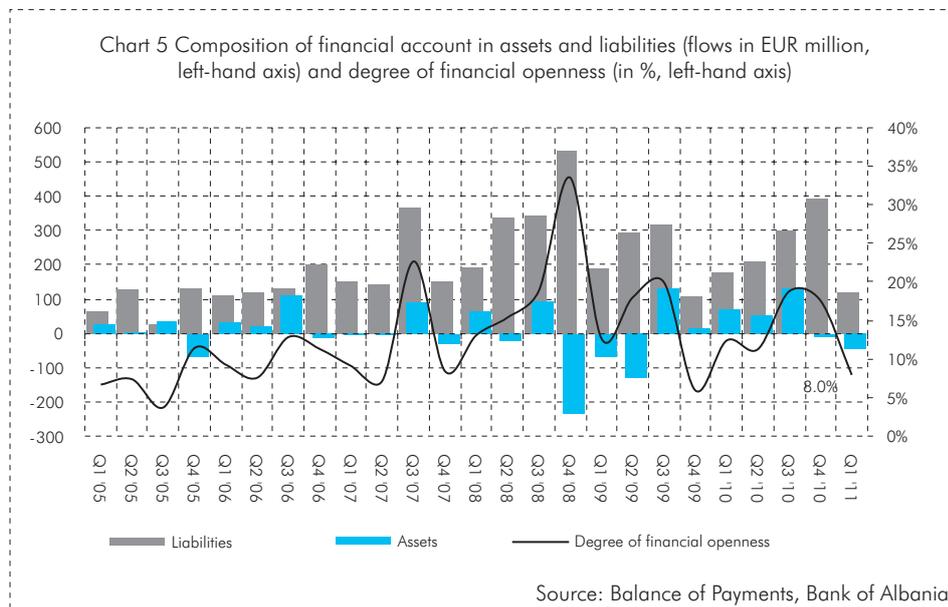


The net flow of financial transactions amounted to about EUR 167.5 million in 2011 Q1, up 56.2% y-o-y. Residents' financial liabilities to non-residents totalled EUR 119.6 million, down about 31.8% y-o-y. Albania's financial assets invested abroad fell by about EUR 47.9 million in 2011 Q1. In the same period in 2010, residents' financial assets invested abroad increased by

¹ Greece is the largest country the workers' remittances to Albania originate from. The latest data on emigrants' transfers from Greece refer to 2009 and their decrease fully explains the decline of workers' remittances to Albania. Italy is the second largest country the workers' remittances to Albania originate from.

² Banca d'Italia's data for Italy and Eurostat's data for Greece.

about EUR 68.1 million. Due to the foreign flow movements in the asset and liability items, the degree of financial openness³ in Albania was about 8.0% in 2011 Q1, 4.5 pp lower than in the previous year.



In 2011 Q1, net flows (inflows – outflows) of foreign direct investment amounted to EUR 53.8 million, down 67.5% y-o-y. In terms of direction of investment, FDI developments were largely determined by their inflows in Q1. In terms of instruments used in investment, FDI inflows in the form of shares and reinvested earnings amounted to about EUR 172.6 million in 2011 Q1, up 7.2% y-o-y. Other capital⁴ played an important role in determining the FDI inflows during 2011 Q1. This item registered capital outflows in the form of intercompany loans amounting to EUR 115.1 million during this period. In the meantime, developments in FDI outflows (residents' FDIs in foreign economies) were negligible during the period under review.

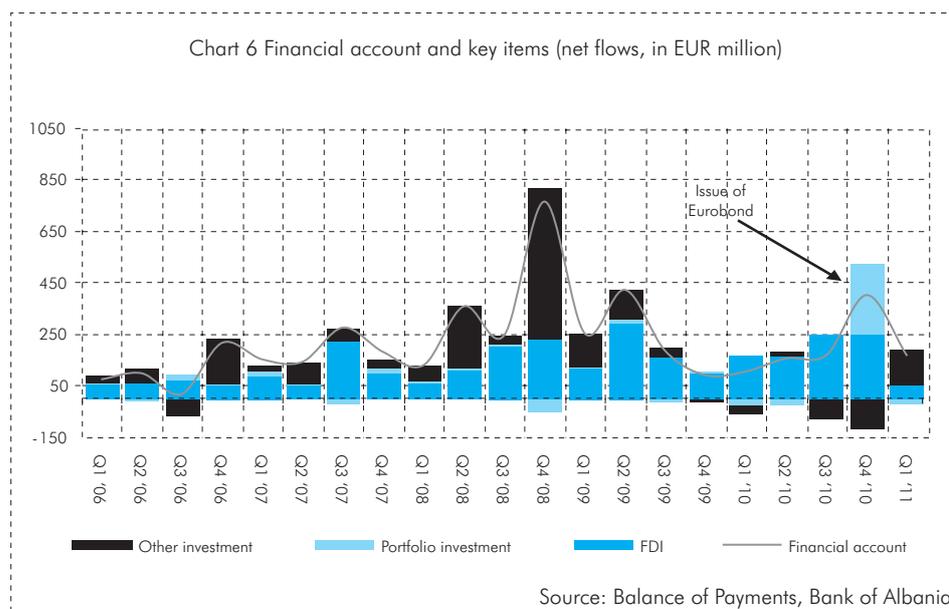
In 2011 Q1, net flows of portfolio investment (inflows – outflows) totalled EUR 20.9 million. In terms of direction of investment, the increase in portfolio investment was largely determined by their outflows. More specifically, in Q1, portfolio investment abroad contributed by about EUR 18.8 million to the increase in our assets invested in foreign economies, of which EUR 8 million were invested in shares and EUR 10.8 million in debt securities.

The other net investment account recorded a positive balance, contributing by about EUR 134.6 million to the increase in residents' liabilities to the rest of the world. The direction of financial flows in this account was determined by the increase in liabilities to the rest of the world and the decrease in our assets invested abroad. As a result of the almost equal increase in non-resident deposits held in Albania and foreign borrowing, our liabilities increased by about EUR 64.1 million. The net borrowing flow was about EUR

³ The degree of financial openness is measured as the sum of liabilities and the absolute value of financial assets as a percentage of nominal GDP.

⁴ Other direct investment capital covers the borrowing and lending of funds – including debt securities and trade credits – between direct investors and subsidiaries, branches and associates.

36.7 million in 2011 Q1, down 20.2% y-o-y. This decrease is attributable to the contraction of public borrowing by about 41.5%. Private borrowing totalled EUR 13.0 million or EUR 10 million higher than the corresponding period in 2010. Non-resident deposits held with domestic institutions grew by about EUR 37.3 million, compared to the decrease by EUR 9 million in 2010. Albania's financial assets invested overseas registered a decline by EUR 47.9 million, reflecting the fall in our banking system deposits held with non-resident financial institutions by about EUR 86.3 million.



In 2011 Q1, reserve assets fell by about EUR 77.0 million. At the end of the period, foreign reserve stock amounted to EUR 1,787.0 million, sufficient to cover 4.3 months of imports of goods and services.

PAPERS*

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

ACTUAL TO POTENTIAL TRADE BETWEEN ALBANIA AND ITS MAIN TRADING PARTNERS

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1. INTRODUCTION

Certain phrases, like regional integration, economic integration, free trade area and European integration, are the “words of the day” characterizing the relations between the South-East European (SEE) and the European Union (EU) countries. The EU originates as from 1950, as an initiative of political, trade and economic cooperation between six of its founding members (Belgium, France, Germany, Italy, Luxembourg and the Netherlands). The traditional economic approach to regional trade integration suggests that free trade agreements mainly generate the creation of trade between the member countries. There is broad consensus among the academics that the creation of free trade areas generates productivity, improved welfare and economic benefits to the member countries¹. The purpose of this article is to analyze the trade flows between Albania and its main trading partners in the region and EU through the gravity model. Actual trade flows are compared to potential trade flows, hence exploring the opportunities for intensifying trade with those trading partners where actual trade flows are below their potential.

2. LITERATURE REVIEW

Gravity models of trade are among the most widely used models in evaluating bilateral trade among countries. Linder (1961) and Linnemann (1966) are known as the founders/initiators of the gravity models of trade. Similar to the original theory of gravity², gravity models of trade express bilateral trade flows between two countries as a function of two key variables: as positively related (attracted) to the economic mass of two countries trading between them and inversely related to the distance between the capital cities of these two countries. More recent studies add four other variables to the gravity model equation (see Cheng and Wall, 2004). The first consideration is that countries speaking the same language are more likely to trade between them than otherwise (when they do not speak the same language). Second, countries sharing a common border trade more between them, mainly because transaction costs might be reduced due to closeness between these countries. Third, if countries have been part of the same political and administrative territory (such as former Czechoslovakia or former Yugoslavia), they are likely to have built trading ties throughout their common history, hence stimulating

¹ Pllaha, A., “EU-Albania Stabilization and Association Agreement. Trade Integration and Economic Implications”, 4th Research Workshop, 2010.

² Isaac Newton’s theory of gravity. This theory in physics explains the gravity force between two bodies as directly proportional to the size of their masses and inversely proportional to the square of the distance between them.

intensified trade flows between them. Finally, gravity models also consider the possibility of trade stimulation between a country entering a free trade area and constituent countries. For instance, Spain intensified trade with Euro area countries in the second half of the 1980s (Bussiere et al., 2005).

This paper uses a simplified gravity model equation proposed by Kaminski and de la Rocha (2003) and Frankel, Stein and Wei (1997)³, to measure potential trade flows between Albania and its main trading partners. The equation uses standard parameter values as follows:

$$\log T_{ij} = 0.7 \log (GDP_i * GDP_j) + 0.3 \log (GDPPC_i * GDPPC_j) - 0.7 \log (Distance_{ij}) \quad (1)$$

where: T_{ij} represents trade flows from country i to country j ; GDP stands for the total Gross Domestic Product; GDPPC stands for the Gross Domestic Product per capita; $Distance_{ij}$ denotes the distance between capital cities of the trading partners.

By means of this equation, we measure the potential trade flows. The results are later compared to the actual trade flows for each specific country.

The predicted results from the gravity model should be interpreted circumspectly since actual flows tend to be underreported, hence causing the gap between actual to potential trade flows to be smaller. This is due to the poor data quality and lack of reporting by each country.

Second, the equation has the tendency to exaggerate potential trade flows. As explained earlier, this equation uses the distance between the capital cities of the trading partners as an explanatory variable. However, SEE countries are characterized by poor infrastructure, leading as such to increased trading costs. Kaminski and de la Rocha (2003) emphasize the fact that Albania does not have very good transportation networks to most Balkan countries, apart from Greece. In addition, the distance variable between two countries does not take into consideration other costs related to transportation, such as time lags caused by border controls, cost of adapting the documentation to the importing/exporting country, etc.

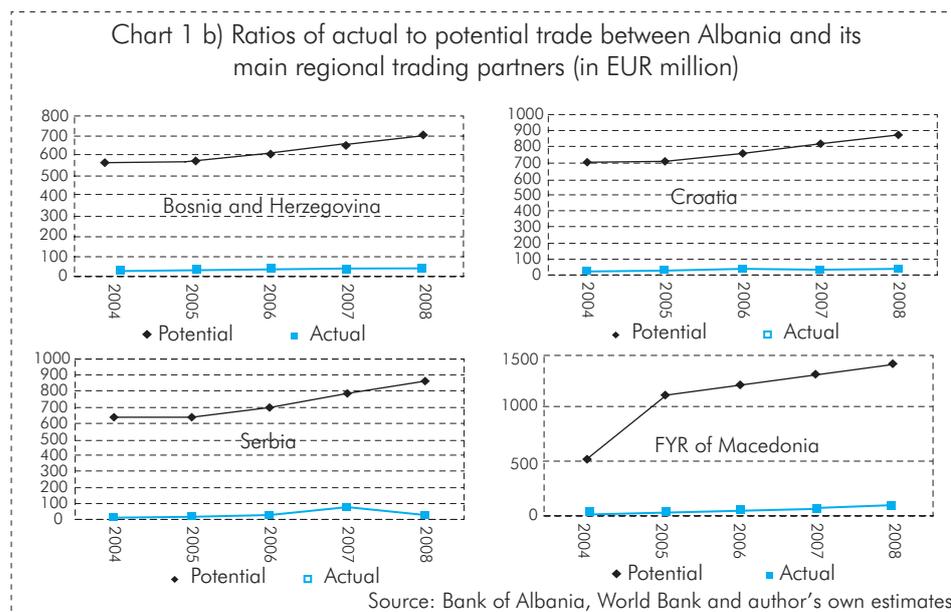
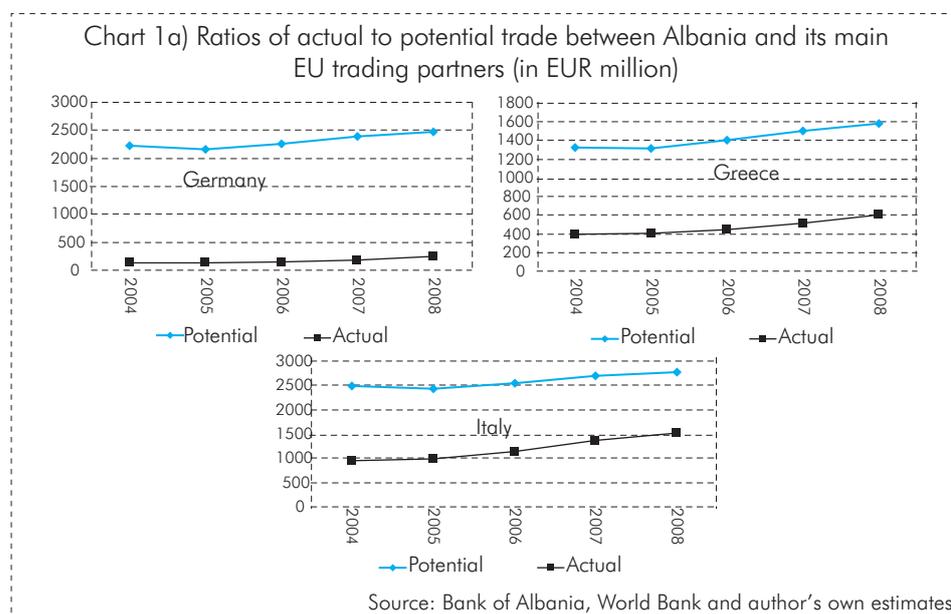
3. DATA SOURCES AND RESULTS: THE CASE OF ALBANIA

This article uses two main data sources applied to the above described gravity model: Bank of Albania and the World Bank. Reporting of actual annual trade volumes, expressed in terms of import and export flows for the period 2004-2008, and statistics from the Bank of Albania for Albania and each trading partner have been used. The data on Gross Domestic Product (GDP) and Gross Domestic Product per capita (GDPPC) have been obtained from the World Bank (World Development Indicators) for each specific country.

³ This simplified gravity model takes into consideration two main concerns characterizing the SEE region: the poor data quality and unreported trade flows between the Balkan countries (see Kaminski and de la Rocha, 2003).

The annual GDP and GDPPC original indicators are expressed in US dollars. For consistency purposes, the annual GDP and GDPPC are then expressed in Euros, using the official exchange rate of the Bank of Albania. The distance variables are obtained from the official website of Michelin⁴.

The application of the above model allows us to generate data for potential trade flows between Albania and seven of its main trading partners, among which the EU as Albania's main trading partner with its three member countries: Germany, Greece and Italy. Countries of the region represent an important group of trading partners for Albania, namely Bosnia and Herzegovina, Croatia, FYR of Macedonia and Serbia. Despite being an important regional trading partner, Kosovo is not included in the projections for potential trade due to insufficient data.



Note: The scale may differ across charts to enhance readability in accordance to trade flow differences across countries.

⁴ www.viamichelin.com

4. RESULTS

As mentioned earlier, based on the characteristics of this type of model, it should be noted that the results generated from the gravity model should be interpreted with caution. These projections, however, are to be considered as recommended indicators of the potential direction of changes.

Based on the results obtained from this model, we derive that: the graphical presentation of the actual to potential trade flows with Germany (see Chart 1 a)) reveals some interesting facts. As it can be clearly noticed, the actual (real) trade flows with Germany are far below their potential. Actual trade flows with Germany in 2008 were about 1/10th of their potential. Even though Germany is EU's main exporting country, trade flows with Germany remain below their potential. Projections from the gravity model suggest that Albania and Germany could intensify their trading volumes by about 90% more than the actual ones (see Chart 1 a)).

