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C O N T E N T S

EDITORIAL
A BRIEF OVERVIEW OF VIENNA INITIATIVE II

The Vienna Initiative II builds on the success of Vienna Initiative I, which was established at the height of the global financial crisis of 2008-2009. It uses a private-public sector platform, which brings together key international financial institutions, such as the European Commission (EC) and relevant European Union (EU) institutions, the principal cross-border banking groups in Central, Eastern and Southeast Europe (CESEE) and home and host country authorities.

The objective of Vienna Initiative II is to foster home and host authority coordination in support of stable cross-border banking and guard against disorderly deleveraging. Western banking groups continue to play an important role in the Initiative, both by supporting the coordination efforts and doing their own part to avoid disorderly deleveraging.

Vienna Initiative I

The Vienna Initiative I was launched by the European Bank for Reconstruction and Development (EBRD), International Monetary Fund (IMF) and the Ministry of Finance of Austria at the height of the global financial crisis 2008-2009, bringing together public and private stakeholders to secure adequate capital and liquidity support by Western banking groups for their affiliates in CESEE.

Following, the European Commission decided to join this Initiative, considering it as rather important. The ongoing lobbying by IMF and EBRD provided for the large participation of home and host country public authorities of cross-border banks operating in Southeast European countries. Moreover, the World Bank Group and European Investment Bank played a key role in the creation and further development of the Vienna Initiative.[1]

As part of the Vienna Initiative, cross-border banking groups signed country-specific commitment letters, in which they pledged to continue to credit the economy and confirmed to maintain their subsidiaries well capitalised and sufficiently liquid. At the same time, concerns surfaced as this fact might prompt multinational banking groups to support these countries through withdrawals of funds from other countries which have not signed commitment letters. In fact, no large and uncoordinated withdrawal of emerging countries banks was concluded.

[1] *Wolfgang Nitsche, 2010, Working Paper 4/2010, The Vienna Initiative/European Bank Coordination Initiative: Assessment and Outlook.*

Vienna Initiative I is broadly perceived as a successful mechanism for coordinating public and private sector endeavours during the global financial crisis. This Initiative has helped countries stabilise and recover their economies, and build mutual confidence among cross-border banks, home and host authorities and the international financial institutions.

Vienna Initiative II

The CESEE countries are important hosts to foreign parent banks, headquartered predominantly in Western Europe. In this view, the financial crisis, and particularly the sovereign debt crisis in the euro area, has brought the conflict of interest between the banking sector's home and host countries sharply into focus. The ongoing euro area crisis has highlighted the risk of disorderly deleveraging of western parent banks vis-à-vis their affiliates in CESEE and difficulties in cooperation between home and host country authorities. Hence, countries where foreign banks' subsidiaries or branches are systemic face particular challenges in safeguarding the financial stability and ensuring adequate credit supply for their economies.

Due to these developments, in January 2012, the Vienna Initiative was re-launched as Vienna II in response to renewed risks for the region from the euro area crisis.

The objective of the Vienna Initiative II is to:

- Avoid disorderly deleveraging, which could jeopardize financial stability in host countries and ultimately hurt home and host country economies alike. The objective is not to prevent deleveraging in general. Some deleveraging is beneficial, leading to more stable funding structures, reduced external debt, or stronger bank owners. On the other hand, the large-scale, unanticipated rapid deleveraging has created systemic risks and unduly curtails overall funding of CESEE banks;

- Ensure that potential cross-border financial stability issues are resolved. The multi-jurisdictional setting is prone to gaps, overlaps, competing objectives and conflicts of interest among authorities, all of which demands attention. In addition banking groups would benefit from progress in this area as it would strengthen the conditions for stable and well-functioning cross-border banking;

- Achieve policy actions, notably in the supervisory area, that are taken in the best joint interest of home and host countries. This requires mutual recognition of concerns by home and host countries, ensuring that host authorities have an appropriate voice, and fostering an atmosphere of trust amongst all relevant parties. The issues of bank resolution call for the participation in discussions and potential involvement of authorities beyond supervisors and central banks, notably the fiscal authorities responsible for taxpayers´ money.[2]

[2] *http://vienna-initiative.com/vienna-initiative-part-2/.*

The Vienna Initiative II functions as a public and private sector platform, which brings together key International Financial Institutions, the European Commission and relevant EU institutions, the principal cross-border banking groups, and home and host country authorities. Its geographical coverage extends beyond the European Union (EU) and includes other CESEE countries with a substantial presence of Western banks.

While the Vienna Initiative I was focused on western banking groups maintaining exposure to their CESEE affiliates and providing capital and liquidity as needed, the Vienna Initiative II is, in addition to private sector participation, mainly geared towards authorities, encouraging them to cooperate. Nonetheless, the private sector has an important role to play both in terms of helping identify concrete steps to improve coordination of authorities and in terms of working itself to avoid disorderly deleveraging.

The work within the Vienna Initiative II aims for practical results by monitoring of, and reporting on the deleveraging process and by setting up temporary structures, where private and public sector decision makers meet to exchange experience and discuss appropriate actions. Drawing practical conclusions from the experience of the host countries and proposing action on those conclusions is also within the remit of the Vienna II. The agenda of this Initiative includes also addressing macro-prudential issues. The Initiative takes into account new regulatory developments at the European level, such as the European Commission resolution proposal and the Banking Union.

Steering bodies of the Initiative are:

1. Full Forum, consisting of all participants in the Initiative. The forum decides by consensus on the Initiative's priorities and approves the working plan and reports. It also approves the principles and recommendations undertaken in the framework of the Initiative.

2. Steering Committee composed by international financial institutions (EBRD, EIB, IMF, World Bank), European Commission and selected participants (Italy, Romania), manages the practical work of the Initiative and prepares strategic decisions for the Full Forum. Steering Committee reports to the Full Forum during its meetings. Mr. Marek Belka, Governor of the National Bank of Poland, was appointed as the Chairman of the Vienna Initiative's Steering Committee in June 2012. As from 2013, Mr. Ardian Fullani, the Governor of the Bank of Albania, has been a member of the Vienna Initiative II Steering Committee.

The assignment of the Bank of Albania Governor at the highest steering body of Vienna Initiative II is a rather important step to project more effectively Bank of Albania's position to the European Union authorities, international institutions and large banking groups, related to the euro area developments' impact on the Albanian financial system. However, this role does not only consist in simply transmitting the Bank of Albania concerns in the quality of a supervisory authority of a host country but will also be a possibility to provide

a significant contribution with relevant suggestions to build on a more fruitful collaboration mechanisms between EU and non-EU members' authorities. These mechanisms are aimed at ensuring the joint stability of already integrated European markets in the long run. Considering that Albania is the only non-EU member country represented in Vienna Initiative II Steering Committee, it is committed to represent the interests of countries aspiring to join the EU. Albania will, therefore, play an important role to enhancing cooperation between EU and non-EU member countries.

In the framework of Vienna Initiative II, the Bank of Albania has clearly highlighted the need for establishing prerequisites for CESEE countries to be credited by Western banks, and addressing possible negative consequences of deleveraging in these countries. Also, the Bank of Albania has evidenced the need for EU authorities to tackle extensively issues related to the interconnection between EU/euro area financial systems and non-EU member countries, in order to compile balanced and sustainable macro-prudential policies, which should consider the possible impacts on non-EU host member countries. Also, the Bank of Albania holds that a more effective coordination of supervision activities, with well-functioning colleges and other supervisory collaboration forums, is crucial.

Vienna Initiative II and European Banking Union

The focus of Vienna Initiative II on the observation of major reforms on banking regulation and supervision at European level has obtained the needed attention, materialised in the establishment of special structures. Thus, with the aim to estimate the effects of European banking union on European emerging economies and to contribute to the ongoing debate on its compilation and implementation, in the framework of the Initiative, an ad hock group is established, where Bank of Albania provides active contribution.

The beginnings for a banking union are found in the EU summit of June 2012, which analysed a report by the EC President. The President called for an integrated financial framework, based on three main pillars: banking supervision, selection of banks, and deposits insurance at European level. Related to the first pillar, the summit agreed on the establishment of a Single Supervisory Mechanism (SSM) led by the European Central Bank (ECB). In this context, an effective supervision will provide ground for a direct recapitalisation of banks through the SSM, thus avoiding the negative effects of banks' public recapitalisation on the countries fiscal positions.

The second pillar aim as final step the establishment of a Single Resolution Mechanism (SRM) expected to provide timely resolution of banks and agree on dividing losses. The third pillar highlights the need for an integrated framework for deposit protection.

A working group encompasses representatives from home and host supervisory authorities and ministries (euro area and non-euro area countries), bank

groups' representatives, IMF, EBRD, World Bank and European Investment Bank. The European Commission is not part of the working group, but provides comments and suggestions.

Notwithstanding the bank union is concentrated on euro area needs, the Working Group's main goal is to consider the implications for emerging European countries, where euro area banks 'subsidiaries dominate the local banking systems.

Through its contribution in this Group, the Bank of Albania' objective is to represent the interests of non-EU host countries to EU authorities.

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

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the China-Europe Economists Symposium
"China-Europe economy: future challenges and opportunities"
12 January 2013

Dear Mr. Chairman,
Dear Colleagues,
Ladies and Gentlemen,

It is a great pleasure for me to participate in this Symposium. The rapidly evolving economic landscape of the past few years poses to policy-makers a demanding set of challenges and opportunities. I am sure that the honest and productive exchange of ideas will facilitate a deeper understanding of the problems we are facing and will allow us to design more appropriate strategies for overcoming them.

INTRODUCTION

Our topics of discussion today focus on the performance and prospects of China and Europe, the two economic regions which probably are at the opposite ends of the spectrum of contagion from the global crisis. While China has remained largely unaffected, Europe has suffered significantly. The crisis exposed fundamental structural and institutional weaknesses in the Eurozone and the EU.

In my short address, I will concentrate on the current state of Europe's economic and financial situation. It would be almost an understatement to define the past, the current and the expected developments in the Europe, as difficult and short-term. The so-called "Great Depression" tested the Eurozone and the European economy. The EU convergence process proved to be incomplete, from economic and institutional point of view. From a longer term perspective, the process of globalization and the adverse demographic trends have challenged the sustainability of the economic and social systems of the EU. In spite of these problems, I remain firmly convinced that Europe will continue to be a dynamic and prosperous region in the future. The short term costs of structural reforms will be far outweighed by their targeted long-term gains. A more competitive and integrated Europe, underpinned by stronger institutions and governed by more sustainable economic and financial policies, will benefit the whole global economy. The remaining part of my speech will address these points in more detail.

EUROPE THROUGH THE CRISIS

Europe has been one of the worst hit regions from the global crisis. The initial impact of the subprime market crash in the US was felt across the European financial sector, with stock markets plummeting and banks facing

huge losses on their balance sheets. The resulting decrease in asset prices and the drying up of bank credit, the decline in global trade activity as well as the collapse of business and consumer confidence were immediately reflected in a widespread recession during the 2008-2009 period, followed by a period of uncertain and slow growth. Unemployment shot upwards while fiscal balances deteriorated rapidly. The decline of the economic activity fed into further uncertainty in the financial sector, originating a negative feed-back loop which became difficult to overcome in the presence of private sector deleverage, widespread risk aversion and public finance constraints.

Most of the aforementioned features were shared with other economies, such as US and Japan. The balance sheet recession they describe remains tractable, at least in theory, with a combination of short term economic stimulus, long term commitment to macroeconomic stability, structural reforms, and patience. However, there have been several idiosyncratic issues which set the European experience apart from the other economies. They were manifested into severe public sector problems in several Eurozone countries, widespread lack of trust in institutions and authorities, and the strengthening of centrifugal forces which risked breaking the euro apart.

What were the factors that exacerbated the crisis in the Eurozone? While an exhaustive list would be long, I would like to highlight three of them.

- First, the inter-dependence between sovereign credit rating, financial sector risk premia and the real economy was exacerbated by incomplete financial market integration. While the region as a whole suffered from capital outflows, financial integration within EU went in reverse during the past four years. The repatriation of cross-border financial flows created further problems in the Eurozone economies and neighboring region. In fact, the subsequent cross-border deleveraging and de-risking has been one of the main crisis propagation channels that has affected eastern European countries, Albania included.
- Second, the divergence in intra-regional economic policies resulted in a divergence of competitiveness within the EU and Eurozone. This accentuated existing intra-regional balance of payments issues during the crisis, highlighting the need for long overdue economic and fiscal reforms.
- Third, the absence of a fiscal union has meant that the policy response has been lacking, especially in the presence of a monetary policy dealing with the zero lower bound of interest rates. Furthermore, doubts about the long term fiscal position of certain Eurozone countries, such as Greece, Ireland, Italy, Portugal and Spain, increased to unsustainable levels their sovereign risk premia and their public and private sector borrowing costs.

WHAT HAS BEEN THE POLICY RESPONSE WITHIN THE EU?

The EU crisis management policy aimed to contain and overcome its effects, but, to a large extent, it has been conditioned by some of the constraints I mentioned before.

Monetary policy took the lead in providing countercyclical stimulus to the economy, with the ECB rapidly lowering its policy rate and injecting huge amounts of short and long-term liquidity. Lastly, the announcement in September of the Outright Monetary Transactions by the ECB has been a turning point in regaining the trust of the financial markets.

On the other hand, given the lack of space for stimulating fiscal policies, the public sector has been more interested in controlling long-term public debt trajectories, subtracting rather than adding to economic stimulus. To this end, the agreed fiscal compact and macroeconomic surveillance policies aim to put the Eurozone public finances into a sound and credible long-term footing. On the financial side, the EU has revised its financial architecture by establishing the EFSF (European Financial Stability Fund) and European Stability Mechanism, by agreeing to establish a single banking system supervisor. Lastly, there have been several structural measures undertaken, aiming to revive both the EU and country-specific competitiveness. Among others, these measures include increasing labor market flexibility, reforming the pension system, further liberalizations in the goods and services markets.

WHAT REMAINS TO BE DONE?

While arguably late, I think the policy response within the EU has gone in the right direction and has been rather comprehensive. Nevertheless, further work is required in the future.

I would like to highlight two of these areas.

- First, the reform agenda identified by four presidents (of the European Council, of the European Commission, of the Eurogroup and of the ECB) aims to complement the monetary union with a financial union, a fiscal union, an economic union and some higher degree of political union. This is an ambitious goal, but I am fairly convinced it will be accomplished within a reasonable time-scale. In this context, it is not much a wish list as it is a prerequisite for long term growth. It would indicate to the world that Europe has answered the dilemma about its role in the global economy of the 21st century.
- Second, I think that efforts to increase EU integration should extend to include a deeper cooperation with candidate and potential candidate countries in the Eastern and Southeastern Europe. These economies are very much connected to the EU, from an economic and financial perspective. They have undertaken structural reforms to liberalize their economies, to increase their competitiveness and to coordinate their policies. EU efforts should concentrate in aiding and speeding the convergence process in the design of markets and institutional frameworks while minimizing the related short term costs. This would be to the mutual benefit of both the EU and the region.

I would like to add that in realizing such an agenda, the policy-makers need to pay special attention to the time dimension. Reforms that need to be made

should be made in time. Furthermore, such reforms have to be made with the whole of the EU project in mind. Individual countries have much work to do, but a lasting solution to the challenges will be a comprehensive reform that looks beyond specific borders and aims at raising the competitiveness and sustainability of the EU as a whole.

EUROPE IN THE FUTURE

Ladies and gentleman, to conclude my address allow me to restate my belief in the future of Europe.

A brief glimpse at some figures would illustrate this point. EU comprises roughly 7% of world population but accounts for a quarter of global GDP. It has a mature social and economic model, which in spite of long-term challenges remains a viable paradigm of economic development. The external position of both EU and Eurozone is broadly balanced, with current account deficits of less than 1% of GDP. The public debt to GDP ratio of 83% compares favorably with that of other advanced economies and competitors such as the US and Japan, respectively at 103% and 230%. EU is one of the core areas of global innovation. In terms of Research and Development expenditure it is not far behind the US, while in terms of number of researchers and patent application actually outperforms it.

Europe and the EU offer a mature legal environment, with adequate protection for investors and intellectual property. Its macroeconomic policies remain stability-oriented and its financial system is both mature and sound. Five out of the ten highest ranked countries in the latest Global Competitiveness Index are EU countries.

Furthermore, I would like to emphasize, apart of Eurozone, there are other countries in the Eastern and Southeastern Europe which offer a qualitatively different picture. Up to 2008 they included some of the fastest growing emerging economies. These are fast growing economies, with better demographic trends. They offer untapped growth potential, in terms of qualified work force, business friendly environment and stable institutions. European integration process has been the main anchor and major driving force of growth and convergence. Therefore, I strongly urge countries of the SEE region to dedicate substantial efforts towards a closer regional integration in infrastructure, markets, education and legal framework. Deeper economic regional integration will increase the competitiveness of the region from European and global perspective.

Lately, efforts have been made towards a closer regional integration, making the region more attractive to potential foreign investors. With a deeper regional integration, a better anchoring in the EU convergence process and more funding, the Eastern and Southeastern Europe has much to offer to Europe and to the global economy.

The periphery of the Eurozone or the future new members provide many attractive investment opportunities in development projects in infrastructure, trade, exploitation of natural resources, energy and production capacities. Most importantly, the development of these strategic sectors is designed within the framework of the European development plans and the future larger European economy. Therefore, investing in the region would mean to invest in the future of the European economy itself.

Dear Participants,

A prosperous and integrated European economy and confident single currency provides a better anchor for the future of our economic, financial and institutional convergence and therefore additional benefits for the European economy itself. European economy is an important partner in global scale, accounting for a substantial share of global demands, financing, education and technology advancement. The strength of European economy is mutually beneficial for Europe and its partners, including China.

Considering the past and the present state of economic, social, political and intellectual affairs, I remain firmly convinced in the ability of the Europe to rise up to current and future challenges to reintroduce itself as the land of opportunity and prosperity. Europe will be an important partner for China and the global economy. Before I leave the floor, I would like to bring to your attention a very old Chinese proverb: "No one who can rise before dawn 360 days a year fails to make his family rich".

Thank for your attention.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision of Bank of Albania's Supervisory Council,
30 January, 2013

Today, on 30 January 2013, the Bank of Albania's Supervisory Council reviewed and approved the biannual Monetary Policy Statement. Based on the latest monetary and economic developments in Albania, and following the discussions on their future outlook, the Bank of Albania's Supervisory Council decided to lower the key interest rate by 0.25 percentage points. After this decision, the one-week repurchase agreement rate drops to new record-low level of 3.75%. The Supervisory Council deems that further easing of monetary conditions will help in meeting the inflation target in the medium term.

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

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The Albanian economy improved slightly in the seconds half of 2012. This performance was driven by a fuller reflection of monetary stimulus and improved external economic and financial environment. However, the economic activity remains below potential and the growth resources appear unstable. Production growth is not reflected in decreasing the overall uncertainties, which contain private investments and consumption, and lead to downward credit demand and supply. The banking system has sound and liquid balance sheets but it remains highly prudent in terms of financing long-term investments. These tendencies will condition the economic developments over the period ahead. Inflationary pressures were low during the last quarters. Reflecting also the Bank of Albania's prudential monetary policy, inflation settled within its target in 2012. The increase in annual consumer prices was 2.4% at year-end, while the annual average inflation rate was 2%. The inflation rate increased progressively during the first three quarters and fell slightly during the fourth quarter.

Inflation volatility was mainly driven by food prices, which were affected by the international market and domestic production. The effect of other basket goods' prices on inflation was low and slightly volatile. Regulated or administered price inflation was insignificant, while higher prices for consumer goods, oil and primary commodities in the global market did not cause any higher inflation in the Albanian economy.

From the macroeconomic viewpoint, all determinants of inflation contributed to keeping it at low levels. The incomplete utilization of productive capacity

was associated with businesses' low demand for labour, hence no pressures for increase in wages and labour costs. Also, the weak demand for goods and services reduced businesses' ability to dictate final product prices and affected low levels of profit margins. On the other hand, low increase in the global market prices and the exchange rate stability helped in keeping import prices in check. Finally, expectations for a low inflation in the medium term were reflected in stable costs, prices and interest rate in medium and long-term contracts concluded in the labour market, in consumer goods and financial instruments.

According to data from INSTAT, the Albanian economy grew by 2.7% in the third quarter of 2012, and similar growth rates are expected for the fourth quarter. Services, industry and agriculture sectors supported the economic growth, while the construction sector continued to contract.

Assessment of third-quarter and fourth-quarter aggregate demand components confirms, to a great extent, the expectations noticed from previous periods. Foreign demand has been the main driver of economic growth in the country. Net export deficit narrowed in the third quarter of the year, mainly due to growth in exports of goods and services. Third-quarter data attest to continuation of this trend. During October-November, exports grew by 14.3%, while imports fell by 5% on a year earlier. As a consequence, trade deficit has dropped by 15.5%, y-o-y. On the other hand, the domestic demand has remained sluggish due to lack of fiscal stimulus and slow performance of consumption and private investments.

Indirect available data for the third quarter of the year depict improved consumption but low private investments due to incomplete capacity utilization on production, uncertainties about the future and tighter financing conditions. Fiscal indicators have reflected the overall performance of the economy and the fiscal consolidating policy pursued in 2012. Slow growth in budget revenue and expenditure, and budget deficit contraction characterise fiscal developments. Fiscal revenue for the first 11 months of the year increased by 2.0%, y-o-y, reflecting the low contribution of related taxable component. Public expenditure increased by 0.9%, y-o-y, mostly reflecting the negative growth rates of capital spending. As a result, the budget deficit of this period marked 8% annual decline.

The fourth quarter highlighted a better pass-through of monetary stimulus in financial markets. It was also characterised by a better anchoring of interbank market rates and their decreasing volatility. The Bank of Albania has pursued an easing monetary policy during the last three years. The monetary stimulus has increased progressively during this period, bringing the key interest rate to record low levels and mitigating the liquidity pressures on the interbank market.

However, the pass-through of easing monetary policy effects on the economy has been contained due to higher perceived risk premia and changed stance by financial market agents and the real economy. Over the first half of the

year, the domestic primary market faced structural changes arising from implementation of new tight measures by European supervisory authorities. This development impacted on maintaining relatively high yield rates, despite the easing monetary policy and lowering short-term interest rates in the money market. Normalisation of the primary market in the second half of the year was reflected in progressively falling yields over this period. This tendency might have been passed on to ALL-denominated private sector credit costs, though with lower intensity as a consequence of risk premia reflected in private agents' credit price. Overall, controlling the borrowing in the domestic money market, expanding the Government securities investment base and stabilising the risk premia in the economy create grounds for a better functioning of transmission channels in the future. Therefore, the Bank of Albania believes that the long-term public debt sustainability and public borrowing constraint in the domestic money market help enhance the monetary policy effectiveness and increase the space for the private sector credit to the economy.

Monetary indicators were characterised by slowing growth rates in the second half of the year. They signal low monetary inflation pressures on the economy. The annual monetary supply growth averaged 5.9% in October and November, supported primarily by developments in the external sector of the economy. Money demand by the domestic agents of the economy was low. The increase in households' participation in public debt securities was reflected in lower financing of this sector by the banking system. Businesses' and households' demand for funding decelerated significantly, reflecting the low demand for consumption and investments. Also, banks continued to pursue a more prudential approach in lending, applying tight standards in response to uncertainties perceived at sector level and the economy. Responding to them, annual growth of credit to economy reached 4% in November. Credit to economy was based on the 18% increase in ALL-denominated loans, against the 3.2% decline in foreign currency-denominated loans. Also, credit growth continued to be driven by increase in business loans, while consumer loans and home loans appeared rather low.

The so-far economic activity performance and projections for 2013 support the outlook for positive economic growth close to the previous year's figure. Foreign demand is expected to contribute positively to Albania's economic growth, but this contribution is expected to be lower due to unfavourable developments in trading partner countries and relatively low diversification of Albanian exports. Private demand is also expected to be positive, taking advantage of monetary stimulus growth and domestic savings utilization. Finally, the public sector is also expected to provide a positive stimulus. Despite the positive growth, the economic activity in Albania is expected to remain below its potential during the current year and the demand-side inflationary pressures are expected to remain low during this time horizon. The Bank of Albania deems that with a 90% probability, the annual inflation as to four quarters ahead is forecasted to range within the 0.8 - 3.8% band. Low annual inflation rates and forecast for their continuation over the monetary policy time horizon dictate the maintaining and strengthening of the stimulating monetary policy over the next four quarters.

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Considering the information summarised above, the Supervisory Council deems that consumer price pressures in Albania remain weak along the monetary policy time horizon and have shifted downward during the last months. Concluding, the Supervisory Council decided to lower the key interest rate by 0.25 percentage points, to 3.75%. This decision aims to create appropriate monetary conditions to meet the medium-term inflation target. The easing of monetary conditions keeps the short-term financial market interest rates low, encouraging the activity and decreasing the related liquidity trading premia. By lowering the financing costs, the Bank of Albania aims to increase consumer loans and investments in the economy. This transmission mechanism promotes the aggregate demand, and under current circumstances, creates appropriate conditions for meeting the medium-term inflation target.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision of Bank of Albania's Supervisory Council
27 February 2013

Today, on 27 February 2013, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the latest monetary and economic developments in Albania, and following discussions on their future outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 3.75%. The Supervisory Council deems that the monetary conditions are adequate to comply with the medium-term inflation target, providing the necessary monetary stimulus to boost domestic demand.

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

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Annual inflation was 2.7% in January. Higher food prices were the major contributor, about 75%, to inflation formation. In this regard, unprocessed foods, which recorded double-digit growth rates, contributed the most to this formation. The prices of the other consumer basket items fluctuated narrowly, maintaining their low contribution to inflation.

In the macroeconomic aspect, inflation was formed by the presence of spare production capacities, while supply-side shocks were absent. The slow growth of production costs and low profit margin for businesses were reflected in low core and headline inflation rates.

In addition, the stable exchange rate, anchored inflation expectations and low monetary expansion contributed to maintaining price stability.

The Albanian economy is estimated to have grown below its potential in 2012. Recent economic and monetary data confirm, overall, our earlier assessment for the presence of a negative output gap. On the demand side, economic growth was driven mainly by net exports growth, whereas domestic demand is estimated to have provided low contribution. Data on trade in goods during the fourth quarter show that exports increased 12% and imports fell 9.5%, year on year. Subsequently, the nominal trade deficit narrowed 20.1%, in annual terms, boosting aggregate demand in this quarter. On its side, domestic demand remains weak, due to consumers and businesses hesitation to consume and invest.

Lending standards continue to be tight as banks are more prudent about lending. Budget expenditure fell about 0.3%, year on year, owing mainly

to contracting capital expenditure. Collected revenue was also downward, eventually reducing the budget deficit by 1.2% compared to 2011. However, the fiscal policy was stimulating during the fourth quarter, materialising in 35% expansion of the budget deficit for this period. Though at low rates, public expenditure is expected to have positive contribution to economic activity in 2013.

The monetary policy eased further in January, through the key interest rate cut to the record low of 3.75%. The easing was transmitted into the interbank market interest rates during February, while it is expected to be transmitted into other segments of the financial market.

Low government demand for borrowing has exercised downward pressures on government securities yield.

Overall, monetary and financial developments point to low inflationary pressures and liquidity risk. Monetary indicators continued to slow down in December, as well. Annual money supply growth fell to 5.0%. Developments in the external sector were the main drivers of money growth, whereas domestic demand for money was low. The relatively low demand of the government for borrowing and higher demand of households to invest in public debt securities was reflected in reduced funding of the budget deficit by the banking system. Similarly, credit to the economy recorded low annual growth rates both for businesses and households. The domestic currency prevailed over foreign currencies in the credit market, hence enabling better transmission of the monetary policy signals to the economy.

Recent information reconfirms our projections for future economic developments.

In the period ahead, economic growth will be driven by economic developments in the global setting and in our trading partners, the fiscal policy nature and enhanced productivity. In 2013, economic activity is expected to remain weak and will continue to be driven by net exports growth, although at lower rates from 2012. The forecast is based on a non-encouraging economic outlook for our trading partners. It also reflects the low diversification of Albanian exports. Domestic demand is expected to remain at low levels, reflecting the sluggish private consumption and investments and the positive contribution of the public sector. Taking into account the available information, the Bank of Albania deems that, with 90% probability, the consumer price inflation is expected to range between 0.8 - 3.8%, after 12 months.

This assessment takes into account our projections for the continued negative output gap, low pressures from global market prices, and anchored expectations of economic agents.

Concluding, the Bank of Albania expects the inflationary pressures to remain weak in the medium run.

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At the end of the discussions, the Supervisory Council decided to keep the key interest rate unchanged at 3.75%. The Bank of Albania will continue to implement a stimulating monetary policy for as long as inflationary pressures remain weak. Stimulating monetary conditions support aggregate demand growth and full utilisation of production capacities, creating, therefore, the premises for complying with the medium-term inflation target.

SPEECH BY ADRIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At a forum on "Lending to the economy and the long-term stability of the banking system"
04 March 2013

Dear Guests,

It is my pleasure to welcome you to this forum and say a few words about its significance. The Bank of Albania considers that an open and ongoing communication with the banking industry and business community is a prerequisite to ensure a greater macroeconomic and financial stability in the country. These meetings serve as platforms to present incentives and strategic decisions that affect directly the economic and financial activity of both components represented in this meeting. This is an open forum, where the Bank of Albania's analysis, conclusions and decision-making will be juxtaposed with other groups' analyses and conclusions.

What I expect from this meeting is a good understanding and an assignment of responsibilities to provide Albania's economic activity with a new stimulus by recovering credit to economy. Hence, allow me to speak on the main topic of today's forum: lending to economy and banking system's long-term stability. Besides professional discussion on the topic, this meeting also aims to launch Bank of Albania's new initiative, which I would call Bank of Albania's credit revival package.

Let me now elaborate this topic further, by dividing my speech into three main sections:

- Highlights on recent economic and financial developments in Albania;
- A retrospective view of the confrontation of our economy with the global crisis; and
- A package of measures we propose to revive lending to economy.

ALBANIAN ECONOMY IN 2012

Year 2012 was a challenging year for Albania's economic development. Albanian economy recorded positive growth and its economic and financial balances were stable. Economic growth, however, has pursued a clearly slowing path over the past four years and the concerns behind this performance remain present.

As we have continuously stated, Albania's economic activity suffers from lack of final demand for goods and services. Consumers and businesses, in particular, appear reluctant to consume and invest due to higher uncertainty and tighter lending standards. Lack of this demand is reflected in incomplete utilisation of productive capacities, yielding, in turn, a low economic growth, a

sluggish labour market, financial constraints to businesses, and deteriorating loan quality.

Though non-performing loans increased to 22.5% as a percentage of total loans as at end-2012, the banking sector appears stable. Capitalisation and liquidity figures remain at good levels. Profit is distinctly higher than in 2011.

Loans and deposits grew higher but at slower paces than in 2011. The decelerating lending was considerable, as it grew by merely 2.1% in the past year. Only lending in lek provided a positive contribution, while lending in foreign currency shrank on a year earlier. Banks increased their prudence in lending, leading to a relatively tightening credit supply. The tightening of the regulatory and prudential regulations at European level made a considerable impact, which was passed on to a refrained lending activity throughout the countries where European banks operate. This phenomenon, which is technically recognised as deleveraging or reduced "risk appetite", has brought about a phenomenon which according to McKinsey is known as "balkanization" of the European financial system.

This phenomenon, either open or hidden, is rather damaging for the development perspectives of the countries in the region and for the European integration process. From our viewpoint, the banking system should be avant-garde in this process, by exposing the country's competitive advantage at parent banking groups and attracting foreign investors.

In its analyses, the Bank of Albania has identified the decline in demand as the main concern facing the Albanian economy. Mandated by law to maintain price stability, we assess that the low economic growth may prevent us from achieving our mandate in the medium run. We have, therefore, emphasised that Albania's economic policies should be stimulating.

We also deem that the fiscal policy faces lack of room for fiscal stimulus and it should increase its orientation toward consolidating the long-term stability of public finances. Under these circumstances, we have fully steered our policies and instruments toward boosting consumption and investments in Albania. Bank of Albania's monetary policy has been more and more stimulating. It has lowered the key interest rate for six consecutive times to the record low of 3.75%. We have also continued to supply the banking system with the required liquidity to support the public and private sectors' activity. In parallel, our communication with the public has aimed to guarantee economic agents and financial markets for maintaining an easing monetary policy in the future.

Overall, our monetary policy has been successful in preserving macroeconomic balances; however, its effect on stimulating the economy has been more limited. The financial market and the banking system have not fully reflected the key interest rate cuts in their main products - loans, deposits and Government securities - while the Albanian consumers and businesses have slightly responded to monetary stimulus and lower interest rates. To our opinion, this performance reflects two main problems that our economy and

macroeconomic policies are facing. These two problems are: 1. structural vulnerabilities of the Albanian economy; and 2. the restriction of conventional instruments of economic control, of monetary and fiscal policies, in boosting the aggregate demand and economic growth.

Addressing them in a differentiated way requires the formulation and implementation of necessary structural reforms to support entrepreneurship, enhance productivity, improve competition and support economic growth. In addition, it points out the need for taking unconventional measures to boost lending and support the economy.

Let me now briefly dwell on the structural vulnerabilities and then focus on Bank of Albania's initiative designed to address the second challenge.

ALBANIAN ECONOMY IN THE FACE OF THE GLOBAL CRISIS

Like all developing and emerging economies, the Albanian economy has undergone a rapid economic growth on its path to catching up EU economies. This growth has been mostly supported by rapidly increased consumption in economy and has been financed by using previous savings or foreign financing sources. The main beneficiaries of this demand are construction and services, i.e., the sectors that use labour force intensively and ensure the increase of wages and employment, which are, however, less export-oriented. On the other hand, industry and agriculture slowed down, suffering from lack of attention by the banking system, the degree of investments and expertise, and longer time needed for return on investments. This tendency has left Albania with a small base of export-oriented industries or of those competing with import products.

The global crisis served as an important testing for this growth model. It highlighted its limits to face external shocks and its restrictions in an ever challenging global environment. In simpler words, the global crisis highlighted the importance of maintaining sound balances in both public and private sectors. It also depicted that the most competitive economies that have successfully competed in global markets are the ones that have higher and more sustainable growth rates. It is my pleasure to state that this lesson has been learned by the Albanian economy at both consumer and producer level. More specifically, Albanian households have been more reluctant to spend and more inclined to save.

In a longer-term horizon, this is undoubtedly positive. First, it guarantees the health of individual household balances, and second, it creates a sufficient fund of financial savings to boost credit and investments in the country.

In a shorter-term horizon, it induces lack of demand and makes economic growth difficult. On the other hand, the Albanian business learned that the domestic market has restricted abilities to generate a sustainable economic growth. As a consequence, it is showing a rising interest in industry and agriculture, as sectors that have a better development perspective and a larger market share.

The above-mentioned situation has important implications for the country's development pace and macroeconomic policies. First, it implies that the country's economic growth potential is lower in the medium term. In other words, the transfer of financial and human resources across sectors, acquisition of technologies and modern business practices, as well as exploration of foreign market penetration, need time and determine the economic growth rate. Moreover, this development is faced with an unfavourable external environment, relatively high cost of funds and lack of domestic demand. Recovery of previous development paces takes time. Second, the higher propensity to save and increased risk premia restrict the ability of monetary policy to generate additional demand in the economy by lowering the key interest rate.

Global economic developments are optimistic. The euro area and the European currency appear more consolidated due to ECB's contribution and nation-wide efforts for fiscal consolidation. However, the optimism is fragile. Central banks of advanced economies have stated clearly that they will continue to apply the quantitative easing, as long as inflation remains below the target and unemployment remains high.

Actually, the so-far solutions have been in forms never experienced before. In fact, they represent new challenges with regard to implementation and potential risk spillover effects in the long run.

Under these circumstances, the Bank of Albania, regarding the situation as rather complicated and working intensively, has managed to design a full package of measures. They aim to boost credit and improve micro and macroeconomic balances of financing the economy, about which I will inform you in the following.

CREDIT REVIVAL PACKAGE

The idea about the package that we are introducing today occurred last year, when we discussed jointly with you and representatives from the Ministry of Justice, about legal amendments needed to promote collateral execution. Since that meeting, our experts have worked intensively to enrich it and bring it to today's form.

The package consists in three pillars: legal pillar; monetary policy pillar and prudential pillar. I will dwell on them in the following:

1 – Legal pillar

The rapidly increased non-performing loans in the recent years, reflects, inter alia, a number of known and unknown problems about collateral execution. Therefore, together with the banking industry, we have identified and put forward concrete proposals for higher efficiency in the collateral execution process. In consultation with other important stakeholders in this process, legal amendments to the Civil Procedures Code and to the Civil Code have been drafted.

These amendments aim to accelerate the obligatory collateral execution, by avoiding procedural delays that bank debtors cause.

More specifically, the proposed amendments address the following:

- Courts do not take measures to secure charges, in the event the bailiff actions are rejected;
- Courts do not take measures to secure charges and do not suspend collateral execution, in the event the debtor requests the invalidation of the executive title arising from a bank credit;
- Reduction by 50% of the initial price of the immovable property, placing an acceptable average for the debtor and the bank, and making clearer the value (price) of the item with which the second auction begins.

We are informed by the Ministry of Justice that these amendments are in process of finalisation and this legal package will be sent for approval to the Council of Ministers and then to Albania's Parliament. I take this opportunity to iterate the need for these legal proposals to be approved by Albania's Parliament at the earliest time possible. Improvements in the legal framework and collateral execution practice would provide public authorities with new spaces to boost lending in Albania.

2 – Monetary policy pillar

I mentioned earlier that recently, the Bank of Albania has eased the monetary policy, by undertaking 6 consecutive key interest rate cuts.

Following the last cut in January 2013, the one-week repurchase agreement rate has fallen to record low (3, 75%), even when compared to other economies in the region, including most new EU member states as well. The Bank of Albania deems that the monetary conditions are appropriate to ensure the meeting of inflation target in the medium run, providing, at the same time, the necessary monetary stimulus to support domestic demand. However, from the viewpoint of this meeting, the future of monetary policy is what really counts.

As stated in the last Statement by Bank of Albania's Supervisory Council, the Bank of Albania will continue to pursue a stimulating monetary policy, as long as inflationary pressures remain weak. Furthermore, I would like to ensure the banking system that our operational framework will maintain the same stimulating nature. It aims at preventing banks from any tensions, even sporadic ones, with regard to liquidity adequacy (quantity, price and maturity) in the market.

3 – Prudential pillar

While both first pillars have an indirect impact and over an extended period of time, the prudential pillar impacts directly and swiftly on credit revival. It includes a number of measures that will release financial resources to banks

and encourage them to channel those resources toward lending. Regulatory changes are at the core of these measures:

- Reduce bank requirements for liquid assets;
- Change risk coefficients in the investment structure to boost lending.

Reduction of bank requirements for liquid assets may be conducted without undermining the stability of the system, since their level is generally higher than that of international standards and of banks in the region. Moreover, given that banks operating in the country have their origin mostly in Europe, this reduction may take place in the context of declining risk premia in European financial markets. However, it should be monitored and implemented according to each bank's risk profile. This means that though the reduction may be overall, the level of liquid assets requested by currency and in total may be different in different banks.

The risk coefficients of the investment structure will change, so that banks' capital would support shifting of their resources to lending. More specifically, we propose that the risk coefficients used to calculate the banks' capital increase, considering the new flows of bank investments with non-residents.

This increase in risk coefficients may take place also for a part of the stock of bank investments with non-residents, taking into consideration:

- Regulatory requirements for liquid assets;
- Adequate coverage of bank liabilities to non-residents; and
- Time needed so that this shift does not cause any operational overburden to banks.

On the other hand, risk coefficients may decrease in banks for the amount of new credit added to the existing stock, for a certain period of time. In this way, the intended shifting of funds toward lending in the country may take place even in those banks that have a lower capital adequacy ratio.

These measures are not administrative. The decision to conduct funds shifting to private sector credit in the country will be made by the bank itself. As in any other case, the bank should balance all the factors affecting the risk, costs and benefits from such a shift.

The implementation of the above measures requires amending the existing regulatory framework. It will be effective temporarily and after that, banks should gradually return to implementing the existing regulatory framework on the methodology for calculating capital requirement. In this way, banks retain the necessary stimulus to lend prudentially.

We deem that the need to address non-performing loans is a concerning issue for both the banking industry and the Bank of Albania, not so much for the stability of the system, as for the costs that this phenomenon brings to banking activity, consumers and related services.

Public authorities may also take measures in this regard. I take this opportunity to iterate the need for settlement of public sector's liabilities to private entities. This would positively contribute to settling a part of liabilities that these companies or connected ones have to the banking sector, hence mitigating the level of non-performing loans.

In parallel, this process should be treated at its roots to establish a transparent and stable mechanism for addressing the factors that affect the increase in public sector liabilities to private companies, and for avoiding their increase in the future.

Moreover, the Bank of Albania will amend the regulatory framework to urge banks to support borrowers' requests for credit restructuring right from the moment the credit is regarded as good. If the banks realise this effectively, they will have a lower cost from loan-loss provisioning requirement.

This element would make banks address prudently and proactively their best clients, who may be showing their first signs of credit repayment problems because of factors beyond their control.

To monitor this action, the regulatory framework will require that the restructured loan stays temporarily in this category (or in the substandard category), and that it falls immediately under a lower category, if, after the restructuring, the loan quality deteriorates.

I emphasize that, after broad consultations with the banks, the Bank of Albania has drafted the relevant instructions to guide them in the debt restructuring process.

Similarly, the Bank of Albania has concluded that a part of the non-performing loans, mainly loss loans, are still in the banks' balance sheets because of the different interpretation by the banking industry and the tax authorities about the commencement and completion of the legal proceedings against a debtor.

Lack of coordinated interpretation about writing off these loans from the banks' balance sheets, leads to consequences in the banks' tax burden and prevents writing off loss loans from the balance sheets, hence swelling the level of non-performing loans and engaging banks' capacities inefficiently.

I take the opportunity to emphasize that the banking industry and fiscal authorities need to identify the factors leading to different interpretations of the same problem, and to formulate the necessary legal and sublegal amendments for a definite solution. The Bank of Albania is willing and stands ready to provide the needed assistance in this regard.

ROLE OF BUSINESS

The business-bank relationship is fundamental to economic activity success.

This relationship is always conditioned by developments in the surrounding environment. The effects of the economic slowdown have been uneven across the economy sectors, and businesses do not face the same problems.

Nevertheless, today the business activity has declined and their income is downward. Some businesses need to restructure their activity, not only by decreasing costs and improving efficiency but also by entering new markets and introducing new products.

