The Role Of Statistics In The Conduct Of The Monetary Policy In Albania[1]

Sound policies are driven by sound statistical support, specially in the case of transition economies where changes are ongoing and frequent. The same is true for Albania, being a transition country, where maintaining an accurate and reliable database has become a key issue in conducting economic policies.

This paper tries to give an overview of the statistical information available in Albania pointing out main problems with their collection and compilation. Furthermore, it describes the use of the statistics in formulating economic policies in the country, with a focus on monetary policy. A brief history of monetary policy and plans for the future are also described in order to give a full picture of the context in which monetary policy is conducted in Albania.

1. Introduction

Albania, like many other transition countries, started the huge detachment from the centralized economy at the beginning of `90s. The start of the difficult transition did not save anything comprising statistics contributing to a fast and deep degeneration in the process of data collection, data processing and data dissemination. Even though the central statistical unit in Albania never put its existence into doubt, in the early '90s, that unit was not anymore capable of providing any valuable piece of statistical information to decision-making bodies.

For many reasons, during 1990 – 1993, the statistical output was very poor, due to the incapability of authorities to monitor, measure and publish the main macroeconomic statistics categories, the low degree of the coverage of the private sector of the economy, numerous delays in preparation and publication, etc..

The initial serious efforts to install and use an up-to-date output system of macroeconomic statistics in Albania date back to year-end 1992. For the first time, due to the assistance provided by IMF Statistics Department, such statistical outputs as the balance of payments, money and banking statistics, consumer price index, etc., were conceived and presented. Since that time onwards, although during the transition period Albania experienced various twists, the overall statistics compilation process in general, has progressed continuously.

On September 1996 the money and banking statistics produced by the Bank of Albania were considered complete, reliable and appropriate to be included in the Albanian page at the IFS. The progress picked up 1998 when the Albanian authorities approved the country's membership to the International Monetary Fund's (IMF) General Data Dissemination System (GDDS). On May 22, 2000, Albania joined eight other developing countries as the first set of countries included when the GDDS site was officially launched. It should be mentioned that Albania was selected by IMF as a pilot country to prepare a set of information on the national statistical practices (metadata). Its metadata were used as a model not only for Europe, but also for many other countries.

At present, the aforementioned statistics are produced by three different institutions: Bank of Albania, INSTAT and Ministry of Finance.

Bank of Albania (the central bank) is responsible for producing and publishing monetary and banking statistics on monthly basis and balance of payments statistics on quarterly basis. In some cases BoA has financed several statistical projects, especially surveys which aim to capture the performance of separate economic sectors.

INSTAT (statistical institute, government body), being the national statistical agency, is responsible not only for producing and disseminating statistics on national accounts and demography, but also has the legal right[2] to formulate and implement policies on compilation and management of statistics in Albania.

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[2] These rights are expressed controversially and thus this topic is subject to strong disputes.

Ministry of Finance is responsible for production and dissemination of government finance statistics on quarterly basis.

2. Macroeconomic Statistics in Albania

In a transition country, there is need for timely and accurate statistics in order to be able to take appropriate policies in reaction to rapid changes in economic environment. Therefore, the demand for statistical information has incresed both in terms of the type of information and in terms of quality. Over the past years, the collection of statistics by the authorities in Albania has improved as new information which was not available in the past is being obtained. Now, data on monetary aggregates, banking system, balance of payments, and major data from the real sector are available. On the other hand, accuracy of the data has increased, thus addding to the reliability of this information. The processing of the statistical data is based on internationally standard methodologies, allowing also for comparison among countries. In addition, specially in the case of monetary data and CPI, the set of data is sutable for application of various statistical analyses and econometric methods which assist the monetary policy decision making.

However, the decision making process in Albania still cannot fully rely on the statistical information available. Despite the major improvements with regards to the collection and processing of this information, macroeconomic statistics still face some crucial problems.

The data coverage is not complete. With an exception of monetary statistics and consumer price indices (which are produced on a monthly basis), all other groups of statistics have a relatively longer periodicity (mostly three months). The timeliness of data availability is also of a big concern. In most cases, data are disseminated with a lag of three to four months after the end of reporting period. In short, the weaknesses can be summarized in the following key areas:

- Lack of satisfactory national accounts data;
- Insufficient account of the private or informal sector activities;
- Need for improving various surveys and estimation procedures;
- Inadequate legal and institutional framework for statistic;

- Low degree of statistical information exchange;
- Short time series that date back to the beginning of '90, with recurrent interruptions because of methodological changes.

It is important to stress out that weakness of the system of data collection, processing, compilation and publication are already identified. The responsible institutions are also committed to eliminate these weaknesses as soon as possible. We believe that the challenges facing the Albanian authorities in the coming two to three years will be to ensure that significant efforts are made in improving the governance of statistics sector. In that respect, we would like to list the work priorities as follows:

1. **Build a clear and unambiguous policy-making body.** Although, according to the existing law, the highest authority is the Council of Statistics, it should be noted that *de facto* it plays only an advisory role. It remains unclear who is responsible for the decision making process with regard to statistics in Albania. Although this problem has been identified a long ago, unfortunately, no solution has yet been found to this legal vacuum. The draft law which is foreseen to be approved by the end of this year will settle this issue.