Gravity model projections on potential trade flows with Greece offer a different setting. Actual trade flows with Greece in 2008 were about 40% of their potential. Taking into consideration the above mentioned problem of underreported trade flows, it can be assumed that actual trade might be considerably higher than 40%. The proximity between Albania and Greece as two neighbouring countries might be one of the explanatory reasons why actual trade flows with Greece are more intense compared to trade flows with Germany.

As explained earlier, gravity models theory suggests that neighbouring countries are likely to trade more between them. Trading costs between the neighbouring countries tend to reduce due to closeness, cultural similarities, and historical trading networks.

The gravity model projects some interesting data about potential trade flows with Italy. Differently from the other two EU countries (Germany and Greece), trade flows with Italy are significantly more intense. Italy represents Albania's most important trading partner. In 2009, Albanian exports to Italy accounted for 62.60% of total Albanian exports, and 27.90% of total Albanian imports from abroad. However, the gravity model findings suggest that the actual trade with Italy is still below its potential. In 2008, actual trade flows with Italy accounted for only 54% of their potential. Taking into consideration the possible underreported data on actual trade flows, it can be said that trade flows with Italy are very close to their potential. Apart from the proximity factor, it appears that the large presence of Albanian expatriates in Italy and Greece is the key explanatory factor why trade flows with these two countries are much closer to the equilibrium level, unlike the case with Germany. Even though the actual trade flows with Germany, Greece and Italy are below their potential, an escalation of trade flows between Albania and these three trading partners is to be expected after the full implementation of the Stabilization and Association Agreement (SAA) (The SAA was ratified in spring 2009).

Chart 1 b) shows the graphical presentation of the gravity model projections for trade flows between Albania and four of its regional trading partners (Bosnia and Herzegovina, Croatia, Macedonia and Serbia)⁵. Gravity model projections suggest that the actual trade flows with Bosnia and Herzegovina are almost inconsiderable weighed against the potential trade flows. Similarly, actual trade flows with Croatia are far below the potential trade flows generated by the gravity model. Actual trade flows with Croatia accounted for only 4% of potential trade in 2008. The gravity model suggests the existence of a 90% potential to accelerate trade flows between Albania and Croatia. Even though trade flows with Serbia have increased significantly during the past five years, actual trade flows remain far below their potential. During 2007, actual trade flows with Serbia accounted for about 10% of their potential. Yet again, it can be concluded that there is room for trade intensification with these two regional trading partners. Albania and FYR of Macedonia share a common border and, as such, they are expected to have considerable trade flows between them. However, in practice, gravity model projections offer contradicting results to the theory suggestions. For instance, in 2008, actual trade flows with FYR of Macedonia accounted for only 7.5% of their potential. Gravity model projections suggest that actual trade flows during the previous years were even more disproportional to the potential trade.

Concluding, it can be stated that actual trade flows with the countries of the region are far below their potential. It is assumed that trade flows between Albania and the countries of the region are considerably lower than their potential due to the following reasons: First, during the communist regime, Albania turned into one of the most isolated countries; as such, Albania had no trading networks (trade ties) with the countries of the region. Second, several empirical studies suggest that statistical data on trade flows in the SEE are underreported. Kaminski and de la Rocha (2003) suggest that corrupted customs and high border taxes on certain products support smuggling activities among the Balkan countries. They suggest that actual trade flows between the countries of the region are considerably higher than as officially reported. Lastly, Albania inherited a poor transportation infrastructure with the countries of the region, which represents an enormous barrier for trade intensification between Albania and the countries of the region.

5. CONCLUSIONS

Gravity model findings on trade suggest that actual trade flows with Italy and Greece are close to their optimal levels. The model also suggests that trade flows between Albania and Germany could intensify by at least 90%. Actual trade flows between Albania and the countries of the region are considerably below their potential. Gravity model projections suggest that Albania could intensify trade flows with each of the countries of the region (Bosnia and Herzegovina, Croatia, Macedonia and Serbia) by at least 90%.

⁵ Despite being two important regional trading partners, Kosovo and Montenegro could not be included in the gravity model projections due to insufficient data.

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“EVALUATING THE VOLATILITY OF RESERVE HOLDINGS AND THE DEVIATION FROM THE OPTIMAL LEVEL: THE CASE OF ALBANIA”

GERTI SHIJAKU, RESEARCH DEPARTMENT

I. INTRODUCTION

The stock of reserve holdings of a country is the set of all liquid assets in foreign currency held by central banks as a guarantee to ensure the payment of obligations that may arise in the context of trade and financial transactions obligations. It is a public asset that could and should be used to guarantee the continuation of economic activity and financial stability in case of crises. Reserve holdings are generally held in the form of hard currencies or metals in a monetary or monetarised form, and they have the ability to generate profit when used in the money and capital markets. By definition, it can be understood that the security motive predominates the profit motive, and therefore, reserve assets are invested in safer investments with a low rate of return. Consequently, raising the level of reserve holdings has a high opportunity cost.

However, the overall definition fits and varies depending on the choices that countries make in terms of the degree of openness, external sector characteristics, economic model and the exchange rate regime. In general, reserve holdings would play a more active role in countries with fixed exchange rate regime, or in economies that use this mechanism as a tool to maintain comparative advantages in exporting industries, or to accommodate the negative effects of unstable foreign capital inflows as in the case of remittances and portfolio investments. In such cases, reserve holdings may serve:

- First, to support external trade policy and to avoid any difficulties in international transactions as a result of lack of liquidity in foreign currency;
- Second, to be self-insured against the fluctuations of foreign capital inflows, mainly remittances and foreign direct investment, and to accommodate the negative seasonality effects, speculative shocks and current account deficit effects caused by both public and private sector.

Generally speaking, globalization has brought some new tendencies relating to the stock of reserve holdings. The globalization process originally appeared through the reallocation of production to developing and transition countries. This promoted substantial foreign investment inflows and was followed by the growth of trade from developing to developed countries. These phenomena led to a substantial raise of trade surpluses and reserve holdings of the developing countries. Reserve holdings also increased in transition economies, which have experienced high current account deficits

driven by higher foreign direct investment inflows. These tendencies are also noted in small economies in South-Eastern Europe, which have accumulated large reserve stocks compared to the relative size of their economy. In contrast to these countries, Albania has accumulated reserves at a lower speed, in a framework of a floating exchange rate regime and a liberalized capital account, and persistent current account deficit.

Against a background of higher free capital mobility, financial integration increases the exposure to the volatility of capital flows (Aizenman and Marion, (2002) and Calvo, (1998)), while reserve holdings may serve to promote exports and channel domestic and foreign direct investments in the exporting industries (Aizenman and Lee, (2005)). Another explanation for holding reserves is that provided by Frenkel and Jovanovic (1981), who view reserve holdings as a guarantee to balance external sector shocks and accommodate flows in the balance of payments. This article attempts to assess the performance of foreign reserves and the nominal and real exchange rate in terms of the volatility of payments and receipts in the balance of payments¹.

II. METHODOLOGY AND DATA

The volatility of payments and receipts in the balance of payments is measured by the standard deviation from the long-term trend of changes in the stock of reserve holdings for a given period of time (see Prabheesha, et al., (2009), Ramachandran (2006), Ford and Huang (1994), Landell-Mills (1989), Frenkel and Jovanovic, (1981)). The disadvantage of this method is that it produces greater (increasing) biased estimation due to the re-accumulation of reserves, and lower (decreasing) estimation due to the rapid decline of reserve holdings during financial crises (Flood and Marion, (2002)). To avoid this, the change in the stock of reserve holdings (Silva and Silva, (2004)) and the average change in the real and/or nominal effective exchange rate (REER and NEER) (Ramachandran, (2006)) are adapted as proxies for the volatility of payments and receipts in the balance of payments.

The volatility of IR, REER and NEER was estimated through the Autoregressive Conditional Heteroskedasticity (ARCH) approach because the diagnostic ARCH-LM test indicates that the time series suffers from the ARCH effects. In this case, in order to generate a suitable variable to measure the volatility of payments and receipts in the balance of payments, different specifications of ARCH, GARCH, EGARCH, TGARCH, PARARCH and C-ARCH were tested, by adjusting the model specification used by Ramachandran (2006) and Silva and Silva (2004), mathematically expressed as:

$$\Delta IR_t = \delta_0 + \sqrt{h_t} * v \quad (1)$$

$$\Delta REER_t = \delta_0 + \sqrt{h_t} * v \quad (2)$$

¹ Shijaku, G., (2011), "Optimal Level of Reserve Holdings: An Empirical Investigation in the Case of Albania", published in "Economic Policies in SEE: Design, Performance and Challenges", Fullani, A., (2011), 4th South-Eastern European Economic Research Workshop, Bank of Albania.

$$\Delta NEER_t = \delta_0 + \sqrt{h_t} * v \quad (3)$$

where, δ_0 is a country-specific factor, which is a function of fixed costs of adjusting payments and receipts in the balance of payments; h_t is the square root conditional variance, and v_t is a random variable. The use of alternative ARCH approach aims to explain the volatility of reserve holdings especially during the period of economic crisis that swept Albania in the late 2008 and early 2009.

The time series on (IRt) represents the stock of reserve holdings and is the sum of gold, foreign currency tranches and stock Special Drawing Rights. The data are in millions of Euro and are taken from the Monetary Operations Department at the Bank of Albania. The data on (REERt) and (NEERt) are taken from the Research Department. The exchange rate is expressed as the national currency per unit of foreign currency. A rise in the exchange rate indicates the appreciation, and a decline indicates the depreciation of the Albanian Lek (ALL). The volatility of these variables covers the period 1996M1–2010M12.

III. EMPIRICAL RESULTS AND DISCUSSION

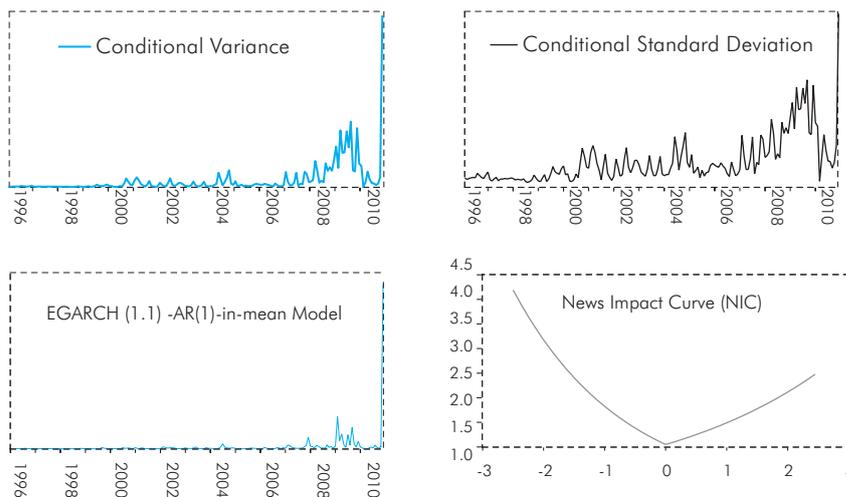
The best suitable model was selected based on the Akaike Info Criterion (AIC) and the diagnostic test of Q-statistic and ARCH LM-test. Thus, EGARCH(1,1)-AR(1)-in-mean model specification to measure the volatility of changes in reserve holdings, and EGARCH(1,1)-in-mean and EGARCH(1,2)-AR(12)-in-mean for the REER and NEER changes were selected as the best arrangement. Diagnostic tests on the models do not indicate problems with the serial correlation and ARCH effects on residuals.

The results (see Table 1a) show that the conditional standard deviation is statistically significant, implying that it affects the volatility of reserve holdings. The AR(1) is significant and improves the Q-square statistics test. The coefficient of the conditional shock $c(5)$ is statistically significant and positive. This implies that the conditional shock raises the conditional volatility of the reserve holdings. The coefficient $c(6)$ has a negative sign, even though it is statistically insignificant. This indicates that shocks have asymmetric effects on the volatility of reserve holdings. The magnitude of the coefficient, albeit statistically insignificant, confirms that positive shocks react positively by reducing volatility. This occurs mostly in response to a negative shock. This result (see Chart 2) is reconfirmed by the News Impact Curve (NIC). The magnitude and the significance of the coefficient $c(7)$ suggest that the degree of persistence of the shocks is high. This tendency is observed throughout the whole estimated ARCH type models, confirming that the impact of shocks to reserve holdings does not die out and has long-lasting effects (see Table 1).

The estimated results (see Chart 2) show that the volatility of changes in reserve holdings is higher during the period 2008M01-2010M02 and at the end of 2010. This owes to a number of reasons. First, during the period 2008M01-2010M02, the high volatility level corresponds to the economic

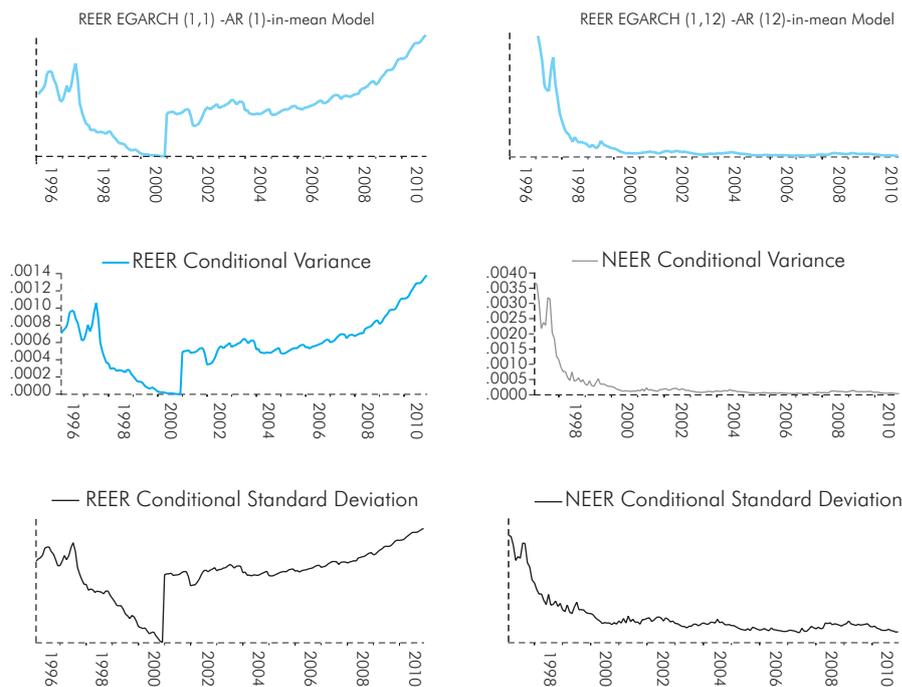
crisis that swept Albania due to the global financial crisis. In this aspect, volatility is affected by the fall of domestic demand during this period and the management of reserve holdings to cover a certain number of imports. Second, the level of reserve holdings, consequently their volatility, was affected by the stabilization of the Albanian Lek in the short run and the decisions on the payment of public debt. The higher level of volatility at the end of 2010 was due to the disbursement of foreign borrowing from the Ministry of Finance.

Chart 1 Volatility of reserve holdings based on EGARCH(1,1)-AR(1)-in-mean model



Source: Author's own estimates

Chart 2 Volatility of REER and NEER based on EGARCH-in-mean Model



Source: Author's own estimates

Results in Tables 2b and 2c show that the conditional standard deviation is statistically significant for REER. The coefficient of the conditional shock $c(5)$ is statistically significant, and for the REER (NEER) it is negative (positive). This implies that the conditional shock decreases (raises) the conditional volatility of the REER (NEER). The coefficient $c(5)$ (Table 2b) has a positive sign, while the coefficient $c(7)$ (Table 2c) has a negative sign. This suggests that shocks have asymmetric effects on the volatility of NEER and not on REER, albeit statistically insignificant. The magnitude and sign of the coefficient indicate that the volatility of REER (NEER) increases more in response to positive (negative) shocks. The models show that the degree of shocks is high and persistent, even though it is insignificant on NEER. Furthermore, the estimated results (see Chart 2) show that the volatility of changes in NEER is higher during the period 1997-1998, and normalizing thereafter. In the meantime, the volatility of changes in REER is higher during the period 1997-1998 and is again rising since 2001, reflecting more the changes in relative prices.

IV. CONTRIBUTION OF OTHER VARIABLES

The empirical assessment of the optimal level of reserve holdings (see Shijaku (2011)) shows that the actual level of reserve holdings is higher than the optimal level estimated by the model (see Chart 4). This is explained by the Monetary Approach to the Balance of Payments strategy pursued by the Bank of Albania to be self-insured against the fluctuations of foreign capital inflows. Empirical studies, however, show that the optimal level of reserve holdings is a stable function of some macroeconomic variables, among which the volatility of reserve holdings, as a result of capital flows, opportunity cost and imports of goods and services.

