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C O N T E N T S

T A B L E S

C H A R T S

MONETARY POLICY STATEMENT FOR THE THIRD QUARTER OF 2009

I. GOVERNOR'S SPEECH

The third quarter of 2009 witnessed positive signs in the Albanian economy and financial markets. It particularly marked a turning point in terms of restoring confidence in the Albanian banking system. The stable liquidity situation, the preservation of financial stability and the banking system's capitalization parameters constitute a solid platform for restoring its intermediation and financial role in economy. In tandem with the latest positive tendencies of the global economy, which still remain frail in terms of their nature and permanence, these developments prompt us to consider the future Albanian economic activity under the optics of a prudent optimism.

Over the course of the year 2009, the Albanian economy has been affected by the global economic and financial crisis primarily through the decline of foreign demand and remittances, higher risk premiums and reduced and high-cost financial support. However, our economy continued to record positive economic growth rates during this period, while the domestic inflationary pressures remain contained. Economic activity at home has been sustained by the fiscal stimulus and the preservation of relatively high consumer demand rates. In the meantime, investments and export demand have recorded lower growth rates in the first nine-month period.

At a global level, the second quarter of 2009 and the following period witnessed stable economic activity. Although the world economy continued to contract in annual terms, the consumed stock cycle replacement set a floor on the downturn of Euro area and US economies. Moreover, this cycle served as a short-term catalyser for the reactivation of their industry and production sectors. In a longer-term perspective, the stable economic activity of the Asian countries -China in particular-, and the global trade growth will fuel the global economic growth. However, the world economy path to a sound and stable growth is a long one. The existing model of global economy has relied on the high consumption and the severe debt situation of the USA, against an Asian countries' strategy that favours exports and savings. Coupled with below potential economic growth and downward inflationary pressures for a relatively long period of time, the addressing of these imbalances at a global level requires time.

The global financial system, the capital markets, the banking sector and other financial intermediaries seem to be recovering. The monetary and fiscal stimulus has provided its effect at a global level, helping first the recapitalization of the financial system and restoring the lending system. Despite the high risk

perception and low risk readiness across the financial agents, the resumption of global financial flows will provide assistance to emerging countries through higher available funds.

Amidst the global development challenges, the Albanian economy recorded positive economic growth during the first half of 2009. According to preliminary data reported by the INSTAT, the GDP grew at an annual rate of 5.3 percent in the second quarter, maintaining similar growth rates as in the preceding quarter. Activity in services provided the main contribution to the GDP growth. The production sector provided additional contribution to the annual GDP growth, mainly owing to the performance of the construction sector. By contrast, industry deepened the downward growth rates that began in early 2009.

The economic growth tendency, albeit at lower magnitude, is also present in several indirect indicators of the economy, namely the higher budget revenues, higher lending to the economy and more stable labour market indicators. However, these indicators, particularly monetary and business and consumer confidence indicators, reflect slower economic growth rates relative to the previous year.

In a macroeconomic context, the slowdown is mostly a reflection of the fall in investment and foreign demand, while consumption and public expenditure have led to higher economic activity.

The economic performance of the first half of 2009, albeit positive, attests to a slowdown of about 1.4 percentage points compared with the same period in 2008. In addition to the general slackening of global inflationary pressures, this situation has been translated into the gradual reduction of inflationary pressures on the Albanian economy. Average inflation marked 2.0 percent in January to September 2009, fully reflecting the termination of the first round effects generated from the rise in raw material prices during 2007-2008 and the cessation of effects arising from the latest administrative rise in the energy price. The downward trend of core and non-tradable goods' and services' inflation attest to the fact that the inflationary pressures generated from the domestic demand-side are subsiding. On the other hand, the relatively strong depreciating movements of the domestic currency, the ALL, during 2009 have pushed the tradable goods' inflation higher to about 3.1 percent in the third quarter. Developments in the labour market and wages do not signal higher future inflationary pressures on the supply-side. Unemployment rate was 12.7 percent in the first half of 2009, similar to the year-end 2008 level. For the same periods, the growth rates of average real wage in economy have been more contained.

The Bank of Albania forecasts and the anchoring of economic agents' expectations for consumer prices support the preservation and firming up of consumer price stability in the medium run, expressed in low and stable inflation rates.

Current account deficit narrowed slightly by 1 percentage point y-o-y in the second quarter of 2009, reflecting slower imports and exports in the Albanian economy. In the meantime, workers' remittances have reduced at relatively lower rates than in the preceding quarters. However, the current account deficit remains high, reflecting the high levels of consumption in the Albanian economy and the unfeasibility of the production capacities at home to meet it. Privatization receipts and the public sector's foreign currency borrowing led to a positive balance of payments; however, its future stability should rely on longer-term factors.

The government ran an expansionary fiscal policy in the first eight months of 2009. In annual terms, budget expenditure increased by 23 percent, reflecting primarily the rapid increase of capital expenditure. Budget revenues maintained a slower rate than expenditure due to the slower economic growth rate during this period. Consequently, the additional budget expenditure was financed through the use of privatization receipts and the higher public borrowing. This policy has exerted pressure over the increase of Government debt securities' interest rates of long maturity term.

The influence of fiscal policy on the domestic monetary markets was more moderate during this period since the public debt was to a large extent borrowed from the international capital markets. However, the future persistence of this policy will face less funding potentials of both the Albanian and the international market. This fact calls for the quick return to the consolidating trajectory that the fiscal policy pursued in the pre-crisis years.

The monetary indicators of the third quarter of 2009 attested to the slow money growth tendency. Money supply, M3, recorded an annual growth of 4.5 percent in August vis-à-vis the average growth rate of about 7 percent in the first half of 2009, owing mainly to the lower credit flows to the private sector. Deposits grew substantially in August – about ALL 25.4 billion in monthly terms – in line with their seasonal performance during this period of the year. As at end of period, about 70 percent of the total deposits' stock growth was time deposits, hence signalling the higher confidence in the banking system.

Private sector credit maintained its slower growth rates in July and August 2009, reflecting both the tightening of credit supply and the contraction of credit demand. Coupled with the reduced use of capacities as reported by businesses in the Bank of Albania survey, this performance signals that the private sector's investments in economy are downward. Banks continue to apply tight lending standards, while consumer demand and private sector investments have fallen.

In nominal terms, private sector credit grew by an annual average of 16 percent in June to August, markedly lower than the first five months' average (29 percent). Despite the low growth rates, business credit provided the main contribution to the private sector credit growth, accounting for about 65 percent. The downward trend of credit attributes to the deceleration of foreign currency lending, whose growth rate was zero in August. In the meantime, ALL lending

continued to maintain its average growth rate of 30 percent throughout the year 2009. As a result, the share of foreign currency credit in the private sector's loan portfolio dropped to 67 percent. The understanding of the consequences of exchange rate movements and the greater tightening of lending for loans denominated in a currency other than that of the borrower's income caused the individuals to borrow less foreign currency credit than businesses.

The financial markets attested to an improved liquidity situation and the recovery of the agents' confidence in these markets. The persistent Bank of Albania's liquidity supply to the money market helped to calm the market participants down and to supply the market with funds, which served to the private sector's domestic currency intermediation. The liquidity needs in the interbank market have been declining, hence exerting no pressure over the short-term interest rates. By contrast, the Government securities' primary market experienced a reverse situation, with the T-bill yields of long-term maturity going up despite the ample liquidity. In September's last auction, the 12-month yield was 9.40 percent, up by 0.64 percentage points from the year-end 2008.

The high risk premium on long maturity terms and the existence of a shallow financial market were the rationale behind the high Government securities' long-term yields. On the other hand, the high yields attracted the individuals' investment in this market, hence providing them with an alternative instrument to keep their savings and at the same time, increasing the share of budget deficit financing from this item. The individuals' deposits held in the banking system have had a satisfactory return. Weighted average interest rate on ALL deposits marked 5.94 percent in August or up by 0.48 percentage points from the end of the second quarter. This increase led to lower intermediation cost for the ALL during the recent months. Interest rates on new ALL loans declined to an average of 12.86 percent in July and August, down by 0.79 percentage points from the average rate of the first half of 2009. The banking system's inclination to relieve the cost of ALL loans is attested by the narrowing of its margin and the corresponding reference rate, the T-bills. The spread declined to an average of 3.6 percentage points in summer, from 4.8 percentage points in early 2009.

The long-term development perspective of the Albanian economy is positive. Macroeconomic stability and confidence in the Albanian financial system are the product of our responsible macroeconomic and financial policies undertaken continuously over the course of the recent years. Macro financial stability is a solid foundation for boosting the country's development in the future.

This development will to a large extent depend on the capacity of the Albanian economy to attract funds, which will buttress its growth. The monetary conditions are relaxed in line with the dynamics of economic and financial developments in Albania, in our main trading partners and broader in the global economy. This decision represents a new incentive for the economic developments at home, aiming at reducing the financing cost of the economy further.

The performance of lending to economy will be of prime importance in the medium run. The Bank of Albania considers that the stabilization of the banking system's liquidity and balance sheet indicators will pave the way for the lending process. In this context, the Bank of Albania has been engaged in an active role in terms of stimulating demand and supply with funds. The relaxation of monetary conditions will fuel the growth of business and consumer demand for funds, while the Bank of Albania's injection of liquidity will assist the banking system in meeting the demand for funds in quantitative terms. The Albanian banking system should understand its role rightly and transmit the relaxation of monetary policy in economy completely and rapidly. On the other hand, a lower pressure of the fiscal sector over the domestic financial markets will in the future lower the risk premium in economy, will create more room for private sector lending and will facilitate the smoothing out of the interest rate curb in favour of lowering the cost of credit further. The efficiency of the monetary policy decision will depend on the market and its participants' behaviour, wherein fiscal policy plays a key role.

In the long run, the attraction of foreign direct investments and other forms of stable capital inflows should be at the core of our development policies. These funds will not only improve the external position in terms of its stability, but also sustain the country's long-term growth. Time is ripe for all the actors to carefully analyze the country's economic growth model in the decade we are approaching. The future economic growth model should in particular consider the competitive advantages of the Albanian economy more, mitigating its reliance on short-term capital inflows and expanding the economic basis, which generates stable and long-term capital flows. In this context, the Bank of Albania remains committed to playing a key role in the periods to follow.

In compliance with our legal and institutional commitment, the Bank of Albania's monetary policy will aim at creating the proper conditions for a balanced development, characterized by low consumer price inflation environment, moderate fluctuations of monetary indicators and sound macroeconomic agents' balance sheets.

II. DEVELOPMENTS IN THE WORLD ECONOMY

The most recent data show that the global economic conditions improved during the first nine months of 2009. This assessment is underpinned by the pronounced deceleration of economic contraction in the largest advanced and emerging economies. Despite the more positive recent developments, economic growth is forecast to be relatively slow and reach positive figures in 2010. The economic downturn pushed the unemployment rates up to peak levels in some of the main economies. The inflationary pressures have been low, in many cases resulting in negative annual inflation rates owing also to the high comparative basis.

Table 1 Some main macroeconomic indicators

	GDP change (in %)		Unemployment rate (in %)	Inflation (in %)	
Country	Q2 2009/ Q2 2008	Q2 2009/ Q1 2009	August 2009	September 2009/ August 2009	September 2009/ September 2008
USA	-3.8	-0.7	9.8[1]	0.2	-1.3
Euro Area	-4.8	-0.2	9.6	0.0	-0.3
Germany	-5.9	0.3	7.7	-0.5	-0.5
Greece	-0.3	0.2	9.6[2]	1.9	0.7
Italy	-6.0	-0.5	7.4[3]	0.6	0.3
Japan	-7.2	0.6	5.5[4]	-0.3[4]	-2.2[4]

Source: Eurostat, Respective Statistical Institutes

[1] Data for September. [2] Data for July.

[3] Data for the second quarter of 2009. [4] Data for August.

II.1 ECONOMIC GROWTH AND MACROECONOMIC BALANCES

After two quarters of rapid contraction, the economic activity in the Euro area decelerated its downward rates by only -0.2 percent in the second quarter of 2009 vis-à-vis the previous quarter. The Euro area GDP contracted 4.8 percent in annual terms, comparable to the first quarter's figure. The deceleration of economic activity downturn has been pushed by the positive contribution of commercial activity, where exports have declined less than imports. The slight increase of consumer spending curbed the downward trend of domestic demand, which fell slightly. The latter, coupled with the contraction of investments and industrial production, curbed the positive effect of commercial activity growth. Unemployment rate maintained its upward rates, which began in the second quarter of 2008, and reached 9.6 percent in August 2009, the peak rate of the last decade. The upward unemployment trend, which continues to hit demand, has been associated with the gradual decrease of annual inflation, which marked -0.2 and -0.3 percent in August and September.

The first signs of recovery have emerged in the macroeconomic situation in the USA, although it still remains weak. The US economy shrank at a 0.7 percent pace in quarterly terms in the second quarter of 2009, considerably lower than in the previous quarters. The poor performance of aggregate investments, consumer spending and exports are the main rationale behind this trend. Some economic developments in the third quarter of 2009 suggest for the further improvement of the economy. Industrial production, exports and consumer spending manifested an upward tendency in July and August. The labour market remains weak. Unemployment rate marked 9.8 percent in August, while the annual inflation marked -1.3 percent in September.

The BRIC[1] countries showed signs of recovery in their economic activity. In annual terms, the economies of India and China grew by 6.7 and 8.1 percent, respectively, in the second quarter of 2009, higher than in the previous quarter. In the meantime, the economies of Brazil and Russia experienced a decline in annual terms. In contrast to the economic contraction of Brazil, which has been moderating, the Russian economy has recorded continuous decline to

its lowest level. However, the data for July and August show signs of recovery in Russia's economic activity. The inflationary pressures have been subsiding in Russia and China. In Brazil and India, the slight rise of raw material prices during the recent months has been translated into added inflationary pressures over these economies. In their respective meetings in September, the central banks of China and Russia cut the key interest rates, while the central banks of Brazil and India left them unchanged.

The regional countries' macroeconomic situation deteriorated further in the second quarter of 2009. Their economies declined at more accelerated rates compared with the first quarter of 2009. According to the latest data on the performance of the main macroeconomic indicators, the same trend is expected to persist in the third quarter. In the meantime, the inflationary pressures have subsided in the majority of these countries.

The Italian economic activity continued to decline for the fifth consecutive quarter in the second quarter of 2009. The GDP contracted 6 percent in annual terms, with the fall of aggregate investment and exports[2] providing the main contribution. The latest data on the economic performance for the third quarter of 2009 attest to a slight improvement of the economy. For the first time since April 2008, industrial production grew about 7 percent in August, in monthly terms. However, exports maintained their downward trend in annual terms, about 25 percent. Unemployment rate marked 7.4 percent and annual inflation 0.3 percent.

Until the first quarter of 2009, the Greek economy was the least affected by the financial crisis that swept the other European Union countries. However, the Greek economy recorded the first contraction in the second quarter of 2009 owing to the accelerated fall of domestic investments and exports. The latest data on the economic performance for the third quarter of 2009 attest to the deepening of economic downturn. Construction industry and retail sales recorded further annual decline in July[3]. In August, industrial production and exports fell by 8.8 and 29.6 percent, respectively, in annual terms. Unemployment rate marked 9.6 percent in July. In August, annual inflation marked 0.7 percent.

The Turkish economic activity contracted -7 percent in the second quarter of 2009, following the contraction by -14.3 percent in the first quarter the present year. The improved foreign demand did not manage to recover the accelerated fall of domestic demand. Despite the improvements in investments, industrial production and consumer spending, they remained at negative figures. The improved confidence indices signal a turning point in the economic conditions in the country for the periods to follow. Inflation maintained its downward trend in September and marked 5.3 percent. In September 2008, it marked 10.4 percent.

According to the IMF assessments, Kosovo's economy grew 5.4 percent in 2008. The forecasts for 2009 show that it will shrink to 3.8 percent to later pick up again in 2010. The growth will be sustained by consumer spending

and investments. Annual inflation continued to record negative rates to -2.7 percent in September 2009. The rationale behind this figure is the fall of food and transportation prices.

Table 2 Economic indicators for the regional economies

Country	GDP change Q2 2009	Annual inflation September 2009	Unemployment rate August 2009
Italy	-6.0	0.3	7.4[1]
Greece	-0.3	0.7	9.6[2]
Macedonia	-1.4	-1.4	31.9[1]
Serbia	-4.0	9.5	15.5
Croatia	-6.3	1.0	14.2
Turkey	-7.0	5.3	12.8[2]
Kosovo	:	-2.7	:
Albania	5.3	2.0	12.7[3]

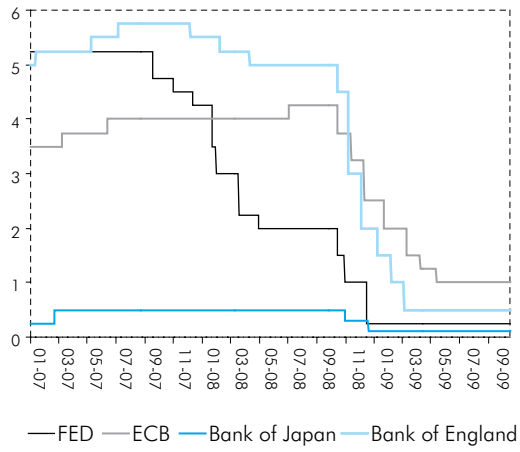
Source: Respective Statistical Institutes, EuroStat, EcoFin, IMF
[1] Data for the second quarter of 2009.
[2] Data for July. [3] Data for the first quarter of 2009.
: Data not available.

Former Yugoslav Republic of Macedonia's economy contracted 1.4 percent in the second quarter of 2009 vis-à-vis the same period the previous year, hence deepening the decline shown in the first quarter the present year. Investments and industrial production recorded substantial fall, while imports and consumer and public spending recorded a more moderate decline. Inflation marked -1.4 percent in September 2009 due to the fall in food and transportation prices, while the energy price rose.

II.2 MONETARY POLICY, FINANCIAL MARKETS AND EXCHANGE RATE

The European Central Bank (ECB) cut the key interest rate four times in the first nine months of 2009 to 1 percent from 2.5 percent in January the present year. The key interest rate remained unchanged in the third quarter. The ECB considers that the current rate is adequate since inflation is moving towards the target and economic activity is showing positive performance. The US Federal Open Market Committee kept the key interest rate unchanged in the first nine months of 2009 at 0-0.25 percent. The key interest rate was last changed in December 2008. The Bank of England changed the key interest rate three times in the first nine months of 2009 reducing it to 0.5 percent from 2 percent in the early year. The last key interest rate cut was made in March 2009. The Bank of Japan kept its benchmark interest rate unchanged at 0.1 percent throughout the year 2009. The last benchmark interest rate change was made in December 2008.

Chart 1 Key interest rate performance



Source: ECB, FED, Bank of England, Bank of Japan

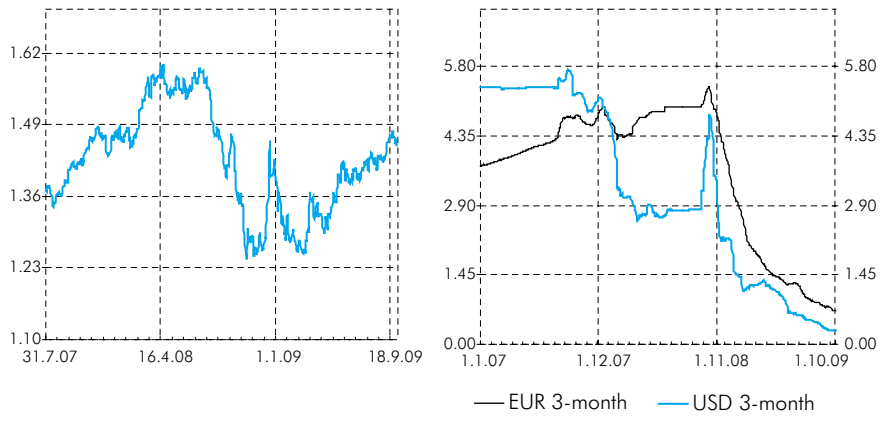
The financial markets attested to downward interest rates trend and improved confidence indices. Stock markets have also experienced a better performance. Starting from April 2009, the stock prices have risen for most items and volatility in this market has been more moderate. The improved economic and financial indicators have recovered the markets and fuelled the exchange activity, although the risk premiums show a cautious behaviour for long-term maturities[4].

LIBOR and EURIBOR interest rates in the money market maintained their downward trend during the third quarter of 2009, transmitting the flattening of liquidity pressures and the decrease of risk premiums. In early October, EURIBOR interest rates of 1, 3 and 12-month maturity term were 0.43, 0.74 and 1.23 percent, respectively, down by 31, 34 and 27 basis points vis-à-vis the early July. LIBOR interest rate of 3-month maturity term dropped by 30 basis points from June 2009.

Bond markets in Europe, Japan and the US attested to a downward performance. The US bond market experienced more pronounced volatilities during this period. Dow Jones, S&P and Nikkei indices were characterized by satisfactory growth and lower volatility in the recent months. The more positive outlook on business economic indicators and the market agents' more optimistic expectations led to higher stock quotes.

As from the end of June, the Euro appreciated against the US dollar, in particular during September. The market agents' assumptions, some of which confirmed by the poorer performance of some US economy sectors led to the depreciation of the US dollar. The Euro has also appreciated against the British pound and other European currencies. In quarterly terms, the Euro appreciated 4.93 percent against the US dollar. In early October 2009, one euro exchanged against the US dollar at 1.46.

Chart 2 EUR/USD exchange rate (left-hand) and USD/EUR LIBOR performance (right-hand)

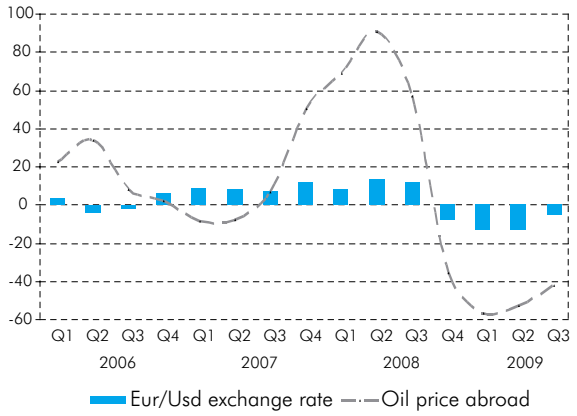


Source: ECB

II.3 OIL AND PRIMARY COMMODITY PRICES

Conditions in the international oil market improved in the third quarter of 2009. The combination of the positive performance of global oil demand and supply, and the weak US dollar in the international foreign exchange markets helped to recover the oil market. Average oil price per barrel, albeit lower than the same period the previous year, rose by 16 percent in quarterly terms in the third quarter of 2009. The positive performance of economic activity in emerging countries, the exit of the main advanced economies from the economic crisis and the recovery of manufacturing industry at a global level preceded and fuelled the global demand for oil. The latter, although still below the average level of 2008, grew 1.6 percent in quarterly terms in the third quarter of 2009. Given the favourable economic conditions, oil producing and exporting countries decided to increase the amount of oil produced in the second quarter. Global supply grew 0.7 percent in quarterly terms, with the OPEC countries, Russia and some of former Soviet Republics providing the main contribution.

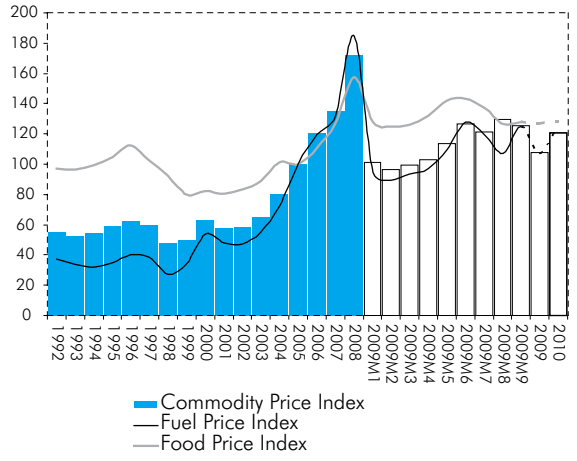
Chart 3 Annual change of oil price in the international market and EUR/USD exchange rate



Source: Eurostat, EIA

Commodity Price Index increased 9.6 percent in quarterly terms in the third quarter of 2009. In annual terms, it recorded a severe drop of 36.2 percent. The main rationale behind the latter is the statistical effect of the very high comparative basis. Fuel Price Index maintained a similar tendency and rose 11.9 percent in quarterly terms and fell 43.1 percent in annual terms. Food Price Index attested to a dissimilar performance, dropping in quarterly and annual terms by 3.2 and 18.8 percent, respectively.

Chart 4 Performance of price indices by main commodity groups



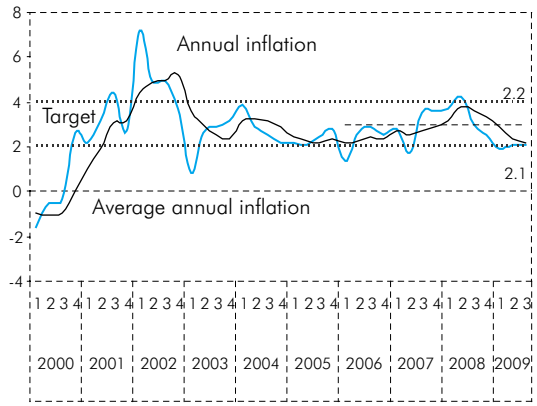
Source: IMF

III. PRICE STABILITY AND BANK OF ALBANIA OBJECTIVE

The primary objective of the Bank of Albania is to achieve and maintain price stability. This is the greatest contribution the central bank can provide to boost savings, sustain productive investments and promote a stable economic growth. In accordance with its strategy, the Bank of Albania is committed to achieving and maintaining inflation at 3.0 percent in annual terms, with a symmetrical tolerance band of +/- 1 percentage point. The announcement of the inflation quantitative objective aims at anchoring the economic agents' expectations, reducing the inflation premiums and promoting long-term investments in economy.

Annual inflation marked 2.1 percent in the third quarter of 2009, similar to the previous quarter. Following a pronounced downward trend[5] until March (1.6 percent), the annual inflation rate stabilized at the lower limit of the 3.0 percent inflation target of the Bank of Albania. Average annual inflation[6] marked 2.2 percent over this quarter, 0.2 percentage points below its historical average. This figure stands very close to its annual rate, attesting to the complete cessation of the first round effects of the primary commodity (food and oil) and energy price rise over the course of the previous year.

Chart 5 Annual inflation by quarters (in percent)



Source: INSTAT and Bank of Albania estimates

The inflationary pressures over the Albanian economy have been moderate during the last 12 months. In addition to the substantial fall of primary commodity prices in the international market, the disinflation process was also triggered by the weakening of inflationary pressures arising from the domestic demand against a background of global economic recession. Core and non-tradable inflation marked 1.0 and 0.8 percent, respectively, in the third quarter of 2009, attesting to a non-inflationary domestic macroeconomic environment. Starting from early 2009, tradable inflation increased by 1.6 percentage points owing to the exchange rate depreciating trend.

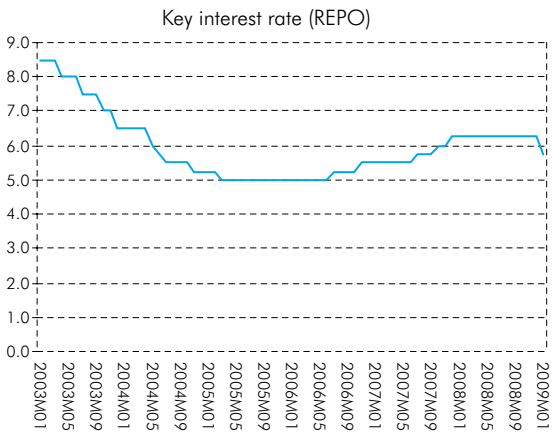
The Bank of Albania pursued a prudent monetary policy, aiming at creating the proper monetary conditions for a stable macroeconomic environment and mitigating the global crisis effects on the Albanian economy. Although the economic developments were affected by the global economic recession via the foreign trade and financial channel, they attest to positive economic activity growth rates in the first half of 2009. However, the slower growth rates of credit and money supply, budget revenues, trade exchanges and other indirect indicators of various economic sectors suggest that the economic activity in the country has slowed down. The latest data on global economy signal stable growth rates and primary commodity prices in the international market. The available data on the Albanian economy show a similar performance, although the figures are below the previous year's. Confidence survey results show that economic activity has weakened, although the indicators improved slightly in the second quarter. The economic agents' expectations remain anchored around the central bank's inflation target.

The Bank of Albania has been prudent in applying the monetary stimulus, aiming first and foremost at meeting its primary objective, which is conducive to safeguarding the overall macroeconomic stability.

III.1 MONETARY CONDITIONS

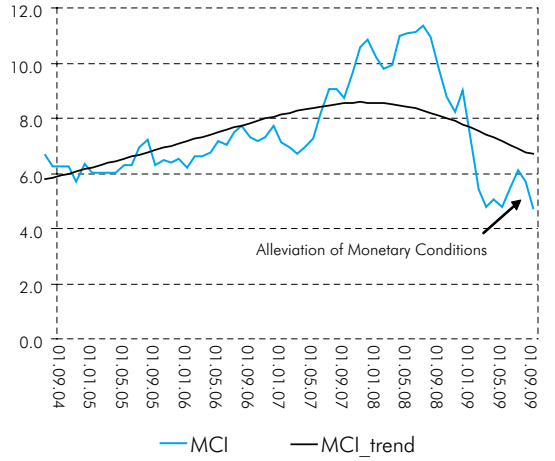
Against a backdrop of weak inflationary pressures and expectations

Chart 6 Key interest rate of the Bank of Albania



Source: Bank of Albania

Chart 7 Monetary Conditions Index



Source: Bank of Albania

anchored around the 3.0 percent target, the Bank of Albania continued to generate stimulating monetary impulses to the economy. In addition to lowering the key interest rate to 5.75 percent in January 2009, it injected ample liquidity. By increasing the amount of injected liquidity, extending the maturity term and expanding the collateral base, better conditions were created for stabilizing the liquidity and interest rates situation in the banking system and meeting the economy's needs for liquid funds.

Monetary policy maintained a neutral stand during this quarter as in the previous one. In spite of this, the Monetary Conditions Index (MCI) has alleviated and fluctuated below its historical tendency.

During this period, the MCI seems to have been entirely oriented by the performance of the exchange rate, one of the most significant components in small open economies. Reflecting the exchange rate performance, the MCI manifested a slight alleviating tendency in July. However, this tendency abated in August and September as a result of the depreciation of the ALL in the foreign exchange domestic market.

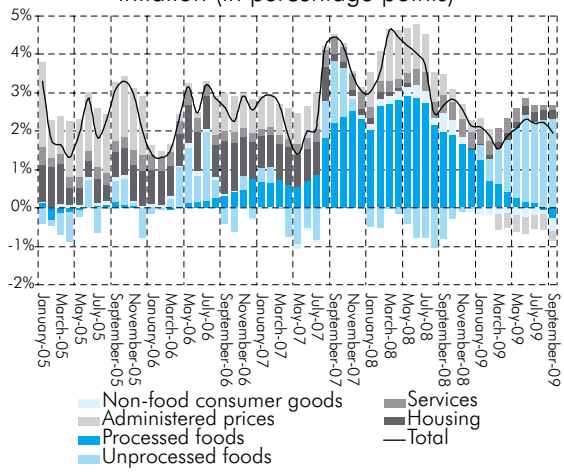
III.2 PRICE PERFORMANCE OF MAIN CPI BASKET ITEMS

Inflation of goods and services by their economic function maintained almost a similar profile during July to September 2009. The third quarter of 2009 attested to the higher inflation rate of foodstuffs, particularly of vegetables and fruit. Annual headline inflation was almost entirely formed by the contribution of "unprocessed foods", while the negative contribution of "administered prices", "processed foods" and "non-food consumer goods" eased the headline inflation for this period to lower positive rates.

The performance of the inflation rate of "unprocessed foods" is particularly significant in explaining and forecasting the short-term inflation fluctuations. This item's negative contribution to headline inflation over the course of the year 2008 helped to alleviate the strong inflationary pressures that were mainly generated by the supply-side. This item's contribution increased progressively during 2009 peaking in September with 2.4 percentage points. Its inflation marked double-digit rates in the last three months, peaking in August and September when it marked about 13.3 percent. The high monthly inflation (2.8 percent) in the two respective months owed primarily to the depreciation of

the Albanian Lek vis-à-vis the Euro, which led to the price rise of consumer goods mainly imported from the neighbouring countries. Prices of "vegetables" and "fruit" in particular contributed by 67 percent to the formation of the overall inflation figure during this quarter[7].

Chart 8 Contribution of items to annual inflation (in percentage points)



Source: INSTAT and Bank of Albania estimates

Prices of "processed foods" fell during this period manifesting an entirely dissimilar performance from the previous year. This item's annual inflation marked -0.2 percent while the previous year it stood at 10 percent. The imported share of these products has undergone a period of relaxation as a result of the marked fall of their prices in the global market the previous year. The downward inflation trend seems to have been determined by a gradual "shift" of prices below their level of August 2007 to February 2009 period, owing to the almost complete cessation of the price rise effect of "bread and cereal" sub-item since autumn 2007.

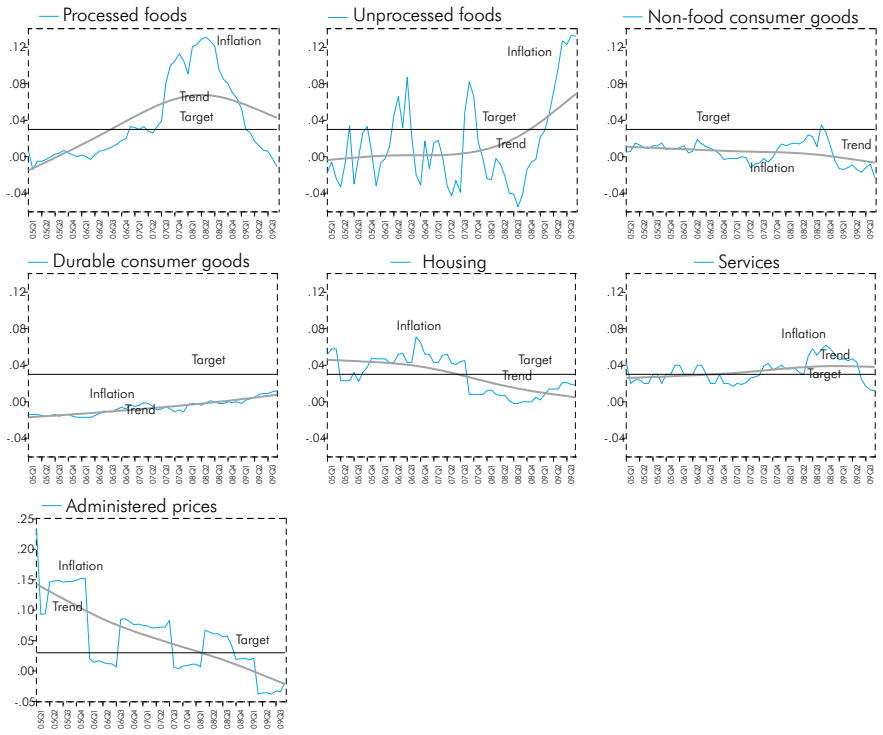
Table 3 Contribution of items to annual inflation (in percentage points)

	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Processed foods (pp)	2.9	2.3	1.7	0.9	0.3	-0.1
Bread and cereal (pp)	1.7	1.3	1.0	0.6	0.2	-0.1
Alcohol and tobacco (pp)	0.1	0.0	0.1	0.1	0.1	0.1
Unprocessed foods (pp)	-0.4	-0.9	-0.1	0.6	1.8	2.3
Fruit (pp)	0.3	-0.1	-0.1	0.0	0.3	0.5
Vegetables (pp)	-0.2	-1.3	-0.7	-0.3	1.4	0.9
Services (pp)	0.3	0.5	0.5	0.4	0.3	0.1
Administered prices (pp)	0.7	0.8	0.3	0.1	-0.4	-0.4
Fuels and energy (pp)	0.6	0.6	0.7	0.4	0.0	0.0
Housing (pp)	0.1	0.0	0.0	0.1	0.2	0.2
Non-food consumer goods	0.3	0.3	0.2	-0.2	-0.2	-0.2
Durable consumer goods (pp)	0.0	0.0	0.0	0.0	0.1	0.1
Consumer Price Index (y-o-y, %)	4.2	3.0	2.5	1.9	2.1	2.1

Source: INSTAT and Bank of Albania estimates

The annual inflation rate of "services" dropped for the third consecutive month in September 2009, marking 1.4 percent in the third quarter of the present year compared with 5.5 percent in 2008. The decrease of this item's inflation rate mainly attributes to the cessation of the public transportation price rise effect in June 2008. In addition, within this item, the price of hotel and restaurant services[8] fell during this quarter, which also represents a period of high demand for this type of services. The downward trend of prices in this item attests to the more complete satisfaction of the growing demand during the summer season[9] by the domestic supply.

Chart 9 Annual inflation by items of goods and services (in percent)



Source: INSTAT and Bank of Albania estimates

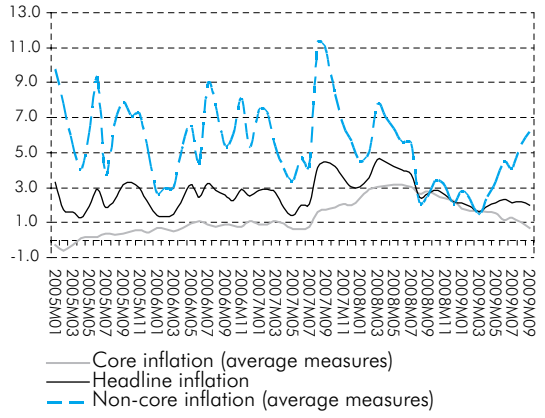
"Administered prices" item, which has historically determined the inflation trend, provided a downward contribution to the annual inflation during the last two quarters. The cessation of the administrative energy price rise in March and the maintenance of the energy price at an unchanged level for the following period, reduced the inflation and this item's contribution to a figure close to zero. This item's average annual inflation has marked about -3.5 percent since March the present year. The negative rates owe primarily to the fall of prices in "communication". The low inflation in other basket items caused this downward effect to be more pronounced on headline inflation during March to September 2009. The contribution of other items underwent minor changes during this quarter. Worth noting is the rise of oil price in monthly terms, which bears the risk of inflationary shocks arising from supply-side factors originating from outside the Albanian economy.

III.3 MAIN INFLATION TRENDS

Annual core inflation[10] marked 1 percent in the third quarter of 2009, deepening the downward trend, which began at year-end 2008, further. In September 2009, core inflation marked 0.7 percent converging to its long-term average[11]. The period from January to September 2009 attested to lower core inflation rates and fluctuating non-core inflation. The low core inflation

rates owed to the continuous dampening of relatively long-term inflationary pressures on the Albanian economy. In addition, the transitory movements in the consumer prices were more moderate. The rationale behind this behaviour is the contained nature of inflationary pressures at a global level.

Chart 10 Annual headline inflation and average measures of annual core and non-core inflation (in percent)



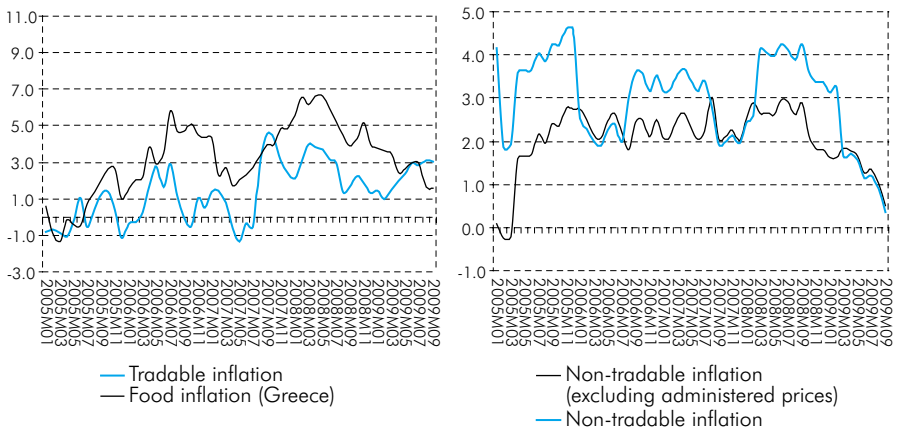
Source: INSTAT, Bank of Albania and Bank of Albania estimates

Annual tradable and non-tradable inflation of the CPI basket marked 3 and 0.8 percent, respectively, in the third quarter of 2009. Tradable inflation marked 3.1 percent in September, similar as in August. Its relatively high rate was mostly determined by the depreciation of the Albanian Lek vis-à-vis the Euro and the presence of strong fluctuations in the foreign exchange market since the early 2009. In the meantime, the global conjuncture of primary commodity and raw material prices continued to play a favourable role in dampening the inflationary pressures originating from outside the Albanian economy.

Non-tradable inflation maintained its downward trend. In September 2009, it marked 0.4 percent, one of the lowest historical rates since the early 2003. As a result of the combination between the cessation of administrative factors' effects and those generated from the economic activity slowdown, the performance of non-tradable inflation dampened the inflationary pressures over the first nine months substantially.

The above analysis attests to a balanced domestic demand in economy, expressed in low core and non-tradable inflation rates. They were important determinants of the headline inflation, which stood at the lower half of the tolerance band (2 percent) in January to September 2009.

Chart 11 Annual tradable and non-tradable inflation



Source: INSTAT and Bank of Albania estimates

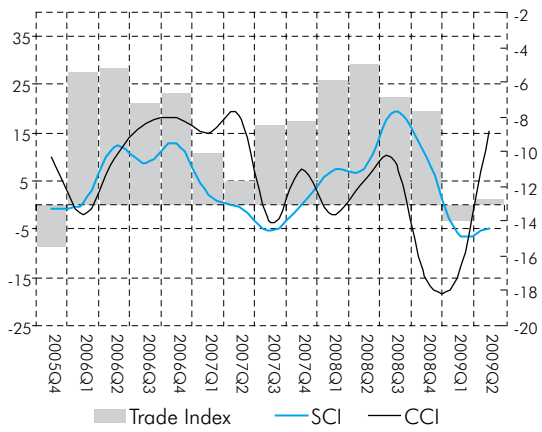
IV. MACROECONOMIC DEVELOPMENTS AND THEIR IMPACT ON INFLATION

Indirect indicators of aggregate demand in the Albanian economy attest to its contraction in the second quarter of 2009 and the period to follow. Consumption, private investments and export-related indicators continue to record lower rates than in the previous year. The expansionary fiscal policy pursued during January-August 2009 on short-term expenditure and public investments is assessed to have provided the main incentive to aggregate demand in economy. The contracted demand has slowed down the economic activity growth rates further during the first half of 2009 relative to the previous year.

IV.1 AGGREGATE DEMAND COMPONENTS

Indirect indicators show that consumer demand declined at more moderated rates in the second quarter of 2009 compared with the sharp decline in the first quarter of the present year. After recording the sharpest historical fall in the first quarter of 2009, services and consumer confidence indices showed signs of improvement in the second quarter. Based on quantitative data on consumer expenditure, the latest developments in the retail sector attest to the positive shift of this indicator compared to its downward trend since the third quarter of 2008. In annual terms, the Retail Trade Index (RTI) increased by 1.3 percent in the second quarter, following the decline by 3 percent in the first quarter. Its average rate for the first half of 2009 was -0.9 percent, which is far below the rate of the same period the previous year (+27.5 percent) and its average historical rate (+11 percent). With respect to private consumption, the downward trend of wages in the private sector, the labour market performance, the decline of remittances throughout the year 2009 and the pronounced reining in of household credit growth rates led to lower consumption rates during the first three quarters.

Chart 12 Retail Trade Index and Services and Consumer Confidence Indices



Source: INSTAT and Bank of Albania

Indirect indicators attest to the contraction of private investments during the first half of 2009. Based on quantitative data, the import of "capital goods" has declined 19 percent y-o-y in the second quarter. The fall of private investments is also confirmed by the confidence survey results. The contraction of investments owed to the undermined confidence in the industry and construction sectors, to the very low use of their production capacities and the curbing of lending for investment-related purposes. The annual drop of electrical energy consumption by non-households -mainly by businesses (-15 percent in annual terms)- signals the contraction of economic activity, reflected in the fall of demand by the private sector of economy during January to August 2009.

The fall of private investments has been followed by high growth rates of public investments, materialized in budget expenditure. Judging on the carrying out rates and level of budget expenditure for the period January to August 2009, public finances attested to an expansionary nature. Their annual increase by 23 percent marked one of the peak historical levels of the last four years' average. The increase in short-term expenditure and investment-related expenditure provided the main contribution to the higher expenditure rates. In the meantime, short-term investments continue to provide the highest contribution.

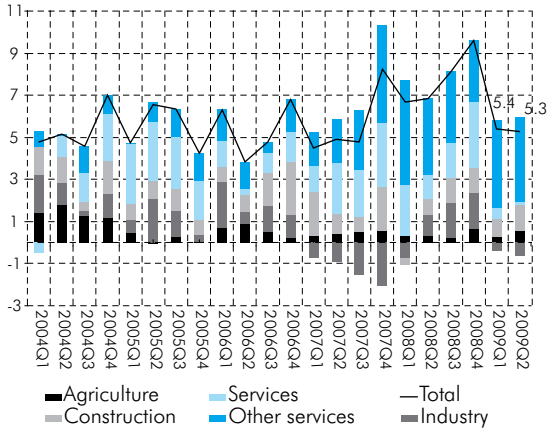
Foreign trade developments attest to the annual narrowing of trade deficit or net exports for the period January to August 2009. The 4 percent narrowing reflected the drop in both imports and exports, the latter being about 19 percent lower than in 2008. The performance of this aggregate demand component, which is mainly created by the private sector of the economy, suggests its general contraction during the first eight months of the present year.

IV.1.1 Production by Sectors of Economy

According to the data provided by the INSTAT, the GDP grew by an average annual growth rate of 5.35 percent in the first half of 2009, relative to about 6.8 percent the previous year. In the first and second quarter of 2009, the GDP grew 5.4 and 5.3 percent, respectively, in annual terms, down by 1.3 and 1.6 percentage points from the same period the previous year. Quarterly growth rates featured a similar tendency, attesting to the slower economic activity during January to June 2009.