2. **Increase data coverage to include all private sector.** Private sector accounts for almost 75% of GDP in the country however, few data are collected from this sector. A major reason for this is the high level of informal economy in the country, which consequently does not provide any data on its activity to the authorities. Efforts of the authorities are recently concentrated in introducing appropriate measures to reduce the informal economy in the country.

It is very important that increasing data coverage be associated with increasing information reliability as well as strengthening the opinion that the information gathered by the state agencies will not be used for purposes other than those related to developing statistics. There are various reasons that encourage the registered private enterprises and agencies to ignore providing or to distort information given to the state agencies. The reasons, for example, are lack of knowledge with respect to the extent to which the information provided by the private sector is used by the state agencies, distrust in these agencies, degree of information confidentiality, competition in the market, etc.

3.   Make use of surveys to extract valuable pieces of information. In Albania, basic data sources, particularly for capturing private sector and informal market activities and for estimating illegal transactions, are seriously inadequate. Therefore, for reliable macroeconomic statistics, estimates should be made based on data collected from well-designed surveys using appropriate samples, which are representative of the population. Bank of Albania has started making use of surveys specially in the capturing balance of payments statistics, but statistical surveys to this end face sampling and representation problems and certain estimation procedures need to be revisited. Recently, the bank is engaged also in constructing confidence indices, thus conducting surveys on businesses, consumers and banking sector, and the results have been satisfactory.

4.   Produce and publish national accounts statistics as soon as possible. INSTAT has made some attempts to estimate the national accounts and it has promised that all the data for the period 1995-2000 will be published. However, the greatest challenge will be the concern over the quality of the figures that will be published. To a significant extent, the data quality will be assessed based on how the consumers of this information will react as well as how the international institutions will view the data quality. Recently, there are some undergoing projects, which I believe will be a great help for bringing the national accounts statistics close to international standards.

5.   Improve the dissemination process of the statistical information from the producer to the user. Although the authorities are committed to increase the quality and transparency of statistical data, overall attempts are needed from all of them with regard to outlining a publication calendar and shortening the time between the processing of final data and their release. Perhaps, from this point of view the greatest challenge relates to the usage of Internet and the design of functional websites so that anyone interested in statistics can access the desirable statistical information. Although the Bank of Albania and INSTAT have already launched their web pages, it should be noted that the public does not have facilities to access them. Additionally, websites are utilized to a level that is not fully satisfactory, especially because statistics presented in these sites are not selected on a professional basis. Anyhow, the

increasing number of users should be considered as a good incentive for increasing further the quality and dissemination of national statistics.

6.   Apply the information technology available today. The level of knowledge on Internet applications in Albania is low. In addition, many problems in the respective infrastructure do not allow us to take advantage of the rapid advancements in technology that the information world is experiencing today. Obviously, we are bearing in mind that the enlargement of the Internet usage with regard to data collection process means more exposure to abuse and as a consequence the need for more prudential measures in providing confidentiality.

7.   Train skills of producers and of analysts of statistics. The process of formulating policies is supported by various statistical analyses which are based on reliable data. Furthermore, at a certain extend, the reliability of the data depends on their producer. Currently, there is still room for improving the skills of the existing data managers in order to process information appropriately. In addition, few are trained to analyze the data statistically, to develop models using econometric methods, to apply these models on gives cases, etc.. Thus, one of the priorities of the institutions that compile statistics is the training of their human resources. (It should be noted that this training is costly and sometimes it becomes a burden for these institutions.) Also, with the return of students who have qualified abroad, the authorities might be able to fill some of the gaps in their human resources skills (assuming that the authorities develop strategies to attract this part of potential employees).

3. The monetary policy in Albania

On the course of economic transformation usual for transition countries, monetary policy in Albania has undergone several changes. Overall, we distinguish three periods when major turning points were taken with regard to the policy. The first step relates to the central bank's attempts to achieve macroeconomic stability, the second relates to the collapse of economy due to pyramid schemes when the monetary policy became almost powerless, and the third relates to efforts to recover and maintain the stability of the economy. In all stages, the monetary policy has followed a general

path having as its final objective the stability of prices, and using intermediate targets to achieve this. The operational framework applied to control the targets has changed over time.

3.1. *Monetary Policy during 1992 - 1996*

As well as in many other countries of Eastern Europe the monetary policy in Albania started to be implemented in the early stage of '90s. The breakdown of centralized economy was followed up by a sharp deterioration of macroeconomic stability. The outcome of that was a contraction of the entire economy, which was reflected to the destruction of production capacities, to the exploit of accumulated inflation as well as to the large number of the people losing their job. On the other hand, the hemorrhage of foreign currency was so big, bringing to a very low level of official foreign exchange reserves. At mid 1992 the foreign official reserves were practically nothing, maybe few weeks of imports.

This critical environment coincides with the time when the Parliament passed the Law on the Bank of Albania on April 1992. In that Law, beyond other issues, was explicitly written that the main function of Bank of Albania is to conduct the monetary policy of the country, to provide and to maintain the price stability.