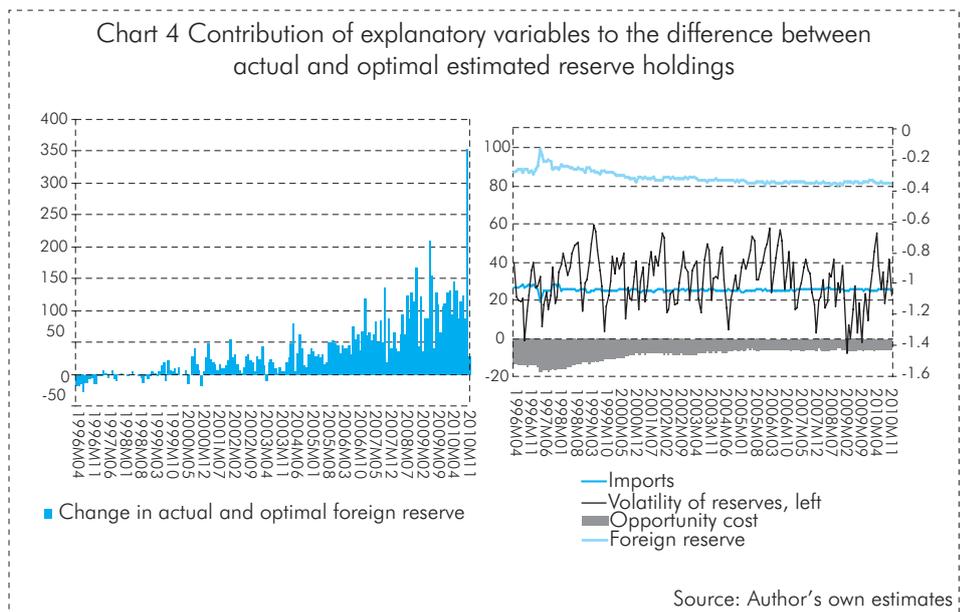
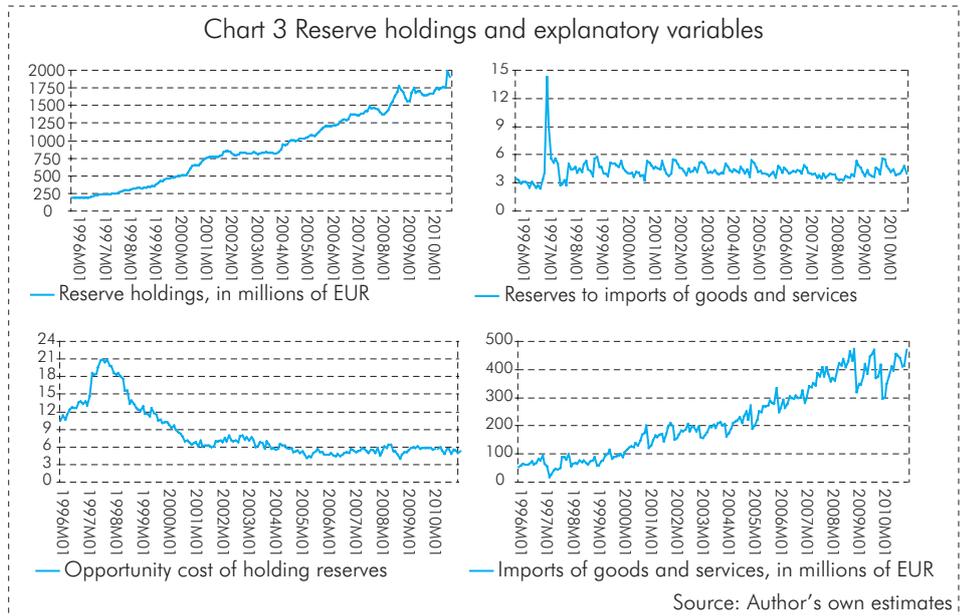
The elaborate analysis of the increasing difference between the actual and optimal level of reserve holdings was made by analyzing the weighted contribution of the specific impact of the macroeconomic variables included by Shijaku (2011) in estimating the optimal level. The weights of the contribution of each variable were based on the estimated long-run coefficients². The results show that the increasing difference between the actual and the optimal level has been mainly caused by the lower opportunity cost of holding reserves, thus affecting the increase of the level of reserves held by the Bank of Albania. In addition, the impact of the volatility of reserve holdings, albeit relatively low, was higher and variable mainly during the financial and economic crisis. Meanwhile, the contribution of the dynamic developments in reserve holdings and the imports of goods and services were constant during the period under review. This evidences that their impact, albeit high compared to other variables, was on the whole unchanged.

V. CONCLUSIONS

The purpose of this analysis was to assess the volatility of changes in

² This analysis was based on the estimated long-run coefficients (see Shijaku (2011), Table 7, page 169) and on the time dynamics of each variable.

foreign reserve holdings and the nominal and real exchange rate during the period 1996-2010. The results suggest that the economic and financial crisis had a more distinct impact on the dynamics of foreign reserve due to the foreign reserve management strategy pursued by the Bank of Albania and



the volatility of domestic demand. The exchange rate has generally been stable, although the increasing volatility of the real exchange rate reflects the upward tendency of relative prices. The analysis of the weighted contribution of each macroeconomic variable suggests that the increasing difference between the actual and the optimal level has been mainly caused by the lower opportunity cost of holding foreign reserve and the higher volatility in the level of accumulated reserves due to the economic and financial crisis.

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APPENDIX

Table 1 Information criteria of the estimated models (normal distribution)

Model	AIC	SIC	HQ	Serial Correlation Effects	Negative Coefficient in the Variance Equation	ARCH Effects
ARCH (11)	9.275463	9.346690	9.304345	No	No	[0.5625]
GARCH (11)	8.860027	8.949061	8.896130	Yes	No	[0.0112]
GARCH (11) - AR(1)	8.944731	9.054564	9.054564	No	No	[0.7190]
TGARCH (11)	8.869650	8.976490	8.912973	Yes	Yes	[0.0203]
TGARCH (11) - AR(1)	8.935122	9.060248	8.985864	No	No	[0.4375]
EGARCH (11)	9.092575	9.199414	9.135897	No	No	[0.6058]
EGARCH (11) - AR(1)	8.987551	9.112877	9.038495	No	Yes	[0.9179]

Table 2a EGARCH (11) – AR(1)-in-mean model for dIR (normal distribution)

Dependent Variable: dIR				
Method: ML - ARCH (Marquardt) - Normal distribution				
Sample (adjusted): 1996M03 2010M12				
Included observations: 178 after adjustments				
Convergence achieved after 112 iterations				
Pre-sample variance: backcast (parameter = 0.7)				
LOG(GARCH) = C(4) + C(5)*ABS(RESID(-1)/@SQRT(GARCH(-1))) + C(6)*RESID(-1)/@SQRT(GARCH(-1)) + C(7)*LOG(GARCH(-1))				
	Coefficient	Std. Error	z-Statistic	Prob.
@SQRT(GARCH)	0.179143	0.087136	2.055907	0.0398
C	7.751772	1.630941	4.752943	0.0000
AR(1)	0.452236	0.057105	7.919381	0.0000
Variance Equation				
C(4)	-0.101686	0.411550	-0.247082	0.8048
C(5)	1.554286	0.435741	3.566996	0.0004
C(6)	-0.312856	0.209856	-1.490815	0.1360
C(7)	0.849841	0.090535	9.386923	0.0000
R-squared	-0.469417	Mean dependent var		9.599526
Adjusted R-squared	-0.520976	S.D. dependent var		31.72249
S.E. of regression	39.12266	Akaike info criterion		8.987751
Sum squared resid	261729.6	Schwarz criterion		9.112877
Log likelihood	-792.9098	Hannan-Quinn criter.		9.038493
Durbin-Watson stat	2.370426			
Inverted AR Roots .45				

Dependent Variable: DLOG(REER)				
Method: ML - ARCH				
Sample (adjusted): 1996M02 2010M12				
Included observations: 179 after adjustments				
Convergence achieved after 22 iterations				
Pre-sample variance: backcast (parameter = 0.7)				
LOG(GARCH) = C(3) + C(4)*ABS(RESID(-1)/@SQRT(GARCH(-1))) + C(5)*RESID(-1)/@SQRT(GARCH(-1)) + C(6)*LOG(GARCH(-1))				
	Coefficient	Std. Error	z-Statistic	Prob.
@SQRT(GARCH)	-0.743097	0.090018	-8.254986	0.0000
C	0.011058	0.001447	7.641938	0.0000
Variance Equation				
C(3)	-0.095318	8.44E-05	-1129.304	0.0000
C(4)	-0.029071	2.64E-09	-11014674	0.0000
C(5)	0.083754	0.021803	3.841314	0.0001
C(6)	0.987315	1.03E-07	9627658.	0.0000
R-squared	0.008603	Mean dependent var		-0.001798
Adjusted R-squared	-0.020050	S.D. dependent var		0.022531
S.E. of regression	0.022756	Akaike info criterion		-5.171984
Sum squared resid	0.089586	Schwarz criterion		-5.065144
Log likelihood	468.8925	Hannan-Quinn criter.		-5.128661
F-statistic	0.300237	Durbin-Watson stat		1.240005
Prob(F-statistic)	0.912189			

Table 2b EGARCH (1,1)-in-mean model for dlog (REER)(normal distribution)

Dependent Variable: DLOG(NEER)				
Method: ML - ARCH				
Sample (adjusted): 1997M02 2010M12				
Included observations: 167 after adjustments				
Convergence achieved after 24 iterations				
Pre-sample variance: backcast (parameter = 0.7)				
LOG(GARCH) = C(5) + C(6)*ABS(RESID(-1)/@SQRT(GARCH(-1))) + C(7)*RESID(-1)/@SQRT(GARCH(-1)) + C(8)*LOG(GARCH(-1)) + C(9)*LOG(GARCH(-2))				
	Coefficient	Std. Error	z-Statistic	Prob.
@SQRT(GARCH)	-0.258491	0.249465	-1.036183	0.3001
C	0.000675	0.001777	0.379808	0.7041
AR(1)	0.236256	0.069688	3.390192	0.0007
AR(12)	0.183470	0.062415	2.939497	0.0033
Variance Equation				
C(5)	-0.737533	0.376449	-1.959183	0.0501
C(6)	0.318137	0.154865	2.054278	0.0399
C(7)	-0.094910	0.090280	-1.051290	0.2931
C(8)	0.569088	0.637559	0.892603	0.3721
C(9)	0.380631	0.615127	0.618784	0.5361
R-squared	0.157560	Mean dependent var		-0.000822
Adjusted R-squared	0.114905	S.D. dependent var		0.022439
S.E. of regression	0.021110	Akaike info criterion		-5.813511
Sum squared resid	0.070412	Schwarz criterion		-5.645475
Log likelihood	494.4282	Hannan-Quinn criter.		-5.745309
F-statistic	3.693799	Durbin-Watson stat		1.374214
Prob(F-statistic)	0.000558			
Inverted AR Roots	.89	.77+.43i	.77-.43i	.45-.75i
	.45+.75i	.02+.87i	.02-.87i	-.42-.75i
	-.42+.75i	-.73+.43i	-.73-.43i	-.85

Table 2c EGARCH (1,2)-AR(12)-in-mean model for dlog (NEER) (normal distribution)

“REMITTANCES IN ALBANIA OVER THE PERIOD 1996-2010 AND THEIR KEY DETERMINANTS” ESIDA ABAZAJ, RESEARCH DEPARTMENT¹

1. INTRODUCTION

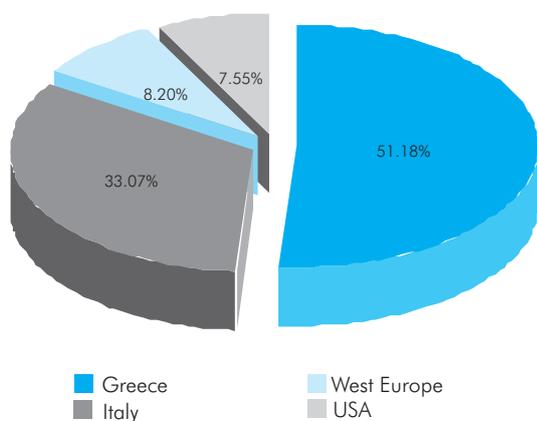
Workers' remittances constitute a very important source of foreign exchange in Albania, accounting for about 12.5% of Gross Domestic Product (GDP) and 14.43% of consumption over the last 15 years. These transfers are a key component of the Bank of Albania's Balance of Payments, accounting for about 80% of current transfers. In addition, compared to other sources of foreign financing (exports or foreign direct investment), remittances have “a private profile”, implying that they are unlikely to end up in the hands of the government officials.

Over the last three years, Albanian emigrants' remittances have attracted much attention from the policymakers, media and international organizations in Albania. Such attention mostly stems from their progressive and considerable slowdown in the last three years, as well as their significance to the Albanian economy and to the remittance-recipient households. It is, therefore, important to empirically study and analyze the key determinants or driving forces behind the remittances behaviour, and to use these forces, if possible, to attract more remittance flows.

2. STYLIZED FACTS – SIGNIFICANCE OF REMITTANCES TO THE ALBANIAN ECONOMY

Despite the small population, Albanian migration, as Russel King puts it, is “a type of laboratory on studying new migration processes”, because of its dynamic, chaotic and illegal streams of migration that have prevailed during all stages of transition, though with different degrees of intensity. According to the latest available official data, it is estimated that around 1.2 million Albanians were practising emigration in 2008, accounting for a considerable part of the Albanian population (about 25%). Around 85% of them live and work in Greece and Italy, and the rest in Western Europe and the U.S. (see Chart 1).

Chart 1 Albanian emigrants by host country



Source: DEVINPRO Consortium Members Fact Sheet

According to Bank of Albania's official data,

¹ For more information, refer to “Macroeconomic Determinants of Remittances: The Case of Albania”, 4th South-Eastern European Economic Research Workshop, Bank of Albania.

remittances in Albania have increased at an annual average rate of 5.6% during the last 15 years. This rate was much higher until 2007 (about 10.37%), but it has dropped significantly in the last three years, registering an annual decline of 15.21%, 6.56% and 13.06% in 2008, 2009 and 2010, respectively (see Chart 2).

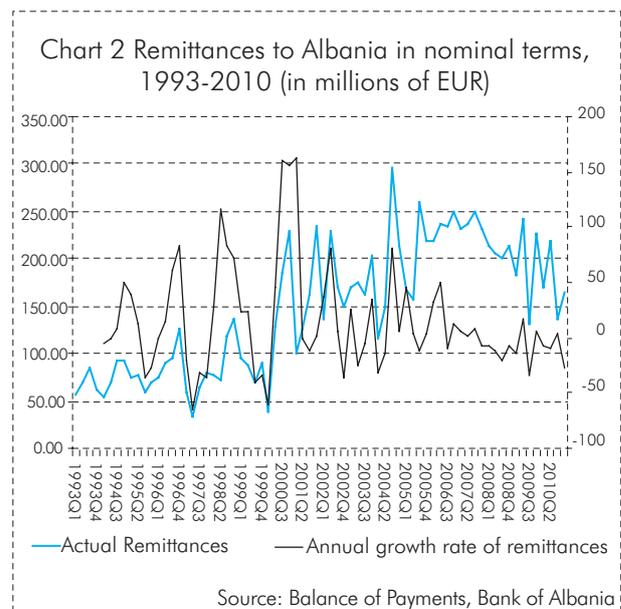
Gëdeshi (2010) mentions two main factors responsible for the progressive reduction of remittances. First, the recent global economic crisis affected countries like Italy and Greece significantly. The crisis in these countries affected the Albanian emigrants' employment opportunities and income levels adversely, which in turn led to their lower ability to save and remit. Second, as widely accepted by various studies (Docquier, Rapoport 2005; IOM, 2005), remittances have a long-term downward trend. Over time, emigrants have their status regularized, establish new families in the host country, or unite with the rest of the family in migration, which all lead to weakening of relationships with the country of origin.

There is, however, a lot of controversy and debate whether the progressive reduction in remittances over the last three years is due to the global economic crisis affecting the countries emigrants live and work in, or due to weaker relationships between emigrants and their households in the country of origin.

The 2008 survey of remittance-recipient households showed that 94% of remitters are the households' children (son or daughter), who account for about 80% and 15% of total emigrants, and share 81% and 5% of total remittances, thus supporting the persistence and continuation of household relationships in the medium run, and subsequently, of remittance flows.