Activity in services sectors[12] provided the main positive contribution to the GDP growth in the first half of 2009. Production sector increased its contribution to the GDP annual growth, mainly as a result of the improved activity in construction. In the meantime, industry deepened the downward rates that commenced in the first quarter of the present year.

Chart 13 Contribution of sectors to GDP growth (in pp)

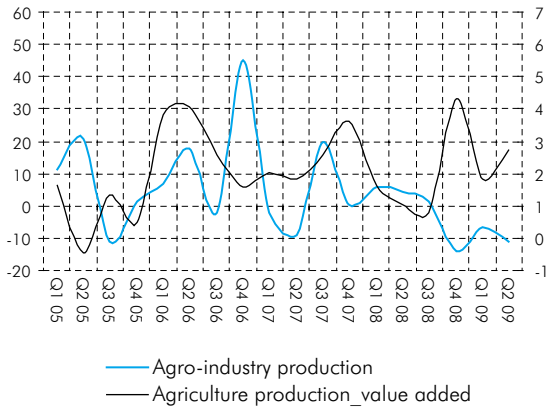


Source: INSTAT (GDP, Q2 2009) and Bank of Albania estimates

PRODUCTION SECTORS IN ECONOMY

Following the contraction in the first quarter of 2009, activity in agriculture[13] showed signs of improvement in the second quarter. GDP of agriculture grew 2.7 percent relative to the previous year, contributing by 0.55 percentage points to the annual GDP growth. In terms of quarterly changes, activity in this sector increased by 0.3 percent in the second quarter, following the decline by 0.3 percent in the first quarter the present year. In the meantime, agro-industry continued to decline during the first half of 2009, despite the

Chart 14 GDP annual changes in agriculture and agro-industry



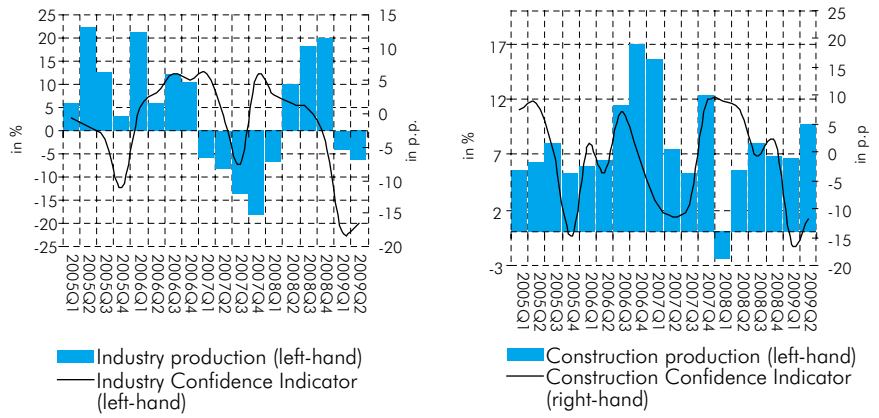
Source: INSTAT, Ministry of Agriculture, Food and Consumer Protection

relative improvement in the agriculture production sector's GDP growth rates.

For the second consecutive quarter, activity in industry declined in annual terms during the second quarter of 2009, providing a negative contribution to the GDP growth. Industry's GDP fell 6.3 percent in the second quarter relative to the same period the previous year. This fall deepened by 2 percentage points vis-à-vis the first quarter the present year. Despite the slight signs of improvement in the second quarter of 2009, the use of production capacities[14] in industry remains below the average level. The survey data signal the contraction in industry activity during the first half of 2009. Industry confidence indicator remains at low levels compared with its long-term average, in spite of the slight improvement marked in the second quarter of the present year.

In the second quarter of 2009, construction's GDP recorded the highest annual growth (9.8 percent) since the last quarter of 2007, hence reflecting into positive contribution to the GDP growth of the quarter. Starting from the second quarter of 2008, production in construction has recorded positive growth rates. Construction confidence indicator marked a turning point in the second quarter of 2009, following the deteriorated figures in the first quarter of 2009.

Chart 15 GDP annual change and Industry Confidence Indicator (left-hand); GDP annual change and Construction Confidence Indicator (right-hand)



Source: INSTAT and Bank of Albania

The positive tendency of energy sector indicators during the first half of 2009 persisted in July and August. Despite the poorer hydro conditions during this period of the year, energy production grew 3 percent in August

and September compared with the same period the previous year. Electrical energy production grew substantially in the first eight months of 2009, about 26.5 percent. The management of the energy distribution network has also manifested a positive performance. The ratio of losses in distribution to production dropped 4.5 percentage points in annual terms.

Despite the commencement of the electrical energy export in the first half of 2009, the volume of its export curbed in July and August owing to the lower production rates. The balance of the energy exchange recorded positive figures for the first time in 2009. The exported energy was 275.6 GWh higher than the imported energy. Households remain the main user of energy accounting for 57 percent of the market. Energy consumption by non-households, wherein business has the main share, dropped in annual terms.

Table 4 Annual indicators of the electrical energy balance (in GWh)

	8M 2007	8M 2008	8M 2009	Annual change 8M 2009/8M 2008 (in %)
Net production	2,103	2,837	3,590	26.5
Import	1,990	1,842	54	-97.1
Export	0	0	352	100.0
Losses in distribution	1,260	1,260	1,433	13.7
Losses/Production*	59.9%	44.4%	39.9%	-4.5 (pp)
Consumed energy	4,046	4,478	4,192	-6.4
Billed consumption	2,675	3,080	2,759	-10.4
Unbilled consumption	1,371	1,397	1,433	2.6
Household consumption	1,532	1,710	1,590	-7.0
Non-household consumption	1,143	1,371	1,169	-14.7

*Source: KESH; *) Bank of Albania estimates*

Losses in the distribution system remained a concern during the early third quarter of 2009. The 13.7 percent annual increase of this indicator owes mainly to the higher non-technical losses.

SERVICES SECTOR

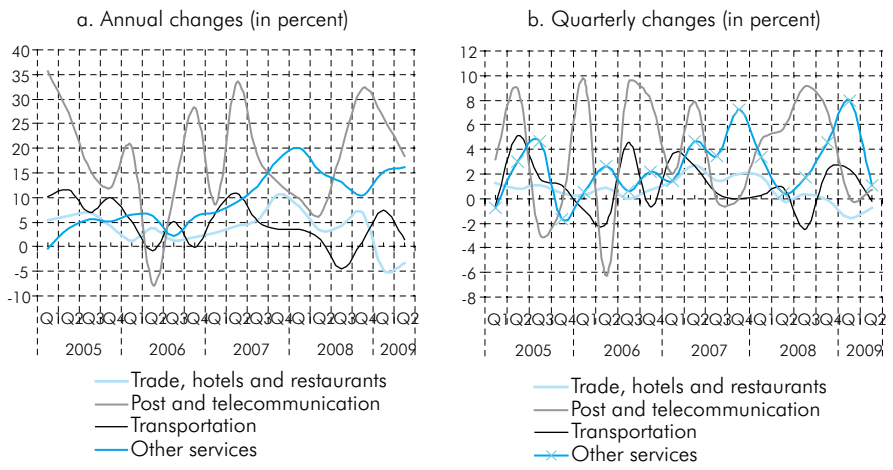
The services sector contributed 4.1 percentage points to the annual GDP growth in the second quarter of 2009. As in the first quarter, "other services" provided the main contribution. According to the latest quarterly GDP data, this item has recorded substantial growth in the last two years compared with previous periods. The annual growth rate of "other services" is comparable to the previous quarter's figure, about 16 percent.

The activity of services in "trade, hotels and restaurants", "transportation", "post and telecommunication" provided a slight contribution by about 0.1 percentage points to the annual GDP growth, relatively lower than in the first quarter of 2009.

Among these items, services of "transportation" and "post and telecommunication" recorded positive annual growth rates, although markedly

lower than in the previous quarter (1.7 and 18.1 percent, respectively). By contrast, activity in "trade, hotels and restaurants" dropped during the first two quarters of 2009 (by -4.7 and -3.2 percent, respectively). The five-year series of the annual change rates of these services' items recorded for the first time negative figures. In quarterly terms, services in "trade, hotels and restaurants" and "transportation" recorded negative growth rates, as well.

Chart 16 GDP performance in services



Source: INSTAT (GDP, Q2 2009)

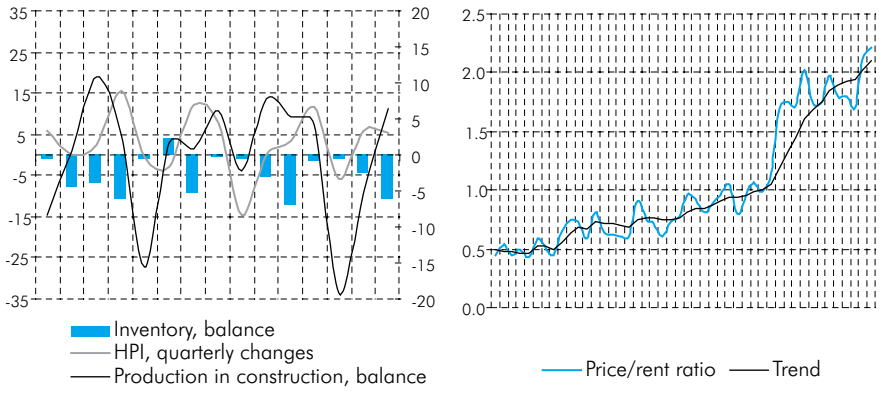
The relatively curbed growth rates in services were also signalled by businesses in the Services Confidence Survey. However, their expectations are relatively more positive than in the previous quarter.

HOUSE AND RENT PRICES[15]

House Price Index (HPI) rose 18 percent in the third quarter of 2009 vis-à-vis the same quarter the previous year. This performance confirmed the shift to its gradual rise that commenced in the first quarter of the present year. The data obtained from the construction business confidence surveys attest to the downward tendency of producer prices, which however have not been reflected in the transaction prices of the last two quarters[16]. Excluding the annual depreciation effect of the Lek vis-à-vis the Euro, the annual price rise of houses is only 10 percent (18 percent including the annual depreciation effect).

Indirect data show that the house price performance will largely depend on the expected growth of supply, expressed in the more optimistic expectations of construction, and on the decline of construction-related business inventories in the last two quarters (see Chart 18).

Chart 17 Performance of production and inventories in construction[17] and HPI quarterly changes (left-hand). HPI/HRI ratio and its long-term trend (right-hand)

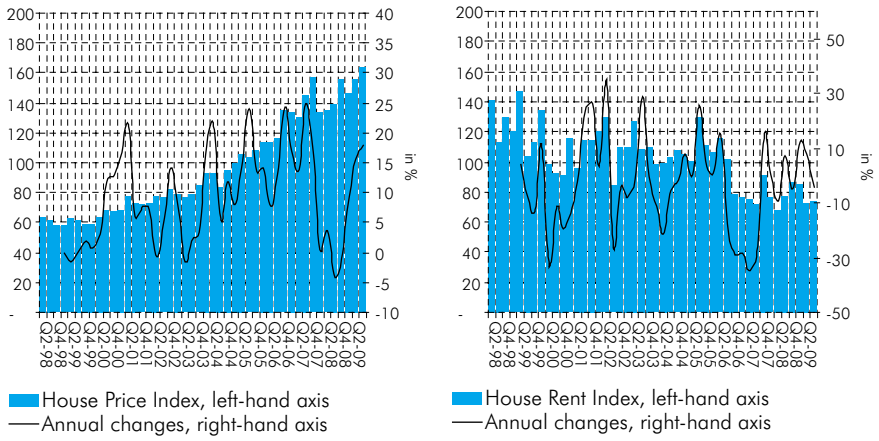


Source: Bank of Albania

House Rent Index (HRI) dropped 4.5 percent in the third quarter of 2009 compared with the same period the previous year.

The HRI remained at almost similar levels as in the previous quarter. House price/rent ratio[18] (see Chart 19) rose in the third quarter of 2009. It currently stands above the historical trend of this ratio owing to the higher house prices and the lower rental prices in the third quarter of 2009.

Chart 18 House Price Index and House Rent Index performance

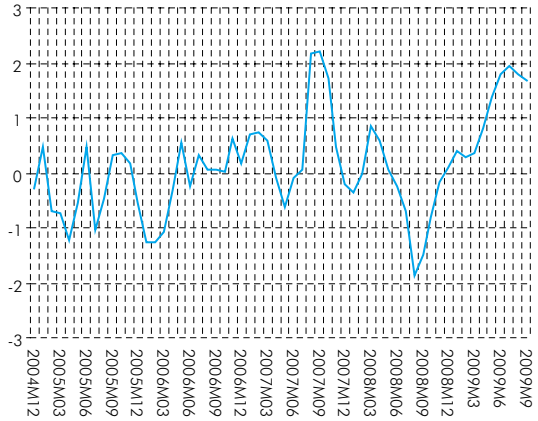


Source: Bank of Albania

PERFORMANCE OF IMPORT PRICES IN ECONOMY

The performance of import prices attests to low inflationary pressures deriving from the external economy and contracted aggregate demand in the Albanian economy. Import prices were a result of the counterbalance between the

Chart 19 Spread of domestic inflation and foreign inflation (in percentage points)



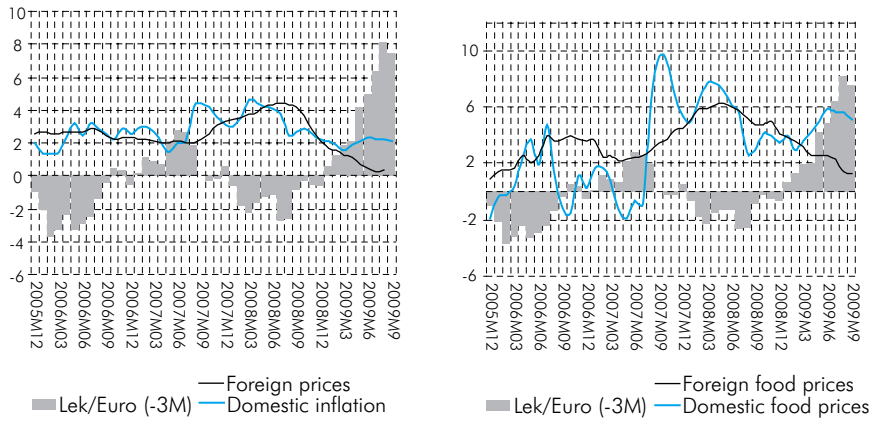
Source: Bank of Albania estimates and Statistical Institutes (Italy and Greece)

inflationary impact of the exchange rate devaluation on consumer prices and the favourable conjuncture of raw material prices in the international market, the global economic contraction and the statistical effect of the comparison. Foreign prices[19] rose on average 0.4 percent, while the Lek depreciated 7.7 and 13.1 percent vis-à-vis the Euro and the U.S. dollar in the third quarter, relative to the same period the previous year.

The spread between inflation at home and the average inflation of Italy and Greece increased substantially in the last two quarters. It peaked in the third quarter (1.8 percentage points) while during the period 2005-2008 it was almost zero. The higher gap and the depreciating exchange rate may give rise to inflationary pressures in the future.

Despite the low foreign prices, imported inflation has been going up owing to the devaluation of the Lek over the course of the year 2009. The latter has mainly affected the inflation of "food and non-alcoholic beverages" and the tradable inflation component[20]. Although food prices in Italy and Greece rose at low rates in the third quarter, about 1.1 and 2.0 percent, the annual depreciation of the Lek vis-à-vis the Euro curbed the transmission of the lower import prices to the Albanian economy.

Chart 20 Annual changes of foreign and domestic prices and the exchange rate (total – left-hand and only food prices – right-hand)



Source: Bank of Albania estimates and Statistical Institutes (Italy and Greece)

IV.1.2 Performance of the External Sector of the Economy

The overall balance of payments attested to the increase of foreign assets by EUR 142 million in the second quarter of 2009. The current account deficit totalled EUR 360 million, narrowing by EUR 3 million relative to the same

period the previous year. Trade deficit in goods amounted to EUR 567 million compared with EUR 561 million the second quarter in 2008. Capital inflows totalled EUR 434 million, thereby financing the current account deficit entirely.

The overall balance of payments attested to the increase of foreign assets by EUR 142 million in the second quarter of 2009. The current account deficit narrowed slightly in nominal annual terms, accounting for 16.7 percent of GDP[21]. Trade deficit in goods amounted to EUR 567 million, accounting for 29.5 percent of GDP.

Remittances declined 4.4 percent in annual terms, financing 35 percent of the trade deficit in goods. Foreign direct investments increased substantially during this quarter (by 2.6 times in annual terms) owing primarily to the privatization receipts.

Table 5 Balance of Payments indicators, in annual terms

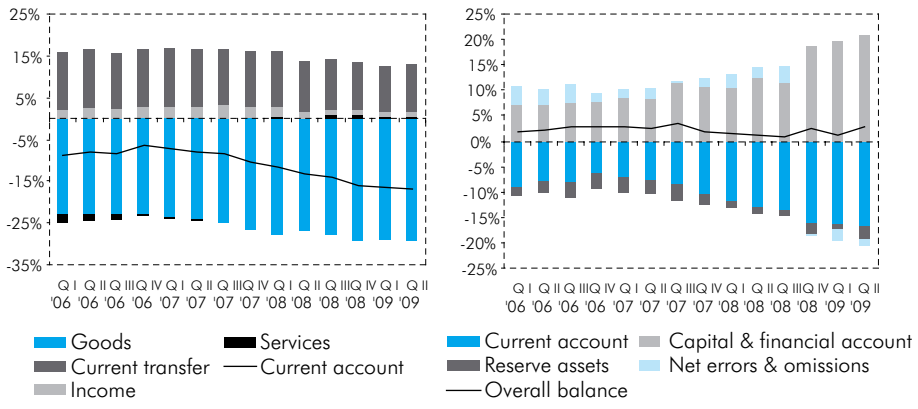
	In million Euros				As a share of GDP[22]			
	Q2 2006	Q2 2007	Q2 2008	Q2 2009	Q2 2006	Q2 2007	Q2 2008	Q2 2009
Current account	-153.2	-187.4	-363.5	-359.8	-7.9	-7.9	-13.2	-16.7
Trade balance	-413.8	-500.7	-561.2	-567.4	-22.9	-24.3	-27.0	-29.5
-Exports	165.7	209.8	260.4	195.0	8.2	9.5	10.3	10.0
-Imports	-579.5	-710.5	-821.6	-762.4	-31.1	-33.7	-37.3	-39.5
Services (net)	-9.5	13.3	-17.9	-18.4	-1.7	-0.3	0.1	0.6
Revenue (net)	41.1	43.5	-17.5	-10.6	2.4	2.8	1.5	1.1
Current transfers (net)	229.0	256.5	233.1	236.5	14.2	13.8	12.3	11.2
Capital and financial account	138.4	161.4	372.4	433.7	7.1	8.5	12.6	20.7
Overall balance	29.5	23.1	9.9	141.6	2.3	2.6	1.1	2.7

Source: IMF assessments and Bank of Albania estimates

CURRENT ACCOUNT

Current transactions amounted to EUR 2,203 million in the second quarter of 2009, down by 7.3 percent in annual terms. The largest portion of current expenditure financed the import of goods (above 60 percent), while foreign

Chart 21 Current account and the balance of payments as a share of GDP, yearly



Source: IMF assessments and Bank of Albania estimates

inflows entered mainly in the form of the export of goods and services (64 percent) and current transfers (30 percent). Current account deficit narrowed slightly by 1.0 percent in annual terms and amounted to EUR 360 million. Its slight narrowing was mainly triggered by the substantial lowering of the deficit in the revenue account balance[23] and the higher surplus in the current transfers' account[24].

FOREIGN TRADE

The analysis of the foreign trade developments for the period January to August 2009 attests to the decline of trade exchanges by approximately 10 percent in annual terms. Subsequently, the trade deficit narrowed 4 percent relative to the same period in 2008. Imports' coverage by exports reached 24 percent. In total, imports and exports declined during this period 7.7 and 19.2 percent, respectively, in annual terms.

The short-term dynamics of trade in goods' indicators attest to a similar setting. Albania's trade activity with the rest of the world contracted in August 2009. Trade exchanges have maintained a downward trend since January the present year[25]. Trade deficit narrowed further by about 11 percent in annual terms and 3 percent in monthly terms. Imports' coverage by exports is 21.4 percent or down by 2.4 percentage points from the same period the previous year.

Table 6 Exports and imports (in millions of Euro) and the annual and monthly change by commodity groups (in %) for August 2009

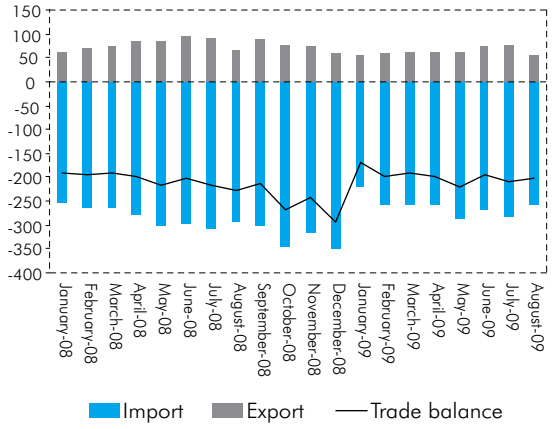
	Exports (in millions of EUR)	Annual change (in %)	Monthly change (in %)	Imports (in millions of EUR)	Annual change (in %)	Monthly change (in %)
Food and live animals	2.6	65.8	-7.1	32.2	-12.9	-13.8
Beverages and tobacco	0.1	-85.0	-82.3	18.1	31.0	40.5
Raw materials	9.6	-41.6	-17.7	9.6	80.1	9.2
Fuels	8.2	-1.1	55.3	45.6	-32.2	38.3
Vegetable and animal fats and oils	0.0	174.3	7527.2	2.9	-27.2	6.5
Chemical products	1.4	73.7	65.1	25.7	-11.1	-16.4
Processed goods	7.7	-44.5	-35.3	56.8	-9.8	-18.8
Machinery and appliances	3.7	47.9	-2.5	47.9	-3.4	-22.8
Other processed goods	21.8	7.5	-43.1	18.4	-21.1	-27.0
Miscellaneous	-	-	-	-	-	-
Total	55.1	-14.1	-26.4	257.2	-12.0	-9.0

Source: Bank of Albania

The performance of exports attests to the persistent downward trend in August, although slightly more moderate since April the present year. Exports declined 14 percent in annual terms, while in monthly terms they declined sharply by 26 percent.

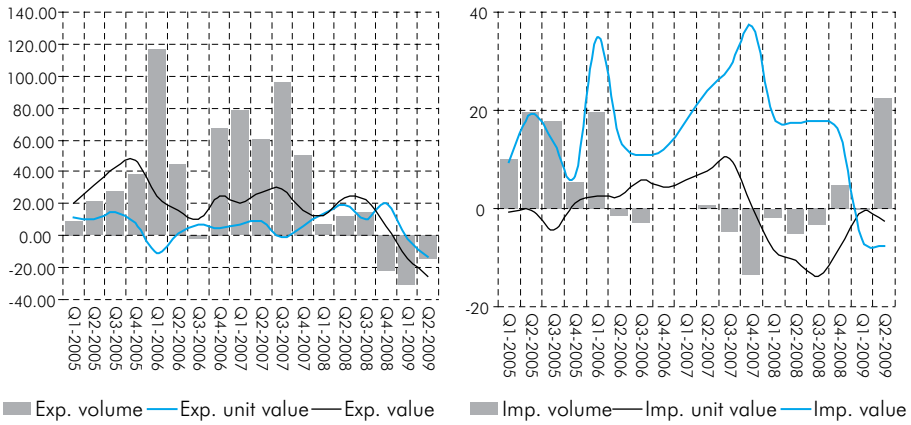
Imports show a similar performance as well. In August, they declined 12 and 9 percent in annual and monthly terms, respectively. In terms of commodity groups, the imports of "fuels" and "food and live animals" recorded double-digit decline in annual terms. In the meantime, "machinery and appliances" and "raw materials", which have the largest share to total imports, recorded more moderate annual decline. The short-term dynamics of these items attests to more accelerated monthly growth rates of "fuels" and more accelerated monthly decline rates of the other three items. The performance of prices in the international markets has also triggered the annual fall of the unit value index of imports by 3 percent in annual terms. The unit value index of exports has maintained the downward trend shown since the third quarter of 2008, a period during which the demand from Albania's main trading partners began to slacken.

Chart 22 Imports, exports and trade balance (in million Euros)



Source: Bank of Albania

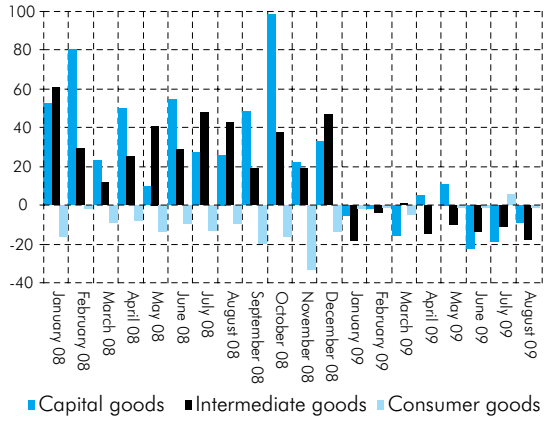
Chart 23 Annual change of imports' and exports' value and the unit value index (in percent)



Source: General Customs Directory, INSTAT and Bank of Albania

In terms of purpose of use, imports of "capital goods" and "intermediate goods" posted a decline. In annual terms, their imports' value declined 9 and 17.6 percent, respectively, in August. By contrast, the imports' volume of "consumer goods" was less volatile, recording an average annual change of 0.7 percent. In August, this item's imports declined 1 percent relative to the same month the previous year.

Chart 24 Annual changes in the imports of capital, intermediate and consumer goods (in percent)



Source: Bank of Albania

In terms of geographical distribution, the EU countries -mainly Italy and Greece- remain

Albania's main trading partners. Exports to EU countries accounted for 67 percent of total exports' volume, with Italy sharing the main weight, about 48 percent. With respect to imports' origin, the diversity is less concentrated. Imports from Italy declined their share to total to 20 percent in August 2009 from 27 percent in July, which is explained by seasonal-related factors. In the meantime, there has been an increase in the trade exchanges with China, Russia and Turkey.

PERFORMANCE OF OTHER CURRENT ACCOUNT ITEMS

Services posted a negative balance for the second consecutive quarter. Its deficit stood at an almost similar level as in the second quarter of 2008, while in quarterly terms, it improved by 14 percent. Revenue and expenditure remained at an almost similar level in annual terms. In quarterly terms, they grew 31.3 and 28.3 percent, respectively. Albania remains a net importer of freight and insurance services. Travel services posted a positive figure of EUR 2.7 million, shifting from deficit to surplus[26]. Travel services account for the largest share in services' revenue and expenditure, sharing 75 and 71 percent, respectively, of the total. Foreign currency inflows from travel services totalled EUR 299.4 million, up by 19.8 percent from 2008. Albanian tourists spent abroad EUR 296.7 million or 6.0 percent more than in 2008.

Net revenue posted a negative figure of EUR 10.6 million. Relative to the previous year, the situation is more positive for income from labour and investment income. Income from labour is slightly higher than in 2008, while down by 11.6 percent from the previous quarter. Net investment income posted a reduction in its deficit of 12 percent in annual terms.

Net current transfers are 1.5 percent higher than in the same quarter the previous year[27]. The considerable growth in official inflows[28] provided the main contribution to this increase. Around EUR 198 million entered Albania in the form of remittances, which declined 4.4 percent in annual terms.

CAPITAL AND FINANCIAL ACCOUNT

Net foreign inflows in the capital and financial account amounted to EUR 434 million in the second quarter of 2009. Around EUR 16 million entered Albania in the form of capital investment transfers and EUR 418 million in the form of net financial flows. Capital inflows financed the current account deficit entirely and accounted for 20.7 percent of GDP[29].

Albania's financial liabilities to the rest of the world grew EUR 285.3 million, while residents' assets abroad declined EUR 132.1 million. The considerable increase of foreign direct investments' inflows by EUR 312.8 million[30] provided the main contribution to the increase of liabilities to non-residents. Extensions of long-term and soft loans from abroad amounted to EUR 161.4 million during this quarter. The increase of this type of liabilities leads to higher future external debt-service payments. In the second quarter of 2009, external debt service lowered the residents' liabilities by EUR 37 million.

The decline of foreign currency assets invested abroad is mainly manifested in investments in the form of banking system's deposits held with non-resident financial institutions (EUR 126.3 million). Financial assets in the form of portfolio investments posted a decline as well (EUR 14.7 million).

Reserve assets increased by EUR 141.6 million. As at end of the second quarter, the reserve stock was EUR 1,711 million, sufficient to cover 4.2 months of imports of goods and services.

Box 1 Performance of Foreign Direct Investments – A Comparative Approach

Emerging countries consider the absorption of Foreign Direct Investments (FDI) to their economies a key priority. Economic theory underlines several economic and financial benefits arising from the increase of FDI in emerging countries. The entry of non-resident companies for business-related purposes – in addition to creating financial inflows and opening new jobs – increases productivity and competition in the respective industries (Jun & Singh 1995).

The level of the FDI in an emerging economy depends on several main factors. Some of them are directly related to the home authorities and the others to the domestic market profile. More specifically, the market size, wage costs, interregional competition, and slightly less the exchange rate stability, mainly relate to the domestic market profile. On the other hand, political and financial stability are two major determinants, which mainly relate to the home authorities. In addition, FDIs are flexible to the fiscal framework -temporary and permanent facilities- such as the measures applied on financial inflows and other administrative incentives.

After several years of positive performance, FDI inflows to South-East Europe declined in 2008. The majority of countries recorded negative growth rates of the FDI, while only a few of them (including Albania) recorded more moderate FDI growth rates relative to the previous year. Since the largest portion of FDI in the region originates from the advanced Euro area countries, the financial and economic turmoil in these countries provided their impact on the decline of the FDI, which began once the crisis was first shown in Europe.

Albania is the only country in the region to have recorded a double-digit figure of the FDI growth in 2008. The performance of the FDI in 2005 to 2008 attests to its double-digit growth in annual terms[31]. Relative to other regional countries, excluding Montenegro which does not record any changes in the FDI inflows, all the other countries recorded double-digit decline figures in 2008.

Table 7 FDI inflows, in millions of EUR

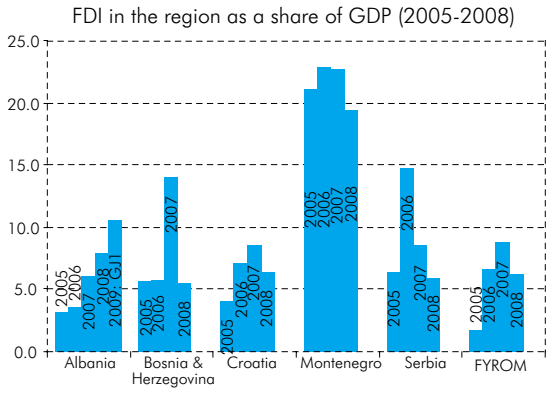
	2007	2008	Q1:2008	Q2:2008	Q3:2008	Q4:2008	Q1:2009
Albania	481	653	103.8	120.4	178.1	250.9	123.6
Bosnia and Herzegovina	1,543	686	80.3	142.2	259.9	200.0	30.7
Croatia	3,634	2,982	-	-	-	-	-
Montenegro	639	639	166.0	198.6	150.3	124.5	110.5
Serbia	2,525	2,037	853.7	728.6	225.2	229.9	635.5
Macedonia	510	407	117.0	136.7	90.5	63.3	54.5

Source: World Investment Report 2009 (UNCTAD) and Bank of Albania estimates

The same trend persisted in the first quarter of 2009. The FDI inflows to Albania grew 20 percent relative to the same quarter the previous year. In the meantime, regional countries recorded substantial decline in the FDI growth rates; subsequently

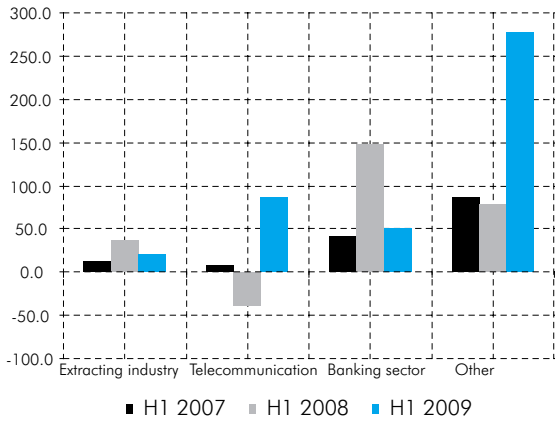
the FDI share as a percent of GDP declined as well. In the case of Albania, the upward trend of the FDI persisted in the second quarter of 2009, owing primarily to the increase of privatization receipts.

Chart 25 Performance of the FDI as a share of GDP, in years



Source: World Investment Report 2009 (UNCTAD) and Bank of Albania estimates

Chart 26 Distribution of FDI by sector, in years and millions of EUR



Source: Bank of Albania

The distribution of the FDI by sectors attests to their lack of uniformity and diversity during 2005 to 2009. The period 2005-2007 shows higher FDI inflows to telecommunication. However, the period from 2008 to the first half of 2009 shows lower FDI inflows to this sector. The year 2008 proved to be a successful one for the FDI to extracting industry and the banking sector. It also marked the peak year of FDI inflows to these sectors for the period 2005-2009. Given the remarkable performance in 2008, these two industries were less attractive to foreign investors during the first half of 2009. Manufacture of textiles and wood, classified under the item "other", has attracted a large portion of FDI inflows. This industry, mainly a re-exporting one, has enjoyed progressive growth rates of the FDI since 2005. The favourable labour conditions in the Albanian market and the fiscal facilities provided to the business sector are the two main incentives for the positive performance in this industry. The growth of the FDI inflows to this industry has been also spurred by the need to increase the Albanian exports to the international and interregional markets, in order to cope with the risks arising from the trade deficit deepening.

FDI inflows to Albania have been also affected by significant reforms aiming at improving the conditions of "doing business" in the country. More specifically, the creation of the National Registration and Licensing Centre reduced and eased the procedures for the business registration and licensing. Another incentive for foreign businesses that decide to invest in Albania relates to the reduction of the fiscal burden: the reduction by half of the profit tax to 10 percent, the reduction of the flat tax to 10 percent, the reduction by half of the tax on small-sized businesses to 1.5 percent and the reduction by half of the employer's contribution to 15 percent. In 2008, the Corporate Law was amended with the purpose of enhancing the corporate transparency further. The reforms in this Law ranked Albania among the first 20 countries in the Investor Protection index in the World Bank "Doing Business" report.

IV.1.3 Fiscal Indicators and Fiscal Policy Performance

The government ran an expansionary fiscal policy throughout the year 2009, however its intensity moderated in August. Mid-first quarter marked the beginning of the expansionary fiscal policy peaking in May and June. As at end of August, budget revenue amounted to ALL 195 billion, meeting 92 percent of the projection[32]. Budget expenditure totalled ALL 242.5 billion,

meeting 93.3 percent of the projection. As at end August, the budget deficit was at almost the same level as the projection.

Table 8 Main fiscal items for the first eight months relative to the previous years

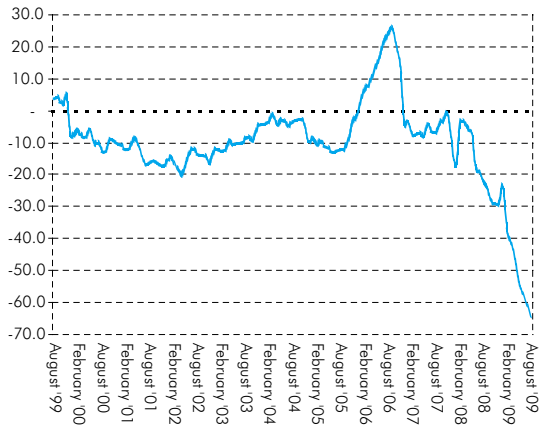
	Actual (in billions of ALL)	Projection versus plan* (in %)	Annual change (in %)		
	8-month 2009	8-month 2009	8-month 2007	8-month 2008	8-month 2009
Revenue	195.0	91.8	8.7	18.6	5.4
- Tax and customs	138.1	94.2	13.1	18.9	4.7
VAT	71.1	94.8	21.1	23.2	4.3
Tax on profit	11.5	84.0	-7.6	-10.7	-6.4
Excises	22.5	78.6	27.1	21.1	3.2
- Local government	8.6	69.6	-7.7	16.2	11.3
- Independent budget	33.7	94.0	0.1	17.7	10.5
- Non-tax revenue	12.9	92.2	12.6	22.9	-8.9
- Grants	1.7	49.2	-56.3	-21.3	142.3
Expenditure	242.5	93.3	10.8	34.0	23.3
- Current expenditure	177.3	92.7	7.0	15.6	18.4
Personnel	40.2	95.4	0.6	17.2	-1.7
Interests	23.8	96.5	-3.5	24.6	13.0
Social insurance and pensions	62.4	96.4	15.7	9.7	27.9
Local government expenditure	20.8	89.6	0.9	36.6	40.3
- Capital expenditure	65.1	94.9	50.9	142.4	55.7
Budget balance	-47.5	99.9	-16.3	-228.7	304.7

Source: Ministry of Finance
Note: According to the early 2009 projection.

Primary deficit deepened further during the year 2009. As at end August[33], it amounted to ALL 64.7 billion.

The performance of the primary deficit reflects the concurrent increase of the domestic and external debt over the course of this period. In addition, the widening of the primary deficit mirrors the widening of the negative difference between economic growth and the interest rate on public debt.

Chart 27 Moving sum of primary deficit, August 1999-August 2009, in billions of ALL



Source: Ministry of Finance and Bank of Albania's staff estimates

PERFORMANCE OF BUDGET REVENUE AND EXPENDITURE

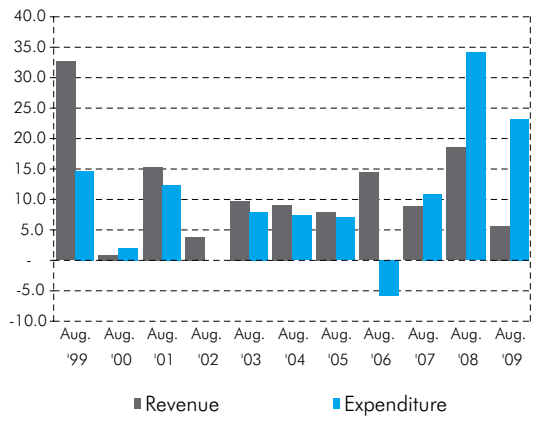
As at end of August 2009, budget revenue posted an annual increase of 5.4 percent, the lowest increase since 2002. Relative to the previous years, VAT revenue, which makes up the main source of budget revenue (about 36 percent of the total),[34] posted a downward contribution to total revenue. Other items, namely tax on profit, social and health insurance and non-tax revenue have also lowered their contribution to the annual increase of revenue relative to the previous years. The performance of the main revenue items attests to the contraction of economic activity at home.

Budget revenue projection for the first eight months of 2009 was not met by ALL 17.3 billion, which primarily owes to the non-meeting of tax revenue projection.

Revenue from VAT amounted to ALL 71.1 billion, up by 4 percent in annual terms. Although the VAT rate was kept unchanged from the previous years, revenue from VAT posted the lowest increase in annual terms since August 2001. As in the previous two years, revenue from *tax on profit* posted negative growth rates during the first half of 2009, despite the termination of the tax rate reduction effect by 10 percent[35]. The projection for this period was met 84 percent. *Excise duty* revenue recorded a substantial slowdown in terms of the growth rate relative to the previous years.

Independent budget revenue (social and health insurance contributions) increased by 10 percent relative to the first eight months of 2008. However, this item failed to meet the projection for this period by ALL 2.2 billion[36].

Chart 28 Annual changes of revenue and expenditure (January-August, in percent)



Source: Ministry of Finance

Revenue from tax on personal income, customs duties and budget institutions met the eight-month projection. However, in annual terms, revenue from customs duties continued to contract owing to the various agreements promoting the free movement of goods.

As at end of August, budget expenditure amounted to ALL 242.5 billion, meeting 93.3 percent of the plan. Unlike revenue, budget expenditure grew at higher growth rates during the year. In annual terms, total expenditure grew 23 percent, about 12 percentage points higher than the average growth rate for the period August 2005-August 2008.

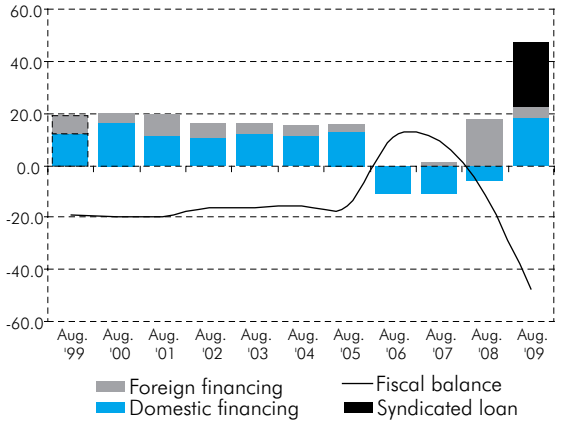
Short-term expenditure provided the main contribution (17 percentage points) to the annual growth of total expenditure. The rest of contribution (6 percentage points) was provided by investment expenditure. All current expenditure items have grown in annual terms, among them local government expenditure, social and health insurance expenditure and operation and maintenance expenditure[37] having grown at the highest rate. Despite their high growth rates, the same items share the main weight in terms of non-meeting the 8-month projection of short-term expenditure.

Capital expenditure amounted to ALL 65.1 billion, meeting 95 percent of the projection. In annual terms, long-term expenditure grew 56 percent during the 8-month period. The increase of investment expenditure during the last two years, owing primarily to the Durrës-Kukës road, brought about the increase of this item's share in total expenditure. Although in the short-term the increase of this item gives rise to higher budget deficit, in the long run, the upgrade of infrastructure will be key to bolstering economic growth.

BUDGET DEFICIT AND ITS FINANCING

As a result of the more active fiscal policy on the expenditure side, the budget deficit has been going upward starting from February this year. The performance of budget revenue and expenditure, in terms of growth rates and meeting of projection, gave rise to higher budget deficit, which remained above the Ministry of Finance's projection throughout the largest part of the year.[38] In August, the budget deficit met the 8-month projection, owing to the relatively lower expenditure than in the previous three months[39].

Chart 29 Budget deficit performance and main financing sources (January-August, in billions of ALL)



Source: Ministry of Finance

In addition to the "conventional" instruments employed to finance the budget deficit, the Government employed another new instrument called the "syndicated loan"[40]. The latter financed 50 percent of this period's budget deficit. About 75 percent of the syndicated loan was extended by non-resident banks and the rest by resident banks and institutions operating in Albania.

Privatization receipts provide substantial contribution to financing the budget deficit. As at end period, they amounted to ALL 22.9 billion[41].

Table 9 Budget deficit and its financing during the 8-month period, 2006-2009, in billions of ALL

	8-month 2006	8-month 2007	8-month 2008	8-month 2009
Budget balance	10.9	9.1	-11.7	-47.5
Financing	-10.9	-9.1	11.7	47.4
Domestic financing	-10.5	-10.5	-6.0	24.5
Domestic borrowing	-8.7	11.7	13.4	3.0
T-bills	-26.6	-18.9	-8.2	-0.4
Bonds	17.9	30.7	21.6	6.4
Direct loans[42]	0.0	0.0	0.0	-3.0
Privatization receipts	2.1	0.1	0.7	22.9
Other[43]	-3.9	-22.3	-20.1	-7.6
Syndicated loan	0.0	0.0	0.0	24.6
Foreign financing	-0.4	1.3	17.8	4.5

Source: Ministry of Finance

Government's borrowing policy through financial instruments was more oriented to long-term instruments, which is consistent with the securities' market development principles. Domestic debt stock with financial instruments grew ALL 6 billion during January to August 2009, which is ascribable to long-term debt securities. Long-term debt as a share of total domestic debt increased by 0.9 percentage points from the same period the previous year to 38.5 percent.

As at end of the first half, external debt stock accounted for 20.8 percent of GDP, up by 2.4 percentage points from the previous year. As at end the same period, public debt accounted for 56.3 percent from 56 percent as at end 2008.

*Box 2 Role of Fiscal Policy during the Crisis and the Future Challenges**

The crisis that hit the global economy in September 2008 required the immediate intervention of the monetary and fiscal authorities in order to curb the extent of its consequences on the real sector of different economies. The global crisis called for a number of measures that were mainly focused on two directions: first, the recovery of the financial system, and second, the stimulation of aggregate demand. In addition, these measures aimed at restoring the economic agents' confidence in the financial system. While some of these measures overlap and given the limited room for monetary policy, the focus of these measures was on fiscal policy. A survey of the countries that have experienced severe systemic financial crises shows that the successful resolution of the financial crisis is a precondition for achieving sustained growth. The government's intervention in economy consisted in two directions: the recapitalization of the financial system and the design and implementation of countercyclical fiscal policies. If the central banks and governments had not acted timely and appropriately, the financial crisis would have been even more intense and the recession deeper.

The fiscal costs of the crisis were significant, with substantial impacts of the contraction in economic activity on public finances. Based on the Euro area data, the fiscal costs of the economic and financial crisis are expected to be considerable. In 2007, Euro area general government borrowing amounted to around half a percent of GDP. In its Spring 2009 forecast, the European Commission projected that government borrowing in the Euro area would rise to 5.3 percent of GDP this year and 6.5 percent in 2010. The Euro area government debt ratio, which stood at 66 percent of GDP in 2007, is projected to rise to 88 percent of GDP in 2010. In addition, 13 of Euro area governments are projected to breach the 3 percent of GDP deficit reference value of the Maastricht Treaty. The latter is expected to persist in the following years as well.

The deterioration of fiscal figures compared to pre-crisis periods also reflects the costs of discretionary fiscal stimulus measures adopted in many countries. Against this backdrop, the regional countries have taken measures to improve the negative effects of the global crisis on their domestic economy. Almost all the regional countries (Croatia, Bosnia, Serbia, Macedonia and Montenegro) have revised their initial budget based on new economic growth projections (which is expected to be lower than the early-year projection). Against this background and in order to avoid unsustainable budget deficit or public debt in the future, the regional countries have reduced the early year budget expenditure projections, although these measures have relatively been of an "anti-social" nature.