For the first time, the monetary policy was prepared and implemented in the mid
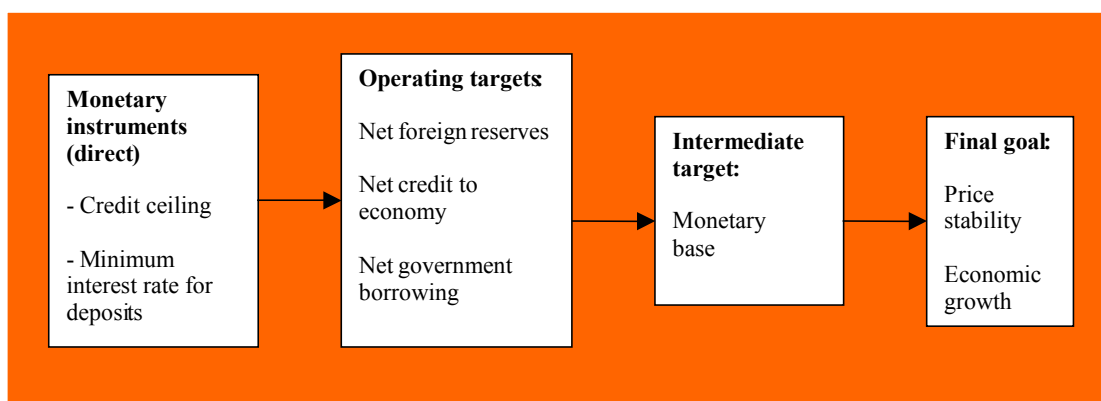
1992, when as a part of a emergency 6-months program (supported by IMF through a Stand – By Agreement), the Bank of Albania presented some measures which aimed to put under control the money supply. Apart of price stability other final targets were

established to provide economic growth and to balance the external position of the country.
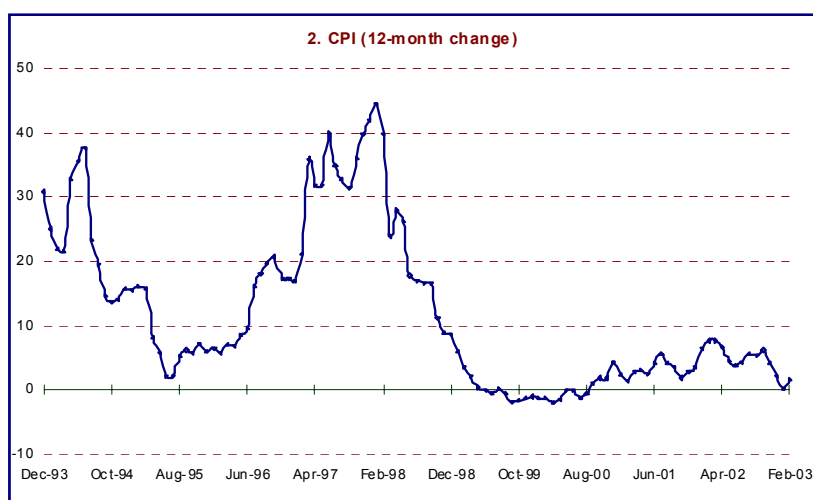
The monetary policy of Bank of Albania, during this period can be summarized by the following scheme:
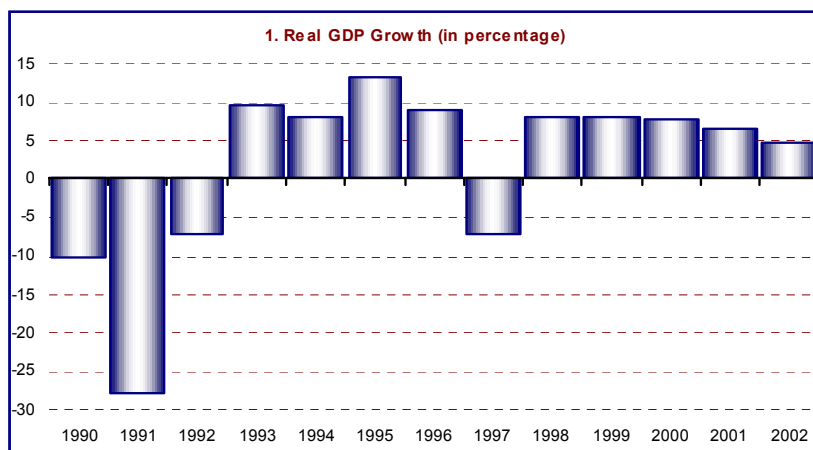
1. Real GDP Growth (in percentage)

Since that time and now a day the Bank of Albania adopted a kind of monetary policy, which is very closed to monetary targeting regime. This means that intermediate target will be the money, monetary aggregate M3. Taking into consideration the macroeconomic environment at that time was decided to achieve the control through implementation of direct monetary instruments, like credit ceiling and administrative interest rates for deposits. This monetary regime took place in the circumstances when a free float foreign exchange rate regime was adopted (still continues). Since that time the restrictions on the current account movements were abolished whereas the capital part remained limited regarding outward capital transactions.
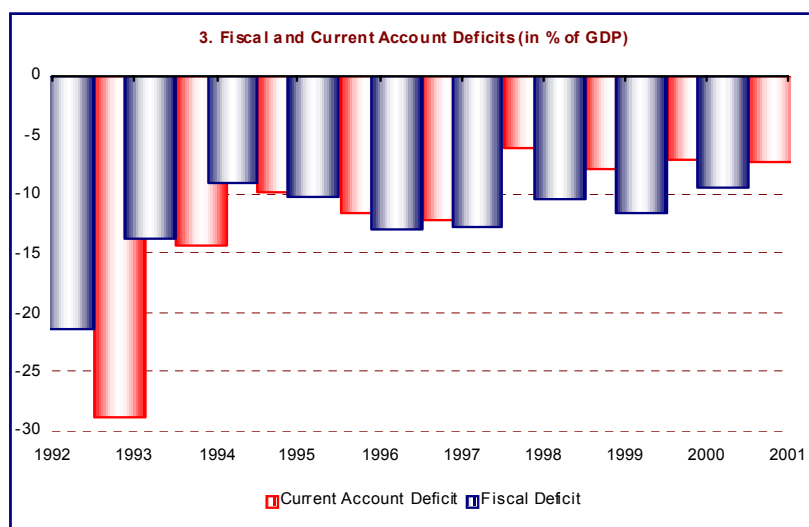
2. CPI (12-month change)