According to official statistics, remittances are significant given the size of the Albanian economy (see Chart 3). Among 8 countries in the region, Albania is ranked the third in terms of the remittances-to-GDP ratio, being exceeded only by Bosnia and Herzegovina (14.90%) and Kosovo (13.41%). However, the magnitude of remittances is yet questionable, due to the methodology employed in measuring them.

Since 1996, remittances to Albania constitute an important source of foreign financing, accounting for about 12.51% of GDP, compared to 21.08% of GDP in exports and 4.35% of GDP in foreign direct investment. However, in the last two years, the latter seem to converge to the remittances-to-GDP ratio, thus offsetting the reduction in remittances on macroeconomic terms (see Chart 3).



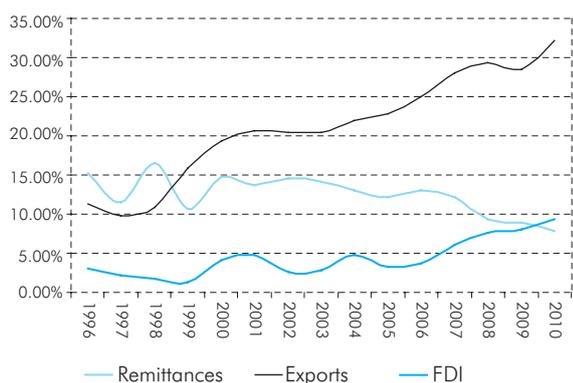
Another important stylized fact worth mentioning in the discussion of foreign flows is the volatility of these flows, measured as the ratio of standard deviation

to the mean. Judging by this measure, remittances are less volatile than the exports of goods and services and foreign direct investments, hence, making them a very attractive source of foreign financing. The standard deviation of remittances is about 33.69% of the mean, compared to 68.16% of exports and 91.23% of foreign direct investments (see Chart 3).

The cyclicity of remittances with the economic activity of the country of origin has been widely discussed by literature, which has produced mixed and contrary findings. Chami et al. (2003), using panel estimation methods for 114 countries over a 30-year period, concluded that remittances are countercyclical, supporting the hypothesis that remittances are altruistically motivated. An IMF study in 2005 found an insignificant statistical relationship between remittances and real per capita output growth of the country of origin, regardless of the financial development.

Chart 3 Stylized facts about remittances to Albania

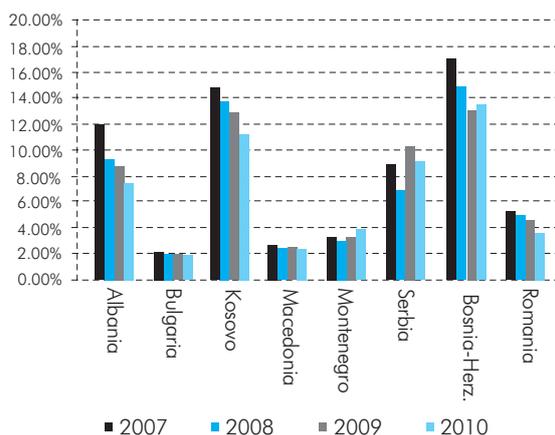
a) Sources of foreign financing in Albania 1996 - 2010 (% of GDP)



Source: Bank of Albania, IMF and Albanian Institute of Statistics

Chart 3 Stylized facts about remittances to Albania

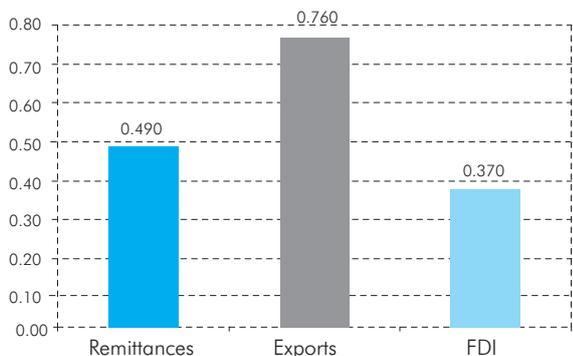
b) Comparative view: Remittances to countries in the region



Source: Bank of Albania, IMF and Albanian Institute of Statistics

Chart 3 Stylized facts about remittances to Albania

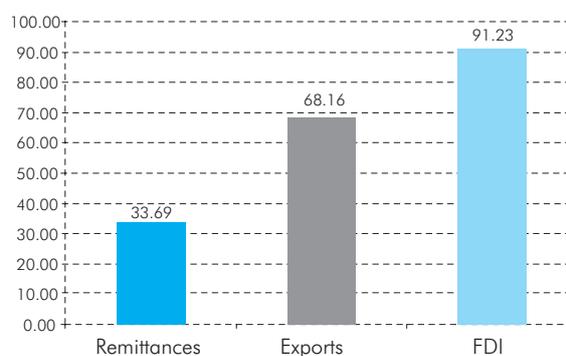
c) Cyclicity of inflows 1996-2010



Source: Bank of Albania, IMF and Albanian Institute of Statistics

Chart 3 Stylized facts about remittances to Albania

d) Volatility of inflows 1996-2010



Source: Bank of Albania, IMF and Albanian Institute of Statistics

In order to study the cyclical characteristics of remittance flows, we follow the Hodrick-Prescott filter technique, which decomposes the time series of output and remittances into their cyclical components and stochastic trend (Giuliano and Ruiz Arranz, 2005). If remittances are remitted for altruistic reasons, the correlation between the cyclical component of remittances and output is statistically significant and negative. In case remittances are profit-driven (sent for investment purposes), the correlation coefficient should be statistically important and positive. Lastly, remittances are considered a-cyclical if the correlation coefficient is not statistically significant, either positive or negative (Giuliano and Ruiz-Arranz, 2005). Chart 2 shows the correlations of the cyclical components of remittances, exports of goods and services, and foreign direct investments with the cyclical components of Albanian GDP. Remittances show a positive correlation of 0.49 with Albanian GDP, which is considerably smaller than that of exports. The positive sign of the correlation seems to contrast the findings of the Bank of Albania's survey on remittance-recipient households, studies of the World Bank, IMF, other institutions, which converge to the same results: "remittances are sent for the daily consumption needs and they represent a restricted source of capital for investment and for the financing of the stable economic development of the country of origin" (Economic Bulletin, Bank of Albania, No. 3). According to these studies, remittances are expected to show a negative correlation with output (see Chart 3). It is, however, noteworthy to mention that the correlation coefficients shown in the chart should be interpreted carefully as they are not checked for their statistical significance.

3. DATA AND METHODOLOGY

Following the literature on macroeconomic determinants of remittances, we classify the main variables that may affect remittances behaviour into three main groups: variables that represent the macroeconomic situation of the host country; variables that represent the macroeconomic situation of the home country; and variables that capture the relationships between the host and home country. The primary research question is to determine which macroeconomic conditions (host/home/both/none) the Albanian emigrant takes into account when deciding how much to remit. In trying to answer this question, we also find some explanation and interpretation on two other issues. One regards the question: "Why do Albanian emigrants remit?" The second issue regards: "Can Albania attract more remittances? How?"

To represent the macroeconomic conditions of the home country, we use the Albanian GDP, obtained from the Albanian Institute of Statistics. The economic activity of the home country is used in many studies as a proxy to reflect the employment and income-generating opportunities of emigrants' households (Sayan and Tekin-Koru, 2007; El-Sakka, 2005; and Eric Lueth and Marta-Ruiz Arranz, 2007). However, the effect of GDP on remittances depends on the motive driving the remitting behaviour. If altruism is the main motive to remit, negative shocks to home output will encourage emigrants to remit more. However, if remittances are remitted for investment purposes, then negative shocks to home output will reflect deteriorated investment

opportunities and, therefore, lower remittances.

To represent the host country, we use the weighted average unemployment rate of Greece and Italy, given that 85% of Albanian emigrants are located in these two countries. In order to construct the index, we give weight to the unemployment rate of these countries based on their share of remittances sent. Previous studies show that host-country output is a significant determinant of workers' remittances because it translates into higher labour demand, higher wages, higher income and, therefore, higher remittances transfers. In this study, we choose to represent the host-country macroeconomic conditions with the unemployment rate rather than the GDP, since the former is considered a better proxy of income-generating opportunities of emigrants due to their possible social marginalization (Higgins et al., 2004). Data on the unemployment rates of Italy and Greece are obtained from the European Central Bank Statistics.

To represent the relationship between the host and home country, we use the nominal exchange rate of ALL/EUR obtained from the Bank of Albania. Previous studies show that the exchange rate effect on output is ambiguous.

The data used in the econometric approach cover the period from 1996 to 2010, in quarterly terms. That is, the number of observations is 60.

The data on remittances are obtained from the Bank of Albania's Balance of Payments, and they include monetary transfers of emigrants employed in the host country and considered residents in the economy of this country². Official data on remittances include the transfers sent through formal channels (commercial banks or money transfer agencies) and informal channels (cross-bordering in cash). While the former can be measured automatically, the latter are estimated as the difference between foreign currency coming in (exports of goods and services, credits and foreign investment) and foreign currency coming out (imports of good and services, foreign currency going out through the banking system). We understand that the measurement methodology, coupled with the dynamic and chaotic pattern of the Albanian emigration and remittances behaviour, might impose some limitation to our study, which should be borne in mind as they might influence our empirical findings.

This study employs the Vector Error Correction Model (VECM) to study the long and short-term dynamics of remittances. The use of VECM solves the problem of endogeneity, which might exist between remittances and other macroeconomic variables. Several studies have found that remittances affect other macroeconomic variables, such as investment or consumption in the home country (Acosta et al. 2007). In the case of Albania, there is no empirical evidence on how remittances affect the home country macroeconomic variables, except for stylized facts and various surveys. The 2008 Bank of Albania survey results on remittance-recipient households show that about

² According to the definition provided by the BoP manual, persons who work for and stay in new economies for less than a year are considered non-residents, and their transactions/transfers are included in "compensation of employees".

30% of monthly income for households obtaining these transfers derives from workers' remittances. The survey also shows that once these remittances join the household basket, they may be used for productive or unproductive households' needs; may increase the households' dependency on these flows and consequently, increase the unemployment rate; or they may be used for increasing investment in businesses or real estate.

4. MAIN FINDINGS

This study found that remittances, both in the long and short run, depend solely on the macroeconomic conditions of the host country, which is proxied by the weighted unemployment rate in Greece and Italy. An increase of the unemployment rate by 1 percentage point, decreases remittance transfers by 0.13% in the long run. The other two explanatory variables used in this study proved statistically insignificant, both in the long and short run, thus rejecting the conventional hypothesis that remittances are primarily remitted to meet the consumption needs of the emigrants' households in the home country. The only finding supporting the altruism hypothesis is the fast adjustment of remittances to their long-term equilibrium, as shown by the high and statistically significant error correction term. In addition, the study found no evidence of the investment motive driving Albanian emigrant's remitting decision.

These findings have important policy implications for Albania, to which remittances represent a major source of foreign financing. First, remittances are another important channel through which economic developments and shocks in the Euro area may be transmitted to Albania. Second, if Albania wants to increase remittance transfers over the long run, it should focus more on the demographic and individual characteristics of the Albanian emigrants, as these flows are not that responsive to home country macroeconomic developments.

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MICROCREDIT IN ALBANIA

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The role and contribution of microfinance to one's country economic development is considered highly important. In addition to the social role in supporting the poor and strengthening certain segments of the population in the social and economic life, microfinance is also viewed as a promoter of economic development. It compensates the absence of commercial banks in urban and rural areas by responding to the needs of individuals and small-sized businesses uncovered by the banking sector. According to INSTAT's data, small and very small-sized businesses in Albania account for 90% of total entrepreneurship¹, hence representing the key driver of the economy. The majority of them focus on services and trade, thus proving their micro nature. The development of these businesses is closely related to their opportunities to be financially supported. Hence, microcredit institutions help develop the economy, contribute to employment and improve the standard of living.

STRUCTURE OF MICROCREDIT SECTOR

The package of microfinance service in Albania primarily consists of the provision of microcredit. The history of microcredit in Albania began in the early 1990s with the assistance of various international organizations and government's commitment to develop and consolidate this financial market segment. However, microfinance service providers, licensed and supervised by the Bank of Albania started their activity in 2002. The products of the first microfinance programme in Albania are two Credit Unions, whose lending methodology was based on the principles of financial cooperative. Unlike other microcredit institutions, they operate with the collection of deposits.

In the recent years, microcredit has also attracted the interest of banks, given the advantage of their portfolio diversification. The first bank in the market that has offered this service is ProCredit Bank, which since its establishment has been identified as an institution with expanded activity in microcredit. Other banks are Credins Bank and National Bank of Greece – Albanian Branch. Their share in total microcredit portfolio is significant, while the number of clients is more limited. Currently, there is no high competition in this market because there is no major overlap of microcredit services in the same geographical areas. Therefore, providing this service from banks is considered positive, enabling in this way the coverage of customers' needs for credit.

¹ Based on INSTAT's classification of enterprises according to the number of employed people (1-4 employed people). The data refer to end-2009.

Table 1 Microcredit market segmentation at the end of 2010, by institution type

Entity	Total portfolio (ALL million)	NPLs/total portfolio	No. of active borrowers	Total deposits (ALL million)	Urban	Rural
Non-bank financial institutions (1)	11,492.88	9.45%	42,789			
NOA sh.a.	4,736.13	11.08%	17,904	-	√	
Besa Fund sh.a.	4,558.67	7.58%	17,954	-	√	
First Albanian Financial Development Company sh.a.	1,970.22	10.18%	4,452	-	√	√
Vision Fund Albania sh.p.k.	215.62	6.93%	2,459	-	√	
Capital Invest sh.a.	12.24	0.00%	29	-	√	
Savings and Loan Associations (2)	4,475.33	4.13%	41,663¹	1,776.32		
SLAs' network of Albanian Savings and Credit Union (100 SLAs)	4,003.81	3.81%	31,029	1,380.57	√	√
SLAs network of Jehona Union (26 SLAs)	471.52	6.87%	10,634	395.75	√	√
Total (1+2)	15,968.21	7.96%	84,452	1,776.32		
Banking segment (3)	7,857.21	12.79%	13,705			
ProCredit Bank	6,003.04	13.95%	10,678		√	
Credins Bank	1,322.95	7.25 %	2,917		√	
National Bank of Greece – Albanian Branch	531.22	13.40%	110		√	
Total (1+2+3)	23,825.42	12.24%	98,157			

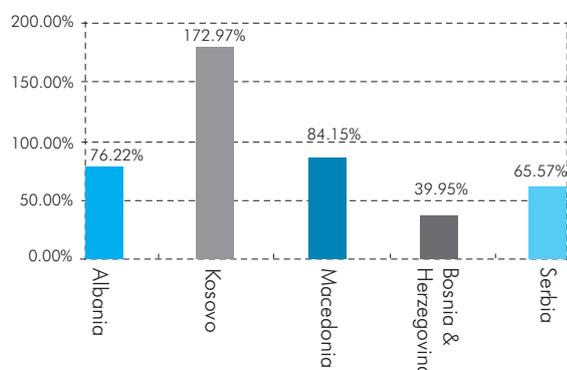
Source: Bank of Albania

¹ In order to derive the number of active borrowers in savings and loan associations, we have referred to the number of members in them.

NOA, Besa Fund and Albanian Savings and Credit Union have the major share in the group of institutions focused on microcredit, and organized as non-bank financial institutions and savings and loan associations (83% of total microcredit portfolio).

There has been a positive tendency in the recent years towards the increasing presence of entities licensed to conduct microcredit activity, hence expanding the microfinance market both in terms of size and products. Only in the second half of 2010, two associations were licensed: Vision Fund Albania and Capital Invest. This market, however, is still in its early stages of development and reform. As at end-2010, its share in the banking system portfolio, excluding banks providing microcredit services, reached only 3.28%.

Chart 1 Comparison of average credit to GNI¹ per capita ratio across countries of the region²



¹Gross National Income: GDP + dividends and interests paid into the country by other countries – dividends and interests paid out to other countries).

²The data refer to end-2009.

Source: Mixmarket (Microfinance Information Exchange)

Compared to the countries of the region, there is room for a more active role of microcredit financial intermediation in Albania. The relatively higher average credit-to-GNI per capita ratio, as shown in Chart 1, compared to other countries of the region, excluding Kosovo, shows the insufficient penetration of microcredit in the low-income population. This is also because the Albanian law had not provided a clear definition of microcredit as an activity yet. The change of the regulatory framework in this regard enabled the new licensed operators to address to this segment of borrowers, who also represent the key microcredit target.