To achieve this target, the owners' instinct and willingness do not suffice; it needs professional expertise, well-studied projects and additional financing or restructuring of the existing debt. I think that the business-bank partnership is indispensable in this process. Banks are increasingly developing their financial advisory capacities and are also developing banking products to keep close to business needs. Also, they are increasingly active in the business loan restructuring process.

Anyway, both parties have complaints to each other. Businesses complain that banks are tight fisted and often the financing does not correspond to their businesses cycle.

On the other hand, banks claim that businesses submit unreliable projects in their application for loans, and inadequate financial information for decision making.

The Bank of Albania is confident that the bank-business relationship will progress to their benefit, if they:

- Increase their understanding of the activity profile, market conditions and regulatory requirements, which determine the activity of each of them;
- Enter into cooperation agreements, based on transparent, comprehensive and professional information;
- Act proactively to detect situations that should be reviewed and improve the possibilities to settle liabilities to each-other.

The measures put forward by the Bank of Albania today support the need for a closer bank-business relationship, given Albania's current economic situation. They expand the banks' room for a greater flexibility in the credit restructuring process. However, banks would not finance unsuccessful businesses; neither would they lend to businesses that do not supply transparent and complete information. A closer relationship implies that, in their analyses, banks should utilise more effectively the available information about existing and new borrowers, which may be generated by such sources as the Credit Registry.

Banks should establish a stable long-term relationship with businesses to increase consultancy and lending, especially with regard to the small and medium-sized enterprises.

CONCLUSIONS

Concluding, I would emphasize that Albania's current economic and financial situation requires maintaining the paces of financial intermediation and addressing non-performing loans with priority. Collaboration with other public authorities has been successful. We expect concrete actions to settle outstanding payments to private companies and approve the proposed legal amendments on collateral execution. Today, the Bank of Albania proposed several additional measures aimed at bank credit revival. These measures, which will be soon reflected in the regulatory framework, have a countercyclical nature and are generally temporary.

This element, and the needed control mechanisms that accompany such measures, will encourage banks to respect their obligation to lend prudentially and soundly. Given that currently, additional risks are posed to lending, the bank management structures and shareholders should ensure that these short and medium-term risks are covered by adequate capital. The outcome of these measures would improve, if businesses understood and used them properly. To this end, the business- bank relationship should be based only on transparent and professional collaboration. This should be transmitted better by the media and to the public.

The Bank of Albania will assess the impact of these measures and monitor their implementation on a regular basis. To this end, we stand ready to adapt them to the economic and financial developments, or support them with other measures. The financial system stability will be at the core of each action taken by the Bank of Albania in this regard.

Finally, I would like to remind all the representatives of the private sector, whether in production or financial industry, that due to the effects and impact of the crisis, the public authorities, lawmakers, fiscal and monetary authorities have made important changes in terms of philosophy, objectives and decision making, far from traditional considerations. These temporary changes aim at mitigating the crisis effects, stabilising the economy, consumption and private investment.

The package I introduced today is a good example to illustrate this change. It is necessary, therefore, for the private sector to adopt such a temporary adjustment.

Ms. Lagarde, Managing Director of the International Monetary Fund, appealed that in the current situation, the goal of the private sector cannot be only profit; it must also be to add value, create jobs, develop new ideas that drive an economy forward and provide stability. Boosted employment and higher income from employment means more consumption and investments, higher consumer demand for goods, services and lending instruments. The economy needs a more responsible private and financial sector to the real economy, a private sector that supports employees and consumers, and a

financial sector that adds values instead of destroying them.
Concluding, I would like to share with you an important message: the crisis came in as a global crisis and its solution should come as such. However, each country should do its homework and undertake the necessary structural reforms to overcome it.

People only accept change in necessity and see necessity only in crisis - said Jean Monnet, regarded by many as chief architect of the European unity.

Thank you and success in your work!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision of the Bank of Albania's Supervisory Council
27 March 2013

Today, on 27 March 2013, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the most recent monetary and economic developments in Albania, and following the discussions on their outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 3.75%. The Council notes that monetary conditions are appropriate to ensure the achievement of the inflation target in the medium-term period, providing, at the same time, the required monetary stimulus to boost economic activity.

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

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Annual inflation was 2.5% in February, down by 0.2 percentage points from January. The lower inflation was primarily driven by the falling oil price, due to the base effect of the environmental tax rise in 2012 and the falling global prices. Overall, inflation continues to be determined by the rise in food prices. Their inflation accounted for about 90% of February's headline inflation. Other basket prices have generally been stable and making low contribution to headline inflation.

In the macroeconomic aspect, the general economic and monetary conditions have contributed to keeping inflation low.

Aggregate demand, in particular, remains sluggish and insufficient to generate full utilisation of production capacities, hence exerting no pressures on producer prices, profit margins and, consequently, the final prices of goods and services. As we have constantly pointed out, below-potential economic growth is and will remain a key factor driving the low inflation. In parallel, global prices, liquidity situation in the Albanian economy and financial markets, and economic agents' inflation expectations have not and are not expected to generate strong inflation pressures in the medium-term period.

Indirect information on the performance of the Albanian economic activity in the last quarter of 2012 suggests sluggish growth. Aggregate demand was primarily driven by the higher exports, while the private domestic demand provided positive, albeit low, contribution. On the other hand, public sector expenditure shrank, hence making a negative contribution to the growth of aggregate demand.

There is scarce information on economic developments during the first quarter of 2013. However, the analysis of available indirect data suggests that aggregate demand remains sluggish and economic growth below potential. Economic activity has been mostly driven by the external demand and a higher fiscal stimulus, while the contribution of consumption and private investment remains low. The latter continue to suffer from the uncertain outlook, the lower increase in disposable income, the spare production capacities, and the relatively tight lending standards. These factors have been reflected in Albanian households' increasing propensity to save and businesses' reluctance to invest.

External demand and the favourable weather conditions increased Albanian exports by about 34.6% in January. In light of the poor consumption and investment levels, which have reflected in the decline of imports by 8.1% during this period, this tendency has improved the external position of the Albanian economy further.

Albania's trade deficit shrank 32.5% in January. The developments in the external sector of the Albanian economy reflected in improved foreign currency demand and supply ratios, contributing, in turn, to a stable exchange rate.

The Albanian government pursued an accommodating fiscal policy in the first two months of 2013, expressed in the increase of public expenditure and widening budget deficit. Budget expenditure increased at an annualised rate of 1.3% in January and February. This increase was reflected in both current and capital expenditure. Amidst the sluggish economy, budget revenues continued to contract, registering an annualised fall of 0.8% over the months under review. This performance of public expenditure and revenues increased the fiscal deficit by about 5.1%.

Reflecting upon the expected economic and financial developments, the Bank of Albania has been pursuing a stimulating monetary policy.

Through the constant key rate cuts and liquidity injections into the banking market, the Bank of Albania has aimed at ensuring more appropriate monetary conditions to meet its inflation target in the medium-term period. The financial market evidences low liquidity and inflation pressures, which, in turn, have enabled the pass-through of monetary easing into the money and primary market. Interbank market rates soon reflected the last key interest rate cut and the yields on government debt securities continued to drop. The falling interest rates were mostly reflected in the deposit market rather than in the credit market, signalling a more conservative bank approach to lending and a savings-oriented real sector.

Monetary indicators have performed in line with the developments in the real economy and the monetary inflationary pressures remain low. Money supply decelerated its growth rates further in January to 4.9%.

The slowing money supply has reflected the low business and household

demand for borrowing, and the lower budget deficit financing from the banking system. The annual growth of lending to the economy continued to decelerate to record lows of 2.1% in January. The poor performance of lending is evidenced in all categories and currency denominations, both for businesses and households.

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The new available information does not alter our baseline projection for the performance of the economy over the current year; however, it evidences a shift in the balance of risks to the downside. The Albanian economy is expected to grow at low and below-potential rates, reflecting the slowing external demand, poor consumption and private investment and a positive fiscal stimulus based on the planned budget for this year.

Against a background of a negative output gap and in the absence of global market and liquidity pressures on the Albanian economy, the inflationary pressures are expected to remain low.

At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 3.75%. The outlook of economic and financial developments inside and outside Albania establishes the continuation of an accommodating monetary conditions cycle over the monetary policy-relevant horizon. This policy establishes the proper conditions to meet the inflation target in the medium-term period, contributing at the same time to the growth of aggregate demand and full utilisation of production capacities in the economy.

In its meeting today, the Supervisory Council decided to amend some regulations relating to banking system activity.

These amendments strengthen the monetary policy transmission mechanism and establish better conditions to boost lending. They harmonize well with the easing monetary policy and help stimulate economic activity in Albania. More specifically, the approved amendments increase the level of liquidity allowed for banks' use and provide the banking system with greater room to use the financial leverage. Both these initiatives provide a direct impact on a faster growth of lending to the economy.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Parliamentary Committee on Economy and Finance
09 April 2013

Honourable Chairman,
Honourable Deputies, Ladies and Gentlemen,

I would like to start by expressing my great appreciation for this opportunity to present to you, on behalf of the Bank of Albania, the central bank's work progress and results over the past year. Also, this will help us share our opinions about recent economic and monetary developments, and touch upon the challenges, which, in Bank of Albania's opinion, deserve attention in the future.

Right from the start, I would like to emphasize that the Bank of Albania succeeded in fulfilling its legal responsibilities in 2012. Consumer prices remained stable, as depicted by the 2% average inflation rate during the year. The financial system soundness also improved at both macro and micro levels.

The major objectives of the Bank of Albania were achieved, despite adverse internal and external environment, and shocks posed to the Albanian economy over this period. Their achievement reflected, to a great extent, the Bank of Albania's cautious monetary and supervision policies, and regulatory measures. They were favoured by ongoing improvement of the financial payment infrastructure, prudential and efficient liquidity management operations, and transparent communication with the public. All our work was supported by the qualitatively improved financial literacy of the public, analytical study of several phenomena, matters of interest for the development of the country, and production of financial statistics conform to international standards. Finally, I would like to emphasize that the Bank of Albania has been a serious and important player in Albania's integration process, completing and updating all its legal responsibilities and institutional commitments.

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Honourable Ladies and Gentlemen,

In my speech, I will address the key issues of the Annual Report 2012, focusing on main directions of Bank of Albania's work over the past year. I will start my speech with our work and results in fulfilling the primary objective: achieving and maintaining price stability.

1. ECONOMIC DEVELOPMENTS, PRICE STABILITY AND MONETARY POLICY IN 2012

The year 2012 was another difficult year for the Albanian economy. Weaknesses in our financial and trading partners were manifested in a low demand for Albanian exports, tight financing conditions for foreign capital, and elevated uncertainty among economic agents. Also, the public and private sector domestic demand remained weak in the Albanian economy.

Besides these factors, two other specific shocks hit the economic activity over the past year. Hence, bad weather in the first quarter was reflected into a sluggish activity in construction and exports over the period. The banking system's response to new and tighter regulatory measures provided by the European Banking Authority (EBA) was another shock of higher importance and influence. Direct impact of this shock on financial markets, and especially on government securities market, accounted for about 2% of GDP. However, their indirect impact was even greater. As in other countries of the Central and Eastern Europe, banks originating from the euro area countries adopted a more conservative approach, manifested in further slowdown of lending during the year.

As a result, the Albanian economy slowed further over the past year, leaving spare capacities in the labour and capital markets.

This development was associated with low increase in wages and producer costs and was reflected in slightly increased consumer prices. Over the past year, supply shocks were few and of low intensity, inflationary expectations remained anchored and liquidity position was favourable to keep inflation in check. This balance of factors was materialized in low annual inflation rates, and the annual consumer price rise eased to 2.4% at end-2012.

Low inflationary pressures and lack of fiscal stimulus made room for further easing of monetary policy in 2012. The Bank of Albania cut the key interest rate three times, to 4.0%, from 4.75%. The monetary conditions were eased to stimulate the domestic demand and create better conditions for meeting the medium-term inflation target.

Also, the Bank of Albania increased significantly the liquidity-providing operations in the banking system to calm down financial agents, control the rising interest rate trends, and ensure the smooth functioning of markets. Overall, our efforts resulted effective in managing the liquidity problems; however, tighter funding conditions faced the Albanian economy in both public and private sectors. This tendency reflects, to a great extent, the risk aversion in financial agents and markets. Addressing it will be our main challenge over the next year.

Back to economic development. Official data show that the economic growth for 2012 remained positive but slower than in the previous year. According to INSTAT data, gross domestic product grew by 1.6% in 2012, supported by

boosted activity in services and agriculture sectors.
Meanwhile, the industrial sector remained stagnant, while the construction sector shrank, reflecting the weak domestic demand and specific sector-related problems. Though to a lesser extent, the economic growth was supported mainly by external demand and increased exports. On the other hand, despite the stimulating monetary policy, the domestic demand appeared weak, reflecting the reluctance of consumers and businesses to consume and invest, and the limited space for increasing public spending. Overall, the Bank of Albania deems that these determinants of economic growth will continue to be present even over the rest of the year. The low degree of existing capacity utilization affected the labour market. The increase in employment slowed down, though the unemployment rate has remained 13.3% over more than one year.

Rising exports and slowing imports narrowed the current account deficit by 13.8%.

Although the capital and financial account inflows fell by 11.3% in annual terms, the overall balance of payments resulted positive and the Bank of Albania's foreign-exchange reserves increased over the past year. The current level of this reserve is in accordance with our operational adequacy rates and could pay for 4.5 months of imports of goods and services. Improvement of the structural current account deficit should be one of our long-term policy objectives; it helps in maintaining the financial stability of our country and increasing the country's resilience to foreign shocks.

Fiscal policy was generally consolidating in 2012. Budget deficit dropped by 1.2% in annual terms, estimated at 3.4% of GDP, or down by 0.3 percentage points from a year earlier. Current account deficit narrowed due to reduced public expenditures, which fell by 0.3% on a year earlier. Similarly, public revenues dropped by 0.2% in annual terms, reflecting the cyclical condition of the economy.

On the other hand, public debt exceeded 60% as a percentage of GDP, reflecting the higher-than-projected rise in budget deficit and the increase in public guarantees. Bank of Albania's attitude to this problem has always been transparent: maintaining public debt at sustainable and harmless levels for the Albanian economy and preserving financial market confidence regarding the Albanian public debt should remain the primary objective of the fiscal policy.

Monetary indicators slowed down in 2012, in line with the real-economy ones. Low demand of businesses and households for bank loans and tight lending standards led to poor performance of credit to economy. Its annual growth dropped to 2.4% at year-end. Poor credit performance was present in all its segments, by purpose of use. Meanwhile, foreign-currency loan continues to shift to lek loans. Shifting household savings from bank deposits to public debt securities was a striking financial development over the past year.

This trend led to increase in financing the budget deficit by households and decline in this financing by the banking system.

Financial market liquidity position and risk premium performance conditioned the pass-through of easing monetary policy to financial markets. Key interest rate cuts were immediately reflected in the interbank market and in lek deposit market, but their pass-through to government securities markets and to lek credit was more limited, mainly due to above-mentioned developments. However, as lek intermediation cost dropped in 2012, increase in lek intermediation created grounds for better transmission of monetary policy signals to economy during the current year. Finally, the foreign exchange market and the exchange rates were generally calm due to a balanced ratio of the foreign-currency supply and demand.

On the operational aspect, the Bank of Albania upgraded the infrastructure of its role as a lender of last resort to commercial banks.

Due to this work, the Regulation "On the liquidity supporting loan" was reviewed and approved, stipulating an appropriate framework to support banks that are temporarily illiquid. Also, the Bank of Albania reviewed its regulation on the required reserves of banks, raising their flexibility in the manner of holding it and creating more opportunities in increasing the banking sector's exposure to the economy.

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Another important aspect of the central bank's functions is the banking system supervision and regulation, which contributed significantly to strengthening the financial stability. In the following, I will focus on the performance of some key indicators and banking system risks, as well as on the most important developments in supervision, licensing, legal and regulatory framework.

2. BANKING SUPERVISION AND FINANCIAL STABILITY

Banking sector assets to GDP accounted for 87.9% at end-2012, up by 3.1% on a year earlier. Profit improved, leading to improved indicators of Return on Average Assets (RoAA) and Return on Average Equity (RoAE). At end-2012, the banking system capital adequacy ratio was 16.2%, increasing on a year earlier. Both at system level and for each individual bank, this indicator remained above the 12% minimum requirement.

Supervision has aimed at assessing and monitoring the risks posed to the banking system. Special attention has been paid to monitoring the loan portfolio quality and the systemic risks stemming from lending, as well as to their actual or potential effects on the degree of banking system capitalisation. The banking system exposure to credit risk increased in 2012.

The ratio of non-performing loans to total loans was 22.5% at year-end, from 18.8% a year earlier. However, the share of non-performing loans secured by collateral was larger than a year earlier, accounting for about 81% of the non-performing loan portfolio. Also, the banking system increased the loan loss provisioning by 31%.

Liquidity indicators improved in 2012. The ratio of liquid assets to short-term liabilities was 36.7%, being above the minimum level for both the lek and foreign currencies. Deposits were the main source of financing the banking activity and the parent-bank lines of credit decreased significantly compared to end-2011. The reduced dependency on parent-bank financing in Albania is a positive development that has increased the domestic banking system's resilience to foreign shocks.

The banking system is hedged against market risks. Our estimates point to a banking system that is slightly exposed to interest rate risk. It is also slightly exposed to direct effects from exchange rate volatility and its foreign-currency open position is obviously below our limits. The banking system continues to be exposed to indirect exchange rate risk due to foreign currency loans granted to borrowers whose income is not in foreign currency.

The control on operational risk improved in 2012, by improving the framework of procedures. The banking system has the necessary technological infrastructure to meet the regulatory requirements, hence ensuring that the activity is carried out even in extreme circumstances. Transparency and publication of information continue to be in focus of the Bank of Albania, as important pillars to protect customers and foster discipline in market competition.

Aiming to enhance transparency and boost competition among banks in the market, on July 2012, the Bank of Albania started publishing on its website the interest rates and banks' commissions on their products. However, we are well aware that there is still room for improvement in reference interest rate used in credit contracts and in the information that banks publish on their websites.

Addressing the prevention of money laundering and of terrorism financing was an important part of the regulatory and supervisory process in 2012. Besides improving the regulatory framework in line with the new Law and EU standards, we have also strengthened our cooperation with the General Directorate for the prevention of Money Laundering and have fostered the supervision of financial institutions. On-site and off-site examinations revealed that financial institutions have taken appropriate, preventive measures and have established a proper infrastructure to identify and report suspicious transactions.

The year 2012 highlighted important developments in the area of financial activity licensing. Hence, two branches of foreign banks turned into their subsidiaries, reducing the risk of their exposure to parent-bank risks, enhancing their independence and the control level by the Bank of Albania. An important change was also the transfer of 100% shares of the Emporiki Bank from Emporiki Bank of Greece to IUB Holding France, contributing to long-term and stable development of the banking industry. Finally, in 2012, the number of non-bank financial institutions and the range of financial products and services provided in the market by the financial system increased.

In 2012, the legal and regulatory framework of the banking system underwent important changes. The Bank of Albania and the Deposit Insurance Agency, taking into consideration the European Union regulatory alterations, prepared relevant amendments to the Law "On Deposit Insurance".

In line with EU directives, the base of contributors to insurance scheme expanded, including the savings and loan associations. Also, the formulas for calculating compensation were clarified and simplified. The Assembly of the Republic of Albania approved the related amendments on 26 July 2012. The adoption of the new Regulation "On the establishment, licensing and functioning of the bridge bank" improved significantly the regulatory framework on bank management in the event of bankruptcy. Other important regulatory amendments and improvements took place on bank management, risk management and related structures, supervision decisions, as well as insurance and re-insurance activity.

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Besides the main directions of the Bank of Albania's work described above, I would like to dwell on some other activities of our work. These activities not only help us fulfil our legal responsibilities, but also serve the development of the financial system and market economy in Albania.

3. OTHER ACTIVITIES OF THE BANK OF ALBANIA

Money issuance

The Bank of Albania has the exclusive right to issue and circulate our national currency and to oversee and ensure banknote and coin quality. One of the biggest investments of the Bank of Albania to guarantee our currency's integrity is the construction of the new building of Currency Issue Centre, which started operating in 2012. The closed and automated cycle of controlling, processing, packaging and shredding of banknotes takes place in this building. Soon professional examination on banknotes and coins suspected to be counterfeit will be made, hence fulfilling one of the obligations of the Albanian state in view of the Stabilisation and Association Agreement.

Foreign-exchange reserve management

Holding and managing Albania's foreign-exchange reserve to preserve financial stability of the economy is another constitutional function of the Bank of Albania.

The gross foreign-exchange reserve was up by EUR 65 million, registering EUR 1.972 million at end-December 2012.

Payment Systems

Fulfilling its legal duty, the Bank of Albania promotes smooth functioning of payment systems to support the monetary policy implementation and maintain

financial stability. During 2012, lek interbank transactions were cleared and settled timely, efficiently and safely, conform to rules and procedures of both systems (AECH and AIPS). Also, several regulations and manuals were reviewed and drafted, consisting in strengthening the supervision and further developing the Albanian payment system.

Improvement of statistics

The year 2012 pointed to improved statistics as a legal responsibility of the Bank of Albania.

During this year, a model was drafted to improve the balance of payments statistics and the international investment position, aiming to approximate the national statistics system with the ECB and ESCB standards. Also, the objectives under the IPA-2009 project on "Regional statistical cooperation programme for the Balkans countries" were successfully completed and project coordinators have commended the Bank of Albania.

Other (research, human resources, communication and transparency, European integration)

In addition to fulfilment of legal duties, the Bank of Albania is committed to attaining other objectives that help in fulfilling a modern central bank's role in economy. The Bank of Albania intensified its research and academic activities in international arena during 2012. Worth of note is the 10th International Conference on "Monetary Policy: From the past to the present", which was coordinated with other activities in the framework of the 100-th anniversary of Albania's Independence.

Also, through the Institute of Economic Studies, we have promoted the broad interest of Albanian and foreign researchers, and have organised two regional workshops.

Since some years ago, the Bank of Albania has put the improvement of bridges of communication with the public and enhancement of transparency on focus of its development plan. During 2012, we continued to complete the published information and diversify it according to target audience. We built up contacts with the media and intensified our efforts in financial education, aiming to increase financial literacy and clearly transmit the Bank of Albania's messages.

The Bank of Albania was an active participant in fulfilling obligations arising from the SAA, Central European Free Trade Agreement, and other national commitments. International authorities have assessed the Bank of Albania's work progress as positive. Regarding institutional issues, the European Commission, International Monetary Fund and World Bank have given the Bank a maximum score.

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Dear Members, Ladies and Gentlemen,

Concluding my speech, I would like to highlight some problems which have conditioned and will condition the functioning of Albanian economy and financial markets. We deem that these problems require prior attention and cautious solution.

- First, the integration of the Albanian economy with the European financial systems and markets implies that shocks and swings to our financial and trading partners are soon transmitted to the Albanian economy. The medium and long-term outlook of the Albanian economy is related to that of our trading partners. Global market ups and downs increase or decrease the economic activity in the country. Overall, the integration process remains beneficial to the Albanian economy, but it poses challenges as well.
- Therefore, I would like to emphasise that the Albanian economy and financial system should pay more attention to global market developments; our structural reforms should aim at increasing resilience to their swings, while our economic policies should be cautiously oriented toward long-term global trends.
- Secondly, the country's financial stability should be seen as a duty of all and not as an issue of one or some institutions. The financial stability is a public good that serves the long-term development of a country. Recent global developments have proven that the financial system is a highly integrated mosaic; its stability has many dimensions and it is determined by the interplay of many segments and stakeholders. Therefore, I would like to reiterate my appeal for finding a political consensus that would enable the establishment of a fiscal rule, which serves the maintaining of long-term sustainability of public finances and investors' confidence in the Albanian economy.
- Third, the reform of social and health insurance systems is another important aspect that remains problematic for the long-term stability of the country. Deficits resulting from them are upward and may substantially affect fiscal parameters in the future. This reform should open the way to development of relatively backward segments of the financial system, those of private pension and insurance funds. This would really contribute to expanding and deepening the financial market in Albania.
- Fourth, sticking to financial stability, I would like to bring to your attention the changes in the Code of Civil Procedure relating to enforcement of collateral execution. Further to the package launched recently by the Bank of Albania and the letter I sent a few days ago to the major parliamentary parties, I would appeal once more for their approval at an earlier time possible.
- It is a set of proposals that we and international experts regard as indispensable for the stability of the banking system, guarantee of deposits and recovery of credit to economy.
- Finally, the long-term development of Albania and the policies and strategies supporting it deserve greater attention. The Bank of Albania

remains confident in the long-term development prospects of the country. These prospects are favoured by natural resources and low labour costs, but above all, they must rely on our opportunities and abilities to be integrated into the value-added chain of the European economies. The road ahead is long and arduous. In short and medium term, it needs political will and wisdom to carry out reforms, and increased attention to issues of Albania's macroeconomic and financial soundness.

In the long term, the structure of the Albanian economy should be more aligned with those of the European countries; economic growth should be based more on production factors productivity, and Albanian businesses should pay more attention to finding and exploring new markets.

Being heedful and aware of the challenges ahead, the Bank of Albania has started to analyse new tools and techniques to fulfil its mission. Pinpointing the economic slowdown as the main risk facing the Albanian economy and financial system, and assessing the role of bank credit to economy, on March 2013, the Bank of Albania adopted a set of macro-prudential measures oriented toward promoting lending and lowering banking system risk. Briefly, these measures consist in easing capital requirements to boost credit, easing liquidity requirements, reducing provisions for restructured loans, and increasing capital requirements for assets abroad above the rates required by the Bank of Albania.

These temporary measures are another sign of our willingness to accomplish the mission and our legal duties.

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Concluding, I would like to inform you that the Bank of Albania's Annual Report 2012 and Financial Statements are presented to you. I remain open to any questions or remarks.

Thank you for your attention.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision of Bank of Albania's Supervisory Council
30 April 2013

Today, on 30 April 2013, the Supervisory Council of the Bank of Albania reviewed and approved the quarterly Monetary Policy Report. Based on the most recent monetary and economic developments in Albania, and following the discussions on their outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 3.75%. The Supervisory Council deems that the current monetary conditions are adequate to meet Bank of Albania's inflation target in the medium term.

The present interest rates and liquidity situation in the economy provide simultaneously the necessary monetary stimulus to boost domestic demand.

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

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According to INSTAT data, economic activity in Albania increased 1.6% in 2012. The Albanian economy showed signs of weakness during the past year, reflecting an overall uncertainty in the internal and external environment. Nonetheless, against the backdrop of unfavourable developments, the main indicators of domestic and external balances remained within healthy parameters. During this period, inflation ranged within the Bank of Albania target band and indicators of banking system soundness improved.

Maintaining these balances provides the right macroeconomic premises for sustainable and long-term growth.

Referring back to the performance of inflation, INSTAT data reveal that consumer prices rose on average 2.5% in the first quarter of 2013. Inflation continues to be determined by food prices; their contribution accounts for about 90% of headline inflation. Moreover, food inflation was offset by the lower inflation of non-food consumer goods. Inflation of this category reflected the downward oil price, following its decline in international markets. Also, the price fall of long-term consumer goods provided downward effects, whereas prices of other consumer goods did not change significantly.

From the macroeconomic perspective, inflation continues to reflect the weak pressures from the aggregate demand-side and the absence of supply-side shocks.

Below-potential growth of aggregate demand leads to underutilisation of production capacities and generates weak pressures on increasing wages,

producer prices and profit margins. Under these circumstances, internal pressures on consumer prices appear weak, as reflected by the low core inflation. On the other hand, imported inflation was subdued due to the low inflation in Albania's trading partners and the stable exchange rate.

The most recent data on the real economy are as at 2012 Q4. According to these data, the Albanian economy grew 1.7% driven by expanded activity in the services, industry and agriculture sectors. The activity of the construction sector continued to shrink. Data on economic activity for the first quarter of this year remain limited.

Based on indirect indicators, our analyses point to low economic growth, relying mainly on foreign demand, while the domestic demand components continue their sluggish performance. Private consumption and investment remain weak in the presence of uncertainties for the future, decelerating disposable income, tighter lending terms and spare production capacities.

The performance of budget indicators in the first quarter of the year shows increased fiscal stimulus. Budget deficit increased 41.5% during this quarter, reflecting the 3.6% decline of fiscal revenues and 1.4% increase in public expenditure. The Bank of Albania once again draws the attention on maintaining the fiscal equilibriums and keeping the budget deficit and public debt at affordable and harmless levels for the Albanian economy. In our opinion, the medium-term priority for the fiscal policy should be maintaining budget discipline.

In the long term, the Albanian public debt should be reduced and anchored in a reliable, effective and transparent fiscal rule.

Developments in the external sector of the economy reveal continued positive contribution of net exports to aggregate demand growth. Data on foreign trade for January and February show that trade deficit narrowed 27.1% annually, reflecting at the same time the further surge in exports and the weak performance of imports. During this period, imports shrank 9.5% in annual terms, while exports maintained their high annual growth rates, at 18.6%.

Monetary developments were in line with the performance of the real economy during the first quarter. In January and February, credit to the economy was weak across all its segments.

As at end-February, the loan portfolio of the banking sector stood only 1.7% higher than a year earlier. As we have already underlined, the main problem with regard to lending remains the low business and consumer demand for loans. However, banks' lending policies appear more conservative, as reflected in the relatively tight lending standards.

The forecast for subdued consumer prices and weak economic growth in the period ahead motivated the further easing of the monetary policy at the outset of the current year. In January, the Supervisory Council of the Bank of

Albania cut the key interest rate by 0.25 percentage points to 3.75%. Through anchoring inflation expectations, easing liquidity pressures and cutting the short-term interest rates, the monetary policy has aimed at reducing the costs of long-term lending to the economy and supporting the growth of credit, consumption and investments in Albania.

The Bank of Albania's easing policy did not reflect uniformly across the financial market segments. The latest key interest rate cut was reflected swiftly and completely both in the interbank market and the primary market of government securities. On the other hand, it was only partially transmitted to the deposits market and even less to the credit market. These developments illustrate the fact that, in the presence of added risk premiums and structural changes of behaviour in the financial market and the real economy, the effectiveness of monetary policy action is lower. Based on these reasons, the Bank of Albania decided to support its stimulating monetary policy with a number of changes on the easing side of the supervisory, regulatory and macroprudential framework. Set out in details in the previous month, these measures aim at further reducing liquidity premiums and intermediation costs in the financial markets, in order to boost lending and economic growth.

Our projections for 2013 support the assessment for Albania's economic growth ranging close to past year's rates. Foreign demand will be the main driver of economic growth, while the fiscal policy is expected to contribute to growth on the same direction, but at lower intensity, in the period ahead. On the other hand, private consumption and investment remain weak and unstable. The continuation of below-potential economic growth will determine weak inflationary pressures in the upcoming months as well. In the absence of unexpected supply-side shocks, consumer prices will continue to rise at low rates. With a 90% probability, four-quarter-ahead annual inflation will range within the 0.6-3.6% band. The low annual inflation rates and forecast for their continuation over the monetary policy-relevant horizon call for maintaining the stimulating nature of the monetary policy over the next quarters.

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At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 3.75%. It concluded that stimulating monetary conditions establish the proper premises for meeting the inflation target in the medium term, and contribute to the growth of aggregate demand and full utilisation of production capacities. The weak inflationary pressures determine the continuation of a stimulating monetary policy by the Bank of Albania. Lastly, the Supervisory Council reiterates the need to continue and deepen structural reforms, which boost productivity and enhance the competitiveness of the Albanian economy. These reforms pave the way for expanding the economic potential and should be seen as the main instrument supporting sustainable and long-term growth for Albania.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision of Bank of Albania's Supervisory Council
29 May 2013

Today, on 29 May 2013, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the most recent analysis of monetary and economic developments in Albania, and following the discussions on their outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 3.75%. The Supervisory Council deems that the monetary conditions are adequate to ensure the inflation target is met in the medium term, providing, at the same time, the required monetary stimulus to boost domestic demand.

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

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The latest economic and monetary data reveal that inflationary pressures remain weak. In April, Annual inflation was 2.3%, slightly down from a month earlier. This trend owed mostly to the downward oil price and lower rental prices. Against the background of low inflation, the inflation profile continues to be determined by the performance of food prices, which contributed to the formation of about 95% of the annual inflation in April.

Prices of other goods and services of the CPI basket remained around the levels recorded in earlier months.

From the macroeconomic perspective, the domestic and external inflationary pressures have been either weak or downward, whereas inflation expectations are anchored to the Bank of Albania's target. The Albanian economy continues to be characterised by spare capacities of production factors. This landscape is accompanied by the significant reduction of headline inflation during the first four months of the year, hence reflecting the low pressures for increase in production costs, profit margins and final product prices. Furthermore, global market prices decelerated their rise, whereas the stable exchange rate did not support higher imported consumer prices.

The latest information suggests that the weakness of economic activity has been carried over to the first months of 2013. In balance, available data point to a slow performance of consumption and private investments. Albanian households continue to be reluctant to spend, due to the uncertainties for the stability of their funding sources and deceleration of disposable income growth rates. Because of the contagion effect, the weak aggregate demand, businesses' uncertainties about the future and tightened crediting conditions

have not encouraged new private investments. On the other hand, economic growth in the first months of the year has relied mainly on foreign demand and public sector demand.

The fiscal policy has been stimulating in the first four months of the year, reflected in the annual expansion of the budget deficit and public spending during this period. Fiscal expenditure's annual increase was 9.8%, mainly due to the rapid increase of capital expenditure, whereas current expenditure maintained the low annual increase rates. On the other hand, fiscal revenues increased at the minimum rate of 0.3%, reflecting the slow economic activity. This performance of budget expenditure and revenue is materialised in the budget deficit that is two times higher than in the first four months of a year earlier. The Bank of Albania notes that the medium and long-term fiscal policy should be more oriented toward maintaining the public debt stability. Achieving this objective helps curb the uncertainty and subdue risk premiums. The low and contained public debt improves the environment for the private initiative, by maintaining low interest rates and increasing available funds, thus contributing to Albania's sustainable and long-term growth.

Trade exchanges with our partners have provided a positive stimulus to economic activity increase during the first quarter. Trade deficit narrowed 28.6% in annual terms during this period, reflecting the good performance of exports and downward imports. Exports expanded 17.2%, in annual terms, during the first three months, dominated by energy-sector exports. Imports continued their annual decline, down by 11.1% during the period.

A more detailed analysis of exports finds that they are highly concentrated in the segment of natural resources. The Bank of Albania deems that higher competitiveness of our products and services, and the expanded export base, are the best instrument to ensure a healthy adjustment in the current account. This objective requires that structural reforms continue with regard to both the goods market and factors of production.

Performance of monetary indicators attests to low monetary inflation pressures on the economy. Annual growth of money supply continued to slow down, descending to 4.6% as at end-March. The economic agents' low demand for money is reflected in a poor credit performance. Annual credit growth as at end-March stood at 1.2%. The slow performance of credit reflects the prudent crediting policy applied by banks and their reluctance to take risks, besides the demand-side factors. This conservative behaviour of banks is also conditioned by the developments in the European arena and tightened supervisory and regulatory policies applied in home countries. Given the current situation of the European banking system, the Bank of Albania deems that it may continue to be present in the Albanian economy in the medium run.

The financial market has been characterised by low liquidity and inflation pressures, thus enabling a better transmission of the monetary stimulus to the economy. Interbank rates have followed the key interest rate cut and continue to be anchored around it.

Moreover, in April and May, the primary market yields were downward, in line with the easing cycle of the monetary policy. The interest rates in the deposit and credit markets reacted more slowly, in accordance with the time lag in the monetary policy transmission mechanism. The pass through of the easing monetary policy to the credit interest rates was also affected by high risk premiums that accompany crediting.

Returning to economic developments, the economic outlook for the period ahead remains similar to that of a month earlier. Economic activity in Albania is expected to grow at low positive rates, close to last years' figures. Foreign demand and fiscal policy are expected to provide positive stimulus to economic growth. Consumption and private investments will have a weak performance during this year. The below-potential economic growth will continue to condition low pressures on consumer prices. In the absence of unforeseen supply-side shocks, annual inflation is expected to remain close to the actual levels in the current year.

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At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 3.75%. The Supervisory Council deems that the actual monetary conditions are adequate to comply with the medium-term inflation target. The earlier cuts of the key interest rate are being gradually translated into lower lending rates for the public and private sectors, hence providing the premises for a faster growth of aggregate demand.

Similarly, the easing of several supervisory and regulatory requirements in March is stimulating crediting by the banking system.

Expected economic and financial developments require that the easing monetary conditions continue over the policy-relevant horizon. The Bank of Albania remains heedful and stands ready to respond duly and timely to create appropriate monetary conditions for meeting its inflation target.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Conference "Interlinkages with the euro area and long-term convergence dynamics", hosted by the European Central Bank, Frankfurt, Germany
17 June 2013

Mr. Chairman,
Ladies and Gentleman,
Dear Colleagues,

The topic of this Conference is of crucial importance for the economic and financial prospects of Western Balkan countries. These countries are fully integrated with the EU economy and the EU financial system. The European Union represents their main trading partner and banks originating in the EU dominate the financial system in our region. As amply demonstrated by our experience, prior to and during the recent crisis, developments in the EU affect immediately both the real and the financial system in the region. The EU and Western Balkans can be considered partners and, as such, they have a legitimate interest in the policies and actions of the other. I trust this conference will try to explore the best mechanisms for mutual consultation and coordination.

CESEE countries have chosen integration with the EU as the main vehicle to deliver sustainable and long-term economic prosperity to their citizens. I would like to point out that our countries have consciously chosen the path of EU integration: we have undertaken painful structural reforms; we have made legal and regulatory reforms around this process; we have opened our markets to goods, services and capital from the EU. I think it is only fair for us to expect long-term commitment and solidarity from our partners.

This integration and convergence process has certainly delivered in the past two decades. GDP growth has outpaced that of the EU and financial intermediation has rapidly improved. Common economic wisdom based on indicators such as GDP per capita, relative financial intermediation, relative cost of labour and technology indicate that this process will continue in the future. CESEE countries still offer attractive investment opportunities: they have, in general, better demographic dynamics and are geographically closer to Europe than other emerging markets. This political and economic integration has naturally led to financial integration.

However, I would like to make three remarks regarding the economic and financial integration path we are pursuing.

- First, the main focus of national authorities in SEE should be to facilitate the allocation of capital to more productive sectors, by providing the right incentives, structural reforms, legal environment, tax policies, and

economic stability. This requires a common understanding with banks operating in the region. Banks are and will remain profit-maximizing entities. Nevertheless, they should be more attentive to long-term trends, because they have a stake in the sustainable development of the economy.

- Second, we have developed a financial system and pursued a financial integration strategy based on banks, which account for more than 90% of the financial system throughout the region. Therefore, recent suggestions about developing domestic capital markets as an alternative to a bank-based financial system are useful, but perhaps unfeasible in the short to medium term.
- Third, the SEE is and will remain a capital-hungry region, which should be partly intermediated through international banks. This fact should be recognized by both EU regulators and EU parent banks. A new business model relying purely on domestically-generated deposits is a wrong answer to the previous extremes of huge capital inflows.

Currently, key challenges to financial stability in the SEE area comprise non-performing loans, slow growth of credit to the economy, the problem of fiscal finances, and the exchange rate stability. Their nature and magnitude are directly related to the growth problem and the private sector approach to consumption, savings and expectations. These problems were either created or exposed by the crisis and have exacerbated due to financial stability-related issues of our partner countries and their approach to the solution of such challenges. More directly, the banking sector has seen deleveraging due to required financial stability measures of the European banking authorities. Does this have an impact on credit and growth? The obvious answer is yes. Whether directly or indirectly and despite their origin, current financial stability problems are related to slow economic growth, which, in turn, is the result of shrinking financial intermediation. In principal, these developments have combined in a vicious circle, which is leading the economy in a slow downward spiral.

There are certain important lessons learned by the crisis. Above all, there is a substantial change in the perception of policy design and policy implementation by authorities with two defining trends. First, we are observing a new paradigm - the rethinking of the central bank policy design and policy implementation. The new model consists first in the idea that CPI-based inflation targeting might not be enough to preserve macroeconomic and financial stability, and second, in the use of macroprudential regulation in combination with traditional monetary policy measures. To be effective, these measures require a strong coordination with traditional monetary policy and banking regulation and supervision measures. Unless coordinated, they can do more harm than good. Moreover, given the strong cross-border financial links between the EU and the SEE, they have over reaching effects across the borders. In this respect, coordination becomes a multi dimensional effort.

Due to these strong financial and economic linkages of the CESEE with the euro area, European policies and regulations, macroeconomic and macro

prudential intervention have authentic real-time impact on our economies giving way to new challenges. The coordination of macroeconomic and macroprudential measures within the euro area will continue to exert macro stability pressures on the CESEE. Therefore, it is important for the economies of the CESEE to know, in advance, and understand the EU's legal, institutional and regulatory developments in the financial system and possibly have an opinion on the potential impact and unintended consequences that such developments may have on their economies.

I would invite the EU monetary and supervisory authorities to focus on the overall picture and think about long-term solutions rather than short-term adjustments, which, instead of solving the problems, recycle the old ones (problems) into new challenges, transforming the nature and the subject without really addressing the overall stability issue.

The EU Banking Union, in our view, is a very important step towards further integration and coordination between home and host authorities. We appreciate the fact that the establishment of the centralized supervisory authority will facilitate the information exchange between supervisors, creating a more efficient communication between home and host regulators by reducing the complexity of dealing with multiple national supervisors and regulatory bodies. The Bank of Albania, as a member of the Vienna Initiative Steering Committee, advocates the need for EU authorities to comprehensively assess interconnectedness issues between EU/euro area and non-EU/non-euro area economies in order to design balanced and sustainable policies. In particular, macro prudential measures in the euro area should also consider the situation and the potential impact on non-EU host countries. We expect that the ECB, as a leading authority within the SSM, to play an important and constructive role, whereas non-EU supervisors to be granted the opportunity to express their views on EU financial policy decisions affecting their domestic financial stability, before the actual decisions are taken. The effective functioning of supervisory colleges is also considered a very important issue, where countries with systemic EU subsidiaries may address their supervisory concerns.

On the other hand, it would help if small countries of the region outside the Banking Union had a unified view and approach towards EU authorities and expressed their concerns as a single voice. In this regard, the Bank of Albania, assuming a coordinating role, has invited other non-EU countries to contribute in formulating a common regional approach towards the Banking Union and its effects on these countries.