The scale of the challenge for fiscal policy is considerable. Over the past 12 months, governments, like central banks, have taken unprecedented action to restore stability to the financial system and to tackle the largest recession in post-war history. Although this action was largely "justified", most governments will come out of this crisis with the highest debt levels, as a proportion of GDP, ever to have been experienced in modern history. And this at a time when the fiscal burden associated with the population ageing looms ever larger over the horizon. If confidence in future stability is to be ensured, now is the time to set out an effective fiscal exit strategy.

Faced with the prospect of large deficits in the coming years, the priority for fiscal policy must be to set out a clear and credible plan for restoring order to the public finances over the medium term. Just as central banks are mulling their exit strategy from non-standard monetary policy measures, governments need to develop their exit strategy too. Beyond this, there is a risk that the increase in government borrowing

during the crisis is viewed as being purely the consequence of the operation of the automatic stabilisers and fiscal stimulus packages. Cyclical effects should cancel out over time. Stimulus measures are supposed to be largely temporary. So once the crisis is over and the stimulus measures unwind, the economic indicators should be more or less back to long-term equilibrium or pre-crisis levels.

Note) The references for Box 2 are as follows: "Fiscal policy and the financial crisis: the need for an effective exit strategy", CFS Conference, September 2009; "Fiscal policy for the crisis", A Spilimbergo, A., Symansky, S., Blanchard, O., Cottarelli, C., December 2008; World Economic and Financial surveys: Regional Economic Outlook, October 2009.*

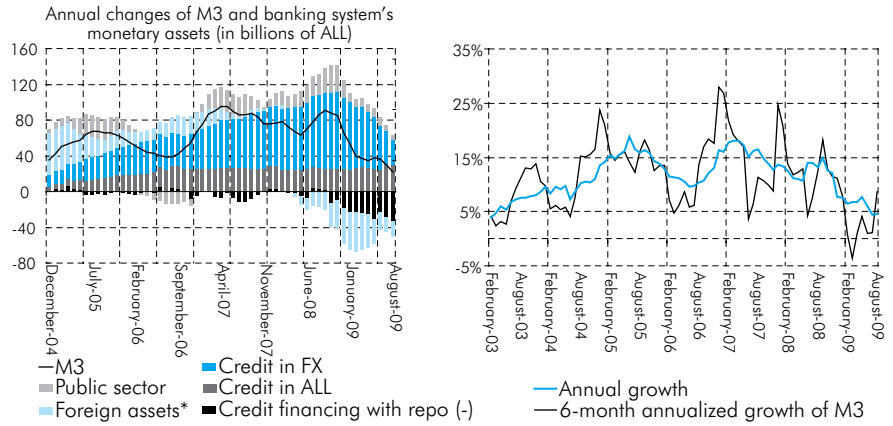
IV.1.4 Monetary developments

Third quarter's monetary indicators attested to the downward trend of money growth, which materialized into the decline of money circulation in economy. In annual terms, broad money (M3) grew 4-4.5 percent during the third quarter. Money growth in economy was mainly sustained by the stable growth of ALL lending to the private sector. The seasonal developments attest to the positive performance of net foreign inflows in the form of remittances. The banking system backed the growth of ALL financial assets through the borrowing instrument of repurchase agreements, while foreign currency inflows partly improved its foreign currency position.

PERFORMANCE OF MONETARY AGGREGATES

The performance of monetary aggregates reflected the slowdown of money supply to the economy during July and August 2009. Money supply (M3) grew 4.5 percent in annual terms relative to the average growth rate of 7 percent during the first half of 2009. The statistical effect of deposits' withdrawal at year-end 2008 continues to be reflected in the annual growth rate of M3.

Chart 30 Contribution of asset items to the annual performance of M3 (in billions of ALL) and it annual growth rate (in percent)

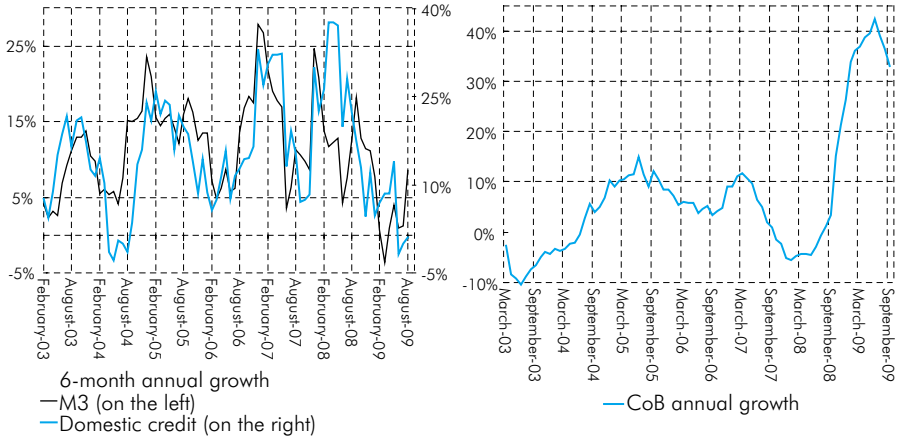


* Net foreign assets have been adjusted to the exchange rate effect and the public sector's foreign currency deposit.
Source: Bank of Albania

However, the withdrawal of foreign currency-denominated deposits and the decline of commercial banks' net foreign currency assets during the first half of 2009 gave rise to lower foreign currency lending. Against this backdrop, money circulation declined vis-à-vis 2008, while the money growth in economy was primarily sustained by the ALL lending.

Non-banking sector's presence in financing the budget deficit led to lower domestic borrowing contribution to the annual growth rate of M3. Non-banking sector's role in financing the budget deficit grew at more rapid rates vis-à-vis the previous years. For the period January to September 2009, non-banking sector's financing totalled ALL 11 billion against the commercial banks' financing of ALL 2.2 billion. Non-banking sector's direct participation in financing the deficit has approximately totalled ALL 7-9 billion over the course of the recent years. The increase of individuals' direct participation in financing the deficit led the public sector to contribute by only 1.1 percent to the annual change of M3[44].

Chart 31 6-month growth of domestic credit (in annual terms); performance of currency outside banks* (in percent)



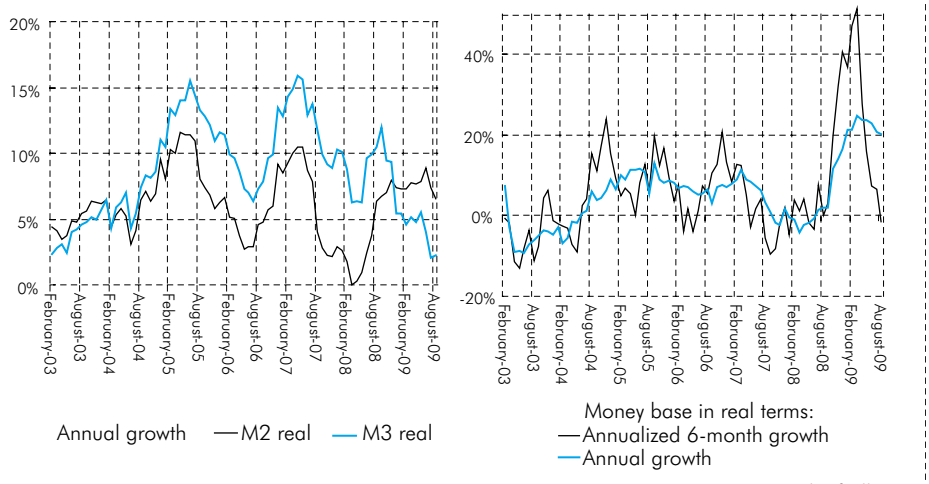
Note: *) Preliminary data on the performance of currency outside banks in September.
Source: Bank of Albania

The relatively higher participation of individuals in financing the Government debt has reflected the return of currency outside banks to meet the demand for money in economy. According to preliminary data on September, currency outside banks declined vis-à-vis this year's peak of ALL 210 billion in July. In terms of M2 aggregate, the ratio of currency outside banks is 35.8 percent from 37 percent in July. In September, the annual growth rate slowed down to 33 percent from 36.5 percent in August[45].

In real terms, the performance of monetary aggregates has reflected the deposits' withdrawal effect on the money creation process[46]. The more accelerated decline in M3 annual growth rate vis-à-vis M2 aggregate attributes to the slower foreign currency lending by the banking system. In real terms, money supply (M3) grew 2.3 percent against M2's annual growth rate by 6.6 percent. ALL private sector credit was not affected by the deposits' withdrawal, while the lower M3 growth rates attribute to the statistical effect

of the withdrawal of foreign currency-denominated deposits and the lower foreign currency lending by the banking system. The liquid money aggregate, money base, was affected by the gradual decline of the share of currency outside banks in money aggregates. The annual growth rate slowed to 20 percent in August vis-à-vis 25 percent in March.

Chart 32 Performance of real aggregates and seasonal volatility (in annual terms, in percent)



Source: Bank of Albania

Short-term developments of M3 are dominated by the performance of domestic credit to the public and private sector. The slowdown in private sector credit during 2009 was also reflected in the deceleration of M3 growth rates. In annual terms, M3's 6-month growth in August was 8.6 percent, following the decline in the M3 growth in the first quarter as a result of the deposits' withdrawal. M3's 6-month growth during this period reflects the foreign currency inflows in the form of remittances, which concentrated in the third quarter. Foreign currency flows improved commercial banks' external position. Banks' net foreign assets grew ALL 24 billion vis-à-vis ALL 2.5 billion in July.

Table 10 Performance of domestic credit and the banking system's foreign currency position (August 2009)

	Level	Monthly change		Annual change		Contribution to M3**
		In billions of ALL	In percent	In billions of ALL	In percent	In percent
Net foreign assets	241	19	8.7%	14	6.2%	-2.4%
Bank of Albania	214	-5	-2.3%	34	18.8%	
Commercial banks	26.5	24	1134%	-20	-43.0%	
Domestic credit	738	11	1.5%	67	10.0%	
Public sector borrowing*	315	7	2.2%	9	2.9%	1.1%
Credit to economy	423	4	1.0%	58	16.0%	7.2%
- State-owned enterprises and financial institutions	13	0	--	6	--	0.8%
- Private sector	410	4	0.9%	52	14.6%	
-in ALL	130	2	1.4%	29	29.3%	3.6%
-in foreign currency	280	2	0.8%	23	8.8%	2.8%

** The public sector's net borrowing (net to deposits) is also affected by the money flows in the form of privatization receipts held with the Bank of Albania. The change in the government deposit level, which also includes other unspent revenue, generates money flows that affect the performance of the M3. **The contribution to the annual M3 growth does not consider the exchange rate changes or the changes in the capital account and other statistics not included in the measurement of monetary aggregate.*

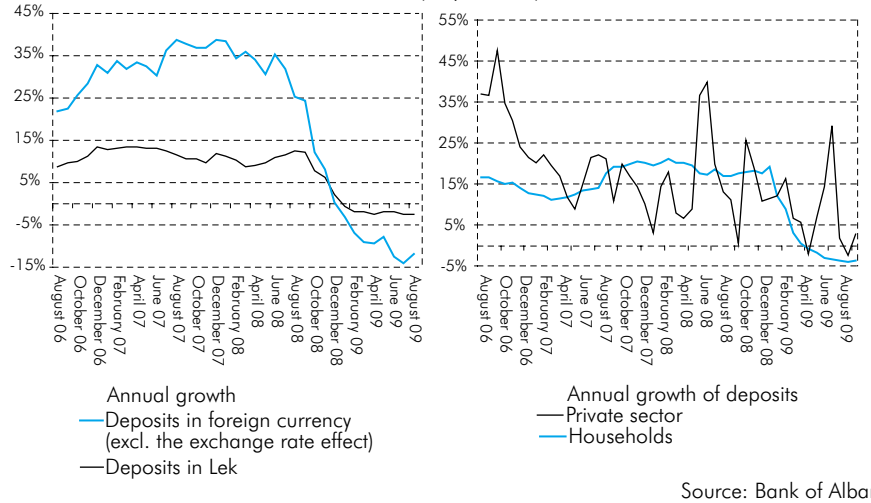
Source: Bank of Albania

DEPOSIT PERFORMANCE

The wavering of confidence in the banking system that associated the global financial crisis was manifested in the withdrawal of a portion of deposits from the Albanian banking system. In response to the measures taken to improve the situation, savers' behaviour showed the first signs of shift in the beginning of the second quarter. This period was characterized by slower deposits' withdrawal rates, while in April the deposit stock grew in monthly terms. The latest developments' dynamics on the supply side attests to the further improvement of the deposit situation in July and August. In August, deposits grew substantially by ALL 25.4 billion in monthly terms, in line with their seasonal performance during this period of the year. Despite the positive deposit developments in August, the total deposit stock is 3 percent lower than in 2008.

The growth of deposits in August primarily reflected the growth of household deposits denominated in foreign currency. Foreign inflows in the form of remittances and tourism income in foreign currency during the summer season are the rationale behind the recovery and growth of deposits in foreign currency. The withdrawal of deposits at the end of 2008 led to lower foreign currency deposit stock in annual terms starting from April. Although as at end of August the deposits denominated in foreign currency were 3.4 percent lower than in the same period the previous year, the foreign currency deposit stock grew ALL 23 billion in nominal terms only in August. Excluding the exchange rate effects, this growth was more moderate, ALL 18.4 billion[47].

Chart 33 Annual changes of deposits by currency and customer (in percent)[48]

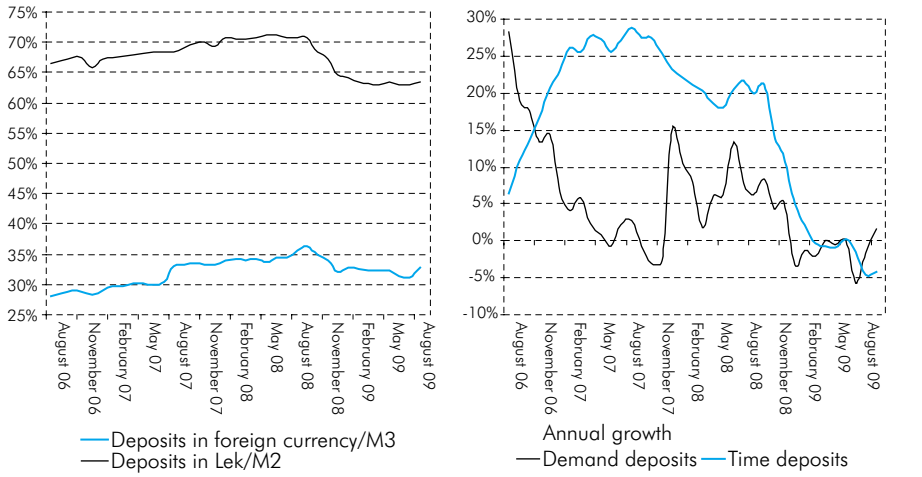


Source: Bank of Albania

As at end of period, about 70 percent of total deposits' stock growth was in time deposits, signalling the recovery of confidence in the banking system. This is also attested by the slower growth rates of household demand deposits, while the business demand deposits grew at faster paces. In August, time deposits grew 3.7 percent in nominal monthly terms from the monthly average

of 0.3 percent in the previous quarter. Bank deposits in foreign currency as a share of broad money manifested an upward trend growing to about 33 percent at end August from 31.4 percent at the end of the second quarter.

Chart 34 Annual deposit performance (in percent)



Source: Bank of Albania

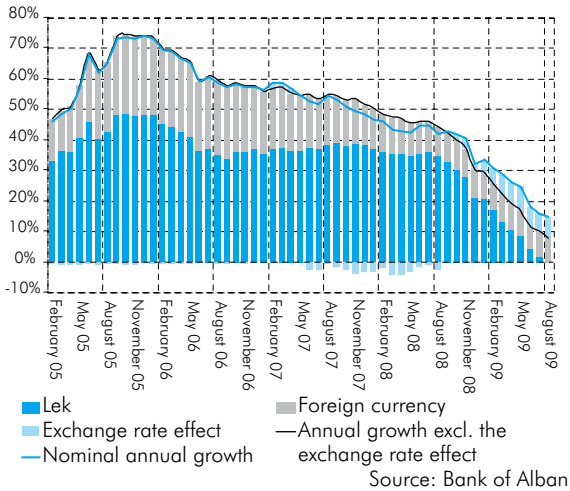
The growth of ALL deposits was stable in July and August but lower than the previous quarter's monthly growth. Despite the lower level of deposit withdrawal and the constant improvement, ALL deposit stock was 2.5 percent lower as at end August than in the same period the previous year. The growth of ALL deposit stock in July and August mainly reflects the growth of household deposits. ALL deposits as a share of M2 aggregate have remained stable at 63 percent since February the present year.

PRIVATE SECTOR LENDING

Private sector lending maintained the downward growth rates during July and August 2009, reflecting both demand and supply-side factors. On the supply-side, banks continued to apply tight lending standards, while the liquidity -in particular in Euro- remained at reduced levels. The Bank of Albania pursued an accommodating policy by injecting liquidity in order to support the higher intermediation in ALL in the banking system. Demand-side factors mainly originate from the fall of consumption and investments, which has also been shown in the imports of this type of goods throughout the year.

Average annual growth of private sector credit was 16 percent in nominal terms in June to August 2009, markedly lower than the first five months' average (29 percent). Excluding the ALL devaluation

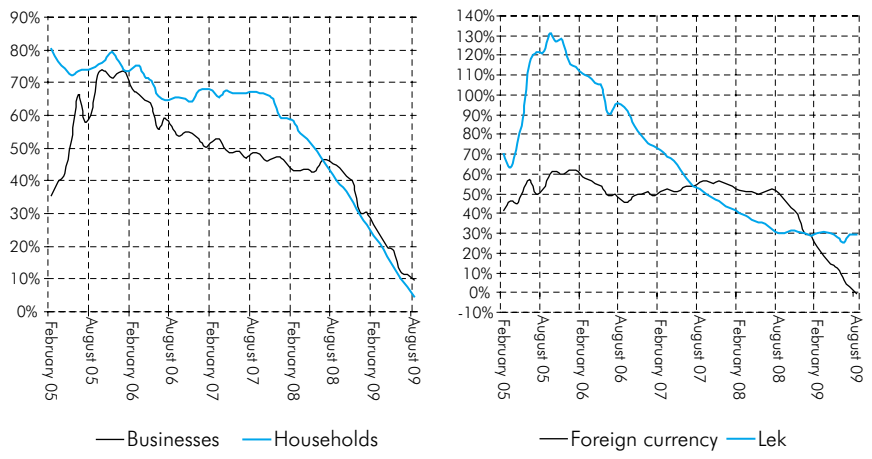
Chart 35 Performance of private sector credit and contribution by currency (in percent)



Source: Bank of Albania

effect, the average annual growth is only 10 percent[49]. The downward trend of credit attributes to the deceleration of foreign currency lending, whose growth rate was zero in August. ALL credit continued to maintain its average growth rate of 30 percent throughout the year 2009. As a result, the share of foreign currency credit in the private sector's loan portfolio dropped to 67 percent. In addition to the banks' tightening of lending conditions, these developments primarily reflect their prudence in foreign currency lending and the higher Government's demand for foreign currency credit from banks. The contained foreign currency lending was more pronounced in household credit than in business credit, which attributes to the understanding of the consequences of exchange rate movements and the greater tightening of lending conditions for loans denominated in a currency other than that of the borrower's income.

Chart 36 Annual growth of credit by borrower and currency (in percent)

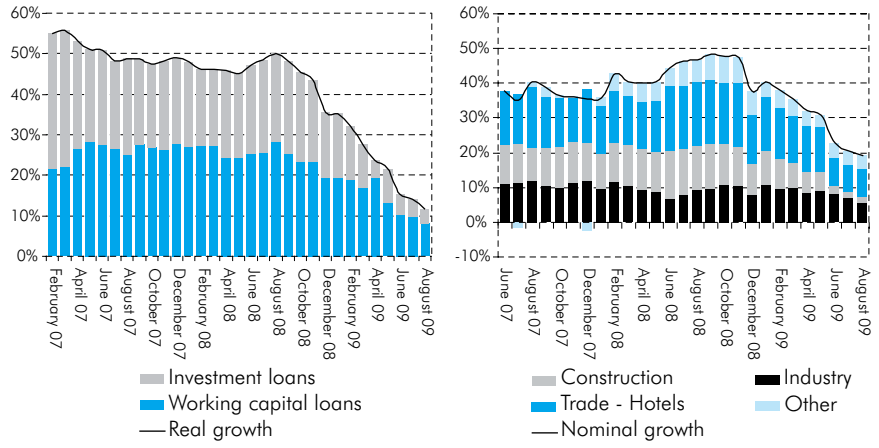


Source: Bank of Albania

New private sector credit extended during summer was at similar levels as in the previous year. The largest portion of new credit is of short maturity term, reflecting the uncertainty of the economic agents to commit to long-term lending.

In average annual terms, business credit grew 11 percent in June to August 2009. Despite its low growth rates, business credit provided the main contribution to the growth of private sector credit accounting for about 65 percent of its total. New business credit for this quarter was mainly of short maturity term in the form of overdrafts and working capital. About 70 percent of the business credit growth in June and August attributes to credit for working capital purposes, whose share has been increasing particularly since February the present year. This performance, in addition to providing evidence for the business needs for liquidity, reflects the curbing of investments by the economic agents, which may materialize in the contraction of economic growth in the following year.

Chart 37 Contribution of business loans, by purpose and main sectors to the annual growth (in percent)

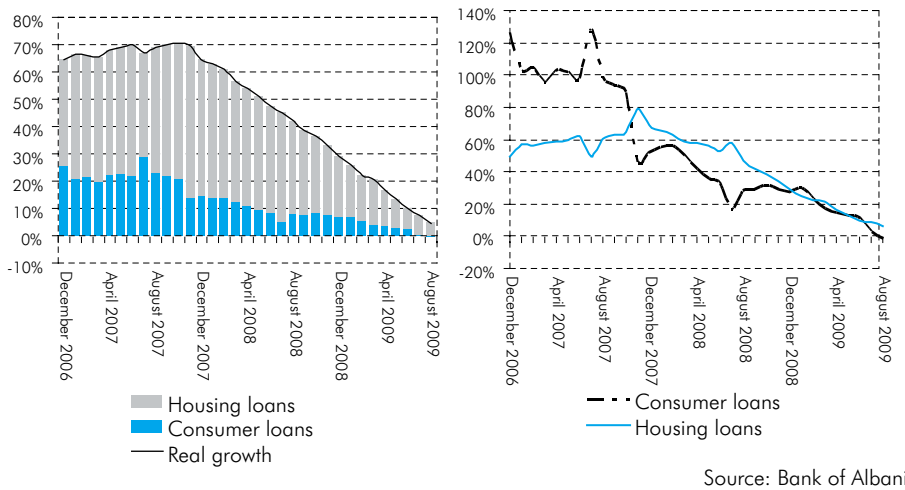


Source: Bank of Albania

The contraction of lending has been reflected in all the sectors of the economy, however the construction sector has been affected the most by its contraction. This sector's contribution to the loan portfolio growth was 2 percentage points from 13 percentage points the previous year. The annual growth of credit to the construction sector reduced to 8 percent in August vis-à-vis the average of 31 percent in the first half of 2009. Credit to the trade sector and hotel and tourism maintained high annual growth rates (20 percent) throughout summer.

Household loans grew at an average annual rate of 8 percent in June to August, contracting at more accelerated paces than business loans. The growth of consumer loans has contracted, while housing loans have provided the main contribution to the growth of household loans. In annual terms, housing loans grew 9 percent in summer, compared with 20 percent in the first half of 2009. For the same period, consumer loans grew 4 percent from 20 percent in the first five months of 2009.

Chart 38 Performance of household loans' portfolio (in percent)



Source: Bank of Albania

Box 3 Bank Lending Survey Results for the Third Quarter of 2009

Bank lending survey results show that the lending standards remained tight in the third quarter of 2009, although at a lower level than in the previous quarter. The majority of surveyed banks report that they kept their lending standards unchanged -both for business and household loans- from the second quarter of 2009. This performance attests to the turning point in the lending standards' tightening trend of the previous survey.

The tightening of lending standards was higher for businesses than for households. In terms of business size, small and medium-sized enterprises were subject to tighter lending standards than large enterprises. While in terms of purpose of use, investment-related loans were subject to tighter lending standards than working capital-related loans.

All the considered factors kept the lending standards tight in the third quarter of 2009, both for business and household loans. In general, the impact of factors on the net tightening was lower than in the second quarter of 2009, excluding the factors related to non-performing loans -both for business and households-, and the households' financial situation.

Based on banks' responses, business demand for loans fell again in the third quarter of 2009 after a slight improvement in the second quarter the present year. By contrast, household demand for loans improved slightly in the third quarter of 2009 vis-à-vis the very low and negative level of the previous quarter.

Expectations for the last quarter of 2009 show that banks will apply similar lending standards as in the third quarter of 2009, both for business and household loans.

Business Loans. The net tightening of lending standards was lower in the third quarter of 2009: the net balance increased to -7.6 percent compared with -23.4 percent in the second quarter of 2009. The majority of banks' experts state that they kept the lending standards unchanged from the previous quarter. All the factors have led to less tight lending standards, excluding the one related to non-performing loans, whose contribution has increased.

Banks have applied tighter lending policy mainly through the application of higher commissions, the reduction of the loan amount and that of the maximum loan maturity. The average loan margin and the collateral requirement, albeit still tight, have slightly loosened in the third quarter of 2009. In general, the tightening is higher for credit cost-related conditions rather than for non-cost related conditions and it is particularly higher for credit that banks rate as high risk loans.

The less tight lending standards in the third quarter of 2009 were reflected in loans to small and medium-sized enterprises (SMEs) and corporate loans. In contrast to previous surveys, the lending standards applied on SME loans were slightly tighter than those applied on corporate loans. In terms of purpose of use, the lending standards applied on loans for working capital purposes loosened for the first time this quarter (balance: +3 percent). The net percentage of banks reporting looser lending standards for investment-related purposes remains negative (-11 percent), although at lower levels compared with -30 percent in the second quarter of 2009.

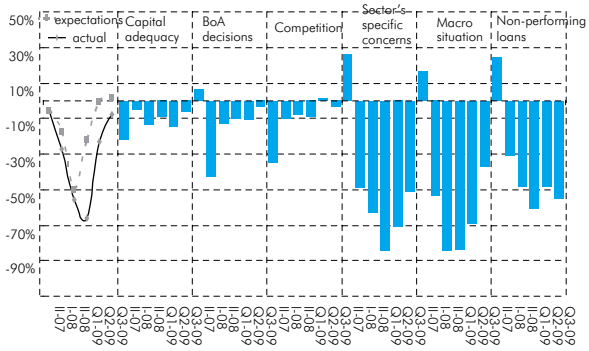
After experiencing some slight growth in the second quarter of 2009, the net demand for business (SME and corporate) loans fell in the third quarter of the current year. The fall owes mainly to the lower business demand for investment-related loans, whose net balance dropped to -33 percent versus -23 percent in the previous quarter.

Household Loans. The lending standards applied on household loans did not undergo any changes in the third quarter of 2009 relative to the previous one. Therefore, the net balance recorded the neutral value of zero. This represents an increase by 21.6 percentage points compared with the previous quarter's balance. Banks report that the lending standards applied in the third quarter of 2009 remained almost similar to the ones applied in the second quarter for housing loans and consumer loans.

The main factors to have determined the maintenance of lending standards' tightening at almost the same level during the third quarter of 2009 remain similar to those of the second quarter. More concretely, the household's financial situation is ranked the most significant factor in this regard. Its net balance for the third quarter was -51.2 percent versus -42.6 percent in the previous quarter. Other factors relate to non-performing loans and the developments in the real estate market.

Household demand for loans has been less negative during the current quarter. Households' needs to finance consumption and the house purchase are the main factors to have provided a positive contribution to the growth of household demand for loans. On the other hand, the developments in the real estate market continue to represent the main driving force behind the fall of household demand for loans.

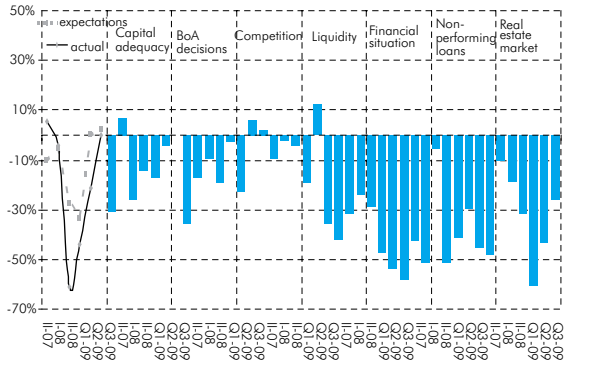
Chart 39 Changes in lending standards applied on business loans and the impact of different factors (net balance, in percent)



Source: Bank of Albania

Note 1. The positive balance refers to the easing of lending standards or that the factor has contributed to the easing of lending standards. The negative balance refers to the tightening of lending standards or that the factor has contributed to the tightening of lending standards.

Chart 40 Changes in the lending standards applied on household loans (housing and consumer loans) and the impact of different factors (net balance*, in percent)



Source: Bank of Albania
*) See Note 1.

IV.2 LABOUR MARKET PERFORMANCE

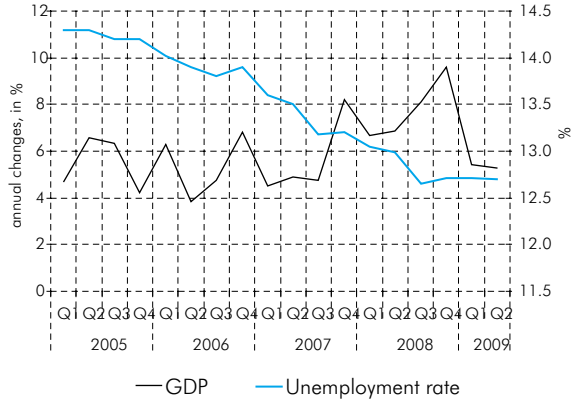
The data on the main labour market indicators for the second quarter of 2009 (INSTAT) attest to the annual increase in the total number of employed persons by 0.7 percent and in the average number of registered unemployed persons by 0.9 percent. The higher rate in the increase of the number of employed persons in the private non-agricultural sector provided the main contribution to the performance of total employed persons and labour force during this quarter. The dynamics in these indicators have maintained the unemployment rate for the second quarter of 2009 almost at the same rate (12.70 percent).

Table 11 Performance of labour market indicators

Labour market indicators	2008				2009		Annual change, Q2:2009/ Q2:2008, in %
	Q1	Q2	Q3	Q4	Q1	Q2	
Labour force	1,080,107	1,105,932	1,109,968	1,115,562	1,114,161	1,114,166	0.74
Total employed persons	939,298	965,915	969,893	974,067	972,851	972,831	0.72
Number of employed persons in the public sector	166,750	166,589	166,549	166,543	166,563	166,453	-0.08
Number of employed persons in the agriculture sector	542,000	568,549	568,549	568,549	568,549	568,549	0.00
Number of employed persons in the private non-agriculture sector	230,548	230,777	234,795	238,975	237,739	237,829	3.06
Average number of total registered unemployed persons	140,809	140,017	140,075	141,495	141,310	141,335	0.94
Unemployment rate, in %	13.04	12.66	12.62	12.68	12.68	12.70	0.04 pp

Source: INSTAT

Chart 41 Annual growth rate of GDP (left-hand axis) and unemployment rate (right-hand axis) (in percent)

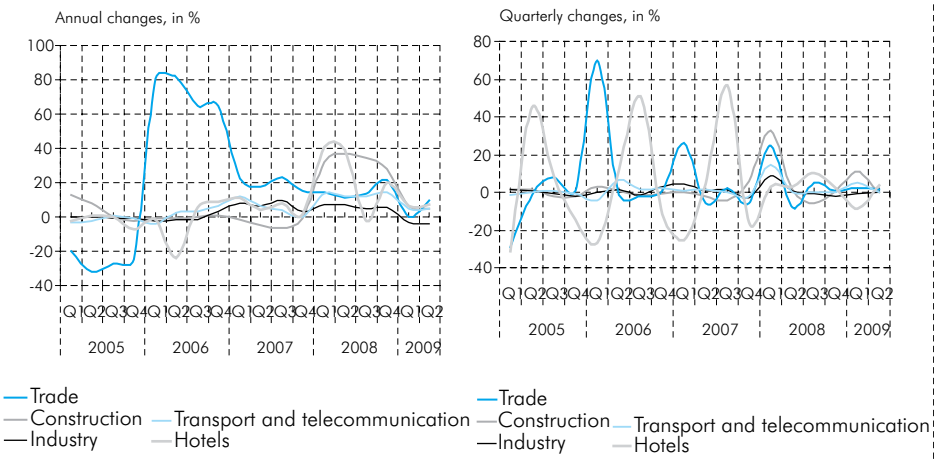


Source: INSTAT

Official data[51] on the number of employed persons in non-agriculture economic enterprises show that the Employment Index has increased at lower rates during the first two quarters of 2009 following the slowdown of the Albanian economic activity during the first half of 2009.

In terms of sectors, services sector provided the main contribution to the annual increase in the number of employed persons during the second quarter. In the production sector, the number of employed persons in industry declined 4.2 percent, hence maintaining the downward trend commenced in early 2009. In construction, this indicator increased 5 percent, markedly lower than the average annual growth rate of 33 percent in 2008.

Chart 42 Employment Index performance by economic activity



Source: INSTAT

IV.3 PERFORMANCE OF PRODUCER PRICES

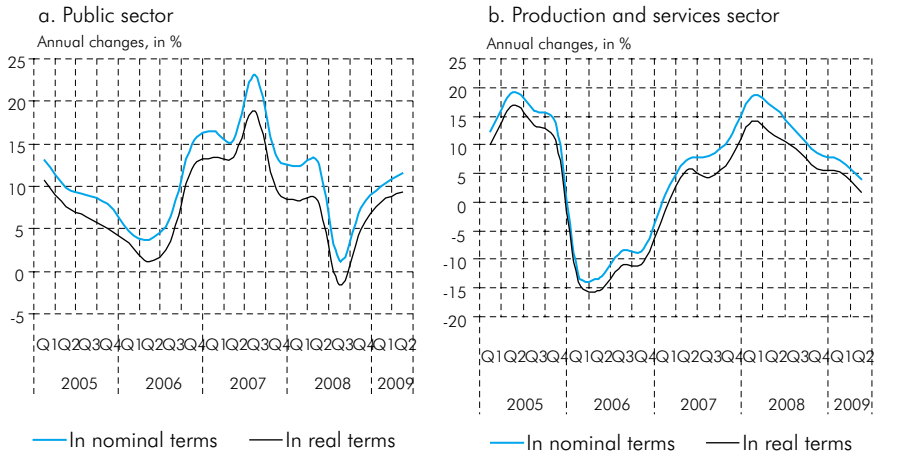
WAGES IN ECONOMY

Wages indicator in economy[52] for the first two quarters of 2009 shows lower annual growth rates of average nominal wage[53] by 7.3 and 4 percent, respectively. In the first half of the year, it increased by an average of 5.6 percent, down by 12 percentage points from the same period the previous year.

Deflated by the consumer prices, the annual increase of the real average wage index is 3.6 percent for the first half of 2009 or approximately 9.3 percent lower than the same period the previous year's increase.

According to the latest data provided by the INSTAT for the second quarter of 2009, public sector's[54] average monthly wage accelerated its annual growth rates by about 11.6 percent in nominal terms and 9.3 percent in real terms. Government's decisions on the increase of the monthly minimum base salary and the differentiated increase of the salary for some categories of professions may affect the growth rates of the public sector's average monthly wage in the following quarters. In the second quarter of 2009, monthly minimum base salary increased by 12.5 percent in annual terms to ALL 18,000, remaining at the same levels in the third quarter of 2009.

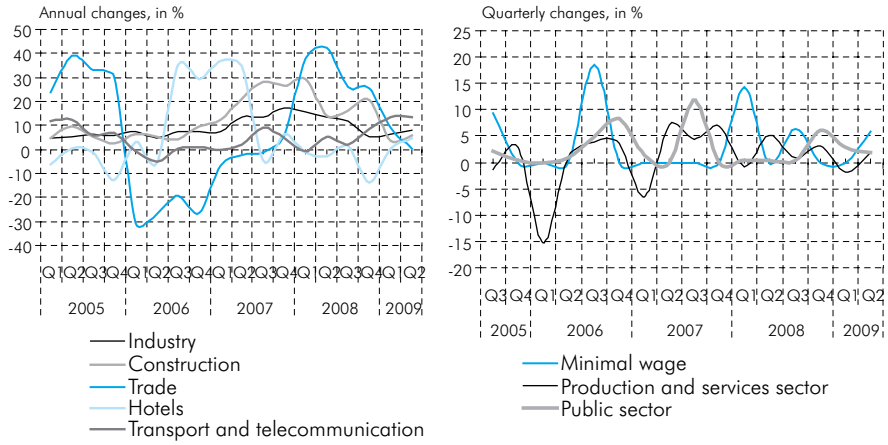
Chart 43 Performance of average monthly wage



Source: INSTAT and Bank of Albania estimates

In terms of sectors, the highest annual growth rate of average wage in the second quarter of 2009 was recorded in transportation and telecommunication (13.6 percent). In industry and construction, the same indicator increased by 7.9 and 5.6 percent, respectively, 1.5 times higher than in the first quarter. In annual terms, average wage in the trade sector increased by 0.6 percent, compared with 9.3 percent in the first quarter of the current year.

Chart 44 Performance of average wage in some branches of economy (left-hand chart) and minimum and average wage by sectors (right-hand chart)

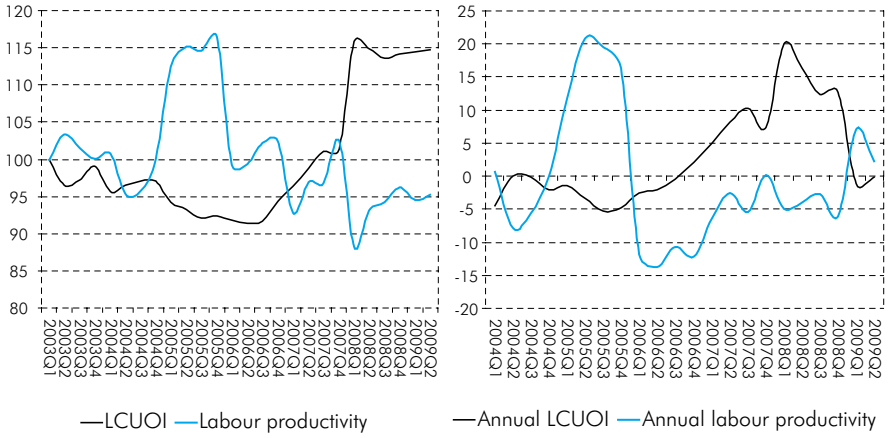


Source: INSTAT, Short-term Statistics

PERFORMANCE OF LABOUR PRODUCTIVITY AND THE LABOUR COST PER UNIT OF OUTPUT

According to the latest data, Labour Productivity Index (LPI) and the Labour Cost per Unit of Output Index (LCUOI) in economy[55] maintained more evident trends starting from the second quarter of 2008. LPI trend has increased slightly, while the LCUOI has maintained a smooth fall until the second quarter of 2009. The annual change rates of the LPI were positive in the first half of the current year. In the meantime, the LCUOI's annual change rates have reflected the relative cessation of effects of the administrative measures taken in view of declaring wages in the business sector.

Chart 45 Performance of LPI and LCUOI indices (above); annual changes of LPI and LCUOI indices (below)



Source: INSTAT (Quarterly GDP, Short-term Statistics) and Bank of Albania estimates

PRODUCER AND OIL PRICES

The inflationary pressures generated by producer prices on the overall level of consumer prices at home have been declining. The downward trend of the Producer Price Index (PPI) persisted in the second quarter of 2009 for the second consecutive quarter. Impacted by the fall of prices in the international conjunctures, business producer prices were 2.6 percent lower than in the same quarter the previous year.

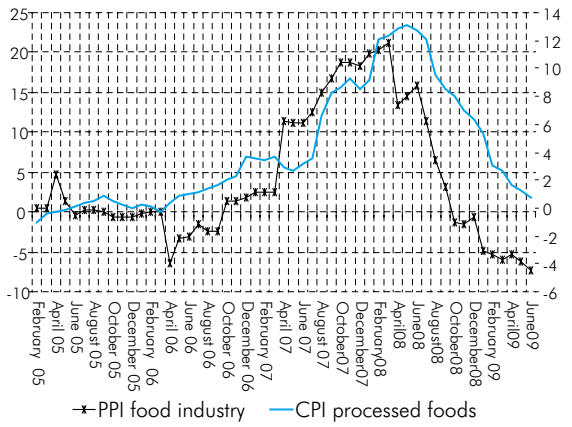
Table 12 Annual change rates of some PPI and CPI components of "processed foods" (in percent)

	PPI	PPI Total processing industry	PPI Food industry	CPI – Processed foods	PPI Extracting industry
Q1:07/Q1:06	2.1	14.4	2.5	3.2	8.1
Q2:07/Q2:06	3.3	7.3	11.3	2.9	2.8
Q3:07/Q3:06	3.6	6.3	14.7	7.3	4.7
Q4:07/Q4:06	7.5	10.2	18.6	10.8	4.5
Q1:08/Q1:07	7.4	-1.5	20.5	11.2	5.6
Q2:08/Q2:07	7.4	6.9	14.6	12.9	2.9
Q3:08/Q3:07	7.1	6.1	7	10	9.7
Q4:08/Q4:07	4.2	1.8	-1.1	7.1	9.2
Q1:09/Q1:08	-1.2	0.6	-5.4	3.6	2.3
Q2:09/Q2:08	-2.6	-1.2	-6.4	1.2	5.8

Source: INSTAT and Bank of Albania estimates

In terms of sectors, the PPI declined in the industrial components sharing the main weight. The PPI in "processing industry"[56] declined in annual terms for the first time following the recurrent increase for four consecutive quarters. "Food industry" provided the main contribution to the decline of this index. Its index was 6.4 percent lower than in the same quarter the previous year. This trend curbed the increase in "processed foods", which recorded more moderate growth rates than in the previous quarter. The upward trend of producer prices in "extracting industry" persisted in the second quarter of 2009, although at more contained rates than in the second half of 2008.

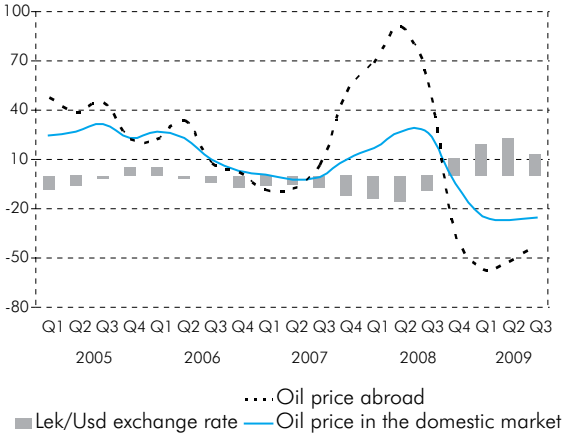
Chart 46 Annual change of the indices of goods included in the PPI (right-hand axis) and CPI (left-hand axis), in percent



Source: INSTAT and Bank of Albania estimates

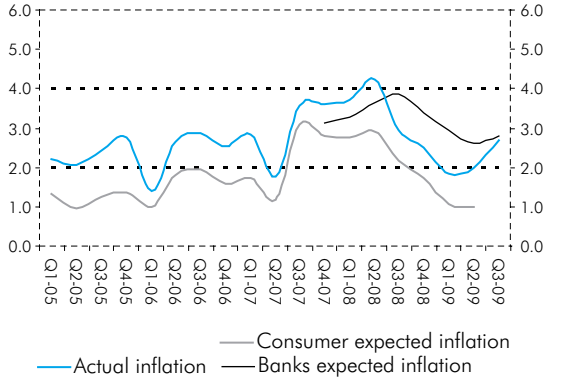
The oil price movements in the international markets were passed through to the domestic oil market and later to the Albanian consumers and business activity, though at more contained rates. After reaching the lowest average price per litre in the first quarter of 2009, oil price began to increase. In the third quarter of 2009, average oil price per litre in the retail market was ALL 114.4, approximately 7 percent higher than the previous quarter's average. Owing to the appreciation of the Albanian Lek against the USD by 5 percent in quarterly terms, the oil price increase is markedly lower than in the international markets. Although the oil price has been upward, the last year's high comparative base causes the oil price annual rates to record negative values.

Chart 47 Annual change of oil price, domestically and internationally, and the ALL/USD exchange rate



Source: INSTAT, Bank of Albania, EIA

Chart 48 Consumer and banks' experts expectations of annual inflation after 12 months and the annual inflation rate measured by the CPI (in %)



Source: INSTAT and Bank of Albania

The index of "service to personal vehicles", which is closely related to the oil price movements in the market, increased by 3.7 percent in quarterly terms during the third quarter of 2009. In annual terms, it dropped by 12.5 percent, providing a negative contribution to the performance of average annual inflation rate in the third quarter of 2009. By contrast, the indices of "services" and "transportation services", which are less related to the performance of oil price in the retail market, have undergone minor changes.

IV.4 EXPECTATIONS FOR THE PERFORMANCE OF PRICES IN ECONOMY

EXPECTATIONS FOR INFLATION

Expectations for inflation over the short and medium term as measured by different market agents are anchored around 1-3 percent band[57]. Consumer expectations for inflation after 12 months remain lower than the other economic agents' expectations.

Consumer expectations in the second quarter of 2009 show that inflation after 12 months will be about 1 percent, deepening the downward trend commenced in the last quarter of 2008. The rationale behind this figure is the low inflation rates during January to September 2009. In the confidence survey of the second quarter of 2009, businesses expect the inflation after 12 months to be about 2.6 percent. The last survey held with bank experts in October 2009 shows that they expect the inflation after 12 months to be about 2.7 percent.