Currently, the supply of microcredit is mainly oriented towards urban areas of the country, thus

leaving rural areas uncovered with financial services. Depending on the type of institution and its level of development, there are different customer target groups and different levels of lending, which are materialized at the level of average loans. More specifically, NOA and Besa Fund – in addition to lending to individuals – lend to small and very small-sized businesses as well. In the meantime, banks are also focused on lending to small-sized businesses and a portion of medium-sized ones. However, unlike non-bank institutions, being equipped with greater financial resources, banks apply higher maximum credit amounts. Other operators are primarily focused on lending to self-employed individuals and small family businesses. The network of savings and loan associations serves to clients, whose distinctive feature is the existence of a common relationship, such as community, professional, etc. The average amount of their credit is relatively small².

Regulatory Approach and Bank of Albania's Role in Developing and Regulating the Microcredit

The current Albanian legislation on the microcredit sector allows these institutions (excluding savings and credit unions) to be licensed for lending only. They are licensed to operate as Non-Bank Financial Institutions (NBFI). The legal framework governing their activity is the Law "On Banks in the Republic of Albania", while the Law "On Savings and Loan Associations" regulates the activity of savings and loan associations and their Unions.

Bank of Albania's focus has been oriented towards the adoption and development of a regulatory framework that does not only allow an adequate surveillance of microfinance/microcredit activity, but also provides additional impulse to its development. In February 2009, the new regulation on the licensing of non-bank financial institutions distinguished the microfinance/microcredit activity from the other activities and allowed more relaxed initial capital requirements. This new novelty in the Regulation gave rise to higher licensing applications from non-bank financial institutions providing microcredit services.

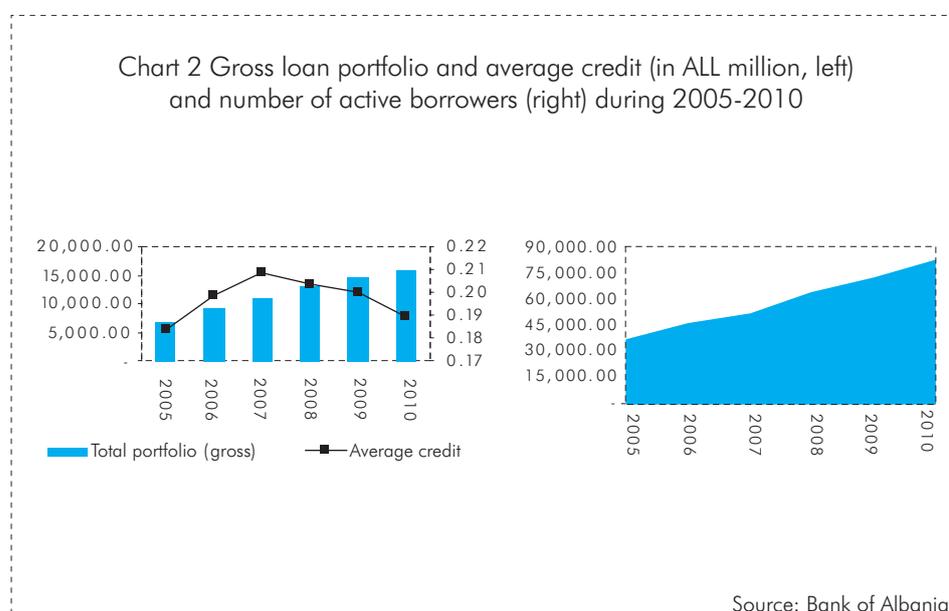
Along the same lines, the supervision process has progressed positively in terms of strengthening the supervisory and analytical structures. The supervision of these institutions – even when they do not accept deposits – is important as it improves their operational management by enhancing the reporting standards and the sound lending practices. This enables the provision of more funds by creating more room to expand the activity, the customer base, the range of products offered, and by creating financial independence. The supervision of these entities, including the savings and loan associations, is based on the licensing criteria and some supervisory norms that need to be observed. The main aspects of the regulatory and supervisory framework concern the capital adequacy, credit risk, liquidity risk and foreign position. Credit risk is considered one of the main risks. The inclusion in November 2010 of these entities in the Credit Registry as reporters and authorized data

² Average credit for SLAs network amounts to ALL 107 thousand. For non-bank financial institutions, it amounts to ALL 575 thousand.

users represents one of the latest undertakings of the Bank of Albania to improve risk management in these institutions.

Main Highlights in Microcredit Activity

At year-end 2010, gross outstanding loans of the microfinance market in Albania, outside the banking system³, amounted to ALL 15.967 million, being disbursed to about 84,000 active borrowers. This portfolio has maintained an upward performance, albeit at reduced rates during 2009-2010. Consequently, average credit has been decreasing. Against a background of an increasing number of active borrowers over the course of years, the decline in average credit owes to the reduction in outstanding loans disbursed to new borrowers, mainly during 2010, as one of the measures taken in response to the financial developments in Albania.

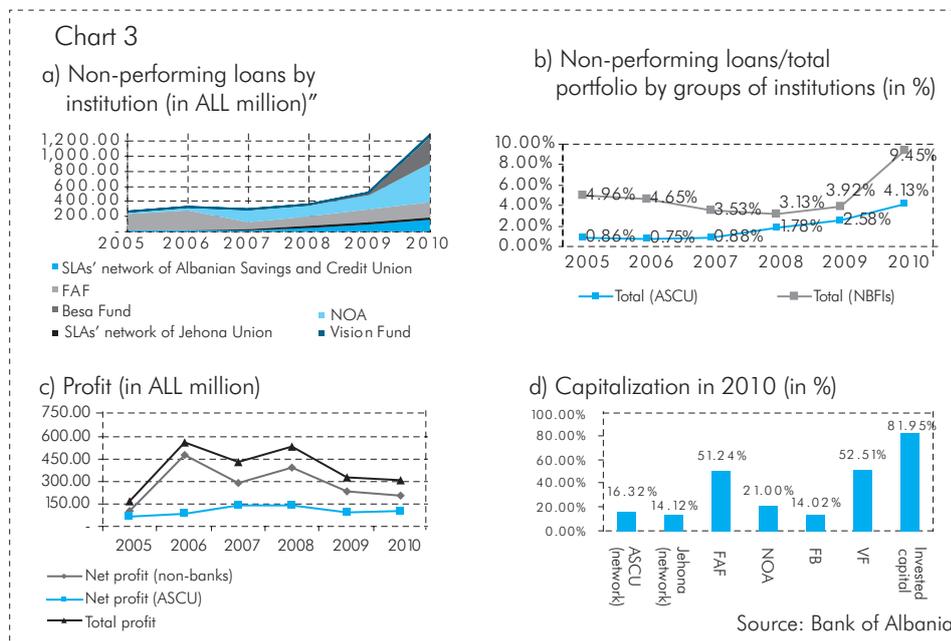


Non-performing loans have been slightly increasing over the course of years, excluding 2010 when they worsened significantly. This tendency is identified in all institutions participant in the microcredit market. Unlike the banking system, non-bank institutions and savings and credit unions operating in the microcredit market experience the deterioration of their loan portfolio quality later.

Focusing on the developments during 2010 alone, the level of non-performing loans, coupled with the downward growth rates of the total portfolio, shows the deterioration of the loan portfolio quality, as measured by the non-performing loans-to-total portfolio ratio. In terms of groups of institutions, non-bank financial institutions show the poorest level of the loan portfolio quality. The methodology of lending in savings and loan associations

³ Developments in the microcredit market analyze non-bank financial institutions and SLAs network. This analysis excludes the respective indicators on the banking system, given the different characteristics of banking activity in terms of the client nature, maximum amount of credit and specifications concerning the regulatory and supervisory framework.

– which is a trust-based relationship among the members and the social pressure – is the key factor that affects their low level of non-performing loans.



The expectations for the loan portfolio quality are on the upside, mainly due to supply-side factors. More specifically, the loan portfolio growth rate will reduce due to the following two aspects:

- The finalization in November 2010 of the project that included these institutions in the Credit Registry is expected to be associated with restrictions on lending to customers exposed to other institutions as well.
- In response to the economic developments, these institutions have reinforced the lending analysis criteria and have reduced the maximum amount of credit extended to one individual.

Meanwhile, the growth rate of non-performing loans is expected to slow down compared to 2010, due to the improvement of macroeconomic indicators compared to last year and strengthening of lending standards by the institutions themselves.

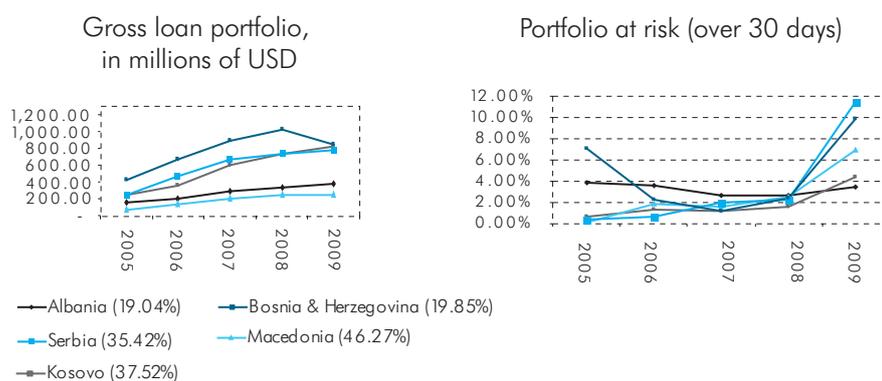
Concerning the microcredit portfolio structure by sectors of economy, at year-end 2010, it mainly concentrated in agriculture and forestry, trade and hotels, whose respective share accounted for 22.9%, 23.6% and 10.7%. This orientation of lending is viewed as positive considering that these sectors make a significant contribution to GDP growth. In terms of groups of institutions, SLAs network has the largest share in lending to agriculture and forestry (54% of the network portfolio). Agriculture is considered as one of the sectors with long-term economic development potential, and therefore, its lending from other microcredit institutions is broadly encouraged. At the same time, there is

room to orient the microcredit portfolio to other important sectors as well, like manufacturing or collective services, whose current respective share is 7.84% and 8.80%. In the meantime, lending to individuals, currently sharing 3.3%, contributes to developing microcredit and accomplishing its social role.

The financial performance of microcredit institutions appears to be positive. As shown in Chart 3, their activity has been positive across the years. The increasing level of non-performing loans during 2009-2010 exerted pressures on the profit, which reduced due to the higher provisioning expenses. Despite hitting a positive profit, earnings do not represent a stable source to support their growth yet. Net profit to average assets ratio remains low⁴. In the meantime, capitalization in 2010 was above the regulatory minimum for all institutions, thus displaying an adequate level of capitalization to ensure a stable activity⁵.

Despite the growing concerns about the higher default credit level and lower profit in the microcredit activity over the last two years, the aforementioned financial indicators show moderate levels of risks facing the microfinance sector, as well as a stable financial situation. At the same time, these institutions have played an active role in dealing with this situation. They have taken measures in terms of strengthening the lending standards through more stringent analysis criteria, longer maximum maturity, greater concentration of headquarter-based approvals, thereby reducing the role of branches in the decision-making process, portfolio restructuring, etc. Several institutions have established risk management departments in order to enhance the effective management of risks associating their activity.

Chart 4 Comparison of microcredit growth and loan portfolio performance for the period 2005-2009 in several countries of the region



Source: Mixmarket (Microfinance Information Exchange)

⁴ At year-end 2010, non-bank financial institutions' RoA was 1.58%. For SLA's network, it was 0.36%.

⁵ The analysis of the level of capitalization is based on the capital-to-total assets ratio for non-bank financial institutions, and capital-to-loan portfolio ratio for SLA's network. Their minimum regulatory level is 10% and 8%, respectively.

Compared to some countries of the region⁶, microcredit in Albania has the potential to expand. The average annual growth of the loan portfolio in Albania during 2005-2009 appears to be the lowest (19.04%), owing mainly to the fast growth of this market in the region during 2005-2008. However, unlike these countries, the slower growth of microcredit over 2008-2009, and the higher portfolio at risk (over 30 days) appears lower and well under control in Albania.

Concerns and Future Challenges

Microcredit in Albania is still in the early stages of its development and reform. Its further promotion remains under the constant focus of the Bank of Albania considering the particular importance of economic growth to this sector.

The main challenge for microfinance institutions, beyond banking institutions, is the provision of funds to ensure the continuation of their activity. Funds are frequently provided by international institutions and they are, therefore, extended in foreign currency.

The latter open the way to another challenge – that of exposure to open foreign currency position. Given that the microcredit is mainly extended in the Albanian Lek, microfinance institutions face an additional cost by using hedging methods to convert these funds into the Albanian Lek. Therefore, the cost passed on to the clients is higher.

As a result of the additional cost faced by the microfinance institutions, the interest rate applied to clients gets higher too. In comparison to other microfinance markets, the Albanian clients pay higher interest rates. The higher price on loans extended to this segment of the population in need bears the risk of a possible deviation of microfinance from the original purpose it was intended for.

In view of this, subsidy programmes or the creation of other facilities for microfinance institutions would be possible options.

⁶ The analysis excludes the year 2010 due to lack of data.

BANK OF ALBANIA BULLETIN NEWS, JANUARY-JUNE 2011

On 10 January 2011, the Governor of the Bank of Albania Mr. Ardian Fullani met, at the Bank of Albania premises, the World Bank Managing Director Ms. Ngozi Okonjo-Iweala.

Governor of the Bank of Albania Mr. Ardian Fullani Meets with the World Bank Managing Director Ms. Ngozi Okonjo-Iweala

The discussions during this meeting were centred on the very good relations between the two institutions and on the further strengthening of the bilateral cooperation. The World Bank has continuously stated its willingness to support the Bank of Albania in the implementation of projects having the consolidation, modernization and the stability of the Albanian banking system as their ultimate goal.

The Governor of the Bank of Albania informed Ms. Okonjo-Iweala about the latest macroeconomic developments in Albania, with special emphasis on the performance of inflation and the efforts of the Bank of Albania to keep it under check. Governor Fullani also dwelt on the latest developments in the Albanian banking system and the work of the Bank of Albania to maintain its stability.

On her part, Ms. Okonjo-Iweala commended the role and contribution of the Bank of Albania to ensure the country's macroeconomic and financial stability.

On 17-18 January 2011, a high-level delegation of the Department for the Supervision of Credit and Financial Institutions of the Bank of Greece, paid a two-day visit to the Bank of Albania, in the framework of the bilateral cooperation between the two central banks.

Governor of the Bank of Albania Mr. Ardian Fullani Meets with Heads of the Department for the Supervision of Credit and Financial Institutions of the Bank of Greece

During its visit to Albania, the Bank of Greece delegation was received by the Governor of the Bank of Albania Mr. Ardian Fullani. Governor Fullani and senior officials of the Bank of Albania discussed, in their meeting with the Bank of Greece delegation, issues related to economic and financial developments, with a special focus on the performance of banking groups operating in both countries.

The Greek delegation and their Albanian counterparts held joint meetings with the Chief Executives of the Greek banks operating in Albania. In these meetings, the supervisory authorities had the opportunity to discuss the situation and the developments of these banks and the market in general, as well as to address issues related to their strategies in the future.

At the end of their visit, Governor Fullani had a joint meeting with the Greek delegation and the Chief Executives of the Greek banks operating in Albania. The Governor informed them about the conclusions of the Bank of Albania on the progress of the Albanian economy, the banking system and the Greek banks during 2010. More specifically, Governor Fullani stated that the Greek banks operating in Albania have been and remain an important part of the Albanian banking system in the recent years.

Governor of the Bank of Albania Mr. Ardian Fullani Meets with Representatives of the Local Government, Banking Sector, Business Community of Shkodra District and with Academics of Luigj Gurakuqi University in Shkodra

On 20 January 2011, the Governor of the Bank of Albania Mr. Ardian Fullani met in the city of Shkodra with representatives of the business community and senior officials of the banking sector in Shkodra. Local government officials and academics from Luigj Gurakuqi University were also present in this meeting.

After his speech, Governor Fullani answered questions raised by the participants in this meeting.

At the end of the meeting, senior officials of the banking sector operating in the Shkodra District expressed their willingness to create opportunities required to support the business community.

Book Release Ceremony of "The Age of Turbulence: Adventures in a New World" by Former Chairman of the Federal Reserve Alan Greenspan

On 3 February 2011, the Bank of Albania held the book release ceremony of "The Age of Turbulence: Adventures in a New World" by former Chairman of the Federal Reserve Alan Greenspan. The foreword of this book is written by the Governor of the Bank of Albania Mr. Ardian Fullani. In his address at the ceremony, Governor Fullani stated that the management of the Federal Reserve monetary policy by Greenspan, an ardent believer in the free market, follower of innovation and an agile problem-solver, fully justifies the statement that monetary policy is not a science but an art.