We also argue that it is at the benefit of the ECB, and other monetary and supervisory authorities and EU authorities to bring the CESEE countries on board of discussions, like a responsible doctor, who, while providing a strong remedy for his patient, tries to minimize potential side effects. The ECB must consider the potential side effects of its policies in our region. This consideration concerns five important issues:

First, the ECB has a large theoretic and empiric expertise on financial stability, monetary and economic analysis; however, the CESEE countries may have a more precise and direct view of potential side effects on their economies;
Second, this discussion among the ECB and the CESEE must start early, possibly in the design process rather than after the implementation of legislation and regulation. This will allow enough time for CESEE authorities to implement legal and regulative amendments to complement EU regulation and adapt its institutional structures in timely manner.

The reforming EU deposit insurance and banking resolution mechanisms, for example, will have legislative and regulative implications for economies of the CESEE due to dominance of European banking groups in our financial sectors. However, until the ECB and the EU decide on a solution and legislation is eventually approved, we would not know what the potential implications (like regulatory arbitrage opportunities), the required legal changes, and the financial costs are for our banking system and our economies. Information is clearly in the interest of the CESEE countries as it would remove uncertainty and risk among host supervisors (non-EU and non-euro area) regarding the effective resolution (including burden-sharing) of multinational European banks;

Third, establishing "Resolution colleges", similar to "colleges of supervisors", might be an intelligent and efficient way to prepare for extreme situations. These colleges would allow home and host supervisors to discuss ex-ante regarding possible resolution of multinational European banks, with the purpose of bridging differences in the process and burden sharing as much as possible. In principle, some form of supervision could be designed to allow the ECB to share the responsibility of supervising multinational European banks with the host supervisors (particularly in case of their systemic importance in host countries).

Fourth, establishing swap lines of liquidity in euro, between the ECB and the host countries' central banks (or supervisory authorities) – non-EU countries, managing and overcoming unexpected liquidity risk and other potential constrains faced by multinational European banks, which might rise directly or as unintended consequences in response to decisions taken by supervision and financial stability authorities in the euro area. This could be the case only for those (non-euro area, non-EU) host countries, where the European banks have a systemic importance. In return, the host countries' supervisors will provide the ECB with information on the financial situation of the systemic subsidiaries and their respective supervisory policies;

Fifth, it is about the role of international financial organizations. The IMF, the World Bank, and the Basel Committee have had and continue to play an important role in shaping the financial system and building its resilience in our economies. The EFSAP is an excellent example to illustrate this point, and they have vast expertise in dealing with related issues in developed and emerging countries. Therefore, I believe that involvement of these institutions in the discussion process would benefit both EU and CESEE economies.

The euro area and the CESEE economies will be ultimately part of the same political economic and monetary union. Despite current hardships, the EU political and economic integration agenda remains committed in this goal. One might even say that despite potential political, social setbacks caused by the crisis, it (the crisis) is pushing the integration agenda faster and stronger than before. In this respect, it is necessary to connect the political and economic integration process together and continue developing both processes at the same speed. Under current circumstances, regional cooperation and communication becomes a necessary objective of the CESEE integration process, at least for the banking and financial market reform. It would be much easier for the EU authorities to adopt and address the concerns of the CESEE as a single group rather than individually.

In conclusion, it is so important to establish a significant level of communication and coordination among the central banks and EU institutions, their legal and regulative framework. Finally, I would recommend complementing it with a similar level of coordination among other institutions, which play a significant role in macroeconomic and financial stability in our economies. In particular, there is more need for communication and coordination among the ministers of finance in the region because fiscal policy is essential for the macrofinancial stability of the economy and plays a significant role in the successful implementation of the macroprudential tools. The coordination is not an easy task, especially when benefits come at the cost of one's partners, but, if we aspire to have far-reaching results, this is the right manner and the appropriate moment to react.

Thank you!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Summit of Finance Ministers and Governors
"The Financial Future of the Region", Becici, Montenegro
14 June 2013

Dear Ministers of Finance,
Dear Governors,

The crisis we are going through, being so profound and lasting, will leave its mark on economics in general, and central banking in particular. Up until the Great Recession, monetary policy was living in a world that we may call "the inflation targeting era". To anyone that has followed the discussions regarding the optimal central bank policy ever since the onset of the crisis, it is clear that the validity of the previous approach has been heavily questioned.

In many ways inflation targeting made the central bank's job simple, as long as it followed the policy correctly. The Central Bank, seen by the public as an independent institution, had to credibly commit to an explicit inflation target, in order to anchor mid-term inflation expectations. Self-fulfilling expectations from economic agents and price setters would, in turn, help deliver the objectives of monetary policy.

Unfortunately, as shown recently, this strict approach to monetary policy has some shortcomings. What this approach missed, due to its focus in consumer prices, was the drift in prices of assets in general. Escalating asset prices and their sudden burst affected significantly the behaviour and balance sheets of the economic agents and challenged the stability of the financial system. In this respect, the concept of financial stability was seen as a by product of monetary stability.

Economists believed that by stabilizing consumer prices, financial assets would also behave in a stable and predictable way. The crisis painfully reminds us that this is not necessarily true. Behaviour in financial markets is not always rational and lack of confidence in the markets can spiral out of control, sending shockwaves throughout the economy.

Fortunately, the Bank of Albania adopted a more conservative approach considering monetary policy and financial stability issues simultaneously, conditioning either decision-making process by the other one. Due to this behaviour, the crisis had a direct but trivial impact on the financial system.

Despite this, the banking system faced immediate difficulties in the form of deposit withdrawals, emerging as indirect effects of fear contagion and irrational expectations. The liquidity problems that emerged spilled over to the credit market and later to the real economy and foreign sector.

The Bank of Albania reacted quickly to this changing economic climate. Liquidity was abundantly injected to our banks and more stringent regulations were applied in regard to the transfer of funds. However, unlike in most other countries where monetary policy was used initially to boost aggregate demand, in Albania, monetary policy stayed in its course giving way to expansionary fiscal policy.

Due to a relatively long period of consolidation, fiscal policy at the outburst of crises had abundant room for manoeuvre and has a more direct impact on the economy. Our policy response was conditioned by the concerns of financial stability, assuming that interest rate cuts would speed up deposit withdrawals from the banking system.

Bank of Albania took bold and decisive steps to control these problems and restore the credibility in banking system. As the effects of the fiscal stimulus began to phase out and confidence was restored in the banking system, we reduced our policy rate to its historic low in order to provide further stimulus for the economy. More importantly, our supervision of the banking system has been enhanced by establishing a thoroughly new Department of Financial Stability and by bringing financial stability issues in the decision-making process of monetary policy.

As a result, the set of tools available to the Bank of Albania has extended to include several macro-prudential measures, which aim to address simultaneously both economic growth and financial stability concerns.

I believe that similar steps have been taken by most central banks around the world. Willingly or not, the objective of financial stability is now seen as the central duty of our institutions. It does not matter whether the legal mandate of the central bank is amended to include this new objective or not. What matters is that financial stability is a prerequisite to overall macroeconomic stability and monetary stability. The challenge that lies ahead of us is how to include this new objective in our policy making; whether inflation targeting and financial stability can be combined or whether a new regime altogether is needed.

Various new radical approaches have been mentioned so far. However, I believe that we should not discard all the hard-learned lessons and the successes of the past. Stabilizing inflation should be something that central bankers may be proud of, something that we should cherish and continue to strive for.

Incorporating financial stability objectives with the inflation targeting regime should be seen as an opportunity to understand economic developments and potential macro-financial risks, to achieve both these objectives and preserve long-run economic stability. I believe the course of the monetary policy will continue to be extensively discussed in the future, including our improved understanding of the role of asset prices and financial frictions.

Under the current conditions, the largest central banks in developed countries have stretched central banking theory and practice beyond traditional activities.

Their balance sheets have increased beyond imagination and, in some cases, include private assets; they have accepted a much broader role and have assumed more responsibility. This all new and untested type of central banking will have a strong impact not only on the nature of monetary policy and its interaction with other central bank objectives but also on the independence and credibility of the central bank itself. The nature of future monetary policy will largely depend on the success of the largest central banks to get out of this situation in a controlled and timely manner, without causing excess inflation and damaging central banks hard-earned credibility.

These developments will affect monetary policy in the emerging markets through interest and exchange rates, but most importantly in the way central banks conduct their monetary policy.

Influenced by current practices of leading central banks, some other central banks have reoriented their objectives and engaged in activities which are traditional for development banks and governments. We have been careful to stay away from adopting and targeting such objectives not only in monetary policy but also in our macro-prudential policy.

The Bank of Albania has traditionally based its policy on two important pillars. Our first focus has been to achieve our inflation target and manage inflation expectations to preserve the purchasing power of our currency. This policy has simultaneously provided necessary stimulus to economic activity. Second, our focus on banking supervision and financial stability has enhanced the confidence on our financial system and, therefore, increased the efficiency and credibility of our monetary policy.

As I have said in April of 2008, during the annual conference with the banking system in Albania, "every investment we make today in financial stability yields increased efficiency in our monetary policy".

Recently, the Bank of Albania has introduced financial literacy as a third pillar of our policy and independence. This objective is founded on my belief that the first two pillars gain sustainability only if the public understand the role of the central bank, its independence and its policy.

Last but equally important, I would like to emphasise the need of cooperation and coordination with the fiscal policy. Fiscal policy and its impact are facts of life which can't be ignored. Therefore, monetary and macro-prudential policies have to be designed and implemented in full awareness of its existence.

A Central Bank does not live in an isolated island; its success will, among others, depend on its ability to act in coordination and cooperation with the fiscal policy, without losing its independence.

Incorporating this understanding in the central bank theory and practice requires some adjustments and flexibility but, at the same time, requires that central banks preserve their focus and independence and acknowledge their limitations.

Altogether these changes will allow the central bank and its inflation targeting regime to become a useful tool at the hand of the monetary authorities to preserve economic and financial stability in the post-Global Financial Crisis period.

Thank you very much for your attention!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision-Making of the Bank of Albania's Supervisory Council
26 June 2013

Today, on 26 June 2013, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the most recent monetary and economic developments in Albania, and following the discussions on their outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged, at 3.75%. The Supervisory Council deems that the current monetary conditions are adequate to meet Bank of Albania's inflation target in the medium term. At the same time, these conditions ensure the necessary monetary stimulus to support the domestic demand.

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

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Annual inflation continued its downtrend in May, settling at 2.1%. Prices of agricultural products fell, thanks to the higher supply in the domestic market, shifting this month's inflation down. On the other hand, prices of other goods and services of the CPI basket ranged around the previous months levels.

From the macroeconomic perspective, consumer prices continue to reflect low inflationary pressures, arising from both the demand and the supply side. The cyclical weakness of the economy was associated with strong reduction of core inflation during this period. Due to spare capacities in the labour market and capital, production costs and profit margins increased at low levels, leading to lower increase in final prices of consumer goods produced in Albania. Furthermore, price stabilisation in global markets and economic agents' anchored expectations on inflation were reflected in low price rise in the domestic market. Consumer price inflation appears to be at low rates and is expected to range in these levels, in the period ahead.

The macroeconomic analysis, updated with the latest available information, suggests low aggregate demand growth during the first five months of the year. Economic growth was supported by foreign demand and higher public spending during this period, while consumption and private investments were weak. Over the last quarters, consumption and private investments have suffered from uncertainties for the future and tighter lending terms. Their performance will be broadly conditioned by the improvement of these two drivers.

In the first five months of the year, the fiscal policy was stimulating to the economy, materialised in the rapid expansion of the fiscal deficit and public spending. Additionally, the fiscal easing relied also on the taxation policy, as a number of taxes were reduced directly or indirectly. Budget expenditure surged 13.3%, mainly due to public investments during this period. Fiscal revenues fell 0.2%, mainly due to contraction in the tax component. For the first five months of the year, budget deficit stood at ALL 38.3 billion, about 1.1 times higher than a year earlier, affecting, therefore, the increase in the public debt to GDP ratio, to 62.4%. The Bank of Albania continues to draw the attention on the need for fiscal measures, which would guarantee the long-term stability of the public debt, boost financial markets' confidence in our public finance, and cut long-term costs of debt service. This objective should be the main medium-term priority of public finances.

Data on the external sector of the economy reveal that the net foreign demand contributed positively to economic growth in the first quarter. The current account deficit narrowed, in annual terms, settling at 9.8% of GDP during this period. Foreign trade data for April point to further narrowing of the annual trade deficit by about 5.3% in annual terms, thanks to the rising exports. Meanwhile, for the first time since September 2012, total imports increased about 3.6% in this month. As pointed out earlier, the current account deficit constitutes a structural deficiency of the Albanian economy. Its adjustment would mitigate one of the potential sources of risks to the Albanian economy and financial markets, and broaden the space for implementing stimulating macroeconomic policies in the future.

Monetary indicators were in line with the real-economy developments and our analysis reveals that the monetary inflation pressures are weak. Annual increase of money supply accelerated in April, reversing the deceleration trend that had started in July of last year. The broad money aggregate, M3, picked up 5.2% from 4.6% in March, mainly reflecting the higher demand for funding by the public sector. By contrast, the private sector's weak demand is reflected in the sluggish credit performance. Lending to the economy slowed down further in April, marking only 0.9% annual growth. Besides the weak demand, lending deteriorated also due to banks' prudence in lending, materialised in relatively tight standards. This phenomenon is regionally dispersed and is dictated, to a large extent, by the developments in the euro area's financial markets.

The main feature of financial markets developments has been the downward trend of interest rates in recent months. The easing signals of the monetary policy were transmitted, though unevenly, across all the market segments. The interbank interest rates followed the latest key interest rate cut in March and remain anchored around it. In May and June, the yields continued to fall in the primary market in line with the monetary policy easing cycle. Deposits and loans interest rates are reacting more slowly conform to the time lag in the monetary policy transmission mechanism, and in the presence of economic agents' uncertainties about the future and risk premia that accompany crediting.

Insofar factual developments have not altered our base projections on economic developments. For 2013, economic growth rates are projected to be close to those of the past year, although the balance of risks has shifted on the down side. Foreign demand is expected to contribute less, affected by the economic slowdown in partner countries. Intensification of expenditures in the second quarter is expected to be counted as positive contribution by the public sector to the aggregate demand in this period. However, its capacity to induct stable growth on the private sector appears limited in time and restricted by requirements for compliance with budget deficit indicators. Under these circumstances, the domestic private demand remains a determinant factor for boosting aggregate demand in the future. Accumulation of financial savings and easing stimulus of the monetary policy are expected to materialise in better consumption and private spending in the period ahead. Demand growth below the potential of the economy for the rest of the year will continue to exercise low inflationary pressures from the demand side.

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At the end of discussions, the Supervisory Council decided to keep the key interest rate unchanged, at 3.75%. The outlook of economic and financial developments in Albania and abroad determines the continuation of the easing monetary conditions over the monetary policy-relevant horizon. This policy establishes the proper conditions for meeting the inflation target in the medium-term period, contributing at the same time to the growth of aggregate demand and full utilisation of production capacities in the economy.

Expected economic and financial developments require that the easing monetary conditions be maintained in the monetary policy-relevant horizon. The Bank of Albania stands ready to react duly and timely to provide the necessary monetary conditions for meeting its inflation target.

PERIODIC ANALYSES*

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

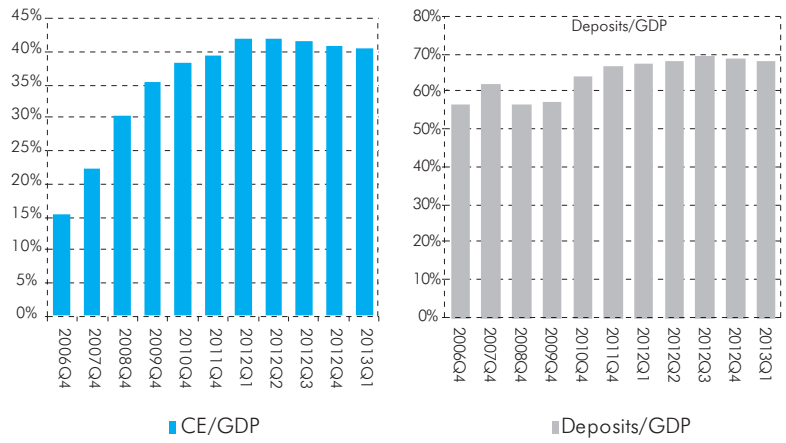
ANALYSIS OF FINANCIAL INTERMEDIATION 2013 Q1

ERJONA SULJOTI, SOFIKA NOTE AND OLTA MANJANI
MONETARY POLICY DEPARTMENT, APRIL 2013

1. BANKS AND INTERMEDIATION

The Albanian financial system consists of 16 commercial banks and other financial institutions such as savings and loans associations, investment private funds and other financial corporations. Banking sector continues to dominate the financial system structure, sharing more than 90% of the system's total assets. Thus, the banking sector covers the largest part of financial intermediation in economy and financial intermediation and banking intermediation are exchangeable. Depositing and lending dictated the performance of financial intermediation. Banking system plays the main role to intermediate funds from economic agents as savers - mainly households - to users of these funds such as private businesses and other households.

Chart 1. Credit to economy and deposits as a percentage of GDP (in %)



Source: Bank of Albania.

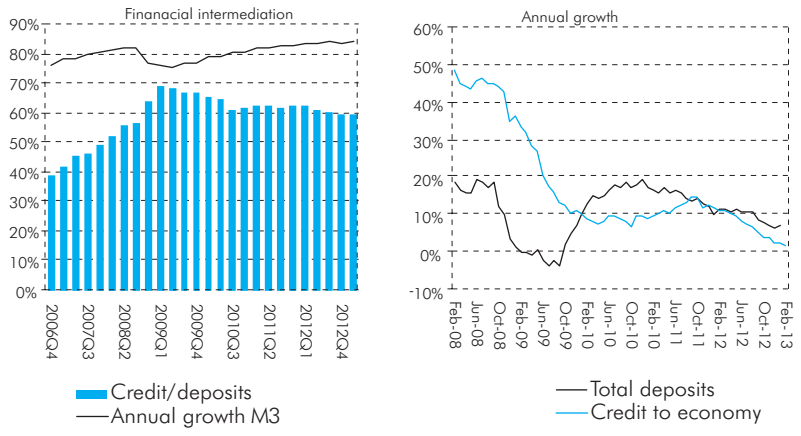
Indicators of financial intermediation during 2013 Q1[1] recorded a slight declining trend. Deposits-to-GDP ratio stood at 68.7% in February, compared to 68.9% at the end of the previous quarter. Credit to economy-to-GDP ratio was 40.6% in February, about 0.5 percentage point lower than at the end-2012. Demand and supply continue to impact the decrease in lending to economy. In the framework of the overall sluggish economic activity , and due to psychological factors related to the perceived doubts for the economic developments in future, the demand for monetary assets by economic agents

[1] *The latest monetary data in the analysis refer to the period January-February 2013.*

is low. On the supply side, although well-capitalised and liquid, banks continued to maintain tightened lending standards and appeared rather selective related to the projects they finance. The low use of this liquidity for the intermediation of funds to lending has persisted to simulate maintaining funds as net foreign assets.

Financial intermediation measured as credit-to-system deposits ratio in the banking system was low and almost at the same levels of the previous quarter, albeit a slight falling tendency. Notwithstanding the increasing monetisation, banking system intermediated about 59.1% of funds from deposits in credit to economy in February, or 0.5 percentage point lower compared to the end-2012. This fall in intermediation rate is mainly due to the high savings of economic agents in deposits. Deposits-to-broad money ratio was about 83.4% in February, against the low demand for lending from the banking system. Thus, the annual growth of total deposits was 6.1% in February, standing close to the rate of end-2012. This performance is close to long-term average increase of banking system's total deposits in the last 10 years (excluding 2008-09). On the other hand, the increasing annual paces of loan portfolio continued to reduce. In February, this portfolio was only 1.7% higher than a year earlier. This is the lowest historical rate of loan portfolio increase in the last 10 years.

Chart 2. Intermediary indicators for banking system



Source: Bank of Albania.

2. INTERMEDIATION

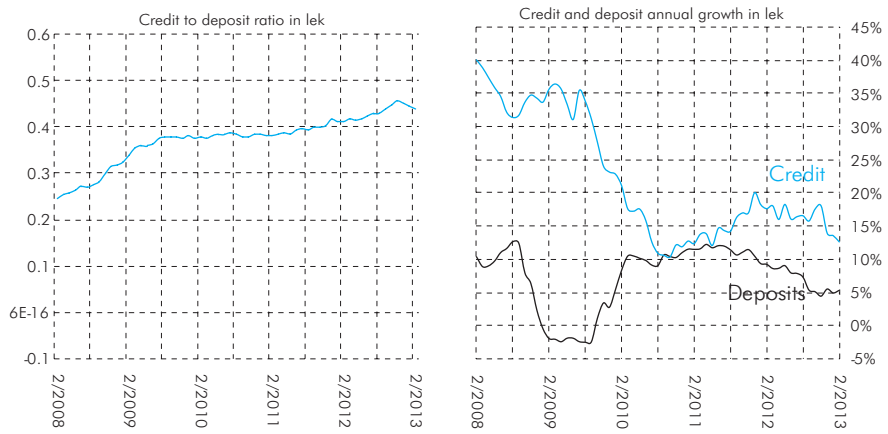
Intermediation in the first two months of 2013 is characterised by a good performance in deposits, but a low mobilisation of them in lending. Lending to economy appeared sluggish, reflecting the low demand of economic agents and the conservative position of banks, expressed in tightened lending standards. Intermediation margins had a high monthly volatility and were affected by the low credit supply and volatile credit interest rates. In average

terms, these rates are lower than a year earlier. The majority of non-cost elements of lending conditions continue to operate on the tightening side, particularly regarding the loan to businesses.

2.1 INTERMEDIATION IN LEK

Intermediation in lek slowed down in 2013 Q1. The loan-to-deposits ratio in lek stood at 44.0% as at end-February, down by 1.1 percentage points compared to a year earlier. The fall in the intermediation ratio in lek in the last two months was due to the lending slowdown in lek.

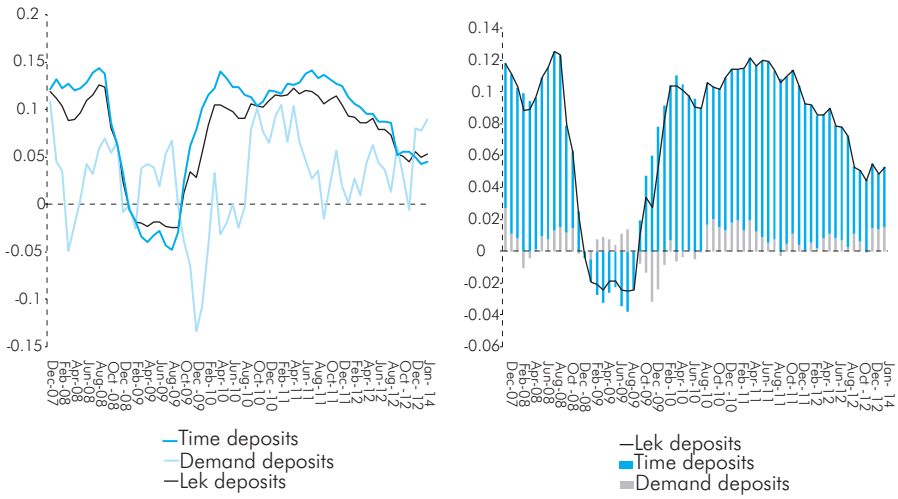
Chart 3. Intermediation in lek



Source: Bank of Albania.

Deposits denominated in lek performed better in 2013 Q1, compared to 2012 Q4, with an annual increase of 5.3%. The good performance of lending in lek and the increased demand for financing by the Government in the first two

Chart 4. Deposits in lek by maturity

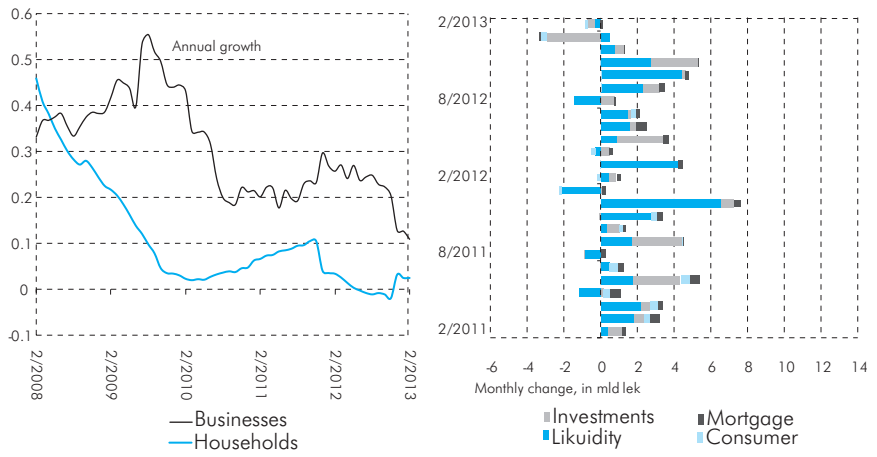


Source: Bank of Albania.

months of the year helped the circulation/creation of money in lek in economy. By maturity, demand deposits in lek maintained high annual growth rates, standing at 8.9% in February. The good performance of lek deposits owed mainly to the demand deposits of businesses, which appeared considerably volatile during the year. Time deposits in lek grew 4.5%, y-o-y, supported by a moderate but steady increase in households time deposits in lek.

Lending denominated in lek was the main driver of lending during the previous year, mainly oriented towards lending to businesses, despite the considerable slowdown in the first two months of the year. Its stock was down by ALL 3.6 billion during this period, mostly investment credit. Its annual growth stood at 12.6% in February, down by 1.3 percentage points, compared to end-year and by 5.0 percentage points compared to the same period a year earlier.

Chart 5. Lending in lek

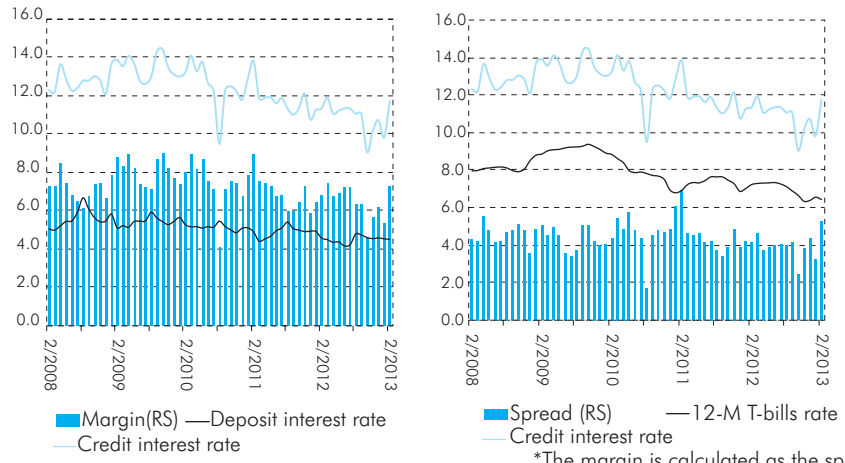


Source: Bank of Albania.

Intermediation cost in lek, was volatile in the first two months of the year. Thus, after the fall at 5.35 percentage points in January, it increased, standing at 7.29 percentage points in February. In presence of the downward tendency of deposits interest rate, its volatility owed mainly to the fluctuations in credit interest rates. Due to the low level of new loans, the average interest rate is considerably affected by the credit with particular risk and return characteristics. In annual average terms, , lek loan interest rates declined at higher rates than deposits ones, compared to a year earlier, leading to a fall in lek intermediation cost during this period.

Volatility in lek loan interest rate in the first two months of 2013 is reflected on their spread with the 12-monthT-bill yield. After the fall in 2012 Q1, the average spread in these two months was 4.3 percentage points, unchanged from the previous year.

Chart 6. Intermediation cost in lek*.



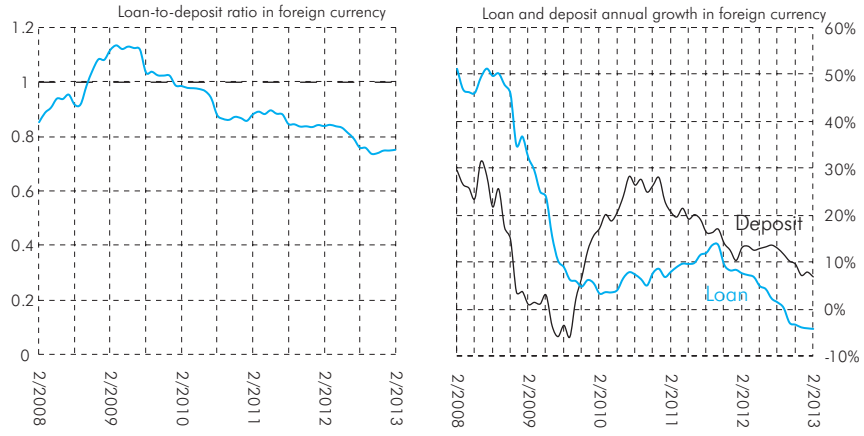
*The margin is calculated as the spread between loan and deposit interest rates. The spread is calculated as the difference between loan/deposit interest rate and the reference rate (12-month T-bill yield for the lek and 12-month euribor for the euro).

Source: Bank of Albania.

2.2 INTERMEDIATION IN FOREIGN CURRENCY

Intermediation in foreign currency, after the fall in 2012 Q4, remained almost steady in 2013 Q1. Credit-to-deposits ratio was 75.1% as at end-February, 8.7 percentage points lower compared to a year earlier. The decrease in foreign currency intermediation mainly owed to the drop in credit in foreign currency. Meanwhile, low intermediation rates in the last months were mainly due to the slowed increase in deposits denominated in foreign currency.

Chart 7. Intermediation in foreign currency

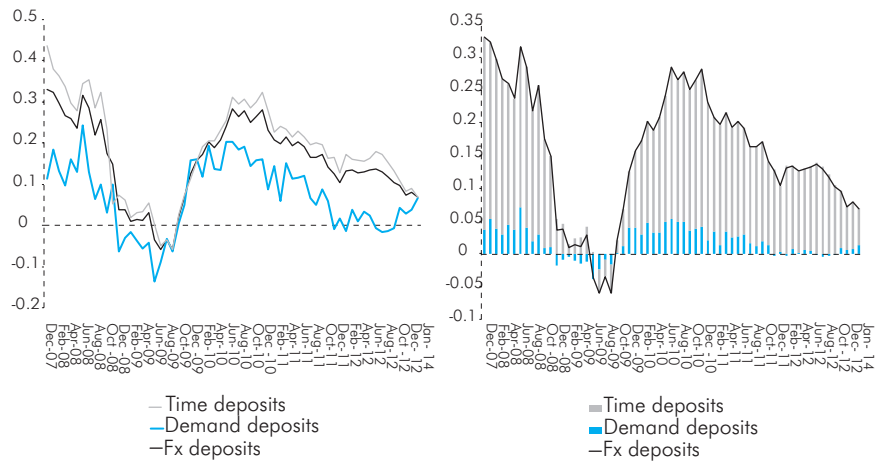


Source: Bank of Albania.

Annual growth rates of deposits in foreign currency slowed down further in 2013 Q1, pointing at 6.9%. This slowdown reflected both lower cross-border foreign currency inflows and the lower creation in foreign currency, due to the weak performance of lending in foreign currency. Also, this performance

was triggered by the transfer of investments in foreign currency savings of households at other non-bank financial institutions in the last three months. Time deposits of households provided the main contribution to the increase in deposits in foreign currency, albeit this contribution has been lowering since July 2012. Meanwhile, the improved annual rate of demand deposits denominated in foreign currency, at 6.7% in during the first two months of 2013 driven by the increase in the demand deposits of households.

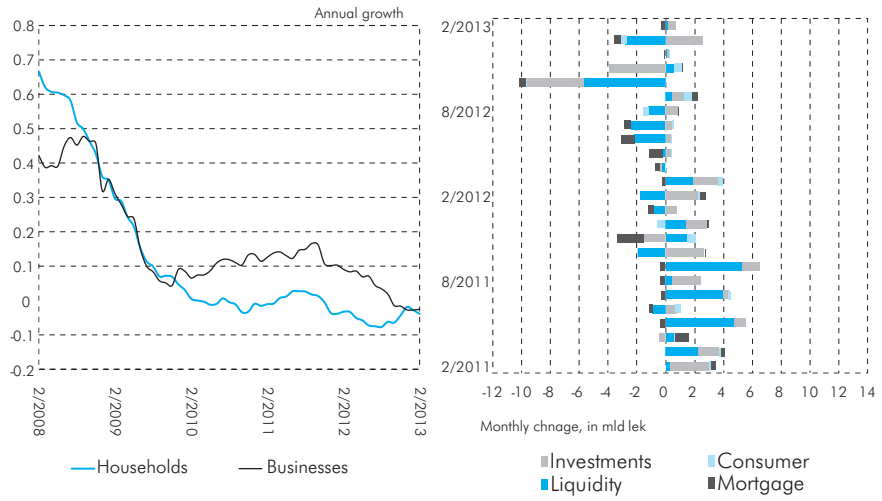
Chart 8. Deposits in foreign currency by maturity



Source: Bank of Albania.

Lending in foreign currency continued to show a weak performance during the first two months of the year. Outstanding credit contracted by ALL 0.6 billion in this period. Although it recorded an increase of credit for investments in foreign currency in these two months, it failed to balance the tightening in other types of credit in foreign currency. The continuing reduction of loan portfolio in foreign currency is reflected in the deepening of its annual tightening. As at end-February, it was 4.2% lower than a year earlier.

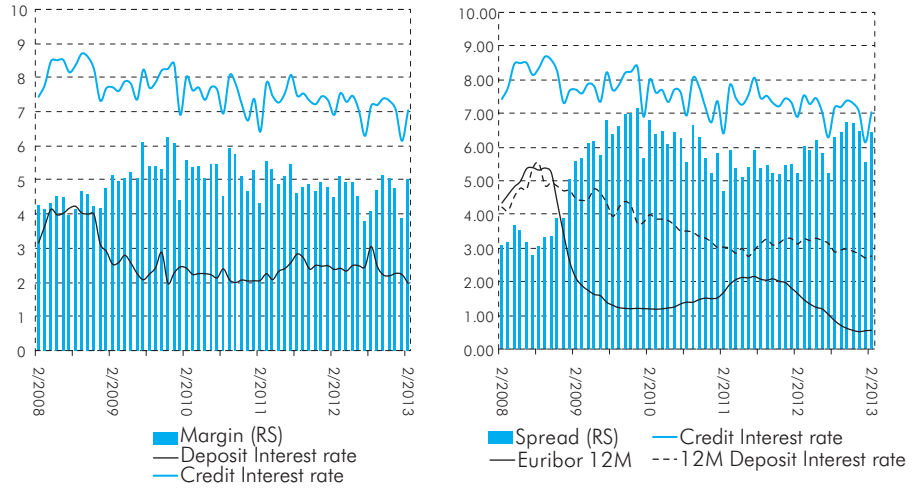
Chart 9. Lending in foreign currency



Source: Bank of Albania.

The weak performance of lending in foreign currency was notable to both businesses and households. Along with the low demand and tight standards characterising the overall performance of lending, the weak performance of lending in foreign currency reflected a shift in tendencies of customers from foreign currencies to the domestic currency. This phenomenon was more notable for mortgage loans to households and liquidity loans to businesses.

Chart 10. Intermediation cost in euro



Source: Bank of Albania.

Intermediation cost in euro[2] also appeared volatile in January and February, because of the fluctuations in credit interest rates and the intermediation cost in lek. Thus, in January it was 3.88 percentage points, down by 1 percentage point from the average of 2012 Q4. It fell particularly due to the low rate of a preferential loan. In February, the average credit interest rate increased again, close to the rates of the previous months. On the other hand, the average interest rate of deposits continued to decline in January and February, thus reflecting the ample liquidity situation in foreign currency.

Euro interest rates in Albania remain significantly higher than in the international markets, reflecting the structural features of the domestic market. However, the decrease in interest rates for deposits in euro at home notable in 2012 Q4 and in the first months of 2013 is reflected in the narrowing of this spread. Also, such a performance establishes the premises for a decline in loan interest rates in euro in the future.

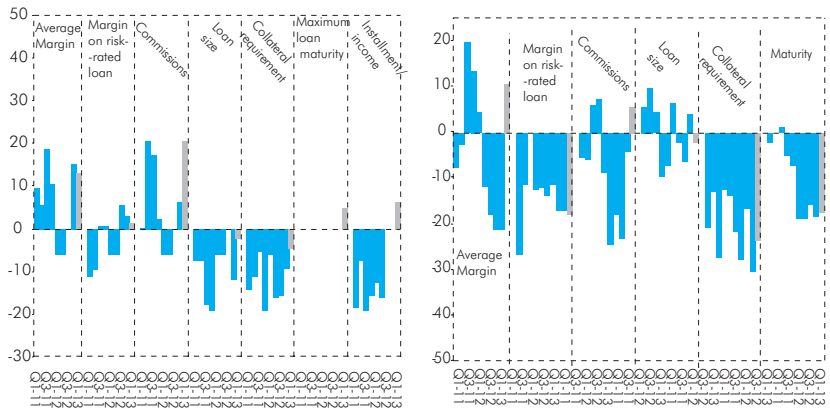
3. NON-PRICE CRITERIA IN INTERMEDIATION

According to the Bank Lending Survey 2013 Q1, lending standards applied to businesses tightened further for all types of loans. Lending conditions to households eased slightly for mortgage loan, but tightened for the consumer

[2] *Banks' activity in foreign currency is dominated by that in euro, which accounts for more than 80% of foreign currency operations.*

loan. The majority of non-price criteria of lending standards continue to operate on the tightening side, particularly regarding the loan to businesses. The lending standards applied to businesses continued to tighten in 2013

Chart 11. Lending standards applied to businesses (left) and households (right) *



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

Q1, but at a lower level compared to the previous quarters. All the non-price criteria of these conditions have acted on the tightening side. Among them, the collateral requirement and loan maximum maturity continue to affect most the tightening of lending standards applied to businesses.

Lending standards applied to households, after remaining unchanged during the last three quarters of 2012, recorded a marginal easing in 2013 Q1. The easing of lending standards, along with price criteria (interest rate, commissions), is realised through the loan maximum maturity and instalment/ income ratio. Two other non-price criteria of lending standards, loan amount and collateral requirement remain tight, but lower than in 2012 Q4.

INFORMATION ON SELECTED ECONOMIC AND MONETARY INDICATORS IN TRADING PARTNER COUNTRIES, 2013 Q1

JONIDA BOLLANO, MEDVIN SHEHU
MONETARY POLICY DEPARTMENT, APRIL 2013

EURO AREA

The euro area economy in 2012 Q4 continued to contract. The latest Eurostat bulletin showed that it contracted 0.6% on a quarter earlier and 0.9% on a year earlier. The euro area economy continues to be influenced by the negative performance of consumption and investments. During this period, net exports slowdown was added to these factors. Preliminary and indirect data as of February (industrial production, retail sales and construction indicator) confirm the continuation of slowdown in the first part of the year. In the medium-term, however, economic recovery in the euro area is expected to be affected positively by the recovery of exports given that the global economy has shown signs of recovery. Financial markets and the monetary policy have played a buffering and contributing role during this period. The key interest rate stands at its all-time low (0.75%) whereas non-conventional operations by the ECB continued to provide ample liquidity. The capital markets have reflected the ECB actions, which has mitigated the tensions and lowered the yields across the categories of the issuers. The financial markets have managed to absorb the spillover effects from the crisis in Cyprus and tensions in Slovenia, hence preventing the replication of the crisis situation in Greece.

The monetary policy transmission mechanism was not homogenous, revealing rigidity in many countries as regards the application of reduced lending interest rates to the economy. In a more specific analysis, the main problem remains the weak economic performance of some key countries (Italy and Spain), which are obliged to implement an austere consolidation policy on fiscal balances. The narrow space in this regard and the prolongation of economic downturn affect the establishment of the requisites for a rapid recovery of economic growth.

Economic slowdown in the countries that had performed positively insofar (such as Germany and France) is considered to have come as a result of the effects related to those euro area countries that are experiencing prolonged economic downturn. Another factor of concern is the increase of unemployment rates on monthly terms (12% in February). Increasing unemployment on the one hand and downward employment indicators on the other have been the focus of the analysis of the Governing Council of the ECB in the recent reports. The key rate was kept unchanged (0.75%) although the financial agents had expected it to be slightly down. Inflation has pursued a downward trend in the recent months, confirming ECB experts' projections for contained inflationary pressures.

Table 1 GDP and CPI projections

	GDP		CPI	
	2013	2014	2013	2014
Euro area	-0.4	0.9	1.7	1.6
Germany	0.7	1.7	1.7	2.0
Spain	-1.6	0.2	2.0	1.5
Italy	-1.4	0.5	1.9	1.7
Greece	-4.9	-1.4	-0.1	1.3

Source: Consensus economics, April 2013.

GERMANY

In 2012 Q4, the German economy slowed down -0.6% on a quarter earlier, but improved 0.4% on a year earlier. Net exports were the main item contributing negatively to growth (especially towards EU countries) being downward in the last months. This performance of the German economy has re-introduced to the focus of the analysts the potential negative impact from the overall global economic situation and negative performance in Germany's main trading partners. Recent data for January and February (industrial production, trade, exports, construction and personal consumption) suggest that the German economic slowdown will be temporary. For the first part of the year, it is expected to experience positive growth rates. Business and consumers confidence indicators (Ifo) point to this direction. Unemployment stood at 5.5% in February and continues to be among the lowest rates in advanced economies. Employment indicators appear positive as well. Inflation has been downward month after month and it is projected (EC) to remain low throughout 2013.

SPAIN

Spain's GDP in 2012 Q4 continued to be negative in both quarterly terms (-0.8%) and annual terms (-1.9%). Contraction of domestic demand remains the main factor, while net exports contributed positively, thus offsetting the downward GDP during 2012 Q4. Persistent weakening of the Spanish economy has triggered questions among financial agents on the achievement and realisation of fiscal balances consolidation, whereas international capital markets appear adverse to the idea of refinancing a potential deficit. Unemployment in general and among youth in particular continue to grow, adding social pressures and weakening consumption and business initiatives. Similar to other euro area countries, inflation in the recent months has been downward. The producer price index has pursued a downward trend for the last five months. Latest data (industrial production, trade, industrial new orders, mortgage loans) reveal that economic contraction will continue over the first half of the year.