These measures, followed by a very tight fiscal policy (the first year of newly elected government), were considered to be main contributor in halting the further deterioration of the general equilibrium. At the end of 1992, the inflation was reduced

significantly, the GDP real growth, even though a negative figure, was four times smaller than previous year, and finally the level of foreign exchange reserves was increased remarkably to a level of three months of imports.

The process of macroeconomic consolidation continued very fast during consequent years (1993 – 1995). During this period the efficacy of monetary policy was high as obviously the market was affected in a direct way through imposing restriction in the credit allocation and deciding the floor of interest rates for deposits in relatively high figures. This stance of monetary policy (easy to establish) was one of the contributors in bringing inflation down year after year up to a single digit at the end of 1995 (chart 2).

3.2. Monetary Policy during 1996 – 1997

The period 1996 – 1997 belongs to the fatal era of so-called pyramid schemes. The very high and very attractive interest rates offered by the schemes substituted perfectly the interest rates set by BoA, converting the monetary policy of the Bank of Albania simply into a notion. The high interest rates were the drive which absorbed the savings of the public. These rates varied from 12-30 percent a month. Some of the companies offered even to double principal in two months. The investors much "infected" with the idea of getting rich without doing any work, that they started selling their assets, such as houses, and deposit the gains at the schemes. The due amounts were not withdrew, even worse, they were re-invested together with interest income amounts.

3. Fiscal and Current Account Deficits (in % of GDP)

The limited ability of the companies to administer properly the deposits collected, obliged these companies to re-deposit the money in the banking system, in the form of current account, increasing enormously the level of excess reserves in system, which is used heavily for financing budget expenditures through buying TB. At the same time, two electoral campaigns were carried out in 1996, so the needs of Government for liquidity were very high. As the consequence of this at the end of 1996, the inflation rate was 3 times higher than previous year while the process of general failure of pyramid schemes had started (December 1996 the first one) in an irreversible way.

The eventual collapse of pyramid schemes was catastrophic both economically and socially. The loss of their savings drove the depositors to violent protests causing the destruction of many public and private tangibles. The economy came to an halt while in midst of a total social chaos.

Speaking of economic deterioration, the GDP fell by 7.3% while the inflation rate picked up to 42.1% in December. The unemployment rate rose while the domestic currency depreciated by almost 50%.



4. M3 Growth (in percentage)
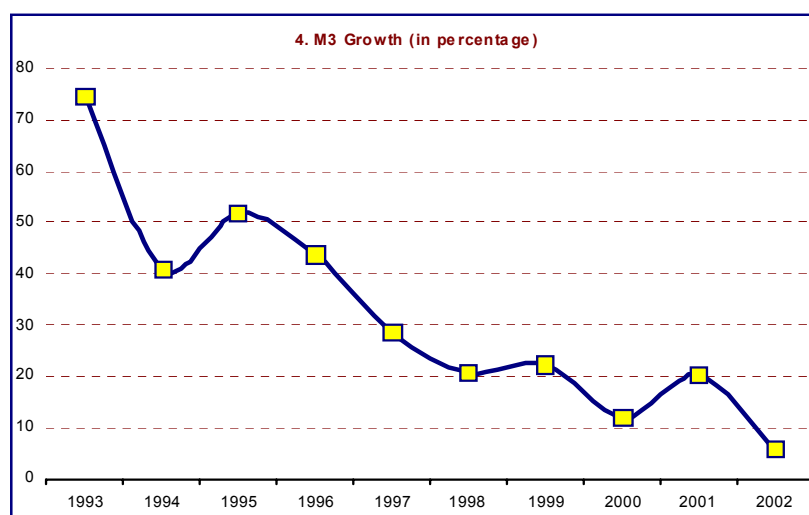
In such conditions the Bank of Albania had to increase once again the interest rates for deposits bringing it at 32 per cent. This time its task became harder as the credibility of the public in the banking system had been shaken. Yet, the measure resulted once again effective in establishing control over inflation. By the end of 1998 the annual inflation rate dropped to 8.7 %. The efforts of both monetary and fiscal policy were made more effective in the course of the consecutive years.