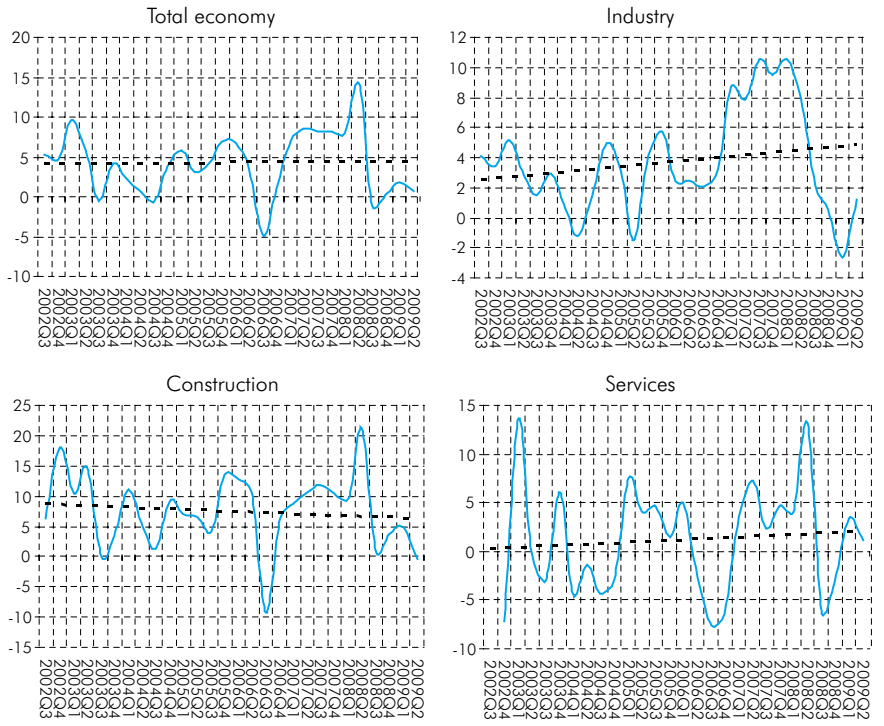
Banks' expectations have generally been higher than consumer and business expectations. These expectations manifested a slight upward tendency in the third quarter of 2009 after three consecutive quarters of downward trend.

EXPECTATIONS FOR PRODUCER PRICES

According to the confidence survey results of the second quarter of 2009, businesses expect the producer prices after three months to slightly fall. However, the expectations were reverse in terms of sectors: in construction and services, businesses expect the producer prices to fall in the third quarter of 2009, while industry-related businesses expect them to increase.

Expectations for producer prices are for all sectors lower than in the previous year and lower than their historical average.

Chart 49 Business expectations for the performance of producer prices after three months (in net percentage)



Source: INSTAT and Bank of Albania

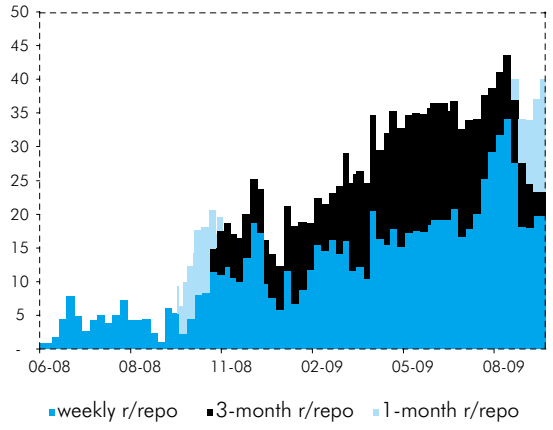
V. FINANCIAL MARKETS, INTEREST RATES AND THE EXCHANGE RATE

In September, the markets signalled the recovery of confidence in the financial institutions one year after the deepening of the global crisis. Against the backdrop of improved liquidity conditions, the volume of borrowing in the interbank market was lower, hence exerting no pressure over the short-term interest rates. Long-term interest rates in the government securities' primary market remained high as a result of the low financial market development, continuous demand to finance the budget deficit and the relatively high risk premiums. Interest rates on new ALL deposits have been relatively high, hence attracting considerable savings. In the meantime, the intermediation cost has lowered. These developments were coupled with high exchange rate volatility in September and October, giving rise to uncertainty in the market.

INTERBANK MARKET

The third quarter of 2009 attested to an improved liquidity situation as a result of the return of deposits to the system, the relatively lower instability of

Chart 50 Bank of Albania's open market operations (in billions of ALL)

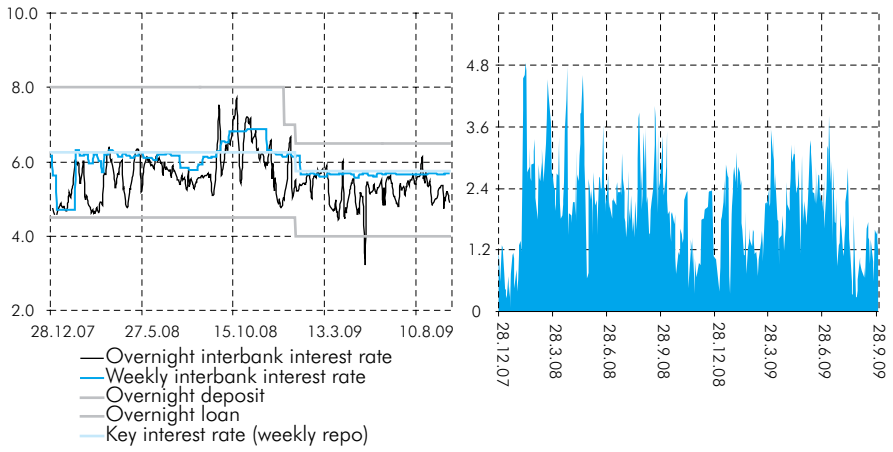


Source: Bank of Albania

currency outside banks and the continuous injection of liquidity by the Bank of Albania through the open market operations. The Bank of Albania provided liquidity through its main instrument, one-week repo agreements, which averaged ALL 23 billion in the third quarter vis-à-vis ALL 17 billion in the second quarter. In addition to one-week repo agreements, the Bank of Albania has, until September, intervened using the fine tuning operations of 3-month maturity term. After September, the 3-month maturity shifted to 1-month maturity reflecting the system's structural need for liquidity.

Banks' operations in the interbank market attested to lower traded volumes over the course of the third quarter of 2009. The operations in this market mainly aimed at meeting the short-term liquidity needs. The volume of one-week transactions reduced leading to lower total borrowing volume. Interest rates were more volatile owing to the replenishment of the required reserve in given periods and to factors related to the supply and demand of individual banks against a background of frequently inefficient liquidity management. The use of the reserve and other deposit instruments as an option to the interbank market have often had an impact over the performance of traded volumes in this market.

Chart 51 Interest rates in the interbank market, in percent (left-hand) and the interbank market volume, in billions of ALL (right-hand)



Source: Bank of Albania

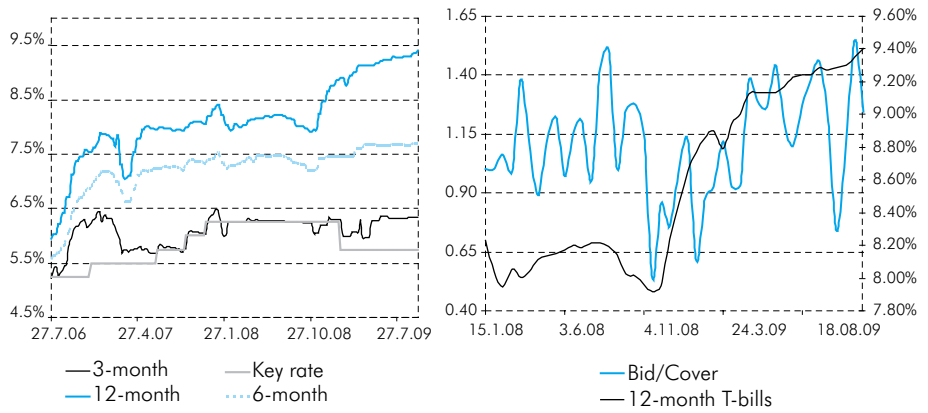
Starting from July 2009, the total traded volume in the interbank market has been downward. The interest rates have gone up, particularly the overnight interest rates, which have increased at more rapid paces in days of low transaction volumes. This performance shifted in September when the interest rates and the interbank transactions' volume began to go downward. The

flattening of liquidity pressures and the more uniform distribution of liquidity in the system was reflected in mitigated interest rates volatility[58]. Liquidity in the system increased during this period owing primarily to the banks' performance in the primary market and the mitigated seasonal effects that generally characterize these months. In average terms, overnight interest rate in the interbank market rose to 5.30 percent in the third quarter vis-à-vis 5.08 percent in the second quarter. One-week interest rate rose to 5.67 percent, up by 0.02 percentage points. In 2008, they were respectively 5.67 and 6.07 percent. Total borrowing volume reduced to ALL 1.49 billion or 0.85 billion less than in the previous quarter. Overnight and one-week borrowing reduced by ALL 0.3 and 0.5 billion to ALL 1.32 and 0.23 billion.

PRIMARY MARKET

Primary market yields maintained the upward trend commenced in the year-end 2008. Government securities' yields increased and the maturity spreads remained higher than in 2008. The pressures for their increase have been fuelled by the higher risk perception of banks at a time when their high participation in auctions has not provided any contribution to abate the pressures. The increase of the yields for all maturities persisted during these months being also affected by the higher issues over this period. The more pronounced increase of 12-month T-bill yields was also transmitted to 12-month bond yields, giving rise to upward yield curve slope. As at end the third quarter, the yield on 12-month T-bills was 9.40 percent, up by 0.16 percentage points from the end of June. In average terms, the yield on 12-month T-bills was 0.14 percentage points higher than in the previous quarter and 1.18 percentage points higher than in 2008. The yields on 6 and 3-month maturity T-bills maintained the same performance, though at more contained rates. As at end of September, 6-month T-bill yield was 7.69 percent, up by 0.02 percentage points from the end of June. For the same period, 3-month T-bill yield increased 0.04 percentage points to 6.35 percent.

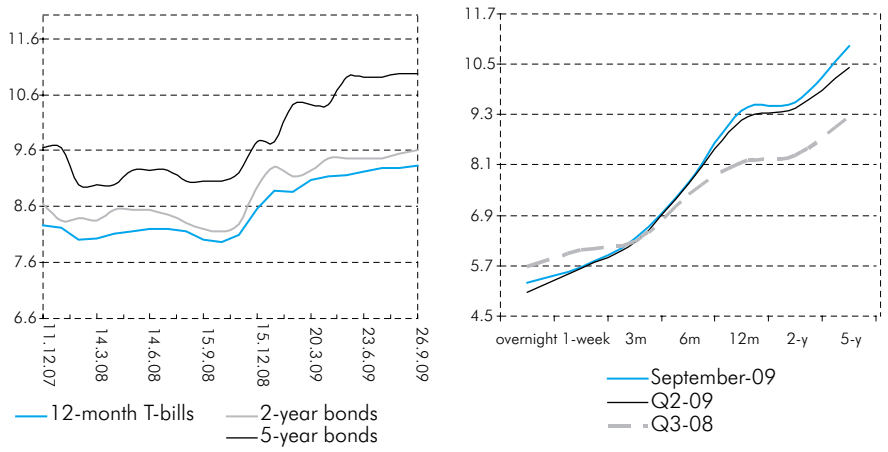
Chart 52 Bid to cover ratio for the deficit financing in the primary market and the 12-month yield (right-hand) and the T-bill yields (left-hand) (in percent)



Source: Bank of Albania

The yields in the bond market attested to a similar performance as the T-bill yields. Bond yields increased owing primarily to the higher risk perception of the instruments employed in the securities' market. Banks' participation in auctions was high[59], however, as in the case of T-bills, it did not have any effect on the upward performance of this market. In September, the yield on 2-year bonds was 9.60 percent and the yield on 5-year bonds (of variable interest rate) was 10.97 percent, up by 15 and 5 basis points, respectively, from the previous quarter. The higher yields on these instruments have primarily reflected the increase of the yields on 12-month T-bills at a time when the accepted margins have reduced. In the auction held in October 2009, the yield on 3-year bonds rose 0.29 percentage points to 9.90 percent.

Chart 53 Long-term securities' yields in the primary market (left-hand) and the yield curve (right-hand) (in percent)



Source: Bank of Albania

INTEREST RATES ON NEW DEPOSITS

In July and August 2009, the interest rates for the two main currencies, the ALL and the EUR, were relatively high maintaining the first half trend. These interest rates reflected the banking system's inclination to attracting new deposits.

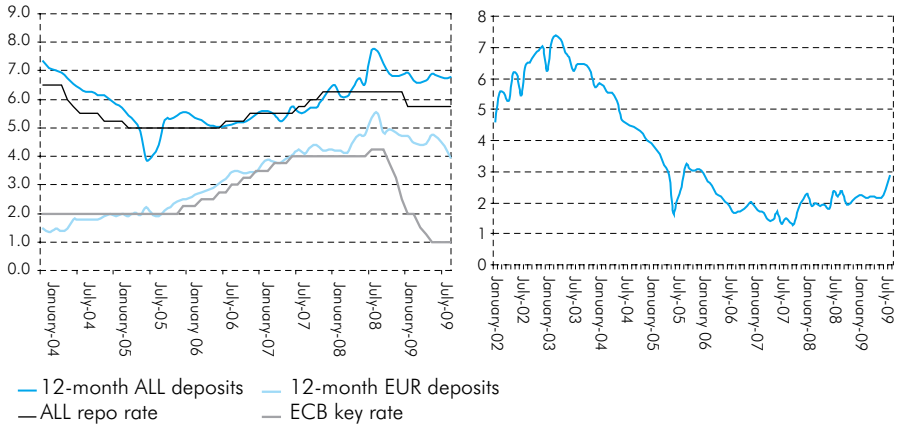
Average interest rate on ALL deposits was 5.94 percent in August, up by 0.48 percentage points from the end of the second quarter of 2009. The summer season promotional offers began in the end of the second quarter and persisted for the coming period as well. In terms of maturity, there is a larger concentration of promotional offers for short-term deposits. Relative to the previous year, the interest rates on deposits in August 2009 were 0.77 percentage points lower. The interest rates on deposits in the same period in 2008 rose considerably as a result of the aggressive short-term policies adopted by several banks to increase their market share.

The interest rates on EUR time deposits dropped slightly in the third quarter of 2009. This drop has a greater effect on long-term (12-month) interest rates.

The beginning of the recovery of deposits in the system made a few banks less aggressive in their efforts to attract funds and match the EUR interest rates with the cost of borrowing in this currency. Weighted average interest rate on new EUR deposits was 2.27 percent in August, down by 0.01 percentage point from the end of the second quarter. Interest rates on 12-month deposits were 3.95 percent, down by 1.56 percentage points from August 2008 (ECB's key interest rate has reduced by 3.5 percentage points during this period).

The spread between the interest rates on 12-month ALL and EUR deposits increased markedly in August owing to the reverse shift of the interest rates on new ALL and EUR deposits.

Chart 54 Interest rates on 12-month deposits and the key interest rate, in percent (left-hand) and the spread between the interest rates on 12-month ALL and EUR deposits, in percentage points (right-hand)



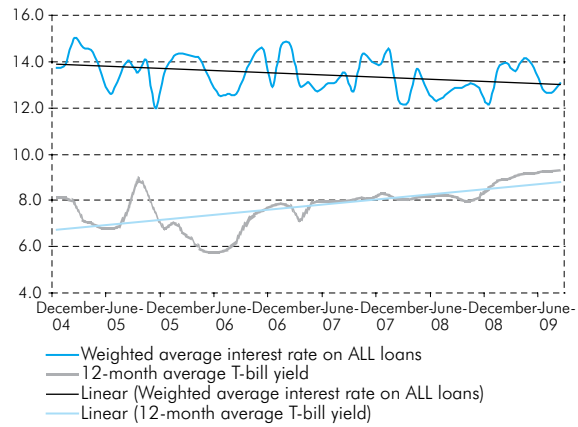
Source: Bank of Albania

INTEREST RATES ON NEW LOANS

The bank lending standards eased slightly in the third quarter of 2009 driven by the more stable economic situation at home. In order to avoid the exchange rate risk, banks have mainly promoted lending in the national currency, the ALL.

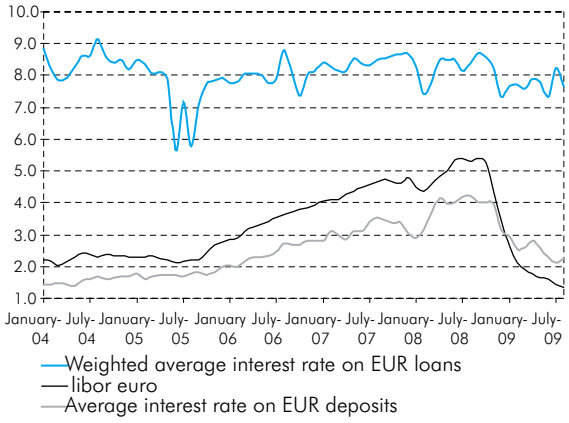
In contrast to the first half of 2009, the interest rates on ALL loans were lower in the last two months of summer. In July and August, the weighted average interest rate on new ALL loans averaged 12.86 percent or 0.79 percentage points lower than in the first half of 2009. This pronounced drop owes partly to special preferential terms lending to individual bank customers. Broadly speaking, the margin to reference interest rates has narrowed. Banks applied eased lending terms on new short-term loans of up to 12-month maturity, which have the largest share of new loans for meeting business liquidity needs.

Chart 55 Interest rates on new ALL loans, in percent



Source: Bank of Albania

Chart 56 Weighted average interest rate on 12-month EUR, EURIBOR deposits and loans (in percent)

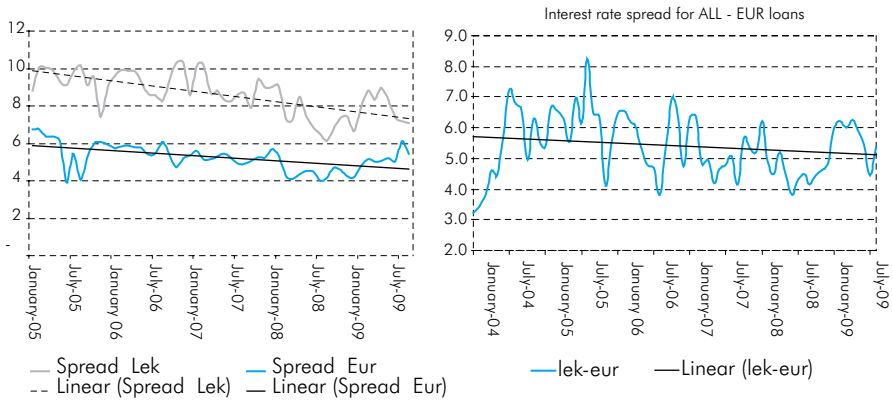


Source: Bank of Albania

Interest rates on EUR loans were relatively high in July and August. Average interest rate on new EUR loans was 7.96 percent, up by 0.29 percentage points from the first half of 2009 and down by 0.30 percentage points from the previous year. Despite the lower LIBOR rates in EUR and EURIBOR in the international markets, the fluctuation of interest rates on new EUR loans was related to the cost of funds in this currency in the domestic market and the banks' tight policies for lending in foreign currency.

Intermediation cost in ALL declined in August 2009 to 7.11 percentage points from 8.27 percentage points in the first half. Average intermediation rate for the EUR increased markedly in July to later decline again in August. It averaged 5.77 percentage points, up by 0.73 percentage points from the average in the first half of 2009.

Chart 57 Average intermediation margin in ALL and EUR (left-hand) and the spread between average interest rate on ALL and EUR loans (right-hand), in percentage points



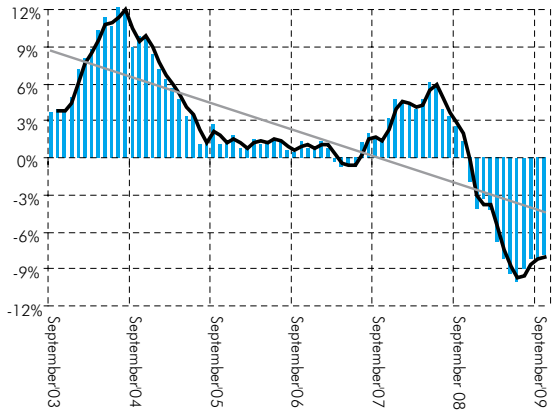
Source: Bank of Albania

EXCHANGE RATE

In the third quarter of 2009, the nominal effective exchange rate of the ALL relative to the main foreign currencies attested to a slight shift from the depreciation trend shown in three consecutive quarters since the beginning of the global financial crisis' effects on the domestic foreign currency market. After the high depreciation by -10.2 percent in May, the NEER manifested more moderate downward rates which move from -8.3 percent to -7.9 percent in annual terms. This performance seems to owe mainly to the partial termination of the comparative basis' statistical effect. In 2008, the USD to the ALL showed an upward trend, converging toward the current ratio in the market, and reducing the NEER in that period.

In the domestic foreign currency market, the ALL depreciated in the third quarter of 2009 both against the USD and the EUR. In quarterly and annual terms, the ALL depreciated 0.2 and 7.7 percent against the EUR. Against the USD, it appreciated 4.7 percent in quarterly terms while depreciating 13.1 percent in annual terms[61]. EUR to ALL has manifested reverse trends during this quarter. In July, the ALL was strong against the EUR as a result of the foreign currency inflows characterizing the summer season. In the following months, this effect terminated early owing to the market positioning towards the end of seasonal supply, hence depreciating the ALL against the EUR. In September, this trend was more pronounced reflecting the swinging supply-demand ratio effect.

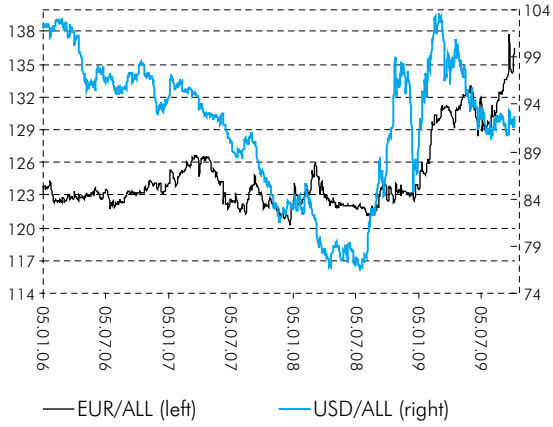
Chart 58 ALL annual changes in nominal effective terms (NEER[60])



Source: Bank of Albania

The devaluation of the exchange rate has been triggered by the swinging foreign exchange supply-demand ratio, owing to the high current account deficit and the expected slowdown in the capital account inflows. To a large extent, the devaluation of the ALL owes to the market agents' lack of confidence in the national currency, expressed in higher EUR to ALL exchange rate volatility compared with the previous quarter and the same period the previous year.

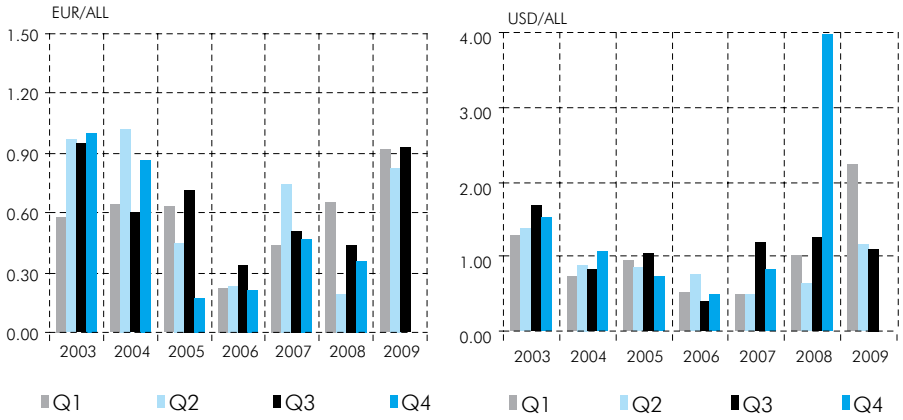
Chart 59 Daily performance of EUR/ALL and USD/ALL exchange rate



Source: Bank of Albania

On the other hand, the USD/ALL exchange rate reflects to a large extent the performance of the USD in the international markets. In annual terms, the USD appreciated 5.3 percent against the EUR,

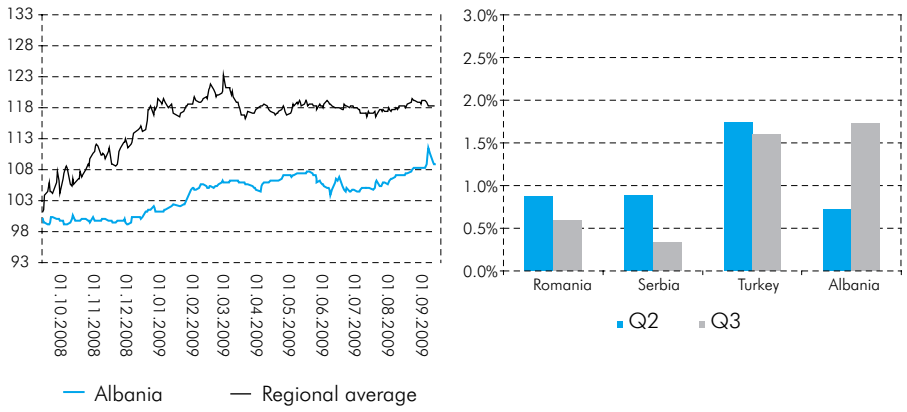
Chart 60 ALL exchange rate volatility[62] in quarters



Source: Bank of Albania

while relative to the previous quarter it depreciated 5.0 percent. Worth noting however, is that the volatility of this ratio, albeit at high historical levels, has been more moderate than in the previous quarters since the financial crisis emergence.

Chart 61 EUR/national currency in Albania and the region (left-hand) and EUR/national currency volatility[63] in Albania and the region in Q2 and Q3 2009 (right-hand)



Source: Bank of Albania

In a regional context, despite the relatively satisfactory position of the EUR/ALL exchange rate in marginal terms, the ALL seems to have depreciated at more accelerated paces during the last quarter relative to the other currencies in the region. This performance is also attested by the relatively high volatility of EUR/ALL during this period.

Box 4 Use of Unconventional Monetary Policy Measures

In order to achieve their objective and depending on the operational regime they apply, central banks employ a number of instruments in view of implementing the monetary policy. In many countries, the key interest rate is the main instrument applied. The level and changes in the key interest rate affect the economy via two main transmission channels: the interest rate channel and the credit channel. The description of the above mechanisms refers to a "conventional monetary policy". However, in specific cases, in the event the conventional monetary policy measures do no longer function satisfactorily, central banks use alternative measures called "unconventional monetary policy measures".

The need for unconventional monetary policy measures arises in periods of "crunch" when the transmission mechanism does not function properly. In this case, the interest rate channel becomes ineffective when the key interest rate reaches the zero bound and when it cannot be lowered further or when it would not affect the economy as a result of the "liquidity trap"[64]. On the other hand, the credit channel becomes ineffective when banks' ability to lend reduces. This situation may arise not only as a result of the reduction in the financing funds but also as a result of

the sharp deterioration of the economic conditions and economic uncertainty. These cases were evidenced upon the emergence of the global financial crisis. Although conceptually this situation is not unfamiliar -as is the case of recession in Japan- the massive and more sophisticated implementation of these measures took place only after the pressure exerted by the financial markets. In order to cope with the new challenges triggered by the non-functioning of the main transmission channels, central banks created some measures that were beyond the conventional operations. These unconventional monetary policy measures can be summarized in three categories and they aim respectively to:

Increase massively the quantity of money in circulation, known as "quantitative easing". Massive money creation aims to circumvent the obstacle of a blocked interest rate channel. In these cases, the central bank attempts to "satiate" economic agents' demand for money, in the hope that these agents will directly spend their excess cash holdings. In some ways, this is tantamount to creating a new monetary policy transmission channel that does not depend on the interest rate. However, the efficiency of this channel, to a large extent, depends on the stability of economic agents' short-term demand for money and on the purposes the absorbed liquidity is used for. Very often, the supply of money is channelled to only one economic agent, the "government". The purchase of government bonds by central banks is therefore one of the most widely used forms of quantitative easing.

Influence the slope of the yield curve in order to guide economic agents' expectations. To do this, the central bank can commit explicitly to keeping its key interest rate at a very low level for a considerable period. Under this policy, the central bank may also extend the maturity of its open market operations. This strategy is even more effective if the central bank's monetary policy framework includes a quantified definition of price stability, in order for the economic agents to be prepared for deviations from the easing policy in case the objective is infringed.

Unfreeze the credit markets by directly purchasing the securities on these markets in order to exert downward pressure on risk premia, known as "credit easing". In more concrete terms, the central bank can broaden the range of eligible assets for its main open market operations and directly purchase the debt securities from the economic agents. These operations have a two-fold impact: they revive the markets for these credit instruments and they directly provide financing to the economy. However, credit easing measures are more effective in economies with advanced financial markets, where companies primarily obtain financing by issuing securities and where loans to households are largely securitised through these instruments. The economies with undeveloped financial markets and where bank intermediation plays a key role, "quantitative easing" measures and those that influence the yield curve appear to be more relevant.

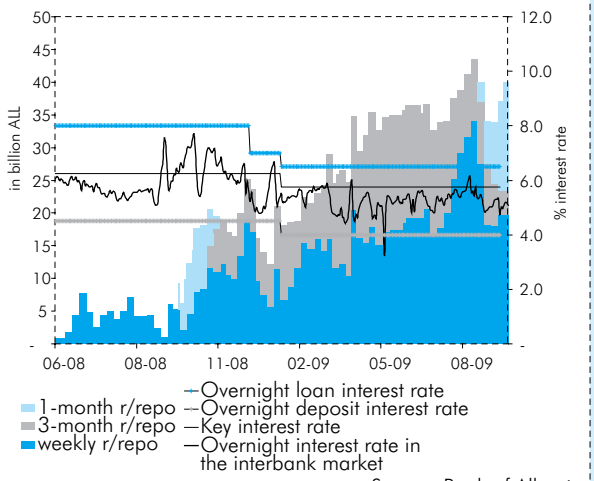
Table 13 Measures taken by central banks to impact the interbank market

	Broadening of the range of acceptable counterparty	Broadening of the range of quality of acceptable collateral	Extension of maturity
Federal Reserve	√	√	√
Bank of England	√	√	√
European Central Bank	√	√	√

Source: Central banks

In the case of Albania, the use of unconventional monetary policy measures was conditioned by the level of development of the domestic financial market, the same factor that prevented the complete and instant pass-through of the global crisis to

Chart 62 Bank of Albania interventions in the money market



Source: Bank of Albania

Albania. But on the other hand, the psychological effect was often coupled with situations of panic, primarily reflected in the form of withdrawal of deposits by the public and the tightening and curbing of lending by the financial institutions. When the use of the key interest rate was conditional, the unconventional monetary policy measures mainly focused on creating easing liquidity conditions and boosting lending activity. Against this background, the Bank of Albania provided ample fixed-price (key rate) liquidity and the maturity of the main open market operations shifted to the 3-month maturity. The range of the collateral used in these operations was expanded and the use of the required reserve increased. On the other hand, the symmetric corridor of overnight deposit and loan interest rates narrowed to an asymmetric one. These measures brought about the increase in the central bank's balance sheet and have helped to overcome the last year's critical phase.

ENDNOTES

[1] BRIC stands for Brazil, Russia, India and China.
[2] Aggregate investments and exports fell 15.4 and 23.9 percent, respectively, in annual terms.
[3] Activity in construction industry fell about 26 percent in annual terms, while retail sales dropped 9.1 percent.
[4] The spread between 12-month and 1-month EURIBOR interest rates in the money market has increased by 13 basis points during these three months.
[5] From the peak of 4.6 percent in March 2008.
[6] Measured as the moving average.
[7] "Vegetables including potatoes" and "fruit" contributed by 0.9 and 0.5 percentage points, while annual inflation marked 2.1 percent. These two sub-items' share in total CPI is 9 percent.
[8] This sub-item has the largest share (51 percent) within this item.
[9] The number of tourists has increased in the coming period.
[10] The average of two measures (permanent exclusion and trimmed-mean).
[11] Average of January 2000 – September 2009 is 0.8 percent.
[12] They include: "trade, hotels and restaurants", "transportation", "post and telecommunication". "Other services" include: financial services, education, health, public administration, protection and mandatory social insurance etc..
[13] According to the GDP for Q2 2009 (INSTAT), agriculture includes the value added in the economic activities in agriculture, hunting and forestry.
[14] The use of production capacities is measured by the industry, construction and services business confidence surveys through direct questions.
[15] The performance of house and rent prices is analyzed based on their respective indices and they are measured by the Bank of Albania. They cover only the city of Tirana.
[16] Data used for the construction of the House Price Index. The largest portion of house prices is expressed in EUR, which appreciated 7.7 percent against the ALL.
[17] Data obtained from the Construction Confidence Survey.
[18] House price/rent ratio is one of the simplest indicators used to assess whether the price of houses has appreciated, comparing the current values of the ratio to its historical values.
[19] Measured as the weighted average of CPI in Italy and Greece.
[20] Tradable inflation was 3.0 percent in Q3, up by 1.6 percentage points from the early-year level. Inflation of "food and non-alcoholic beverages" marked the peak annual increase rate in Q3 (5.4 percent) compared with the previous five quarters.
[21] Nominal GDP for 2009 is based on the IMF estimation of nominal GDP: ALL 1,129,000 million (IMF's Sixth Review under PRGF Arrangement). The values of different indicators expressed as a share of GDP refer to cumulative data for Q3 2008-Q2 2009.
[22] The values of these ratios refer to cumulative data from Q3 of the previous year to Q2 of the reference year.
[23] This item's balance posted a deficit of EUR 10.6 million or 40 percent narrower than the deficit posted in Q2 2008.
[24] This account's surplus amounted to EUR 236.5 million, up by 1.5 percent in annual terms.
[25] Trade exchanges reduced 12.7 percent in monthly terms and 12.3 percent in annual terms.
[26] In both annual and quarterly terms. Travel services' account balance had a deficit of EUR 30 and 10 million, respectively.
[27] Net current transfers totalled EUR 236.5 million in Q2 2009 compared to EUR 233.1 million the previous year.
[28] Official inflows amounted to EUR 11 million from EUR 6 million and 2 million in the previous year and the previous quarter.
[29] As a share of GDP, they accounted for 12.6 percent in Q2 2008. The figure provided in the text refers to cumulative data for the period Q3 2008-Q2 2009.
[30] FDI in Albania increased by 2.6 times compared with Q2 2008.
[31] In 2006, 2007 and 2008, they grew 21.6, 86.0 and 35.7 percent, respectively, in annual terms.
[32] Early 2009 projection.
[33] This figure refers to the moving sum of the primary deficit for the period September 2008-

August 2009.

[34] VAT revenue's contribution to the increase of total revenue for the first eight months of 2009 was about 2 percentage points. In 2008, its contribution was 7 percentage points.

[35] As part of the fiscal package approved in July 2007, tax on profit reduced from 20 to 10 percent starting from 1 January 2008.

[36] This may have also been triggered by the decrease of the employer's contribution by 5 percentage points starting from 1 May 2009.

[37] Their increase in annual terms is 40, 28 and 28 percent, respectively.

[38] Excluding January and March.

[39] Monthly nominal increase of expenditure.

[40] Syndicated loan is a loan borrowed by the government from a group of resident and non-resident banks in Albania. Its full settlement will take place in 2012. The disbursed syndicated loan totalled EUR 192.6 million compared with the early-year projection of EUR 250 million.

[41] They refer to the receipts obtained from the privatization of ARMO (a portion of which were transferred to the 2009 account), OSSH, a part of AMC and the United Bank of Albania stocks, and the licence granted to the fourth mobile telephony.

[42] Direct loan is negative since it refers to the direct loan extended to the government in February 2009 but effective in the 2008 account.

[43] "Other" is negative (-) since it reflects the change in the government account.

[44] The statistical effect of individuals' financing of ALL 11 billion to the annual M3 is about 1 percentage point relative to the current annual M3.

[45] Preliminary data for September.

[46] Monetary aggregates' data excluding the price change effect.

[47] As a result of the ALL devaluation against the EUR in August.

[48] Excluding the exchange rate effect.

[49] The figures shows in the lending analysis refer to data that exclude the exchange rate effect.

[50] The chart on business loans by sectors of economy shows nominal values.

[51] Short-term Statistics (INSTAT).

[52] According to Short-term Statistics, INSTAT, excluding "agriculture".

[53] Average Wage Index is measured as the ratio of wage fund index to the number of employees' index.

[54] Budget and non-budget.

[55] Excluding "agriculture" since it is not covered by Short-term Statistics (INSTAT).

[56] The sub-items of this industry cover 67.5 percent of the PPI basket.

[57] Information obtained from the periodical surveys held by the Bank of Albania.

[58] The standard deviation of overnight interest rate in the interbank market was 0.29 percent in this quarter compared with 0.43 percent in the previous quarter.

[59] Bid to cover ratio in the bond auction was above 1 on average.

[60] NEER – Nominal Effective Exchange Rate, measured against two currencies according to an approximate share they have in trade with abroad, EUR (80 per cent) and USD (20 per cent). A positive change of the NEER implies the appreciation of the ALL.

[61] In Q2 2009, the USD appreciated 18.8 percent against the ALL.

[62] Measured as the quarterly average of exchange rate volatility. The latter is measured as the standard deviation indicator.

[63] EUR/ALL and USD/ALL volatility is measured as the standard deviation in monthly terms.

[64] The term "liquidity trap" is used in Keynesian economics to refer to a situation where the demand for money becomes infinitely elastic, i.e. where the demand curve is horizontal, so that further injections of money into the economy will not serve to further lower interest rates.

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

At the Press Conference on the Financial Stability Report
July 9, 2009

Dear participants,

On the occasion of approval of the "Financial Stability Report for 2008" by the Supervisory Council of the Bank of Albania, I am standing before you today to briefly present the assessment of this report on financial system developments and the factors determining its stability.

Year 2008 will long be remembered as the year when the world economy experienced the greatest financial crisis of the modern times, which culminated in the second half of 2008, upon the bankruptcy of several globally extended financial institutions. Consequently, since that time onwards there is noted a high volatility in the financial markets, investors' flight, liquidity constraints and significant reduction in financial intermediation. The confidence of investors and the public in banks and financial institutions worldwide was shaken, bringing about a general price cut of banks' capital securities, by significantly narrowing their opportunities for refinancing.

The financial crisis magnitude expanded to the real sector of the global economy. The lack of funds and raised financing cost led to the decline of investment and trade, affecting the global domestic demand. Unemployment rate went up in all the developed countries, under the conditions when business enterprises were forced to cut production costs in response to declining demand. Most developed economies entered into a phase of economic recession in the second half of 2008. Slowdown of world economic activity in the demand for raw materials - production and food products – led to price cut of these products.

The deepening and widening of the financial crisis in the second half of the year made necessary the world-wide harmonization of actions, as well as the strengthening of the role of international financial institutions, such as the International Monetary Fund and the World Bank.

In our country, the impact of the international financial crisis increased due to its transformation into a genuine global-wide economic crisis. Initially, the international financial crisis did not provide any significant direct impact on our financial system. The reasons relate to lack of exposure of the banking sector and of the financial system in general to products and financial institutions that were at the centre of the crisis. Another reason is the low exposure to borrowing from foreign markets. However, in the last quarter of 2008, due to the psychological effect that caused the crisis aggravation in international markets, the domestic public reacted by withdrawing a part of banking sector's

deposits. Consequently, liquidity conditions were tightened and lending slowdown was evidenced in the banking system. Under these conditions, the Bank of Albania took immediate measures to normalize the situation and restore public confidence in banks. Therefore, the Bank of Albania injected liquidity into the market in various forms, in order to enable an easier access by the banks. These decisions gave a positive effect on reducing the interbank interest rate volatility by the end of the year.

The crisis extension over time led to restricted financing resources and raised price, shrunk foreign currency inflows, increased depreciating pressures on the lek and worsened economic agents' expectations for the future financial health.

This changed financial environment poses several important challenges for the stability of the financial system in general and for the banking sector, as its dominant segment, in particular. These challenges arise from the close relationship of the financial activity with the domestic and international economic developments, as well as their interaction with the internal situation of the financial system itself.

More specifically, the Bank of Albania has assessed that:

1. There is increased sensitivity of the financial system to domestic macroeconomic developments, where the main risks relate to:

a. Economic activity slowdown at home. Developments over the last quarter of 2008 and first months of 2009 show that the economic growth for 2009, though expected to be positive, will be low. This economic growth slowdown is due to shrinkage of domestic demand, reduced revenues of domestic economic agents that interact with international markets, and significant reduction of banking sector financing in the country. Therefore, the opportunities for expansion of the financial system activity will be more limited and its financial results will be lower during 2009;

b. Financial difficulties of the real sector of the economy. Expectations for slowing down the economy are hampering the financial resources to business enterprises and households. Domestic resources of activity expansion, in the form of income generated from core operation, will be negatively affected by the decline of investments and sales. Foreign financing resources, in the form of borrowing from the banking sector, are still on the downward phase. Various surveys on the business sector situation in general confirm the increase of financial difficulties and lack of optimism for short-term developments. The difficulties of business enterprises will negatively affect their ability to provide work steadily, causing reduced income for individuals and families. Again, the financial system in general and the banking sector in particular will attend these developments, mainly in the form of loan portfolio quality and slowdown of the public deposits growth rate;

c. Possible fiscal complications. The budget deficit increase in 2008, compared to the previous year, was realized under the conditions of a more favourable situation on deficit financing, in both the domestic and foreign market. The expected economic growth slowdown and the real sector's difficulties exerted pressure on public revenues, raising the difficulties for their realization according to the 2009 budget plan.

On the other hand, a more difficult situation of liquidity in the domestic financial market and in the foreign one is accompanied with increased budget deficit financing cost, bringing about a rise in the fiscal burden over the medium run. On the other hand, public expenditure realization should be adapted to actual income realization level. The Bank of Albania estimates that the accomplishment of the target set at the beginning of the year for the budget deficit, would better serve the implementation of its financing at a lower cost and the release of funds for use in the domestic market and for the private sector;

d. High level of current account deficit of the balance of payments. Due to unsteady exports and declining remittances, the current account deficit in the trade balance is aggravated. If this trend goes up, it may steadily affect the foreign currency inflow structure in the domestic market, impacting on the demand and supply for foreign currency and bringing about increased exchange rate volatility of the national currency. The floating exchange rate movement provides an automatic tool to correct these imbalances in the demand and supply for foreign currency in the domestic market. Against this backdrop, all economic agents, public and private, should assess their sensitivity and reliability to possible adverse exchange rate movements and take necessary protective actions.

e. In turn, the banking sector is sensitive to exchange rate movements, particularly in terms of the effect transmitted to foreign currency loan portfolio quality. Therefore, exchange rate developments over the first months of 2009 should give rise to necessary actions by the banking sector to mitigate any undesirable effects on the financial situation.

2. There is mitigated financial system sensitivity to developments in the international financial markets. It is estimated that:

a. Public policies on protecting European banking groups have enhanced the security for their legal and financial stability and the possibility of assistance they can provide for their investments in our country. Financial aid packages approved in Austria, Greece, Italy, France and other countries, and the strong liquidity injection by the European Central Bank have mitigated the difficulties of major European banks to provide liquidity and refinance their liabilities in the market. The positive performance of these banks' shares in stock-exchanges, generally during the first months of 2009, indicates such improvement of the situation.

b. The economic and financial situation in the countries of Central and South-eastern Europe has improved, as a result of financial aid of the International Monetary Fund and the European Commission, thus easing the negative expectations. Actions mitigating investors' uncertainty for economic developments in these countries, improve the perception of our country as well, in terms of the relative similarity that exists, at least in the countries of the region;

c. The signs indicating a gradual stabilization of the global economy have increased. Several relatively optimistic signals are coming from the economies of the developed countries and the largest developing countries. The perception for an improved global economic climate would positively impact on economic agents in the domestic market, not only economically but also creating more optimistic expectations for a return of their relations with the banking sector to normal behaviour.

3. The financial system sensitivity to the performance of several banking activity indicators has increased. It is assessed that:

a. A prudential management of the banking sector demand for liquidity is needed. Specifically, in order to cope with the deposit decline in the last quarter of 2008, commercial banks reduced their portfolio of liquid assets, increased borrowing from the dominant banking groups and from the Bank of Albania. The share of public deposits in banking activity financing, though remaining dominant and at high levels, underwent reduction. This process should be prudentially monitored, in order to see how stable it will be in time, as well as to avoid any significant shifting towards wholesale borrowing, particularly in foreign currency. Under the conditions when the foreign-currency financing resources depend on the foreign market, the banking sector is, however, more protected, because foreign currency financing lines are obtained from dominant foreign bank groups. The banking sector's borrowing from the Bank of Albania provides a stable financing source in a specific situation and helps in enhancing the monetary policy transmission mechanism. This development is particularly important for banks that are not part of foreign banking groups. Simultaneously, it allows commercial banks to work out policies that provide a greater support to the national-currency financial activity. From this viewpoint, of importance is also the portfolio management of securities, which serve as collateral for wholesale borrowing. For such transactions in lek, the commercial banks are supported by holding government debt securities, such as treasury bills and bonds. Banks should establish and administer a special portfolio of these securities, for use in case of unexpected liquidity needs. Undertaking actions to further the development of secondary securities market would also be a supporting factor in this regard.

b. In general, to ensure that banks will follow more conservative policies in terms of liquidity risk management, the Bank of Albania is preparing a special regulation that would require banks to improve their capacities

in terms of forecasting liquidity needs, and will also establish right and closer relationships between financing resources and banks' investments, in terms of type of currency, change of maturity term, creation of special collateral portfolios, etc;

c. The loan portfolio quality has entered into a downward trend. The difficulties of the real sector of the economy, the slowdown of economic growth and the strong contraction of lending due to unstable situation of liquidity in the latest months, have increased the volume of non-performing loans, notwithstanding the type of currency, the manner of or sector using the funds. The rise in non-performing loans has encouraged a tightening of the lending procedures, leading to reduced volume of credit and cutting of credit terms. Also, it is associated with increased bank reserve funds to cope with potential loan losses. This has impacted on the reduction of the banking sector's financial result. The banking sector must withstand this situation, aiming at maintaining a sustainable activity in its financial intermediation, a very important function for the development of the economy and for the situation of the sector itself.

Therefore, this is the time when the banking sector should give priority to lending in the national currency versus the one in foreign currency, making use of greater opportunities offered by public deposits and borrowing from the Bank of Albania. To this end, the banking sector should follow more appropriate policies in determining the credit price, in order to raise the demand for loans in the national currency. Also, there should be found forms that support the deposit growth and increase the flexibility of their use by the public, providing faster access through the Internet or other modern communication elements, etc.