ITALY

Economic activity in Italy contracted again in 2012 Q4. Like in previous quarters, the Italian economy presents a persisting deterioration of consumption,

investments and industrial production. Net exports contributed positively, offsetting to some extent the negative effect of the above-listed items. Latest data on some preliminary indicators and signals of economic performance point to its deterioration in the upcoming months. Hence, industrial production, sales index, industrial new orders recorded downward figures in both monthly and yearly terms. The need to consolidate fiscal balances has limited the possibilities of the central government to manoeuvre while the unfavourable global economic situation has slowed down Italy's exports. In addition to the existing problems, the political stalemate has added to economic agents uneasiness. The protracted accord to create a new government, competent to carry out the necessary reforms, enhanced the uncertainties about the expected recovery of the Italian economy. For four months, the Consumer Price Index and the Producer Price Index have been downward. Inflationary pressures were softened during the last part of the year and BdI experts' projections incline towards the downtrend for the year ahead, as well.

GREECE

Latest data from the National Statistics Institute of Greece shows that in 2012 Q4, the Greek economy continued to shrink, recording -5.7%, y-o-y. The continued downward consumption and domestic demand, reduced investments and modest contribution from net exports were the main determinants. The Greek economy is experiencing a difficult situation where the need to adjust a series of balances both in the fiscal and financial aspects of the banks have rendered the economic recovery even more difficult. Various indicators for January and February such as industrial production, sales index and construction index continued their downtrend both in monthly and annual terms. This setting suggests that the Greek economy will continue to contract in the quarters ahead. Inflation has been downward during this period, registering negative values (-0.2%) in March, moving towards deflation.

CHINA

The Chinese economy continued to post high growth rates in 2013 Q1 (7.7%, y-o-y) albeit at lower rates from 2012 Q4 (7.9%, y-o-y). The GDP expanded thanks to domestic demand, which generated 4.3 percentage points of total growth. Moreover, the accumulation of net capital and annual growth of exports by 17.8% contributed 2.3 and 1.1 percentage points, respectively. Investments in the housing market increased 20.2% in annual terms, whereas income from sales reached 61.3%, increasing the concern for overpricing in the housing market. In spite of these developments, analysts think that the rapid development of a consumer class constitutes a positive factor for the long-term future of the Chinese economy, establishing a basis for sustainable economic growth away from spending in investments and exports. In March, annual inflation surged to 4.5% from 3.2% in February as a result of the low comparative base. The monetary policy is considered as easing and the central bank is not expected to intervene in the short-term perspective.

TURKEY

Annual growth of the Turkish economy was 1.4% in 2012 Q4, continuing the downward trend. The GDP expanded mainly from higher net exports and government spending. On the other hand, the contracted private demand and downward investments by 9.2% contributed negatively. Indirect data point to further growth in 2013 Q1. Industry and confidence indices improved both in January and February in line with estimates for domestic demand recovery. At year start, Turkey experienced high inflation rates. Its annual growth posted 7.3% in March from 7.0% in February and 7.3% in January. Inflationary pressures derived mainly form high food item prices, which expanded 8.1% in annual terms. In the light of this setting, keeping inflation within the 5.0% target for 2013 is considered as difficult for the central bank of Turkey. In response to the high crediting levels, in the first quarter of the year, the central bank of Turkey intervened in the banking market increasing twice consecutively the required reserve remuneration rate for deposits in the Turkish lira (maturity >1 year) and in foreign currencies (maturity >3 years) to 11.0% and 11.4%, respectively. Moreover, to offset the risk arising from the rapid increase of capital inflows and eliminate the appreciating pressures on the Turkish lira, the central bank of Turkey cut the key interest rate to 5.0% from 5.5%.

MACEDONIA

In Macedonia, economic growth was weak in the fourth quarter (0.2% in annual terms). The main drivers to this dynamic were investments and public spending. On the other hand, private consumption recorded negative growth for the second consecutive quarter (-2.0% and -2.4% on annual basis in 2012 Q4 and Q3, respectively) hence reflecting the decline of the net wage by 5.5% in real terms and the prononunced decline of private transfers. Despite higher exports to euro area partner countries, the contribution of net exports to GDP growth remained negative as a result of accelerated imports growth.[1]

The latest assessments speak of recuperation of the Macedonian economy for 2013, as the recovery of domestic demand is expected to play the main role.

Preliminary indicators, such as the Industry and Construction ones point to growing economic activity in the early months of the year. Meanwhile, the value of exports for January-February 2013 was higher than a year earlier.

In March, annual inflation fell to 3.1% from 3.5% in February. The lower energy price was the determining factor for the consumer price decline.

SERBIA

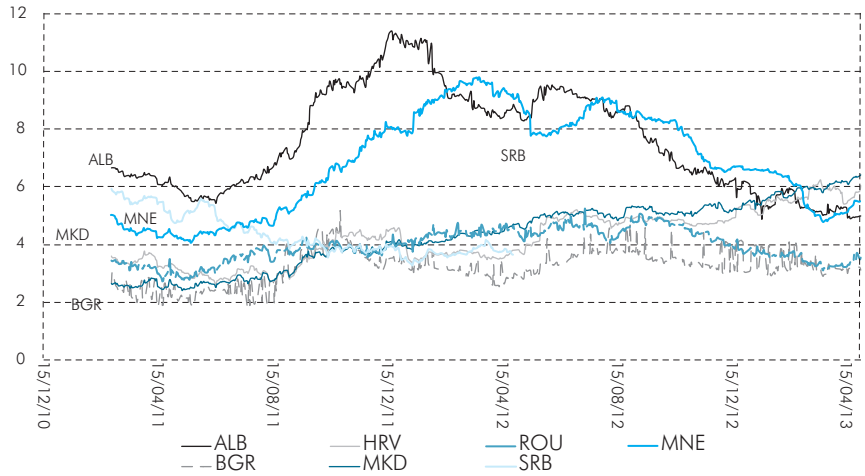
Serbia was the only country among the SEE countries that concluded 2012 in deep recession. Despite the improvement of economic activity in the last

[1] *Imports expanded, mainly due to strong investments in the branch of vehicle spare parts.*

quarter thanks to the better performance of the industry and services sectors[2], the annual GDP narrowed on average by 1.7%. As credit standards tightened, the construction sector activity contracted in the fourth quarter by 24.7% on annual basis. On the other hand, following the drought, agricultural production slumped by 16.9%, pursuing a similar trend to January - September 2012, when the sectoral activity narrowed by 17.2%.

Economic activity in the current year is expected to record positive growth. The normalisation of the agriculture sector and competitiveness of Serbian products as a result of the depreciation of the Serbian dinar in real terms in the past four years are considered as primary factors for supporting GDP in 2013.

Chart 1. Yield spread for regions government bonds against German bonds



Source: Bloomberg, BoA.

Inflation in Serbia continues to record double-digit figures. In March, consumer prices increased 11.2% narrowing 0.8 percentage points from a month earlier. To subdue inflationary pressures, since June 2012, the central bank of Serbia has increased the key interest rate eight times, bringing it to 11.75%. The tightening monetary policy is expected to change direction only in the second half of 2013, when the country is expected to record more contained inflation rates reflecting the subdued domestic demand, the elimination of the VAT increase effect in October 2012 and a more favourable comparative base.

[2] *After the negative growth in the first three quarters, the industry sector expanded 2.1% (y-o-y) in 2012 Q4, driven up by the higher production activity of FIAT and Pancevo oil refinery. On the other hand, the services sector continues to be the engine of the national economy, generating 54% of the GDP.*

ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY, 2012 Q4

OLTI MITRE, MERITA BOKA
MONETARY POLICY DEPARTMENT, APRIL 2013

1. BALANCE OF PAYMENTS HIGHLIGHTS[1]

Trade transactions of Albania with other countries continued to be under the pressure of the global macroeconomic setting in general and neighbouring countries, such as Italy and Greece, in particular. The continuing difficult economic situation in Greece and the precipitated economic and political situation in Italy persisted to impact the performance of external sector indicators in Albania. The decelerating economic growth in these countries and the weakening of external demand led to a significant moderation of the growth rate in exports of goods and services during 2012. The drop in imports of goods and services during 2012 shows a weak domestic demand. Thus, nominal export deficit narrowed at an annual rate 14.4% driven by the fall in imports. Net financial flows in the capital and financial account narrowed by about 11.3% during 2012 and financed about 84.9% of this period's current account deficit.

Table 1 Balance of Payments indicators

	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2011	2012
Current account (in EUR million)	-366,4	-290,4	-251,8	-242,8	-236,3	-1185,4	-1021,3
y-o-y	2.8%	26.7%	-23.9%	-6.2%	-35.5%		-13.8%
/ GDP	-15.8%	-13.5%	-9.8%	-9.4%	-9.8%		10.5%
Trade balance	-658.6	-465.3	-475.5	-540.5	-517.8	-2,241.6	-1,999.2
Exports, f.o.b.	360.0	325.8	394.2	402.5	403.1	1,405.5	1,525.6
Imports f.o.b.	-1,018.6	-791.2	-869.7	-943.0	-920.9	-3,647.1	-3,524.8
Balance of services	41.3	8.5	26.2	132.6	27.9	134.9	195,1
Credit	428.5	293.8	381.1	578.1	402.1	1,747.4	1655.1
Debit	-387.2	-285.4	-354.9	-445.4	-374.2	-1,612.4	-1,459.9
Travel - export	285.1	185.1	246.4	445.3	268.4	1169.4	1145.2
Travel - import	-256.8	-180.8	-240.1	-325.6	-256.1	-1121.5	-1002.7
Travel - net	28.4	4.3	6.2	119.7	12.3	47.9	142.6
Balance of income	10.3	-40.4	-27.7	-20.6	-0.2	22.7	-89.0
Credit	53.2	48.2	43.0	57.8	55.3	220.1	204.4
Debit	-43.0	-88.6	-70.7	-78.5	-55.5	-197.3	-293.3
Net FDI income	-7.0	-54.8	-29.8	-42.0	-26.2	-53.2	-152.8
Current transfers	240.7	206.8	225.3	185.8	253.9	898.5	871,7
Credit	266.6	243.5	265.2	224.1	285.8	1,003.8	1,018.6
Debit	-25.9	-36.7	-39.9	-38.4	-31.9	-105.3	-146.9
Net remittances	182.5	166.5	171.6	140.8	196.3	664.5	675.3
Capital and financial account (in EUR million)	284.9	258.3	185.5	174.4	249.1	978.1	867.3
y-o-y	-30.7%	15.1%	-21.3%	-25.2%	-12.5%		-11.3%
/ GDP	12.3%	12.0%	7.2%	6.8%	10.3%		8.9%
Capital account	27.8	12,9	43,0	9,8	15,6	84.9	81.4
Financial account	257.0	245,3	142,5	164,6	233,5	893.2	785.9

[1] *The latest data on the balance of payments are as at 2012 Q4. Along with the release of 2012 Q4 data, the data on the first three quarters of 2012 are revised. Also, data for 2011 are revised the balance of payments, external debt and FDIs data by economic activity and geographical allocation.*

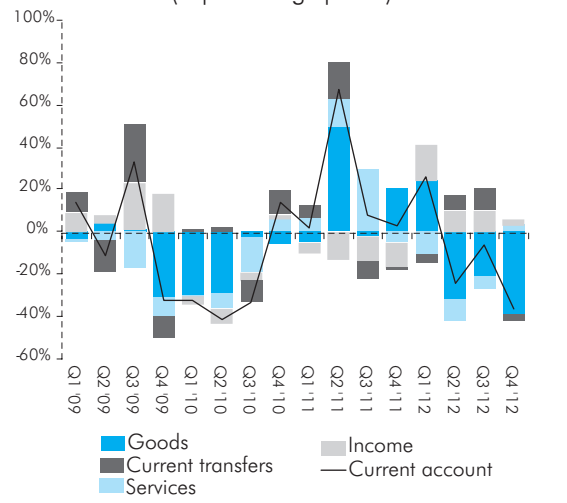
A. Liabilities	398.0	307.5	277.7	378.4	224.4	1302.5	1188.0
FDI	288.2	205.5	191.1	164.5	183.7	745.4	744.9
Portfolio investment	21.3	14.5	19.6	7.8	21.0	75.7	62.9
Other investments	88.6	87.5	67.0	206.0	19.7	481.3	380.2
Borrowing	39.3	41.6	30.4	28.5	10.5	221.6	111.0
Currency and deposits	53.1	69.1	34.8	164.8	3.7	261.4	272.5
B. Assets	-141.0	-62.2	-135.2	-213.8	9.2	-409.2	-402.1
FDI	-19.5	-2.7	-0.3	-7.7	-7.0	-29.9	-17.7
Portfolio investment	14.4	-6.0	9.9	-26.4	-10.0	-88.8	-87.5
Other investments	-135.8	1.5	-144.8	-179.7	26.2	-290.5	-296.9
Currency and deposits	-94.3	-11.0	-133.2	-178.2	67.0	-174.2	-255.4
Lending (for commercial financing)	-56.9	9.7	0.6	-1.8	-52.8	-119.5	-44.3
Errors and omissions	75.3	35.4	73.8	158.0	-36.0	178.6	231.2
Reserve assets	6.2	-3.2	-7.5	-89.7	23.1	28.7	-77.3

Source: Bank of Albania.

1.1 CURRENT ACCOUNT

Albania's net current account balance recorded a deficit of EUR 236.3 million in 2012 Q4. Current account deficit shrank at an annual rate of about 35.5%, hence reinforcing the trend that had begun since 2012 Q2. The current account deficit was estimated at 9.8% of nominal GDP[2] or about 6.0 percentage points lower compared to 2011 Q4. Excluding official transfers' income the current account deficit, is estimated at about 10.2% of nominal GDP in 2012 Q4, compared to 16.2% in the same period a year earlier.

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



Source: Bank of Albania.

As in the three previous quarters, developments in the current account dynamic during 2012 Q4 were broadly determined by the performance of net export balance. Trade deficit narrowed at an annual rate of about 21.4% and services account by about 32.5%. The combined position of both accounts led to the decrease in net exports deficit in 2012 Q4 at an annual rate of about 20.6%. Due to the increase in income outflows, income net balance recorded a deficit, thus providing a negative contribution to current account performance. The surplus in the current transfers increased at an annual rate of about 5.5%. Remittances, the main sub-item in this account, grew at an annual rate of about 7.4% in 2012 Q4.

Albania's degree of economic openness stood at 87.0% in 2012 Q4, about 7.8 percentage points lower compared to the same period a year earlier.

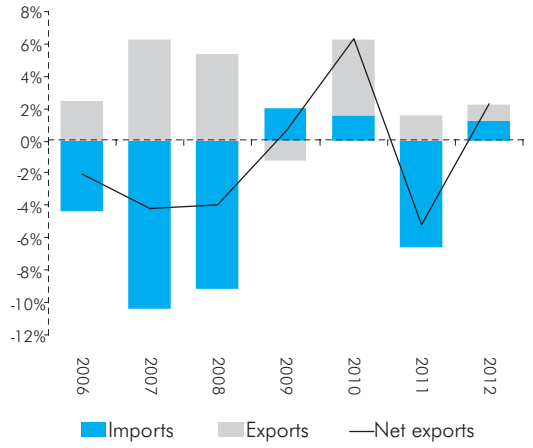
The performance of external sector indicators shows a positive contribution of this component to aggregate demand for 2012. Following the expansion by about 21.2%, y-o-y, in 2011, real net exports deficit[3] narrowed at an annual

[2] *Nominal GDP for 2003-2010 as published by INSTAT. The quarterly distribution is based on quarterly real GDP weights. The authors use Bank of Albania Monetary Policy Department's projections for 2011 and 2012.*

[3] *In order to switch from nominal to real terms of imports and exports of goods, we use the Unit Value Index calculated and published by the INSTAT. The Consumer Price Index of services, as measured by the Bank of Albania, is used for the imports and exports of services.*

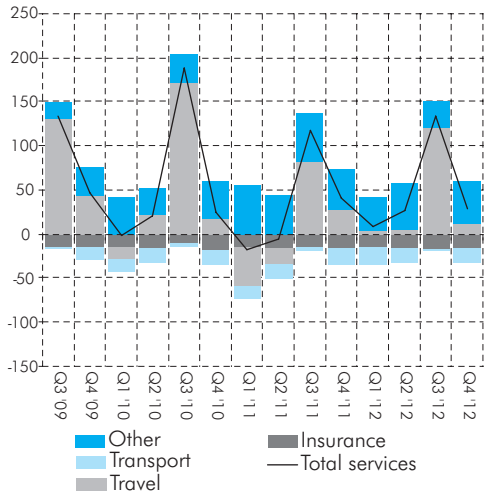
rate of 7.4% during 2012, determined by the fall in imports of goods and services in real terms, by about 1.7%, and the increase in exports, by about 2.4%, y-o-y. The developments in real imports and exports of goods and services materialized into their positive contribution to aggregate demand growth over the period under review.

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



Source: Bank of Albania.

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

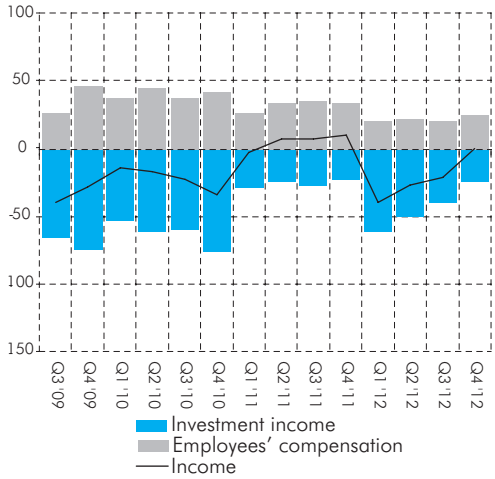


Source: Bank of Albania.

Net financial flows from the combined position of income account, current transfers and services fell at an annual rate of 3.7% in 2012 Q4. Consequently, the net flows of these three accounts altogether financed about 54.4% of the trade deficit, higher by about 10.0 percentage points, compared to a year earlier.

The net balance of services account performed positively during 2012, particularly in Q3. After the pronounced narrowing of this account surplus in 2011 due to the visa-free regime for Albanian citizens travelling to the Schengen area (which brought about an increase in foreign currency outflows for travel service), year 2012 recorded a positive balance of EUR 195.1 million, up at the annual rate of about 44.6%.

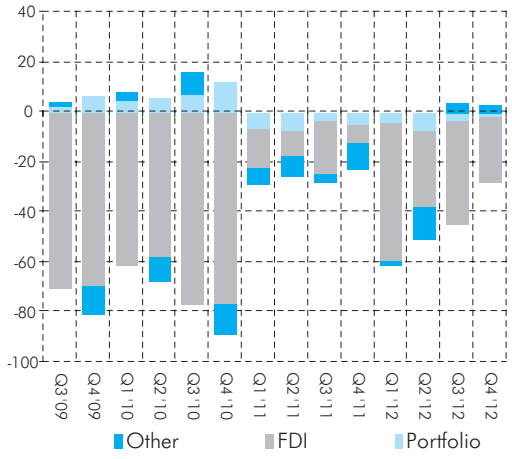
Chart 4. Income balance (net flows, in EUR million)



Source: Bank of Albania.

The quarterly analysis of services shows that the increase in foreign flows in the services account was more considerable in 2012 Q3, which corresponds to the summer tourist season. The 2012 Q4 yielded a surplus of EUR 27.9 million, down by 32.5% compared to a year earlier, mainly due to the fall in foreign currency inflows from travel services. The net balance of travel services (personal and business) sub-item shrank at an annual rate of about 56.6%, mainly due to the fall

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



Source: Bank of Albania.

in foreign currency inflows for services for tourism and business purposes of non-residents in Albania. Foreign currency outflows in the form of expenses by residents for personal travel services dropped by about 0.2% during the period under review. Other services (which include communication, construction, government, financial, computer, information services) sub-item recorded a positive balance of EUR 48.1 million, up at an annual rate of about 3.3%. On the other hand, the deficit in "transportation" and "insurance services" sub-items continue to provide a negative contribution to the total services balance for 2012 Q4.

After a slight increase in 2011, net income balance, recorded a deficit of about EUR 89.0 million in 2012. The accelerated increase in investment profit repatriation and the decline in income from employees' compensation at annual rate determined the developments in this account during the period under review.

By quarters, the income account recorded the highest deficit during the first nine months of 2012. During 2012 Q4, net income account recorded a deficit of EUR 0.2 million, considerably lower compared to the rest of year. The fall by 25.2% in net income from employees' compensation and the investment profit repatriation determined the developments in net total income in 2012 Q4.

The balance of income account from foreign direct investment resulted with a deficit of about EUR 26.2 million, from EUR 7.0 million a year earlier. The increase in income deficit from FDIs was due to the rise in their outflow. In 2012 Q4, income deficit from portfolio investments impacted negatively the income account. The balance of income from other net investment recorded positive figures for the second quarter in a row, mainly due to the lower net interest payments on public and private debt. The surplus of this income account sub-item was about EUR 2.8 million in 2012 Q4, against the deficit of EUR 10.9 million in 2011. Net interest payments on public and private debt lowered Albania's liabilities by about EUR 12.6 million during the period under review.

During 2012, net balance of current transfers account pursued the progressive fall in surplus started since 2009. Current transfers account surplus shrank at an annual rate of about 3.0%, during this period, due to their increased outflow.

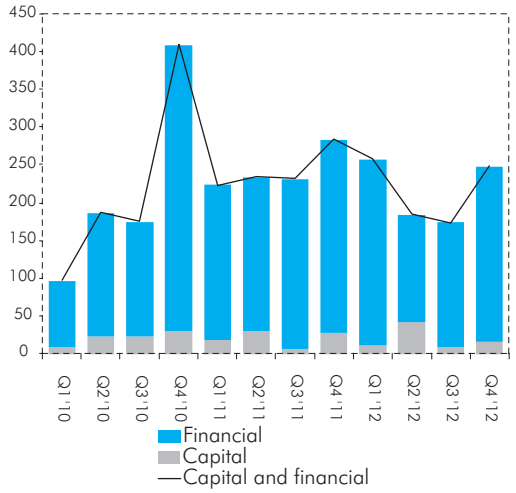
Net current transfers surplus expanded by about 5.5% in 2012 Q4. Public and other sectors' transfers increased at an annual rate of 39.6% and 4.5%, respectively. Remittances grew at an annual rate of about 7.4%. Remittances-to-trade deficit ratio is estimated at 38.0%, about 10.2 percentage points higher than the financing ratio recorded in the same period a year earlier.

1.2 CAPITAL AND FINANCIAL ACCOUNT

Net flows in the capital and financial account recorded a positive balance of EUR 249.1 million in 2012 Q4, financing in full the current account deficit recorded during this period. Capital and financial flows fell by about 12.5% accounting for about 10.3% of nominal GDP. The annual fall in foreign flows in this account was mainly driven by the lower financial flows at an annual rate of about 9.1%. As a percentage to nominal GDP, the financial account was estimated at about 9.7%, about 1.4 percentage points lower compared to 2011 Q4. Net flows in the capital account recorded a surplus of EUR 15.6 million in 2012 Q4. Residents' financial liabilities to non-residents declined considerably at an annual rate of 43.6%, due to the fall in FDI investment and other investment inflows.

Albanian assets invested in non-resident economies were down by about EUR 9.2 million, compared to the increase of EUR 141.2 million in the same period a year earlier. The considerable fall in assets as other investments was the main determinant of developments in Albanian assets invested abroad.

Chart 6. Capital and financial account (net flows, in EUR million)



Source: Bank of Albania.

Net foreign direct investment (inflows – outflows) dropped considerably by 34.2%, compared to 2011 Q4. This change owes, to a large extent, to the decrease in liabilities in the form of FDI (FDI inflows) by about 36.2%. By type of investment instrument, FDI inflows in the form of shares and reinvested earnings fell at an annual rate of about 31.3%. Capital inflows in the form of other capital inflows were down by EUR 1.7 million, against the increase of EUR 23.1 million in 2011 Q4. Privatisation receipts continue to have a modest role on total foreign direct investments. Excluding privatisations, FDI declined at an annual rate of about 36.8% during the period under review.

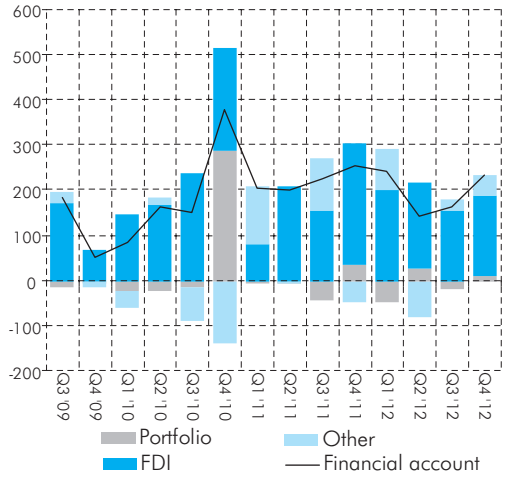
In cumulative annual terms, 2012 recorded a slight increase in foreign direct investments by about 1.6%, after their fall by 9.3% during the previous year.

1.3 FDI STOCK DISTRIBUTION BY ECONOMIC ACTIVITY AND COUNTRY[4]

FDI stock in Albania has increased progressively during the last three years (2009, 2010 and 2011), albeit being under the pressure of the global economic and financial crisis that captured the international markets. FDI stock was estimated at about EUR 3,036.6 million as at end-2011, about 13.9% higher compared to the rate recorded in 2010. Positive performance of

[4] *The latest data on foreign direct investment stock by country and economic activity refer to 2011.*

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



Source: Bank of Albania.

FDI in Albania reflects foreign investor's preference to invest in our country due to the lower production cost and the potentially high profit margins.[5] Privatisations have played a modest role on FDI growth in the last two years, showing the interest of foreign investors in Albania.

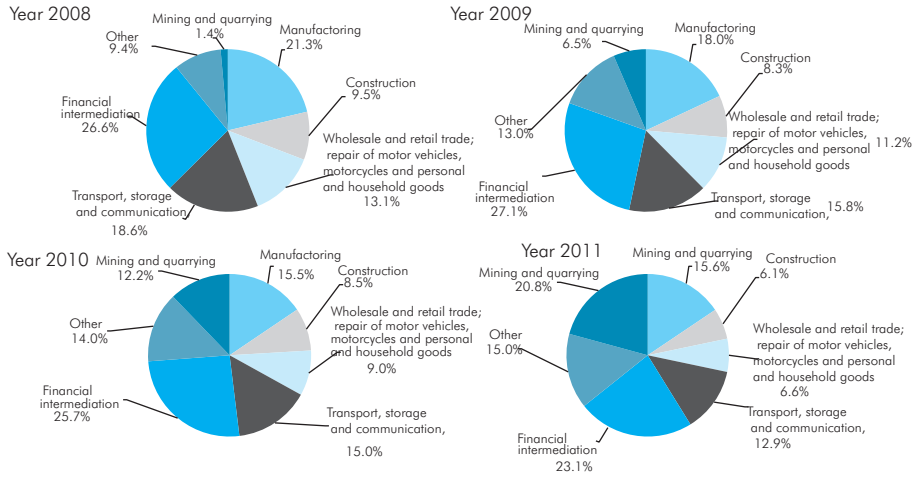
FDI distribution by economic activity suggests a high concentration of investments in services. This fact is related to privatisations characterising this sector during these years. Latest data for 2011 show that "Monetary and financial intermediation[6]" and "Extractive industry" are the main sectors attracting most of FDIs, by 23.1% and 20.8%, respectively against the total stock. During 2011, FDIs by sectors of economy were re-allocated, the FDI portfolio was further diversified and their orientation was multi-dimensional. So far, "Monetary and financial intermediation" has represented the sector with the highest share in FDI stock till 2011. However, this sector's share vis-à-vis other sectors of the economy has decreased progressively, from 32.1% in 2007 to 23.1% in 2011. The most significant change is noted in the increase of "Extractive Industry" share from 12.2% in 2010 to 20.8% in 2011. The extractive industry of energy and non-energy minerals, by 88.6% and 11.4%, respectively had the main share in this sector. Orientation of foreign direct investments to natural resources supported the increase in Albanian exports for these products, providing positive contribution to the improvement of Albania's economy external position. The processing industry did not attract foreign investments in 2011. Its share in FDI stock remained unchanged compared to a year earlier (15.6%). "Electricity, gas, steam, and warm water production and delivery" and "Real estate, renting, informatics, research and scientific work, other professional activities" also increased their share in FDI total stock during 2011. Meanwhile, tourism potentials of our country are not explored by the foreign investors yet. "Hotels and tourism", along with the share in investment stock, pursued a downward trajectory in the last three years.

FDI stock structure by countries of origin during 2007 – 2011 shows considerable changes from year to year. The main partners in investments during these years have been Greece and Italy. In 2007, foreign direct investment from Greece represented about 28.5% of total FDI stock in Albania. Investment from Italy accounted for about 12.0% in the same period. With the beginning of the economic and financial crisis and the intensified debt crisis in Greece, its share in the total FDI stock fell progressively. From 2007 to 2011, FDI share from Greece has dropped by about 11.2 percentage points,

[5] *Approximated by income outflows from foreign direct investment. Starting since 2008, foreign direct investment income has grown considerably, y-o-y. During 2008 – 2011, foreign direct investment income (outflows) were EUR 1,483.8 million.*

[6] *"Monetary and financial intermediation in addition to insurance activities and pension funds" sub-item has the highest share in FDI.*

Chart 8. Foreign Direct Investment by economic activity
(year-end stock, in % to total stock).

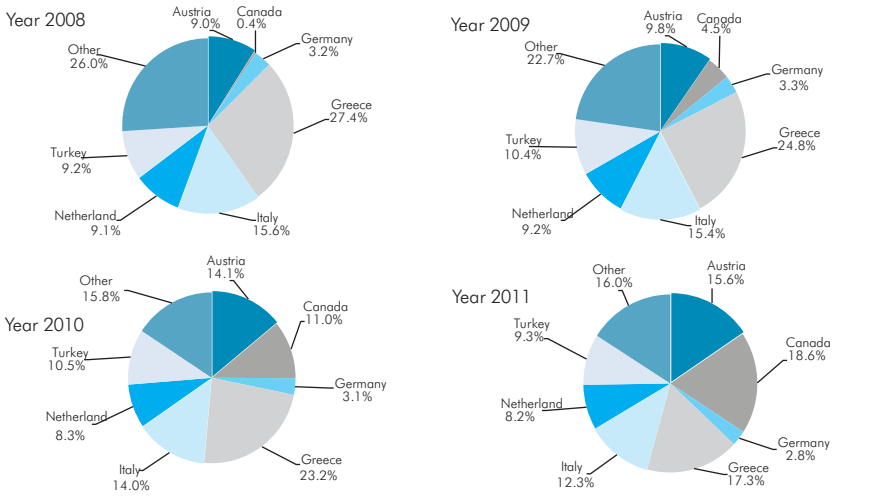


Source: Bank of Albania.

representing in 2011 about 17.3% to FDI stock. On the other hand, Italian investments, after increasing their share by about 3.6 percentage points during 2008, maintained almost the same share till 2009 (averaging 15.5% in 2008 -2009). During 2010 and 2011, Italian investment fell back to the pre-crisis levels. In 2011, investments of Italian origin shared only 12.3% of FDI total stock.

In 2010, three investors countries with the highest share in FDI stock[7] represented about 53.1% of total stock. In 2011, these three countries' concentration on FDI stock decreased . Nonetheless, foreign direct investment stock continued to grow, despite the downward FDI share from Greece and Italy. This growth may reflect the reorientation of foreign investors to the Albanian market,

Chart 9. Foreign Direct Investments by economic countries
(year-end stock, in % to total stock)



Source: Bank of Albania.

[7] *Greece, Italy and Austria.*

mainly those from Austria and Canada.[8] Thus, the attraction of potential investors from other countries might minimise the effects of public debt crisis in Greece and the difficulties in Italy in the inflows of capital at home.

Net portfolio investments contributed to the increase in Albania's liabilities to non-residents by about EUR 11.0 million in 2012 Q4, about 69.2% lower compared to the same period a year earlier. Residents invested about EUR 10.0 million in debt securities in the period under review. Portfolio investment inflows stood almost at the same level with the previous year.

In annual cumulative terms, net portfolio investment contributed to the increase of Albanian's assets invested abroad by about EUR 24.6 million, almost doubled from a year earlier.

Other net investments closed with a positive balance contributing by about EUR 45.9 million to the increase in residents' liabilities to non-residents. Compared to the same period a year earlier, the net creditor position changed to net debtor one. During this quarter, the liabilities inflows fell considerably in annual terms and assets invested abroad declined. In other-investment accounts, Albania's liabilities to non-residents fell by EUR 19.7 million from EUR 88.6 million in the same period a year earlier, mainly due to the decline in borrowing and currencies and deposits flow. Private and public borrowing was about EUR 10.5 million during the quarter under review, compared to EUR 39.3 million in 2011 Q4. The payment of principal by private sector triggered the fall in total borrowing. Private and public debt payments lowered Albania's liabilities by about EUR 69.3 million in 2012 Q4. Domestic assets invested in foreign economies as other investments, fell in 2012 Q4 by about EUR 26.2 million from the increase by about EUR 135.8 million in the same period a year earlier. Our assets invested abroad dropped mainly due to the pronounced fall of assets invested as currencies and deposits by our banking system abroad. Albania's banking system deposits fell by about EUR 67.0 million from the EUR 94.3 million increase in 2011 Q4.

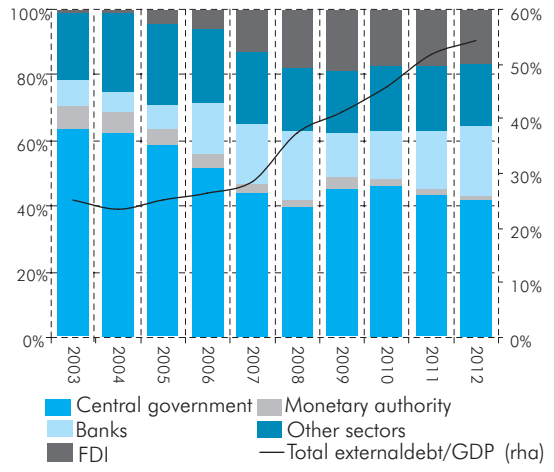
1.4 GROSS EXTERNAL DEBT

As at end-2012 Q4, Albania's gross external debt stock totalled EUR 5,294.4 million, up about EUR 51.8 million compared to the previous quarter and about EUR 498.7 million compared to its stock as at end-2011 Q4. For the most part, the higher debt stock as at end-2012 Q4 was determined by the increase in banking system and central government borrowing. By institutional sectors, as at end-2012 Q4, general government's share in total debt stock was about 42.0%. The remainder of debt has been allocated to: other sectors (19.3%), banks (20.8%), and foreign direct investment – intercompany loans (16.1%) and monetary authority (1.7%).

[8] *In 2011, FDI from Canada represented about 18.6% of FDI total stock at home turning into the partner with the highest share of investments in Albania. FDI from Austria represented about 15.6% of stock.*

Central government continues to have the highest share in total debt stock. As at end-2012 Q4, its debt stock totalled about EUR 2.2 billion. Throughout the four quarters of 2012, the share of central government debt has been in the range of 42.0 - 43.2%, with the lowest share in the fourth quarter. Relative to end-2011, the share of central government debt has declined from 43.1 to 42.0% as at end- 2012 Q4.

Chart 10. Gross external debt by institutional sectors (year-end stock, as a percentage to total)

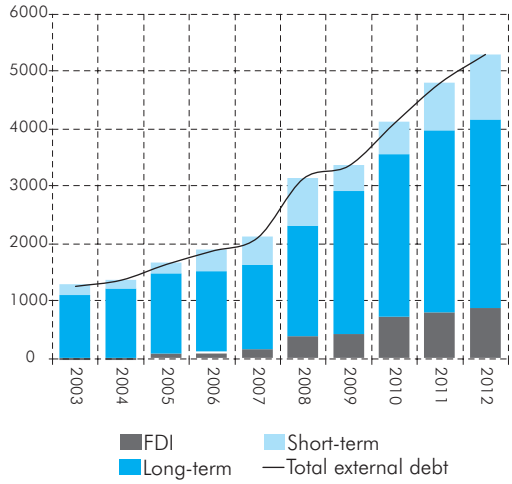


Source: Bank of Albania.

The banking system's gross external debt amounted to about EUR 1.1 billion in 2012 Q4, up about EUR 232.6 million from end-2011. Other sectors' external debt amounted to about EUR 1 billion, up by EUR 69.2 million from 2011. Its share in total external debt stock for the period under review stood at about 19.3%, down by about 0.6 percentage points from end-2011. During the period under review, foreign investment stock totalled EUR 853.4 million, up about EUR 51.6 million or about 6.4% compared to end-2011.

In 2012 Q4, about 62.4% of the debt stock (excluding direct investment – intercompany loans), accounted for long-term debt mainly in the form of loans. For the period under review, short-term debt accounted for 21.4% to total debt stock and was mainly in the form of banking sector currency and deposits. FDIs account for 16.1% of total public debt stock. General government and the monetary authority hold only long-term debt, while the banking sector and other sectors hold a composite portfolio of long and short-term debt. By instruments and maturity, loans represent the main long-term investment instrument, accounting for about 84.8% of total long-term debt (excluding FDIs). About 13.5% of long-term debt is held in the form of notes and bonds. Short-term debt is mainly represented by currency and deposits, accounting for about 84.9% as at end-2012 Q4. Commercial credit accounted for about 10.2% of short-term debt stock.

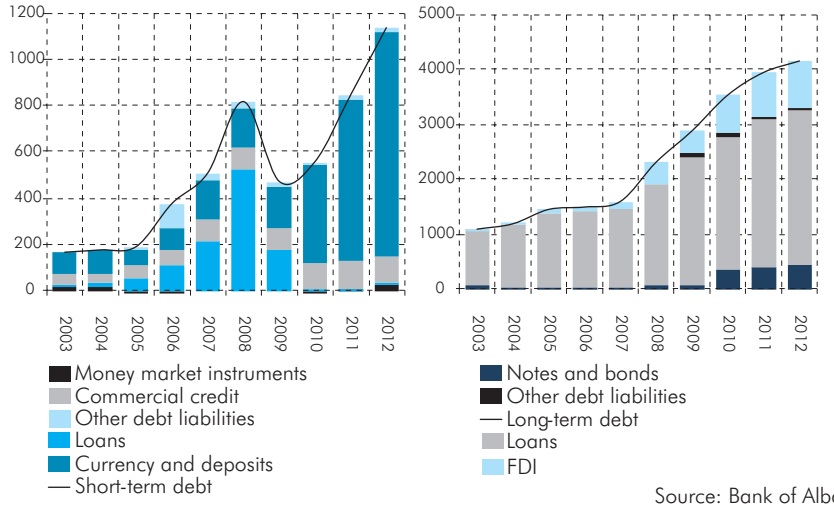
Chart 11. External debt by maturity (year-end stock, in EUR million)



Source: Bank of Albania.

International reserves decreased by about EUR 23.1 million in 2012 Q4. As of December 2012, international reserves totalled EUR 1.972

Chart 12. Short and longterm external debt (year-end stock, in EUR million)



Source: Bank of Albania.

RESEARCH PAPERS*

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

MEDIUM-TERM PROJECTIONS AND USE OF THE GAP MODEL IN DECISION-MAKING

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ABSTRACT

Medium-term projections are a key instrument in monetary policy decision-making. To improve this process, a gap model is employed. This model projects the trajectory of the key interest rate to keep inflation within a certain target in the medium term, and economic growth close to the potential growth rate, which is estimated in time. This model is supplied through short-term projections for inflation and GDP. It provides drafting and analysis according to consistent risk scenarios. To realise its functioning and introduce results in quarterly monetary policy reports, this article identifies important steps for developing the model and utilising it to make projections.

Key words: Structural models, medium-term projections, monetary policy
Jel- classification: C53, E17, E52

1. OVERALL CONSIDERATIONS ON STRUCTURAL AND SEMI-STRUCTURAL MODELS[1]

Models and the way they have been used to analyse various policy implementation methods have evolved significantly. Structural and semi-structural models rely on broad specifications of the economic environment, where the agents of the model operate. The models should, therefore, address the critique of Lucas (1976), at least in principle.

A modern approach to models consists in their use to analyse the implemented policies. Today, the models help provide answers to questions such as: How would policy implementation affect the behaviour of economic agents? Which are the projections on variables of the objective under optimum policies?

[1] *Structural models are part of a relatively new field of economic modelling, with the initial tentative for their development emerging in late 1960s. In structural economic models, economic theory is used to place the set of observed "endogenous or explained" variables, Y_i, with another set of observed "exogenous or explanatory" variables, X_i, in a mathematical relationship. However, economic theory seeks to explain also the relationship between Y_i variables and a set of unobserved variables. In these cases, some functions are known and others are unknown in terms of their probability distribution features. For the latter, economic theory, on its own, does not have information to estimate them econometrically. In structural and semi-structrual models, economic information expressed in equations and known behavioural identities are combined with statistical assumptions on the observed and unobserved information. Therefore, statistical structures (assumptions on the distributions and parameters) are added, rationalising the unknown and unexplained part by economic theory and available data. These models are systems of blocks of equations and identities taking into account estimations for long-term equilibrium and trends.*

How do structural changes in the economy affect parameters of the model? How do these changes affect the compilation of optimum policies?"

The ability to address these questions reflects the evolution over the past thirty years in the field of monetary policy. On the one hand, it uses "the corridor interval" of its instruments as an exogenous variable, on the other, it plays an endogenous role, responding relatively to economic conditions.

Structural and semi-structural models may address very interesting issues, which other models are unable to do. They provide an answer to the questions: what may be the effects of strong shocks that have never been encountered in the historical data used to assess the model? If the policy is endogenous, how can we reach a conclusion on what should policymakers do in unprecedented situations?

Likewise, according to (Canova and Sala 2009), many of the structural parameters of such models may be identified very weakly.

Modern generations of economic, structural and dynamic models have their own pitfalls. Some of the key parameters of the structure are not really "structural". This means that the model is not likely to remain unchanged vis-a-vis important changes in the economy. Hence, it is necessary to assess and adopt new models for analysing monetary policy decision-making.

Understanding the modern class of models is like drawing a parallel line with understanding modern art; not all people can understand modern art, and not all economists can understand these models.

In essence, the results and interpretations should be comprehensible and clear to policymakers, users and the public. This means that agents build approaches on medium-term decision-making depending on the sign and size of projection differences from long-term equilibriums or objectives.

Because models, even specific blocks, have their own restrictions, "they cannot tell" everything to decisionmakers. Nowadays, the novelty in working with the models consists in the question on how to enhance their usefulness to serve the policymaking in general and the monetary policy in particular. With economic uncertainties increasing, the modelling portfolio has been significantly diversified between economic and statistical models[2] and the structural ones; and, specialised judgment of economists and expectations of market agents or the public.

This would require recognition of limitations, but above all, of advantages of the models in terms of projections, decisionmaking and analysis of the latter.