3.3. *Monetary Policy during 1998 – 2003*

Last years have recorded a very low inflation rate, especially for an economy as Albania (this happens in conditions of a high economic growth). Even some shock phenomenon, i.e. Kosovo crisis in 1999, oil shock in 2000, were present during this time again, for aforementioned reasons the inflation rate remained low. Starting from 1999 till July 2003, on the whole Bank of Albania has cut the interest rates, however, in real terms they have remained still high. It should be mentioned that the market
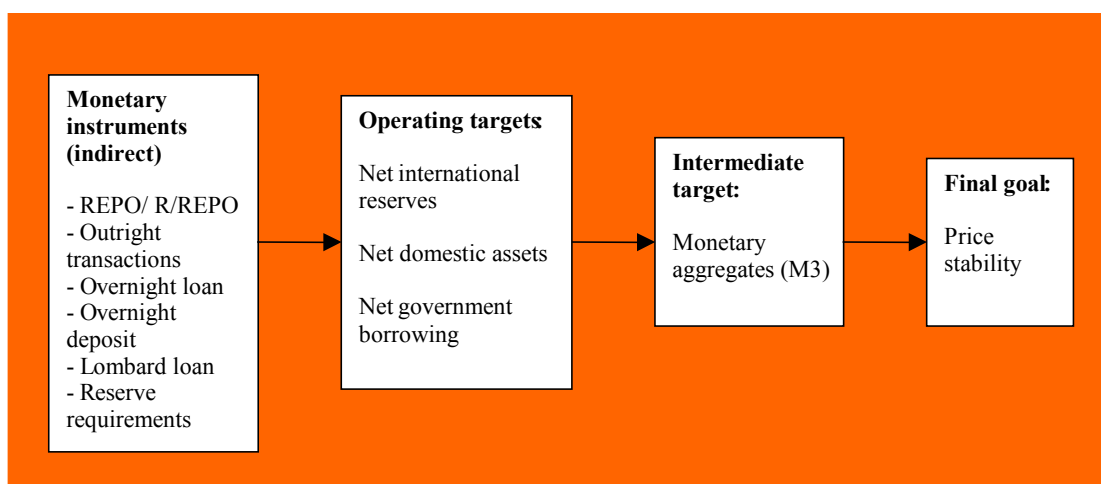
reaction was still weak against such relaxation signals of monetary policy. This is reflected to the high difference between the minimum interest rates offered for time deposits and the treasury bills yield.

Under such conditions the Bank of Albania moves one step ahead, changing its monetary policy strategy:

It removed the all direct instruments for controlling money supply, aiming to explore a new way: that of ensuring monetary control through market. Starting from third quarter of 2000, the Bank of Albania is using the repo rates as the main instrument for achieving its monetary goals.

4. Statistics and the decision making process

Despite the achievement scored in the last 10 – 12 years, it should be mentioned that decision-taking process has not been an easy process. Considering a significant degree of the absence of the statistical information, particularly national accounts data, *BoA's* decision-taking process basically has been relied on the usage of the monetary statistics.

This truth does not stand only for the Bank of Albania decision-making but for the entire decision-making process. However, undoubtedly, the money and banking statistics have significantly been the basic nourishment for the monetary policy.

Utilization of monetary & banking statistics

During the recent decade, the monetary policy has undergone some changes. Since its starting point until the present days, the selected regime, where money is still intermediate objective, has remained unchanged. However, due to recurrent agreements with IMF, the Bank of Albania constantly has to achieve its ultimate targets through the meeting of some quantitative restrictions on some monetary indicators (for more details, see Annex 1).

This policy framework that is simple to a certain degree, enabled the money and banking statistics to be a sufficient statistical feedback for an effective decision-making. The publication of such statistical documents as monetary survey and monetary authority accounts, along with other data on financial market and inflation were deemed sufficient in considering any possible change of interest rate[3].

In the beginning of '00, a kind of ineffectiveness of above-mentioned policy instruments was evidenced. Therefore, after eliminating the credit restrictions in 1999, a year later in autumn of 2000 the monetary control used to be ensured based merely on market instruments. To this end, the weekly repo auction was introduced, the market rate of which won the attribution of the basic percentage in economy. Since that time, the Bank of Albania, started to announce the desired figure of the future inflation, fixing an interval of 2 – 4 per cent.

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[3] During 90's the administrative interest rates on deposits in home currency, placed in state owned banks, played a key role in economy, some times 3-month deposits rate and some times 12-months maturity deposits rates.

Unfortunately, the change in operational framework is not associated with considerable enrichment of statistical information. Maybe, changes mainly consist on the fact that the statistical set available continues to increase the number of observations, manifesting a slight improvement on their quality.

Utilization of real sector statistics

Even currently, the statistical scarcity continues in the field of real economy indicators. Currently we have a new basket[4] of CPI, updated and enriched with additional articles, but, nevertheless, that does not mean a lot, as far as it remains the main qualitative development of these 3 last years. On the other hand, we have not yet fully reliable statistical set of national accounts. The country's economic growth[5] still constitutes an estimation of relatively low degree of confidence, while the GDP composition according sectors or measured by expenditure or income, does not yet exist. Furthermore, the frequency of updating the GDP growth is low, at about 6 months.

The figures of labor market are another story of statistical ineffectiveness in Albania. Even though it is claimed that the unemployment rate is measured in conformity with the international standards, yet there exists a general idea that it conveys deviations from reality and its utility is low. The large migrating movements from rural to urban areas or abroad make the measurement of employment indicators more difficult, damaging in this way the overall decision-making process.

Utilization of fiscal sector statistics

As aforementioned, it is the responsibility of MoF to compile and to disseminate the fiscal statistics. Currently, in Albania, though there exists an independent local government for about one decade, yet its financial independence from the central government is very low. For this reason the balance is consolidated and part of the central fiscal balance published by Ministry of Finance. It should be stressed out that despite the long time passed the periodicity of data is still once a quarter, while the

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[4] The previous basket consisted in 241 articles, and it composed based on households consumption survey of 1993.