The banking sector is sensitive to exchange rate behaviour, particularly due to the impact it passes through the loan portfolio quality. Foreign-currency credit dominates the total loan portfolio of the banking sector. This growth in years is due to the structure of the banking sector's balance sheet, low interest rates compared to credit in lek, as well as the perception that the lek's exchange rate stability would continue even in the future. It is understandable that the lek's significant depreciation within a short period of time, for those borrowers who do not generate their income in foreign currency, raises the value in Lek of loan instalments paid in foreign currency, thus associating loan repayment with delays and causing its transformation into non-performing loans. From this viewpoint, both the public and the banks should be more cautious for a better management of risk arising from exchange rate volatility.

l. Even during 2009 the financial result of the banking sector will continue the downward trend it began in 2008. In fact, this is a consequence of reduced operational revenues, due to the decline in the volume of operations with high earning rates and increased costs of operations, particularly due to increased reserve funds, to cope with potential loan losses. The decrease of net financial result means that the banking sector will have fewer domestic resources to support

operations and to increase the capital. In the case of banks that may experience a financial loss, this will be translated into reduced own funds. Though the decline in the financial result is not expected to have a significant impact on capital values, banks must prudentially monitor the capitalization indicators of operation and increase capital, if necessary. For 2009 capitalization has increased through non-allocation of profits and capital inflows from parent banks.

In conclusion, we stress that the efforts of public authorities should focus on maintaining the stability of macroeconomic and financial indicators. In the framework of fiscal policy, the maintaining of the budget deficit threshold serves to reduce the financing cost, release financing space to the private sector and mitigate the pressure on current account deficit. Simultaneously, this action increases the credibility of fiscal policy to international investors, providing opportunities for financial stability in the future. The prudence for keeping the macro-fiscal indicators on track is automatically translated into stability and credibility of the country against international financial markets. It constitutes the basic ground for a long-term sustainable growth in the country.

In the framework of monetary policy, we will strive for maintaining low inflationary expectations and will manage the liquidity situation in the interbank market, in order to avoid interest rate volatility.

As the regulatory and supervisory authority of the banking sector, we will seek from banks to take all the necessary actions for maintaining good indicators of capitalization and working liquidity. Showing necessary prudence for the borrowing quality and the sustainability of financing resources, the banking sector will be promoted to find ways to increase national currency financing to the economy.

Based on the financial indicators of the banking sector, and on the extent of their volatility according to stress-test analyses, the banking sector remains robust and its resilience to the above-mentioned risks is high.

The latest data speak for a restoring of public confidence, being reflected in the increase of deposits with the banking system. Credit to the economy has also grown, while the lek/foreign currency structure at banks' balance sheets has improved.

The shudder the system suffered in autumn of 2008 may be regarded as already over.

In conclusion, I would like to emphasize that the Bank of Albania will prudentially attend every economic and financial development with possible impacts on macroeconomic and financial balances of the country. We remain fully committed to taking all the necessary actions in due time and manner, while transmitting them with full transparency to the public.

Thank you.

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

at the Press Conference on the Monetary Policy Decision-Making of the Bank of Albania Supervisory Council
July 29, 2009

The Supervisory Council of the Bank of Albania, at its meeting of July 29, 2009, after getting acquainted with the latest economic and financial developments at home and abroad and analysing prudentially the confidence indicators, the banking system expectations and forecasts made by the Bank of Albania staff about the eight coming quarters, decided to keep the base interest rate, i.e., the weekly repurchase agreement rate unchanged, at 5.75 percent.

This decision of the Supervisory Council is based on the following arguments:

The economic developments in the first half of 2009 posed strong challenges to the Albanian economy. The global crisis affected our economy, swinging the factors and balances that have sustained the economic growth, thus testing the immunity and self-adjusting mechanisms of the economy and raising certain complex questions to economic agents and macroeconomic policies.

The economic recession hitting a major part of our trading partners is associated with a decline in trade exchanges and foreign currency inflows. The increased uncertainty in global financial markets has shaken the confidence in the financial system, exerting pressure on the tightening of financial conditions in Albania. Both these factors are reflected in the reduction of consumption, exports and investments, thus leading to economic activity slowdown and exerting pressure on fiscal indicators of budget revenues and budget deficit. On the other hand, the reduction of foreign currency inflows is accompanied by the deterioration of the balance of payments indicators and arising of depreciating pressures on the exchange rate, underscoring the role of current account stability in macroeconomic and financial balances at home and the need for taking precautions to guarantee it.

World economic environment is characterised by further deepening of economic and financial crises. Curtailing of consumption and investments, in the presence of high public and private debt levels and underlined macroeconomic imbalances, have made the world economy experience the sharpest economic downturn in the last 50 years. The developed countries, USA, Euro-zone, United Kingdom and Japan have pursued easing monetary and fiscal policies, aiming to hamper the economic downturn and improve the financial and capital market situation. Under their impact, the latest data have signalled relative improvement signs of some macroeconomic indicators. Tensions observed over the previous periods have relaxed and the

main financial indicators have shown recovery signs. In the meantime, the world inflation rates have been falling, owing to low raw materials prices and low use of productive capacities in the presence of a low aggregate demand and increasing unemployment.

The economic activity downturn worldwide was associated with contraction of world trade, tightening of financial conditions and dropping of economic agents' confidence. The direct impact on emerging countries, such as Albania, is the fall of demand for their exports, decline of foreign direct investments and tightening of lending terms in the global markets. Thereupon, these countries have been increasingly affected by the crisis. According to IMF, the emerging countries of Eastern Europe are estimated to incur a contraction of about 5 percent during this year.

The Albanian economy, in the face of this unfavourable environment, has recorded a comparatively positive performance. There are few data on the real economy. The Bank of Albania estimates that a positive economic growth has characterised the first half of the year. On the others hand, low growth of credit and money supply, worsened business and consumer confidence indicators, slow-down of budget revenues and specific indicators of certain economic sectors, suggest that the economic growth rate has decelerated. It is still early to draw conclusions on the economic performance over the course of 2009 and onwards. The Bank of Albania deems that the premises to keep positive economic growth rates in the country are present, among which the macroeconomic and financial stability of the country is of primary importance.

The economic activity at home is carried out amid favourable consumer price stability. It is sustained by easing monetary conditions and an expansionary fiscal policy over this period. The Bank of Albania cut the base interest rate in January and undertook liquidity-injecting operations, raising its quantity in the market. Simultaneously, we have lengthened the maturity span of liquidity injection operations, in order to lower the upward slope of interest rate curve. We have also expanded the eligible collateral base, in order to facilitate the financial institutions' access to liquid funds. These operations of the Bank of Albania have helped to control the interest rate level. The Bank of Albania's intervention has been more effective in controlling the short-term interest rates. The long-term interest rates of Government securities and loans displayed rising tendencies, owing to Government's demand for financing and increased sensitiveness of the banking system to liquidity indicators. In parallel, the depreciating exchange rate trends have complemented the easier monetary conditions framework, providing advantage to exports and trade deficit improvement. However, as we have constantly emphasised in our statements, the Bank of Albania has paid attention to momentary stimulus management, aiming above all, to achieve its objective for maintaining macroeconomic stability, by preserving internal and external balances.

As of the first half of 2009, the annual inflation rate was 2.0 percent, edging down from inflation rates of the last year, but remaining within the

Bank of Albania's target range. Low inflation rates are due to the weakening of inflationary pressures on the demand and supply side, consequent to raw materials price cut in the international market and the economic activity slowdown at home. Inflationary pressure stabilization is clearly illustrated by low core and non-tradable goods' inflation rates during this period, being reflected also in checked expectations of market economic agents. Meanwhile, after a long disinflationary period and confirming the Bank of Albania's forecasts, the annual consumer price change displayed a slightly increasing trend over the second quarter of 2009. Annual inflation marked 2.3 percent in June, reflecting a fuller pass-through of exchange rate depreciation effect on consumer goods prices. The Bank of Albania estimates that this factor may play a higher role in future price setting, thus creating premises for short-term and medium-term shocks on the level of prices.

In the face of these developments, the Albanian economy continued to be featured by low public and private savings rates even during the first half of 2009, associated with further enlargement of current account deficit and upward pressures on the exchange rate performance. Simultaneous reduction of exports and imports, respectively by 19.6 and 6.3 percent in annual terms, made the trade deficit contract by 1.3 percent during the first five months of the year. However, the reduction of emigrants' remittances by about 8 percent during the first quarter and the services account deterioration, made the current account deficit record an annual growth of 5 percentage points of GDP during this quarter. Though this deficit goes mostly for financing the capital and intermediate goods of import, its sustainability deserves greater attention. Particularly concerning is the low degree of export to import coverage, signalling structural problems of this deficit due to still-low competitiveness in our economy.

In this direction, special attention should be paid to checking costs and productivity growth in the economy, by raising investments in education and attracting most advanced technologies in production. Also, in the medium run, the macroeconomic policies should be prudent in terms of public and private savings level, in order to control the need for using foreign financing resources.

The fiscal policy during the first half of 2009 had an expansionary stance, being featured by a rapid growth of expenditures and budget deficit. Budget revenues have recorded a more moderate growth, partially reflecting the economic slowdown effects. Though remaining within the projected level for 2009, the budget deficit by about ALL 30 billion constitutes a much higher amount than in the same period of the previous year. Under these conditions, the Bank of Albania would appreciate measures for keeping budget deficit levels and public borrowing in check, helping the maintenance of internal and external balances in the economy. The maintenance of projected budget parameters will positively impact the macroeconomic stability, by controlling the fiscal stimulus on aggregate demand and dampening the monetary market pressures.

The demand for monetary assets increased during the last months. Money supply growth by about 8 percent was based on money creation in the economy from the public sector and private sector borrowing, mainly in ALL. Loan portfolio grew moderately, by ALL 7.5 billion or about 5 times less than as of the same period the previous year. Reduction of bank funds source and the increase of uncertainty in the country influenced the significant deceleration of credit growth rates. However, credit to economy increased along the first months of the year, while the banking system signalled no further tightening of the lending terms in the third quarter of the current year. The private sector's demand for Lek-denominated loans met an increasing willingness from banks, thanks to the stabilization of liquidity situation and easing of monetary conditions in the beginning of 2009. The restraint of foreign currency money supply has resulted in the contraction of the foreign currency component of money structure, even on the demand for money side, bringing about a shift of money supply structure towards the Lek.

In the first half of 2009, the financial market situation was influenced by increased uncertainty and revaluation of risk premiums that associated the liquidity constraint, consequent to deposit outflows and lending activity reduction. Ongoing intervention of the Bank of Albania in the money market, combined with measures that aimed at relaxing the market and encouraging the interbank market activity, as well as the maintenance of sound financial system indicators, made the end of the period record stable liquidity and interest rates. The latter displayed different behaviour in terms of maturity term. Short-term interest rates in the money market decreased, consequent to base rate cut and improved liquidity positions. Long-term interest rates rose under the conditions of a high demand for long-term funds and increased risk premium. Primary market interest rate rise was transmitted to interest rates of new Lek-denominated loans of more than 1-year maturity term, influenced even by the overall tightening of lending.

The Bank of Albania deems that the issues of liquidity, internal and external balances in the economy and the financial soundness constitute direct challenges on macroeconomic stability and long-term development of the Albanian economy. Their treatment should be constantly oriented towards the need for observing the necessary macroeconomic balances of the country. Price stability, smoothing of monetary indicators volatility, a robust and efficient financial system, as well as sound public and private sectors' balance sheets, impact on reducing the risk premium in the economy. Also, they open the way to attract foreign investments and cut the cost of borrowing from international markets. In this way, they provide an irreplaceable contribution to the country's long-term growth.

Further promotion of this growth requires constant structural reforms in the economy, which should not only address the deficiencies of our economy but also precede future development trends. Investment in infrastructure should be a priority of funds use in the economy. Also, further development and consolidation of financial market segments, completion and expansion of the pension system in favour of private incentives, investment with priority

in education and medical fields deserve the attention of all players in the economy. We also deem that it is just the time for the private sector to reflect the new development stage of the country, by enhancing and fostering its management. This requires a better management of business and financial risk, signifying also a closer cooperation with specialised agents in the market, extension of business plan horizons and their better orientation towards the global reality and the country's development priorities.

In light of this, the financial system should respond more prudentially to these requirements, enhancing the transparency and efficiency of its products. Now that the banking system has overcome the delicate moments it was faced with at end-2008, it should raise its contribution to financing the private sector's activity of the economy. However, I avail myself of this occasion to once more emphasize that the financial stability of the banking system is another major objective, to which the Bank of Albania remains deeply committed. This system will be constantly subject to Bank of Albania's supervision and stress-test analyses.

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

at the Press Conference on the Monetary Policy Decision-Making of the Bank of Albania Supervisory Council
August 26, 2009

The Supervisory Council of the Bank of Albania, at its meeting on 26 August 2009, reviewed the Monetary Policy Monthly Report. After analyzing the latest economic and financial developments in Albania and discussing their expected performance, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 5.75 percent, which is concurrent with the keeping of inflation close to the Bank of Albania target over the medium-term.

Annual inflation marked 2.2 percent in July, down by 1.5 percentage points from the previous year. In average annual terms, the inflation rate maintained its gradual fall reflecting the downward inflationary pressures both on the demand and supply side. This performance owes mainly to the fall of primary commodity prices in the international markets and the slower economic activity at home. In absence of possible shocks, the same trends are expected to persist in the future.

Although the statistical information covering the developments in real economy is insufficient, the available data and the surveys conducted by the Bank of Albania in the second quarter and in July suggest that the situation has improved slightly compared with the first quarter the present year.

Business and consumer confidence indices, their confidence in the banking system and the latter's willingness to carrying out its financial intermediation function have slightly ameliorated in the second quarter of 2009.

Economic tendency indicator posted a slight upward tendency following the pronounced fall in the first quarter. The production capacity utilization in economy has also enhanced. However, worth noting is that despite this performance, the above indicators remain at low levels by historical standards and below their long-term average. On the other side, the banking system's indicators remain sound, being reflected in greater household willingness to entrust its savings to the system. Although the banking system has increased prudence in terms of lending, the latest surveys show signs of growing banks' inclination to support the economy with funds. Fiscal policy continued to maintain its expansionary stance over the course of the year 2009, being reflected in higher budget deficit and public sector's competition for monetary assets. This policy has led to greater support for the economic activity; however it has been also reflected in higher government bond rates during this period. The Bank of Albania considers that the preservation of the fiscal stimulus at these levels is unsustainable in a medium-term period. Therefore, we believe that measures need to be taken in terms of observing the budget deficit level

projected for 2009 and focusing the state budget on the preservation of macroeconomic stability in 2010 and beyond.

These measures, and a prudent monetary policy, will reflect in improved balance of payments indicators, which continue to witness high figures of trade and current deficit. Better balance of payments indicators are a precondition for preserving financial stability in the medium run.

Annual inflation marked 2.2 percent in July, down by 1.5 percentage points from the same period the previous year. July's annual inflation was almost entirely determined by the contribution of unprocessed foods, while the contributions of other items have "offset" one another. Bank of Albania experts' forecasts for inflation show that it will mark rates close to the target. Against a background of contracted domestic and external demand, inflation is expected to remain stable and at low levels. The alleviated pressures seem to have been balanced by the exchange rate effect on imported prices and by the higher fiscal outlays in the recent months.

The latest monetary figures for June attest to a balanced demand for money in economy. The lower rates of lending to the private sector were offset by the higher fiscal agent's demand for funds. Money supply grew by about 6 percent in June, determined by the public sector's creation of money in economy and private sector's borrowing in Lek.

In response to the lower foreign currency liquidity of the banking system and the lower lending in foreign currency, net foreign assets slowed down. The dynamic role of the public sector has had its say in the shift of this structure.

Despite the positive developments in March and April, outstanding loans' growth slowed down substantially in June. Loan portfolio annual growth rate declined to 14 percent, while lending reduced by about ALL 1 billion compared with May. This performance reflects the lower lending to the private sector (mostly in Euro), the high loan settlements and the short-term nature of new loans. The higher loan settlements led to a moderate improvement of the loan portfolio quality. Banks continue to apply tight lending standards reflecting their concern over the higher non-performing loans as a percentage of the total and their uncertainty over the future developments in economic activity. These policies and the uncertainty over the future developments seem to have inflicted the contraction of demand for loans.

The banking system's liquidity needs have been met through the Bank of Albania open market operations. The central bank has injected the liquidity required by banks maintaining at the same time an adequate time structure for this injection. Although the liquidity needs have been met, interest rates in the primary market remained high in the presence of the government demand. Interest rates on new ALL loans fell in June, maintaining their downward trend shown since April this year.

Interest rates on new EUR loans also fell in April. However, it cannot

be yet concluded that the banking system has eased the lending cost substantially.

Risks to price stability remain balanced for the following period. Inflationary expectations remain anchored close to the 3 percent target of the Bank of Albania over the medium term. The persistence of current trends – slower money supply and lending activity, slower economic growth rates, low primary commodity price rise rates in the international markets and low inflation rates in Albania's main trading partners – sustains the receding of inflationary pressures. On the other hand, the uncertainty over the exchange rate performance in the future remains a possible risk that may lead to the generation of inflationary pressures.

The deteriorated balance of payments, the exchange rate depreciation and the persistent expansionary fiscal policies would generate upside risks to inflation. The exchange rate performance will largely depend on the performance of supply and demand in the market, concurrent with the free floating exchange rate regime adopted by the Bank of Albania. However, in our monetary policy decision-making we will take into account the large exchange rate fluctuations, requiring at the same time the support and rational behaviour of all other economic and macroeconomic agents.

The Bank of Albania considers that the clarification of the future fiscal position and its impact over the balance of payments would provide room for pursuing a looser monetary policy.

In conclusion, I would like to underline that the Bank's Supervisory Council considers that the current key interest rate is concurrent with the developments as indicated by the data and assessments of the current and expected situation in Albania, and decides to keep it unchanged at 5.75 percent. This decision mostly reflects the balance of risks to inflation.

The Bank of Albania remains committed to meeting its primary objective: achieving and maintaining price stability over the medium term. This objective sustains the country's economic development and preserves its financial stability. Therefore, it will monitor and filter any new information on the further developments and take all the proper measures to respond to risks to price stability.

The Bank of Albania is convinced that in the long term, the preservation and strengthening of macroeconomic balances will translate into better country rating, implying lower borrowing costs for the public and private agents, higher foreign direct investment in economy and greater efficiency in using the financial funds. In the long run, these factors will generate higher economic growth and ameliorated welfare at home.

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

At the 8-th International Conference of the Bank of Albania: "Monetary & Financial Stability Policies – Lessons from the Crisis"
September 17, 2009

Honourable Mr. Prime Minister,
Dear Governors,
Distinguished guests,

I feel deeply privileged to open the proceedings of the 8th International Conference of the Bank of Albania entitled: "Monetary & Financial Stability Policies – Lessons from the Crisis". I hope the proceedings will help the participants better realize the issues facing the global economy during this period and draw the proper lessons. I am personally convinced that the prominent speakers' reputation is a guarantee in this regard. Before I invite the guests to discuss the features and lessons drawn from the global and regional crisis according to their viewpoints and experience, allow me to say a few words on this conference.

The topic chosen to be dwelt with in this conference is at the forefront of the institutions' agenda, responsible for macroeconomic policies and financial system surveillance at a national and international level. The panic that followed the Lehman Brothers' failure almost a year ago transformed the turmoil in the U.S. mortgage loan market into a genuine global-wide financial crisis. The integration of the financial markets caused the crisis to spread swiftly, while the vital role of the credit system in free market economies transformed it into a global recession, hitting the East and South-East European countries as well.

The experience gained so far has allowed a better acknowledgment of the causes that led to the crisis and the factors that triggered and accelerated its spreading, and a reassessment of the diverse supervisory and regulatory practices. I would like our discussions on the crisis to focus on two directions: what we learnt and what we could not learn from the crisis. Among the numerous aspects debated at length, I would like to distinguish three of them: the dichotomy between the state and the market, the degree of confidence in the forecast models, and the importance of coordinating the pre-emptive measures.

With respect to the "state vs. market" debate, I would like to re-stress my unwavering confidence in the market and our commitment as policy-makers to make it operate by the rules and efficiently 24/24. The last few years have witnessed the rapid development of forest models and techniques. Avoiding the tendency to underestimate their high importance to the day-to-day work of every analyst and policy-maker, we have to be aware of the restraints in these models and of the risks arising from the excessive reliance on them.

The high cost of coping with the consequences of the crisis makes us aware of the importance of building pre-emptive mechanisms and above all, of the importance of coordinating them at a national and international level.

Today, nearly two years after the first signs of the crisis, the global economy and financial market are in a more optimistic situation. The economic recovery has been reflected in improved business and consumer confidence indices, mitigated deflationary pressures, normal functioning of banking and financial systems and higher economic activity growth rates in almost all production sectors. As in the other regional countries, these developments have been present in Albania as well.

The last quarters have attested to higher lending to economy, improved confidence in the banking system, relative exchange rate sustainability and the anchoring of inflation expectations.

There is now a global consensus that the hardest part of the crisis belongs to the past. This is certainly good news although not sufficient. Time is ripe to consider all the options for the so-called "exit strategy". The mitigation of anti-crisis measures' side-effects calls for co-ordinated, proper and timely actions. Policy-makers need to reassess macroeconomic and financial policy objectives in the light of the most recent positive developments.

Narrowing down the geographic extension of my discussion from global to regional, I will briefly dwell on some of the above-mentioned issues.

I once told a friend of mine that small open economies, as is the case with the Balkan economies, are net importer of goods, services and crises. The crisis did not originate in the region. It was gradually transmitted as a result of the integration of the region with the global markets and economy and a consequence of the presence of large international banking groups. Our countries are all as similar as they are different. Consequently, the form, outburst and consequences of the crisis were as similar as they were different. The economic and social structure, the level of convergence and integration with the global markets, the legal and institutional norms and the nature of exchange rate regimes in particular, have established the features of the crisis for each country. The experience of the distinguished governors present in this conference will throw light on the above aspects.

As regards the Albanian case, the last 12 months have been challenging for the banking industry. Despite the turbulent times, the banking system has in no case shown any signs of panic or confusion. The Bank of Albania considers that the rationale behind is the prudence shown in the recent years with respect to the banking system's financial stability.

The high level of resilience and the quick recovery were a consequence of a number of important decisions. By adopting the new banking law in the Republic of Albania and a range of other monetary policy and banking supervision-related decisions, we have aimed at firming up the macroeconomic

balances further and strengthening financial stability. At the focus of the Bank of Albania's strategy were the good governance and better risk management, improved banking activity transparency to the customer and the strengthening of internal control. This strategy peaked with a large-scale, exceptional and contemporary programme of open and constant communication with the public.

I believe that the favourable liquidity and capital situation characterizing the Albanian banking system on the eve of the financial crisis last fall helped to cope with the withdrawal of deposits during September-October 2008. However, the Bank of Albania deemed as necessary the prudent monitoring of the situation and took a number of actions, which alleviated the pressures over the banking system substantially. These actions helped to relax the liquidity situation and they were in harmony with the ECB's operational response to the crisis.

First, an *ad-hoc* task force was set up. Its main responsibility was and remains the daily monitoring of each individual bank. Our direct conclusion was that the analysis should consider all micro-level aspects, each and every cell of the system and indicators.

Second, a number of facilities were adopted for the incessant supply of the system with the required liquidity. The type of auction for the injection of liquidity changed to fixed-price auctions, the collateral base for repo agreements expanded, the use of the required reserve increased from 20 to 40 percent, and the spread between the Bank of Albania's key interest rate and overnight loan reduced from 175 to 75 basis points.

Third, through a special act, the Bank of Albania required higher capitalization of banking activity from the banking sector, adding to the guarantee of the banking sector's financial soundness.

Current financial system developments show that the overall situation in the banking sector has improved constantly. Deposits are back to the banking system, attesting to the improved public confidence.

Credit to economy has also shown signs of recovery. Another positive development relates to the fact that lending in the Albanian Lek has increased considerably. The European markets have been performing amid a more optimistic climate. Statistics show that the recovery of the crisis began even before the most optimistic forecast.

Distinguished guests,

I believe the prominent panellists and the central bank governors of our region will address all the issues related to the crisis and the lessons drawn from it thoroughly. However, allow me to briefly address some issues I believe are of interest to the audience.

First, the large-scale globalization of the world economy in the past two decades could not but spread the crisis throughout the world; consequently, there was an immense need for co-ordinated protection at an international level. In the early days of the crisis, we saw biased actions which led to arbitrage of negative effects.

Globalization requires the financial infrastructure to be everywhere similar in shape, contents, and human and technological capacities. It should operate under similar standards and practices and have the proper flexibility to precede the financial novelties.

Second, the last crisis calls for the pre-emptive and forerunning nature of supervision and legal regulations in general. I believe a regulatory framework is genuinely effective and successful when it intertwines the simplicity and transparency of a rule-based approach with the flexible and far-sighted characteristics of a principle-based approach. At any case, this is indispensable to make banks accountable, to convince the supervision inspector on the risk characteristics and on the transformation of new different on- and off-balance sheet products, before they exceed a certain threshold in terms of magnitude and exposure. The Bank of Albania is making efforts in terms of identifying the aspects that need further improvement. In this undertaking, we will take into account the similar developments in the region and broader, to preserve the market competitiveness and the convergence in supervisory practices.

Third, I believe that the crisis requires the existence of an international institution which should guide the financial stability, assess the systemic risk and determine the quantitative indicators measuring it. In this process, it is important that the regulatory norms be transparent to everyone. At the same time, it should be followed by an accelerated convergence process of the supervisory and regulatory practices according to the financial centres of influence.

Fourth, the current crisis confirmed our concern related to the exposure of the Balkan region to a relatively small group of banking operators of vast regional extension. Shocks affecting parent banks would affect one or several regional countries. A similar risk still persists even in the case when one of the branches in the region is hit by a shock. Similarly, the contagion risk is still present.

Fifth, I believe the region should scrutinize carefully lending in foreign currency. It is essential to set a better balance between lending in the national currency and lending in foreign currency.

To this aim, the nature of the exchange rate regime and the impracticability of central banks in the region to act as lender of last resort should be taken into account. In this context, we should support a stronger role of the national currency in bank lending, making lending in foreign currency more costly for banks if it is not supported by savings in foreign currency. The strong reliance of banks on foreign currency financial resources to support the rapid lending should be addressed and managed timely.

Sixth, I think the current crisis will make the financial funds, which for a long time have rushed in numerous forms across all former communist countries of East Europe, scarcer. This situation may have considerable implications for the long-term economic growth rates in the regional countries, which still are in need for foreign financial funds to support their convergence process. Therefore, I believe that the crisis has called for another lesson: the need to draft and implement joint regional programmes and structural reforms to absorb projects and financing lines, which will in turn expand and deepen our joint Balkan market.

It is true that after each crisis, macroeconomics as a science has made steps forward. Each crisis represents an event with specific characteristics, dissimilar or partly dissimilar from the previous crises. Each crisis brings in new information, regardless of the intensity, geographic extension or duration. Each crisis fills in a piece of the hard puzzle of free-market economy functioning, helping to a better understanding of the whole.

I hope to provide a consensual conclusion if I say that we, the administrators, had the fortune to govern in a time of crisis and that we have a motive to feel privileged -and why not proud- to have coped with the challenge, being witnesses and active players in that regard.

Thank you for your attention.

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

At the Lecture of the Governor of the Central Bank of the Republic of Turkey, Mr. Durmus Yilmaz, entitled "Current Global Financial Crisis and Recent Developments in the Turkish Economy and Monetary Policy"
September 24, 2009

Ladies and Gentlemen,

It is my great pleasure to give the greeting speech in this joint meeting, in which our dear and honourable friend, the Governor of the Central Bank of the Republic of Turkey, Mr. Durmus Yilmaz, will address very important theoretical and practical issues related to the most recent global developments, sharing at the same time his experience in Turkey.

The global financial crisis hit all the advanced economies severely. It certainly affected the emerging economies of South-East Europe, our two countries are part of. The contraction of global economic growth, the decline in foreign trade, the higher risk premiums, the interrupted functioning of the credit system and the rush to get liquidity affected our economies as well. These economies remain closely related to the Euro area economy through a number of trade and financial channels.

The response of fiscal and monetary policies to this crisis is of prime importance; this aspect will be thoroughly elaborated by our dear friend.

However, I would like to briefly address an aspect of macroeconomic and institutional framework, which has been an important determinant of the extent and magnitude of the national authorities' response to the crises: the exchange rate regime. A quick glance at the current developments in the region and broader allows us to draw the conclusion that the countries adopting a fixed exchange rate regime have been affected by the global crisis proportionally higher. Moreover, they have been more constrained in terms of responding to the crisis. By contrast, countries adopting a free floating exchange rate regime have been affected by the crisis more mildly and smoothly, and they have preserved higher independence in their economic policies for the mitigation of crisis effects.

Obviously, this is not occasional: the free floating exchange rate regime is an important political, economic and institutional investment of emerging countries. Their sacrifices in terms of building reliable monetary and fiscal policies, enhancing public confidence in the respective currencies and national financial institutions are rewarded with the flexibility this regime provides to macroeconomic policies in coping with the crises.

Exchange rate volatility mechanism is precisely a mechanism that allows the economy to absorb various shocks. The free floating exchange rate regime,

devotedly adopted by the Bank of Albania, allows the Albanian economy to withstand these shocks at minimum cost.

Let us leave this mechanism operate smoothly, without excessive reactions from the market or its agents. Any smooth moves towards the exchange rate equilibrium will be in the Albanian economy's own interest. Any hasty short-term reactions, like the ones we have been attesting to over the course of the present year and in the early days of this week, bring about individual financial cost to those undertaking them, as well as financial cost to the economy. No economic agent is stronger than the foundations. The high volatility and uncertainty in the foreign exchange market do not have any real base.

The euroisation of the economy is a visionary idea, not only for Albania but for the entire region as well, since its final aspiration is the membership into the European Union. It encourages the domestic and the regional market and the European authorities to speed up the convergence process. However, convergence in the Euro area is a derivative of continuous structural reforms and strengthening of financial systems, wherein the stability of the currency is of prime importance. There can be no European integration without a long-term equilibrium of the national and European currency.

In the long run, the exchange rate will inevitably reflect the sound foundations of the Albanian economy, which are to remain so. The past years' equilibriums remain real indicators of the potentials of the Albanian economy.

In the long run, we remain deeply convinced of the benefits the free floating exchange rate regime brings about. It will be the passport to and the best support to the Albanian economy in its path to European integration. I take this opportunity to invite all the economic agents to consider the benefits that our national currency provides impassively, as the best long-term instrument for protecting their savings and as the greatest buffer to wealth volatility.

To Albania, the Lek has been, is and will remain a successful currency. The Lek serves as an anchor for all our European initiatives. In the last 17 years, the Lek has managed to withstand the inflationary pressures and the pressures deriving from the foreign markets. Therefore, it should be left alone. It should move freely on its path, concurrent with the market demand and supply. The Lek is the icon of the Albanian economy that will guide us through the European gates. I take this opportunity to invite the media to comprehend this message and transmit it to the public at large.

Before giving the floor to our dear friend, I would like to briefly introduce Governor Yilmaz.

Mr. Yilmaz obtained his BA in Economics from the City University of London and his MA degree from the University College, University of London. Mr. Yilmaz started to work in the Foreign Exchange Department at the Central Bank of Turkey in 1980. After a long and successful career, Mr. Yilmaz was

appointed Executive Director of the Workers' Remittances (Non-Residents FX Deposits) Department in 2002.

One year later, in the Shareholders Ordinary General Meeting held on 7th April 2003, Mr. Yilmaz was elected Member of the Board of the Central Bank of the Republic of Turkey. Having served as Board Member between May 2003 and April 2006, Mr. Durmus Yilmaz was appointed Governor of the Central Bank of the Republic of Turkey on 18th April 2006.

Mr. Governor, the floor is yours.

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

at the Press Conference on the Monetary Policy Decision-Making of the Bank of Albania Supervisory Council
September 30, 2009

The Supervisory Council of the Bank of Albania, at its meeting of September 30, 2009, reviewed the Monetary Policy Monthly Report. After getting acquainted with the latest economic and financial developments at home and at the conclusion of the discussions on their expected future performance, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 5.75 percent, which is concurrent with the keeping of inflation close to the Bank of Albania target over the medium-term.

The analysis of the latest economic and monetary developments has confirmed our expectations for an overall downturn of the economic activity at home, lower domestic inflationary pressures, relaxed monetary markets and slowing recovery of financial intermediation. Moreover, it has underscored the still fragile equilibrium of economic and monetary indicators.

The conclusion of our discussions converged to the decision of keeping the key interest rate unchanged. This decision aims at preserving and firming up the established balances further, considering macroeconomic stability an indispensable precondition for a stable and long-term growth.

Economic activity at home has attested to the improvement of the overall global conditions during the last two months, recovery signs of lending activity and the seasonal effect of the summer season. Global economy is being characterized by a more moderate slowdown of economic activity in advanced economies, accompanied with higher global trade activity and low inflationary pressures at a global level. Despite the insufficient statistical data on the Albanian economy, indirect indicators suggest that it witnessed positive economic growth, although slower compared to the preceding years. The low pace of both retail sales and budget revenue increase, the slower exports, the lower growth of lending to the economy and business and consumer confidence indices show that the Albanian economy is going through slower economic growth relative to the previous year.

This situation is also mirrored in the low inflationary pressures, witnessed by the low core inflation, which is a good measure of domestic demand pressures. Annual inflation marked 2.2 percent in August, remaining within the Bank of Albania target but close to its lower limit. The seasonal tendency of price behaviour maintained the intensity, keeping the inflation rate similar to the previous month. Average annual inflation marked 2.2 percent, similar to the previous year, attesting to the complete termination of the first round effects of the previous year's increase in raw material and energy prices.

Fiscal policy maintained its expansionary tendency in July although at more moderate paces. Budget revenue stood at the same actualization levels as in the previous months -about 94 percent- while expenditure were met by 98 percent of the projection, maintaining the same level as in the previous three months. This gave rise to higher budget deficit during this period. Higher budget deficit and public expenditure boost the economic activity against a background of low demand in economy; however it is also coupled with higher interest rates on the public debt. The upward revision of public expenditure and budget deficit is projected to maintain this effect for the remaining 2009, while a more balanced fiscal position for 2010 would reduce the pressures on the money markets, by providing more room for the increase of the monetary stimulus.

The external sector data on the second quarter of 2009 reveal a further annual reduction of Albania's trade exchanges with the rest of the world. According to preliminary data, these development tendencies persisted during July 2009 as well. Exports decreased by 17 percent relative to the same month the previous year. Imports dropped by about 8 percent in annual terms. Trade deficit remains high, giving rise to imbalanced supply and demand for foreign currency in the economy.

Nevertheless, the maintenance of a flexible exchange rate, the correcting tendency of trade deficit and the attractiveness of savings denominated in ALL, in the form of higher interest rates and low inflation, serve to relaxed exchange rate volatility and to a strong position of the ALL in the medium and long-term.

Monetary indicators for July have reflected a more relaxed dynamic of financial intermediation. The performance of the external sector of the economy provided its impact over the negative rates of the money stock foreign currency component. However, the banking system intermediated the growth of ALL lending to the private and public sector at positive paces. While money supply grew at lower annual rates, about 4.4 percent, M2 ALL aggregate maintained high annual growth rates - 9.7 percent in July. The slower foreign currency lending to economy and the lower supply with foreign currency inflows from the external sector have yielded a negative annual growth rate of foreign currency-denominated deposits. Private sector lending grew 15.8 percent in nominal annual terms from 17.9 percent in June. Business credit provided the main contribution to the monthly growth of credit, a constant phenomenon, which this month appeared particularly more pronounced. Credit denominated in ALL maintained the average annual growth rate, about 28-30 percent. However, the slower foreign currency lending has brought about the decline of the credit growth rate.

The Bank of Albania open market operations met the liquidity needs of the banking system. The central bank injected the required liquidity by commercial banks, preserving at the same time an adequate time structure of this injection. Despite the improved liquidity situation, the yield rates in the primary market maintained the recent months' upward trend. The higher risk perception from

banks has determined the long-term yields, leading the 2 and 5-year bond yields to increase. The performance of new EUR and ALL deposit interest rates appeared stable in July. New ALL credit interest rates maintained their decline in July. In the meantime, new EUR credit cost tightened over the same month.

Concluding, forecasting a relaxed and within target inflation for the future, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged. This move is consistent with the prudent monetary policy pursued by the Bank of Albania in 2009. This policy has aimed at transmitting the controlled monetary incentives and keeping the inflationary expectations close to the Bank of Albania target. The latest developments suggest that the inflationary pressures are downward. The higher pass-through of the recent upward raw material prices in the global market may give rise to higher consumer prices in the Albanian economy. The exchange rate, the inflationary expectations and Albania's fiscal position will continue to condition the risk balance in the future.

The expected relaxation of these developments against a background of stable financial environment will provide enough room for higher monetary incentives in economy.

PAPERS PUBLISHED IN THE ECONOMIC BULLETIN OF 2009

March 2009

DETERMINANTS OF NET INTEREST MARGIN IN THE ALBANIAN BANKING SYSTEM

Irini Kalluci

This material analyses the net interest margin as a measure of efficiency for the banks that operate in the Albanian banking system and the main focus is on the identification of factors that may affect this indicator. Net interest margin can be calculated as the proportion of net interest income to total assets or interest bearing assets. Nevertheless, a reduction of this indicator does not signal in all cases an improvement of efficiency. Under these circumstances, the study of factors that could bring about changes to the intermediation costs represents an interesting topic and broadly discussed by the foreign literature.

The banking system is the most important element of the Albanian financial system, whose assets account for 97 per cent of the financial system assets. For Albania, banks function as the main players in channelling funds from lenders to borrowers, therefore it is important that their intermediation role provides higher welfare for the society, possibly at lower costs. This study was inspired upon this context, aiming to identify the factors that impact the net interest margin for the Albanian banking system and wishing that it will contribute in the written literature dealing with this issue, since it represents the first attempt for the case of Albania.

Different stakeholders, but especially the policy-makers, are interested in the establishment and functioning of stabilized and efficient banking systems. Stability requires adequate profits, while the economic efficiency requires margins at acceptable levels, applied from banks. The results derived from the analysis of factors that impact the net interest margin may be useful for the compilation of specific measures of economic policies.

NET INTERNATIONAL RESERVES IN ALBANIA: LEVEL AND MEASUREMENT, A COMPARATIVE ANALYSIS WITH THE REGIONAL COUNTRIES

Olta Manjani

The purpose of this material is to make a general description of the international reserves held by the monetary authority. The strategy of the Bank of Albania in managing international reserves has foreseen a continuous growth of reserves in accordance with the main features of the Albanian

economy: a high and growing current account deficit, a fast growth of short-term foreign debt and a considerable shift of broad money to its foreign currency component. Given the features of the Albanian economy, the application of reserve adequacy criteria based on conventional benchmarks is useful in the case of Albania. Adequacy benchmark of reserves covering 3-4 months of imports, covering one or up to one year of short-term foreign debt or 5-20 percent of broad money are required to forerun potential risk factors that might impinge the Albanian economy. Despite being widely used, conventional criteria are highly credible and provide good basis for comparison between different countries.

MEASURING INFLATION EXPECTATIONS* *June 2009*

Gent Hashorva
Elona Bollano
Elvana Troqe

This paper attempts to apply some approaches in order to quantify the responses collected via the Consumer Confidence Survey conducted by the Bank of Albania. Moreover, it attempts to better understand the nature of consumer inflation expectations in Albania. The paper is organized as follows: Section one analyzes the testing of expected inflation indicator in order to derive conclusions related to the nature of consumer inflation expectations. Section 2 describes the importance of expectations in the inflation control process and the method of their measurement. Section 3 continues with the methodology of data conversion from qualitative to quantitative, using a number of functions of the probability approach to quantification of inflation expectations. Section 4 applies the methodology and testing in the case of Albania. The last section provides some preliminary conclusions.

THE INTERNATIONAL FINANCIAL CRISIS AND THE REGIONAL COUNTRIES*

Eglent Kika
Erblin Maçi
Medvin Shehu

The purpose of this paper is to provide a retrospective of the crisis evolution from the developed to the developing world, the primary focus being some of the Central Eastern European Countries, some of the regional countries and Albania. Within this context, exceptional interest is paid to the manner the crisis is reflected in these countries' real economic indicators as well as fiscal, monetary and respective institutional operational developments according to their quintessential economic profile.

PAPERS

ANALYSIS OF FINANCIAL INTERMEDIATION*

1. INTRODUCTION

The Albanian banking system consists of 16 universal private banks, dominated by foreign capital, which constitutes about 92 percent of the capital held by the banking system. Though a considerable number of banks have been present in Albania since 2000, the genuine intermediary activity of the banking system has been livened up in the last 4-5 years. In 2004 banking financial intermediation was characterized by the accumulation of economic agents' savings and low mobilization of funds for lending[1], particularly to the private sector. In the meantime, public debt financing accounted for 55% of assets, witnessing a high mobilization of funds for the public sector. This composition of the banking system assets was a consequence of the low geographic expansion of the banking system, higher credit risk, lower integration of the real sector with the banking system, as well as the regulatory and supervisory elements[2] present at the time.

Table 1 Several indicators of the banking system development in years

	2001	2002	2003	2004	2005	2006	2007	2008	H1 2009
No. of banks	13	13	15	16	17	17	17	16	16
Branches / Agencies			161	188	250	294	399	511	531
Foreign capital (in % of the total)	69.5	67.6	64.9	87.3	86.3	85.7	88.8	92	93
Total assets/GDP (in %)	53.5	51.6	50.2	51.9	59.3	69.4	75.9	78	78
Total credit/GDP (in %)	4.7	5.9	6.8	8.5	15.3	22	29.9	37.1	38.9
Credit/deposit (in %)	10.2	13.5	15.7	19.0	28.5	37.4	48.8	63.9	68.3

Source: Bank of Albania

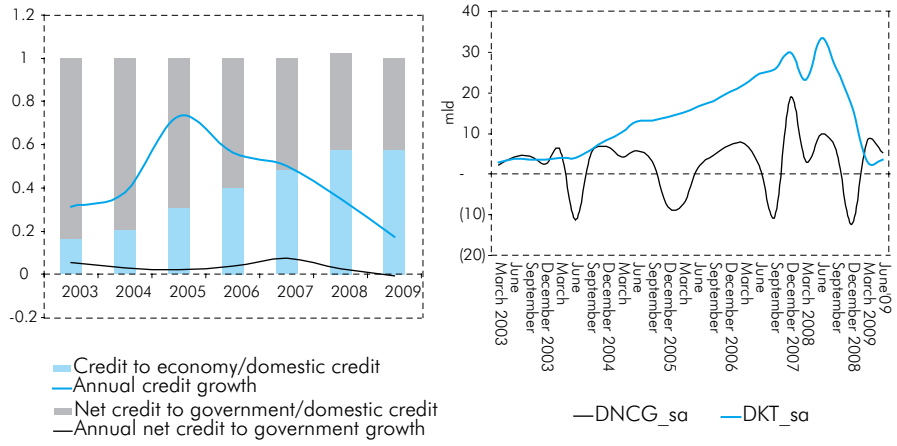
During this period, the level of credit to the economy as a share of GDP was about 7%[3], among the lowest in the region and beyond. After 2004, the Savings Bank's privatization by Raiffeissen Bank and the reduced risk premium for our country due to achievement of macroeconomic stability, were reflected in the banking activity growth in a continually increasing competitive environment. In June 2009, the banking system assets accounted for 78% of GDP, significantly higher than in 2003, when this indicator constituted only 50% of GDP. Also, in these last five years, the banking system has been one of the main contributors to robust growth of the economy.

The expansion of banks with branches throughout the territory of the country has significantly increased the coverage of the entire population with banking services and the use of banking products in everyday life. Currently, the lending activity accounts for 50% of banking system assets, while deposits account for 73% of liabilities.

2. CREDIT AND DEPOSIT ACTIVITY

Consequences of the global financial crisis emerged in Albania in early autumn 2008. During this period, the perception for a global-wide financial crisis of banks affected the shaking of public confidence in domestic banks. Consequently, from October to December 2008, a great number of deposits were withdrawn from banks. Though at a moderate extent, this phenomenon continued also in the first quarter of 2009. In the second quarter and onwards, there was a stabilization of liquidity, due to the interruption of deposit withdrawals and the restoring of public confidence in financial institutions. The passing by the Albanian Parliament of the increase in standard maximum deposit insurance amount, which became effective in April 2009, played an important role in fostering the public confidence in the banking system. However, in the second quarter of 2009, the banking system carried out its financial activity under a precarious situation and continued to face liquidity constraints.

Chart 1 Domestic credit performance and quarterly changes of credit to private sector and net credit to government, seasonally adjusted

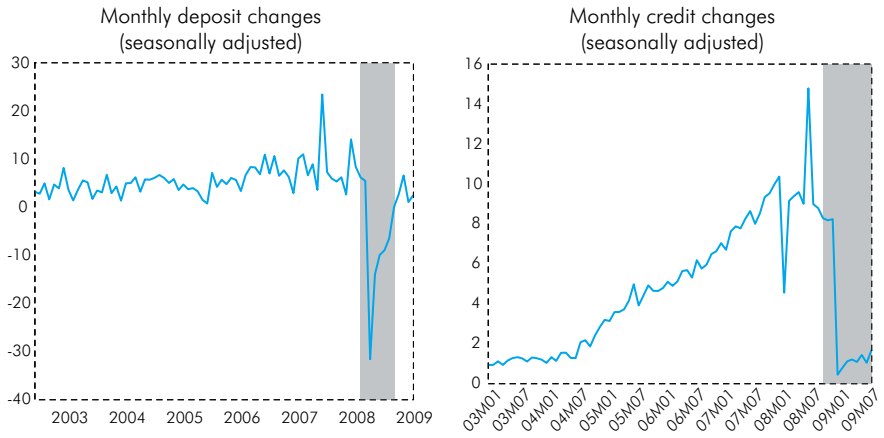


Source: Bank of Albania

The fiscal agent, pursuing an easing fiscal policy, has continued to exert upward pressures on money demand. In the first half of 2009, there was a significant increase of the budget deficit and the need for its financing. The deficit financing was provided chiefly from the banking sector and from non-residents. At the end of the second quarter and onwards, banks have performed higher intermediation to the government. This financing was carried out not only in the form of security portfolio expansion, but also through participation in euro-syndicated loan granted to the government. Hence, in July, this loan amounted to ALL 6.2 billion or EUR 48 million. During the second quarter, the increased risk perception by the private sector and the significant liquidity constraint, particularly in foreign currency, have prompted banks to shift the intermediation from the private sector to the public one, in response to increased financing demand of the government.