[2] *While developed mainly on the past history of time series and on known assumptions for the distribution of model variables, classic models take into account the economic theory for specifying models, but not in the aspect of long-term relations. For this reason, they are applied mainly for short-term projections.*

To conclude the introduction of this technical research, I would like to cite a well-known quote by George Box (1987) "all models are wrong but some are useful".

2. GAP MODEL AND ITS PARAMETERS

Short-term projections are an important element in the decision-making process, when a quantitative inflation target is applied. The main goal for such projections is to set the trajectory of the interest rate, which would ensure inflation ranging within the medium-term target band, over the projection horizon. The (new) Keynesian macroeconomic model, which endeavours to accomplish the above-mentioned mission, has a structure that is very similar to models used by a considerable number of central banks applying an inflation targeting regime. Moreover, the model incorporates specific characteristics related to the Albanian economy. It seeks to realise medium-term projections for inflation, on the basis of a price-formation mechanism in the Albanian economy, describing the channels of monetary policy transmission.

a. Description of the model and its use

Similar to most models of this type, our model implies four blocks of equations of the economic behaviour of macroeconomic variables: equation of aggregate demand, expressed in the form of the output gap (iS curve); equation of core inflation (Phillips curve); equation of the exchange rate (uncovered interest rate parity - uiP); and equation of the monetary policy reaction function.

The model has some additional equations describing the dynamics of other important economic parameters and identities.

During 2011-2012, a model of this form (Dushku and Kota, 2011)[3] has been subject to necessary adjustments and improvement. The process is followed up by the relevant team of experts at the Bank of Albania, in cooperation with IMF technical assistance experts.[4]

The model is categorised under the broad class of models on the new Keynesian theory. The basic principle of such models consists in the contribution of the monetary policy to anchor inflation around the target and expectations for inflation. Only the monetary policy sets out the inflation rate in the long term, by changing the repo rate in response to various shocks on the economy. Because of the limited flexible nature, mainly in the fluctuation of wages, changes in the nominal interest rate result in changes in the real interest rate, anticipating thus deviations of real variables (such as economic activity and the real exchange rate) from their trends and, subsequently, from their impact on inflation. The monetary policy has a long-term impact on nominal variables and a temporary impact on real ones. In contrast to a

[3] *You may find details on the model and the assessment of its parameters in the following link: http://www.bankofalbania.org/web/A_Bayesian_Estimation_of_A_Small_Structural_Model_for_The_Albanian_Economy_6226_2.php*

[4] *IMF technical assistance experts, David Vavra and Zoltan Jakab (2009-2012).*

purely Keynesian economy, in these models, rational expectations play e key role (expectations that in part depend on the projections of the model), which means that economic agents expect monetary policy action to happen, even partially, by reducing the possibility to run into "surprise" effect.

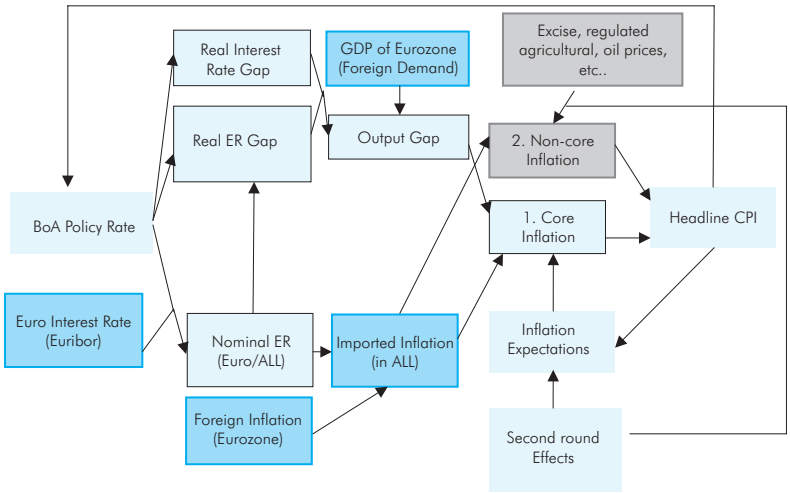
Although the model has four blocks with the set of equations and relevant identities, it belongs to the class of simple models. An advantage of simple models is their capacity to describe the interconnection of main variables affecting inflation. Together with other macroeconomic variables, the latter factor creates a monetary policy transmission mechanism that is clearer and conforms to a simple scheme, while maintaining theoretic coherence. At the same time, clarity and simplicity of the model allow the monetary policymaking to produce better comprehensibility, providing for discussion of projections within the central bank. At the Bank of Albania, it takes place at the forecast unit of the Monetary Policy Department (MPD) and other experts of this department, within the Advisory Committee of the Monetary Policy (ACMP). Therefore, some of its members are not only compilers of the model, but above all, the very staff members that actively create forecast scenarios. Due to this interactive process, the model is not a "black box".

The real variables in the model, such as the GDP, real exchange rate, and real interest rate are expressed as deviations from their trends, that is, in the form of the gap. That is why the model is referred to as the Gap Model (GM). In the short term, the monetary policy may affect, with its measures and decisions, only the gaps and not the trends. However, while gaps and trends are components that are not directly measured (non-observable), the assessment of the time-series history is an important phase based on medium-term forecasts. To realise this, the Kalman filtering method is applied.

According to this semi-structural model, although the model has a clear economic and theoretical interpretation, its development requires to reflect the trends of the Albanian economy in the best possible way. The coefficients of the model are not assessed, but are mostly calibrated in such a way that they follow the intuition and economic theory, taking into account fundamental characteristics of our economy and its developments in the near past. Whenever possible, the econometric assessment has been used. Details about the reasons why the model is more calibrated than it is assessed are given in the explanation about its parameters.

The medium-term projection process is much more than an application or execution of the model. In practice, it is not the models that produce projections, but economists (Berget. al., 2006). Compilation of forecast assumptions and overall economic analyses is a determinant factor for projection results. In this sense, the model would serve primarily to systemise assumptions and judgments on the future, in a unified and consistent way, a process that is confirmed by the experience of other central banks that apply the GM (Djukić, et. al., 2010, 2011).

Figure 1: Transmission of monetary policy according GM



Source: Adopted from the author for the GM in Albania.

b. Parameters of the model: evaluation versus calibration

Characteristics of the model are simultaneously determined by both the structure and the values of parameters. These values determine the dynamics of the relationship between the variables of the model, such as: the effects of several factors on inflation, the speed and intensity of the impact of interest rate on inflation, exchange rate formation.

In general, the models can be estimated based on the available time series or they can be obtained by the calibration technics. The portfolio of the models currently in use to forecast inflation, real growth of quarterly GDP, as well as several satellite ones for different variables involved in the forecasting process such as foreign exchange rate, foreign prices, oil prices in domestic market, and yield of treasury-bills, are evaluated based on main econometrics and statistics principles. Parameters are estimated using the size of determination's coefficient, SWC, AC and other test results. Through these models, the parameters of the explanatory variables are estimated under the assumption of a relatively high stability over time. Due to the above assumption, this group of models is helpful for forecasting in short-term horizons, actually from 4-6 quarters (Çeliku and Hashorva 2011). On the other hand, these forecasts' results help to conduct the medium-term projections. GM uses them as raw material.

Meanwhile in medium-term models, such as the GM, it is not always appropriate to estimate the parameters based on classical econometric methods. The econometric estimation methods may be applied, but the resulted parameters could not always ensure sufficient reliability and consistency over medium-term horizons. For this reason, calibrated parameters, determined through specific criteria, are employed.

There are some well-known reasons why a pure econometric estimation in terms of medium-run projections is not entirely 'reliable'. Firstly, it often happens that in the econometric estimates it is difficult to clarify the causality among the variables or identify the cause and effect variables. This is particularly true when it comes to the rule and the transmission mechanism of the monetary policy. Assume that the monetary policy decision-making precedes anticipated inflationary shocks by changing frequently the repo interest rate in order to keep the inflation on the target all the time. In this case, if the following policy rate econometric equation[5] is estimated, it could not explain the changes of the interest rate through monetary policy rule, given that inflation will be kept on the target.

$$rs_t=\lambda_1 rs_{t-1}+(1-\lambda_1)rr^*-\pi 4_{t+4})+\lambda_2(\pi 4_{t+4}-\pi_t^{ss})+\lambda_3 ygap_t+\varepsilon_t^{rs}.$$

Consequently, there is no need for monetary policy to react in order to return the inflation on the target value, because the expression) $\lambda_2(\pi 4_{t+4}-\pi_t^{ss})$ will result very close or equal to zero.

Secondly, in the case of Albania and similar economies, econometric estimations for medium-term projections are particularly difficult because of a lack of long and stable macroeconomic time series variables. In many cases, economic series are short and have structural breaks. Often they reflect the high dynamics of structural changes in the economy, causing shocks on the relationships between economic variables. These phenomena lead to unstable econometric estimations, producing unrealistic projections in the medium term. For all these reasons, the parameters of the medium-term projection model - GM - are mostly calibrated, besides a few cases when the econometric estimation is deemed as possible to be applied. The parameters in the model are calibrated in such a way that the model's properties (relationships between variables) are consistent with economic theory and reflect some of the main characteristics of the Albanian economy. At the same time, it is desirable for the model to explain, as much as possible, the macroeconomic movements in the recent past.

The calibration technique enables us to use some parameters' values, even when the economic variables history in Albania does not supply either a possible value or an approximated one. In this case, Berg et.al. (2006) suggest taking into account parameters' values derived from the same type of models for other countries with similar economic features. The interval range of parameters orients us to select the value of the absent parameters in our equations. In this respect, the experience of other countries, especially countries in transition, has been useful for the calibration process in our GM.

The explanatory power of the calibrated model is usually checked by the history simulations, because there are no direct quantitative indicators as in

[5] *Where are associated parameters for respectively: the interest rate variable of the previous quarter (rst-1); the gap between the expected annual inflation after 4 quarters (π4t +4) and the inflation target); and the output gap (ygapt). The last one is the residual term. For more details, see: http://www.bankofalbania.org/web/A_Bayesian_Estimation_of_A_Small_Structural_Model_for_The_Albanian_Economy_6226_2.php*

the case of econometric model estimations (R^2k, etc.). The history simulation is proceeded in order to evaluate how well the model projects the movements of the main variables (inflation, exchange rate, output gap, etc.) over the historical data series (in sample simulation); consequently, it identifies the deviation size between projections and actual values. These deviations must be as small as possible, particularly in the recent past or in the last quarters of historical data. This process is performed in order to investigate whether there are sufficient signals showing that the intensity of the relationships between variables changes or not, i.e. there is room for changing the values of the parameters in the model or not. If the need for changing parameters is identified by the simulations of the series at the end of their historical period, then the explanation of the data history from the model (with the parameters set previously) may not be as accurate for the entire period. As long as the model will be used for medium-term projections purposes, it is better reconsidering a set of parameters that explains the latest developments of the time series.

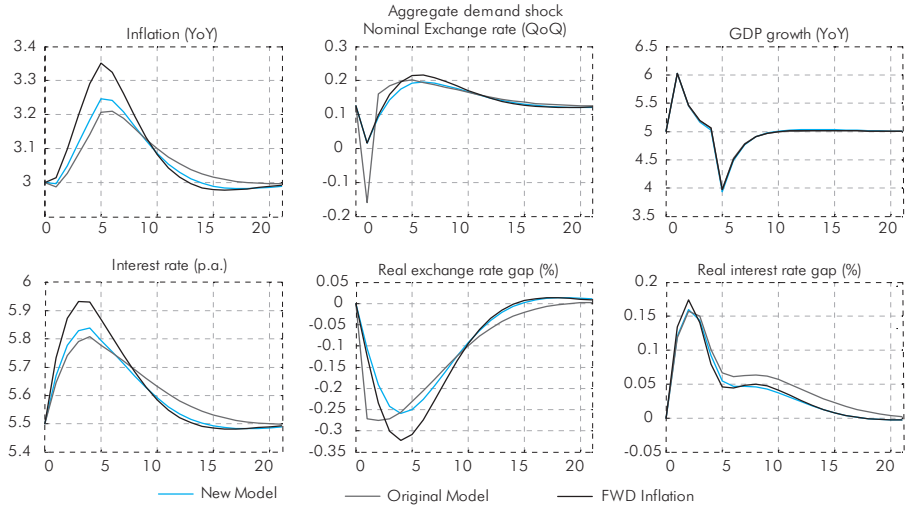
During the calibration process, several approaches are used selected depending on the approximation's quality. These parameters approximate the projections with the latest historical data series. Explaining in simple way the calibration process is 'more tolerant' compared to the econometric estimation one, where failure to fulfil basic criteria exclude parameters and variables from the equations or equations systems. Calibration is an investigative and selective process including all the available information in order to assess the parameters of the models. In our case, the surveys' results and their relationships with published and short-term inflation forecasts are involved during the calibration process, although the surveys series are not directly included in the model. This was particularly applied in the relationship between inflation forecasts and consumers and businesses inflation expectations, since the expectations series are not sufficiently long. When parameters' values have been derived from different independent assessments, their average is considered in the calibration process.

Specifically in the GM, econometric estimation and model properties are used to calibrate the core inflation and the output gap equations. UIP equation is entirely theoretical, while that of the monetary policy rule is calibrated based on the model properties in order to meet the specific features of the monetary policy.

c. The Model Properties

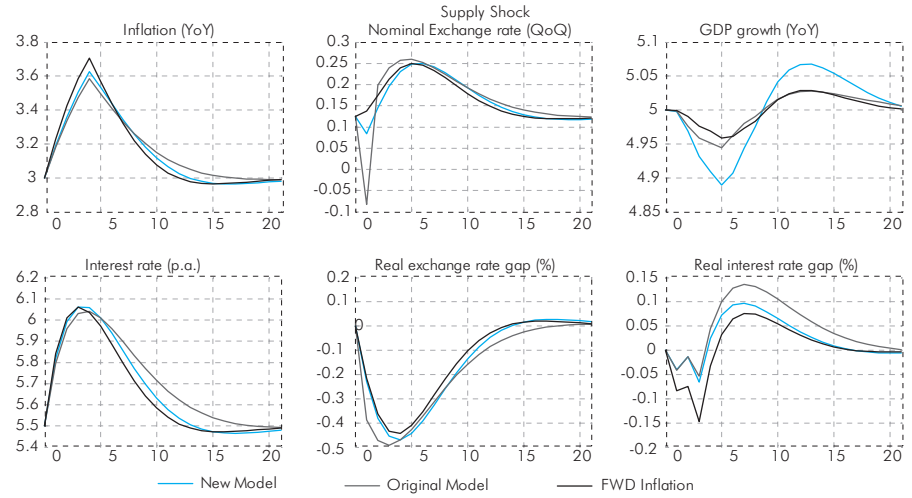
The main method for testing the model properties consists in the investigation of the impulse response function. This function answers the question of how the variables of the system react to a shock on one of them. This reaction cannot be determined by focusing only on the size of the model parameters, as long as we do not have only a single equation, but blocks of equations. These relationships are analyzed by shocking a variable by 1% and then investigating the responses of the other ones in the model. Such analyses, in a simple way, provide the opportunity to check if the model behaves in accordance with economic theory and how well it reflects the known economic developments.

Chart 1. Impulse response function for shock in aggregate demand



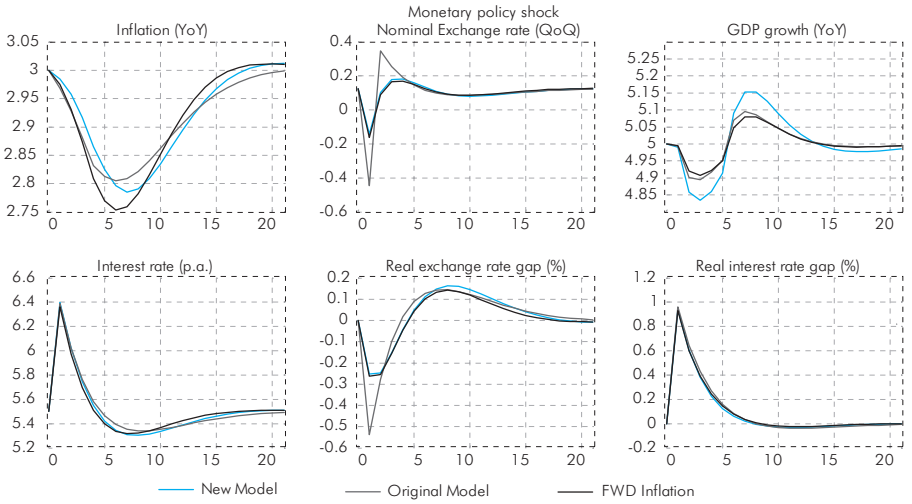
Source: Bank of Albania and the IMF Technical Assistance (2011).

Chart 2. Impulse response function for shock in supply



Source: Bank of Albania and the IMF Technical Assistance (2011).

Chart 3. Impulse response function for shock in policy rate



Source: Bank of Albania and the IMF Technical Assistance (2011).

3. MEDIUM-TERM PROJECTIONS PROCESS AND ITS ROLE FOR MONETARY POLICY

GM should be one of the important instruments for developing medium-term projections. The main result of this process consists of the projection of the interest rate path of the Bank of Albania, in order to keep inflation close to target over the medium term. The projected path of the interest rate (repo), used by policymakers, is a starting point to decide about its level.

Besides the GM quarterly results, other ones derived from monthly forecasting models are more frequent. They inform the policy-makers about short-term and updated developments in shorter terms regarding inflation, real GDP growth, exchange rate, etc. On the other hand, the monthly results feed GM in order to realise the quarterly projection based on the recent monthly information, aggregating it on quarterly bases. However, GM and its projections represent a complex process, including a number of other activities that enable this process. Among them, the most important are: short-term projections for inflation, real GDP growth and exchange rate; assumptions designing the process for exogenous variables, assumptions about trends in real variables, including the impact of the factors outside the model; proposals regarding the possible shocks over the forecasting horizon.

Based on the experiences of other central banks that use models similar to GM for producing medium projections[6], the process begins with an inflation analysis and its main contributors from demand and supply side, during the reference quarter. Specifically in terms of GM, this analysis helps to assess and determine the initial conditions (IC) and to design the projections' assumptions.

As mentioned in the second section, the unobserved or unquantifiable components (trends and gaps of real variables) in a direct way are estimated based on the time series using mainly the Kalman filtering method. Their final values, estimated on time series history, will be the initial values for medium-term projection. The evaluation of unobserved components includes not only a simple application of Kalman filtering, but also economic judgments for the IC of the economy. For example, the first test of quarterly projections performed by the GM, in February 2011, included the following: inertia for high food and commodity prices in world markets; assumption about long-term structural change in the trend of economic growth (downward revision of the potential GDP growth); higher imported inflation; and higher premiums risk. The medium-term projection models do not provide us information about the trend formation of the real variables. Therefore, at this stage it is necessary to adopt assumptions about their future performance. The movements of trends in the future are generally designed based on the assumption that their situation in the medium term (faster or slower) is moving towards equilibrium, despite their volatility.

[6] *Central banks of: Serbia, Macedonia, Romania, the Czech Republic, Armenia, etc.*

Assumptions and forecasts regarding the future performance of some exogenous variables are taken from external sources, because the forecasts of international institutions are more reliable. These variables include, among others, projections for: inflation in EU; real GDP growth in EU; and Euribor interest rate (OECD, European Commission, IMF, ECB).

The assumptions regarding the future developments of non-core inflation take a particularly importance. Its movements depend on the future performance of excise and regulated goods and services' prices, products' prices of a high seasonal profile - fruits and vegetables, and the oil prices. The share of the above-mentioned non-core items to the CPI's basket for Albania is about 23%, impacting directly the headline inflation projections. If the government's plans for regulated and excise prices are previously known to the projection team, if the fluctuations of agricultural prices are accurately assumed (based on their current level and expectations for the crops and product prices in the world markets, especially for cereals prices), then non-core inflation projections will provide useful information for medium-run headline inflation projections.

For one quarter ahead, instead of model projections for headline inflation, we include the results from short-term forecasting. They involve not only the assumptions made for their exogenous variables, but also the economists' judgments, which are more meaningful and reliable. The expert judgements include specific information that cannot be quantified by the models. The short-term forecasts include information about actual and future decisions already known at the moment of the quarterly projections, for the regulated and excise prices. They also include short-term assessments of the impact of other factors, which might cause fluctuations on consumer prices. The short-term quarterly inflation projections are very important for two reasons. Firstly, they directly affect the inflation forecast in yearly terms. Secondly, they impact quarterly inflation due to the inertia component and the inflationary expectations.

The model does not include all the relevant variables in the projection. It is necessary, therefore, to include implicitly the factors that are outside the model. This is achieved by including, intuitively, a shock generated by a factor that is not used as variable in the model, in the terms of shocks/residuals (that are present in the main equations of each block). For example, if it is a known fact that fiscal policy will be significantly expansionary (increase fiscal expenditures), demand will subsequently increase. This development will be included in the projections as a positive/additional shock through the residuals term in the output gap equation (equation IS).

The scenarios for medium-term projection can be generated based on assumptions and short-term forecasts. The baseline scenario or the main one is the scenario that is built on the assumptions which are mostly verified or expected to occur with a high probability, thus considered as the most likely scenario. Besides the baseline projection, other alternatives of projections are presented, by changing the assumptions in line with the possible risks assessments that the economy may face over the forecast horizon of eight quarters. These scenarios surrounding the baseline one play an important

role, because they indicate the future possible paths of the monetary policy, should some events in the economy deviate from the most likely expectations or forecasts of the base scenario. This process is essential, given that the medium-term forecasts will be performed and published every quarter; meanwhile the discrepancies with the baseline assumptions are likely to occur within the months of the quarter. For example, scenarios can be based on the assumptions different from the actual monthly developments of regulated prices, global oil prices or the latest exchange rate developments.

The whole medium-term projection process includes an intensive communication among the Advisory Committee of the Monetary Policy (ACMP) members, the economists and the forecasters. Moreover, as highlighted earlier in this technical analysis, with their concrete proposals, discussions and arguments, ACMP members, play a proactive role for designing an optimal recommendation for the monetary policy decision-making. Based on the discussed scenarios, the probabilities of risks projections are calculated. In general, they are presented in different tables and charts, with the Fan Chart being the most widely-used one. Usually it is presented in quarterly inflation reports in different central banks, mainly those under an "inflation targeting" monetary policy regime. Fan Chart presents the central projection (baseline one) and the range of alternative projections implying the risks above and below the baseline inflation projection. The starting point for the interest rate decision-making is the trajectory of interest rates resulted from the medium-term projections according to the baseline scenario, but also the risks assessment surrounding it.

Between two medium-term projections, updated short-term forecasts are performed. Each month, deviations from the last forecasts are analysed. The deviations may result from the fact that projections are based on assumptions that may not be fulfilled. Based on this analysis, the short-term forecasts are firstly updated. Meanwhile, consideration is given to whether and how much the policy rate should deviate from the projected trajectory of the last medium-term projections. Likewise, the continuous analysis aims to investigate whether the macroeconomic trends are in line with the alternative scenarios. As long as the monetary policy decisions are made monthly, the updating short-term forecasts and analysing the deviations from the last projections are very helpful tools for the monetary policy decision making process.

IV. IN PLACE OF CONCLUSIONS

Each model is a simplified picture of the economic reality. This means that the models may never be completely accurate in describing and forecasting macroeconomic trends. However, the models may introduce useful information for policymakers about the measures to be undertaken for achieving primary objective of the monetary policy.

The GM of medium-term projection is first a good alternative to summarise known facts on the economy of the country in an accurate and consistent way

with the economic theory. Not only during the development of the model, but also throughout the preparatory work for producing medium-term projections, this model allows for the inclusion of information that is deemed as significant from the point of view of Monetary Policy Department experts and others. The model serves to systematise everything, every judgment and economic information in a unified macroeconomic framework.

As highlighted in the analysis of such models (Berg et. al., 2006), the underlying principle in the development of the GM is compliance with two contradicting requirements: on the one hand, it requires to include comprehensive information, on the other it requires to keep the model as simple as possible. The latter means that although some of the variables may be important, they are not incorporated in the model. Nonetheless, that does not mean they are not taken into account or neglected: if their impact on the projection is deemed as significant, they are included through the terms of shocks/residuals that appear as separate terms in each of the main equations of GM blocks.

The projection of the key interest rate trajectory should be in line with the return of inflation on the target in the medium term. This provides the GM with an important and supportive role in the future behaviour of the monetary policy. However, deviations from the projected trajectory of the key interest rate are possible: depending on the risk assessment; when during the months between two projections, considerable deviations from the last medium-term projection happen.

In the future, the realisation of the medium-term projections will be monitored carefully. In addition to the process, their performance will also be followed up, in view of maintaining the trend and accuracy of projections. The GM will be subject to a development and testing process to identify pitfalls and address them. In this sense, projection models in general and the GM in particular, presented so far, are not final. They may be subject to constant improvement, in terms of both parameters and structure.

In conclusion, the functioning of such a model, in accordance with a determined time schedule, would require significant improvements with regard to respecting the publication of statistical data of the real sector; accelerating the publication date; and, enhancing the quality of such statistics. This framework would contribute to the efficient functioning of the model for medium term projections, increase the rational nature of inflationary expectations and boost policymaking transparency, hence bring forecasting at the Bank of Albania closer to advanced European standards in this field.

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PRIVATE SECTOR CREDIT: DEVELOPMENTS IN ALBANIA AND THE REGION

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MONETARY POLICY DEPARTMENT

ABSTRACT

As in most countries in the world, the global financial crisis had a significant impact on banking system intermediation in Albania. After 2008, and especially in the last two years, the role of banks in channelling funds in the economy has diminished. During this period, credit to the economy has slowed down and the financial leverage has been reduced. This article analyzes the factors behind weak credit developments, supporting conclusions with findings from a regional comparison. Looking forward, Albania has still a high potential for credit growth, given the good prospect of economic growth, low financial leverage, and low dependence on foreign borrowing.

INTRODUCTION

Bank credit is an important factor for determining the economic development of a country, serving as financial leverage and enhancing economic growth. It also represents one of the most important channels of monetary policy transmission mechanism. This article tries to analyze the factors behind weak credit developments in Albania, looking at them also against the backdrop of credit developments in other countries in the Central European and South Eastern European countries (CESEE). The analysis is useful not only to the monetary policy decision-making process, but also to the interested actors and the public at large.

Credit developments in Albania seem to reflect both supply and demand factors, with an increasing contribution of the latter after 2011. They are in line with developments observed in other countries in the region, closely following the cyclical path of the economy. Looking forward, Albania has still a high potential for the development of credit growth, given the good prospect of economic growth, low financial leverage, and low dependence on foreign finance.

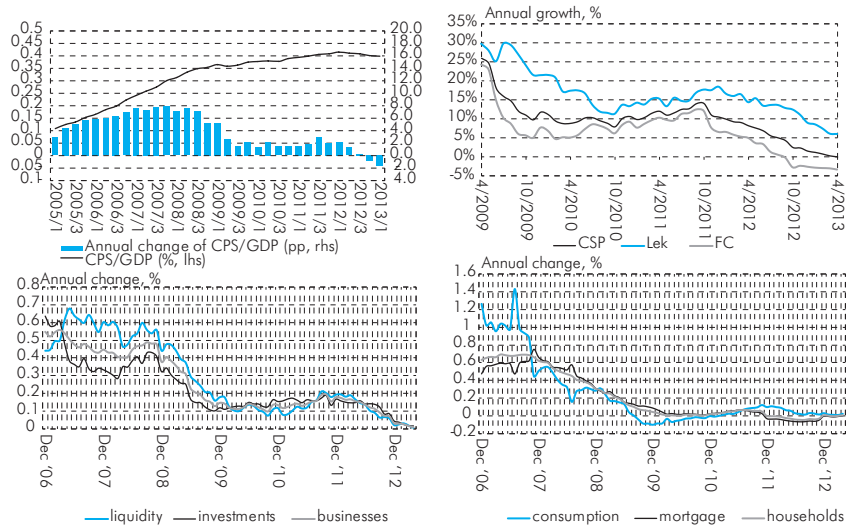
The article is organized in four sections. The first section gives a picture of credit developments in Albania after the global financial crisis of 2008. The second section follows with an analysis of the supply and demand factors determining these developments, using data from the balance sheet and bank lending surveys. The article continues with a comparison analysis of credit developments in the region, pointing out similarities and differences between Albania and other countries. Finally, section four concludes by presenting the

main findings of this analysis and by providing some considerations about future credit developments.

1. CREDIT DEVELOPMENTS IN ALBANIA

The credit portfolio of the banking system stood at 39.1% of the GDP[1] at the end of the first quarter of 2013, decreasing by 1.7 percentage points compared to one year ago. The reduction of the financial leverage began in the second half of 2012 and has continued steadily in the first months of 2013. During the period 2011-2013, the cumulative growth of the credit portfolio was 12%, drastically lower than the 55% increase during the period 2008-2010. This slowdown is present across all credit market segments. Growth of credit to households has stopped since the beginning of 2010 and has remained around zero for more than two years, mainly due to the contraction of mortgage credit. Meanwhile, credit to businesses has been following a downward trend since September 2012, reflecting the slowdown of both working capital credit and investment credit.

Chart 1. Credit developments



Source: Bank of Albania.

Parallel to these developments, credit in foreign currency has been contracting rapidly, while credit in lek has maintained satisfactory growth rates. The contraction of foreign currency credit for more than six months now (-4.6%, year on year, at the end of 2013 Q1) has reflected not only the lower investing propensity, but also exchange rate risk considerations. Lek credit, on the other hand, has been favoured by the easing monetary conditions as well as the banks' preference to extend credit in the domestic currency. Lek credit growth of 11%, at the end of 2013 Q1 reflects these positive developments.

[1] *This ratio approximates the financial leverage in the economy. In its narrow meaning, financial leverage measures the extent to which a project is financed with debt. In a larger macroeconomic sense, financial leverage is approximated with the Credit/GDP ratio, thus measuring the share of credit in financing a country's economic activity.*

Even though, at a glance, credit developments in the first months of 2013 are similar to those in the second half of 2012, its patterns are different in these two periods. In the first period, credit was particularly affected by two main phenomena. First, the writing off of the non-performing loans without hope of recovery from balance sheets of banks has impacted negatively the credit portfolio. Second, credit to public enterprises, after increasing in the first half of 2012, has decreased sharply in the second half. While both these developments have not been present in the first months of 2013, credit slowdown in this period is mainly attributed to the lower level of new loans.

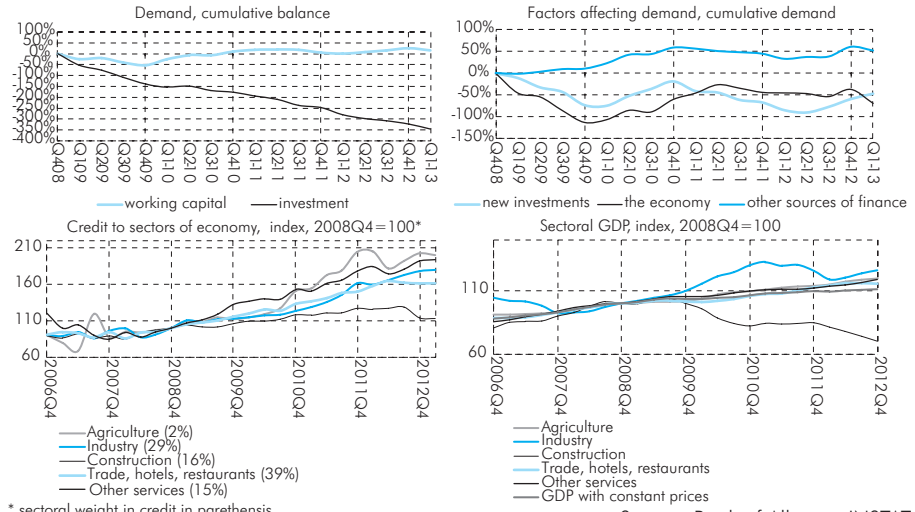
2. FACTORS BEHIND WEAK CREDIT DEVELOPMENTS

To understand the causes behind the sharp slowdown of credit, we need to analyse both demand and supply factors. For sound conclusions, besides indicators from bank lending surveys, we have employed data from the real sector.

2.1 DEMAND FACTORS

Credit developments in Albania have been in line with other macroeconomic developments in the country. The slowdown of aggregate demand has been followed by the fall in the demand for loans from businesses and households. Bank lending surveys indicate that the falling demand for credit is the main factor behind weak credit developments after the second half of 2012.

Chart 2. Business demand for credit and factors affecting it*



* sectoral weight in credit in parethensis.

Source: Bank of Albania, INSTAT.

* The indicators on credit demand, credit standards, and factors affecting them have been calculated as cumulative sum of the balances registered every quarter, starting from the end of 2008.

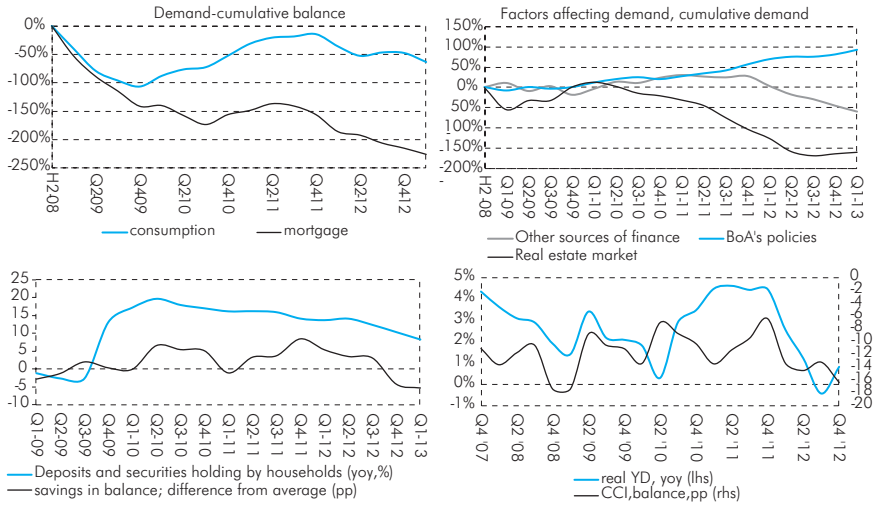
Credit for businesses has followed the developments in the real economy. In the last three years, the services and industry sectors of the economy have obtained more credit. They have been, in turn, the sectors with the highest contribution to the value added in the economy. The services sector, whose contribution to GDP growth in the last three years has been on average 2.4 percentage points, has received 56% of credit to businesses during

this period[2]. The contribution of the industry sector in economic growth has averaged 0.5 percentage points during these years, while this sector has absorbed 35% of credit to businesses. On the other hand, credit for the construction sector increased slightly in 2010 and 2011 and shrank in 2012 and in the beginning of 2013, reflecting the weak economic performance of this sector (negative contribution of 0.5 percentage points in 2010-2012). Despite giving an important contribution in economic growth (1.1 percentage points on average), the agriculture sector remains under-financed due to the high uncertainties involved in loans to this sector.

The businesses demand for finance has been oriented towards working capital financing, especially in the last two years. Demand for investment loans, on the other hand, has been falling since the end of 2008. The low demand for investment credit has also affected initially the fast slowdown and later the contraction of foreign currency credit, which has been traditionally linked to investment financing. According to banks' responses in the bank lending survey, the reasons behind the fall in credit demand are the overall slowdown of the economy and especially the fall in new investments.

Unlike businesses, the households' demand for credit has fallen for both consumption and mortgage, even though banks report to have tightened credit standards less for households. Households demand for credit increased slightly in 2011 to fall again in 2012. The main factors for the fall in households' demand for credit, as identified by banks, are the situation in the real estate market and the choice of other (informal) sources of finance. Meanwhile, the policies of the Bank of Albania provided positive effect on credit demand, especially the base rate cut and the delivering of price stability as a stability anchor in the economy. The behaviour of households seems to be affected by the uncertainties about their future income, in the presence of the slowdown of real disposable income. Households continue to reflect these uncertainties through their high propensity to save, as shown by the sustainable increase in deposits and holdings of other financial assets, such as government securities.

Chart 3. Households demand for credit and determining factors



Source: Bank of Albania, INSTAT.

[2] *Average GDP growth in 2010-2012 was 2.5%.*

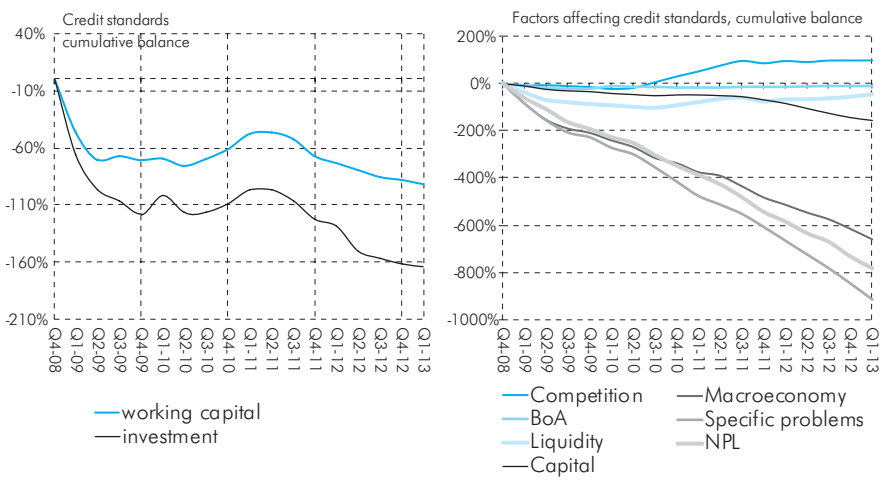
2.2 SUPPLY FACTORS

On the supply side, the analysis of bank survey results indicates tightened supply even though banks have adequate liquidity and capital to carry on their financial intermediation function in the economy. In this part of the material we will analyze not only the banks' opinion on credit standards but also the main elements banks have used to reflect the tightening of supply. Moreover, the analyses of the costs of credit and of the credit market structure complete the analysis of credit standards and the supply factors that have affected the developments in the credit portfolio.

2.2.1 Credit standards

The analysis of credit standards based on the bank lending survey shows that they have been on the tightening side since the end of 2008. At the end of 2010 and the beginning of 2011, credit standards for businesses eased for both working capital credit and investment credit. This was in line with improvements of the macroeconomic conditions and the confidence for their further amelioration. Meanwhile, the worsening of the crisis in the euro area and the beginning of a second-round recession in the CESEE countries brought back the tightening tendency in credit standards. Credit standards for businesses were notably tightened, especially for investment loans. In bank lending surveys, banks identify the specific problems across sectors of the economy, the overall macroeconomic situation, and the high share of non-performing loans as main reasons for tightening credit standards. On the easing side, they mention competition among each other and ample liquidity. On the other hand, capital requirements have contributed to the tightening of credit standards, especially after 2011, reflecting the adoption of the new regulatory requirements established by the European Banking Authority.

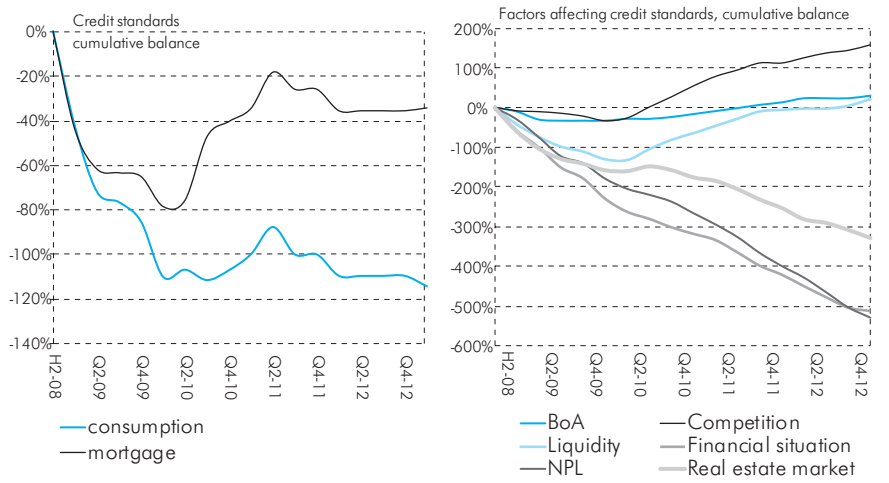
Chart 4. Credit standards for businesses



Source: Bank lending survey, Bank of Albania.

Developments in credit standards for households show a different pattern from that of the businesses. They have tightened considerably up to the end of 2009 and then eased, especially for the mortgage credit, till the first half of 2011. Afterwards, this trend reversed slightly in the two last quarters of 2011 and credit standards have remained around that level ever since. Banks have applied more relax lending policies for households compared to businesses. This approach has been in line with banks' strategies, especially the large ones, to increase their market share in the retail segment. As laid out by banks, the main factors that have negatively affected credit standards for households are the situation in the real estate market, financial conditions of households, and NPLs. On the other hand, the liquidity of the banking sector, competition among banks, and Bank of Albania's policies have contributed to easing credit standards for households.

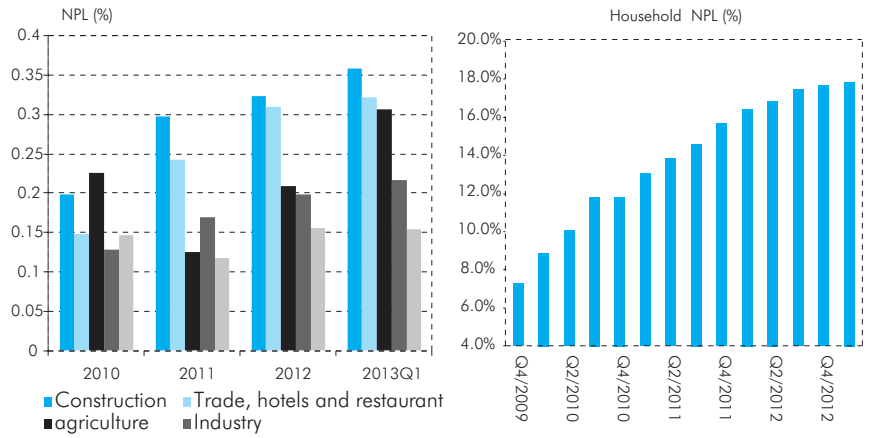
Chart 5. Credit standards for households



Source: Bank lending survey, Bank of Albania.

The above analysis reveals that besides banks' concerns about macroeconomic developments, tight credit standards reflect the deterioration of the loan portfolio. Chart 6 shows NPLs over the last three years for the business sectors of the economy and for households. NPL ratio for households, at 17.8%, is lower than the 27.4% ratio for businesses. NPLs have increased over the years for all the sectors of the economy and they remain problematic for construction and trade sectors. The impact of the loan portfolio deterioration on the banks' intermediation function is twofold. On one hand, higher NPLs impose higher capital needs in order to comply with regulatory requirements. On the other hand, they serve as a signal for credit risk of various sectors in the economy.