Prompted by the conclusions of the author, Mr. Fullani highlighted some of the issues such as: central bank independence, continuation of structural reforms, regional cooperation and necessity to attract foreign investments.

With regard to independence, it is essential that a central bank be independent, transparent, accountable and yet not isolated. Coordination with other decision-making institutions is important.

The book release ceremony was attended by the Albanian Minister of Finance Ridvan Bode, Members of Parliament, Chief Executives of the banking system, representatives of the business community, economists, media representatives and journalists.

Twinning Project between the Bank of Albania and the Central Banks of Italy and France

On 23 March 2011, the Bank of Albania launched the twinning project between the Bank of Albania and *Banca d'Italia* and *Banque de France*. This is an EU co-funded project to the amount of EUR 1 million. The primary objective of this project is to improve the actual working practices of the Bank of Albania, by approximating them to the practices of the European System of Central Banks. It will bring the EU expertise and the experience of two of its founding members to the benefit of the Albanian banking system, and it will provide training to Bank of Albania experts, thus contributing to Albania's road to economic integration into the EU.

This ceremony was also attended by the Ambassador of European Union to Albania Ettore Sequi, the Director General of *Banca d'Italia* Fabrizio Saccomanni, and representatives of the banking system.

This EUR 1 million project will continue until May 2012 and it will be implemented by the central banks of Italy and France.

In the framework of the cooperation between the Bank of Albania and the European central banks, on 23 March 2011, the Bank of Albania and *Banca d'Italia* agreed on a Memorandum of Understanding (MoU) on banking supervision. The MoU was signed on behalf of the Bank of Albania by the Governor of the Bank of Albania Ardian Fullani, and on behalf of the *Banca d'Italia* by the Director General of *Banca d'Italia* Fabrizio Saccomanni.

Bank of Albania and Banca d'Italia Sign Memorandum of Understanding on Banking Supervision

The MoU on banking supervision provides a formal basis for the cooperation between the two central banks, with respect to exchanging information and coordinating the work on the supervision of the banking groups operating in both countries.

This MoU will assist the Bank of Albania in playing its role in safeguarding the banking system stability in Albania.

On 28 March 2011, the Bank of Albania held the inauguration ceremony for the reconstruction works of the Bank of Albania building.

Bank of Albania Holds the Inauguration Ceremony for the Reconstruction Works of the Bank of Albania Building

This ceremony was attended by the Minister of Finance Ridvan Bode, and representatives of the winning project studio, the diplomatic corps accredited to Albania and the banking system. The opening speech was held by the Governor of the Bank of Albania Ardian Fullani. The first brick was laid by Governor Fullani and Minister Bode, thus opening the way for the works that will modernize the internal premises of the Bank of Albania.

The Bank of Albania's central building is situated in the centre of the Skanderbeg Square in Tirana. It represents with dignity one of Albania's most important administrative institutions, its central bank, and the sole monetary and supervisory authority. Built around 70 years ago, this work of art stands out in the square and is under the protection of the state as a Monument of Culture Ensemble right in the centre of the capital.

The construction of the Bank of Albania building was completed in 1938 and it fully met the needs of that time. In the 1940s, the architect Morpurgo designed another project, which envisaged the construction of other buildings that would be in harmony with the overall architecture of the building and would make the Bank of Albania ensemble complete. Unfortunately, this project never materialised.

The new project envisages, in conformity with the philosophy of the Bank of Albania, to meet the requirement for more open communication and transparent relationship with the public, in addition to adequate administrative requirements. For that purpose, it is foreseen that the Bank of Albania will have in its headquarters the museum of numismatics and history of banking

and financial activity in Albania. A rich collection of coins and banknotes issued from antiquity to date will be open to the public.

The rapid quantitative and qualitative developments in the Bank of Albania activities have led to an increased need for more space for the Bank of Albania to carry out its daily activities. The numerous unique functions of its representation, the increasing functional requests, the numerous commitments of the Bank of Albania in international activities, the indispensable information technology-related needs, and a number of other reasons called for additional facilities. Under these circumstances, the acquisition of the former Dajti Hotel constitutes one of the strategic moves of the Bank of Albania for a long-term and suitable solution for new facilities, which will further complement the infrastructure offered by the main building. This will contribute to bringing the Bank of Albania closer to the European Central Bank.

Upon the completion of investments in these two buildings, the Bank of Albania is convinced that its institutional model will get even closer to that of the European central banks. On the other hand, it will be an extraordinary contribution to preserving and disclosing Tirana's cultural heritage, as well as promoting education and science in the area of central banking and finance.

*Bank of Albania
Commemorates the
85th Anniversary of the
National Currency*

The Bank of Albania celebrated this year one of the most important events of the country's economic history in general, and its central bank in particular: the 85th anniversary of the first national coins and banknotes put in circulation.

On this occasion, on 31 March 2011, the Bank of Albania organised at the central hall of the National Historical Museum an exhibition entitled "85 Years – National Currency".

The national currency was presented in this exhibition in its full spectrum of values. The exhibition unveiled these values in a display of coins and banknotes from antiquity to date.

The exhibition was opened with an address by the Governor of the Bank of Albania Ardian Fullani, in the presence of the Albanian Prime Minister Sali Berisha, other country representatives, governors and other representatives of central banks in the region, researchers, representatives of finance and media, and the public at large.

In addition, the Bank of Albania organised a symposium on "The National Currency: Some Historical Aspects", where experts of the field shared their views on the development history of the Albanian currency.

*Bank of Albania and
Banque de France Hold
a Joint Regional Seminar
on "Legal Aspects of
Central Banking"*

On 5 April 2011, the Bank of Albania and *Banque de France* held a joint regional seminar on "Legal Aspects of Central Banking".

This regional seminar was attended by legal experts of *Banque de France*,

central banks in the region, Bank of Albania and Albanian institutions. The proceedings of this regional seminar centred on the legal aspects of central banking in the aftermath of the 2008 global crisis.

This seminar was also attended by the Governor of the Bank of Albania Ardian Fullani, who delivered a speech to the audience.

On 12-13 April 2011, the Group of Banking Supervisors from Central and Eastern Europe (BSCEE) held in Tirana the 24th international conference. This Group was established in 1991 and its current members consist of banking supervisory authorities from 21 countries of this region.

Group of Banking Supervisors from Central and Eastern Europe Holds the 24th International Conference

In addition to participants from member states, special guests to the conference were distinguished personalities, like the Deputy Secretary General of the Basel Committee on Banking Supervision, EBRD Director for Financial Institutions in Western Balkans, and Head of the Banking Groups Supervision Department at the Bank of Italy.

The conference, which was held as a high-level forum for technical discussions, addressed two topics:

Role of the banking system and the supervisors in safeguarding financial stability, and

Basel III: global regulatory standards on financial institutions capital adequacy and liquidity set out by the Basel Committee on Banking Supervision.

The opening speech was delivered by the Governor of the Bank of Albania Ardian Fullani, who provided a brief overview of economic and financial developments in Albania over the past two years, focusing on some concrete issues requiring more attention by the banking industry and the supervisory authority in the future.

The Bank of Albania and the University of Oxford held on 21 June 2011 a high-level seminar on "Current Economic Challenges and Regional Co-operation in Southeast Europe". The opening speech was delivered by the Governor of the Bank of Albania Ardian Fullani.

Bank of Albania and University of Oxford Hold a Joint Seminar

The seminar brought together high-level representatives from the academia in Albania, the region and beyond, representatives from the banking system, state agencies, international organisations operating in Albania, and the Bank of Albania. Organised in the framework of the Co-operation Agreement between the Bank of Albania and the University of Oxford signed in September 2010, this seminar is an item in the agenda of the Bank of Albania to be an active player in the regional co-operation initiatives in Southeast Europe.

The seminar addressed the following key topics:

- identifying and analysing the key economic challenges in fostering sustainable growth in the region;

- identifying the scope for and degree of an intensive regional co-operation; and
- exploring the role of institutions and external anchors in advancing regional co-operation.

In September 2010, the Bank of Albania signed a co-operation agreement with the University of Oxford. The scope of this co-operation is to conduct research studies to promote and deepen knowledge on economic policies and challenges facing Albania and the region, to assess political opportunities for sustainable economic growth in the region, and the EU integration process.

Friday Seminar The Research Department at the Bank of Albania organizes a fortnightly “Friday Seminar”. This initiative invites Bank of Albania experts, researchers from the academia and other financial, research and scientific institutions to present and discuss their theoretical and empirical research papers on the Albanian case and the application of the latest research methods.

During the period January-June 2011, the Friday Seminar welcomed several works from the Bank of Albania representatives and other institutions. The main topics brought up in these seminars related to issues of monetary policy and financial stability, fiscal policy and development policies, and the competitiveness of the Albanian economy in terms of tourism and agriculture. The following provides an elaborate description of the research papers presented in the Friday Seminar.

“Mafia and Public Spending: Evidence on the Fiscal Multiplier from a Quasi-Experiment” by Saverio Simonelli (The University of Naples Federico II, Italy) was the first study presented in the Friday Seminar for the period January-June of 2011. This study aimed to analyze the multipliers of public spending in output, based on the expenditures for infrastructure in various regions of Italy, and also based on the 1991 Law that mandated the interruption of local public work on evidence of Mafia infiltration of local administration. In identifying these multipliers, the authors have employed the panel methodology for various provinces. Empirical results show that this multiplier varies from 1.4 to 2, taking into consideration the contemporary and the lagged effect of governmental anti-measures on output.

“Growth Effects of International Integration in South-eastern Europe – Implications on FDI and Trade” by Jonel Kristo, Research Department. This study aims to assess the impact of regional integration on growth, to study the transmission channels of such growth, and to measure the intensity of these relationships. A data panel approach with fixed effects has been used to measure such effects, including 9 countries from South-eastern Europe for the period 1996-2009. The findings of this study suggest that an integrated region benefits more in terms of trade, especially through exports, and in terms of foreign direct investment. Another finding of this study is that an integrated region grows more in volume if it stimulates trade integration and inter-industrial convergence at an international level, compared to a region

lacking these initiatives. Also, an integrated region attracts more foreign investment, but the analysis shows that a precondition to this is a competent and readily available labour force. The results are valid in the context of a region dominated by cost-oriented industries, and not by high-tech industry.

“Development of Sustainable Tourism: An Empirical Approach for Albania” by Lorena Skufi, the winner of first Governor’s Award for the Best Diploma of year 2010. Some of the addressed issues dealt with the understanding and sustainable development of tourism, and the future challenges regarding its development in Albania. The main aim of this study is to analyze the sustainable tourism in its three dimensions, to measure the economic, environmental, and social impact on the revenues generated by tourism. In quantitatively analyzing the development of tourism, the study uses the Vector Error Correction Model. The research covers the period 1995-2008, and the results show that revenues from tourism are more positively related to the Gross Domestic Product, social development, and negatively related to the environmental degradation.

“Conspicuous Consumption: The Effects of Social Influences on Firms’ Demand, Price and Earnings: Conspicuous Consumption in Albania” by Armando Memushi, Faculty of Economics, University of Tirana. This study aims to understand the role of “social” consumer behaviour in determining prices of conspicuous goods and earnings of firms’ market share, which produce and sell such products. The study uses an analytical model, which includes social influences on the consumer behaviour, and then explores its impact on prices, earnings, and firms’ market share. The results for the Albanian consumer behaviour show that the consumption of conspicuous goods constitutes a small part of total consumption. Also, gender and education of the head of family are the main driving factors behind conspicuous consumption, and that individuals living in Tirana have on average a higher level of conspicuous consumption compared to other cities.

“Current Account Deficit in Albania and Political Implications” by Ilir Vika, Research Department. This study aims to assess the equilibrium level of the current account in Albania. Its estimation is based on two approaches: first, the accounting framework proposed by Lane and Milesi-Ferreti (2006), and second, the empirical approach based on panel data estimation. The equilibrium levels of current account suggested by these approaches are different; therefore, the adjustment magnitude needs to be carefully interpreted. This material also aims to shed light on possible implications derived from the impact that the further worsening of the current account can have on monetary and fiscal policy. Such tendency has been observed during the last years.

“Evaluating the Tourism-Led Economic Growth in Albania” by Jonel Kristo, Research Department. This study aims to measure the effect of the tourism sector on the Albanian economic growth during 1995-2008. In doing this, the author analyses the foreign tourist inflows, and the total real earnings in economy. The final estimation suggests that a 5% sustainable increase in

tourism earnings leads to an increase of 1% in GDP. Also, a deviation from the equilibrium needs 3.4 quarters to be adjusted.

“Macroeconomic Determinants of Remittances: The Case of Albania” by Esida Abazaj, Research Department. This paper aims to empirically estimate the macroeconomic determinants of emigrants’ remittances to Albania over the period 1996-2010. This study is the first of its kind in the case of Albania. The author employs the Vector Error Correction Model to study the long- and short-run dynamics of remittances. The findings suggest that remittances in the long run depend solely on the macroeconomic conditions of the host country, which is proxied by the unemployment rate in host countries, weighted on the basis of shares of remittances received from each host country. An increase of the unemployment rate by 1 pp decreases remittance transfers by 0.13% in the long run. The other two explanatory variables (exchange rate and Albania’s Gross Domestic Product) proved insignificant, both in the long and short run, thus rejecting the conventional hypothesis that remittances are primarily remitted to meet the consumption needs of emigrants’ households in the home country. The only finding supporting the altruism hypothesis is the fast adjustment of remittances to their long-run equilibrium, indicated by the high and statistically significant error correction term. The study also found no evidence of the investment motive driving Albanian emigrants’ remitting decision.

“Corporate Governance in the Albanian Banking System – Survey Analysis on the Corporate Governance of the Albanian Banking System” by Kliti Ceca, Irini Kalluci, Oriela Kodra (Research Department), Vasilika Kota (Financial Stability Department) and Arzana Haxhiaj (Human Resources Department). The aim of this study is to identify the role and importance of sound corporate governance in Albania, through calculating the Corporate Governance Index for the Albanian banking system.

“Political Cycles in Privatization Earnings: The Case of Albania” by Drini Imani, Endrit Lame (Agricultural University of Tirana) and Holger Kächelein (Faculty of Economics, Tirana). This study aims to identify the political cycles in Albania, mainly during election processes, by means of different economic instruments, like monetary and fiscal policy instruments. In the previous study regarding the identification of political cycles in Albania, the results showed a clear evidence of fiscal expansion prior to elections. In this study, earnings from privatization are taken as elements of government financing and fiscal expansion growth in transition countries, in order to test if there is an increase in these earnings prior to elections. Empirical results show considerable and statistically important growth in privatization earnings prior to elections, contributing as an essential element in financing the growth of governmental expenditures prior to elections.

“Optimal Level of Reserve Holdings: An Empirical Investigation in the Case of Albania” by Gerti Shijaku, Research Department. This discussion material makes an attempt to test the importance of the relative precautionary and mercantilist motives that seek to explain the reserve holdings, namely variation

payments and receipts, financial costs and reserve holdings in the case of Albania. First, the aim is to evaluate the impact of changes in international transactions on reserve holdings. Second, the author intends to evaluate reserve holdings from a cost opportunity perspective. The material is based on the Buffer Stock model. This model assumes that reserve holdings are affected by changes of payments and receipts in the balance of payments. Reserves serve as a buffer stock to accommodate fluctuations of external transactions, while the initial stock is the optimal level. The focus of the model is to estimate the optimal level of reserves against possible exogenous shocks or a crisis, particularly fluctuations of foreign capital inflows, mainly remittances. The volatility of reserve holdings is generated by Autoregressive Conditional Heteroskedasticity (ARCH) estimation, while the Buffer Stock model is estimated with an ARDL approach. Results indicate a negative relationship of reserve holdings with opportunity cost, volatility and deviation of exchange rate from the trend and positive relationship with imports. The approach estimation suggests that the level of optimal reserve holdings is more sensitive to precautionary rather than mercantilist motives.

“After the Crisis, New Strategies for the European Monetary Policy and its Management” by Prof. Franco Bruni, University of Bocconi, Milan. In his presentation, Prof. Bruni addressed issues related to new strategies and challenges, which need to be faced by the European Union in the future, in the context of growth pact, and stability and governance of its members. The financial crisis that affected the globe in 2007 brought a new viewpoint for the monetary policy in the world. Its focus in the future will be not only price stability but also financial stability, as an explicit target of monetary policy in the future.