In the second quarter of 2009, the circulation of money in economy was basically in lek. This is noticed in the persistence of high growth levels of annual M2 aggregate, averaging 10.2%. Meanwhile, the annual growth rate of broad M3 aggregate has slowed down significantly. In July, the annual growth of M3 aggregate dropped to 1.6%[4], from 15% in the previous year. This behaviour reflected the shrinkage of its foreign exchange component, as a result of the decline in the deposit level and lower foreign-currency intermediation from the banking system. Significant decline was also reflected in the broad money multiplier[5], which in July 2009 dropped to 0.7, against the peak of 10 recorded in the previous year. This huge drop of money multiplier was driven by the following factors: the increase of public demand for cash holdings; the increase of banks' excess reserves in their accounts in response to deposit outflows; and finally a higher credit risk perception. The most liquid components of money continue to exhibit high growth rates, reflecting not only their seasonal behaviour for a high demand for cash during summer, but also the reluctance of the public to replace their savings to the system.

Chart 2 Monthly credit/deposit changes, (cleared from the seasonal effect)



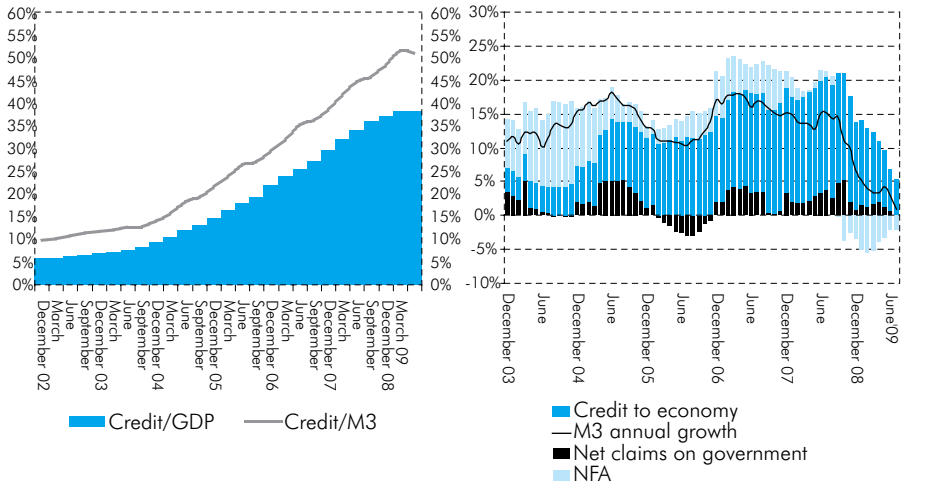
Source: Bank of Albania

During the second quarter, there was an improvement in the deposit performance. In general, monthly deposits were performing well. The passing by the Albanian Parliament of the increase of standard deposit insurance amount contributed to fostering the public confidence in depositing their savings at the banking system. Nonetheless, the ratio of deposits to M3 aggregate stood at 74.5%[6], i.e., the minimum level in the last five years.

Starting from April, lek-denominated deposits have shown positive monthly changes, averaging ALL 3.1 billion. In summer, the monthly changes in lek-denominated deposits are in line with the seasonal monthly growth in the previous years. In the meantime, the situation of foreign-currency deposits continues to be uncertain. Foreign currency savings remain outside the banking system, causing foreign currency liquidity constraint and affecting the performance of foreign exchange market in the country.

During this period, the Bank of Albania, seeking to accomplish its principal objective, i.e., maintaining price stability, and to preserve the financial stability in the country, has pursued an accommodating monetary policy, responding to the liquidity constrains in the system. Meanwhile, until July 2009 the base interest rate was cut only once at the beginning of the year by 0.5 percentage point. During this period, the Bank of Albania has provided the necessary liquidity to banks, creating more room for raising the intermediation in lek. Consequently, the base money has grown at high rates in the second quarter, approximately by 25.2% in annual terms.

Chart 3 Loan Portfolio



Source: Bank of Albania

The annual growth rate of the loan portfolio[7] has continued to slow down, from 25% in March to 12% in July. Compared with end-December 2008, the loan portfolio has increased by ALL 10 billion, fully affected by credit in lek.

In relation to the broad aggregate M3, the credit has maintained the same ratio as at the end of 2008, around 50%. Although credit to private sector continues to provide the main contribution to M3 growth, this contribution dropped significantly during 2009. As a share of GDP, the loan portfolio amounted to 38.5%, standing at the same level as at end of the first quarter and reflecting a modest increase compared to year-end 2008.

The slowdown of the loan portfolio growth rates, besides the supply contraction from banks, reflects also the decline in the demand of the economic agents, in response to raised uncertainties and tightened lending conditions. Loan portfolio throughout the first half of the year has increased by an average of ALL 1.2 billion per month. This figure is the same as the growth of this indicator in 2003, when the developments in the lending activity were very limited. While compared to the same period of the previous year, the monthly flow of credit is about 8 times lower.

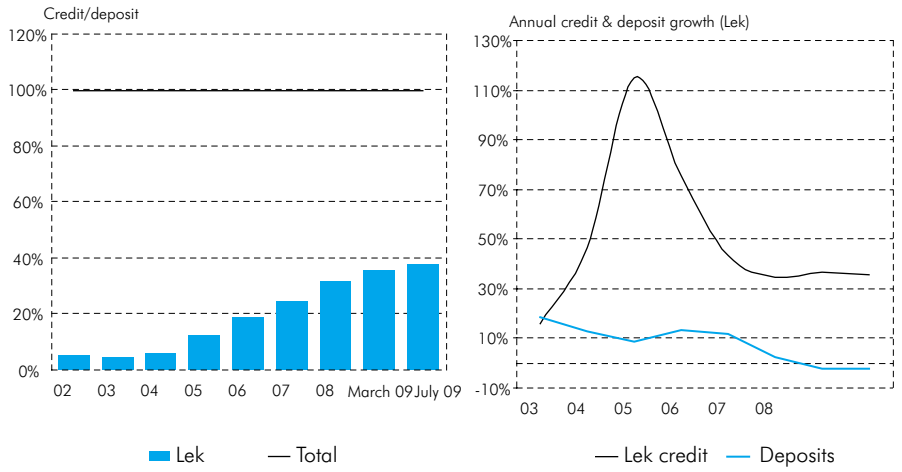
3. BANKING INTERMEDIATION ANALYSIS

The following section presents a detailed analysis of the banking system intermediation by currencies. The year 2009 was characterized by increased ALL-denominated credit and pronounced slowdown in the foreign currency one, due to foreign currency liquidity constraints. These developments have been reflected in the indicators of the banking intermediation and in the costs of the latter by different currencies. Due to fundamental changes in the current behaviour and possible future developments, the intermediation activity is analyzed separately for the lek and for the foreign currency.

3.1. Performance of intermediation in ALL

In late July 2009, the credit/deposit ratio in Lek amounted to 37.6%[8], against 27% in the previous year. The apparent improvement of the ALL intermediation ratio was mainly due to decreased level of deposits and a better performance of ALL loan portfolio. Despite the positive developments over the latest months, the level of ALL-denominated deposits has not yet restored to that of September 2008.

Chart 4 Performance of intermediation in ALL

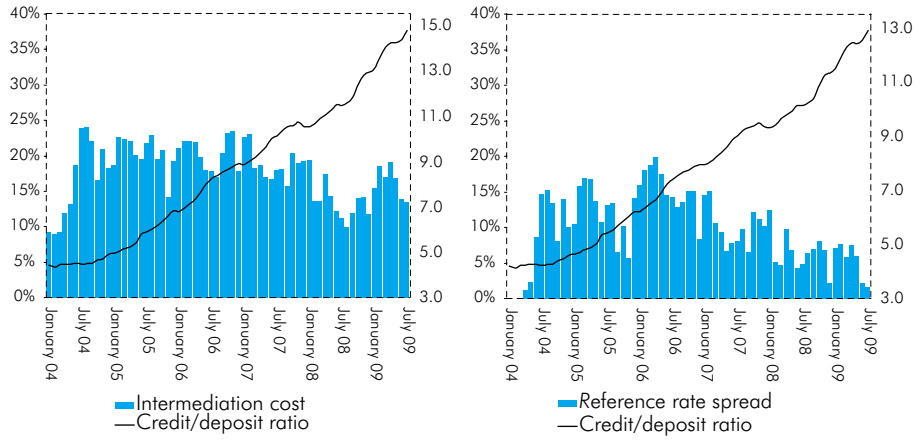


Source: Bank of Albania

During 2009, banks, having more room for intermediation in ALL, as well as accommodated in their liquidity demand from the central bank, have maintained the growth paces of lending in ALL. Also, banks' awareness of the materialization of direct or indirect exchange rate risk has contributed to its growth. Compared to March 2009, ALL-denominated credit has increased by about ALL 13 billion, thus offsetting the drop of foreign currency loan portfolio. The ALL credit expansion is attributed chiefly to business credit growth. Also, the demand of businesses mainly to finance their liquidity needs is regarded as having encouraged Lek-denominated credit.

Seasonally adjusted credit series shows significant improvement of credit in ALL, especially in June and July 2009. Empirical analysis of ALL credit data indicates that the seasonal factor explains about 15% of its behaviour. June and December are the months which reveal a statistically significant seasonal behaviour.

Chart 5 Developments in ALL intermediation cost



Source: Bank of Albania

The ALL intermediation cost, in spite of significant monthly fluctuations over the last 7 years, went on its descending trend, reflecting the growing interest of banks to increase lending in ALL. The Lek intermediation has also been affected by high levels of interest paid for deposits, with the aim to attract savings in the banking system. In the meantime, during the first months of 2009 the ALL intermediation cost went up, reflecting the increase of the rates in the securities market, which serve as reference for lending interest rates, as well as the increased uncertainty perception and the deterioration of the loan portfolio quality.

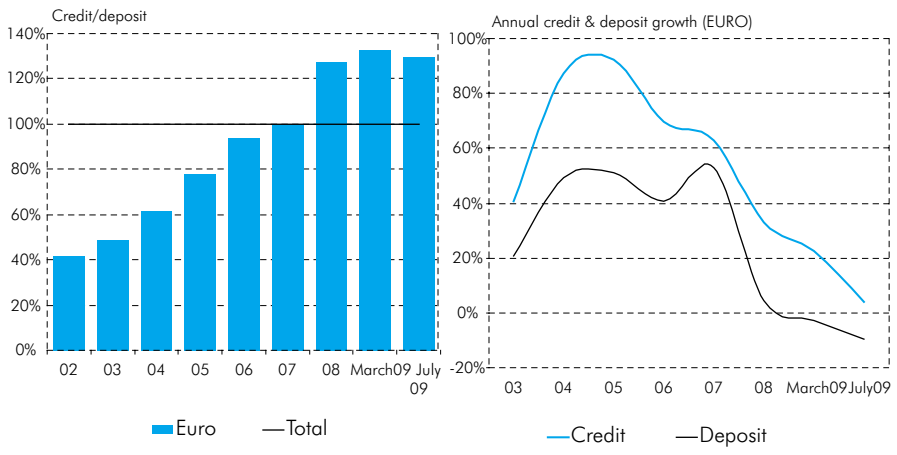
The correlation analysis between ALL intermediation size and its cost indicates that the correlation coefficient is -0.3, revealing that the relation between both variables is not statistically strong. This may be explained by the fact that a growing interest of banks in lending in ALL has been present only during certain periods[9] of time, while most of the time, both, credit demand and credit supply, were mainly oriented towards foreign currency.

3.2. Performance of intermediation in euro

Banking intermediation in the European currency is above the level of the system deposits and has shown an upward trend during the last 6 years. The key factor contributing to the rapid development of this ratio is the high growth of euro-denominated credit, which has been favoured by credit supply at significantly lower interest rates than those in the national currency. Also,

banks themselves, being mostly branches and subsidiaries of foreign banks that carry out their activity mainly in the Euro-zone, have supported lending in euro[10] through their policies. Another important factor contributing to the rapid growth of foreign currency credit[11], particularly in euro[12], is the financing of economic sectors (such as trade, construction, etc.) that carry out their transactions in this foreign currency. Credit to both these sectors is estimated to account for about 54% of the loan portfolio. However, in 2008, following the tightening of the regulation on foreign currency credit, the first sign of its slowdown was noticed. The confidence crisis in October '08 appeared more pronounced for foreign currency (EUR/USD) deposits, causing directly an immediate rise in the euro intermediation ratio, to 127% at year-end. Due to the deepening of the confidence crisis in all international markets, the fourth quarter of 2008 reflected problems in finding the necessary liquidity in euro and increased the cost for providing such funds in the international market. Later on, during the first quarter of 2009, along with difficulties in generating the necessary foreign-currency liquidity, banks were faced with significant depreciation (about 7%) of the lek against the euro. This, besides the psychological effect on the public, affected also the deterioration of the loan portfolio quality. Under this situation, during the first half of 2009 there was a shift towards lending in ALL. The euro-denominated loan to deposit ratio dropped from 132.5% in March 2009 to 129.5% in July, mainly due to the significant reduction of credit in euro.

Chart 6 Performance of intermediation in euro



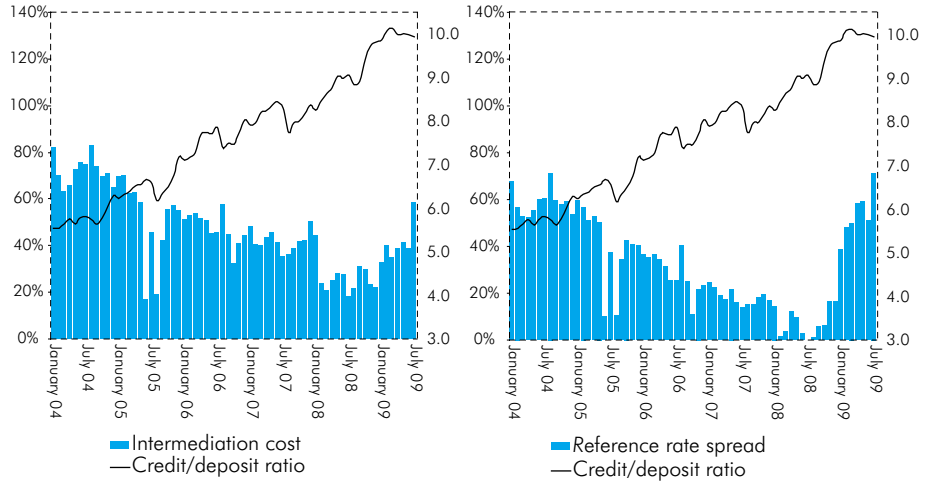
Source: Bank of Albania

In particular, the slowdown of credit in euro appeared more pronounced for credit to households, and mostly for housing loans. Euro credit to households is assessed as having a higher risk than credit to enterprises, because the majority of them lack the natural hedging from exchange rate risk. During 2009, as a consequence of the Lek's depreciating tendency against the euro, the households' ability to repay their liabilities in euro is expected to decrease. The crunch created in the real estate market is another factor that has made

banks more prudential towards lending to households. Moreover, according to the bank lending survey, the situation in the real estate market has also affected the drop in households' demand for housing loans.

Many banks have chosen to raise the interest rate, as a criterion for tightening the euro lending terms. The increased cost of foreign currency credit to the private sector reflected not only the higher cost for finding foreign currency funds in the international markets, but also the exchange rate risk, the tightening of supervisory criteria and the overall uncertainty about the economic outlook and foreign currency developments. In late July 2009, the cost of intermediation in euro reached the maximum level of 6 pp, against 4.7 pp recorded in September 2008. The analysis of euro intermediation and its cost reveals a high negative correlation of 0.72, indicating a strong relation between the performance of loan to deposit ratio and the intermediation cost. Over the last 2 years (January 2007-January 2009), it is evident that banks, driven by increased competition to gain market share, have significantly reduced the intermediation cost in euro, mainly by cutting interest rates on euro-denominated loans, and thus enhancing the demand for such loans. As it comes out from Chart 7, during this period this cost dropped to minimum levels, while intermediation ratio for the same period increased at higher rates. Meanwhile, during the current period, the restraining of euro-denominated credit growth has also been affected by rising intermediation cost.

Chart 7 Developments in euro intermediation cost



Source: Bank of Albania

Besides applying higher interest rates, banks have also used other elements to discourage foreign currency lending, such as the value of collateral pledged to secure a loan, the debt service coverage ratio, following strict requirements in matching the currency of income with that of the loan, etc.

4. BANKING INTERMEDIATION IN THE COUNTRIES OF THE REGION[13]

Uncertainties surrounding the global economy, coupled with the contraction of economic activity in all the countries of the region, have been manifested in the slowdown of the monetary expansion in all these countries. Notwithstanding the difference in extent and intensity, the monetary developments in the countries of the region are triggered by similar factors and are characterized by the same phenomena: decline in the domestic and foreign demand and in production, slowdown in lending, and increased uncertainties about future developments.

The slowdown of money supply growth mostly reflects the constant slowdown of lending in all the countries of the region. Broad money growth in all the economies of the region is led mainly by household deposits, while business deposits have slightly increased or have started to fall. Significant decline in the domestic and foreign demand has negatively affected the financial situation of businesses. Moreover, in presence of limited access to financing from banks, businesses are forced to rely mainly on their own funds, to finance their economic activity.

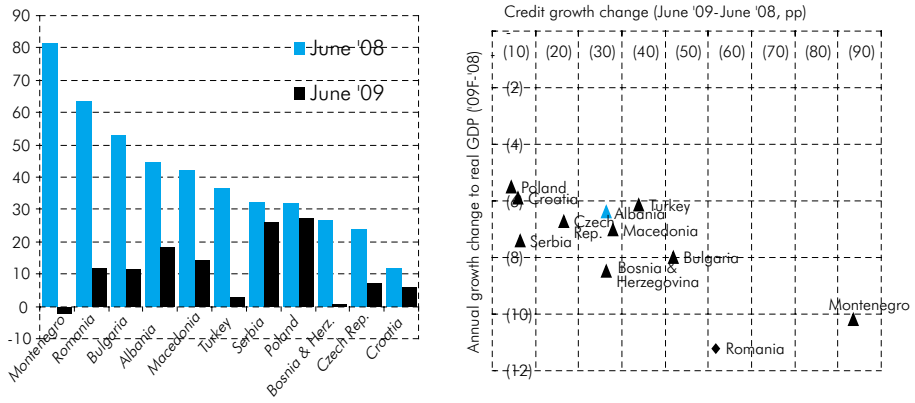
The financial crisis emerged in the countries of Central and Southeast Europe at a time when the cycle of credit to the economy was at a phase with high and steady growth (see Chart 8). Now, after almost one year, the credit growth rates have fallen significantly in all the countries (in the case of Serbia and Poland, the decline in credit growth rate is undervalued, respectively, due to high inflation and exchange rate depreciation). This phenomenon has been more pronounced in economies that are at a later stage of development (Balkan countries, Romania, Bulgaria) compared to the Central European countries, like Czech Republic, Poland and Hungary. Moreover, it is also noted that, generally, the countries with the largest decline in the real GDP forecasted for 2009, exhibit also the largest slowdown in lending growth rates.

Lending has slowed down due to both supply and demand factors. The latter's influence has been greater in countries of the Central Europe than in those of Southeast Europe. On one side there are economic agents who, driven by uncertainty perceptions for the economy in the future, have reduced their long-term investment and consumption plans. On the other side, along with the increase in non-performing loans and relatively uncertain liquidity conditions, banks have become more risk-averse, paying more attention to liquidity and tightening the lending terms.

In most countries of Central and Southeast Europe, the slowdown of credit to businesses has been stronger. New credit to businesses has been mainly extended at a short-term maturity, reflecting simultaneously the contraction of investment plans and the banks' increased risk-aversion. The most prominent feature of household credit is the reduction of housing and consumer loans in most of the countries.

Concerning the future outlook, lending will be influenced by several factors, such as the quality of the loan portfolio, the level of banks' capitalization, and risks coming from economic environment and their implications for economic agents. Generally, lending is expected to continue to grow slowly also in the near future, and to pick up again with the appearance of clear signs of the economic recovery in these countries and in the world economy.

Chart 8 Annual credit growth in the countries of the region (left) and changes in annual growth rates credit and of GDP (right)



Source: Respective central banks, IMF WEO, April 2009
*Real GDP growth for 2009 is a forecast.

ANNEX: PERFORMANCE OF LOAN PORTFOLIO*

Chart 1 Loan portfolio by currency

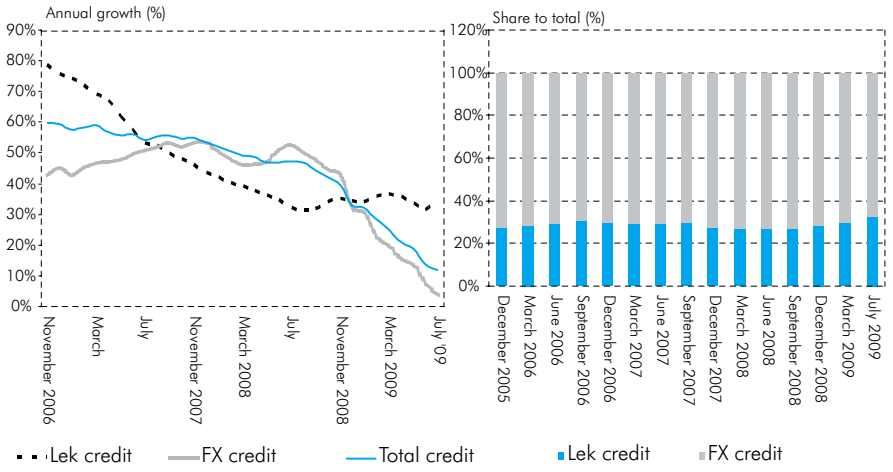


Chart 2 Loan portfolio by clients and purpose of use

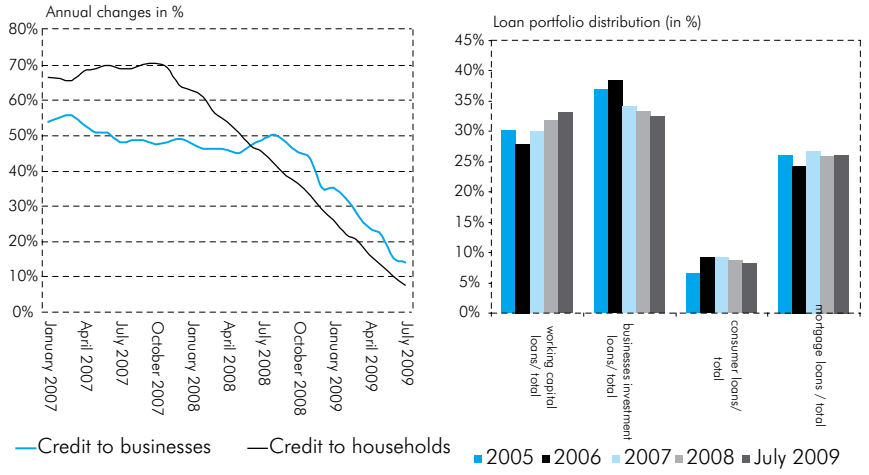


Chart 3 Loan portfolio by clients/purpose (contribution to annual change)

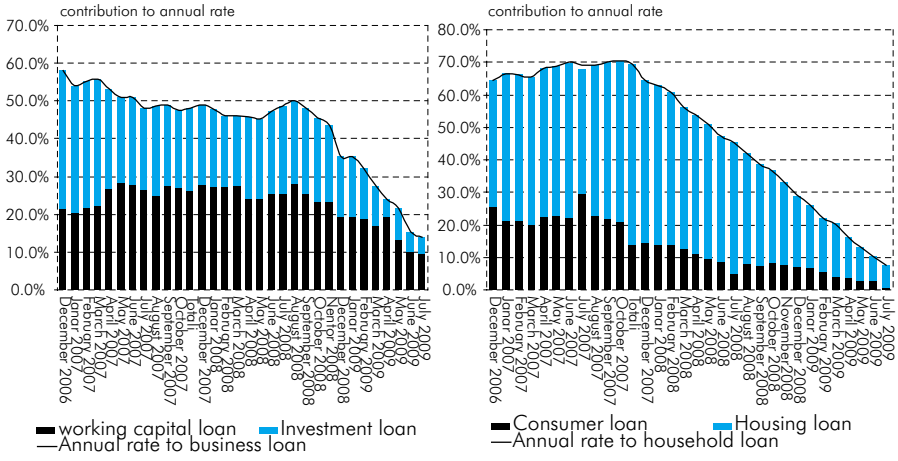


Chart 4 Loan portfolio by sectors of the economy
(contribution to annual change)

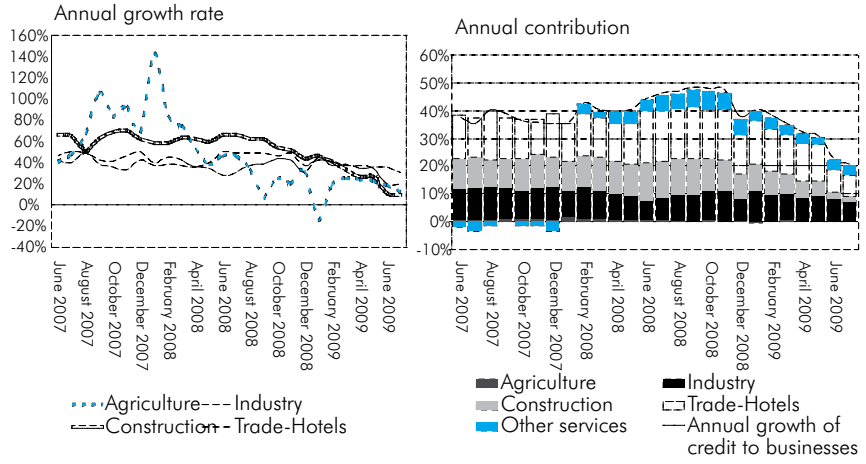


Chart 5 Performance of credit to business
(in ALL billion, exchange rate adjusted)

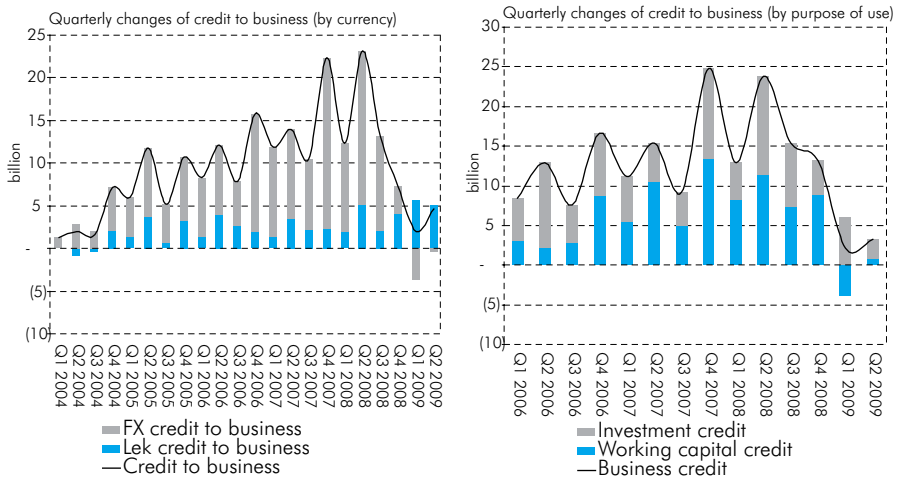
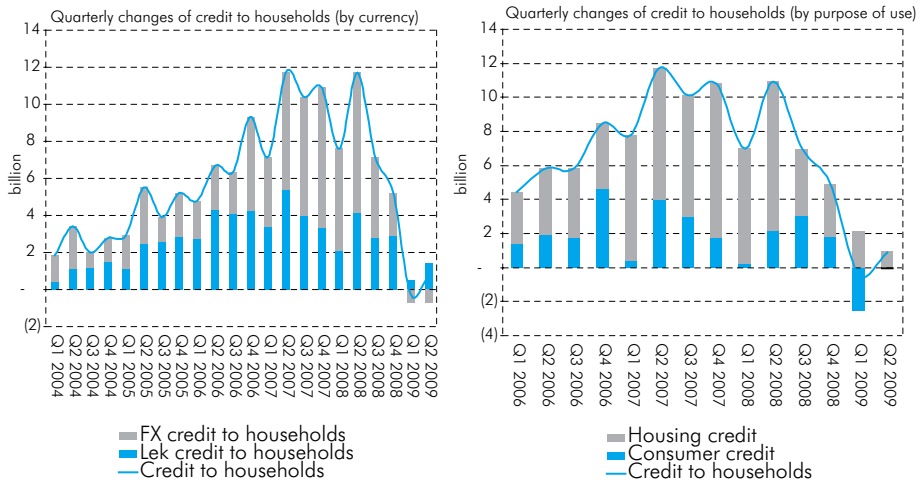


Chart 6 Performance of credit to households
(in ALL billion, exchange rate adjusted)



DEVELOPMENTS IN MONETARY AGGREGATES

Chart 7 Performance of monetary aggregates and their contribution to M3

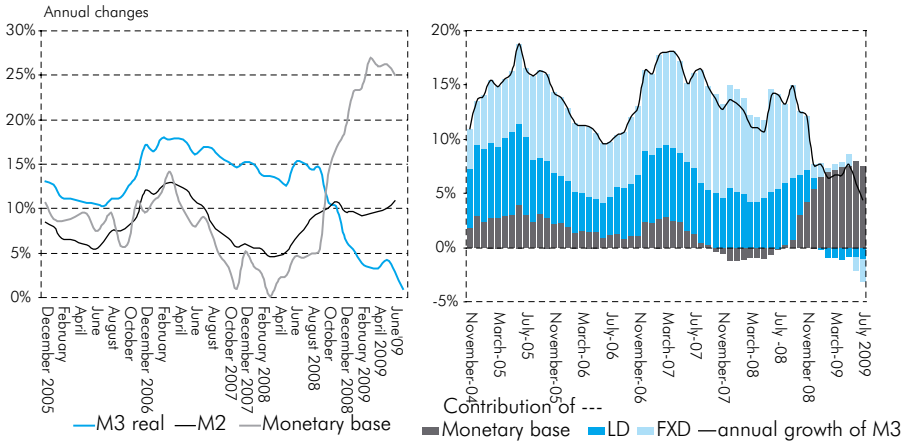


Chart 8 Performance of CoB and its ratio to M2

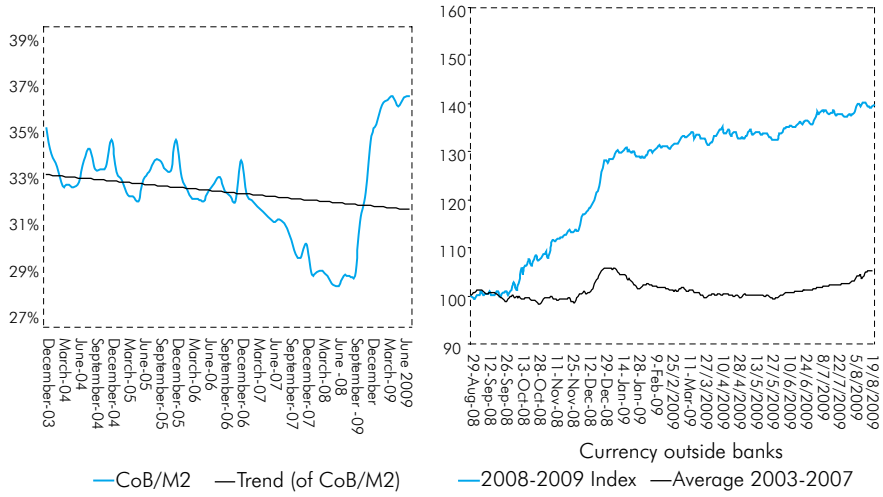


Chart 9 Deposit performance by term of maturity and currency
(annual changes %)

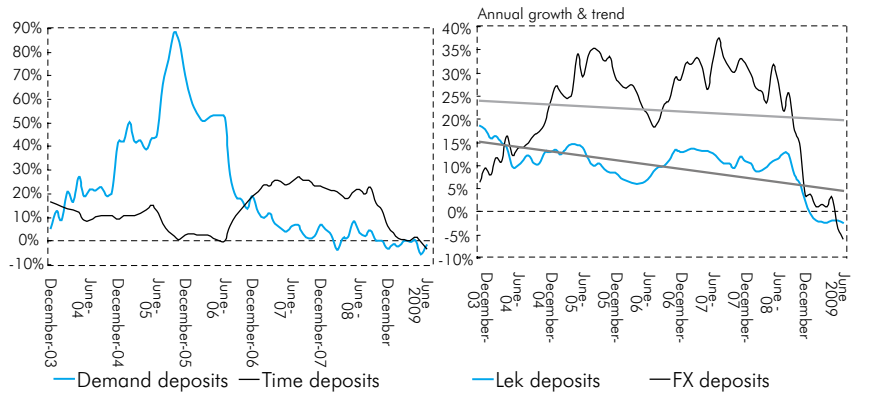
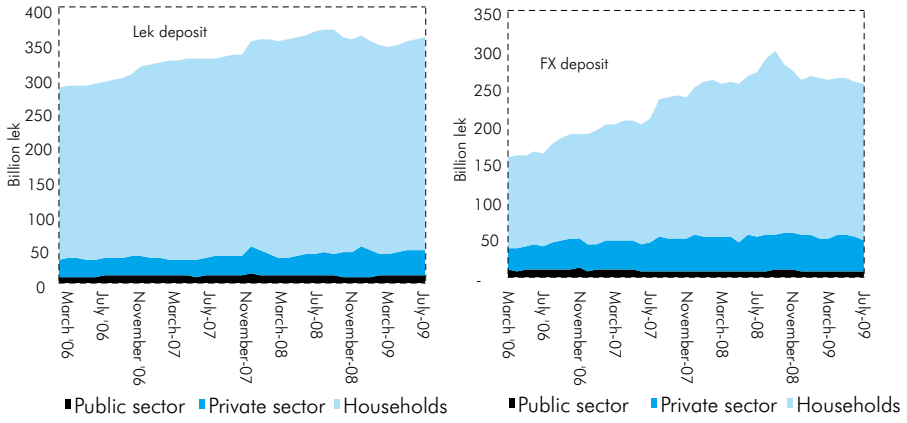


Chart 10 Performance of deposits by currency and client (in ALL billion)



ENDNOTES

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The views expressed in this paper are those of the authors and do not necessarily represent those of the Bank of Albania.

[1] Credit/deposit ratio averaged about 13 percent for 2001 – 2003.

[2] Until 2004, the Savings Bank, the largest bank in the system, was prohibited to extend loans, due to the high level of non-performing loans at this bank.

[3] Average level of credit to GDP for 2002 – 2008.

[4] Excluding exchange rate volatility.

[5] The multiplier is calculated as a ratio of annual broad M3 aggregate changes to annual money base changes.

[6] At the end of July, the total deposits to M3 ratio was 7.5 p.p lower than in September 2008.

[7] Excluding the exchange rate volatility of the lek against the euro.

[8] Or 2.3 p.p. higher than at the end of the first quarter.

[9] In July 2009.

[10] In 2006, 2007, 2009.

[11] This fact is noted mainly in the promotion of new lending products in summer 2008, when most banks issued aggressive supplies to the market for Euro-denominated loans, significantly lower than those in Leks.

[12] Regulation on foreign-currency credit was adopted in 2007.

[13] The analyzed countries of the region are: Macedonia, Serbia, Bosnia and Herzegovina, Croatia, Turkey, Rumania, Bulgaria, Poland, Czech Republic and Hungary.

SURVEY RESULTS OF REMITTANCE-RECIPIENT HOUSEHOLDS (2008)*

ABSTRACT

The following material provides information on the general characteristics of remittance-recipient households, the characteristics of Albanian emigrants and of their remittances to Albania, based on the quarterly data obtained from the Bank of Albania surveys conducted in 2008. The survey results do not only provide a good source of information to complete and replace (in the future) the estimation of workers' remittances in the balance of payments, but they may be also used by the analysts as time series to monitor, understand and forecast remittances.

1. INTRODUCTION

Workers' remittances, for countries like Albania, contribute substantially to improving the remittance-recipient households' standard of living. Given the lack of information from official administrative and statistical sources, there is little evidence of the characteristics, performance and impact of these flows on household income and the national economy.

The survey of remittance-recipient households, which was initially conducted on an annual basis and at present on a quarterly basis, is an important statistical tool that contributes to the quantitative and qualitative improvement of information. Consequently, it improves the statistical assessment of remittance flows as a key element in the balance of payments and national income.

The following material is organized as follows: it begins with a summary of the main results, and then continues with a detailed descriptive analysis of the quarterly results. In conclusion, it provides some recommendations which aim at improving the work in the future.

2. PURPOSE OF SURVEY

The main purpose of the Bank of Albania with respect to the undertaking of the survey of remittance-recipient households is to measure the remittance inflows, which will in turn assist in the compilation of the statistical statement of the Albanian balance of payments.

2.1. MAIN OBJECTIVE

By means of the indicators obtained through this survey, the latter contributes to the statistical measurement of workers' remittances as a key constituent component of national income, and to the improvement of the statistical evaluation of the balance of payments. Indisputably, this type of information,

along with other data obtained from different sources, helps to expand the information basis required for the formulation of economic and social policies at a national and regional level.

2.2. SPECIFIC OBJECTIVES

Among the most detailed and specific objectives, the following are the most important:

(i) Provision of information related to the volume, origin and frequency of workers' remittances sent to Albania.
(ii) Provision of information related to the use of official and unofficial transfer channels of workers' remittances, and the level of remittance-recipient households' inclusion in the Albanian financial system.
(iii) Provision of information related to the use of workers' remittances in Albania.
(iiii) Measurement of quarterly indices, in order to obtain assessments of the variability of workers' remittances.

The annual average of remittances per household is EUR 1160, while the annual average of remittances per immigrant is EUR 1030. Relative to 2007, average remittances per household and immigrants are down by about 20 percent.

3. SUMMARY OF KEY RESULTS

About 26 percent of Albanian households state that they have family members working abroad as immigrants. For 2008, 60 percent of them (or about 15 percent of Albanian households) have received remittances in the form of monetary flows and goods.

The distribution of remittance-recipient households in terms of urban and rural areas shows that 57 percent live in rural areas and the rest in urban areas. They receive 54 and 46 percent, respectively, of the total volume of workers' remittances.

According to the information provided by remittance-recipient households interviewed over the course of the last four quarters, workers' remittances totalled EUR 223.2 million in 2008, down by 16 percent from the preceding year.

According to the reported information, workers' remittances account for about 31 percent of the total average monthly income of Albanian households, which is lower than the previous year (35 percent).

In terms of distribution by rural and urban areas, the structure of monthly income is different in almost all its components. In rural areas' remittance-

recipient households, remittances account for 40 percent of monthly income.

The annual average of remittances per household is EUR 1160, while the annual average of remittances per immigrant is EUR 1030. Although the average workers' remittances per household and immigrant are different in terms of distribution by area and household size, the same tendencies are observed, that is remittances are greater in value in rural areas and multi-member households.

Relative to 2007, average remittances per household and immigrants are down by about 20 percent.

The perception of remittance-recipient households in terms of their impact on the household's economic situation is not optimistic. Compared to the previous periods, there is a higher percentage of households reporting a deteriorated economic situation and a lower percentage of households reporting an improved economic situation (56 percent in 2008 from 70 percent in 2007).

As the number of immigration years increases, the average volume of workers' remittances, per household and immigrant, shows a downward tendency.

About 40 percent of remittance-recipient households state that they have a bank account. However, about 60 percent of households continue to keep their savings in *cash. Compared to the annual average for 2007, this indicator remains at almost the same level.*

More than 50 percent of remittance-recipient households state that they expect remittances to remain stable in the near future, while *33 percent of them are pessimistic* and expect them to decline.

The persistence of remittances relies heavily on the status of family relationship between the immigrant and the recipient household. About *94 percent of remittances are remitted by either the son or the daughter of the family, who represent 80 and 15 percent of the total number of immigrants and account for 81 and 5 percent of total remittances at a national level.*

The two neighbouring countries, Italy and Greece, are the main countries workers' remittances "originate" from, accounting for about 91 and 85 percent of total immigrants and remittances. In 2008, remittances from Italy increased to 55 percent from 43 percent in 2007.

The largest portion of remittances is remitted through informal channels. For 2008, only 10 percent of respondent households state that they received remittances through formal channels. Relative to the previous year, this figure has deteriorated.

In terms of purpose of use of workers' remittances in 2008 relative to 2007, there have been significant changes in some of the main items. The share of remittances used for the purchase of food and clothing has increased to 50 percent in 2008 from 39 percent in 2007. There has also been a decline in the share of remittances used for investment purposes to 3 percent in 2008 from 9 percent in 2007. In the meantime, the share of remittances placed in deposits has remained similar to the preceding year (about 20 percent); however the form of investment has shifted from Treasury bills to savings deposits.

The statistical estimation of the volume of workers' remittances from different administrative and statistical sources shows different figures at present. The differences in their nominal values are a result of the methodological changes and the households' behaviour with respect to providing accurate statements related to their household income and workers' remittances.

4. ANALYSIS OF SURVEY RESULTS

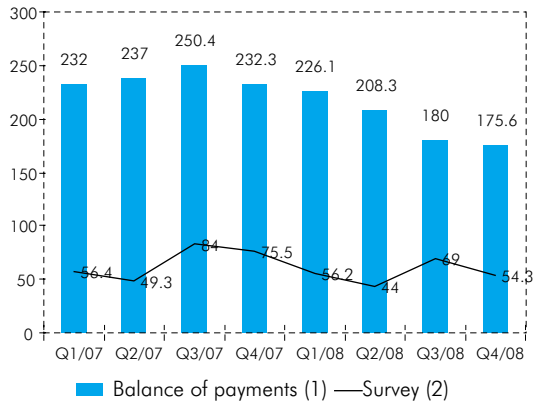
The analysis of the household survey results for the period 2006-2008 shows a downward tendency of annual inflows in the form workers' remittances. The balance of payments statistics attest to the same performance. In more concrete terms, their performance in terms of total volume and average annual indicators per household and immigrant shows the same downward trend. The total volume of remittances declined by about 16 percent in 2008 relative to 2007, and by 36 percent relative to 2006.

Table 1 Workers' remittances by year, according to statistical surveys

	Total remittances, in 000/EUR	Remittances per household	Remittances per immigrant
2006	341,257	1,897	1,310
2007	265,196	1,456	1,013
2008	223,244	1,161	1,034

Source: Bank of Albania survey

Chart 1 Workers' remittances according to the balance of payments and quarterly surveys



Source: Balance of payments and the Bank of Albania survey

Household survey data related to the total volume of workers' remittances provide a figure which is three times lower (or as much as 28 percent) than the statistical estimation of the balance of payments. Compared with the reporting from private transfers of remittances through formal channels (money transfer agencies and banks), it accounts for about 31 percent. Despite the changes in value, the comparison of results from different sources attests to the fact that the decline in workers' remittances is not a hypothesis anymore, but merely an economic fact.

The differences in the abovementioned estimations of the total volume of workers' remittances, in particular when compared with the information provided by the banking system – in addition to informality-related

factors – may be also explained by:

(a) The households' tendency to understate income in general, and workers' remittances specifically;
(b) The relatively low representation level of households in the survey sample.

Accordingly, the coordination of work among the statistical agencies for the improvement of statistical tools and techniques further, in order to ensure the quantitative measurement of these inflows at a national level, is a necessity and a future guarantee. In turn, it will improve the quality and reliability of statistical indicators. The results of quarterly surveys allow for the analysis of the characteristics of workers' remittances sent to Albanian households and the identification of their purpose of use.

The following table shows some of the results and key indicators of statistical surveys of workers' remittances.

Table 2 General figures

General data	Q1	Q2	Q3	Q4	Year 2008
Sample, number of households	1027	996	1033	1023	1,020
Remittance-recipient households	530	509	672	610	580
Percentage of responses (in %)	52	51	65	60	57
Remittances (000/EUR)	56,196	43,606	377,905	54,335	223,244
Remittances per household (in EUR)	292	230	360	280	1,161
Remittances per immigrant (in EUR)	211	323	265	235	1,034

Source: Bank of Albania survey

4.1 PROFILE OF REMITTANCE-RECIPIENT HOUSEHOLDS

The profile analysis of remittance-recipient households may be based on a variety of criteria. The current questionnaire used for the household survey allows the use of two criteria:

(a) The geographical location (urban and rural areas); and
(b) The size of the household by the number of family members.

Based on the quarterly data for 2008, around 192 thousand Albanian households or 26 percent of them state that they have family members working and living abroad as immigrants. However, for 2008, only 60 percent of them (or 15 percent of total Albanian households) state that they have received financial inflows from abroad in the form of workers' remittances.

The geographical distribution of households receiving workers' remittances (as an annual average) shows that 57 percent of households live in the rural areas, and the rest, 43 percent, in the urban areas. They receive 54 and 46 percent, respectively, of the total volume of workers' remittances.

In terms of size[1] at a national level, the structure of households receiving

workers' remittances is shared by households of 2-4 family members in 62 percent of the cases, and by households of more than 4 family members in 28 percent of the cases. The rest of 9-10 percent is shared by households composed of 1 family member. This household structure is relatively similar for the distribution by urban and rural areas as well.

Table 3 Households by geographical area, family size and quarters in 2008

Country	Q1	Q2	Q3	Q4
Total	100	100	100	100
Households of 1 family member	9	10	10	9
Households of 2-4 family members	61	66	62	60
Households of >4 family members	30	25	27	31
Rural areas	41	65	62	62
Total	100	100	100	100
Households of 1 family member	10	8	8	7
Households of 2-4 family members	57	65	60	58
Households of >4 family members	33	27	31	35
Urban areas	59	35	38	38
Total	100	100	100	100
Households of 1 family member	7	13	14	11
Households of 2-4 family members	64	66	65	65
Households of >4 family members	29	20	21	24

Source: Bank of Albania survey

The analysis of workers' remittances in terms of areas and family size identifies distinctly the positive correlation between the volume of workers' remittances and family size, both in the rural and urban areas.

The performance of workers' remittances by quarters attests to their considerable share in the average monthly income of Albanian households (about 25-32 percent).

Wages and pensions are important elements of monthly income. At a national level, they account for approximately 43 percent of monthly income per household.

The average quarterly flow of workers' remittances per household is approximately EUR 500; however this figure differs depending on the area (urban or rural) and on the family size.

The highest average amount of workers' remittances per household was reported for the third quarter of 2008. In terms of geographical location, workers' remittances per family averaged EUR 230-550, peaking in rural areas; while in terms of family size, they average EUR 132-572, peaking in households of more than 4 family members.