Chart 6. NPL ratios for business sectors and for households



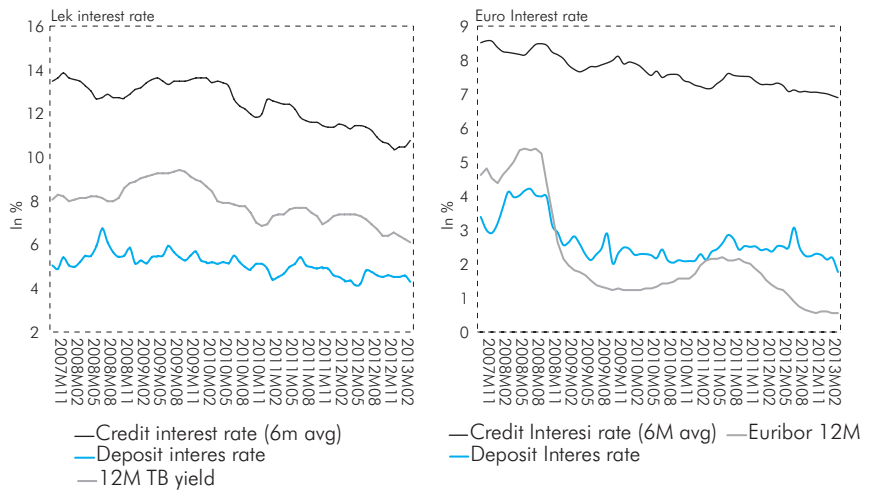
Source: Bank of Albania.

2.2.2 Credit standards

One of the main costs of credit is the interest rate. The banking statistics show that the interest rate changes considerably depending on the currency of the loan and its term to maturity. In general, credit interest rates are indexed to some reference rates and follow closely the latter. Interest rate developments will be analyzed separately for lek and foreign currency due to differences between them. Loans in euro make up the majority of foreign currency loans; around 90% of foreign currency credit is in euro.

The interest rate of new loans in lek, after staying at high levels in the first two years after the crisis, fell sharply at the end of 2010. Afterwards, it increased slightly, but has followed a decreasing trend so far. Despite decreasing steadily, the margin of the lek interest rate above its reference rate is high and has remained almost unchanged during the period 2008-2013. At the end of the first quarter of 2013, this margin shows a slight increase.

Chart 7. Interest rate or lek and for euro loans

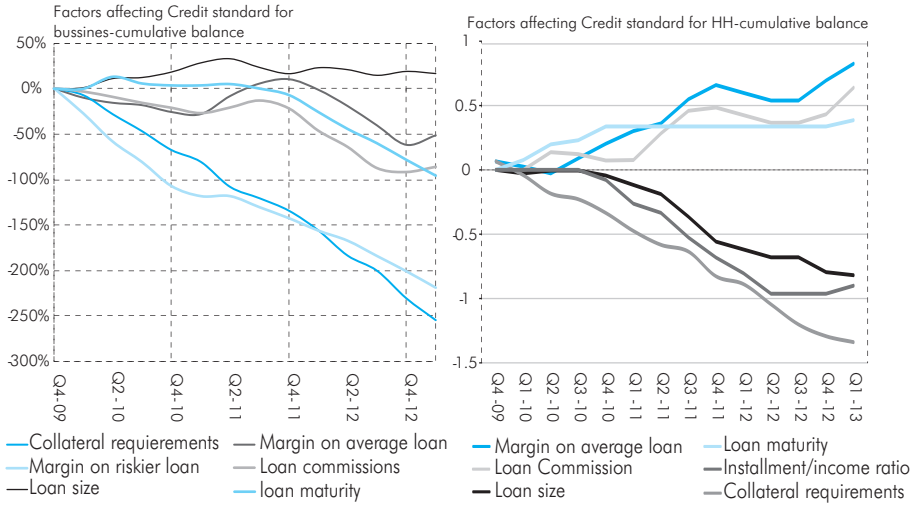


Source: Bank of Albania.

The interest rate for new loans in euro has been more sustainable. Its margin against the reference rate, usually the 12 month euribor rate, has increased considerably after the crisis. These developments are in line with the strategic orientation of banks towards lending in domestic currency and the narrowing of the differential between lek and euro lending interest rates. The increase of the difference between euro rates in the domestic and European markets after the crisis is a regional phenomenon and makes a major concern for functioning of the monetary policy transmission channels. Moreover, the increase of this difference reflects the higher cost of our banks in obtaining foreign finance in international markets.

In tightening lending standards, banks have used both price and non-price[3] elements of credit. The results of bank lending surveys show that after 2008 banks have increased the collateral requirements for businesses. Also, they have decreased the maturity of credit, providing mostly short-term loans. Meanwhile, banks have increased the margins applied for both average loans and riskier loans. Applied commissions have increased as well. The only element that has been eased somewhat for businesses after the financial crisis is the size of the loans.

Chart 8. Non-price elements of credit standards for businesses and households



Source: Bank lending surveys, Bank of Albania.

In the household credit segment, banks relaxed conditions related to commissions, interest rate margin for loans with average risk, and maturity term. As for businesses credit, banks have applied tighter collateral requirements and a higher income/instalment ratio for loans to households. in contrast to businesses, the size of loans has been a tightening tool for households.

[3] *Non-price elements include conditions other than interests and commissions.*

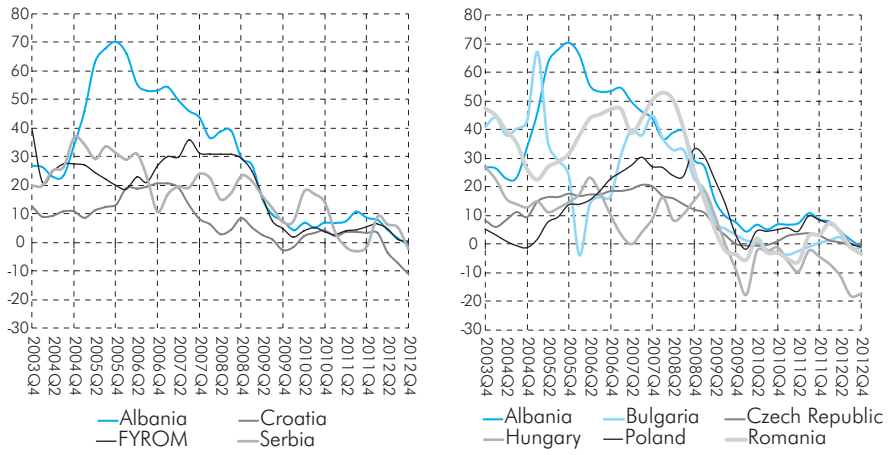
2.2.3 Group Policies

The loan supply from banks and in particular developments in lending standards seems to be conditioned also by the capital origin of banks. As the most recent IMF study shows (April 2013), lending standards and policies pursued by banks in the CESEE countries are subject to the group policies (of the parent bank), in particular those of European origin. The credit crunch in these banks is directly affected by the centralized banking model of European banks. As such, it reflects the impact of austerity measures applied by the new rules of European Banking Authority (IMF, 2013). In Albania, these developments have been reflected in the structure changes of the lending market. Thus, Greek banks after the 2008 financial crisis have followed a consolidating policy, by reducing significantly the loan portfolio and their share in the market, as it has been experienced also in other countries in the region (OeNB, 2012). The lending contraction of the Greek banks has been largely offset by other banks in the system. Meanwhile, subsidiaries of European banking groups, after increasing lending up to mid-2011, have maintained the loan portfolio almost unchanged for more than a year.

3. LENDING IN THE REGIONAL FOCUS

The poor performance of the loan portfolio is not an isolated phenomenon of our economy; it is also observed in all countries of Central and Eastern Europe. Since the second half of 2012, the already weak credit growth slowed further and for most of the countries remained near zero or in negative territory. In this regional comparison, Albania ranks among the countries with the best performance, not only in comparison to the neighbouring countries, but also with other countries in the CEE region.

Chart 9. Annual growth of credit to the private sector (deflated by CPI, in %)

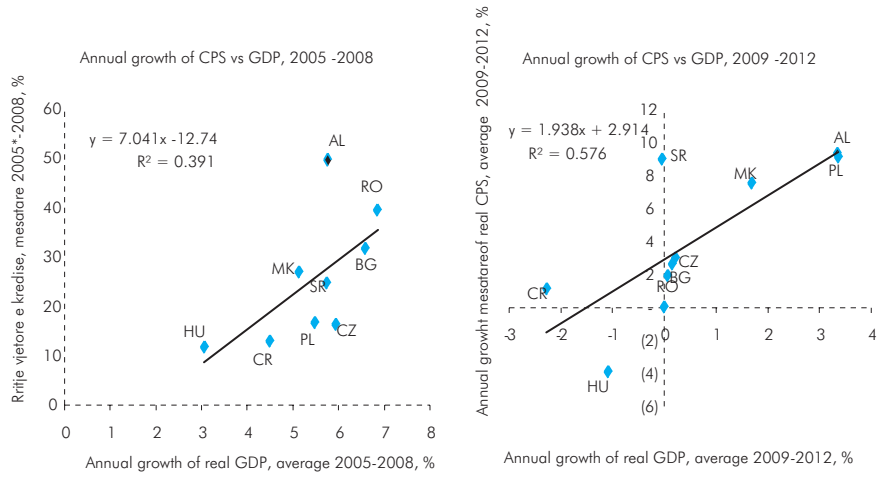


Source: Central Banks and statistical institutes of countries in the region, authors' calculation.

As mentioned above for the Albanian case, the factors that have conditioned the performance of credit portfolio relate to both supply and demand side. However, while immediately after the crises, in the period 2009-2011, the credit standards tightened due to supply-side factors (mainly liquidity problems of banks), in 2012 and following, economic agents demand for funds was the main factor driving credit demand down in these countries (Institute of International Finance, 2013). In many countries (such as Hungary, Bulgaria, Croatia), lower demand was also driven by the higher indebtedness of the economic agents before the crisis, as the result of the rapid credit growth in those years. But in some other countries, such as Albania and other Balkan countries, the economic agents have been less debt ridden and have not been required to adjust their balances sheets massively.

The impact of the demand-side factors can be easily distinguished looking to the relation between GDP growth and the growth of credit to the private sector in these countries (see Chart 10). This relation has been analyzed for both 2005-2008 and 2009-2012 periods. The data show a close relation between these two indicators; countries with the highest growth of the real GDP have the highest growth of credit to the private sector and vice versa. Also, the comparison between the two periods reveals that the relationship between credit and GDP has been stronger after the global financial crisis of 2008. This conclusion is in line with findings of other research of the recent years, which concludes that the link between economic activity and credit is stronger during the downturn of the economic cycle (Raiffeisen Research, 2013).

Chart 10. Relationship of GDP and credit to the private sector

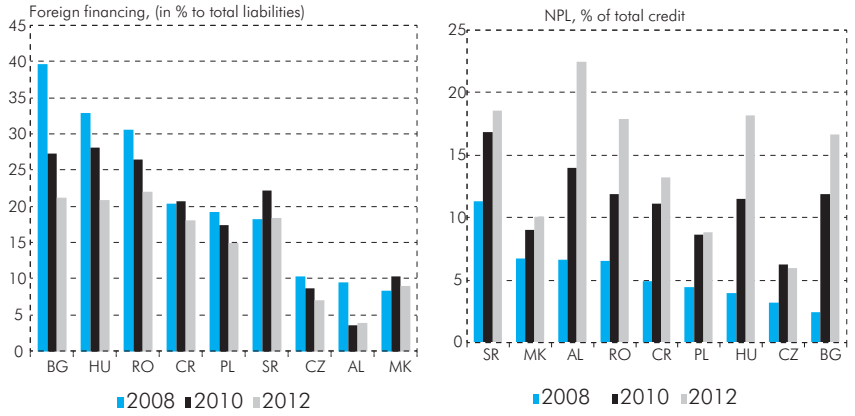


Source: Central Banks and the statistical institute of countries in the region, authors' calculation.

The supply factors have continued to tighten during the 2012, although less than in previous years. Developments that have outlined the credit supply in the CESEE countries in recent years have reflected mostly the buoyant development of the funding sources and the deepening of the intermediation, associated with higher credit risk. In all these countries, banking systems

are characterized by a strong presence of foreign banks, mainly European ones. During the period 2005-2008, these large banks were the catalyst promoting lending in the CESEE, financed mostly by foreign funds originated by advanced European countries. In those years, foreign liabilities of banks in these countries grew on average by 44% per year. In countries such as Bulgaria, Hungary and Romania, these liabilities represent 30% - 40% of the total liabilities of the banking system. The sustainability of this funding model has been placed to a strong test with the financial crisis of late-2008, where the CESEE banks faced massive and rapid withdrawal of foreign financing.[4] This was the main factor dictating initially the tightening of credit conditions and slowing of the credit growth in these countries. With the gradual replacement of foreign funds with domestic funds (deposits), the liquidity situation improved in most countries, without representing an important constraint on credit. At the end of 2008, the Albanian banking system was among the systems less dependent on foreign financing (less than 10% of total liabilities). This rate was halved in the space of two years and continues to remain low. In this regard, the withdrawal of foreign financing by banks is well offset by a higher deposit base, which, up to 2012, has contributed to a robust annual growth of credit to the private sector in our economy.

Chart 11. Foreign financing and the ratio of non-performing loans to the total loans



Source: Central banks in the region, authors' calculation

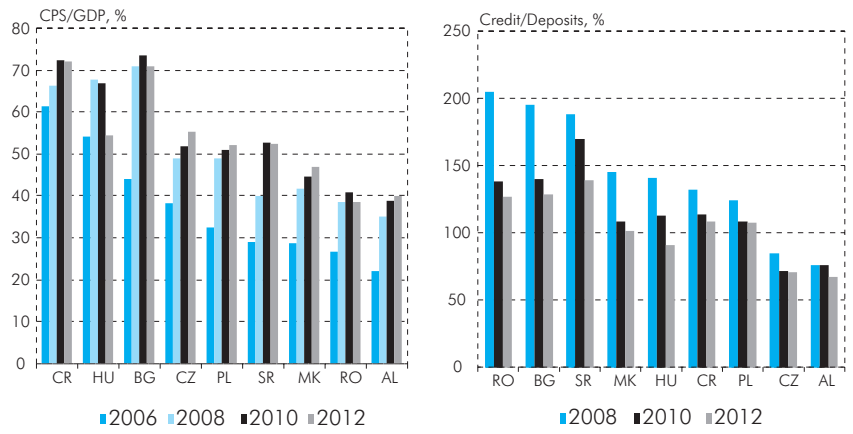
The second factor tightening the supply of credit in the region is the increased credit risk. The ratio of non-performing loans to total loans[5] has increased significantly in most of these countries and primarily reflects the underperformance of the real economy. In the period 2009-2012, this ratio has increased by 9 percentage points, on average, for the entire region. The Albanian banking system is facing a rapid deterioration of the credit quality, which is a key factor for tightening credit conditions, particularly in certain sectors. In a macroeconomic context, the high level of non-performing loans

[4] *This was a result of group policies, according to which subsidiaries had to rely on domestic funds only for their credit activity.*

[5] *This ratio may not be compared across the countries as different countries use different methodologies. Albania uses a conservative methodology, which explains to a great extent the higher ratio compared to other countries.*

leads to unused capital (collateral) and freezing the financing of new projects, hampering, thus, the economic recovery. The prompt handling of this concern and the cleaning of banks' balance sheets in the CESEE countries is an important prerequisite to increase risk acceptance by banks and the recovery of bank financing in the economy.

Chart 12. Intermediation indicators of the countries in the region



Source: Central banks and statistical institutes of countries in the region, authors' calculation.

Finally, another feature of the countries in the region is the differences in degree of intermediation. Albania ranks among the countries with the lowest use of the financial leverage in the economy, as shown by the loans to GDP ratio. This shows that, from the demand-side perspective, there is room for further increase of lending activity, which will require higher banks' participation in financial intermediation and in supporting the economic growth. From the supply-side perspective, the Albanian banking system has the capacity to support private sector credit. In addition, the credit to deposit ratio is also low. The overall low levels of these two financial intermediation indicators, which will determine the path of lending developments in the medium and long run, confirm that the current credit crunch is affected mostly by short and transitory factors, and does not reflect fundamental factors.

4. CONCLUSION

As in many countries in world, the global financial crisis has had a significant impact on the financial intermediation of the banking system in Albania. After 2008, and especially during the last two years, the intermediation of banks in channelling funds into the economy has been reduced. During this period, lending has slowed down and the financial leverage in the economy is lower. This phenomenon is influenced by both demand and supply factors, which have impacted the credit development with different intensity over the years. Initially, there were the supply factors that led to the tightening of the credit conditions and discouraged the demand for loans. Meanwhile, in the

last year, credit demand has fallen significantly, being, therefore, the main contributor to the poor credit performance in the second half of 2012 and first half of 2013.

Lending developments in Albania seem to be in line with the developments in other economies of the region. Low demand for loans reflects the poor economic performance in these countries. Meanwhile, credit supply continues to be constrained by two main factors: the need to finance intermediation activity with domestic funds (deposits), and the increased credit risk (high level of non-performing loans). Comparative analysis shows that Albania is in a better position among the countries of the region, as foreign funding represents a low ratio in Albanian banks' balance sheets. On the other hand, non-performing loans remain at high levels, similarly to the whole region. Addressing and managing this concern promptly represents one of the next challenges for policymakers and banks in the region. "Cleaning off" the banks' balance sheets would increase the banks' ability to lend and help the economy to recover in the future.

Regarding the future, in the short run, lending is likely to continue to be conditioned by the low credit demand, high uncertainty of economic agents and banks for the future performance of the economy, and handling of nonperforming loans. On the other hand, Albania is considered a country with high growth potential. Meanwhile, it has a low financial leverage against the backdrop of the high access to a broad base of deposits from banks. These fundamental factors will determine a positive prospect for the performance of lending in Albania in the medium and long term.

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SERVICES SECTOR PERFORMANCE AND ITS IMPORTANCE FOR THE ALBANIAN ECONOMY

IRIS METANI
MONETARY POLICY DEPARTMENT

Structural changes that take place in the economy, generally, are reflected in the structure of each sector's share in aggregate value added and employment. Over the two last decades, services sector has increased its importance. This trend, together with the substantial role of services[1] to other economic activities, requires a more thorough analysis of sectoral performance. This article examines the dynamic profile of the services sector, focusing in the developments of value added, employment and labour productivity in Albania.

Economic theory and empirical research list several factors that explain the crucial role of the services sector. Clark (1951, cited in ECB (2006)) points out that the major role of the services sector is associated with the importance of services products satisfying higher level needs relative to goods.[2] According to this argument, the increase in income leads to a larger expenditure reallocation toward services products. By contrast, Baumol (1967, 2001, cited in ECB) argues that when relative demand on services products is estimated at basic prices, it does not depend on income. As he explained, a rise in the share of services sector's employment in aggregate employment is stemming from different patterns in productivity growth. Another explanation is provided by Jacobs, Shipp and Brown (1989), as well as Cancedda (2001, cited in ECB). They argue that higher women participation rate[3] in the labour market, and especially in services branches, reflect the importance of services in the economy. This pattern can be distinguished in the increased share of services sector's value added and employment, respectively, in aggregate value added and employment. Additionally, Nicoletti (2001, cited in ECB) highlighted that the liberalisation process and globalisation did play a role in the relative importance of services sector, particularly in branches of air transport, post and telecommunication and tourism.

In Albania, during 2011[4], services sector accounted for 60.3% of aggregate value added at market prices, employing 69.8%[5] of the labour force. The

[1] *Published value added data show a breakdown of services sector into 4 main branches: "Trade, hotels and restaurants", "Transport", "Post and telecommunication" and "Other services".*

[2] *As standard microeconomic theory suggests, services produce superior products, which means demand elasticity to income is greater than 1.*

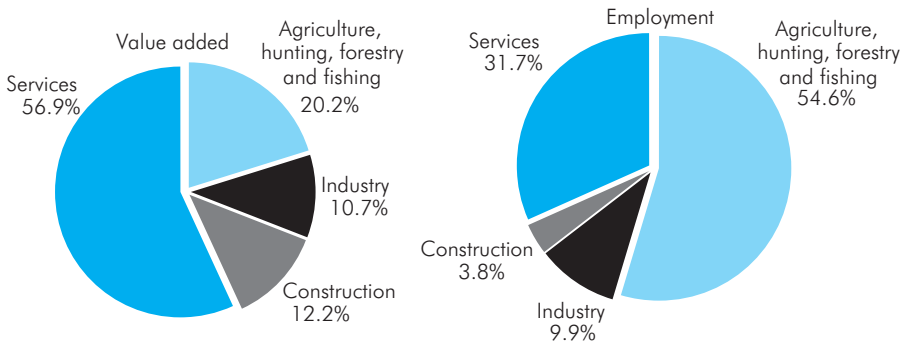
[3] *Unemployed women engaged in household activities are neither included in the estimation of gross domestic product, nor in labour market statistics.*

[4] *Referring to INSTAT's preliminary annual data for gross domestic product by branch. These data may be accessed in INSTAT's database over the period 1996 – 2011.*

[5] *The share is calculated excluding self-employed in private agriculture sector. This sector accounts for the largest share in aggregate employment. Employment in private agriculture sector is derived from annual surveys. The accuracy of such data is low and they are subject to ongoing revisions. According to the data, the share of employees in the private agriculture sector accounts for 54.6% of aggregate employment, whereas 31.7% are allocated in the services sector. The data are derived from INSTAT's publication "Total employment by economic activities" during the period 2000 – 2011.*

share of services sector in aggregate value added and employment should be analysed in two aspects. First, since 1996, the sector's share has increased to a large extent (by 10.7 percentage points) in aggregate value added. Second, changes of the sector's share in aggregate value added and employment might signal different dynamics of labour productivity by sectors (this issue will be discussed below). Additionally, during the period 2006 – 2011, the number of businesses in the services sector increased by 39.6%, accounting on average for 83% of total firms based on market structure[6] indicators. Meanwhile, labour market indicators marked a rise in the share of women employed in this sector from 14.6% to 16.0%.

Chart 1. Services sector weight in aggregate value added at basic prices and employment during 2011



Source: INSTAT.

The structural transformation with activities shifting toward the services sector has taken place in some economies of the region and other countries, as well.[7] The comparison with these economies reveals that the services sector is the largest contributor to aggregate value added and employment. Also, its importance has increased over time, although the speed of restructuring has varied.

The further analysis of services sector is based on value added at basic prices[8] that is available at a quarterly frequency and is disaggregated according to the statistical classification of economic activities (NACE Rev.1.1).[9] The share

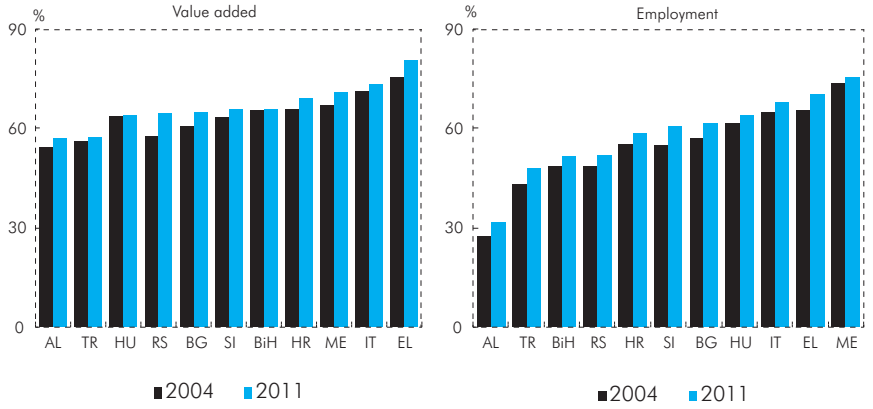
[6] *INSTAT publishes these data in the annual "Structural business survey", accessible in INSTAT database for the period 2006 – 2011.*

[7] *Countries included in the comparative analysis with Albania (AL) are: Bosnia and Herzegovina (BiH), Bulgaria (BG), Greece (EL), Hungary (HU), Italy (IT), Croatia (HR), Montenegro (ME), Serbia (RS), Slovenia (SI) and Turkey (TR).*

[8] *Value added data series by branch used in the analysis are over the period 2005 Q1 – 2012 Q4.*

[9] *INSTAT applies a breakdown of value added in services sector by branch as follows: "Trade" (G), "Hotels and restaurants" (H), "Transport" and Post and telecommunication" (I), "Financial intermediation" (J), "Real estate, renting and business activities" (K), "Public administration and defence; compulsory social security" (L), "Education" (M), "Health" (N), "Other community, social and personal service activities" (O). Additionally, INSTAT refers to NACE Rev. 1.1 to classify employment by economic activities. But, data for public access are reported by the following sections G, H, I, M, N and "Other services" (that include sections J, K, L, O, "Activities of households" (P) and "Extra – territorial organizations and bodies" (Q)).*

Chart 2. Services sector share in aggregate value added at basic prices and employment in Albania, some economies of the region and other countries



Source: INSTAT, Central Banks and Statistical Offices of some economies of the region.

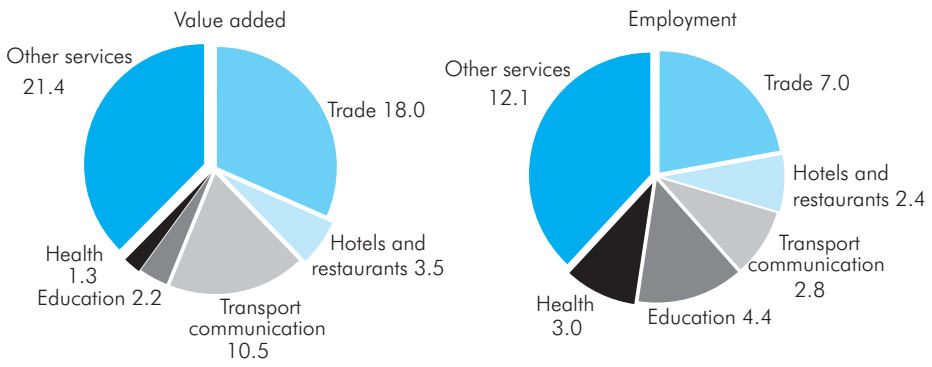
of services sector (by approximately 56.9% of value added at market prices) is lower when calculated using value added at basic prices. Moreover, the analysis of the sector branches reveals a variation in the branches share when expressed in terms of value added and employment. Differences result larger for branches of trade, transport, post and telecommunication, education and health. This might indicate different levels of labour productivity across services, as shown below in the study by the wide changes of labour productivity.

The breakdown of services value added according to NACE Rev. 1.1 does not group activities in market and non-market services. But, in the latest publication of INSTAT "The main results of labour force survey in 2012",[10] a breakdown of employment in market and non-market services is reported.[11] Based on this survey, market services account for a larger weight in comparison with non-market services. Also, when services sector value added by branch is grouped by applying the definitions noted in the survey for market and non-market services, it results that market services have the largest share in services value added.

[10] *This publication reflects employment by sector during 2012, expressed as each sector's share in aggregate employment. However, data provided by the survey are scarce, in terms of their reported units, the time length they cover and the level of disaggregation by economic activities. Consequently, the use of this publication as a principal source of analysis is too confining. Shares of this survey differ from those of "Total employment by economic activities", pointing also to problematic measurement issues related to labour market indicators. Data issues are more complex regarding the estimation of employees in agriculture sector through surveys, thus undermining consistency in labour market analysis.*

[11] *As specified in the Labour force survey in 2012, market services include sections G, H, I, J, K, whereas non-market services include sections L, M, N, O, P, Q.*

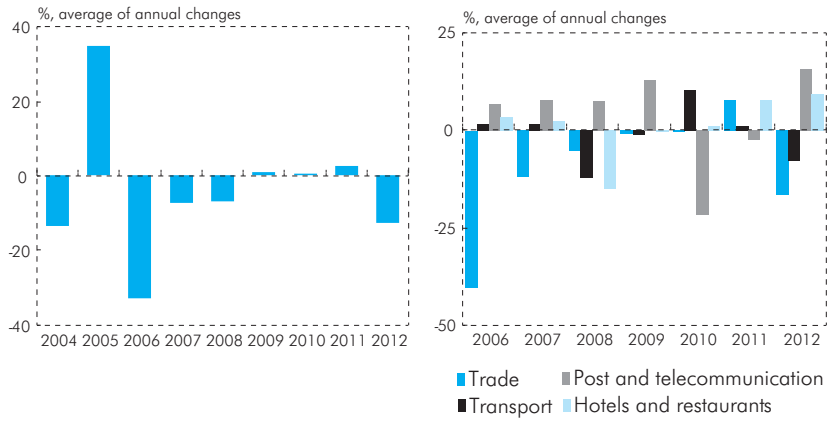
Chart 3. Branch structure of each branch in services aggregate value added at basic prices and employment



Source: INSTAT.

Differences amongst share structure of each branch in services, when expressed in terms of value added and employment, suggest the need to estimate the services performance in terms of labour productivity. The course of labour productivity[12] in the services sector trended down during 2006 – 2008. Conversely, its tendency improved over 2009 – 2011, to eventually fall in 2012. Also, labour productivity, at the branch level, turned out to be quite diverse, indicating a certain degree of heterogeneity between branches. For example, labour productivity in "Post and telecommunication" and "Hotels and restaurants" has shown positive, although low, growth rates. To some extent, this might reflect an increase in efficiency and demand. This might also be the result of a fall in prices or the adoption of new technologies, especially in the telecommunication branch.

Chart 4. Labour productivity in services sector (left) and its composite branches (right)



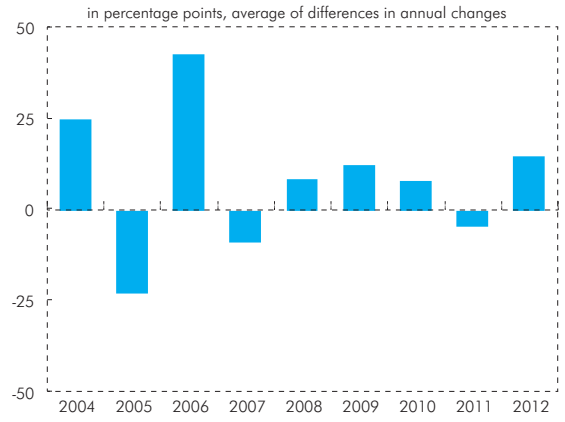
Source: Author's calculations.

[12] *This indicator is computed based on the approach adopted by Çeliku and Metani (2011). According to the authors, labour productivity is estimated as the ratio of value added (expressed as an index 2005=100) with the employees index of services sector and its composite branches.*

On the other hand, labour productivity in trade and transport branches did show a declining path. It should be taken into consideration that these developments might stem from continuous improvements in the methodologies used to estimate value added and the employees' index, including the assumptions applied in the computation of labour productivity by branch.

Meanwhile, the difference between labour productivity in industrial sector and services sector, expressed as annual changes, results in a positive gap.[13] This gap has shrunk over the period 2007 – 2012. The nature of services products that, unlike goods, cannot be stored or preserved, explains to some degree the positive gap. This limits the benefits from economies of scale in the production process, in spite of technological innovations adopted by the services sector.

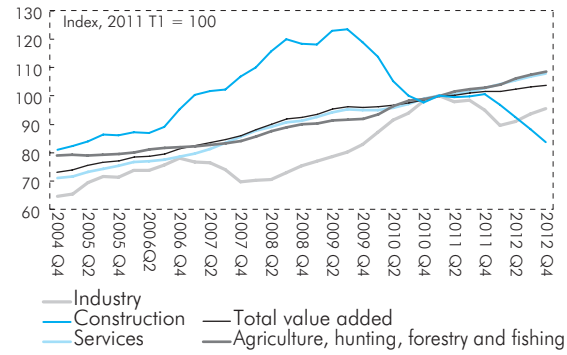
Chart 5. Labour productivity gap between industry and services



Source: Author's calculations.

In addition, the relative importance of the services sector is featured by sectors cyclical dynamism. Cyclical shifts have shown a higher volatility in industry, but a more stable pattern in services. Growth of services value added reflects lower volatility of the sector compared to other sectors in the economy.[14] The low volatility of services is illustrated in Chart 6, reflecting another peculiarity of the sector.[15]

Chart 6. Value added by sectors and gross domestic product*



*The index is built up as the respective moving sum of GDP and sectoral value added at basic prices, with a base period at the first quarter of 2011. The base period is chosen referring to leading indicator, which has taken the lowest value in 2011 Q1 since the 2006 Q2.

Source: INSTAT and Bank of Albania.

Despite the large share of the services sector in aggregate value added, the statistical infrastructure – disposable data and indicators used to monitor short-term developments in services – is at the early stages of development. However, progress has been made related to the provision and convenience of data publications.

[13] *The gap is calculated as the difference between labour productivity in industrial sector and services sector, in terms of annual changes.*

[14] *This is expressed in terms of standard deviation and it is shown in Table 1.*

[15] *Regardless of the low volatility, but due to the highest share in economic activity, services have driven the volatility of aggregate value added, compared to other more volatile sectors like construction, agriculture and industry. This feature highlights specifically the importance of short-term developments in the sector, in order to produce an accurate analysis and forecasting through consistent and timely generated data.*

Table 1. Value added by sector, at a quarterly frequency and seasonally adjusted

Sectoral developments in terms of value added at basic prices (average over the period 2005 Q2 – 2012 Q4)				
	Quarterly changes (in %)	Standard deviation of quarterly changes	Contribution to quarterly growth (in p.p.)	Contribution to quarterly growth in absolute terms (in p.p.
Services	1.3	1.5	0.9	1.2
- Trade, hotels, restaurants	1.1	2.5	0.2	0.4
- Transport	1.2	6.0	0.1	0.2
- Post-telecommunication	2.8	6.5	0.1	0.2
- Other services	1.3	1.0	0.3	0.3
Industry	1.5	7.2	0.1	0.6
Construction	0.5	9.1	0.0	1.0
Agriculture	1.1	1.2	0.2	0.3
Economy	1.1	2.0	1.1	

Source: INSTAT and author's calculations.

Enriching statistics helps to improve and complete the services sector analysis, supporting a thorough understanding of this sector's developments over time. The further improvement of data relates to issues regarding the level of disaggregation, frequency, convenience in publication, time series length and quality of all disposable indicators. The development of the statistical database will also increase the consistency in comparability across the region and other economies.

To conclude, the services sector performance indicates the importance of the sector for the domestic economy. This is reflected in the increase of its share over time and the relatively higher share compared to other sectors. The analysis shows that some degree of heterogeneity characterizes branches in services sector, as well as the fact that the sector presents low volatility. In other words, the growth rates of services sector value added at basic prices do feature low volatility across the business cycle and short- term volatility in terms of quarterly growth rates. Meanwhile, labour productivity developments in the services sector point that a lot of work remains to be done. Higher competition in services might increase efficiency and flexibility in this sector. Furthermore, this will also support labour productivity growth and boost the sector's dynamism. Consequently, these will improve the responsiveness of the economy toward shocks, facilitating the accommodation process of structural changes in the economy.

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THE "STATUS QUO" OF SMEs IN ALBANIA

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ABSTRACT

Small and medium-sized enterprises (SMEs) play, without any doubts, a crucial role in the economic growth of a country. Therefore, SMEs are often considered as the main generators of new jobs and increased income in an economy. That is why studying and analyzing SMEs more in depth, becomes highly important in trying to understand future developments of the economy of a specific country. This article aims to analyze developments of SMEs during 2006 – 2011 in the Albanian economy. Analyses on six key indicators (number of enterprises, number of employees, value added, productivity, profit ratio and their propensity to invest) are used to identify the main trends and developments. Some of the main outcomes indicate that SMEs have positively contributed to increasing employment and value added in the Albanian economy during 2006 – 2011. In addition, SMEs have also managed to perform positive values of net profit during the same period. Therefore, developing the appropriate supportive policies becomes an important challenge for the future in trying to support their continuous progression.

1. INTRODUCTION

Technological level, human capital and its level of knowhow are obviously key elements determining the economic development stage of a certain economy. These key elements are considered as the main accelerators in stimulating the long-term growth of a country's' economy. In practical terms, the above argumentation has been predominantly materialized in the concept of "knowledge-based economy" and the important role SMEs paly to develop a country's economy. The 2008's "Small Business Act for Europe" considers SMEs as the main promoters of; employment, income and economic growth of a country, based on their contribution to employment and value added. In addition, SMEs influence the country's further development by affecting the market's efficiency and by increasing the income level. The European Commission[1] also confirms these results in a study on the EU countries. SMEs in the EU-27 account for about 99.8% of the total number of enterprises, contributing thus, for the employment of about two thirds of the total workforce in the European Union working in the private sector. Consequently, SMEs are considered as powerful market players in contributing to enhancing the country's welfare and boosting employment, becoming an important component of the European strategy plan of 2020. By taking into consideration

[1] EC, 2011

the important role of SMEs in a country's economy, Schmiemann 2009, proposes two main approaches in analyzing SMEs; the multidimensional approach and the unidimensional one. Given that Albanian enterprises are highly heterogeneous, we chose the unidimensional approach to analyze SMEs in Albania, selecting them based on their size, an approach applied also by many other authors.[2] Therefore, by size, enterprises are divided into; micro enterprises that employ 1 to 4 employees, small enterprises that employ 5 to 19 employees, medium-sized enterprises that employ 20 to 79 employees. Large enterprises employ 80 or more workers.

The main objective of this paper is to offer the main trends/tendencies of the Albanian private sector based on enterprise size, for the 2006 – 2011 period, by offering a general overview on the role played by SMEs in creating new jobs, reducing unemployment and increasing ???? value added.

Using data from the "Enterprises Structural Survey"[3] we have classified as SMEs all Albanian enterprises which employ 79 or less employees in their company. All the enterprises that employ 80 or more employees, are classified as large enterprises. In addition, sectoral differences are also part of our analysis based on enterprises' size difference.

This article has the following structure; section two provides an overview on the main indicators used in our analysis, section three poses a brief summary on the specific analyses about the performance of enterprises based on their size, some of the results and main trends, and in the final section we conclude.

2. DATA

The main data source used to analyze the Albanian SMEs is the database on the "Enterprises' Structural Survey in Albania" published by INSTAT. This survey analyses the performance of the main enterprises in several major cities of Albania. The dataset excludes information on banks and non-bank financial institutions, education institutions and health care institutions. Enterprises are analyzed at both aggregated and sectoral level, namely: industry, construction, transport and communication, trade and services.

As mentioned earlier, this article bases its analysis on the following six main indicators; number of enterprises, number of employees, gross value added, productivity, profit ratio, and propensity to invest. The following section describes in more details each of the six indicators, information or tendency they try to indicate.

Number of enterprises is a widely-used indicator to capture the level of the so called "entrepreneurial spirit" of a country. Nevertheless, this indicator has its own limitations as it describes quantitatively the number of enterprises

[2] *For more details refer to " Key figures on European business with a special feature on SMEs", KE, 2011*

[3] *"Anketa Strukturore e Ndërmarrjeve" (Enterprises' Structural Survey in Albania) by INSTAT (www.instat.gov.al)*

in the economy, but does not offer information on the effectiveness and efficiency of these enterprises. Number of employees, on the other hand, represents the capacity of each of the sectors or enterprises in the economy to create new jobs. This indicator is also used to analyze the overall structure of employment in the country's economy, employment distribution by sector, generally measured by comparing small enterprises with larger ones. On the other hand, gross value added is an indicator that, unlike the two previously mentioned indicators is even more comprehensive as it is also used to measure productivity. It does this by representing the difference between the overall production and work in process consumption, for every unit produced, after the abolition of all taxes and costs. Labor productivity is another indicator that is calculated as the gross value added to the number of workers employed. Therefore, this is a general indicator of productivity that practically measures productivity as a ratio to the number of employees. Profit ratio represents the enterprise's performance calculated as a ratio between the net profit and total revenue. This indicator measures the survival capability of enterprises by assessing the enterprises' efficiency. Propensity to investment is measured as the ratio of gross investments to the gross value added to be able to analyze thus the future developments of the sector based on their propensity to invest. The next section offers a general summary on the trends and tendencies of SMEs versus large enterprises in the Albanian economy, using the above-mentioned indicators.

3. GENERAL TRENDS OF ALBANIAN ENTERPRISES

A general overview on the data from Table 1 reveals that SMEs in Albania represent, on average, about 99.6% of the total number of enterprises, a figure that has been almost stable along the 2006 - 2011. Employing an average of 1 to 4 employees, micro enterprises, seem to be the typical enterprises in Albania, accounting, on average, for about 91% of the total number of enterprises. Meanwhile large enterprises represent a very small part of the total enterprises, accounting for only 0.38% of the total number of enterprises.

In terms of employment, SMEs employ averagely 71.3% of total employees in the private non-financial sector of the economy, while large enterprises employ only 28.7%. However, in terms of value added the situation is a little different; large enterprises contribute on average, about 45.84% of total value added, whereas SMEs contribute about 54.16% of total value added. We have also taken into consideration the distribution of SMEs by the main sectors of the economy throughout the period 2006 - 2011 (Table 2)[4].

[4] *Since changes between periods are marginal in Table 2, we have only shown data for 2011, while the full data on the marginal changes can be found at the end of this material, Table 7-A, B appendix 1.*

Table 1: Number of enterprises, employment and value added in Albania, 2006-2011

	2006	2007	2008	2009	2010	2011
		Number of enterprises				
Micro	51,045	57,239	63,388	67,471	68,616	71,371
Small	3,500	4,201	4,303	4,746	5,080	5,374
Medium	910	976	1,094	1,209	1,348	1,362
SME	55,455	62,416	68,785	73,426	75,044	78,107
Large	195	241	260	276	317	322
Total	55,650	62,657	69,044	73,702	75,361	78,429
SME (as % of total)	99.65	99.62	99.62	99.63	99.58	99.59
Large (as % of total)	0.35	0.38	0.38	0.37	0.42	0.41
Total	100	100	100	100	100	100
	2006	2007	2008	2009	2010	2011
		Number of employee				
Micro	79,547	87,906	93,057	97,525	105,194	103,512
Small	30,788	35,204	37,975	40,500	44,703	46,342
Medium	34,334	36,771	39,271	42,886	48,340	49,636
SME	144,669	159,881	170,303	180,911	198,238	199,490
Large	57,522	66,735	70,088	71,314	75,790	81,647
Total	202,191	226,616	240,391	252,226	274,028	281,137
SME (as % of total)	71.55	70.55	70.84	71.73	72.34	70.96
Large(as % of total)	28.45	29.45	29.16	28.27	27.66	29.04
Total	100	100	100	100	100	100
	2006	2007	2008	2009	2010	2011
		Value added (Mill ALL)				
Micro	41,986	47,103	51,497	56,226	57,915	60,039
Small	30,248	38,900	34,603	50,465	60,002	58,973
Medium	26,159	35,298	43,021	47,046	66,525	67,295
SME	98,393	121,301	129,120	153,737	184,443	186,307
Large	87,578	104,972	143,735	112,474	156,675	127,844
Total	185,971	226,273	272,855	266,211	341,118	314,151
SME (as % of total)	52.91	53.61	47.32	57.75	54.07	59.30
Large(as % of total)	47.09	46.39	52.68	42.25	45.93	40.70
Total	100	100	100	100	100	100

Source: INSTAT, authors' calculations.