[5] The estimation of GDP growth is based on some indicators like cement and electricity consumptions, prices of foreign partner countries, etc.

release period takes three other months after the end of reference period. However, considering the fact that BoA and banking system in general are having Government accounts, it is much easier for monetary policy to identify with a degree of accuracy the liquidity needs of Government (naturally in very short-terms). This becomes especially important under conditions when the Bank of Albania is obliged[6] to partially cover the budgetary deficit with direct credit, as law stipulates.

Statistics at Bank of Albania

Undoubtedly, two more mature statistical categories are those that have to do with financial statistics and those that have to do with the balance of payments. Both categories are produced since 1992 and in fact they constitute the basic information for policy decision-making process at the Bank of Albania.

The balance of payments statistics are produced in quarterly basis, with a lag of 3 months after the end of reference period. However, some important parts of it like foreign trade figures, services, remittances etc., are prepared on monthly basis making it easy for us to have a better filling of the developments in current account.

Currently, the Bank of Albania produces in parallel the complete financial statistics in compliance with the old and new statistical manual compiled by the IMF. In fact, the statistical input for the Bank of Albania decision-making consists in the statistical input produced pursuant to the previous IMF manual that was called money and banking statistics. More concretely, this statistical input includes:

- Monetary authority accounts;
- Bank of Albania NFA
- Deposit money banks consolidated balance;
- Monetary survey;
- Performance criteria;
- Interest rates and volume of transactions in financial market (repo rates, interbank rates, treasury bills yields, lending and deposits rate);
- Foreign exchange records; etc.

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[6] Conform Bank of Albania Law, the Bank of Albania is enforced to finance the fiscal deficit to a certain amount, which is equal to the 5 percent of the average fiscal revenues realized in the last three years.

These data are produced on monthly bases and recently the statistics department is taking steps to improve the method for calculating and presenting these data according to the new instructions of the IMF. Financial and banking statistics are published monthly and their release is notified in advance. In addition, daily and weekly information is obtained with regards to interbank market, money market, forex market, and other operational information.

Other sources of information that Bank of Albania is using recently to feed its monetary policy are the surveys. Surveys with regard to balance of payments face the problems of sampling and representation, and they are currently under review. However, since over a year ago, BoA is involved also in building confidence indices and the surveys conducted appear reliable. More concretely, surveys are conducted quarterly on businesses, consumers and banks[7]. The results of these surveys are not published yet, as we are still trying to be fully convinced of the accuracy of results, and also try to have a longer series of indices in order to be able to compare. It should be noted that the surveys are similar with confidence surveys conducted by other countries, therefore, in the future, figures could be compared across countries.

The combination of all this information, i.e. financial statistics[8] with the CPI data and with data from the liquidity situation in the banking system, etc. forms the basic statistical input from the monetary and financial point of view, on which the decision for next stance regarding interest rates is drawn.

In more detail, the Monetary Policy Department every month compiles and submits to Supervisory Council the monetary policy report, a document where proposals for future possible policy actions are included. This report explains primarily the main developments on inflation and money, expectations and various forecasting methods on: monetary aggregates, exchange rate, and inflation.

This document is subject to the Supervisory Council judgement, which, at the end comes up with a conclusion whether it should be changed; to what direction and to what extend.

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[7] Surveys on businesses and consumers are conducted in cooperation with INSTAT, which has the appropriate means and information to do the field work.

[8] The statistical information is available monthly on 25th of the following month.

Forecasting at Bank of Albania

On the whole, the Bank of Albania forecasting of monetary indicators is identified with the approach of IMF that is known as the monetary programming. According to this approach, the change: in net foreign assets[9], in fiscal deficit[10], and in credit[11] to the economy, under the assumption of other assets remain unchanged, is equal with the money supply growth.

On the other hand, recently, we have started to use statistical information for econometric analysis. Also with the assistance of foreign experts, we are applying econometric methods to build models which might apply to our economic structure and trying to find and test linkages among macroeconomic indicators (it must be mentioned that few series are long enough for such analyses.)

Since our main objective is price stability, Bank of Albania has been more concerned monitoring and controlling the process of inflation. Therefore, we have developed two very simple equations, aiming at inflation forecasting. In short, they consist in:

❖ An empirical approach on historical inflation trend, where the highest importance is put to the recent years and where the historical periods with considerable spikes on inflation are excluded, like 1997;

❖ A more analytical approach, which considers those factors assessed to impact more significantly on inflation, measured as a monthly change of consumer price index P.

$$P_t = \alpha_1 \cdot P_{(t-1)} + \alpha_2 \cdot m_{(t-3)} + \alpha_3 \cdot e_{(t-1)} + \varepsilon_t$$

Where m is the monthly stock of monetary aggregate M1, seasonally adjusted, with three lagged periods and e the Nominal Effective Exchange Rate, seasonally adjusted with one lagged period.

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[9] The information issued from the Balance of Payments statistics.

[10] The information issued from the Government accounts statistics.

[11] Credit to economy, according to the data of year-end 2002 is still in very low figures, at about 8 per cent of GDP or around 10 per cent of the banking system total assets. This implies an item not very difficult to be predicted.

The need to set up inflation forecasting models became concrete at the beginning of 2000s, when it was verified that under conditions of meeting the quantitative targets of performance criteria, the money supply stock, many times recorded substantial deviations from programmed values while inflation[12] itself did not manifest such deviations.