In terms of geographical distribution, rural and urban, average workers' remittances by family size show different figures, however maintaining the larger values in rural areas and in households of more than 4 family members.

Average quarterly workers' remittances per household declined by about 20 percent in 2008 versus the quarterly average in 2007. For the same

period, average annual workers' remittances per household show the same tendency.

4.2 HOUSEHOLD INCOME

Worth noting is that this survey is the sole statistical activity that collects information on Albanian households' monthly income on a quarterly basis.

It is also statistically acknowledged that the reporting entities are more inclined to understating their income. By contrast, this is less present in the reporting of expenditure. Therefore, the analysis of monthly income is essential for the study of the component elements and their specific share in total monthly income, rather than for its nominal value of monthly income.

The survey results show that about 30 percent of monthly income -for households obtaining this income- derives from workers' remittances. About 43 percent of monthly household income is represented by monthly wages and pensions, while income from private undertakings shares 21 percent of monthly income. In terms of geographical distribution, rural and urban, this structure is different. The analysis of monthly income structure by geographical areas clearly attests to the vital role of workers' remittances for rural area households.

Workers' remittances account for 27 to 40 percent of monthly income. For urban households, wage provides the main contribution to monthly income (30 percent).

Table 4 Household income, quarterly

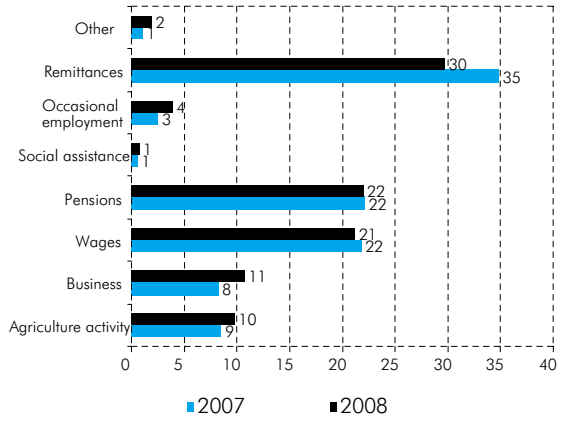
SOURCES OF INCOME	Q1	Q2	Q3	Q4
Agriculture activity	9	11	10	9
Business	10	11	11	11
Wage	22	22	21	21
Pension	22	23	21	21
Social assistance	1	1	1	1
Occasional labour	4	6	3	3
Workers' remittances	31	25	32	31
Other	2	2	2	2
Total	100	100	100	100

Source: Bank of Albania survey

The analysis of monthly income structure is of interest in terms of their classification by household size and geographical distribution, rural and urban.

For households of 1 family member, regardless of the geographical area, workers' remittances account for about 38-42 percent of average monthly income. Despite the family size, workers' remittances play an important role in rural areas' households and their share in monthly income ranges from 32 to 40 percent.

Chart 2 Monthly income structure



Source: Bank of Albania survey

With regard to the urban area household, the larger the family size the lower is the contribution of workers' remittances, and wages and income from private activity have major contribution.

Compared with the annual average of 2007, the specific share of workers' remittances in average monthly household income dropped 5 percent (to 30 from 35 percent).

More than half of households believe that workers' remittances have improved their economic situation, while 31 percent state that they did not provide any substantial contribution to improving their economic and financial situation.

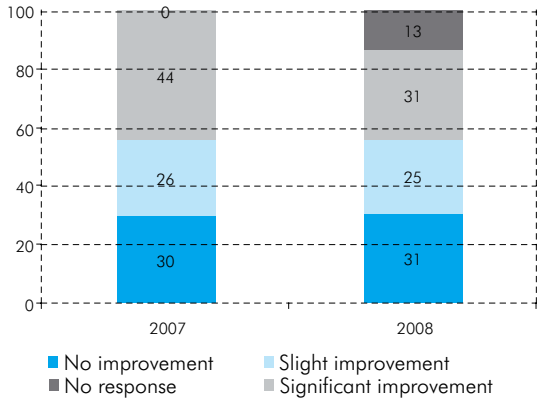
Table 5 Impact of workers' remittances to households' economic situation

	Q1	Q2	Q3	Q4
No improvement	38	45	20	21
Slight improvement	13	15	35	37
Substantial improvement	31	40	27	24
No response	18	0	18	17
Total	100	100	100	100

Source: Bank of Albania survey

The responses for 2008 show a more pessimistic situation than the average for 2007. Expressed in figures, there has been a reduction in the percentage of households stating an improvement of the situation (from 70 percent in 2007 to 56 percent in 2008).

Chart 3 Households' perception of the role of workers' remittances in the economic situation



Source: Bank of Albania survey

The survey results show that about 40 percent of remittance-recipient households have a bank account, while 55-60 percent of households keep their savings in cash. Rural households lacking a bank account (about 63 percent) are proportionally greater in number than urban households lacking one. Compared with the 2007 annual average, this percentage has remained at almost the same level. Remittance-recipient households' propensity to save workers' remittances remains very low. About 66 percent of respondent households (from 52 percent in 2007) report that they save up to 10 percent of workers' remittances. About 10 percent of remittance-recipient households save 10 to 20 percent. Households saving approximately 100 percent of workers' remittances account for only 2 percent of total remittance-recipient households, remaining similar in share as in 2007.

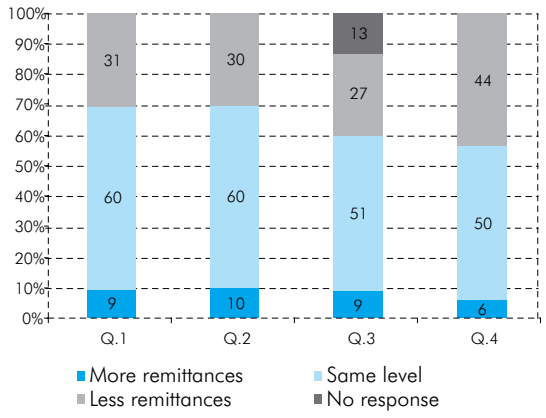
	Q1	Q2	Q3	Q4
1-10%	68	72	56	67
10-20%	10	9	10	10
20-30%	6	6	5	4
30-40%	4	4	3	4
40-50%	0	3	2	2
50-60%	5	1	2	3
60-70%	2	0	2	2
70-80%	3	1	1	2
80-90%	1	3	0	2
90-100%	2	0	3	3
No response			16	
Total	100	100	100	100

Source: Bank of Albania survey

Table 6 Saving of workers' remittances, quarterly

Questioned about their expectations of the continuation and amount of workers' remittances in the future, about 55 percent of remittance-recipient households state that they expect a stable situation. 33 percent are pessimistic about the prospects of workers' remittances, expecting them to go downward. Only 9 percent of households expect them to increase in the subsequent year. In average annual terms, these figures have deteriorated vis-à-vis the previous year. The number of households expecting remittances to remain stable has reduced to 55 from 65 percent, while the number of those expecting them to go down has increased to 33 from 27 percent.

Chart 4 Expectations of workers' remittance flow



Source: Bank of Albania survey

4.3 WORKERS' REMITTANCES/IMMIGRANTS

The share of savings in the form of money remitted by an immigrant to the country of origin depends on a number of immigrant-related factors such as:

- Job stability and security,
- Wage level,
- Cost of living in the country of residence,
- Years of immigration,
- Family relationship status,
- Currency volatility in the respective country of residence,
- Investment opportunities in the country of origin and recipient country, etc.

The questionnaire provides information on some of the immigrant's characteristics, which mainly relate to the years of immigration and family status. Assuming that all other factors remain unchanged, we note that the volume of workers' remittances tends to reduce with the passing of the immigration years. By contrast, the other factor – family status – has the

propensity to keep the workers' remittances stable as long as the family relationship exists.

Using the survey data and making a simple calculation of the number of immigrants by years of immigration, we note that about 66 percent of them emigrated during the 1990-2000 period and 34 percent during the 2000-2008 period.

Despite the very short time series data, we attest to this trend both in terms of the general volume and average indicators.

The annual average workers' remittances per immigrant are approximately EUR 1030, which relative to the annual average of 2007 remain at similar level but down by 21 percent versus 2006.

The year-on-year downward flow of workers' remittances has been also coupled with the reduction of the average nominal value of remittances per immigrant. The rationale behind is economic situation-related, that is the immigrant's centre of economic interest shifts from the country of origin to the country of residence owing to the integration process and for demographic reasons, such as family reunion or detachment in family relationships.

This performance requires further analysis for more specific groups as well.

The family status, i.e. the family relationship between the sender and the recipient, is another important factor that determines the durability and volume of workers' remittances.

Table 7 Workers' remittances by country of origin

Year 2007	Q1	Q2	Q3	Q4
Country	Average workers' remittances per immigrant	Average workers' remittances per immigrant	Average workers' remittances per immigrant	Average workers' remittances per immigrant
Canada	78	52	173	92.4
Germany	201	147	115	107
USA	172	137	164	164
Italy	213.4	215	364.3	330.4
Greece	182.2	187.3	303.3	308.4
England	228.4	216.7	541	466
Average, 2007	199	195.5	329.4	289.3

Survey: Bank of Albania survey

Year 2008	Q1		Q2		Q3		Q4	
Country	Average workers' remittances per immigrant	Workers' remittances in %	Average workers' remittances per immigrant	Workers' remittances in %	Average workers' remittances per immigrant	Workers' remittances in %	Average workers' remittances per immigrant	Workers' remittances in %
Canada					406	1		
Germany					234	1		
USA	203	4	106	1			315	2
Italy	284	56	494	56	396	56	445	51
Greece	150	33	298	34	317	32	300	39
England	234	7	468	9	593	9	540	8
Average, 08	214	100	290	100	366	100	319	100

Source: Bank of Albania survey

Table 8 Immigrants by family status and contribution to workers' remittances for 2008

Family status	Q1		Q2		Q3		Q4	
	Immigrants	Workers' remittances	Immigrants	Workers' remittances	Immigrants	Workers' remittances	Immigrants	Workers' remittances
Son	73	81	81	83	74	82	81	81
Daughter	21	4	11	4	19	5	10	6
Spouse	4	14	7	13	4	12	8	13
Brother/sister	0	0	0	0	0	0	0	0
Other	2	0	1	0	3	1	1	1
Total	100	100	100	100	100	100	100	100

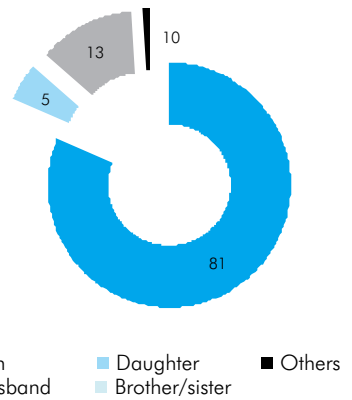
Source: Bank of Albania survey

Based on the average annual data, approximately 94 percent of remittance senders are the household's son and daughter, who account for 80 and 15 percent of total immigrants and share 81 and 5 percent of total workers' remittances.

These data support the assumption that workers' remittances flow will continue to persist as long as the family relationships are strong.

The two neighbouring countries, Italy and Greece, are the main countries workers' remittances "originate" from. The largest number of Albanian immigrants, or 43 and 48 percent of total Albanian immigrants, live and work in these two countries.

Chart 5 Workers' remittances by family relationship to the immigrant

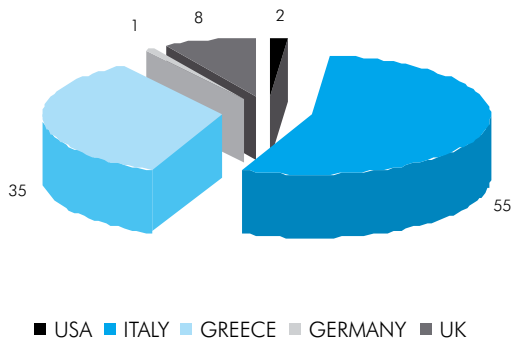


Source: Bank of Albania survey

About 90 percent of total workers' remittances are remitted from these two countries, with a quarterly average amount per immigrant of EUR 405 and 270, respectively. Despite the larger number of Albanian immigrants living and working in Greece, Italy is ranked the first in terms of volume of workers' remittances, accounting for about 55 percent of total remittances. Albanian immigrants residing in Greece have remitted about 35 percent of total workers' remittances.

The analysis of workers' remittances by country of origin identifies a rather complex situation for 2008 when compared to the preceding year. Vis-à-vis 2007, the amount of remittances reduced by 16 percent in 2008. In terms of country of origin, workers' remittances remitted from Italy are reported to have increased their share to total workers' remittances in 2008 to 55 from 43 percent in 2007. The largest portion of workers' remittances continues to be remitted to Albania through informal channels.

Chart 6 Workers' remittances by country of origin



Source: Bank of Albania survey

65 percent of workers' remittances were remitted by the Albanian immigrants themselves or their friends. For 2008, only 10 percent of respondent households state that they received remittances through formal channels[2]. The rationale behind this low figure is Albania's geographical proximity to the main countries workers' remittances originate from, which allows frequent contacts with the family members and the remitting of money or goods by the immigrants themselves. A higher percentage in the future does not necessarily imply larger workers' remittance flows, but rather higher formalization in the remitting of workers' remittances.

Table 9 Means of remitting workers' remittances

	Q1	Q2	Q3	Q4
Immigrants	25	21	37	45
Via friends	39	47	13	31
Via others, cost-free	14	13	3	5
Via friends, upon payment	11	1	0	1
Bank transfers	6	9	4	5
Transfer agencies	0	8	2	5
Other	5	0	0	0
No response			41	8
Total	100	100	100	100

Source: Bank of Albania survey

4.4 USE OF WORKERS' REMITTANCES

Worth noting is that it is difficult to make an accurate identification of the share of workers' remittances used for different purposes or the share of consumption and/or investment covered from workers' remittances since the latter are added to the income from other sources and altogether are used for household consumption-related purposes.

From the economic viewpoint, the key question is: How is it spent or used?

The literature identifies at least three main uses of workers' remittances:

- First, workers' remittances are used just like the other household income, i.e. they join the household basket and are used for productive and unproductive household needs;
- Second, workers' remittances may affect the change of the household behaviour and lower the development level (investment or labour interests etc.) relative to other sources of income;
- Third, workers' remittances may be used for increasing investment in human capacities better than other household income.

Since workers' remittances increase the household income, the larger their proportion in total household income, the higher is their impact on orienting the household behaviour to productive or unproductive consumption.

Table 10 Use of workers' remittances

Use (in %)	Q1	Q2	Q3	Q4
Meet everyday needs	43.3	59	49	49
Furniture	4.7	4	4	3
House/Flat construction or reconstruction	15.9	3	6	9
Real estate investment	2	1	0	1
Business investment	1.7	1	2	5
Savings deposit	18.7	18	24	18
T-bill investment	0.2	3	0	0
Debt payoff	1.9	2	1	1
Improvement of living conditions	9.8	9	10	13
Other	1.8	1	3	0
Total	100	100	100	100

Source: Bank of Albania survey

According to the information provided for 2008, about 50 percent of monthly income, including workers' remittances, is used for household consumption, implying the meeting of the household's everyday needs for food, clothing and other household consumption such as furniture etc. About 13 percent is used for the construction or redecoration of houses/flats and 10 percent for education and health-related purposes.

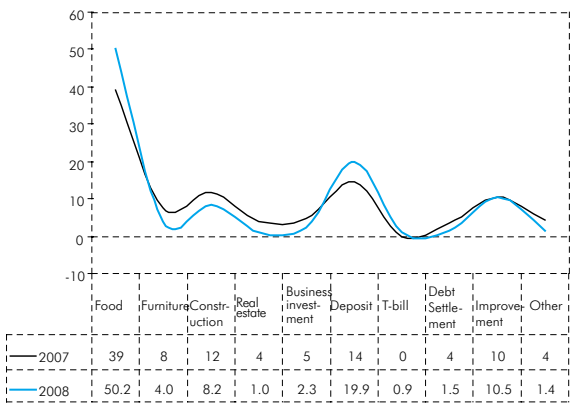
About 20 percent of workers' remittances are used for investment and savings-related purposes, attesting to their economic impact on the country. The use of workers' remittances to finance the business activity and to invest in real estate has a relatively low share, only 3.5 percent.

The use of workers' remittances in 2008 features some changes versus the year 2007. Expenditure on food and clothing rose to 50 percent in 2008 versus 39 percent in 2007. By contrast, expenditure on business and real estate investment fell to 3 percent versus 9 percent in 2007.

The share of remittances placed in bank deposits has remained similar to the preceding year (about 20 percent); however the form of investment has shifted from T-bills to savings deposits.

There is limited possibility to invest a portion of savings from average monthly income, including workers' remittances, in any economic sectors. Only 10 percent of households manage to save more than 50 percent of their total income. Questioned about their investment potentials, about 15 percent of respondent households state that they keep them into consideration. Rural area households appear more interested in investments, with agriculture and the real estate purchase being the most favourite sectors to invest in.

Chart 7 Use of savings, y-o-y



Source: Bank of Albania survey

CONCLUSIONS

- The quarterly surveys show a downward trend of workers' remittances by 16 percent versus the year 2007.
- In spite of the lower workers' remittance volume, the existence of strong family relationships between the sender and the recipient supports the persistence and continuation hypothesis of money remitted from expatriates in the medium run as well.
- However, the volume of workers' remittances in the future is expected to be mainly determined by other external factors that do not relate to the immigrant's characteristics but rather to the economic situation of the countries they live and work in.

5. METHODOLOGY

5.1 DESIGNING THE SURVEY SAMPLE

The household survey is organized in collaboration with the Statistics Institute (INSTAT), the latter being responsible for:

(a) The design of the household survey sample;
(b) The conduct of interviews with the households involved in the sample.

In order to design the sample for the survey of remittance-recipient households, the INSTAT has used the data obtained from the 2002 LSMS[3], which was carried out with the technical and financial assistance of the World Bank[4].

From the above study, INSTAT designed for the Bank of Albania a survey sample of about 1030 households, which meet the condition: "resident workers' remittance-recipient households".

The designed sample allows for the preparation of representative results at a national level and according to the geographical division, urban and rural areas.

The same sample was applied for the collection of information on a per annum basis in 2006 and 2007, and on a quarterly basis for 2008.

5.2 DATA COLLECTION AND ENTRY

The survey questionnaire was compiled by the Bank of Albania and it contains both quantitative and qualitative questions.

The questionnaire consists of 23 questions grouped in 5 main categories, which include:

(i) General information on the composition and location of households; (ii) household income; (iii) workers' remittances and savings in Albania; (iv) savings investment, and (v) other.

In order to provide data corresponding to the quarterly periodicity of the balance of payments compilation, the workers' remittances survey has been conducted on a quarterly basis since 2007.

The survey information is collected via direct interviews with the households involved in the sample.

The interviewers' team is selected by INSTAT and is composed of surveyors who have already been involved in previous interviews conducted in the framework of the LSMS. The Bank of Albania's experts, in collaboration with INSTAT's representatives conduct periodical training for the interviewers, in order to provide clarifications on the questionnaire contents and requirements. The data entry, check and processing of the questionnaires is made by the Bank of Albania. In order to derive indicators on a national level, the INSTAT estimates the preliminary shares prior to the surveying and the updated shares after the surveying is concluded for each surveyed household. The updating of final shares of households involved in the survey takes into account the current situation of households and excludes the inactive households, i.e. the ones that have not been located, from the final calculations. In average annual terms, the percentage of respondents for the survey of remittance-recipient households is 57 percent.

5.3 METHODOLOGICAL FEATURES

Although the quarterly time series data obtained through the survey are short and insufficient to derive final conclusions, we note that the indices produced from the two assessments (balance of payments statistics and the survey) identify different behaviour of the workers' remittances volume. Worth noting is that the model and data source used for estimating the workers' remittances in the balance of payments are highly more statistically reliable and consistent. This holds true for the "workers' remittances" item, as one of the key components of the private current transfers account, and for the congruence of this aggregate and other balance of payments aggregates.

Table 11 Results of workers' remittances according to BP and survey model

In millions of EUR	BP (1)	Survey (2)	Chain indices (1) (%)	Chain indices (2) (%)
Q1/07	232	56.4		
Q2/07	237	49.3	102	87
Q3/07	250.4	84	106	170
Q4/07	232.3	75.5	93	90
Q1/08	226.1	56.2	97	74
Q2/08	208.3	44	92	78
Q3/08	180	69	86	157
Q4/08	175.6	54.3	98	79

Source: Balance of Payments and Bank of Albania survey

The indicators obtained from the quarterly surveys and the model that is currently used to estimate the workers' remittances for the balance of payments statistical statement have dissimilar nominal values and performance due to the methodological distinctions between the two models that relate to the definition of indicators and the statistical estimation methods.

Global experience has identified a number of concerns related to the use of data obtained from the statistical household surveys, among which:

1. The sample designed for the collection of data on remittances may involve:

(a) Households having their family members working and living abroad as immigrants, or;
(b) Individuals (immigrants) working and living abroad.

However, the size of the sample and its composition may not be representative. To this purpose and in order to ensure sufficient results, large-size samples may be designed. However, the drawback is that they are very costly.

2. Households/immigrants are inclined not to provide real information or said otherwise to understate their income in all its components, including the workers' remittances, and other characteristics related to the number of immigrants, their employment status, etc.

3. Omissions may also lead to inaccurate data, in particular when the surveys are on a per annum basis. This risk does not affect the results obtained from frequent periodical surveys substantially.

However, without dwelling on the methodological distinctions between the two estimation methods of workers' remittances, worth noting is that both methods have their drawbacks.

More precisely, the largest "drawback" of household survey is the quality of the sample used to provide information on workers' remittances, which is designed based on the data of another existing survey and not of a household register.

Over the course of years when the survey has been conducted, the number of "valid" households[5] in the sample has reduced as a result of the increase in the number of households with no immigrant family members. The latter have not been replaced with new households with immigrant family members given the lack of information and the method applied in designing the sample.

As a result, the use of data obtained from quarterly statistical surveys as basic information in estimating the workers' remittances in the balance of payments is considered temporary at the current juncture.

5.4 RECOMMENDATIONS

In order to improve the micro data of the quarterly survey the following are recommended:

1. *Updating the data (register) used to design the survey sample*. The use of a non-updated basis that does not truly present the reality increases the risk of not involving the households that truly are remittance-recipients in the designed sample. As previously mentioned, the contents of the sample are the largest drawback of the survey, i.e. the relatively low representation of remittance-recipient households. The updating of the sample may be made by the INSTAT through the use of data obtained from the most recent household surveys like the household budget survey, the labour forces survey and the LSMS of 2008.

The upcoming general census of the population in Albania – the households' register being one of its products – is the major activity that will provide complete and accurate information on the number and composition of Albanian households, including households with immigrant family members as well. The design of the future sample based on a households' register increases the representation level and allows the partial or complete rotation of the sample. The ultimate outcome is the production of accurate and reliable statistical indicators.

2. Updating the current questionnaire to ensure the qualitative and quantitative improvement of the data.
3. Preparing guidelines on the way the questionnaire is completed, in order to avoid misunderstandings or unanswered questions and/or partial responses.
4. Building a programme for the data entry and processing, in order to enhance the efficiency and accuracy of the information to be produced.
5. Determining the statistical methods (imputation) to handle the unanswered questions or partial responses, which are considerable in the survey data.
6. Conducting an *ad hoc* immigrant survey at the border checkpoints. Its results will allow the comparison with the survey of remittance-recipient households as well as yield possible improvements in the re-estimation of the nominal value of workers' remittances volume.

ENDNOTES

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The views expressed in this paper are those of the author and do not necessarily represent those of the Bank of Albania.
[1] The definition of size is based on the number of household members.
[2] Banks or money transfer agencies.
[3] Living Standard Measurement Survey.
[4] For more information, please refer to http:\\wwwworldbank.org\lsms
[5] The households providing the required information.

FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH: THE ALBANIAN CASE*

ABSTRACT

This paper examines the causal relationship between financial development and economic growth for the Albanian economy using the Granger causality test for five different proxies for financial development. For the non-stationary and non-cointegrated series, the VAR model has been constructed and later, the above test has been applied. For non-stationary series but with a cointegrating relationship, the Granger-causality test has been applied after the construction of the vector error correction model (VECM). The empirical findings of the study show that there is a positive relation between all indicators measuring the financial development and economic growth in the long term. While in the short term, this relation is quite vague since different indicators provide different results. The data used in this paper belong to the period 1996-2007.

1. INTRODUCTION

The fundamental question in economic growth that has preoccupied researchers is: Why do countries grow at different rates? The empirical growth literature has come up with numerous explanations of cross-country differences in growth, including human and capital resources, the degree of macroeconomic stability, institutional and educational development, legal system effectiveness, international trade, and ethnic and religious diversity, etc.

One critical factor that has begun to receive considerable attention more recently is the role of financial markets in the growth process. The positive link between financial depth and economic growth is fairly obvious. More developed countries, without exception, have more developed financial markets. Therefore, it would seem that policies to develop the financial sector would be expected to raise economic growth. Indeed, the role of financial development is considered to be the key to economic development and growth.

The purpose of this paper is to examine the relationship between the financial system development and economic growth in Albania.

The structure of this paper is as follows: Section 2 makes a summary of the literature on the financial development and economic growth. Section 3 explains some of the alternative measures of financial development. Section 4 presents the evolution of the financial system and economic growth in Albania. Section 5 introduces the methodology used and discusses the results obtained for the case of Albania. Finally, the conclusions are provided.

2. THEORETICAL BACKGROUND

In the theoretical Arrow-Debreu world, which is built upon unrealistic assumptions, there is no need for financial intermediation. However, it becomes essential once imperfections or frictions are introduced in the model and the latter approaches the real world, which is characterized by the economic exchange. Since the models are merely a simplified reality, no general theoretical model can fully explain why financial intermediaries exist (Khan and Senhadji, 2000). Since financial intermediation facilitates the allocation of goods and services across time and space, it is essential to assess the relationship between financial development and economic growth.

Patrick (1966) identified two possible causal relationships between financial development and economic growth. The first – called "demand following" – views the demand for financial services as dependent upon the growth of real output and upon the commercialization and modernization of economic sectors. Thus, the creation of modern financial institutions, their financial assets and liabilities are a response to the demand for these services by investors in the real economy (Patrick, 1966). On this view, the more rapid the growth of real national income, the greater will be the demand by enterprises for external funds and therefore financial intermediation, since in most situations firms will be less able to finance expansion from internally. For the same reason, with a given aggregate growth rate, the greater the variance in the growth rates among different countries, the greater will be the need for financial intermediation to transfer saving to fast-growing countries from slow-growing countries. The financial system can thus support and sustain the leading sectors in the process of growth. In this case, an expansion of the financial system is induced as a consequence of real economic growth.

The second causal relationship between financial development and economic growth is termed "supply leading" by Patrick (1966). It refers to the transfer of resources from the low-growth sectors to the high-growth sectors, promoting and stimulating growth. This implies that the creation of financial institutions and their services occurs in advance of demand for them. Thus the availability of financial services stimulates the demand for these services.

The emergence of new economic theories proposed by Romer (1986, 1990) has given a new impetus to the relationship between growth and financial development, as these models postulate that savings behaviour directly influences not only equilibrium income levels but also growth rates (Greenwood and Jovanovic, (1990) and Bencivenga and Smith, (1991)). Thus financial markets can have a strong impact on real economic activity.

Indeed, Hermes (1994) argues and financial liberalization theory and the new growth theories basically assume that financial development leads to economic growth. On the other hand, Murinde and Eng (1994) and Luintel and Khan (1999) argue that a number of growth models show a two-way relationship between financial development and economic growth.

Levine (1997), after reviewing many studies on the relationship between financial development and economic growth for individual or broad cross-country level concluded that the functioning of financial markets is important for economic growth. According to the survey results provided by Levine, countries with larger banks and more active stock markets grow faster. Furthermore, the consolidation of the banking and insurance markets provide a stimulus for developing other industries and firms further.

There are mainly three approaches in testing for the correlation between financial development and economic growth. One approach is to test the hypothesis on a group of countries by using the panel data techniques (King and Levine, (1993)). Another approach is to present micro-level evidence that measures this correlation. Rajan and Zingales (1996) analyzed the correlation between the performance and the growth of firms and the financial market developments, while Demirguç-Kunt and Maksimovic (1996) argued that the firms accessing developed stock-markets are characterized by high growth rates.

The third approach is to test the hypothesis for a particular country using time series techniques (Rousseau and Watchel (1998), Neausser and Kungler (1998)), which is also the approach used in this paper.

It is apparent that the debate on the direction of causality between economic growth and financial development remains. It is the bi-directional relationship between economic growth and financial development that motivates this study.

3. ALTERNATIVE INDICATORS OF FINANCIAL DEVELOPMENT

One of the most important issues in assessing the relationship between financial development and economic growth is how to obtain a satisfactory empirical measure of financial development. Since financial development is defined as a process that involves the interaction of many activities and institutions to mark an improvement in quantity, quality, and efficiency of financial intermediary services, its measuring from a single proxy is impossible. The five most commonly used proxies for financial development are: the ratio of M2 to income, the ratio of banking deposit liabilities to income, the ratio of private sector credit to income, the share of private sector credit in domestic credit, and the ratio of domestic credit to income.

The most commonly used measure of financial development is the ratio of broad money or M2 to the level of nominal income. This simple indicator measures the degree of monetization in the economy. The monetization variable is designed to show the real size of the financial sector of a growing economy in which money provides valuable payment and saving services. The "narrow money" stock best reflects the payment services function, and "broad money" the savings function.

In some cases, narrow money is classified as a poor indicator of the extent of financial development. For example, De Gregorio and Guidotti (1995) criticize the use of narrow money to income ratio as a proxy for financial development. In their study, they conclude that a high level of monetization is most likely the result of financial underdevelopment, while a low level of monetization is the result of a high degree of soundness and consolidation in financial markets. They suggest the use of a less liquid monetary aggregate (M2/GDP and M3/GDP) as a proxy for financial development.

In this study, the M2/GDP ratio[1] will be used as one measure of financial development in Albania, since M3 depends largely on other indicators rather than on the financial development. Worth noting is that the time series in Albania are generally short, causing our analysis to focus on a given number of observations. The Albanian GDP reached 52 percent as at year-end 2007 from 30 percent in 1994. This indicator has maintained an upward trend, except for some more marked fluctuations during 1994-1997 reflecting the economic and political situation in that period.

Another indicator that measures the quality of financial development is the ratio of bank deposit liabilities to income (Demetriades and Hussein (1996), Luintel and Khan (1999)). In developing countries, a considerable portion of the broad money stock is currency held outside the banking system. In order to obtain a more representative measure of financial development, currency in circulation should be excluded from the broad money stock. One such proxy is the ratio of bank deposit liabilities to income.

The performance of this indicator in Albania can be viewed in three periods. The first period is characterized by their instant growth to 49 percent of GDP in 1999 from 29 percent in early 1995. In the second period, the ratio of bank deposit to total GDP declined, with the largest fall in 2002 by 45 percent of GDP, which corresponds to the withdrawal of deposits. The third period is characterized by a positive trend of the ratio of bank deposits to GDP. As at year-end 2007, it reached 63 percent.

The ratio of domestic credit to income can be used as a third proxy for financial development (Odedokun, 1989). This represents the domestic assets of the financial sector, which is the major item on the asset side of the consolidated balance sheet of the financial sector. Theoretically, it is expected to increase in response to improved price signalling, represented primarily by the establishment of positive real interest rates.

In Albania, this proxy has experienced considerable growth from an average of 5.7 percent of GDP during 1994-1996 to 61 percent of GDP as at year-end 2007. In order to obtain a more direct measure of financial intermediation, the private sector credit ratio is also employed as a fourth measure of financial development. It is assumed that credit provided to the private sector generates increases in investment and productivity to a much larger extent than do credit to the public sector.

In the case of Albania, the ratio of private sector credit to GDP was very low during 1994-2001, nearly 3.5 percent of GDP. During 2002-2007, it averaged 14 percent. As at year-end 2007, it reached its peak with 27 percent of GDP.

The fifth proxy for financial development is the share of the private sector credit in the domestic credit. According to Lynch (1996), this indicator may capture the aspect of domestic asset distribution of an economy. The share of the credit given to the private sector in the domestic credit may reflect another aspect of the financial sector and can be used as a proxy for financial development.

In the case of Albania this proxy has been volatile during the years. From 40 percent of total domestic credit in early 1996, it declined to an average of 8 percent during 1997-2001. In 2002-2007, it maintained an upward trend with the share of the private sector credit in the total domestic credit averaging 27 percent. As at year-end 2007, private sector credit accounted for nearly half (45 percent) of total domestic credit to the Albanian economy.

4. FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH IN ALBANIA

Prior 1990, the banking sector and the Albanian economy was a completely centralized system. There was a one-tier banking system, which consisted of the Albanian State Bank – the monetary and lending authority; the General Directorate of Savings Cash Offices and Insurance, which collected the public savings and acted as a property insurance provider; and the Agricultural Bank, which provided funds to the agricultural sector. In a study on the performance of the banking system, Cani and Hadëri (2002) have identified several serious deficiencies that characterized the Albanian banking system prior 1990: i) limited financial intermediation, there was a limited range of products and services where banks played the role of recording transactions among producing enterprises; ii) lack of risk assessment and credit risk management; iii) the banking and economic units' accounting system was inconsistent with the international accounting standards and it focused on the recording and monitoring of the process, hence "ignoring" the financial analysis process; iv) substantial lack of experience in international and modern banking governance and management practices.

Following the collapse of communism in early 90s, Albania entered a transitory phase which was accompanied by a number of social and economic changes[2]. Albania's agricultural cooperative and state farm land were rapidly privatized and small household businesses were established, being mainly concentrated in the goods' market. As far as financial intermediation is concerned, it was at very low levels -i.e. hardly existent.

1992 brought about a fundamental change in the banking system –as part of the financial system– through the approval of Law "On the Bank of

Albania" and Law "On the Banking System in the Republic of Albania". This change brought about the introduction of the two-tier banking system and laid down the institutional and legal basis for a free market structure and initiative-based banking system.

A two-tier banking structure implies the concentration of the monetary authority at the first level –with the Bank of Albania being mandated as the responsible authority– and the concentration of commercial functions at the second level. At the moment when the two-tier banking structure was established, the second level consisted of three banks: Savings Bank, National Commercial Bank and Agricultural Commercial Bank.

By the end of 1996 five other banks were licensed, two of which Greek capital-owned, one bank owned by the Government of Kosovo and two other joint venture banks of the Albanian Government with an Italian bank and an Arabic one. Despite these developments, the system continued to suffer the deficiencies inherited from the previous regime, both in the legal and regulatory aspect.

In parallel with the formal banking system, a consolidated informal system was being established during this period in Albania, which consisted of individuals or unlicensed firms collecting deposits from the public, granting credit or getting involved in foreign exchange. Public participation in this informal structure was high given the very high interest rates being offered. The gradual accumulation of a number of problems and the lack of timely and properly addressing of these problems gave rise to the establishment and fast growing of this informal structure which burst in 1997.

Following the pyramid crisis in 1997, which affected both the economic and social aspect of Albania, the financial system entered another development stage. At present, the Albanian financial system consists of 16 banks, 7 non-bank financial institutions[3] and 10 insurance companies. In addition to the increased number of banks, the Albanian banking system has witnessed the privatization of the National Commercial Bank, the Savings Bank and other restructuring. The American Bank of Albania has recently merged with the Italian-Albanian Bank. Domestic-owned commercial banks, albeit few in number, have witnessed rapid growth rates. Table 1 shows some of the main indicators of the Albanian banking system during 1999-2007.

The growth of bank lending, as a percentage of GDP and total assets, constitutes one of the basic features during this period. Despite their growth in terms of number and activity, we note that Albanian banks lack specialization in a certain area, such as investment banks, savings banks or commercial banks. With very few differences among them, all banking institutions cover almost the same activities, hence making their division harder.

Table 1 Main growth indicators, 1999– 2007

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007
Number of banks	13.00	13	13	14	15	16	17	17	17
State-owned banks	2.00	1	1	1	1	0	0	0	0
Public and private-owned banks	2.00	2	2	2	2	2	2	0	0
Private banks	9.00	10	10	11	12	14	17	17	17
Assets	249,485	270,834	319,338	339,305	373,635	426,440	496,561	624,279	742,855
Assets/GDP	49.20	50.20	53.50	51.60	50.20	51.90	59.30	69.65	76.66
Assets' growth		8.56	17.91	6.25	10.12	14.13	16.44	25.72	18.99
Assets' growth/GDP		2.03	6.57	-3.55	-2.71	3.39	14.26	17.45	10.07
Credit	224,290	238,659	258,954	283,829	302,606	331,932	390,953	473,001	589,795
Credit/GDP	44.23	44.24	43.38	43.16	40.66	40.40	46.69	52.77	60.87
Credit/Assets	89.90	88.12	81.09	83.65	80.99	77.84	78.73	75.77	79.40
Credit growth	13.84	6.41	8.50	9.61	6.62	9.69	17.78	20.99	24.69
Credit growth/GDP		0.01	-1.93	-0.51	-5.81	-0.64	15.57	13.03	15.34
Credit growth/Assets		-1.98	-7.98	3.16	-3.18	-3.89	1.15	-3.77	4.79
Deposits	214,363	233,087	277,649	289,006	331,426	375,843	437,548	511,015	606,216
Deposits/GDP	42.27	43.20	46.52	43.95	44.53	45.74	52.25	57.01	62.56
Deposits/Assets	85.92	86.06	86.95	85.18	88.70	88.13	88.12	81.86	81.61
Deposits' growth		8.73	19.12	4.09	14.68	13.40	16.42	16.79	18.63
Deposits' growth/GDP		2.20	7.67	-5.51	1.32	2.72	14.23	9.11	9.73
Deposits' growth/Assets		0.16	1.03	-2.03	4.14	-0.64	-0.02	-7.10	-0.31

Source: Bank of Albania and author's own estimations

4.1. MACROECONOMIC INDICATORS AND COMPARISON WITH OTHER COUNTRIES

Economic growth is one of the basic proxies for the economic development of a country and one of the key indicators of social development. A stable macroeconomic situation provides the basis for the development of the banking and financial system.

Taking a glance at the performance of economic growth in Albania, we note that it has been around 6 percent in the recent years. Despite the more reduced level of poverty, one fifth of the Albanian population still lives in poverty and about 3 percent lives in extreme poverty[4].

In comparison to other regional countries, real GDP growth in Albania shows similar rates. Table 2 shows the GDP growth rates in South-Eastern and Central Europe, the Baltic countries and the Euro area countries.

Table 2 Real GDP growth

	Real GDP growth						
	2005	2006	2007				2008
			Q1	Q2	Q3	Q1-Q4[5]	
Albania	5.6	5.0	...	...	...	5.5	6.0
Bosnia and Herzegovina	4.3	6.2	...	...	...	5.7	5.8
Bulgaria	6.2	6.1	6.2	6.5	4.5	6.0	5.7
Kosovo	-1.0	2.6	...	...	...	2.8	...
Macedonia	4.1	3.2	7.0	4.0	...	4.3	4.1
Moldova	7.5	4.0	...	...	...	5.0	7.0
Montenegro	4.2	8.1	6.6	6.9	7.1	7.0	6.0
Romania	4.4	7.7	6.0	5.6	5.7	5.7	5.3
Serbia	6.2	5.7	8.1	7.5	7.2	7.2	6.0

Average[6]	4.6	5.4	6.8	6.1	6.1	5.5	5.7
Central Europe[7]	4.8	5.9	6.7	6.5	6.1	5.8	5.0
Baltic countries[8]	9.6	10.3	9.6	8.7	9.7	9.0	6.4
Euro zone	1.6	2.9	3.2	2.5	2.7	2.6	1.8

Source: Mihaljek, D (2008)

According to the data provided in Table 2, we note that Albania, as part of South-Eastern Europe, features higher growth rates than in Central Europe countries but lower than in the Baltic countries.

As regards the performance of consumer prices as measured by their annual change, we note that South-East European (SEE) countries, including Albania, have higher inflation rates (in average terms) than Central European countries. Compared to the Baltic countries, SEE countries have lower inflation rates. However, worth taking into account is the fact that the Baltic countries are characterized by higher real growth rates than SEE countries'.

Table 3 shows the inflation rates for the period 2005-2007 and the forecast for 2008.

Table 3 Consumer Price Performance

									Consumer Price Performance
	2005	2006	2007					2008	
			Q1	Q2	Q3	Q4	Average	Forecast	Deviation from MC[9]
Albania	2.4	2.4	2.7	2.0	4.4	3.0	2.9	3	-0.4
Bosnia and Herzegovina	3.0	6.2	0.7	0.0	1.6	3.0	0.9	2.5	-0.8
Bulgaria	5	7.3	4.1	5.6	13.1	12.5	8.4	7.7	4.3
Kosovo	-1.4	0.6	0.7	1.1	6.5	10.5	4.4	...	3.2
Macedonia	0.5	3.2	0.8	1.3	3.6	4.6	1.9	2.5	-0.9
Moldavia	11.9	12.7	10.9	10.3	14.1	13.3	12.6	11.4	8.0
Montenegro	2.4	3.0	2.4	1.6	6.5	7.7	4.2	3.0	-0.4
Romania	9.0	6.6	3.7	3.8	6.5	9.1	7.0	6.5	3.1
Serbia	16.1	11.8	5.7	4.7	6.5	9.1	7.0	6.5	3.1
Average[10]	5.4	6.0	3.6	3.4	6.7	7.8	5.2	5.4	2.1
Central Europe[11]	2.6	2.9	3.7	4.0	3.6	5.0	3.8	4.3	0.9
Baltic Countries[12]	4.5	4.9	6.3	6.5	8.6	10.6	7.5	8.4	5.0
Maastricht Criteria	2.5	2.9	...	...	...	...	2.8	3.4	...

Source: Mihaljek, D (2008)

5. EMPIRICAL MODEL

This session presents the empirical analysis for the bi-relationship testing between economic growth and financial development in Albania. First, general information is provided on the required and available data and next the methodology used and the results obtained are provided.

5.1 DATA

In accordance with the economic theory we have used five proxies for the financial development (FD): the ratio of domestic credit to GDP, LDCGDP;

ratio of private sector credit to GDP, LPCGDP; ratio of private sector credit to total domestic credit LPCDC; ratio of M2 to GDP, LM2GDP; and the ratio of banking deposits to GDP, LBDGDP. As a proxy for economic growth (EG) we have used the changes in real GDP per capita, DRGDP. The data[13] are expressed as logarithms, of quarterly frequency and cover the period 1996-2007. The source of the data is the Bank of Albania and INSTAT (Statistics Institute).

5.2 METHODOLOGY

Bi-relationship testing between financial development and economic growth is based on the Granger-causality test results.

According to Granger's 1969 approach, a variable *Y* is caused by a variable *X* if *Y* can be predicted better from past values of both Y and X than from past values of *Y* alone. For a simple bivariate model, we can test if X is Granger-causing Y by estimating Equation (1) and then test the null hypothesis in Equation (2) by using the standard Wald test.

$$Y_t = \alpha + \sum_{j=1}^{p} \gamma_{11j} Y_{t-j} + \sum_{j=1}^{p} \gamma_{12j} X_{t-j} + \varepsilon_t \qquad (1)$$

$$H_0 : \gamma_{12j} = 0 \text{ for } j=1,.....,p \qquad (2)$$

$H_1 : \gamma_{12j} \neq 0$: for at least one *j*,

where α is a constant and ε_t is a white noise process.

Variable *X* is said to Granger-cause variable *Y* if we reject the null hypothesis (2), where γ_{12} is the vector of the coefficients of the lagged values of the variable *X*. Similarly, we can test if *Y* causes *X* by replacing *Y* for *X* in the equation.

The first step is to estimate a simple bi-variate VAR model, using a proxy for FD and the proxy for the EG. If both variables are found out to be I(1), we test for a cointegrating relationship between these variables. If there is no cointegrating relationship, we make the variables stationary by first differencing and test for non-causality in a VAR context. Finally, for non-stationary variables and a cointegrated relationship, we estimate a VEC model (*vector error correction*) and again test for Granger non-causality in this context.

The VAR model is:

$$\Delta EG_t = \delta_1 + \lambda_{11.1}\, \Delta FD_{t-1} + \lambda_{12.1}\, \Delta FD_{t-2} \ldots + \lambda_{1p-1.1}\, \Delta FD_{t-(p-1)} + \lambda_{11.2}\, \Delta EG_{t-1} + \ldots. + \lambda_{12.2}\, \Delta EG_{t-2} + \ldots. + \lambda_{1p-1.2}\, \Delta EG_{t-(p-1)} + \varphi_{t1} \qquad (3)$$

$$\Delta FD_t = \partial_2 + \lambda_{21.1}\, \Delta FD_{t-1} + \lambda_{22.1}\, \Delta FD_{t-2} \ldots + \lambda_{2p-1.1}\, \Delta FD_{t-(p-1)} + \beta_{21.2}\, \Delta EG_{t-1} + \lambda_{22.2}\, \Delta EG_{t-2} + \ldots. + \lambda_{2p-1.2}\, \Delta EG_{t-(p-1)} + \phi_{t2} \qquad (4)$$

where p is the order of the VAR , ∂-is the constant term, and Ø-denotes the model residuals.

A vector error correction model (VECM) restricts the long-run behaviour of the endogenous variables to converge to their cointegrating relationships. Cointegration is known as an error correction term since the deviations from the long-run equilibrium are adjusted by the short-run dynamics of variables.

In this case, the VECM is:

$$\Delta EG_t = \alpha_1 + \beta_{11.1}\,\Delta FD_{t-1} + \beta_{12.1}\,\Delta FD_{t-2} + \beta_{1p-1.1}\,\Delta FD_{t-(p-1)} + \beta_{11.2}\,\Delta EG_{t-1} + \beta_{12.2}\,\Delta EG_{t-2} + \ldots + \beta_{1p-1.2}\,\Delta EG_{t-(p-1)} + \delta_1\,EC_{t-1} + \varepsilon_{t1} \quad (5)$$

$$\Delta FD_t = \alpha_2 + \beta_{21.1}\,\Delta FD_{t-1} + \beta_{22.1}\,\Delta FD_{t-2} + \beta_{2p-1.1}\,\Delta FD_{t-(p-1)} + \beta_{21.2}\,\Delta EG_{t-1} + \beta_{22.2}\,\Delta EG_{t-2} + \ldots + \beta_{2p-1.2}\,\Delta EG_{t-(p-1)} + \delta_2\,EC_{t-1} + \varepsilon_{t2} \quad (6)$$

where EC is the error correction term, p is the order of the VAR (vector autoregression), which translates into a lag of *p-1* in the VECM, while the short-run dynamic adjustments are captured by nonzero values for the *ß*. In this model, the sources of causation can be investigated using three different tests. The first one is a joint test applied to the lags of the coefficients of each variable separately in each equation above using a Wald test. The second test is a t-test on the coefficient of the lagged error correction term δ for each equation, which is in fact a weak exogeniety test. A significant coefficient for the error correction term indicates a long-run relationship between the variables. The last test is a joint test applied to the sum of each explanatory variable.