Table 2: Number of enterprises, employment and value added for all sectors, according to the size of enterprises, year 2011[5]

Main sectors	2011		
Industry	SME (%)	Large (%)	Total(%)
Number of enterprises	12.4	0.2	12.6
number of employee	14.8	16.2	31.1
Value added	11.0	21.7	32.7
Trade	SME (%)	Large (%)	Total(%)
Number of enterprises	45.6	0.0	45.6
number of employee	24.4	1.6	26.0
Value added	22.9	1.7	24.6
Services	SME (%)	Large (%)	Total(%)
Number of enterprises	25.4	0.1	25.4
number of employee	16.1	4.2	20.3
Value added	8.8	2.4	11.2
Contruction	SME (%)	Large (%)	Totali(%)

[5] *Note: Each indicator is expressed as a percentage of total number of enterprises, number of employees and value added for all sectors.*

Number of enterprises	4.7	0.1	4.8
number of employee	10.1	2.2	12.3
Value added	12.1	3.5	15.7
Transport and Comunication	SME (%)	Large (%)	Totali(%)
Number of enterprises	11.6	0.0	11.6
number of employee	5.5	4.8	10.4
Value added	4.5	11.3	15.8
Total Sectors	SME (%)	Large (%)	Totali(%)
Number of enterprises	99.6	0.4	100.0
number of employee	71.0	29.0	100.0
Value added	59.3	40.7	100.0

Source: INSTAT, authors' calculations.

Analyzed data suggest that the majority of SMEs in 2011 were mainly focused on the trade sector and services sector. SMEs in these sectors account for 45.6% and 25.4% of total enterprises, respectively. Meanwhile, in industry, telecommunications and construction sectors, SMEs account for 12.4%, 11.6% and 4.7%, respectively, of the total enterprises non-financial private sector. By number of employees, SMEs in the trade sector and services sector again contribute more than other sectors. In terms of value added, the industry sector contributes most, due to the activity of large enterprises versus SMEs.

An interesting fact is that, despite the increase in the total number of employees by the private sector, the number of employees per enterprise has decreased (Table 3) for both SMEs and large enterprises. Thus, from 2.61 workers per enterprise in 2006, there was a gradual decline to 2.55 employees per enterprise for the SMEs in 2011, with the sharpest decline for the SMEs registered in 2009. However, given the important role of SMEs in the overall employment by the private sector, marginal changes in SMEs' employment are crucial for the total employment and enterprises. Meanwhile, large enterprises employed about 253.6 workers per enterprise in 2011, compared to about 295 employees per enterprise in 2006. The lowest number of employees for large enterprises was noted in 2010.

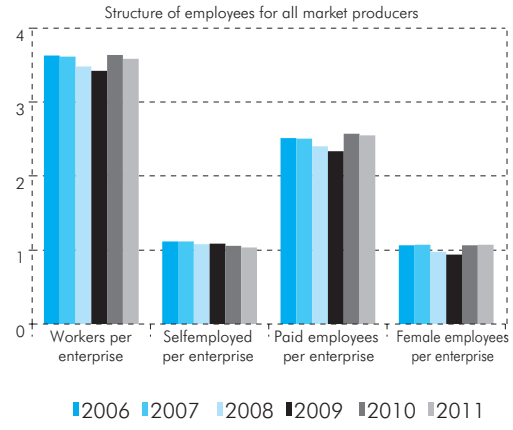
Table 3: Size of enterprises, based on the average number of workers per enterprise

	2006	2007	2008	2009	2010	2011
SME	2.61	2.56	2.48	2.46	2.64	2.52
Large	294.98	276.91	269.94	258.33	238.79	253.56

Source: INSTAT, authors' calculations.

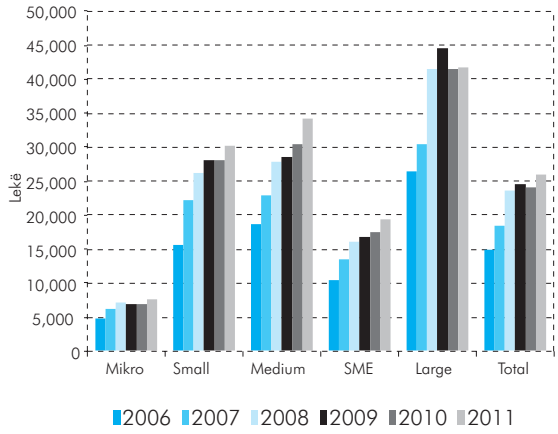
Another component taken into consideration in the analysis is the employment structure per enterprise, based on their employment criteria. Therefore, if the overall private sector employs, on average, 3.5 workers per enterprise, about 30% of them are self-employed, and 70% are paid employees. Analyzed by gender, there is a lower participation of female employees; on average, there is only one female employee per enterprise, and this structure has remained almost unchanged throughout the whole period under consideration.

Chart 1. Structure of employees in the non-financial private sector



Source: INSTAT, author's own calculations.

Chart 2. Average monthly wage by size of enterprise



Source: INSTAT, author's own calculations.

Another evidence taken into consideration relates to salary levels and differences that exist by size and sector. Thus, despite the fact that micro enterprises employ the majority of the individuals, the average salary for the employees in these enterprises is almost 8 times lower than the average salary for employees in large enterprises. Moreover, SMEs have on average a salary level 1.5 times lower compared to the average salary level of employees working for large enterprises, pointing to the importance of the intensity of capital usage by each sector. Based on sectoral level[6], throughout 2011, wages in large enterprises (mostly from the transport sector) were 1.7 times higher compared to the total of enterprises, whereas employees of SMEs from all sectors are paid almost 50% less compared to large enterprises.

Given the importance of SMEs in the overall economy, it becomes crucially important to consider their performance during the period under consideration, as well as the impact of the recent crisis on their performance. Next, we will present a more detailed analysis on the growth rates for the number of enterprises, number of persons employed, gross value added, labor productivity and profit ratio and propensity to invest over the period 2007-2011.

Table 4. Growth rates for enterprises, number of employees and value added.

	Micro	Small	Medium	SME	Large	Total
Enterprises (growth rates %)						
2007	12.1	20.0	7.3	12.6	23.6	12.6
2008	10.7	2.4	12.1	10.2	7.7	10.2
2009	6.4	10.3	10.5	6.7	6.3	6.7
2010	1.7	7.0	11.5	2.2	15.0	2.3
2011	4.0	5.8	1.0	4.1	1.5	4.1
Number of employees (growth rates %)						
2007	10.5	14.3	7.1	10.5	16.0	12.1
2008	5.9	7.9	6.8	6.5	5.0	6.1
2009	4.8	6.6	9.2	6.2	1.7	4.9
2010	7.9	10.4	12.7	9.6	6.3	8.6
2011	-1.6	3.7	2.7	0.6	7.7	2.6
Value added (growth rates %)						
2007	12.2	28.6	34.9	23.3	19.9	21.7

[6] *Refer to Chart 4, in Appendix 1.*

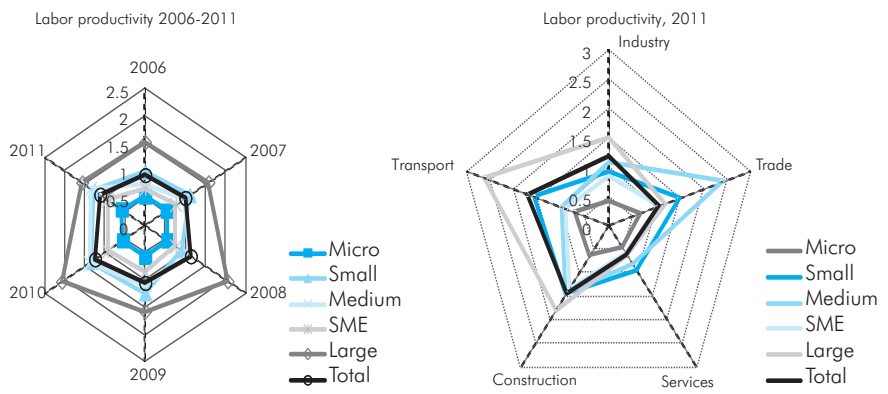
2008	9.3	-11.0	21.9	6.4	36.9	20.6
2009	9.2	45.8	9.4	19.1	-21.7	-2.4
2010	3.0	18.9	41.4	20.0	39.3	28.1
2011	3.7	-1.7	1.2	1.0	-18.4	-7.9

Source: INSTAT, authors' calculations.

Growth rates of the number of enterprises, number of employees and value added show that SMEs are characterized by positive growth rates of these indicators, clearly indicating their positive contribution to employment, entrepreneurial level and value added, taking into account their large share over total enterprises. Year 2011 seems to be characterized by lower rates of employment growth by SMEs, mostly caused by the negative growth rates of micro enterprises, employing on average about 40% of the total employees of the private non-financial sector. Whereas the negative values of value added growth rates are mostly affected by the negative contribution of large enterprises versus the positive contribution of SMEs.

Our analyses have also taken into consideration the labour productivity indicator measured as the ratio of value added over the number of employees. It can be noticed that large enterprises are characterized by a higher level of labour productivity throughout the whole period 2006 - 2011. At the sectorial level, higher productivity characterizes large enterprises in transportation sector compared to the rest of the sectors, throughout the whole period under consideration.[7]

Chart 3. Labour productivity by size and sector



Source: INSTAT, authors' calculations.

In addition to the above indicators, we have taken into consideration businesses' confidence on future economic developments, by analyzing their level of investment, more precisely their propensity to invest based on enterprises' size and the sector they operate in. The outcomes show that, on average, micro enterprises have a lower level of propensity to invest compared to other enterprises. Meanwhile, medium-sized enterprises and large enterprises have almost the same level of propensity to invest. The

[7] *Refer to Chart 5 in Appendix 1 for the agreegated data on sectoral productivity.*

impact of the financial and economic crisis seems to have contributed to lowering the enterprises propensity to invest, since 2008 affecting almost all types of enterprises (Table 5). At sector level[8], the 2011 data show that construction and industry sectors have a higher level of propensity to invest scoring an investment level of 64.5% and 36.9%, respectively, out of their value added. The trade sector tends to have the lowest level of propensity to invest, with only 17.5% of value added.

Table 5: Propensity to invest by enterprise size (in percentage)

	2006	2007	2008	2009	2010	2011
Micro	8.8%	11.2%	13.4%	23.1%	9.6%	9.0%
Small	29.4%	55.4%	33.4%	36.6%	31.6%	43.5%
Medium	52.0%	44.3%	58.2%	28.1%	26.4%	29.1%
SME	26.6%	35.0%	33.7%	29.1%	22.8%	27.2%
Large	61.4%	34.8%	31.9%	43.5%	27.9%	59.1%
Total	43.0%	34.9%	32.7%	35.2%	25.1%	40.2%

Source: INSTAT, authors' calculations.

The propensity to invest, certainly, depends on the profit level of each enterprise, where profits are considered as an important source of future investments. We have calculated profit rates as a ratio over enterprises total income. Results show positive and growing rates of profit ratio throughout the 2006-2011 period. Micro enterprises seem to have a higher profitability rate over total revenue compared to all other enterprises. In 2011, SMEs appear to have a higher profit rate compared to large enterprises, indicating, thus, a better performance compared to larger enterprises, and a higher propensity to invest for 2012.

In terms of sectoral level data[9], the profit ratio as proportion to income suggests that, during 2006-2011, SMEs in the services, trade and industry sectors have shown, on average, positive profit rates higher than those for large enterprises operating in the same sectors. In terms of profit ratios large enterprises have, on average, performed better than SMEs, mainly in construction, telecommunication and transport sectors. A picture on 2011 data shows that all SMEs from all sectors had higher profit rates than large enterprises, pointing out to growing confidence in the country's economy and a greater propensity to invest in the future.

Table 6: Profit Ratio by enterprise size (in per cent)

	2006	2007	2008	2009	2010	2011
Micro	15.0	16.0	16.6	16.3	16.2	18.0
Small	7.1	6.9	6.7	8.3	9.6	8.0
Medium	6.0	7.0	8.4	7.8	9.0	8.6
SME	9.5	9.7	10.0	10.2	11.0	10.3
Large	15.3	16.2	15.0	9.4	14.4	6.5
Total	11.1	11.7	11.7	10.0	12.1	9.0

Source: INSTAT, authors' calculations.

[8] *For data sectoral level, refer to Table 8 in Appendix 1.*
[9] *Table 9 in Appendix 1.*

4. CONCLUSIONS

The stimulation and development of SMEs, especially after the crisis has become part of the strategies, not only in developing countries but also in the EU member countries, aiming thus the stimulation of employment and the growth of value added. Based on the above analysis, we conclude that overall SMEs represent the majority of enterprises in the Albanian economy, accounting for about 99.8% of the total number of enterprises. They have shown a growing trend in terms of number of enterprises in the economy, positively contributing to the increased number of employees. SMEs employ, on average about 71.3% of the total number of employees in the private non-financial sector. They also provide, on average, about 54.2% of total value added. At sectoral level, we identify that the majority of SMEs are mainly concentrated in the trade and services sectors. An interesting fact is that despite the contribution on the overall employment, employees working for SMEs are paid (on average) 1.5 times less than employees working for large enterprises, whereas employees working for micro enterprises are paid 8 times less.

Generally, throughout the 2006-2011 period, SMEs were characterized by efficiency in terms of value added and in profit rate terms, although, we evidence a lower productivity level compared to large enterprises. At the sectoral level, it seems that the productivity of transport and communication sectors has led the productivity of all other sectors throughout the entire period 2006-2011. Although the period of analysis on enterprises in the Albanian economy coincides with the period of global economic crisis, this has not prevented (at least until the period under consideration) private enterprises and their propensity to invest in their businesses, indicating a certain confidence level of enterprises in future economic developments. We also note that despite the increased number of total employees in the economy, the number of employees per enterprise has decreased for both SMEs and large enterprises. Despite the fact that employment changes for SMEs are marginal, their impact on overall employment is significant, given their large share in total employment.

All the above features provide consistent evidence that SMEs have played an important role in the Albanian economy. Therefore, in an environment characterized by increased uncertainties coming also from the international arena, the development of progressive and efficient national strategies and policies to promote and stimulate SMEs in Albania becomes a necessity for future policymaking.

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APPENDIX 1

Table 7-A: Number of enterprises, employees and value added for the sector as a ratio to the total number of enterprises, employees and value added, by enterprise size.

		2006			2007			2008	
Industry	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	11.0	0.2	11.2	11.7	0.2	11.9	11.9	0.2	12.1
Number of employee	15.4	19.4	34.7	15.4	18.7	34.1	14.9	17.6	32.5
Value added	8.9	21.3	30.2	9.5	17.6	27.1	8.5	24.4	32.9
		2006			2007			2008	
Trade	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	50.0	0.0	50.0	49.7	0.0	49.7	49.3	0.0	49.4
Number of employee	24.0	0.7	24.7	24.7	1.2	25.9	25.3	1.5	26.8
Value added	18.7	2.2	20.9	21.0	2.0	23.0	16.7	1.6	18.3
		2006			2007		2008	2008	
Services	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	23.5	0.0	23.6	23.4	0.1	23.5	24.1	0.0	24.1
Number of employee	14.9	2.2	17.1	14.4	2.5	16.8	14.5	2.1	16.6
Value added	8.0	2.0	10.0	7.9	1.8	9.7	7.6	1.5	9.0
		2006			2007			2008	
Construction	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	5.3	0.0	5.4	4.8	0.0	4.9	4.1	0.1	4.1
Number of employee	12.6	1.8	14.4	11.3	2.8	14.1	11.2	3.6	14.8
Value added	12.9	2.2	15.0	11.2	6.5	17.7	9.7	8.6	18.3
		2006			2007			2008	
Transp. Comunication	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	9.8	0.0	9.9	10.0	0.0	10.0	10.2	0.0	10.3
Number of employee	4.6	4.5	9.1	4.7	4.3	9.0	5.0	4.3	9.3
Value added	4.5	19.4	23.9	4.0	18.5	22.5	4.9	16.6	21.4
		2006			2007			2008	
Total of Sectors	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	99.7	0.3	100.0	99.6	0.4	100.0	99.6	0.4	100.0
Number of employee	71.6	28.4	100.0	70.6	29.4	100.0	70.8	29.2	100.0
Value added	52.9	47.1	100.0	53.6	46.4	100.0	47.3	52.7	100.0

Source: INSTAT, author's own calculations.

Table 7-B: Number of enterprises, employees and value added for the sector as a ratio to the total number of enterprises, employees and value added, by enterprise size.

		2009			2010			2011	
Industry	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	11.3	0.2	11.5	12.0	0.2	12.2	12.4	0.2	12.6
Number of employee	14.6	16.3	30.9	15.3	15.7	31.0	14.8	16.2	31.1
Value added	9.4	13.0	22.5	9.8	26.2	36.1	11.0	21.7	32.7
		2009			2010			2011	
Trade	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	48.3	0.0	48.4	46.7	0.0	46.7	45.6	0.0	45.6
Number of employee	25.2	1.5	26.7	24.4	1.5	25.9	24.4	1.6	26.0
Value added	23.0	1.5	24.5	17.7	1.7	19.4	22.9	1.7	24.6
		2009			2010			2011	
Services	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	24.6	0.1	24.7	25.5	0.1	25.6	25.4	0.1	25.4
Number of employee	15.3	3.1	18.3	15.4	3.9	19.4	16.1	4.2	20.3
Value added	9.0	1.8	10.8	8.6	1.9	10.4	8.8	2.4	11.2
		2009			2010			2011	
Construction	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	4.4	0.1	4.5	4.0	0.1	4.1	4.7	0.1	4.8
Number of employee	11.4	3.2	14.5	10.2	2.5	12.7	10.1	2.2	12.3
Value added	12.2	8.4	20.6	13.4	5.2	18.7	12.1	3.5	15.7
		2009			2010			2011	
Transp. Comunication	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	11.0	0.0	11.0	11.4	0.0	11.4	11.6	0.0	11.6
Number of employee	5.3	4.2	9.5	7.0	4.1	11.0	5.5	4.8	10.4
Value added	4.1	17.5	21.6	4.5	10.9	15.4	4.5	11.3	15.8
		2009			2010			2011	
Total of Sectors	SME	Large	Total	SME	Large	Total	SME	Large	Total
Number of enterprises	99.6	0.4	100.0	99.6	0.4	100.0	99.6	0.4	100.0
Number of employee	71.7	28.3	100.0	72.3	27.7	100.0	71.0	29.0	100.0
Value added	57.7	42.3	100.0	54.1	45.9	100.0	59.3	40.7	100.0

Source: INSTAT, author's own calculations.

Table 8: Propensity to investment by sector (2011).

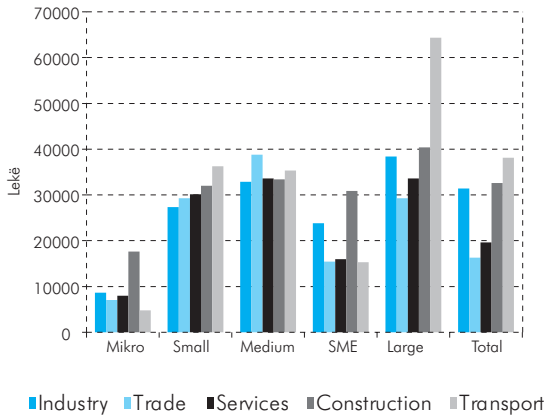
	Industry	Trade	Services	Construction	Transport
Micro	14.0	6.6	6.1	62.1	4.5
Small	73.4	22.0	117.5	28.0	18.3
Medium	33.8	22.5	18.4	36.2	11.4
SME	41.6	15.5	38.2	34.4	10.2
Large	76.1	43.5	25.4	45.3	40.5
Total	64.5	17.5	35.5	36.9	31.8

Table 9: Profitability ratio over revenues by enterprise size.

			Industry			
	2006	2007	2008	2009	2010	2011
SME	9.1%	8.9%	10.3%	13.6%	12.9%	10.5%
Large	9.7%	11.3%	6.4%	-1.7%	18.4%	5.9%
Total	9.4%	10.2%	7.8%	4.3%	16.4%	7.6%
			Construction			
	2006	2007	2008	2009	2010	2011
SME	14.4%	13.7%	14.0%	14.4%	20.0%	18.5%
Large	14.9%	22.9%	24.1%	15.2%	19.3%	13.1%
Total	14.5%	16.3%	17.6%	14.6%	19.8%	17.2%

			Transport and Comunication			
	2006	2007	2008	2009	2010	2011
SME	13.4%	13.4%	16.9%	16.4%	18.4%	17.3%
Large	32.4%	33.4%	41.2%	30.5%	16.7%	8.5%
Total	27.3%	27.2%	32.2%	26.8%	17.2%	11.4%
			Trade			
	2006	2007	2008	2009	2010	2011
SME	6.6%	7.3%	7.5%	7.0%	6.7%	7.7%
Large	2.5%	3.5%	2.9%	1.5%	2.6%	4.3%
Total	6.3%	6.8%	6.9%	6.4%	6.1%	7.2%
			Services			
	2006	2007	2008	2009	2010	2011
SME	12.2%	11.4%	12.4%	14.1%	16.7%	14.7%
Large	10.4%	14.5%	11.5%	4.0%	18.6%	7.2%
Total	11.5%	12.7%	11.9%	9.3%	17.6%	11.0%

Chart 4. Monthly salary per employee, in sectoral level 2011



Source: INSTAT, author's own calculations.

Chart 5. Labour productivity by enterprises size in the sector level

Source: INSTAT, author's own calculations.

FOREIGN CURRENCY DEPOSITS AND RECENT EUROIZATION TRENDS

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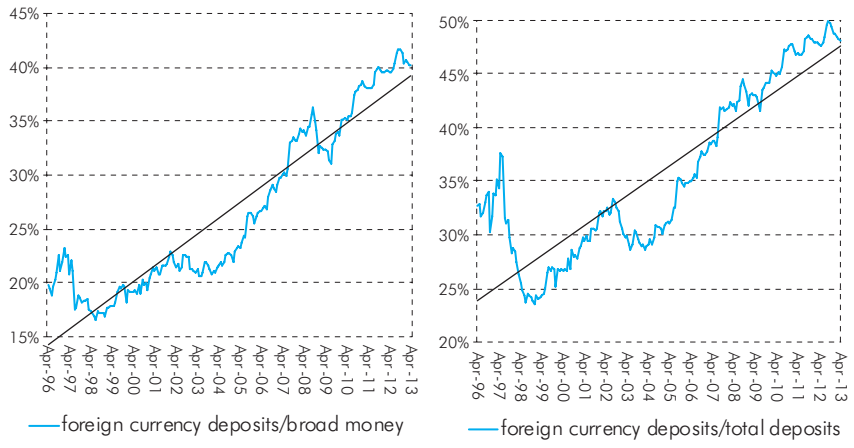
INTRODUCTION

The Albanian banking system has constantly experienced high euroization[1] of both its assets and liabilities. One classic measure of banking system euroization is the ratio of foreign currency deposits to broad money. When this ratio exceeds the benchmark of 30%, the corresponding banking system is considered as highly euroized (Balino et al, 1999). In this respect, the ratio for the Albanian banking system in the last five-six years has been continually recording higher rates than this benchmark, being classified therefore among the highly euroized economies. The ratio of foreign currency deposits to the total stock of deposits has been gradually increasing and the former makes up for almost half of the total stock of the latter.

As the effects of the global financial crisis were spreading out in the domestic economy, the banking system experienced a withdrawal of deposits in the last quarter of 2008 and the first half of 2009. The stock of foreign currency deposits was the one mostly affected by the withdrawal. These developments, in turn, affected the structure of broad money, as the share of foreign currency deposits to broad money (M3) in July 2009 slumped to 31%, the lowest ratio recorded in the last five years. However, with deposits flowing back to the banking system and the full recovery of the total stock, this ratio has been consistently following a growing pattern. At the end of 2012, the share of foreign currency deposits to M3 reached 40.4%.

Chart 1. Indicators of the euroization of the banking system



Source: Bank of Albania.

[1] *Initially dollarization and then euroization with the introduction of the euro*

SOME OF THE FACTORS AFFECTING EUROIZATION RATES

High rates and main causes of euroization, a persistent concern for many countries worldwide, have also been addressed in various studies and research works of the Bank of Albania. Theory suggests that following episodes of high inflation or sudden depreciation of the domestic currency[2] – when the domestic currency does not fulfill its function as store of value – economic agents like banks or their clients, spontaneously shift part of their business portfolio or financial assets from domestic currency to foreign currency.[3] Hence, the high rates of inflation recorded in the beginning of the 1990s have probably been the very origins of this phenomenon. But, as inflation rates and other macroeconomic indicators were stabilized, foreign currency was extensively used for transactions, while other factors affected the growth of euroization rates along the way. In the verge of the inception of open markets and free movement of goods, capital and people, the foreign currency inflows of the balance of payments started to grow rapidly. Albanian emigrants abroad, mainly in Greece and Italy, sent their savings back home in the form of remittances. The share of these monetary flows that was channelled into the banking system was deposited in the original currency, increasing therefore the euroization ratio. Meanwhile, the high credit rates to the economy in foreign currency, most of the time fueled by the high available stock of foreign currency deposits, has mainly served as a feedback loop in the system. In addition, the high demand for foreign currency loans, given the favorable foreign currency interest rates, expectations of economic agents for a stable exchange rate and the elastic supply of the banking system to satisfy the market needs, have also been part of the reason of increased euroization rates.

Beyond analyzing the factors that might have caused euroization in its very origins, the main focus of this study is to examine the euroization tendency after the spillover of the global financial crisis in the domestic economy and, more specifically, analyze the relationship between the growth in foreign currency deposits and the reduction of foreign currency cash outside banks (COB). Survey results on the portfolio of household financial assets show that the share of foreign currency deposit growth has been sustained due to the shift of household foreign cash in circulation as deposits into the banking system.

DEPOSITS AND FOREIGN CURRENCY CASH OUTSIDE BANKS

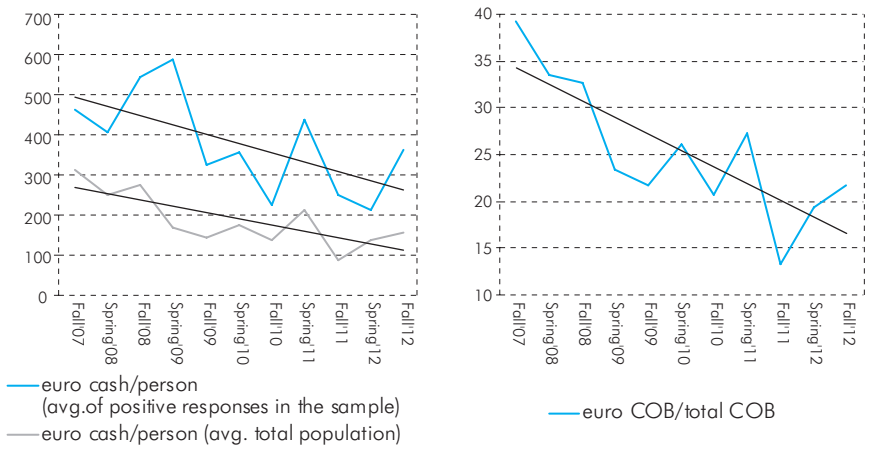
The shift of foreign currency cash into deposits is another indicator of the gradual restoring of economic agents' confidence in the banking system. The amount of foreign currency cash in circulation is generally unknown (Hellerstein, Ryan 2011) and estimating the exact amount of cash holdings

[2] *Or fluctuations of the exchange rate in general*

[3] *Yeyati (2005) differentiates between de jure euroization (use of foreign currency as legal tender) and de facto (use of foreign currency in addition to domestic currency, when the former is not used as legal tender).*

in foreign currency in an economy is a very challenging task,[4] usually with some degree of uncertainty. Foreign currency cash holdings in an economy may be estimated either through surveys with domestic economic agents (Luçi, Muço, Sojli 2005) or through other methods used by economists such as measuring the wholesale physical shipment of money (USD) to other countries (Hellerstein, Ryan 2011), measuring money transfers from abroad (Feige et al, 2002), and a variety of other methods. The surveys referred to in this study[5] are conducted regularly twice a year through interviews with 1088 households, aged 15 years old and above. The sample is selected through the method of stratified random sampling. They include estimations on the use of euro cash in circulation, as the currency that has been extensively used not only in Albania, but also throughout the Central and Southeast Europe. This inclination of households in holding their cash in euro – and not as much in other foreign currencies – is also compatible with the statistical data of the banking system, as they show that the share of the euro deposits to the total stock of foreign currency deposits stands at around 80%.

Chart 2. Projections of cash in euro; currency substitution index



Source: Bank of Albania; National Bank of Austria.

Despite the fluctuations within a given year, surveys show a decreasing tendency of euro cash holdings by economic agents in the long run. This trend has been confirmed as well by the data on euro cash holdings per person and, consequently, the estimated stock of the total cash holdings in euro. Data shows that in the fall of 2012,[6] the average amount of euro cash per person – as assessed by households reporting to hold cash in euro – was around 363 euro/person. Projections for euro cash holdings for the whole

[4] *The monetary authority has the exclusive right of issuing domestic currency and as such able to determine and measure only the cash outside banks in domestic currency; in the case of Albania only the amount of cash in lek.*

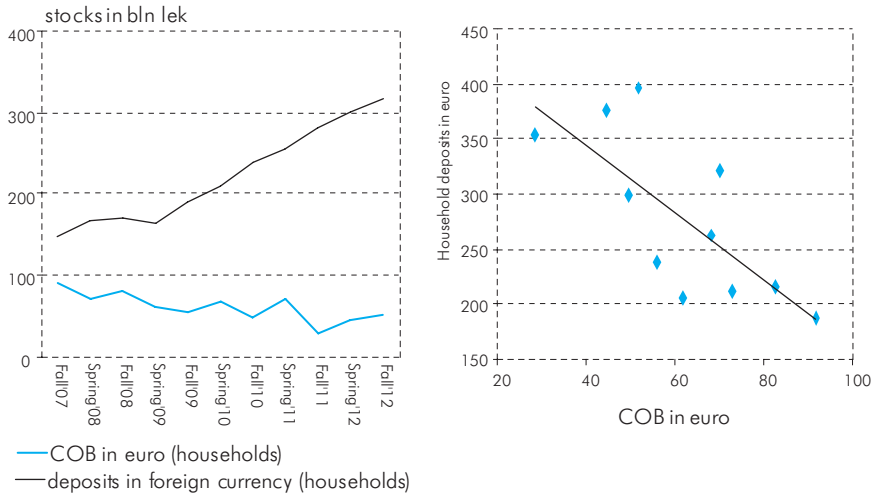
[5] *Projections of foreign currency cash estimations in Albania (and the region) are found in OeNB Euro Survey series of publications of the National Bank of Austria*

[6] *This period in the survey corresponds to data of October-November, while data for spring correspond to period May-June.*

population above 14 years old amounts to 155 euro/person.[7] Fluctuations of the euro cash holdings in the short run reflect the current liquidity needs of households at various times of the year. Typically, there seems to be a higher demand for liquid cash balances during springtime. However, due to the very short series of data and the fact that the survey is conducted only twice a year, it is quite challenging to define a seasonal pattern of the COB circulation in euro.

Towards the end of 2007,[8] the currency substitution index measured as the ratio of cash in euro to the total cash outside banks – including cash in domestic currency – stood at around 39%. Within five years, this ratio has been reduced by almost 17 percentage points, as euro cash holdings to total cash outside banks at the end of 2012 stood at around 22%.[9] The total stock of currency outside banks has been decreasing, but the reduction of euro cash held by households seems relatively higher to the reduction of their cash holdings in domestic currency.

Chart 3. Euro cash holdings and foreign currency deposits



Source: Bank of Albania; National Bank of Austria* (*OeNB Euro survey).

The decreasing trend of euro cash seems to be correlated with an expansion of household deposits in foreign currency, as given by the scattered diagram in the Chart 3. Theory suggests that euroization might be increasing in periods of high confidence in the banking system, indicating, on the one hand, the growth of total deposits in foreign currency and, on the other,the reduction of cash in foreign currency (Nicolo et al.2003). Compared to the end of 2007, the stock of total household deposits of the banking system in foreign currency has expanded by almost ALL 210 billion. The total stock of households' cash in euro, despite at a slower pace, has been almost reduced to half for the same period, decreasing by almost ALL 40 billion, or 20% of deposit inflows.

[7] *These estimations might have a systematic downward bias due to the sensitivity of survey questions and the tendency of economic agents to report less than their real cash holdings*

[8] *This period corresponds to the start of the OeNB euro surveys on euro cash holdings.*

[9] *The total COB referred to includes only lek and euro cash holdings, not accounting for other foreign currencies as their use is negligible in comparison.*

While showing an increased confidence in the banking system,[10] these developments count towards a more formalized relation between the economic agents and the banking system. The reduction of euro cash holdings is a positive development as it helps better track liquid money, i.e. "high powered" money in the economy.[11] Among others, the channeling of euro cash into the banking system has also improved the liquidity of the banking system in foreign currency. A banking system with ample liquidity has better chances to increase the intermediation of these funds into the economy. Financial intermediation is important in supplying economic agents with monetary assets and meeting their needs for liquidity, consumption and investment. Accomplishing this "mission" is immensly important to the economy, especially since late 2008 when the financial intermediation rates started to slow down consistently.

IN PLACE OF CONCLUSIONS

The implications and the disadvantages of the euroization of the financial assets in the Albanian banking system have been widely discussed by Luçi, Muço, Sojli (2005). However, an expansion of foreign currency deposits due to the partial shift of household savings – formerly held in cash – to deposits into the banking system is a positive and welcome development. The channeling of cash outside banks into the banking system helps to better track foreign currency flows that are usually very difficult to estimate quantitatively. It also helps to establish a stronger bond between economic agents and financial institutions, hence reducing informality and improving banking system liquidity. Beyond the advantages related to the expansion of foreign currency deposits through this channel, further empirical analysis of factors affecting euroization rates in the Albanian banking system remain one of the most important issues to be addressed in forthcoming studies.

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[10] *Also supported by a gradual decrease of the COB/Albanian lek deposits ratio after July 2009, when it recorded its highest value.*

[11] *Monetary base or reserve money, otherwise known as high powered money, includes currency outside banks in Albanian lek as its main component with a share of more than 60%, as well as the required reserves of the banking system held by the monetary authority.*

BANK OF ALBANIA NEWS JANUARY-JUNE 2013

Round table with banking system with business representatives

In the framework of establishing a continuous dialogue of partnership with market agents, the Bank of Albania, in cooperation with the Albanian Association of Banks and Business Albania, organised on 4 March 2013 a forum on "Lending to the economy and the long-term soundness of the banking system".

During the proceedings of the forum, participants discussed on the new package of recent measures by the Bank of Albania, which aims to boost bank lending.

Albania Financial Forum

On 9 April 2013, the first meeting of the Albania Financial Forum, a host country cross-border banking forum, was held in Tirana yesterday. The meeting was organised under the auspices of the Governor of the Bank of Albania Mr. Ardian Fullani and co-organized with the International Monetary Fund. It brought together the main banking groups operating in Albania, their subsidiaries, banking regulators from Austria, France, Turkey, and Italy. The Albanian Minister of Finance Ridvan Bode participated and discussed in the forum. Representatives of the World Bank, the European Bank for Reconstruction and Development, the European Banking Authority, and the European Central Bank also attended.

Participants discussed prospects for the Albanian economy and financial system, local bank strategies, the role of Albanian subsidiaries in the operations of the banking groups, and the implications of broader international banking initiatives. There was a frank discussion of the challenges that the participants face in their activity. A special session was devoted to improving financial intermediation in Albania.

Governor of the Bank of Albania, Ardian Fullani, is appointed member of Vienna Initiative 2 Steering Committee

As from 2013, the Governor of the Bank of Albania, Mr. Ardian Fullani, is a member of Vienna Initiative 2 Steering Committee.

Considering that Albania is the only non-EU member country with a membership in Vienna Initiative 2 Steering Committee, it is committed to represent the interests of countries aspiring to join the EU. Albania will therefore play an important role in enhancing cooperation between EU and non-EU member countries.

The Vienna Initiative 2 follows the success of Vienna Initiative 1, which was launched at the height of the global financial crisis of 2008-09. It continues to use the public-private sector platform, which brings together major international financial institutions, the European Commission and other EU institutions, the largest international banking groups, and home and host country authorities, to complement the other initiatives.

Its geographical reach exceeds the EU borders and includes Central, Eastern and South-Eastern European countries, with an influential presence of Western banks.

Against this background, the objective of the Vienna Initiative 2 is to help: avoid disorderly deleveraging; ensure that potential cross-border financial stability issues are resolved; and achieve policy actions, notably in the supervisory area, that are taken in the best joint interest of home and host countries.

Friday Seminar held at the University of Tirana, Faculty of Economics

The Friday Seminar was held on 16 April 2013 at the Faculty of Economics, University of Tirana, under the aegis of the Governor of the Bank of Albania, Mr. Ardian Fullani, and the Dean of the Faculty of Economics, Mr. Sulo Hadëri.

Lecturers and students of the Faculty of Economics, as well as representatives of the Bank of Albania attended this seminar and presented a paper on "A financial model for Albania: An approach to panel data".

Further discussions about various macroeconomic models, their implementation and importance for the decision-making process in the case of Albania, indicate that the goal of the seminar was met, serving as a communication bridge between both institutions.

Activities by the Bank of Albania in the framework of the Orphans' Day

On 27 May 2013, the Bank of Albania organised social, humanitarian and educational activities in the Infant's Home and in the Children's Home "Zyber Hallulli", Tirana.

Along with the activity in the Infant's Home in Shkodra, they were organised in the light of principles of Social and Institutional responsibilities the Bank of Albania, promotes. As part of such activities, the Bank of Albania organised on 5 June 2012 an activity on: "Green economy: Does it include you?" as well as, different activities held on the occasion of the anniversary of the Albanian currency.

During May 2013, in the framework of the Orphan Day, the employees of the Bank of Albania donated toys and monetary contributions for the children in the orphanages of Shkodra and Tirana.

During the activities at Zyber Hallulli chilrens' home the Governor of the Bank of Albania, Mr. Ardian Fullani answering to the children's curiosity, explained to them the role of the Bank of Albania institution, the main concepts behind its key functions, and Bank of Albania's impact on the Albanian society.

On this occasion, the Governor introduced "1, 2, 3, ... Çufo piglet is learning to save", the newest educational set designed by the Bank of Albania. The set, which will be provided for free by the Bank of Albania to the public and private schools in Albania for I, II and III graders, consists in a book of short stories about Çufo, the little piglet, workbook and teachers' book.

Governor and high-level delegation of the Central Bank of the Republic of Turkey visit the Bank of Albania

On 30 May 2013, a high-level delegation of the Central Bank of the Republic of Turkey, headed by its Governor, Erdem Basci, paid an official visit to the Bank of Albania.

During the meeting with the Governor of the Bank of Albania, Ardian Fullani, both governors discussed the most recent developments in the respective economies. Governor Fullani introduced Governor Basci to the measures taken by the Bank of Albania with a view to maintain price stability and foster a sound banking system.

Both governors agreed on strengthening bilateral cooperation between the two institutions further, mainly in the field of monetary policy and financial stability.

Following the meeting, the two governors attended the opening of the exhibition of paintings from the collection of the Central Bank of the Republic of Turkey entitled "Time and Places, Istanbul". The exhibition was open until 14 July 2013 at the Albanian National Arts Gallery.

Friday seminars

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

During the first half of 2013, the Friday Seminar welcomed ten presentations by the Bank of Albania's experts and other researchers from the academia in Albania and abroad. These presentations covered various issues, such as fiscal policy and monetary policy, business cycle and banking sector performance, perception of finanicial literacy, etc. The following section provides a more detailed summary of these papers.

Fiscal sustainability in european union and potential candidate countries, by Gerti Shijaku (Research Department)

This paper focuses on the long-run mean-reverting properties of debt-to-GDP ratio in the EU-27 and in potential candidate countries for the period 2000-2011. The paper evaluates the solvency condition by means of panel unit root, and estimates the fiscal policy reaction function in relevant countries, using a VAR approach with panel data. Findings show that the fiscal policy exhibits substantial inertia, and that fiscal authorities react systematically to increasing debt-to-GDP ratio, while generating future surpluses.

Synchronization of business cycles: A measurement of integration for eastern european countries, by Endrit Yzeiraj (Research Department)

This paper aims to measure the level of integration between economies of the region, using macroeconomic indicators and a methodology based on

the Blanchard and Quah (1989) decomposition for structural VARs. Results suggest that synchronization of supply and demand shocks between regional economies is low, but with demand shocks being more synchronized than the supply ones. A main factor explaining these findings relates to the role of the trade channel compared to other structural channels.

The impact of stochastic trend on economic fluctuations in Albania, by Bledar Hoda (Research Department)

This paper analyzes the characteristics of main macroeconomic indicators within business cycle models. The purpose is to confirm whether they are consistent with productivity-oriented balanced growth and to estimate the role the stochastic trend and cycle play towards economic growth. Based on the Structural Error Correction Model, this study finds that stochastic trend related permanent shocks cause larger fluctuations compared with the trend obtained by standard statistical filters.

J-Curve effect. The effect of exchange rate on bilateral trade balance between Albania and its main trade partners, by Alban Pllaha (Research Department)

This paper addresses the impact of exchange rate fluctuations on bilateral trade flows between Albania and its main trade partners including: the euro area, Italy, Greece, Germany, and Turkey, with the aim to identify a possible J-curve effect during the period 1998-2012. The Error Correction Model methodology determines the short and long-term effects on bilateral trade between Albania and its main partners as a result of the domestic currency depreciation.