However, the above-mentioned forecasting models are considered to have many limitations, especially from the point of view of the employment of the econometrical techniques. Therefore, it is being worked out in parallel to set up a more reliable model, on quarterly basis, which has in its focus the division of the CPI into tradable and non-tradable. Similar analysis are also being made with regard to measuring the imported inflation and core inflation.

Finally, it should be mentioned that, based on the research made by the IMF Technical Assistance Mission in cooperation with experts of Research and Monetary Policy Department, it is being worked for a long time for the identification of the future monetary policy regime, trying to come up with an answer whether repo rate at certain moment and at certain degree does it fully impact the inflation or not?

5. The future: Inflation targeting or… ?

Answering the above question, at the present, Bank of Albania has taken a decision that above all implies adopting a monetary policy regime, which is called *Inflation Targeting Regime* (IT). Bank of Albania has already understood that IT is a successful strategy if, on one hand it finds a sound macroeconomic and institutional environment and on the other it faces an audience (economic agents, individuals, general public) that understands and welcomes it.

In this regard, the Albanian reality, despite the impressive macroeconomic consolidation, is evaluated to be still in early steps of long road towards free market.

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[12] The final monetary policy target consists in holding the headline annual inflation at the end of the year within the interval of 2 – 4 per cent.
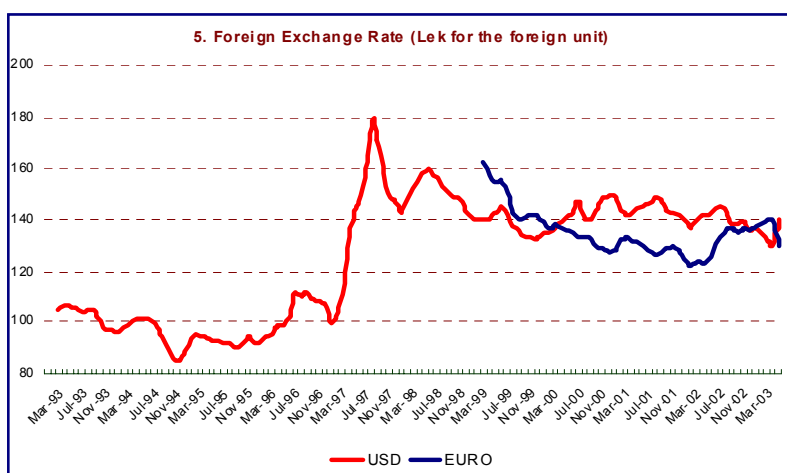
5.1. Macroeconomic Aspect

Inflation

In general, literature recommends that a period of two-three years of low inflation[13] should proceed to application of *inflation targeting* regime. Low rate is considered an inflation rate within 1-3 per cent. In general, during the last years, the trend was towards low rates and for almost two years, inflation has varied close to the upper level for the objective.

In different years, *shock* factors have been present when there was high inflation as well as when there was low inflation. On average, annual inflation rate from January 1998 to July 2003 has been 5.75 per cent, while during the last three years, July 2000 – July 2003 it has been 3.44 per cent. If we look at each of the last five years, annual inflation rates have been 21.6 per cent, 0.4 per cent, 0.0 per cent 4.2 per cent and 2.1 per cent for 1998, 1999, 2000 2001 and 2002 respectively.

Based on inflation developments up to now, even though the current year implies that inflation is higher compared to that of the two previous years, it is believed that the preconditions to apply IT regime almost exist.

Exchange Rate

Exchange rate regime is one of the other strong points for adopting IT. In the case of Albania, it is a fortune that Bank of Albania has the exclusive rights to take decisions that choose and administer the type of exchange rate policy in Albania. Also, since 1992, Bank of Albania has chosen a free floating exchange rate regime whose main feature is that currency price is determined by supply –demand relationship. The existence of this

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[13] Yet, countries like Czech Republic, Poland and other have adopted this regime in circumstances when inflation rate varied from 6 to 10 per cent.

regime is one of the criteria for adopting inflation targeting, and thus this indicator provides a strong point in its support. This becomes more plausible considering the stability of domestic currency, Lek, compared to US dollar and European currency, EURO. For the fourth year in a raw, Lek has been stable putting Bank of Albania more or less in the position of a "simple spectator" of the developments in foreign exchange market.

Fiscal Consolidation

The last five years have marked important developments with regard to fiscal consolidation. The budget deficit has fallen from 11.3 percent of GDP in 1998 to 6.2 percent of GDP in 2002[14]. It is a fact that during the years 2000 and 2001, budget deficit enjoyed the "fortune" of earning considerable revenues in foreign currency (financial assistance and privatization revenues). These revenues have smoothed out fiscal pressure on monetary policy and thus, banking system has not faced liquidity problems, while Bank of Albania has met the limits of financing budget deficit as defined by the law.

However, it cannot be talked about fiscal stability and consolidation yet. To say this, we consider the structure of budget revenues (a considerable part of it comes from custom office), fiscal evasion and somehow arbitrary practices in collecting taxes and deciding on reference prices.

Financial Stability

If we look at financial system crises, it seems that Albania has not gone through major ones. This holds true for that part of the economy, which is called "formal". In Albania, despite the establishment of five new insurance institutions, *de facto* financial system can be identified with the banking one. On the other hand, we should not forget that 1997 crisis, though it was not caused by banking system, still it was a typical financial phenomena, whose outcome on main macroeconomic indicators, production, inflation, unemployment, balance of payment, etc. was unmeasurable.