“Can the Small Agricultural Economy of Albania Compete amid Regional and European Agricultural Market Competition” by Ismail Beka, Vice Director of GIZ (Deutsche Gesellschaft für Internationale Zusammenarbeit). This presentation aims to analyse the agricultural sector in Albania, its actual problems, and the identification of future challenges. Official data of Instat show that half of Albanian population lives in rural areas, and that agriculture is one of their most vital activities. During the whole period of transition, reforms in this sector have been scarce, enabling the Albanian economy to continue being a net importer, regardless of its potential natural resources. So, some of the future challenges in further reviving the agricultural sector are: urbanisation of certain areas, rural and spatial planning, individuals’ education and qualification, defining new strategies with long-term vision, etc.

LEGAL EVENTS, JANUARY-JUNE 2011

BANKING SUPERVISION

On 19 January 2011, the Supervisory Council of the Bank of Albania adopted by Decision No. 3 the Regulation "On the Management of Operational Risk". This Regulation sets out the rules and requirements for the management of operational risk in banking and financial activity. The entities subject to this Regulation, more specifically banks, non-bank financial institutions, savings and loan associations and their unions, shall set up an internal system consisting of policies, procedures, rules and techniques, in order to ensure an efficient management of operational risk.

On 9 March 2011, the Supervisory Council of the Bank of Albania adopted the Decision No. 13 "On some Changes and Amendments to Regulation "On Consumer Credit and Mortgage Credit for Households"". This Decision establishes that the pre-contractual and contractual information shall also include the amount of the instalment, the number of instalments and the periodicity of the settlement of instalments, as well as a credit settlement plan, including the total obligation (principal and interest) for the entire credit amount. This Decision also envisages changes to the article that sets out the rights and obligations in case of early credit repayment.

On 9 March 2011, the Supervisory Council of the Bank of Albania adopted the Decision No. 14 "On some Changes and Amendments to Regulation "On the Transparency in Banking and Financial Products and Services"". The amendments approved by this Decision affect the articles that set out the general requirements for banking products and services, the calculation method and the disclosure of the effective interest rate on loans, the elements of the loan agreement and specific information concerning this agreement.

On 11 May 2011, the Supervisory Council of the Bank of Albania adopted the Decision No. 33 "On an Amendment to Regulation "On Granting a Licence and Exercise of Banking Activity of Banks and Branches of Foreign Banks in the Republic of Albania"". Following this change, in addition to the activities envisaged in Law No. 9662 "On Banks in the Republic of Albania", banks and branches of foreign banks shall be allowed to conduct the activity of safe custody service after being granted the licence or prior approval by the Bank of Albania.

On 11 May 2011, the Supervisory Council of the Bank of Albania adopted the Decision No. 34 "On Granting Preliminary Approval for the Increase of

the Qualifying Holding of Mr. Renis Tërshana in the Shareholders' Equity of Credins Bank sh.a.". According to this Decision, the qualifying holding of shareholder Mr. Renis Tërshana increases from 19.48% to 20.78% through the acquisition of 1.3% of Mr. Sejdin Zere's shares in the shareholders' equity of Credins Bank sh.a.

On 15 June 2011, the Supervisory Council of the Bank of Albania adopted by Decision No. 42 the Regulation "On the Statutory Auditor of Banks and Branches of Foreign Banks". The purpose of this Regulation is to set out the criteria, terms and procedures for the approval of the statutory auditor of banks and branches of foreign banks by the Bank of Albania, the auditing by the statutory auditor of banks and branches of foreign banks for the purposes of the Bank of Albania, and the relationships between the statutory auditor and the Bank of Albania.

On 15 June 2011, the Supervisory Council of the Bank of Albania adopted the Decision No. 43 "On some Amendments to the Regulation "On Granting a Licence and Exercise of Activity of Non-Bank Financial Institutions". According to this Decision, non-bank financial institutions or micro-credit financial institutions shall, within 30 (thirty) days, notify the Bank of Albania of the list of their agents or changes thereof. In addition, the agent, for the purpose of conducting the financial activity of money transfer, shall obtain the approval of the Bank of Albania, except when the agent is a bank or the branch of a foreign bank licensed by the Bank of Albania.

On 15 June 2011, the Supervisory Council of the Bank of Albania adopted the Decision No. 44 "On Granting Tirana Bank sh.a. Preliminary Approval to Conduct Additional Activity". Upon this Decision, Tirana Bank sh.a. is granted preliminary approval to conduct additional trading and financial activities, on its account or for the account of its clients, be it in a foreign exchange, over-the-counter, other negotiable instruments and financial assets, and participation in the issuance of all types of securities. This Bank may also carry out advisory and intermediation services, and other auxiliary services for the above-listed activities.

SECURITY AND PROTECTION

On 19 January 2011, the Supervisory Council of the Bank of Albania adopted by Decision No. 4 the Regulation "On the Minimum Security Requirements in the Premises where Banking and Financial Activities are Carried Out". The purpose of this Regulation is to set out the minimum security requirements in the premises where banking and financial activities are carried out, in order to ensure that they are carried out safely and normally. This Regulation sets out the procedures for the technical conditions of security, the conditions for the bank tellers' area, the storage of monetary values, protection through electrical appliances, the transportation of monetary values etc.

PAYMENT SYSTEMS

On 23 February 2011, the Supervisory Council of the Bank of Albania adopted the Decision No. 12 "On the Approval of some Amendments to Regulations "On the Functioning of the Albanian Interbank Payment System - AIPS" and "On the Functioning of the Automated Electronic Clearing House System - AECH"". These amendments, *inter alia*, establish that the commissions charged for all outgoing payment orders in the AIPS shall not exceed ALL 1,500, while the commissions charged for all outgoing payments orders in the AECH shall not exceed ALL 500.

MONETARY POLICY

On 23 March 2011, the Supervisory Council of the Bank of Albania adopted the Decision No. 21 "On Raising the Interest Rate on Repo and Reverse Repos". According to this Decision, the interest rate on repo and reverse repos is raised by 0.25 percentage points, from 5% to 5.25%.

On 23 March 2011, the Supervisory Council of the Bank of Albania adopted by Decision No. 22 the Bank of Albania Annual Report for 2010. According to this Report, economic activity in Albania grew progressively during this year, driven also by the positive performance of global economy and the dynamic private sector. Annual inflation averaged 3.6%, hence remaining within the Bank of Albania's target. The change of the Bank of Albania's monetary policy operational framework in June 2010 contributed to enhancing the efficiency of monetary policy and encouraging the functioning of the interbank market.

On 27 April 2011, the Supervisory Council of the Bank of Albania adopted by Decision No. 26 the Monetary Policy Report for 2011 Q1. According to this Report, the Albanian economy had a positive performance in 2011 Q1. The rapid expansion of exports and the moderate increase in imports brought about the improvement of the trade deficit. Inflation marked 4.0%, mainly due to the price rise of food and oil in the global markets. In response to this phenomenon, at the end of March 2011, the Bank of Albania raised the key interest rate by 0.25 percentage points. The inflationary pressures are expected to remain high in the future, but their intensity will be downward over the course of 2011.

On 27 April 2011, the Supervisory Council of the Bank of Albania adopted the Decision No. 29 "On some Amendments to Regulation "On the Minimum Required Reserve Held by Banks with the Bank of Albania"". According to these amendments, the Bank of Albania may remunerate banks for the required reserve they hold in Lek and in foreign currency, for the period it is held. The remuneration rate is determined by the Supervisory Council decision and it is disclosed at least 30 business days prior to the beginning of the holding period.

INFORMATION AND TECHNOLOGY

On 9 March 2011, the Supervisory Council of the Bank of Albania adopted by Decision No. 17 the Regulation "On Information Security". The purpose of this Regulation is to formulate a strategy for the implementation of the Information Security Policy at the Bank of Albania. It sets out the general rules on the security of information and it includes all the information sources and systems in possession of or in use by the Bank of Albania.

FINANCIAL STABILITY

On 23 March 2011, the Supervisory Council of the Bank of Albania adopted by Decision No. 24 the Financial Stability Report for 2010 H2. According to this Report, at the end of 2010 H2, Albania's financial system and banking sector were assessed as being stable. The banking sector's financial system expanded further and its share in Albania's GDP increased to 85%. Capitalization and operating liquidity position appeared satisfactory. The need to improve the quality of loans remains the main challenge facing the banking sector. Banks need to assess their resilience and take advance measures to strengthen their capital position and ensure better control of their operational risks. The Bank of Albania will take all the necessary operational measures and it will assess the need for further amendments and improvements in the regulatory and supervisory framework.

ISSUE

On 25 May 2011, the Supervisory Council of the Bank of Albania adopted by Decision No. 39 the Regulation "On the Import and Export of Albanian Banknotes and Coins". The purpose of this Regulation is to set out the quantity and procedures for the import and export of legal tender or non-circulating legal tender Albanian banknotes and coins. The Regulation establishes, *inter alia*, that the import of legal tender Albanian banknotes and coins in cash is an exclusive right of the Bank of Albania and that individuals are entitled to import or export legal tender Albanian banknotes and coins without exceeding the value of ALL 50,000 (fifty thousand).

On 25 May 2011, the Supervisory Council of the Bank of Albania adopted the Decision No. 40 "On an Amendment to the Supervisory Council Decision No. 27, dated 30 March 2005 "On Minting Coins for Numismatic Purposes for the Year 2006"". The purpose of this Decision is to set out the technical specifications of 50 Lek denomination non-circulating legal tender coin themed "Purple Codex of Berat 043 Φ - Beratinus – 1".

On 29 June 2011, the Supervisory Council of the Bank of Albania adopted the Decision No. 48 "On Reprinting the 1000 Lek Denomination Legal Tender Banknote". The purpose of this Decision is to envisage the reprinting of the 1000 Lek banknote themed "Pjetër Bogdani", issue of 2007, in 2011.

ECONOMIC POLICY

On 7 January 2011, the Minister of Finance adopted the Instruction No. 3 "On some Amendments to Instruction No. 5, dated 30 January 2006 "On Income Tax", as Amended"". This Instruction establishes, inter alia, that when calculating personal income tax, the monetary income invested in the increase of the capital of the company shall be included in the taxable income of the individuals, provided the source of income is other than from the company and these individuals have not been taxed previously for such income. The tax liability should be paid on the same date when the individual contributes the monetary income for the increase of the company's capital at the National Registration Centre.

On 10 January 2011, the Board of Commissioners of the Albanian Electricity Regulatory Authority adopted the Decision No. 1 "On Adopting the Rules and Procedures for the Sale of Electric Energy". The purpose of this Decision is to ensure simple rules and procedures for fast operations, based on a competitive and transparent process, in the sale of electric energy, without impinging on the safety of the supply of customers with electric energy.

On 12 January 2011, the Council of Ministers adopted the Decision No. 18 "On some Amendments to Decision No. 1058, dated 21 October 2009 of the Council of Ministers "On Setting the Minimum Threshold of Registration for Value Added Tax (VAT)"". Following this amendment, the VAT registration threshold is abolished for tax registered freelancers, such as lawyers, notary public, specialized doctors, pharmacists, architects, designers, economists, accounting experts, etc, and all such tax registered freelancers are obliged to register for VAT purposes regardless of their annual turnover.

On 19 January 2011, the Council of Ministers adopted the Decision No. 33 "On Adopting the Regulation "On the Examination Procedure, by the Public Procurement Commission, of Complaints Against the Auction Procedures or Decisions on the Disqualification from these Procedures" and an Amendment to Decision No. 1719, dated 17 December 2008, of the Council of Ministers "On Adopting the Public Auction Rules"". The purpose of this Regulation is to set out comprehensive rules for the examination procedure, by the Public Procurement Commission, of complaints against the auction procedures, in order to guarantee the principles of lawfulness, equality, impartiality in decision-making, transparency and protection of personal data.

On 2 February 2011, the Council of Ministers adopted by Decision No. 84 "The Protocol between the Republic of Albania and the Czech Republic, on Amendments to the Agreement between the Republic of Albania and the Czech Republic "On the Encouragement and Reciprocal Protection of Investment"". The Amendments to the Protocol concluded previously between the parties mainly concern the acknowledgement of all obligations arising out of the membership into a customs, economic or monetary union, a common market or a free trade area. In addition, the provisions of this Agreement shall not be construed so as to oblige one contracting party to extend to the investors of the other contracting party, or to the investments or returns of such

investors, the benefit of any treatment, preference or privilege, which may be extended by the contracting party by virtue of any international agreement or arrangement relating wholly or mainly to taxation.

On 10 February 2011, the Parliament of the Republic of Albania ratified by Law No. 10369 "The Assistance Agreement between the Council of Ministers of the Republic of Albania and the Government of the United States of America on Just and Democratic Governance, Investment in Human Capacities and Economic Growth". In order to further the foreign assistance objectives of governing justly and democratically, investing in people and economic growth, the parties to this Agreement agree to work together by focusing on activities in the areas of health, rule of law, good governance and private sector growth. The objectives of this Agreement focus on the support and transformation of Albania into a stable social and economic democracy. In order to help achieve these objectives, the USAID's contribution shall total \$75,000,000 (seventy-five million U.S. dollars).

On 11 February 2011, the Albanian Electricity Regulatory Authority adopted by Decision No. 9 the Regulation "On the Procedures of Licensing, Modification, Partial or Complete Transfer, Removal or Renewal of Licences in the Natural Gas Sector". The purpose of this Regulation is to set out the licensing procedures for carrying out the activity in the natural gas sector, by specifying the terms and conditions for granting, modifying, renewal or removal of a licence. The Regulation establishes that ERE shall be responsible for establishing the payments made for each type of licence application. This Regulation provides the rules for the licensing of activities such as: transmission, distribution, supply or trade of natural gas.

On 17 February 2011, the Minister of Public Works and Transportation and the Minister of Finance adopted the Instruction No. 6 "On some Amendments to Instruction No. 6257, dated 2 September 2008 "On Establishing the Subsidized Loan Amount to Households Benefiting Loans from the State", as Amended"". These amendments set, *inter alia*, the condition that no member of the household benefiting subsidized loans from the state shall be subject to value added tax. The Albanian National Housing Authority shall be responsible for following up and supervising the implementation of this programme, by making the necessary verifications in all the public and private, central and local institutions responsible for issuing documents.

On 24 February 2011, the Parliament of the Republic of Albania ratified by Law No. 10382 "The Development Co-operation Agreement between the Council of Ministers of the Republic of Albania and the Government of the Kingdom of Denmark". The purpose of this Agreement is to strengthen the friendship ties between the two countries, aiming at contributing to economic growth and a sustainable and socially equal development, and to the political, economic and social reforms necessary for Albania to adapt to the EU structures. In order to accomplish these objectives, Denmark commits to make available to Albania financial assistance, material resources, technical assistance and training opportunities, while Albania shall ensure their efficiency.

On 2 March 2011, the Minister of Labour, Social Affairs and Equal Opportunities adopted the Instruction No. 4 "On the Criteria for the Use of Undistributed Social Protection Fund for 2011". According to this Instruction, the undistributed social protection fund shall be used to fund events not provided for in the local government units' funds and the state budget funds. The categories benefiting from this fund are households or people in need in events of misfortune, local government units to meet unexpected needs, as well as the social community services that contribute to the welfare of children, old people or people in need.

On 10 March 2011, the Parliament of the Republic of Albania ratified by Law No. 10392 "The Agreement between the Council of Ministers of the Republic of Albania, represented by the Ministry of Finance, and the Government of the Republic of Austria, represented by the Federal Minister of Finance, on Financial Co-operation". By signing this Agreement, the Governments of both countries seek to promote and expand financial co-operation within the framework of their respective existing laws, regulations and policies. For this purpose, the Austrian party commits to support the granting of tied aid credits on concessional terms, refinanced by Oesterreichische Kontrollbank Aktiengesellschaft (OeKB), for an indicative financial framework of up to EUR 40,000,000 (forty million).

On 17 March 2011, the Parliament of the Republic of Albania ratified by Law No. 10396 "The Agreement on Maritime Transport between the Council of Ministers of the Republic of Albania and the Government of the Federal Republic of Germany". By signing this Agreement, the parties seek to accomplish the common interests for the establishment of a continuous legal basis that ensures the progress of reciprocal commercial relations via maritime transport, in order to ensure the development of free trade and the increase of international relation opportunities in this area.

On 17 March 2011, the Parliament of the Republic of Albania adopted the Law No. 10399 "On some Changes and Amendments to Law No. 9355, dated 10 March 2005, "On Social Assistance and Services", as Amended". These amendments establish, *inter alia*, that the economic assistance will be provided to children in need, orphans who are not part of the institutions dedicated to them, parents giving birth to more than two children at the same time and who belong to households in need; victims of trafficking after they leave the social care institutions until they are employed, and victims of domestic violence.