A financial model for Albania: A panel data approach", by Elona Dushku (Research Department) and Vasilika Kota (Financial Stability Department)

The paper presents a financial model for the case of Albania based on detailed analysis of balance sheets of 16 banks operating in Albania. The model includes 35 equations of which 8 are estimated equations and 27 are identities. The variables that are estimated through panel data including: credit volume (for households and businesses), net income generated from interest, credit risk, non-performing loans ratio (for households and businesses), credit interest rate, and credit cost. Simulations and various shock analyses estimate the transmission mechanism of the model to indicators of banking soundness and the impact on Albania's real economy.

Globalisation, exchange rate regimes and financial contagion, by Branko Urošević (Central Bank of Serbia)

The recent financial crisis showed the fragility of the international financial architecture while highlighting two important issues in terms of financial stability: the optimal level of financial linkages and determination of the appropriate exchange rate regime between two countries, in order to ensure financial stability of many countries together. The paper supports and addresses the

issues raised above in the context of the DD model, while simultaneously assessing the above-mentioned phenomena.

*On other aspects regarding pbc (political business cycles): Political business cycles and expectation*S, by Drini Imami (Tirana Agricultural University), Holger Kächelein (SouthEast Europe Center for Economic Development) and Endrit Lami (Ph.D. candidate at Budapest University)

The paper analyzes political business cycles in Albania and their impact on various macroeconomic indicators applying the ARMA model. The results show that good expectations for economic growth prior to political elections and expectations regarding their impact after the elections might influence the decision-making process of private sector enterprises.

The role of money as an important pillar for monetary policy: Case of Albania, by Gerti Shijaku (Research Department)

The main focus of this paper is to estimate the money demand function and the velocity of broad money, M3, in the medium and long-term, while taking into consideration the role of money as the second important pillar for the monetary policy of the Bank of Albania. The results show that demand for money is stable, even in the aftermath of the financial and economic crisis, and that money contains important information for inflation developments in the future.

Performance of inflation forecast and monetary policy decision-making during 2011-2012, by Evelina Çeliku, and Gent Hashorva (Monetary Policy Department)

This study analyzes the performance of the inflation forecasting process and its role in the monetary policy decision-making of the Bank of Albania, during the period 2011-2012. The paper identifies the main challenges that are faced in the forecasting process, especially in periods of high economic uncertainties, focusing on published inflation, realized projections, expectations, and their role in the implementation of the monetary policy.

Financial literacy in Albania: Survey results on measuring the financial literacy of the population, 2011, By Kliti Ceca and Borana Haxhimusaj (Research Department), Arlinda Koleniço and Egnis Isaku (Foreign Relations, European Integration and Communication Department)

The report presents the results collected from "The survey measuring the financial literacy of the population in Albania during year 2011", organized for the first time by the Bank of Albania in cooperation with the Bank of Italy. Results of this survey reveal the main trends regarding individuals' financial literacy and their behaviour and stance towards personal or household finance management in Albania.

Financial literacy in Albania: Survey results on measuring the financial literacy of the population, 2011", by Kliti Ceca and Borana Haxhimusaj (research department), Arlinda Koleniço and Egnis Isaku (Foreign Relations, European Integration and Communication Department)

Identifying gaps and finding appropriate ways for a more efficient approach towards the real needs of the public plays an important role in creating and adapting educational programs. Therefore, the "Survey on measuring the financial literacy of the population, 2011" was conducted, an activity in the framework of the twinning project between the Bank of Albania and Bank of Italy, funded by the European Union. Main findings of this survey shed light on financial inclusion, financial knowledge, as well as the attitudes held by Albanian respondents on different aspects of personal or household finance management. Precisely for this reason, this survey constitutes a key element in defining and outlining issues, which need to be addressed in the context of the strategy aiming to increase the financial literacy in Albania.

MONETARY POLICY DECISIONS

30 January 2013

Supervisory Council of the Bank of Albania decides to cut the key interest rate by 0.25 percentage points, bringing it to down to 3.75%.

27 February 27 March, 30 April, 29 May, 26 June 2013

Supervisory Council of the Bank of Albania decides to keep the key interest rate unchanged at 3.75%.

LEGAL NEWS, JANUARY-JULY 2013

BANKING SUPERVISION

On 17.01.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 1 Regulation on the granting of license to non-bank financial institutions. This Regulation sets out the conditions, requirements, terms, documentation and procedures for the granting of a license to non-bank financial institutions, to microcredit financial institutions, and electronic money institutions to carry out financial activities in the Republic of Albania. The Regulation stipulates that an institution may begin financial activities only upon receiving the relevant approval by the Bank of Albania.

On 17.01.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 2 Regulation "On risk management in the activity of non-bank financial institutions". This regulation sets out the rules for the management of risk in the activity of non-bank financial institutions. It shall apply on non-bank financial institutions, micro-credit financial institutions and electronic money institutions, licensed to carry out financial activities on the Republic of Albania.

On 17.01.2013, the Supervisory Council of the Bank of Albania approved the Decision No. 4 "On the prior approval for the merger by absorption of Societe Generale Albania sh.a. bank with the Sogelease Albania sh.a. non-bank financial institution". The decision grants the prior approval for the merger by absorption of Societe Generale Albania sh.a. bank (absorbing entity) with Sogelease Albania sh.a non-bank financial institution (the absorbed institution).

On 27.03.2013, the Supervisory Council of the Bank of Albania approved the Decision No. 26 "On amendments to Regulation 'On capital adequacy ratio'". The amendments envisage, among others, reporting forms on the calculation of the increase of total risk-weighted assets, according to non-resident, forex 'treasury and interbank transactions' and 'securities transactions'; calculations to decrease total risk-weighted assets and off-balance sheet items, based on the expansion of the gross domestic portfolio; and sum of asset items, sum of risk-weighted off-balance sheet items, and sum of other off-balance sheet items.

On 27.03.2013, the Supervisory Council of the Bank of Albania approved the Decision No. 27 "On amendments to Regulation 'On credit risk management'".

Following this Decision, the Article that regulates the credit restructuring terms and modalities, as well as the restructuring credit classification is amended.

On 27.03.2013, the Supervisory Council of the Bank of Albania approved the Decision No. 28 "On amendments to Regulation 'On liquidity risk management'". Amendments are made to the Article that provides for the liquidity rate. According to this decision, the bank shall calculate and comply, at any time, with liquid assets to short-term liabilities ratio in the national (lek) and foreign currencies, at the minimum level 15% and as a total at the minimum level of 20%.

On 30.04.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 33 Guidelines "On managing interest rate risk in the banking book". This Guideline sets forth the requirements and basic rules on managing interest rate risk in the banking book, the calculation methodology for the exposure to this risk and the reporting to the Bank of Albania. This Guideline shall apply on banks and branches of foreign banks, which conduct banking and financial activities in the Republic of Albania, in compliance with the licence granted by the Bank of Albania.

On 29.05.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 37 "Annual Supervision Report 2012". The report states that, during 2012, supervision was characterised by more frequent on-site supervision of banking activity preserving a balanced coordination between risk-based approach, that is, the identified risks, and available resources. The supervisory philosophy implemented during 2012 is based on key elements set forth in the medium-term development strategy of supervision, expanding their scope, for enhancing human resources capacities, the analysis methodology and regulatory framework, and the close cooperation with international authorities.

PAYMENT SYSTEMS

On 17.01.2013, the Supervisory Council of the Bank of Albania approved the Decision No. 03 "On amendments to Regulation 'On electronic payment instruments'". The amendments are made to Articles that regulate the issue of electronic money, funds recovery and loss or damage of the electronic money instruments, etc.

On 26.06.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 42 "On licencing, regulation and supervision of operators of national card payment schemes" This Regulation seeks to guarantee the security, stability, well-functioning and efficiency of national card payment schemes as an integral element of low-value payment systems. The objective is to establish criteria time frame, documentation and procedures for licensing national card payment schemes operators in Albania; granting preliminary approval by the Bank of Albania and the obligation of operators to notify the

Bank of Albania during the conduct of activity, and; regulating and supervising operators during the conduct of national card payment schemes activity.

ISSUE

On 17.01.2013, the Supervisory Council of the Bank of Albania approved the Decision No. 5 "On reprinting Albanian banknote, legal tender, denomination 5000 lek" The Decision provides for the reprinting of the Albanian banknote, legal tender, and nominal value 5000 lek, with the year of issue 2013.

On 17.01.2013, the Supervisory Council of the Bank of Albania approved the Decision No. 6 "On reminting Albanian coins, legal tender, denomination 1 lek and 10 lek" The Decision provides for the reminting of the Albanian coins, legal tender, and nominal value 1 and 10 lek, minted in 1996 and reminted in 2000, 2008, and 2009. Year of issue for these coins shall be 2013.

On 13.02.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 15 Regulation "On the authenticity checking and criteria for recycling of Albanian lek banknotes". This Regulation lays down the criteria for the authenticity and fitness checking, and recycling of lek banknotes. Entities subject to this regulation are banks and branches of foreign banks, licensed to exercise banking and/or financial activity in the Republic of Albania, as well as other specific-status entities that carry out cash operations with the Bank of Albania.

On 13.02.2013, the Supervisory Council of the Bank of Albania approved the Decision No. 17 "On extending the deadline for the exchange of selected non-legal tender banknotes. According to this Decisions, all banks, branches of foreign banks and foreign exchange bureaus shall accept for exchange, until 31.12.2023, specified non-legal tender banknotes and submit them immediately to the Bank of Albania and its branches. Non-legal tender banknotes, subject to this Decision are those whose nominal value is 100, 200, 500 and 1000 lek, years of issue 1991-1997.

On 10.04.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 29 Regulation "On destruction of Albanian banknotes, coins and privatisation vouchers". This Regulation sets out the rules and procedures for the destruction by the Bank of Albania of Albanian banknotes, and coins withdrawn from circulation classified as unfit for recycling or damaged, of banknotes classified as invalid, or privatisation vouchers after their use.

On 26.06.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 41 Regulation "On Albanian banknotes and coins suspected as counterfeit". This Regulation defines the rules and procedures for the treatment of national (lek) coins and banknotes suspected as counterfeits, with a view to protect Albanian coins and banknotes against counterfeiting. This Regulation shall apply on the Bank of Albania, commercial banks, branches of foreign banks and other non-bank financial institutions, licenced to carry out banking

and/or financial activities in the Republic of Albania, in compliance with the licence issued by the Bank of Albania.

MONETARY POLICY

On 30.01.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 7 "Monetary policy statement of the Bank of Albania for the second half of 2012". According to this statement, the Albanian economy improved slightly in the second half of 2012. This performance was driven by a fuller reflection of monetary stimulus and improved external economic and financial environment. However, the economic activity remains below potential and the growth sources appear unstable. Consumer prices rose 2.4% annually, at end- 2012, while annual inflation rate averaged 2%. The so-far economic activity performance and projections for 2013 support the outlook for positive economic growth close to the previous year's figure.

On 30.01.2013, the Supervisory Council of the Bank of Albania approved the Decision No. 8 "On cutting the interest rate on repurchase and reverse repurchase agreements". According to this Decision the key interest rate is cut by 0.25 percentage points. Consequently, the rate changes from 4.00% to 3.75%.

On 27.02.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 22 "Annual Report of the Bank of Albania 2012". According to the Report, the Albanian economy faced unfavourable shocks in 2012, deriving from both the internal and external environment. During the first nine months of the year, production increase was 1.6%, whereas employment in the economy increased on average 0.33%. The budget deficit was estimated at 3.4% of GDP, while the public debt reached 61% of GDP at end-2012. The loan portfolio quality continued to deteriorate as evidenced by the increase in the share of non-performing loans to total loans to 22.5%, compared to 18.8% in 2011. Annual inflation averaged 2%, remaining within the tolerance band of the Bank of Albania. With a view to meeting the medium-term inflation target and reducing the negative output gap, the Bank of Albania lowered its key interest rate three times over 2012 to 4.00% from 4.75%.

On 30.04.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 31 "Monetary policy report on the first quarter of 2013". According to the Report, despite the unfavourable developments, Albania's main indicators of internal and external balances remained within the sound parameters. Consumer prices rose on average 2.5% in the first quarter of 2013. Budget indicators performance in Q1 of the year point to increased fiscal stimulus. In January, Bank of Albania's Supervisory Council cut the key interest rate by 0.25 percentage points to 3.75%. By anchoring inflationary expectations, mitigating the liquidity pressures and lowering the short term interest rates, the monetary policy aimed to cut the long-term financing cost of the economy and support the growth of loans for consumption and for investments in the country. Our projections for 2013 support the projections

for the economic growth close to previous year's levels. With 90% probability, annual inflation is expected to range 0.6% - 3.6% after 4 quarters.

MONETARY OPERATIONS

On 13.02.2013, the Supervisory Council of the Bank of Albania approved Decision No 14 "On payment for the increased membership fee of the Republic of Albania in the International Monetary Fund" According to this Decision, the payment of 79.3 million SDR for the increased membership fee of the Republic of Albania in the International Monetary Fund, shall be made from the SDR account of the Bank of Albania with the International Monetary Fund, by depositing a non-negotiable non-interest bearing interest, in the securities account of the International Monetary Fund at the Bank of Albania.

FINANCIAL STABILITY

On 10.04.2013, the Supervisory Council of the Bank of Albania approved by Decision No. 30 "Financial Stability Report for the second half of 2012". According to this Report, during the period under review, banking sector and financial system's performance and situation were stable. The banking sector improved further its financial result, capitalisation indicators and liquidity. However, banks' activity volume expanded at lower rates, driven by a more sluggish deposit growth and considerably lower credit growth rates. Economic developments in Albania were similar to the preceding period, characterised by slower economic growth rates. The banking sector improved further its financial result, capitalisation indicators and liquidity. However, banks' activity volume expanded at lower rates, driven by a more sluggish deposit growth and considerably lower credit growth rates.

ECONOMIC POLICY

On 22.01.2013, the Ministry of Finance approved Instruction No. 3 "On amendments to Instruction No. 26, dated 4.9.2008 "On national tax", as amended". Amendments are made to 2.4.6 and 2.4.7 of the Instruction, which regulate the distribution of revenues from mineral rent, allocated to local government units. The Instruction redefines the procedures to be followed by stakeholders in the process and the calculation methodology.

On 22.01.2013, the Ministry of Finance approved Instruction No. 4 "On amendments to Decision No. 17, dated 13.5.2008 "On Valued Added Tax", as amended". These amendments, among others, address articles and paragraphs in the instruction that regulate hydrocarbon operations and specific cases on the right to VAT crediting. In addition, this instruction envisages that contractors (not-for-profit organisations) for projects funded with IPA funds shall be reimbursed by the Regional Tax Department for the VAT paid to purchase goods and services for such projects, after the submission of the

request for VAT reimbursement, and other relevant documents laid down in this document.

On 23.01.2013, the Council of Ministers approved the Decision No. 47, "On an amendment to Decision No. 45, dated 21.1.2009 of the Council of Ministers "On conducting public procurement procedures electronically", as amended. The amendments stipulate that the smaller value procurement procedures shall be conducted electronically, except for emergency cases and procurements for the value of less than ALL 10000 (ten thousand).

On 23.01.2013, the Council of Ministers approved the Decision No. 60 "On increasing the membership quota of the Republic of Albania in the International Monetary Fund". According to this decision, the membership quota of the Republic of Albania in the International Monetary Fund, is increased to the amount of 79.3 (seventy nine point three) million SDR.

On 23.01.2013, the Council of Ministers approved by Decision No. 71 "Agreement on the Swedish grant no. TF012392 TF012392 between Albania and the International Bank for Reconstruction and Development (IBRD), which administers the grant funds provided by Sweden, to co-finance the land administration and management project". According to this agreement, the grant SEK 18 711 000 (eighteen million, seven hundred and eleven thousand Swedish Kroner), will be used to fund a project that aims to improve the efficiency and effectiveness of land administration and management through enhanced security in the temporary use of land and improved urban planning in addition it would re-establish physical assets and restore necessary services in flood-affected areas in Albania.

On 23.01.2013, the Council of Ministers approved by Decision No. 73 "Macroeconomic and fiscal framework 2014-2016". According to the table of main macroeconomic indicators, in the following years, inflation is expected to remain around 3.0%, real GDP growth is projected upward from 3.1% in 2013 to 4.2% in 2016, whereas unemployment rate is expected to move down, from 13.2 in 2013 to 12.0% at the end of the period under review.

On 30.01.2013, the Council of Ministers approved by Decision No. 78 "Agreement between the Council of Ministers of the Republic of Albania and the Republic of Bulgaria on economic co-operation". Following the approval of this agreement, the governments of both countries are committed to contribute to developing and expanding the economic cooperation, which will bring mutual benefits, and will make efforts to develop a broad cooperation especially in fields such as industry, agriculture, forestry, and education.

On 30.01.2013, the Council of Ministers approved by Decision No. 79 "Economic and fiscal programme in Albania, 2013-2015". This document presents clear information on economic policies and medium-term priorities for Albania in the framework of structural reforms envisaged for 2013-2015, aiming at ensuring macroeconomic stability and providing relatively high economic growth, as well as establishing a regulatory framework and sectoral

policies in line with European standards. According to this document, economic growth is projected to be (during 2012-2014) to continue to remain above 3%, conditioned by higher domestic and foreign demand, and continuity of fiscal stimuli. For the periods ahead, domestic demand is expected to play the major role to boost aggregate demand.

On 01.02.2013, the Minister of Agriculture, Food and Consumer Protection and the Minister of Finance approved Instruction No. 1 "On the implementation of the Council of Ministers Decision No. 89, dated 16.1.2013 "On establishing the basic criteria for the sectors that will be supported and the degree of benefit from the funds of the agriculture and rural development programme for 2013". According to, the instruction the approved funds in the 2013 budget for the Ministry of Agriculture, Food and Consumer Protection, budget item "Transfers to household budgets" will be used to support agricultural, dairy and agro-processing products. The sectors that will be supported under the programme for agriculture and rural development, among others, include: production of fruit, nut, pomegranate, greenhouse vegetables, milk, olive oil and honey, organic products; and promotion of cooperation.

On 06.02.2013, the Council of Ministers approved by Decision No. 124 "National standards for administering the bankruptcy measure" The national standards for administering the bankruptcy measure set out the procedures and rules on the activity of bankruptcy administrators. This document provides for detailed rules to be implemented by administrators, in all cases of the administrator's appointment for covering a bankruptcy procedure.

On 07.02.2013, the Regions Development Committee approved Decision No. 1 "On project funding pursuant to the regions development fund" This decision sets out the amounts that will be liquidated for various projects, by Region, from the total amount of 1 677 288 969 ALL (one billion, six hundred and seventy seven million, two hundred and eighty eight thousand, nine hundred and sixty nine), part of the 2013 budget, for the Regions Development Fund, local infrastructure.

On 20.02.2013, the Council of Ministers approved by Decision No. 138 "Preparatory ceiling for medium-term budget expenditure programme, 2014-2016". This decision presents detailed expenditure in total, by budget item for each local government units for 2014-2016, complying with the projections boundaries of macroeconomic indicators and revenues for the upcoming three years. With a view to boost the efficiency of human resources, the total personnel fund in real terms is envisaged to be down from 5% of GDP in 2014, to 4.8% of GDP in 2016. Operational and maintenance costs for the stated period are projected to have a constant increase of 3%. They will continue to be oriented towards increasing expenditure for the functioning of priority sectors such as infrastructure, education, health care and agriculture.

On 21.02.2013, the Parliament of the Republic of Albania ratified by Law No. 89/2013 "Loan agreement between the Republic of Albania and the International Bank for Reconstruction and Development (IBRD) for funding

the water resources and irrigation project". The IBRD agrees to lend to the other party the amount of EUR 31 000 000 (thirty one million), to assist funding projects for rehabilitation of dams, irrigation and drainage systems, institutional support for irrigation and drainage, and integrated management of water resources.

On 25.02.2013, the Ministry of Finance approved Instruction No. 10 "On amendments to Instruction No. 5, dated 30.01.2006 "On income tax in the Republic of Albania", as amended". Through this Decision, among others, two categories are added to income exempted from taxation on income-earning for compensation deriving from final court decisions or compensations allocated for court costs, and income made by individuals for achievements in science, sports and culture, granted by public institutions. The article setting out the criteria and procedures for payment of taxation on earning in the form of an advance is also amended.

On 27.02.2013, the Minister of Labour, Social Affairs and Equal Opportunities approved Instruction No. 02 "On criteria and procedures for distributing the social protection fund". According to this Instruction, the allocated funds for the "social protection" programme, as a restricted transfer, allocated the funds periodically for the compensation of former political convicts, payments for unemployment benefits, for disabled peresons, and local government funds for the functioning and maintenance of premises of social care centres.

On 25.03.2013, the Parliament of the Republic of Albania ratified by Law No. 104/2013 "Agreement between the Republic of Albania, the Hellenic Republic and Republic of Italy, on the Trans Adriatic Pipeline (TAP". Through this agreement, the parties aim to promote further the mutual cooperation favourable to guarantee secure supply of natural gas from the gas fields of Central Asia and Middle East, including those in the Republic of Azerbaijan, towards the European Union, via the Republic of Turkey, taking into account the fact that development and interconnection (in accordance with the interconnection agreements signed for this project) of the Trans Anatolian pipeline with other natural gas transportation systems with the TAP would increase the security and natural gas supply reserves, as a result of diversification of itineraries and sources of natural gas supply towards the European Union.

On 27.03.2013, the Council of Ministers approved the Decision No. 239 "On the approval of the new methodology for using counterparty funds, collected under Japanese grants for agriculture and food sectors". After the approval of this Decision, counterparty funds granted by the Japanese government and collected by the Agency of Agricultural and Rural Development, as a payments agency, amounting ALL 173 095 454 (one hundred and seventy three million, ninety five thousand, four hundred and fifty four), shall be handled as off limit income and shall be used through the treasury account, within 2013. They will be used by the Agency of Agricultural and Rural Development in the form of zero interest credit, to promote production and processing of agricultural and dairy products.

On 28.03.2013, the Assembly of the Republic of Albania adopted Law No. 106/2013 "On amendments to Law No. 9632, dated 30.10.2013 "On local tax", as amended". These amendments, among others, envisage that the tax shall not be applied for occupying public space that are not in ownership or under the administration of the local government. The law specifies that mobile telephony antennas, and any other transmission antena, erected in compliance with the legal framework in force, shall not be subject to temporary taxes.

On 01.04.2013, the Assembly of the Republic of Albania adopted Law No. 111/2013 "On amendments to Law No. 7928, dated 27.04.1995 "On Valued Added Tax", as amended". According to the approved amendments, the supply of raw material and breed livestock used in agriculture: chemical fertilisers, pesticides, seeds, fruit trees, pure breed cows, pure breed sheep, goats etc., biological material for conception, animal foodstuffs, materials for bees, plastic material for use in agriculture, agricultural machinery supplied to the farmer, and fishing nets, are exempted from the value added tax.

On 03.04.2013, the Council of Ministers approved the Decision No. 264 "On the organisation of work to approximate legislation in the areas of right of establishment and free movement of services". This Decision determines the methodology to identify, examine, change, abrogate or draft legal and sub-legal acts, related to the right of establishment and free movement of services and their approximation to the EU acquis.

On 10.04.2013, the Council of Ministers approved the Decision No. 295 "On establishment, organisation and functioning of the State Inspectorate of Labour and Social Services". This Decision provides for the establishment of the State Inspectorate of Labour and Social Services as a central, budgetary institution, subjected under the Minister responsible for labour and social affairs. Its mission is to guarantee compliance with legal requirements in the field of labour and social services. The Inspectorate is responsible for inspecting and compliance of legal work-related requirements, in accordance with the labour and social services legislation.

On 10.04.2013, the Council of Ministers approved the Decision No. 301 "On setting the rules for the collection, management and use of data in the fishing sector and support with scientific counselling for the fishing National Strategy". This Decision sets out the rules for the collection, management and use of biologic, technical, environmental, and social-economic data, in the framework of the multi-year programme of the fishing sector; use of fishing sector data in the framework of the fishing national strategy, for scientific analysis; and improvement of scientific counselling, necessary for implementing the national fishing strategy.

On 10.04.2013, the Council of Ministers approved the Decision No. 475 "On State Inspectorate of Market Supervision". This Decision provides for the establishment of the State Inspectorate of Market Supervision, as a central, budgetary institution, subjected under the Minister responsible for trade. It is

the entity responsible for market supervision, in accordance with the legislation for the overall security of non-food products and trade and supervision of the products market, for all products or non-food group of products, except for those that are explicitly the responsibility of another state inspectorate or institution.

On 11.04.2013, the Assembly of the Republic of Albania adopted Law No. 113/2013 "On adhering to the resolution of the board of governors of the Black Sea Trade and Development Bank (BSTDB)". According to this resolution, from the capital increase authorised by the BSTDB, i.e. SDR 2.000.000.000 (two billion), the amount offered for subscription is set to SDR 1.000.000.000 (one billion) divided in 1.000.000 (one million) shares with the nominal value SDR 1.000 (one thousand) each. The total amount of subscribed capital of the Bank is divided in 2.000.000 (two million) with the nominal value SDR 1.000 each. The number of shares and percentage of total stock of the subscribed and authorised capital of the Bank held by the Republic of Albania is 40,000 shares (SDR 40.000.000, full nominal value) - 2% (two per cent) of the subscribed capital of the Bank.

On 18.04.2013, the Assembly of the Republic of Albania adopted Law No. 120/2013 "On some amendments to Law No. 9975, dated 28.7.2008 "On national tax", as amended". Amendments to this law regulate and determine the formula for calculating the annual tax of used vehicles, and procedures to be followed for its payments by the owners. The law envisages also the pardon of all payments in arrear for the annual tax on circulation for vehicles sequestered or confiscated by a final court decision, whose administration is transferred to the Agency for the Administration of Sequestered and Confiscated Assets, for use or resale purposes.

On 24.04.0213, the Council of Ministers approved the Decision No. 353 "On the programme to promote employment of young unemployed jobseekers". This decision specifies, among others, that private sector employers, who employ young people aged 16-30, who have graduated from a university, general high school, and vocational training courses, may benefit a monthly funding for three years, amounting 100% (one hundred per cent) of the obligatory health and social securities, for the part of the employer, provided that the employment contract lasts for 3 years and the duration of the programme is another 3 years, uninterrupted, after the completion of the programme.

On 25.04.2013, the Assembly of the Republic of Albania adopted the Law No. 125/2013 "On concessions and private public partnerships". This law lays down a favourable and sustainable framework to promote, attract and facilitate investments that are realised in the form of a concession/private public partnership. It regulates the competencies of contracting authorities to enter into a concession/private public partnership agreement for investment based on concession/private public partnerships, procedures for granting such contracts, as well as issues related to financial regulation, support and policies for these concessions, as well as the authority for their implementation.

On 29.04.2013, the Assembly of the Republic of Albania adopted the Law No. 133/2013 "On payment systems". The law seeks to promote the security, stability and efficiency of Albania's domestic payment system. The law lays down the main standards on licensing, regulation and oversight of important components of Albania's domestic payment system, and lays down the rules for the protection of the systems. The Bank of Albania, in performing its tasks laid down in this law, shall cooperate with any domestic and/or foreign authority, in order to exchange information, coordinate activities, or other cooperation agreements, as it deems necessary.

On 02.05.2013, the Council of Ministers approved by Decision No. 382 "Agreement between the Council of Ministers of the Republic of Albania and the Republic of Azerbaijan on economic, industrial and technologic co-operation". This agreement will contribute to boost economic, industrial and economic cooperation, based on the principle of parity, mutual benefit and reciprocity, taking into account the benefits from the expansion of the possibilities for long-term and successful bilateral relations. Both countries commit, through this agreement, to promote development and strengthen economic, industrial and technological cooperation, of mutual interest and benefit, conform to the relevant domestic laws and regulations, and international agreements they are party of.

On 02.05.2013, the Council of Ministers approved the normative act No. 2 "On revaluation of immovable property". According to this act, all individuals who own an immovable property, may, from the date of entry into force of this law until 31 October 2013, revaluate the immovable property to the market value. The revaluation may be done by a licenced expert, relevant institutions or local immovable property registration offices. When selling the revaluated property, the tax will be calculated the difference of the sale price and the revaluation price.

On 06.05.2013, the Parliament of the Republic of Albania ratified by Law No. 146/2013 "Convention on Mutual Administrative Assistance in Tax Matters". This convention is signed by Member States in the Council of Europe and the Organisation for Economic Cooperation and Development (OECD). Against the backdrop of free movement of capital, persons and services, a positive development in itself, it helps fight tax evasion, seeking increased cooperation between tax authorities. It provides a basis for mutual administrative assistance in tax matters. It may include, as the case may be, measures taken by courts. Administrative assistance may also include information exchange on issues such as simultaneous tax examinations; compensation, measures for storing and delivering documents.

On 06.05.2013, the Assembly of the Republic of Albania ratified Law No. 147/2013 "On the financing agreement between the Council of Ministers of the Republic of Albania, represented by the Ministry of Finance, and Artigiancassa S.p.A., to fund the integrated assistance programme for the development of small and medium-seized enterprises in Albania". Under

this agreement, the Government of the Republic of Italy, represented by the Ministry of Foreign Affairs, undertakes to fund the programme through a soft loan for the maximum amount of EUR 15,000,000.00 (fifteen million). This loan will be repaid within 16 years, in 16 consecutive equally-distributed instalments, bearing 0.00% (zero point zero per cent) interest rate.

On 08.05.2013, the Council of Ministers approved the Instruction No. 1 "On approving the average cost of construction for dwellings by the National Enterprise, for 2013". This instruction approves the average cost of construction for dwellings by the National Enterprise, nationwide, for 2013, at ALL 37 806/sqm, for used space. In addition, the Instruction sets out the average cost of construction and the average value for apartments in the free market, by city, for 2013.

On 15.05.2013, the Council of Ministers approved the Decision No. 418 "On increasing the shares of the Republic of Albania in the capital of the Black Sea Trade and Development Bank". Upon the approval of this decision, the shares of the Republic of Albania in the capital of the Black Sea Trade and Development Bank are increased for the amount SDR 20 000 000 (twenty million), of which 30% shall be paid in Albanian lek (equivalent to 6 000 000 (six million) SDR) and 70% in a promissory note.

On 15.05.2013, the Council of Ministers approved the Decision No. 419 "On the establishment of the Albanian Competiveness Fund". This Decision provides for the establishment of the Albanian Competiveness Fund for 2013, amounting to ALL 20 000 000 (twenty million). The Fund shall be applicable for three years during 2013, 2014 and 2015 for the amount of ALL 20 000 000 (twenty million) each year. Small and medium-sized enterprises will benefit subsidiaries from the Fund, up to ALL 1 000 000 million.

On 22.05.2013, the Council of Ministers approved the Decision No. 460 "On setting out the criteria, rules and procedures for renting state-owned agricultural land". According to this decision, the subject of rent shall be state-owned agricultural land, originating from former state-owned agricultural farms. The decision determines the responsible institutions, conditions and procedures to be followed for renting state-owned agricultural land.

BANK OF ALBANIA MANAGEMENT, AS AT 30 JUNE 2013

SUPERVISORY COUNCIL

ARDIAN FULLANI	Chair
ELISABETA GJONI	Deputy Chair
ADRIAN CIVICI	Member
ARJAN KADAREJA	Member
DHORI KULE	Member
ELA GOLEMI	Member
ERMELINDA MEKSI	Member
HALIT XHAFA	Member
PETRAQ MILO	Member

GOVERNOR

ARDIAN FULLANI

DEPUTY GOVERNORS

ELISABETA GJONI	First Deputy Governor

GENERAL INSPECTOR

ELIVAR GOLEMI

GOVERNOR'S OFFICE

GENC MAMANI

HEAD OF COORDINATION

GRAMOZ KOLASI

DEPARTMENTS AND OTHER UNITS

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

BRANCHES

SHKODRA	*Ermira Istrefi*
ELBASANI	*Valentina Dedja*
GJIROKASTRA	*Anila Thomaj*
KORÇA	*Liljana Zjarri*
LUSHNJA	*Shpresa Meço*

BANKS AND BRANCHES OF FOREIGN BANKS LICENSED BY THE BANK OF ALBANIA, AS AT 30 JUNE 2013

1. RAIFFEISEN BANK SH.A.
Licence No. 2/1998, dated 11.01.1999
Approved by the Bank of Albania Supervisory Council Decision No. 163, dated 11.12.1998
Certificate No. 2 "On Deposit Insurance"
Director: Christian CANACARIS
Address: Bulevardi "Bajram Curri", European Trade Center, Tirana, Albania
Tel: +355 4 2274 910
Fax: +355 4 2275 599
E-mail: info@raiffeisen.al
Website: www.raiffeisen.al

2. UNITED BANK OF ALBANIA SH.A.
Licence No. 3/1998, dated 11.01.1999
Approved by the Bank of Albania Supervisory Council Decision No. 165, dated 11.12.1998
Certificate No. 3 "On Deposit Insurance"
Director: Emina ŠIŠIĆ
Address: Rruga e Durrësit, sheshi tek Zogu i Zi, Godina Teknoprojekt, P.O. BOX 128, Tirana, Albania
Tel: +355 4 240 45 75 / 76 / 77
Fax: +355 4 240 45 58
E mail: info@ubaal.com
Website: www.uba.com.al

3. VENETO BANKA SH.A.
Licence No. 5/1998, dated 11.01.1999
Approved by the Bank of Albania Supervisory Council Decision No. 164, dated 11.12.1998
Certificate No. 4 "On Deposit Insurance".
Director: Lucio Luigi GAITA
Address: Bulevardi "Dëshmorët e Kombit", Ndërtesa Kullat Binjake, Tirana, Albania
Tel: +355 4 2280 555
Fax: +355 4 2280 356
E-mail: info@venetobanka.al
Website: www.venetobanka.al

4. NATIONAL COMMERCIAL BANK SH.A.
Licence No. 6/1998, dated 11.01.1999
Approved by the Bank of Albania Supervisory Council Decision No. 162, dated 11.01.1999
Certificate No. 5 "On Deposit Insurance"
Director: Seyhan PENCAPLIGIL
Address: Bulevardi "Zhan D'Ark", Tirana, Albania
Tel: +355 4 2250 955
Fax: +355 4 2250 956
E – mail: info@bkt.com.al
Website: www.bkt.com.al

5. TIRANA BANK SH.A.
Licence No. 7, dated 12.09.1996
Approved by the Bank of Albania Supervisory Council Decision No. 9, dated 12.09.1996
Certificate No. 6 "On Deposit Insurance"
Director: *Georgios CHARALAMPAKIS*
Address: *Rruga "Ibrahim Rugova", Tirana, Albania.*
Tel: *+355 4 2269 616 / 7 / 8, 2233 441*
Fax: *+355 4 2233 417 / 2369 707*
E – mail: *info@tiranabank.al*
Website: *www.tiranabank.al*

6. NATIONAL BANK OF GREECE – ALBANIA SH.A.
Licence No. 8, dated 25.11.1996
Approved by the Bank of Albania Supervisory Council Decision No. 4, dated 14.03.1996.
Certificate No. 7 "On Deposit Insurance"
Director: *Ioannis KOUGIONAS*
Address: *Rruga e Durrësit, Godina "Comfort", Tirana, Albania*
Tel: *+355 4 2274 802 / 2274 822*
Fax: *+355 4 2233 613*
E – mail: *nbgalbania@icc-al.org*

7. INTERNATIONAL COMMERCIAL BANK SH.A.
Licence No. 09, dated 20.02.1997
Approved by the Bank of Albania Supervisory Council Decision No. 9, dated 30.04.1996
Certificate No. 8 "On Deposit Insurance"
Director: *Gideon van den BROEK*
Address: *Qendra e Biznesit, Rruga "Murat Toptani", Tirana, Albania*
Tel: *+355 4 2254 372 / 2256 254*
Tel/Fax: *+355 4 2254 368*
E – mail: *info@icbank-albania.com*

8. ALPHA BANK - ALBANIA SH.A.
Licence No. 10, dated 07.01.1998
Approved by the Bank of Albania Supervisory Council Decision, No.01/03/96, dated 27.12.1997
Certificate No. 9 "On Deposit Insurance"
Director: *Periklis Drougkas*
Address: *Rruga e Kavajës, G – KAM Business Center, kati II, Tiranë.*
Tel: *+355 4 2278 500*
Tel/fax: *+355 4 2232 102*
E – mail: *tiranabranch@alpha.gr*

9. INTESA SANPAOLO BANK ALBANIA SH.A.
Licence No. 11, dated 10.08.1998
Approved by the Bank of Albania Supervisory Council Decision, No. 105, dated 10.08.1998
Certificate No. 10 "On Deposit Insurance"
Director: *Alexander RESCH*
Address: *Rruga "Ismail Qemali" Nr. 27, P.O. Box 8319, Tirana, Albania*
Tel: *+355 4 2248 753 / 4 / 5 / 6, 2276 000.*
Fax: *+355 4 2248 762*
E – mail: *info@intesasanpaolobank.al*
Website: *www.intesasanpaolobank.al*

10. PROCREDIT BANK SH.A.
Licence No. 12, dated 15.03.1999
Approved by the Bank of Albania Supervisory Council Decision No. 22, dated 03.03.1999
Certificate No. 11 "On Deposit Insurance"
Director: Flutura VEIPI
Address: Rruga "Dritan Hoxha", Nr. 92, H. 15, Njësia Bashkiake no. 11, Kodi Postar 1026, Tirana, Albania
Tel: +355 4 2389 300
Fax: +355 4 2233 918
E-mail: info@procreditbank.com.al
Website: www.procreditbank.com.al

11. EMPORIKI BANK - ALBANIA SH.A.
Licence No. 14, dated 28.10.1999
Approved by the Bank of Albania Supervisory Council Decision, No.105, dated 19.10.1999
Certificate No. 13 "On Deposit Insurance"
Director: Luc BEISO
Address: Rruga e Kavajës, Nr. 59, "Tirana Tower", Tirana, Albania
Tel: +355 4 2258 755 / 56 / 57 / 58 / 59 / 60
Fax: +355 4 2258 752
E-mail: headoffice@emporiki.com.al
Website: www.emporiki.com.al

12. CREDIT BANK OF ALBANIA SH.A.
Licence No. 15, dated 28.08.2002
Approved by the Bank of Albania Supervisory Council Decision No. 66, dated 28.08.2002
Certificate No. 14 "On Deposit Insurance"
Director: Sherine KAMEL
Address: Rruga "Perlat Rexhepi", Al-Kharafi Group Administration Building, Kati 1&2, Tirana, Albania
Tel: +355 4 2272 168, +355 4 2272 162
Fax: +355 4 2272 162
E-mail: creditbkalb@icc-al.org

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

14. SOCIETE GENERALE ALBANIA BANK SH.A.
Licence No. 17, dated 16.02.2004
Approved by the Bank of Albania Supervisory Council Decision No. 06, dated 11.02.2004
Certificate No. 16 "On Deposit Insurance"
Director: Hubert de SAINT JEAN
Address: Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Kulla 1, Kati 9, Tirana, Albania
Tel: +355 4 2280 442 / 3
Faks: +355 4 2280 441

Mobile: *068 (69) 20 60 974*
E-mail: *sgalb.info@socgen.com*
Website: *www.societegenerale.al*

15. UNION BANK SH.A.
Licence No. 18, dated 09.01.2006
Approved by the Bank of Albania Supervisory Council Decision No. 101, dated 28.12.2005.
Certificate No. 17 "On Deposit Insurance"
Director: *Gazmend KADRIU*
Address: *Bulevardi "Zogu I", pallati 13-katësh, përballë stacionit të trenit, Tirana, Albania*
Tel: *+355 4 2250 653 / 2258 081*
Fax: *+355 4 2272 880*
E-mail: *info@unionbank.com.al*
Website: *www.unionbank.com.al*

16. FIRST INVESTMENT BANK ALBANIA SH.A.
Licence No. 19, dated 06.07.2007.
Approved by the Bank of Albania Supervisory Council Decision No. 35, dated 27.06.2007
Certificate No. 12 "On Deposit Insurance"
Director: *Bozhidar TODOROV*
Address: *Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Kulla 2, 14&15, Tirana, Albania*
Tel: *+355 4 2276 702 / 3*
Fax: *+355 4 2280 210*
Website: *www.fibank.al*

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

Nr.	ENTITIES
21	NON-BANK INSTITUTIONS
328	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 2013 H1

This list is designed to inform readers about publications issued by the Bank of Albania over the first half of 2013. By visiting our website (www.bankofalbania.org) you can subscribe to our mailing list either by e-mail at public@bankofalbania.org or sending a fax to + 355 4 2419408 and enroll in the mailing list for the publications of the Bank of Albania.

You can also subscribe to updates by signing up to receive free e-mail notices when new items are posted on the Bank of Albania website. You will receive e-mail notices each time we post new items of the series you selected.

Listed below you can find all the publications issued by the Bank of Albania over the first half of 2013. This list does not include surveys carried out by the Bank of Albania as they are available only online (http://www.bankofalbania.org/web/vrojtime_3405_1.php).

ANNUAL REPORT:

Annual Report 2012

FINANCIAL STABILITY REPORT:

Financial Stability Report 2012 H2

SUPERVISION ANNUAL REPORT

Supervision Annual Report 2012

MONETARY POLICY PERIODICAL REPORTS:

Monetary Policy Report 2012 Q4
Monetary Policy Report 2013 Q1

PUBLICATIONS ON STATISTICS:

Statistical Report (Published monthly)

OFFICIAL BULLETIN

Official Bulletin – Volume 15, no. 1 Year 2013
Official Bulletin – Volume 15, no. 2 Year 2013
Official Bulletin – Volume 15, no. 3 Year 2013
Official Bulletin – Volume 15, no. 4 Year 2013
Official Bulletin – Volume 15, no. 5 Year 2013

BULLETIN OF THE BANK OF ALBANIA:

Bulletin of the Bank of Albania - 2012 H2

STRATEGIES OF THE BANK OF ALBANIA:

Medium -Term Development strategy of the Bank of Albania for 2013-2015

RESEARCH PAPERS:

Fiscal position and yield curve in Albania- Esida Abazaj

Corporate governance framework and practice in Albanian banking sector - Roden Pajaj, Rezart Ferzaj

Cyclically-adjusted budget balance: An alternative approach in estimating the fiscal position for Albania - Anjeza Gazidede

Fiscal Policy and Economic Growth: The Case of Albania - Gerti Shijaku

A Financial Systemic Stress Index for Albania- Vasilika Kota, Arisa Saqe

Survey report on the use of payment instruments - individuals - Kliti Ceca, Alban Pllaha, Valentina Semi

Survey report on the use of payment instruments - business - Kliti Ceca, Alban Pllaha, Valentina Semi

SCIENTIFIC NOVELTIES AT THE BANK OF ALBANIA:

Scientific Novelties at the Bank of Albania No. 9

OTHER PUBLICATIONS

Leaflet on “Printing of the Albanian lek banknote“