5.3 EMPIRICAL RESULTS

Table 4 represents the unit root test results[14] for each variable. In applying the unit root tests, the Dickey-Fuller approach is used.

Table 4 ADF Unit Root Test results

	Levels			First differences		
	with constant	with trend constant	without constant without trend	with constant	with trend constant	without constant without trend
Time series	ADF	ADF	ADF	ADF	ADF	ADF
LDCGDP	0.0942	0.0287	0.9015	0.0000***	0.0000***	0.0000***
LPCGDP	0.9999	0.9857	1.0000	0.0000***	0.0001***	0.2463
LPCDC	0.9281	0.6123	0.9094	0.0000***	0.0001***	0.0000***
LM2GDP	0.0130	0.2556	0.5804	0.0080***	0.0170***	0.0002***
LBDGDP	0.8350	0.6667	0.9539	0.0014***	0.0220***	0.0001***
DRGDP	0.9999	0.0543	0.9994	0.0000***	0.0000***	0.0000 ***

*Note: ***; **; implies that H:0 is rejected and the alternative hypothesis, that the series are stationary at 5; 10 percent significance levels, is accepted.*

All of the variables are found out to be non-stationary for the 5 percent level of significance; however their first difference turns these series into stationary ones.

As a second step, we construct the VECM model by running the Johansen and Juselius (1990) approach. As we have a bi-variate model, we have only two possibilities: one cointegrating relationship or no cointegration. The approach proposed by Johansen and Juselius (1990) suggests two test statistics to determine the cointegration rank. The first one is known as the trace statistic and the second one is known as maximum eigenvalue test (max test). Eviews program uses the critical (non-standard) values of MacKinnon-Haug-Michelis (1999), which change very little from the critical values of Johansen and Juselives (1990). After applying this test, we have the following results as shown in Table 5.

Table 5 Cointegration test

	Cointegration test			Results
		Trace test	Max test	
DRGDP- LDCGDP	r=0	24.53***	21.47***	cointegrated
	r=1	3.05	3.05	
DRGDP -LPCGDP	r=0	14.09	12.75	non-cointegrated
	r=1	1.34	1.34	
DRGDP- LPCDC	r=0	35.09***	24.19***	cointegrated
	r=1	10.90	10.90	
DRGDP- LM2GDP	r=0	38.57***	34.51***	cointegrated
	r=1	4.06	4.06	
DRGDP- LBDGDP	r=0	23.19***	22.85***	cointegrated
	r=1	0.34	0.34	

*Note: *** the rejection of H:0, which has no cointegrating relationship at 5 percent significance level.*

Based on the above results, we cannot find a cointegrating relationship between economic growth and private sector credit to total income (DRGDP-LPCGDP). Furthermore, the relationship between other indicators of financial development and economic growth is found to be positive in each cointegrating vector.

As a final step, we start testing for non-causality between the variables. First, we test for the non-causality between the non-stationary but non-integrated variables. We first difference each series in order to make each variable stationary. The order of VAR is selected by using the relevant information criteria and adjusted LR statistics. Table 6 indicates the results generated based on the relationship between DRGDP-DLKGDP.

Based on the results generated from this test we find out that it is economic growth what causes the financial development, which in this case has been measured as the ratio of private sector credit to the level of income.

Table 6 Test for the direction of causality, non-stationary, non-cointegrated variables

		Test of non-causality		Direction of causality
	order VAR	direction 1[15] probability	direction 2 probability	Economic growth causes financial development
DRGDP-DLKGDP	(2)	0.5389	0.0006***	

*Note: *** indicates the rejection of the null hypothesis for the non-causality of the two variables at 5 percent significance level.*

The next step is to test for the causality between the cointegrated variables. In a bi-variate VAR, economic growth does not cause financial development and vice versa if all coefficients $\beta_{ii.1}$ (equations 5, 6) are 0.

The Eviews program we use for estimating the VAR provides two statistics χ^2. One statistic shows the joint significance of all coefficients of the lagged endogenous variables in the equation, which we have termed χ^2 for lagged coefficients. The other statistic –which we have termed χ^2 for all variables, tests the joint significance of all variables affecting the endogenous variable. These two statistics and the results obtained are presented in Table 4. Since there are only two variables in the VAR, the statistics value χ^2 is the same for both tests. Table 4 also presents the *t*-statistic, which shows the significance or insignificance of the cointegrated relationship in the long-run.

Table 7 Test for the direction of causality, cointegrated variables

	T-stat test for EC		χ^2 for lagged coefficients		χ^2 for all variables	
	direction		direction		direction	
	1 EG	2 FD	1 FD-EG[16]	2 EG-FD	1 FD-EG	2 EG-FD
DRGDP- LDCGDP	-4.71***	2.58**	2.06	0.83	2.06	0.83
Result	Two way causality in the LR; no relationship in the SR					
DRGDP -LPCDC	-3.69***	-4.17***	10.42***	5.22***	10.42***	5.22***
Result	Two way causality in the LR and SR					
DRGDP- LM2GDP	-6.24***	6.72***	0.06	0.04	0.06	0.04
Result	Two way causality in the LR; no relationship in the SR					
DRGDP- LBDGDP	-7.08***	5.06***	4.98	9.33***	4.98***	9.33***
Result	Two way causality in the LR and SR					

*Note: *** and ** indicate the significance at the 5 percent and 10 percent levels, respectively.*

According to the results, there is a positive long-term relationship between all indicators measuring the financial development (FD) and economic growth (EG). While in the short-term, this bi-directional relationship is confirmed for only two indicators: the share of private sector credit in total domestic credit (LPCDC) and the ratio of total banking deposit liabilities to total income (LBDGDP). With respect to the relationship between economic growth and the two indicators of financial development, the ratio of domestic credit to total income (LDCGDP) and the ratio of M2 to total income (LM2GDP), no bi-directional relationship is found in the short-term.

6. CONCLUSIONS

The performance of financial development and financial intermediation plays a key role in the economic activity in all countries, and also in Albania. This paper investigates the bi-directional relationship between financial development and economic growth in Albania for the period 1996-2007. In order to examine the impact of different financial development-related aspects, we use five different indicators that measure the level of financial development. The Granger causality test and the VECM mechanism have been applied for testing this relationship. The empirical results show that there is a bi-directional relationship between all financial indicators and economic growth, hence supporting the "supply-leading" and "demand-following" phenomena in the long-run. For the short-run, we obtain different results using different proxies for financial developments; hence the relationship between them is not clearly established.

However, the abovementioned model has some restraints. The first relates to the poor data quality, in particular on the real growth, number of population and the number of observations. The number of years under investigation is only 11, which is relatively small compared to the years various authors consider in their papers (15-25 years).

Second, the model does not investigate the relationship between economic growth and international finance, and the relationship between financial development, growth of productivity and capital accumulation, which would trigger further research in this area.

ANNEX 1

Chart 1 M2 as a percentage of GDP

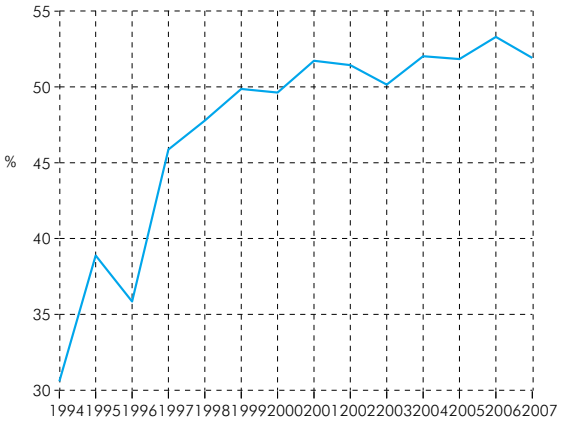


Chart 2 Deposits as a percentage of GDP (in percent)

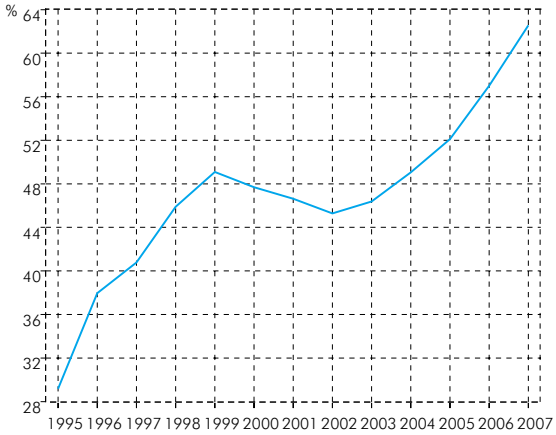


Chart 3 Domestic credit as a percentage of GDP (in percent)

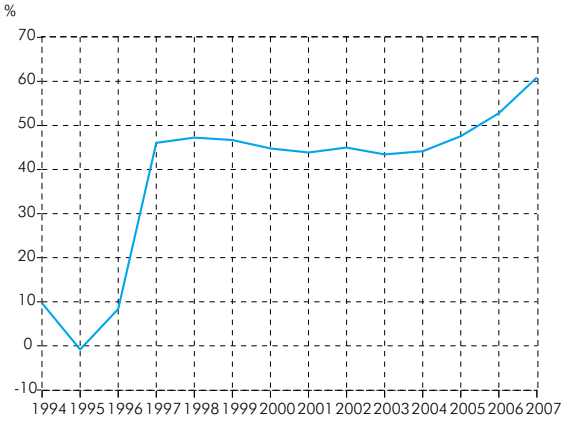


Chart 4 Private credit as a percentage of GDP (in percent)

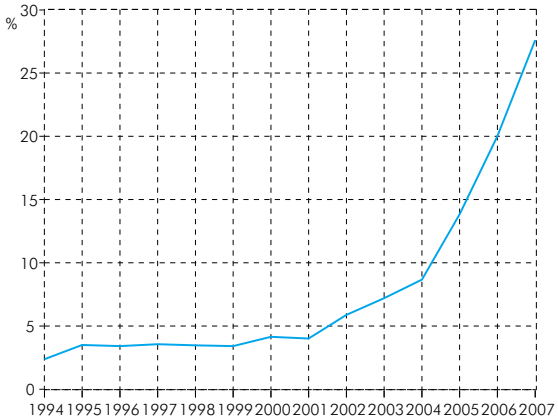
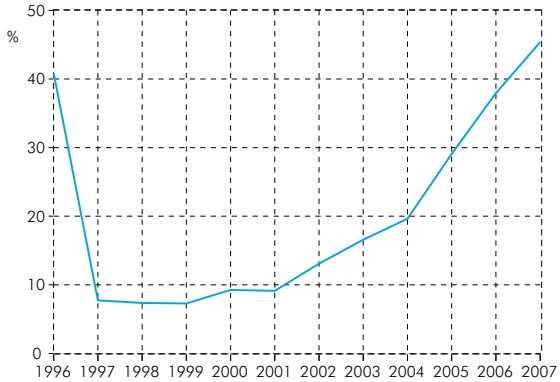


Chart 5 Private credit to total domestic credit (in percent)



ANNEX 2 DESCRIPTION OF DATA

M1 aggregate – includes currency outside banks and residents' demand deposits in Lek. Period of data 1994-2007. Source: Bank of Albania.

M2 aggregate – includes M1 and residents' time deposits in Lek in deposit-accepting banks. Period of data 1994-2007. Source: Bank of Albania.

M3 aggregate – includes M2 and residents' foreign currency deposits in deposit-accepting banks. Period of data 1994-2007. Source: Bank of Albania.

Domestic credit – represents total credit to economy from deposit-accepting banks. This indicator includes all banks' claims on the public sector, private enterprises and households. These claims are expressed as pure loans and other debt instruments that have not been used yet. The data are in million of Lek. Period of data 1996-2007. Source: Bank of Albania.

Private credit – represents total claims of deposits-accepting banks on private commercial and industrial entities and households. These claims are expressed as credit and other debt instruments. Period of data 1996-2007. Source: Bank of Albania.

Total deposits – represents total (demand and time) deposits of the banking system. Period of data 1995-2007. Source: Bank of Albania.

Real economic growth – represents the GDP change per capita at constant prices. Period of data 1995-2007. Source: INSTAT.

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ENDNOTES

*Elona Dushku, Research Department.
The views expressed in this paper are those of the author and do not necessarily represent those of the Bank of Albania.
[1] The charts on the data are provided in Annex 1.
[2] World Bank Report No. 34627, 2005.
[3] Non-bank financial institutions are companies or institutions that operate as financial intermediaries, but which do not accept deposits and do not include pension funds and insurance companies.
[4] IMF, Country Report no. 286, 2006.
[5] Estimations and projections.
[6] Arithmetic average of the listed countries.
[7] Czech Republic, Hungary, Poland, Slovenia and Slovakia.
[8] Estonia, Latvia and Lithuania.
[9] Deviation from the Maastricht Criteria.
[10] Arithmetic average of the listed countries.
[11] Czech Republic, Hungary, Poland, Slovenia and Slovakia.
[12] Estonia, Latvia and Lithuania.
[13] You may find a detailed description of the data in Annex 2.
[14] Based on the critical values used by the Eviews program.
[15] First direction implies that financial development does not cause economic growth; second direction implies that economic growth does not cause financial development.
[16] FD-EG direction implies that we test that EG does not cause FD, while EG-FD implies that we test that FD does not cause EG, i.e. H:0 is of no Granger causality.
LR implies the long-run; the SR implies the short-run

BANK OF ALBANIA NEWS OVER JULY - SEPTEMBER 2009

8th International Conference of the Bank of Albania: "Monetary & Financial Stability Policies – Lessons from the Crisis"

On 17 September 2009, the Bank of Albania hosted the 8th International Conference "Monetary & Financial Stability Policies – Lessons from the Crisis". Participants in this International Conference were Governors, Deputy Governors and senior representatives of central banks, distinguished guests from the economic and financial field and the academia, representatives of international financial institutions, senior officials of commercial banks operating in Albania and other national and foreign personalities.

This International Conference was held at a time when financial stability is at the forefront of the central bankers' agenda to have a sound banking and financial system amid turbulent times, which contributes strongly to the sustainable macroeconomic development of the country. The Conference was organized in three discussion panels and it attempted to address key issues related to the global financial crisis and it implications. In the first two panels, the Conference guests from the international academic, banking and financial sphere discussed the crisis with all its components and implications for the South-East European economies. In the third panel, the Governors and Deputy Governors of central banks in the Balkan region discussed their points of view, measures and experiences in a crisis situation. Mr. Sali Berisha, Prime Minister of the Republic of Albania and Mr. Ridvan Bode, Minister of Finance, also delivered a greeting speech at this International Conference.

At the conclusion of the conference proceedings, Ardian Fullani, Governor of the Bank of Albania, announced the winners of the Bank of Albania Governor's Award for the Best Diploma Thesis for the year 2009.

Fifth Sports Tournament of Central Banks in the Region

Following the recent years' initiative of central banks in the Balkan region to further encourage the co-operation and friendship spirit between the respective central bank employees, on 17-19 September 2009, the Bank of Albania hosted the Fifth Sports Tournament of Central Banks in the Region. This cultural and sports event was attended by the sports teams of central banks of Albania, Bosnia and Herzegovina, Bulgaria, Greece, Kosovo, Macedonia, Montenegro, Romania, Serbia and Turkey. In a very friendly environment, 300 participants from the regional central banks challenged each other in three disciplines: volleyball, basketball and soccer.

The winning teams awarded at the end of the Fifth Sports Tournament of Central Banks in the Region were as follows:

- Female team of the Central Bank of Montenegro was awarded the

first place in volleyball, followed by the Central Bank of Bosnia and Herzegovina and the Bank of Greece, ranked the second and the third, respectively.

- Men team of the National Bank of Romania was awarded the first place in soccer, followed by the Bank of Albania and the Central Bank of Montenegro, ranked the second and the third, respectively.
- The Bank of Albania won the golden cup award in men basketball, followed by the National Bank of Romania and the Central Bank of Montenegro, ranked the second and the third, respectively.

The fair play cup was awarded to the Central Bank of the Republic of Turkey; the friendship cup was awarded to the Bulgarian National Bank female team and to the National Bank of Serbia men team. Golden medals were awarded to the best sports players of the three disciplines. The Central Bank of the Republic of Kosovo basketball team was awarded with the encouragement medal for its first time participation in the Sports Tournament of Central Banks in the Region.

Governor of the Central Bank of the Republic of Turkey, Mr. Durmus Yilmaz, Visits the Bank of Albania

At the invitation of the Governor of the Bank of Albania, Mr. Ardian Fullani, the Governor of the Central Bank of the Republic of Turkey, Mr. Durmus Yilmaz, visited Albania on 24-25 September 2009. This visit marks a step further to strengthening the bilateral relations between the Bank of Albania and the Central Bank of the Republic of Turkey.

The two governors discussed the priorities of institutional co-operation between the two central banks and expressed the commitment of the respective institutions to consolidating experience sharing in various fields of central banking. Governor Yilmaz ensured all the support and partnership from the Central Bank of the Republic of Turkey to the Bank of Albania in fields of common interest.

On this occasion, the Bank of Albania held an open meeting at its premises, which was also attended by the Ambassador of the Republic of Turkey to the Republic of Albania, H.E. Hasan Sevilir Asan, representatives of the Turkish entrepreneurship in Albania, senior officials of commercial banks operating in Albania and many other personalities. Mr. Yilmaz lectured on "Current Global Financial Crisis and Recent Developments in the Turkish Economy and Monetary Policy".

Bank of Albania Trains High School Teachers of Elbasani Region in the Framework of the Economic and Financial Educational Programme

The educational programme "Central Bank in Everyday Life" marked its beginning in the city of Elbasan. On 23-29 September, the Bank of Albania organized a training seminar for high school teachers teaching Economics and related subjects. Around 40 teachers representing 15 high schools of Elbasani region attended this 5-day training seminar. The Bank of Albania experts lectured on 15 topics related to central banking.

This educational programme aims at broadening and deepening the knowledge and understanding of the Bank of Albania, its main objective and its role in promoting the country's economic development. On the other hand,

this programme aims at broadening the understanding of the banking system, commercial banks operating in Albania and particularly of the services and products they provide. The topics selected to be lectured aimed at helping the teachers of Economics in their teaching process.

On 28 September, the Governor of the Bank of Albania, Mr. Ardian Fullani, met with high school directors and teachers and social workers of Elbasani region, and with representatives of the Regional Educational Directory. Dwelling upon the great attention that the Bank of Albania has paid to public education and high school teachers and students in particular, Governor Fullani addressed the attendees with these words: "Only during the present year, I have met and talked with around 300 high school teachers and 2500 high school students in different regions throughout Albania. Since the beginning of this educational programme, we have distributed around 150,000 educational publications (more specifically 35 titles). What we have done so far for financial education is not a minor investment. Moreover, we at the central bank fully realize that education is an investment for both the present and future". The Governor also launched the final aim of the Bank of Albania's educational programme: The Albanian public should be well-equipped with the financial understanding that allows everyone to live with dignity as a citizen of this world.

Friday Seminar

Following a two-month period of interruption, Friday Seminar organized by the Research Department at the Bank of Albania resumed its activities in September. The main purpose of Friday Seminar is to present and discuss theoretical and empirical scientific works having at their main focus the case of Albania and the application of the most recent research methods.

The paper discussed in September's Friday Seminar was presented by Didar Erdinç, Associate Professor of Economics, American University in Bulgaria, Blagoevgrad, Bulgaria, entitled "Does Credit Boom Increase Bank Fragility? Transitional Challenges in Bulgarian Banking, 1997-2007". The paper identifies the determinants of the rapid credit growth in Bulgaria and evaluates whether the credit boom has increased bank fragility. The analysis is based on a panel data analysis of 30 Bulgarian banks over the 1999-2006 period. Employing Fixed Effects and GMM estimation techniques to explore the link between credit and capital base of banks, the study provides evidence for the growing risks of credit expansion and assesses the potential for banking distress in Bulgaria. The study argues that the credit boom has come at the expense of increased banking fragility in Bulgaria, raising the probability of bank failure in the event of a downturn in global financial flows, which became a disturbing reality in 2008.

CHRONOLOGY OF MONETARY POLICY DECISIONS

12 July 2006

The Supervisory Council of the Bank of Albania decides to increase the key interest rate by 0.25 percentage points, to 5.25 percent.

30 November 2006

The Supervisory Council of the Bank of Albania decides to increase the key interest rate by 0.25 percentage points, to 5.5 percent.

4 April, 2 May and 6 June 2007

The Supervisory Council of the Bank of Albania decides to keep the key interest rate unchanged at 5.5 percent.

27 June 2007

The Supervisory Council of the Bank of Albania decides to increase the key interest rate by 0.25 percentage points, to 5.75 percent.

19 July and 29 August 2007

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

26 September 2007

The Supervisory Council of the Bank of Albania decides to increase the key interest rate by 0.25 percentage points, to 6.00 percent.

31 October 2007

The Supervisory Council of the Bank of Albania decides to keep the key interest rate unchanged at 6.00 percent.

27 November 2007

The Supervisory Council of the Bank of Albania decides to increase the key interest rate by 0.25 percentage points, to 6.25 percent.

27 December 2007

The Supervisory Council of the Bank of Albania decides to keep the key interest rate unchanged at 6.25 percent.

30 January, 27 February, 26 March, 30 April, 27 May, 25 June, 30 July, 29 August, 29 September, 29 October, 26 November and 24 December 2008

The Supervisory Council of the Bank of Albania decides to keep the key interest rate unchanged at 6.25 percent, all through 2008.

28 January 2009

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

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

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

LEGAL EVENTS OVER JULY-SEPTEMBER 2009

FINANCIAL STABILITY

On 7 August 2009, the Supervisory Council of the Bank of Albania approved by Decision No. 57 "The Financial Stability Report for 2008". The purpose of this Report is to detect and assess the risks the financial system and its infrastructure are faced with, in order to provide the public authorities the opportunity to identify the relevant measures for the necessary corrections. Based on the analysis of development and financial activity's risk characteristics for 2008 and the first months of 2009, general evaluations indicate that the level of risk for the financial system and the banking sector has increased. Although the financial system and banking sector's activity has grown at lower rates and the banking sector's financial result is expected to maintain the decline that commenced in 2008 over 2009 as well, the sensitivity of the banking sector and the financial system to developments in the international markets seems to have moderated significantly, and the financial system appears resilient to the domestic, regional and global risks.

MONETARY POLICY

On 29 July 2009, the Supervisory Council of the Bank of Albania approved by Decision No. 58 "The Bank of Albania Monetary Policy Statement for the First Half of 2009". According to this Statement, economic activity at home was carried out amidst satisfactory consumer prices. Despite the unfavourable international environment, the Albanian economy performed positively. There are good premises that the positive economic growth rates at home will persist, among which macroeconomic and financial stability remain primary. Annual inflation averaged 2.0 percent in the first half of 2009, down compared to the inflation rates in the previous year; however remaining within the Bank of Albania target.

MONETARY OPERATIONS

On 29 July 2009, the Supervisory Council of the Bank of Albania approved by Decision No. 61 the Regulation "On Securities Transactions at Banks and the Operation of Securities Registration System". The purpose of this Regulation is to encourage and support banks' activity in securities transactions. This Regulations sets out the terms and procedures for opening a securities account in their registration system at the Bank of Albania, and for the clearing and settlement of securities transactions in the secondary market.

BANKING SUPERVISION

On 16 September 2009, the Supervisory Council of the Bank of Albania approved by Decision No. 65 "The Medium Term Banking Supervision Development Strategy 2009-2014". The purpose of the Medium Term Banking Supervision Development Strategy is to provide a comprehensive regulatory framework for banking supervision development, aiming at enhancing its efficiency further. This document provides an assessment of the expectations, needs and changes in banking supervision, and includes as major priorities: the development of risk-based supervision, the further approximation of the regulatory and supervisory framework with the EU Directives in the area of banking regulation and supervision, the relations between the Bank of Albania and the international supervisory authorities, and the strengthening of banking sector's self-regulation and customer protection.

On 30 September 2009, the Supervisory Council of the Bank of Albania approved by Decision No. 70 the Regulation "On Foreign Exchange Activity". The purpose of this Regulation is to set out the rules for carrying out the transactions recorded in the capital and current account (as payments and transfers), from and into the Republic of Albania. This Regulation shall apply to all judicial entities licensed by the Bank of Albania to conduct banking and financial operations.

ECONOMIC POLICIES

On 1 July 2009, the Council of Ministers approved the Decision No. 733 "On a Change and Amendment to Decision No. 489, dated 6 May 2009 of the Council of Ministers "On the Approval of 2010-2012 Macroeconomic Framework and Macroeconomic and Fiscal Indicators, Revised"". The amendments affect the fiscal indicators of 2009-2011 and 2010-2012 Medium Term Budget Programme, found in parts 2 and 2/1 attached to Decision No. 489 of the Council of Ministers, and the final expenditure ceiling amounts of 2010-2012 Medium Term Budget Programme for local government entities and their special funds, as defined in part 3.

On 1 July 2009, the Council of Ministers approved by Decision No. 741 "The Amending Agreement No. 1 of the Loan Agreement between the Republic of Albania and the European Bank for Reconstruction and Development (EBRD) for the Financing of the Road Development Project in Tirana Municipality". This Agreement provides, *inter alia*, for the transfer of EUR 1,400,000 from the fund pre-established in the initial Loan Agreement for the financing of goods, works and services for the reconstruction of Lana bridge in the vicinity of the Technological School, to the fund for equipment to be used for the rehabilitation and upgrade of Tirana Ring, in the area between Zogu i Zi and Zhan D'Ark Boulevard.

On 1 July 2009, the Council of Ministers approved the Decision No. 738 "On Some Changes and Amendments to Decision No. 1638, dated

17 December 2008, of the Council of Ministers "On the Evaluation Criteria of State-Owned Properties to be Privatized or Transformed and the Sale Procedure"". This Decision re-regulates the organization of the property evaluation commission and the evaluation and sale procedures.

On 8 July 2009, the Council of Ministers approved the Decision No. 765 "On the Approval of the Grant Agreement between the Council of Ministers of the Republic of Albania and the Global Fund for the programme "Escalation of National Response to Tuberculosis" (second phase)"". The purpose of this programme is to reduce the escalation of tuberculosis in Albania through the strengthening of the health system as regards the control, prevention and treatment of this disease. In order to assist the financing of this programme, the Global Fund extends to the Government of the Republic of Albania a grant of USD 1,263,490.

On 19 August 2009, the Council of Ministers approved by Decision No. 889 "The Contribution Agreement between the Republic of Albania and the Council of Europe Development Bank (CEB) for the Financing of Second and Local Roads". The EUR 180,000 grant is envisaged to be mainly used for technical assistance in the monitoring and evaluation of the project "Rehabilitation of Second and Local Roads".

On 26 August 2009, the Council of Ministers approved the Decision No. 913 "On the Establishment of the National Centre for Energy Applications". The establishment of this Centre, as a public and budgetary institution, under the Ministry of Economy, Trade and Energy, aims at facilitating the granting process of licences, permits and other administrative acts, the follow-up of all projects in the area of electrical energy through the co-ordination of procedures with the respective institutions and public entities.

On 1 September 2009, the Ministry of Finance approved the Instruction No. 37 "On Some Changes and Amendments to Instruction No. 24, dated 2 September 2008 "On Tax Procedures in the Republic of Albania"". The changes expand, *inter alia*, paragraph 121 of the Instruction "On Tax Procedures in the Republic of Albania", which envisages that the goods confiscated due to lack of tax documents, and in case the tax-payer rejects to pay the fine equal to the market-value of these goods, are put under the administration of the State Reserves.

On 2 September 2009, the Council of Ministers approved in principle by Decision No. 932 "The Grant Agreement, PHRD, No. TF 093096 for the Preparation of the Governance, Finance and Granting Project of Municipal Services". The grant fund extended by Japan and administered by the International Bank for Reconstruction and Development (World Bank) is envisaged not to exceed the amount of USD 980,000 and it will be used for the financing of a long-term programme for Albanian Municipalities. The purpose of this grant agreement is to set up a framework for the systematic inclusion of the municipal sector and to improve the municipal services, such as: water and canalization services, inert waste, local roads, etc.

On 28 September 2009, the Parliament of the Republic of Albania approved the Law No. 10154 "On Some Amendments to Law No. 10025, dated 27 November 2008 "On 2009 Budget"". The Amendments to this Law mainly affect the articles establishing the revenue and expenditure for 2009, revenue and expenditure for this year's state budget, the social insurance budget and the sources of state budget expenditure.

On 28 September 2009, the Parliament of the Republic of Albania approved the Law No. 10144 "On Some Amendments to Law No. 7928 "On Value Added Tax", as amended". The purpose of this Law is to mainly re-regulate the articles establishing the procedures followed during the tax evaluation, reviewing of this evaluation, complaints and reimbursement as a result of tax administration reviewing or complaint.

On 28 September 2009, the Parliament of the Republic of Albania ratified by Law No. 10150 "The Establishment Agreement of the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC)". The purpose of the Islamic Corporation for the Insurance of Investment and Export Credit is to expand the range of transactions between the Member States of the Organization of the Islamic Conference and to encourage the flow of investment between them. Through the ratification of this Agreement, the Republic of Albania authorizes the ICIEC to provide within its territory insurance and re-insurance services for different categories as specified in the Agreement provisions.

On 28 September 2009, the Parliament of the Republic of Albania ratified "The Financial Agreement between the Council of Ministers of the Republic of Albania and the Commission of the European Communities concerning the Cross-Border Programme between Albania and Montenegro under the IPA (Second Instrument for Pre-accession Assistance) Cross-Border Co-operation for Albania for the Year 2008". Through this Agreement, the Commission of the European Communities aims at providing support to pre-accession countries in their efforts to strengthen the democratic instruments and the rule of law, to undertake public administration reforms and to advance regional co-operation. The Commission of the European Communities will contribute for the year 2008 an amount of up to EUR 750,000.

BANK OF ALBANIA MANAGEMENT, 30 SEPTEMBER 2009

SUPERVISORY COUNCIL

ARDIAN FULLANI	Chairman
FATOS IBRAHIMI	Vice Chairman
TEFTA ÇUÇI	Member
LIMOS MALAJ	Member
KSENOFON KRISAFI	Member
ADRIAN CIVICI	Member
ARJAN KADAREJA	Member
HALIT XHAFA	Member
BENET BECI	Member

GOVERNOR

ARDIAN FULLANI

GOVERNOR'S OFFICE

GENC MAMANI

HEAD OF COORDINATION

GRAMOS KOLASI

DEPUTY GOVERNORS

FATOS IBRAHIMI	First Deputy Governor

GENERAL INSPECTOR

TEUTA BALETA

DEPARTMENTS AND OTHER UNITS

HUMAN RESOURCES DEPARTMENT	Roden Pajaj
MONETARY POLICY DEPARTMENT	Erald Themeli
RESEARCH DEPARTMENT	Altin Tanku
MONETARY OPERATIONS DEPARTMENT	Marjan Gjermeni
SUPERVISION DEPARTMENT	Indrit Banka
FINANCIAL STABILITY DEPARTMENT	Klodion Shehu
INFORMATION TECHNOLOGY DEPARTMENT	Xhilda Kanini
STATISTICS DEPARTMENT	Diana Shtylla
ISSUE DEPARTMENT	Valer Miho
ACCOUNTING AND FINANCE DEPARTMENT	Artan Toro
PAYMENT SYSTEMS DEPARTMENT	Dashmir Halilaj
LEGAL DEPARTMENT	Toni Gogu
AUDIT DEPARTMENT	Teuta Baleta
FOREIGN RELATIONS, EUROPEAN INTEGRATION AND COMMUNICATION DEPARTMENT	(vacant)
ADMINISTRATION DEPARTMENT	Agron Skënderaga
SECURITY AND PROTECTION DEPARTMENT	Eduard Sinani

BRANCHES

SHKODRA	Ermira Istrefi
ELBASANI	Valentina Dedja
GJIROKASTRA	Anila Thomaj
KORÇA	Liljana Zjarri
LUSHNJA	Shpresa Meço

LIST OF ALL ENTITIES LICENSED BY THE BANK OF ALBANIA*

BANKS AND BRANCHES OF FOREIGN BANKS

1. RAIFFEISEN BANK (JOINT-STOCK COMPANY)
Licence No. 2/1998, dated 11.01.1999
Approved by the Supervisory Council Decision of the Bank of Albania No. 163, dated 11.12.1998.
Certificate No. 2 "On Deposit Insurance".
Director: *Oliver WHITTLE*
Address: *Bulevardi "Bajram Curri", European Trade Center, Tirana, Albania*
Tel.: *222 66 99, 222 45 40, 222 26 69, 222 54 16*
Fax.: *227 55 99, 222 35 87, 222 36 95, 222 40 51*

2. UNITED BANK OF ALBANIA (JOINT-STOCK COMPANY)
Licence No. 3/1998, dated 11.01.1999
Approved by the Supervisory Council Decision of the Bank of Albania No. 165, dated 11.12.1998.
Certificate No. 3 "On Deposit Insurance".
Director: *Abdul Waheed ALAVI*
Address: *Rruga e Durrësit, Godina 14 katëshe Teknoprojekt, Tirana, Albania*
Tel.: *222 84 60, 222 38 73, 222 74 08*
Fax: *222 84 60, 222 83 87*

3. ITALIAN BANK OF DEVELOPMENT (BANCA ITALIANA DI SVILUPPO)
Licence No. 5/1998, dated 11.01.1999
Approved by the Supervisory Council Decision of the Bank of Albania No.164, dated 11.12.1998. Certificate No.4 "On Deposit Insurance".
Director: *Libero CATALANO*
Address: *Bulevardi "Dëshmorët e Kombit", Ndërtesa Kullat Binjake, Tirana*
Tel.: *228 03 51 / 2 / 3 / 4 / 5*
Fax: *228 03 56*

4. NATIONAL COMMERCIAL BANK (JOINT-STOCK COMPANY)
Licence No. 6/1998, dated 11.01.1999
Approved by the Supervisory Council Decision of the Bank of Albania No. 162, dated 11.01.1999.
Certificate No. 5 "On Deposit Insurance".
Director: *Seyhan PENCAPLIGIL*
Address: *Bulevardi "Zhan D'Ark", Tirana, Albania*
Tel.: *225 09 55*
Fax.: *225 09 56*

5. TIRANA BANK (JOINT-STOCK COMPANY)
Licence No. 07, dated 12.09.1996
Approved by the Supervisory Council Decision of the Bank of Albania No. 9, dated 12.09.1996.
Certificate No. 6 "On Deposit Insurance".
Director: *Dimitrios SANTIXIS*
Address: *Rruga "Dëshmorët e 4 Shkurtit", Tirana, Albania*
Tel.: *226 96 16/7/8; 223 34 41/42/43/44/45/46/47*
Fax.: *223 34 17*

** As of September 30, 2009.*

6. NATIONAL BANK OF GREECE (JOINT-STOCK COMPANY) – TIRANA BRANCH
Licence No. 08, dated 25.11.1996
Approved by the Supervisory Council Decision of the Bank of Albania No. 4, dated 14.03.1996.
Certificate No. 7 "On Deposit Insurance".
Director: *Ioannis KOUGIONAS*
Address: *Rruga "Durrësit", Godina Comfort, Tirana, Albania*
Tel.: *227 48 02; 227 48 22*
Fax.: *223 36 13*

7. INTERNATIONAL COMMERCIAL BANK (JOINT-STOCK COMPANY)
Licence No.09, dated 20.02.1997
Approved by the Supervisory Council Decision of the Bank of Albania No. 9, dated 30.04.1996.
Certificate No. 8 "On Deposit Insurance".
Director: *Mahendra Sing RAWAT*
Address: *Qendra e Biznesit, Rruga "Murat Toptani", Tirana, Albania*
Tel.: *225 43 72 / 225 62 54*
Fax.: *225 43 68*

8. ALPHA BANK (JOINT-STOCK COMPANY) – ALBANIA
Licence No.10, dated 07.01.1998
Approved by the Supervisory Council Decision of the Bank of Albania No. 01/03/96, dated 27.12.1997.
Certificate No. 9 "On Deposit Insurance".
Director: *Andreas GALATOULAS*
Address: *Rruga e Kavajës, G – KAM Business Center, Kati II, Tirana, Albania*
Tel.: *223 35 32; 223 33 59; 234 04 76/77*
Fax.: *223 21 02*

9. INTESA SANPAOLO BANK ALBANIA (JOINT-STOCK COMPANY)
Licence No.11, dated 10.08.1998
Approved by the Supervisory Council Decision of the Bank of Albania No. 105, dated 10.08.1998.
Certificate No. 10 "On Deposit Insurance".
Director: *Stefano FARABBI*
Address: *Rruga "Ismail Qemali", Nr. 27, P.O. Box 8319, Tirana, Albania*
Tel.: *224 87 53/4/5/6*
Fax.: *224 87 62*

10. PROCREDIT BANK (JOINT-STOCK COMPANY)
Licence No. 12, dated 15.03.1999
Approved by the Supervisory Council Decision of the Bank of Albania No. 22, dated 03.03.1999.
Certificate No. 11 "On Deposit Insurance".
Deputy Director: Borislav KOSTADINOV
Address: *Rruga "Sami Frashëri", Tirana e Re, P.O. Box. 2395, Tirana, Albania*
Tel.: *227 12 72/3/4/5*
Fax.: *227 12 76*

11. EMPORIKI BANK OF ALBANIA (JOINT-STOCK COMPANY)
Licence No. 14, dated 28.10.1999
Approved by the Supervisory Council Decision of the Bank of Albania No.105, dated 19.10.1999.
Certificate No. 13 "On Deposit Insurance".
Director: *George CARACOSTAS*
Address: *Rruga "Kavajës", Tirana Tower, Tirana, Albania*
Tel.: *225 87 55/ 56/ 57/ 58/ 59/ 60*
Fax.: *225 87 52*

12. CREDIT BANK OF ALBANIA (JOINT-STOCK COMPANY)
Licence No. 15, dated 28.08.2002

Approved by the Supervisory Council Decision of the Bank of Albania No. 66, dated 28.08.2002.
Certificate No. 14 "On Deposit Insurance".
Director: Kamal Abdel MONEIM
Address: Rruga "Perlat Rexhepi", Al-Kharafi Group Administration Building, Kati 1&2" Tirana, Albania
Tel.: 227 21 68, 227 21 62
Fax.: 227 21 62

13. CREDINS BANK (JOINT-STOCK COMPANY)
Licence No. 16, dated 31.03.2003
Approved by the Supervisory Council Decision of the Bank of Albania No. 22, dated 26.03.2003.
Certificate No.15 "On Deposit Insurance".
Director: Artan SANTO
Address: Rruga "Ismail Qemali", Nr. 21, Tirana, Albania
Tel.: 222 29 16, 223 40 96
Fax.: 222 29 16

14. POPULAR BANK (JOINT-STOCK COMPANY)
Licence No. 17, dated 16.02.2004
Approved by the Supervisory Council Decision of the Bank of Albania No. 06, dated 11.02.2004.
Certificate No.16 "On Deposit Insurance".
Director: Henri Maus de ROLLEY
Address: Bulevardi "Dëshmorët e Kombit", Ndërtesa Kullat Binjake, Kulla 1, Kati 9, Tirana, Albania
Tel.: 227 27 88 / 89 / 90 / 91
Fax.: 227 27 81; 228 04 41

15. UNION BANK (JOINT-STOCK COMPANY)
Licence No. 18, dated 09.01.2006
Approved by the Supervisory Council Decision of the Bank of Albania No. 101, dated 28.12.2005.
Certificate No.17 "On Deposit Insurance".
Director: Gazmend KADRIU
Address: Bulevardi "Zogu I", Pallati 13-katësh, përballë Stacionit të Trenit, Tirana, Albania
Tel: 225 06 53; 225 80 81
Fax.: 225 06 54; 227 28 80

16. FIRST INVESTMENT BANK (JOINT-STOCK COMPANY)
Licence No. 13, dated 16.04.1999
Approved by the Supervisory Council Decision of the Bank of Albania No. 35, dated 27.06.2007.
Certificate No. 12 "On Deposit Insurance", dated 18.07.2007.
Director: Bozhidar TODOROV
Address: Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Kulla 2, Kati 14, Tirana, Albania
Tel.: 225 64 23/4; 228 02 10
Fax.: 225 64 22

*In addition to banks and branches of foreign banks, the Bank of Albania has as of 30 September 2009 licensed the following entities**:*

NO.	ENTITIES
9	NON-BANK INSTITUTIONS
205	FOREIGN EXCHANGE BUREAUS
2	UNIONS OF SAVINGS AND CREDIT ASSOCIATIONS
134	SAVINGS AND CREDIT ASSOCIATIONS
1	REPRESENTATIVE OFFICES OF FOREIGN BANKS

** The full list of these entities may be found in section "Banking Supervision" of the official website of the Bank of Albania www.bankofalbania.org

PUBLICATIONS ISSUED BY THE BANK OF ALBANIA SINCE 2008

This list was designed to inform readers about publications issued by the Bank of Albania since 2008. By visiting our website (www.bankofalbania.org) you can subscribe to our mailing list by submitting a written request either by e-mail at public@bankofalbania.org or sending a fax to (355 4) 2223 558. You can also subscribe to updates by signing up to receive free e-mail notices when new series items are posted on the Bank of Albania website. You will receive e-mail notices each time we post new items of the series you selected. Listed below you can find all the publications issued by the Bank of Albania from January 2008 till August 2009. This list does not include periodical surveys carried out by the Bank of Albania as they are available only online (http://www.bankofalbania.org/web/survey_3405_2.php).

ANNUAL REPORT:

Annual Report 2007
Annual Report 2008

MONETARY POLICY PERIODICAL REPORTS:

Monetary Policy Report for the First Quarter of 2008
Monetary Policy Report for the Third Quarter of 2008
Monetary Policy Statement for the First Half of 2008
Monetary Policy Statement for the Second Half of 2008
Monetary Policy Report for the First Quarter of 2009
Monetary Policy Statement for the First Half of 2009
Monetary Policy Document for 2008
Monetary Policy Document for the 2009 - 2011 Period

PUBLICATIONS ON STATISTICS:

Statistical Report (Published monthly)
Balance of Payments Bulletin 2007
Balance of Payments Bulletin 2008

OFFICIAL BULLETIN:

Index of the Official Bulletin of the Bank of Albania (1998-2009)
Official Bulletin - Volume 10, no.1 Year 2008
Official Bulletin - Volume 10, no.2 Year 2008
Official Bulletin - Volume 10, no.3 Year 2008
Official Bulletin - Volume 10, no.4 Year 2008
Official Bulletin - Volume 10, no.5 Year 2008
Official Bulletin - Volume 10, no.6 Year 2008
Official Bulletin - Volume 10, no.7 Year 2008

Official Bulletin - Volume 10, no.8 Year 2008
Official Bulletin - Volume 10, no.9 Year 2008
Official Bulletin - Volume 10, no.10 Year 2008
Official Bulletin - Volume 10, no.11 Year 2008
Official Bulletin - Volume 11, no.1 Year 2009
Official Bulletin - Volume 11, no.2 Year 2009
Official Bulletin - Volume 11, no.3 Year 2009
Official Bulletin - Volume 11, no.4 Year 2009
Official Bulletin - Volume 11, no.5 Year 2009
Official Bulletin - Volume 11, no.6 Year 2009
Official Bulletin - Volume 11, no.7 Year 2009

ECONOMIC BULLETIN:

Economic Bulletin - Volume 11, no.1 Year 2008
Economic Bulletin - Volume 11, no.2 Year 2008
Economic Bulletin - Volume 11, no.3 Year 2008
Economic Bulletin - Volume 11, no.4 Year 2008
Economic Bulletin - Volume 12, no.1 Year 2009
Economic Bulletin - Volume 12, no.2 Year 2009

FINANCIAL STABILITY REPORT:

Financial Stability Report 2007
Financial Stability Report 2008

SUPERVISION ANNUAL REPORT:

Supervision Annual Report 2007
Supervision Annual Report 2008

INFORMATIVE PUBLICATIONS:

Publications Catalogue:
Publications Catalogue 2007
Publications Catalogue 2008

WORKING PAPERS:

Articles Published throughout a Decade in the Economic Bulletin of the Bank of Albania. Volume I, Period 1998-2000
Articles Published throughout a Decade in the Economic Bulletin of the Bank of Albania. Volume II, Period 2001-2004
Articles Published throughout a Decade in the Economic Bulletin of the Bank of Albania. Volume III, Period 2005-2007
Index of Foreign Prices/Unit Values of Albanian Imports
Exchange Rate Pass-Through in Albania
Measuring Import and Export Functions in Albania
New Core Inflation Measures: Their Usage in Forecasts and Analysis
The Role of Exchange Rate in an IT Framework, What do we do?
An Estimation of Balassa-Samuelson: Effect in Albania
Role of Banks in the Monetary Policy Transmission in Albania
Albanian Current Account Deficit: Does it Possess Mean Reverting Properties?
Monetary Policy Strategies for Small Economies - Editor, Ardian Fullani
Alternative Methods of Estimating Potential Output in Albania

SCIENTIFIC NOVELTIES AT THE BANK OF ALBANIA:

Scientific Novelties at the Bank of Albania No.1
Scientific Novelties at the Bank of Albania No.2

LEGAL PUBLICATIONS:

Law No.9662 dated 18.12.2006 "On Banks in the Republic of Albania"

EDUCATIONAL PUBLICATIONS:

*A Guide to Your First Bank Account**
*Students' Financial Guidebook**
*Story of Ice-Cream (Reprint)**
*Speaking Simply about Inflation (Reprint)**
*Banknotes Withdrawal from Circulation (Leaflet)**
*"The Real Value of Money"**
Bank of Albania - Our Central Bank
*IBAN - The International Bank Account Number (Leaflet)**
*Bank of Albania's Monetary Policy Instruments and Procedures for their Execution (Reprint)**
*Payments System (Reprint)**
*"The Real Value of Money", Vlorë, 2008**
Education - The New Challenge of the Bank of Albania