On 24 March 2011, the Parliament of the Republic of Albania ratified by Law No. 10402 "The Agreement between the Council of Ministers of the Republic of Albania and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income". According to this Agreement, where a resident of Albania derives income which, in accordance with the provisions of this Agreement, may be taxed in Singapore, Albania shall allow as a deduction from Albanian tax on the income of that resident an amount equal to the

income tax paid in Singapore. In addition, where a resident of Singapore derives income from Albania, which, in accordance with the provisions of this Agreement, may be taxed in Albania, Singapore shall allow the Albanian tax paid, whether directly or by deduction, as a credit against the Singapore tax payable on the income of that resident.

On 24 March 2011, the Parliament of the Republic of Albania adopted the Law No. 10404 "On some Changes and Amendments to Law No. 8976, dated 12 December 2002, "On Excises in the Republic of Albania", as amended". The purpose of these changes and amendments is to stipulate the general requirements for excise goods requiring revenue stamps, as well as the price and payment method of each revenue stamp produced and distributed by a concessionary authorized for their issue, distribution and monitoring.

On 31 March 2011, the Parliament of the Republic of Albania ratified by Law No. 10407 "The Loan Agreement and Programme between the Republic of Albania, represented by the Ministry of Finance and the Albanian Development Fund, as the Project Implementation Agency, and KfW Frankfurt am Main, for Financing the Project "Social Investment Fund IV". The loan fund of no more than EUR 20,000,000 (twenty million) will be used to improve the use of rehabilitated and reconstructed infrastructure of rural roads, as well as rehabilitated and reconstructed rural gravity water supply. The fixed interest rate on this loan is 2% and it is expected to be fully settled in 2025.

On 7 April 2011, the Parliament of the Republic of Albania adopted the Law No. 10415 "On some Changes and Amendments to Law No. 9920, dated 19 May 2008, "On Tax Procedures in the Republic of Albania", as Amended". The changes and amendments to this Law refer to the articles that provide the provisions for the identification of persons engaged in commercial activities without being registered, the procedures to be followed for the removal from the registration list of entities after having paid all unpaid tax duties, as well as the sequestration, confiscation and liquidation process in the event of failure to pay these obligations fully.

On 13 April 2011, the Minister of Economy, Trade and Energy approved the Order No. 305 "On the Procedures and Form of Formulation of the Operational Programme for the Implementation of the Mineral Strategy". According to this Order, the operational programme for the implementation of the mineral strategy is the medium-term document of mineral planning, which is formulated on the basis of the mineral strategy and it is valid for a three-year period. It should contain the directions for the development of the mineral sector; the promotion of mineral areas being granted mineral permits for through a competition process; the schedule of basic geological research activities; the overall projection of the annual product in the mineral sector; the danger areas where the mineral activity and granting of mineral rights are prohibited; the perspective of mineral areas, etc.

On 21 April 2011, the Parliament of the Republic of Albania adopted the Law No. 10418 "On the Legalization of Capital and Cancellation of Part

of Tax and Customs Liabilities". The purpose of this Law is to set out the principles and guarantees of entities benefiting from the legalization of the capital, the competences of public administration authorities and banks being part of the capital legalization process, and related activities. In addition, this Law provides for the cancellation of part of tax and customs liabilities, social and health insurance contribution, and the competences of the tax and customs administration authorities, which identify the debtors benefiting from this Law.

On 26 April 2011, the Minister of Finance adopted the Instruction No. 9 "On some Changes and Amendments to Instruction No. 5, dated 30 January 2006, "On Income Tax", as Amended, Regarding the Individual Annual Income Statement"". The purpose of these changes and amendments is to provide the provisions for the procedures followed to meet the obligation of submitting the individual annual income statement. This Instruction also establishes the cases when certain individuals are exempt from this obligation.

On 26 May 2011, the Parliament of the Republic of Albania ratified by Law No. 10419 "The Istisna'a Agreement between the Council of Ministers of the Republic of Albania and the Islamic Development Bank (IDB) to Fund Tirana-Elbasan Road Project". According to this Agreement, the Islamic Development Bank will finance the project through an Istisna'a's contract amounting to USD 222,700,000 (two hundred and twenty-two million and seven hundred thousand). The Islamic Development Bank's project financing will cover the cost of construction and consulting services from km 10+400 to km 18+400 (the tunnel is entirely included in this section). The new Tirana-Elbasan road will be a four-lane highway. The main objectives of this project are to ensure an uninterrupted flow of traffic on the highway, reduce the operational cost of vehicles and the number of car accidents, save the travel time and increase the economic level around the project area.

On 26 May 2011, the Parliament of the Republic of Albania adopted the Law No. 10421 "On the Ratification of the Additional Protocol to the Agreement on the Amendment of and Accession to the Central European Free Trade Agreement". According to this Protocol, the Republic of Albania, the Republic of Croatia, the Republic of Macedonia, the Republic of Moldova, Montenegro and the Republic of Serbia shall abolish all customs duties on imports, all charges having equivalent effect, and all import duties of a fiscal nature in trade between the Parties on the date of entry into force of this additional protocol, on all products other than those subject to bilateral concessions.

On 1 June 2011, the Council of Ministers adopted the Decision No. 391 "On the Approval of the Statute of the Association for the Social Business Promotion, sh.a.". According to this Decision, the Association for the Social Business Promotion is a shareholders' association of private offer. It seeks to achieve a stable economic and social development by promoting a stable, balanced and cohesive social business development nation-wide. In view of achieving this objective, the association pursues its social and environmental goals

through the support and encouragement it provides to social and microfinance businesses, and by creating opportunities to Albanian poor people to have stable income. On the date of its establishment, the Albanian State, represented by the Ministry of Finance, holds 10,000 (ten thousand) shares equal to 100% (one hundred) of the equity of the association.

On 2 June 2011, the Parliament of the Republic of Albania ratified by Law No. 10427 "The Agreement between the Council of Ministers of the Republic of Albania and the Government of the Russian Federation on the Meeting of the Financial Obligations of the Republic of Albania to the Russian Federation for the account balances of the State Corporation "Bank for Development and Foreign Economic Affairs (Vnesheconombank)" at the State Bank of Albania". This Agreement shall be implemented for the financial obligations of the Republic of Albania to the Russian Federation that represent the overall unsettled balance in the accounts of the State Corporation "Bank for Development and Foreign Economic Affairs (Vnesheconombank)", open at the State Bank of Albania, to serve the commercial turnover and non-commercial operations between the U.S.S.R. and the People's Republic of Albania. Converted to U.S. dollars, the debt amounts to USD 1.036.723,48 and it will be fully settled by the Albanian party no later than 30 June 2011.

BANK OF ALBANIA MANAGEMENT, 30 JUNE 2011

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

ELIVAR GOLEMI

GOVERNOR'S OFFICE

GENC MAMANI

HEAD OF COORDINATION

GRAMOZ KOLASI

DEPARTMENTS AND OTHER UNITS

HUMAN RESOURCES DEPARTMENT	Roden Pajaj
MONETARY POLICY DEPARTMENT	Erald Themeli
RESEARCH DEPARTMENT	Altin Tanku
MONETARY OPERATIONS DEPARTMENT	Marjan Gjermani
SUPERVISION DEPARTMENT	Indrit Banka
FINANCIAL STABILITY DEPARTMENT	Klodion Shehu
INFORMATION TECHNOLOGY DEPARTMENT	Xhilda Kanini
STATISTICS DEPARTMENT	Diana Shtylla
ISSUE DEPARTMENT	Dorian Çollaku
ACCOUNTING AND FINANCE DEPARTMENT	Elsa Bizhga
PAYMENT SYSTEMS DEPARTMENT	Dashmir Halilaj
LEGAL DEPARTMENT	Toni Gogu
AUDIT DEPARTMENT	Elivar Golemi
FOREIGN RELATIONS, EUROPEAN INTEGRATION AND COMMUNICATION DEPARTMENT	Oneda Andoni
ADMINISTRATION DEPARTMENT	Agron Skënderaga
SECURITY AND PROTECTION DEPARTMENT	Eduard Sinani

BRANCHES

SHKODRA	Ermira Istrefi
ELBASANI	Valentina Dedja
GJIROKASTRA	Anila Thomaj
KORÇA	Liljana Zjarri
LUSHNJA	Shpresa Meço

BANKS AND BRANCHES OF FOREIGN BANKS LICENSED BY THE BANK OF ALBANIA, AS AT 30 JUNE 2011

1. RAIFFEISEN BANK SH.A.

Licence No. 2/1998, dated 11.01.1999

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

Certificate No. 2 "On Deposit Insurance"

Director: Christian CANACARIS

Address: Bulevardi "Bajram Curri", European Trade Center, Tirana, Albania

Tel: +355 4 2274 910

Fax: +355 4 2275 599

E-mail: info@raiffeisen.al

Website: www.raiffeisen.al

2. UNITED BANK OF ALBANIA SH.A.

Licence No. 3/1998, dated 11.01.1999

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

Certificate No. 3 "On Deposit Insurance"

Director: Hikmet GÜLER

Address: Rruga e Durrësit, sheshi "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: www.uba.com.al

3. VENETO BANKA SH.A.

Licence No. 5/1998, dated 11.01.1999

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

Certificate No. 4 "On Deposit Insurance".

Director: Lucio Luigi GAITA

Address: Bulevardi "Dëshmorët e Kombit", Ndërtesa Kullat Binjake, Tirana, Albania

Tel: +355 4 2280 555

Fax: +355 4 2280 356

E-mail: info@venetobanka.al

Website: www.venetobanka.al

4. NATIONAL COMMERCIAL BANK SH.A.

Licence No. 6/1998, dated 11.01.1999

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

Certificate No. 5 "On Deposit Insurance"

Director: Seyhan PENCAPLIGIL

Address: Bulevardi "Zhan D'Ark", Tirana, Albania

Tel: +355 4 2250 955

Fax: +355 4 2250 956

E-mail: info@bkt.com.al
Website: www.bkt.com.al

5. TIRANA BANK SH.A.

Licence No. 7, dated 12.09.1996

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

Certificate No. 6 "On Deposit Insurance"

Director: Georgios CHARALAMPAKIS

Address: Rruga "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 – ALBANIA BRANCH

Licence No. 8, dated 25.11.1996

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

Certificate No. 7 "On Deposit Insurance"

Director: Ioannis KOUGIONAS

Address: Rruga e Durrësit, Godina "Comfort", Tirana, Albania

Tel: + 355 4 2274 802 / 2274 822

Fax: + 355 4 2233 613

E-mail: nbgalbania@icc-al.org

Website: -

7. INTERNATIONAL COMMERCIAL BANK SH.A.

Licence No. 09, dated 20.02.1997

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

Certificate No. 8 "On Deposit Insurance"

Director: Mahendra Singh RAWAT

Address: Qendra e Biznesit, Rruga "Murat Toptani", Tirana, Albania

Tel: +355 4 2254 372 / 2256 254

Tel/Fax: +355 4 2254 368

E-mail: info@icbank-albania.com

8. ALPHA BANK - ALBANIA

Licence No. 10, dated 07.01.1998

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

Certificate No. 9 "On Deposit Insurance"

Director: Andreas GALATOULAS

Address: Rruga e Kavajës, G – KAM Business Center, kati II, Tirana, Albania

Tel: +355 4 2278 500

Tel/Fax: +355 4 2232 102

Fax: +355 4248 762.

E-mail: tiranabbranch@alpha.gr

Website: -

9. INTESA SANPAOLO BANK ALBANIA SH.A.

Licence No. 11, dated 10.08.1998

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

Certificate No. 10 "On Deposit Insurance"

Director: Stefano FARABBI

Address: Rruga "Ismail Qemali" Nr. 27, P.O. Box 8319, Tirana, Albania

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

Fax: +355 4 2248 762
 E-mail: helpdesk@intesasanpaolobank.al
 Website: www.intesasanpaolobank.al

10. PROCREDIT BANK SH.A.

Licence No. 12, dated 15.03.1999

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

Certificate No. 11 "On Deposit Insurance"

Director: Flutura VEIPI
 Address: Rruga e 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 - ALBANIA SH.A.

Licence No. 14, dated 28.10.1999

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

Certificate No. 13 "On Deposit Insurance"

Director: Luc BEISO (as from 1 July 2011)
 Address: Rruga e Kavajës, Nr. 59, "Tirana Tower", Tirana, Albania
 Tel: +355 4 2258 755 / 56 / 57 / 58 / 59 / 60
 Fax: +355 4 2258 752
 E-mail: headoffice@emporiki.com.al
 Website: www.emporiki.com.al

12. CREDIT BANK OF ALBANIA SH.A.

Licence No. 15, dated 28.08.2002

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

Certificate No. 14 "On Deposit Insurance"

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

13. CREDINS BANK SH.A.

Licence No. 16, dated 31.03.2003

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

Certificate No. 15 "On Deposit Insurance"

Director: Artan SANTO
 Address: Rruga "Ismail Qemali", Nr. 21, Tirana, Albania
 Tel: +355 4 2234 096
 Fax: +355 4 2222 916
 E-mail: info@bankacredins.com
 Website: www.bankacredins.com

14. SOCIETE GENERALE ALBANIA BANK SH.A.

Licence No. 17, dated 16.02.2004

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

Certificate No. 16 "On Deposit Insurance"

Director: Hubert de SAINT JEAN
 Address: Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Kulla 1, Kati 9, Tirana, Albania

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

15. UNION BANK SH.A.

Licence No. 18, dated 09.01.2006

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

Certificate No. 17 "On Deposit Insurance"

Director: Gazmend KADRIU

Address: Bulevardi "Zogu I", pallati 13-katësh, përballë stacionit të trenit, Tirana, Albania

Tel: +355 4 2250 653 / 2258 081

Fax: +355 4 2272 880

E-mail: info@unionbank.com.al

Website: www.unionbank.com.al

16. FIRST INVESTMENT BANK ALBANIA SH.A.

Licence No. 19, dated 06.07.2007.

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

Certificate No. 12 "On Deposit Insurance"

Director: Bozhidar TODOROV

Address: Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Kulla 2, 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 2011 licensed the following entities:

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

PUBLICATIONS ISSUED BY THE BANK OF ALBANIA OVER 2011 H1

This list was designed to inform readers about publications issued by the Bank of Albania over the first half of 2011. 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 the first half of 2011. This list does not include 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 2010

FINANCIAL STABILITY REPORT:

Financial Stability Report 2010 H2

SUPERVISION ANNUAL REPORT:

Supervision Annual Report 2010

MONETARY POLICY PERIODICAL REPORTS:

Monetary Policy Report for the Fourth Quarter of 2010

Monetary Policy Report for the First Quarter of 2011

PUBLICATIONS ON STATISTICS:

Statistical Report (Published monthly)

OFFICIAL BULLETIN:

Official Bulletin - Volume 13, no. 1 Year 2011

Official Bulletin - Volume 13, no. 2 Year 2011

Official Bulletin - Volume 13, no. 3 Year 2011

Official Bulletin - Volume 13, no. 4 Year 2011

Official Bulletin - Volume 13, no. 5 Year 2011

BULLETIN OF THE BANK OF ALBANIA:

Bulletin of the Bank of Albania - 2010 H1

Bulletin of the Bank of Albania - 2010 H2

WORKING PAPERS:

Competitive Position of the Albanian Economy in Terms of Productivity and Labour Cost - Evelina Çeliku, Iris Metani

Estimation of Weights for the Monetary Conditions Index in Albania – Oriela Kodra

The Persistence of Inflation in Albania – Vasilika Kota

Analysis of the Albanian Banking System in a Risk-Performance Framework – Irini Kalluci

SCIENTIFIC NOVELTIES AT THE BANK OF ALBANIA:

Scientific Novelties at the Bank of Albania No. 5

Scientific Novelties at the Bank of Albania No. 6

EDUCATIONAL AND INFORMATIVE PUBLICATIONS:

Brochure "Significance of Albanian Banknotes"

Brochure "7 Short Lessons on Money"

Leaflet "The Journey of Currency"

Brochure "The European Central Bank; the Eurosystem; the European System of Central Banks"

Brochure "Credit Registry" (reprint)

Brochure "What is a Report on the Borrower?" (reprint)

Brochure "Research and Training Centre of the Bank of Albania in Berat"
(available only in English)

OTHER:

"Monetary & Financial Stability Policies – Lessons from the Crisis" – Proceedings of the 8th International Conference of the Bank of Albania

"Economic Policies in SEE: Design, Performance and Challenges" - Edited by Ardian Fullani (available only in English)