In this context, the question arises: Which can be Albanian immunity system from financial crisis?

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[14] Over the medium term, the budget deficit to GDP ration is projected at 5.2 by 2005.

Despite the continuous attempts to strengthen banking supervision, yet our banking system is underdeveloped and offers a low level of intermediation. It shows large concentration and it operates in conditions where the risk is high (the whole spectrum from political to operational one), regulations are incomplete and there are problems with implementing the rules, etc. One example of a combination of all this dates back just one year ago when the financial stability of the banking system in Albania was threatened by the deposit withdrawals that took place during the period March-April 2002.

Apart from the banking market, other markets and financial institutions are almost inactive. They are newly born and the level of exposure is high.

Informal economy is still present and, despite the bitter experience, there are hints that borrowing activity in this market still continues, though at a low extend. According to the latest survey on businesses conducted by the Bank of Albania, the demand for credit in informal market has fallen.

As it might be noticed, defensive mechanism of Albania towards financial crises suffers from many problems and although they are known for quite a while, it is not possible to eliminate them. The weak immunity system causes Albanian economy to have a relatively high degree of exposure and consequently an important condition of IT regime is not met.

5.2. Institutional Aspect

While in the macroeconomic aspect there are factors, which favor the choice of IT regime as a monetary policy regime, it is believed that in the institutional aspect there are more disadvantageous points, which weaken this choice.

Central Bank Independence

The law offers an independent position for central bank, but in reality central bank independence is far from the legal independence and under threat. It seems that other authorities have no intention to fully respect central bank independence. On the other hand, there is not sufficient guarantee that independence as granted by the existing law (all of it or specific aspects of it) will not be subject to later changes.

Central Bank Transparency

Also, it is assessed that central bank is not yet fully applies transparency especially on explaining decision-making process, with regard to monetary policy.

Central Bank Credibility

It cannot be mentioned that Bank of Albania enjoys full credibility in the public. On the other hand, adopting IT regime weakens central bank credibility if the bank is shifting away from the objective.

Central Bank Accountability

It is estimated that real accountability should increase. Bank of Albania has taken on to respect all the reporting requirements, but the quality of this report is subject to further improvements that are expected to increase Bank of Albania's accountability.

Not So Good Relationships with Fiscal Authority

The coordination between fiscal and monetary authority is not at levels required by IT regime. In practice, this lack of coordination hinders Bank of Albania to implement efficiently the instruments to complete monetary policy.

Overall, institutional aspect is considered a weak point in adopting tar*geting inflation*.

5.2. The level of understanding from the public

Albanians took the first practical lectures of what inflation is at the beginnings of the '90s. As years passed by, everybody understood that more or less, price increases erode their income and savings, however few understand that the difficult mission of keeping stable prices belongs to an institution named Bank of Albania. In fact, Albanians learned one thing; "short-term sacrifices can reap long-term rewards". Both main political forces called out this statement when each of them came to power. Despite this, they could not understand the mechanism, which can take one from the devastated present to a richer and safer future. An evidence of this is the unending period of transition and the many failures during this period (mostly for subjective reasons). A limited number of people are able to explain why serious reforms are needed while some remain disappointed and the majority accepts them indifferently.

In this context, it is hard to believe that Bank of Albania will find "suitable" partners on the other side that can rightly understand and perceive its decisions. When the public understands and welcomes central bank policy, then the public and its

expectations for inflation (guided by the objective for inflation) turn into a factor that determines future inflation rates.

In fact, public awareness, its familiarity with policies, banking, etc. improvements in institutional framework are today's tasks and they do not need to wait for the completion of other preliminary conditions. Some of the issues which need to be looked at are as following:

1. Increasing Bank of Albania's transparency. For this reason, central bank has increased the number of publications specially the explanatory ones, presentations with media, contacts with public, meetings and seminars and has also approved a strategy and regulation on transparency which is in line with the Code of Good Practices in Monetary Policy approved by IMF. Following this regulation, the decisions of the governing body of Bank of Albania are not only published but also explained giving the context in which they are taken. Monetary policy reports are published on regular frequencies, and their release is made known to the public in advance. Statistical data produced by BoA are fully explained in appendices. Currently, the methodology for compiling monetary and financial statistics (IMF's) is being published in Albanian.

BoA has started the practice of organizing an annual conference with a different topic related to BoA or economic and monetary policies and statistics (the Conferences of 2000 was dedicated to statistics only), which aim at bringing academics and experts together and in contact with the audience BoA is trying to get attention of. Representatives of the governing body of BoA have been engaged in meetings with students from Economic Departments, trying to point out the importance of role of the central bank in the economy and sharing the experiences in formulating policies.

2. Improving relationships with other state institutions. For this reason, Bank of Albania has adopted an intensive approach towards all international organizations (integration in EU, Stability Pact, and discussions of documents such as development strategies for SMEs). The most notable is the participation in debt committee.

3. Increasing accountability. Bank of Albania has increased its contacts and reports with and to the Parliament trying to expand on explanations about decision-making.

4. Increasing credibility. Apart from achieving the objectives and making these known, Bank of Albania is trying to win the public and establish regular communications with it. The bank is organizing campaigns (on lending); it is approaching businesses to understand the latter's expectations, etc.

5. Achieving education. The importance of training skills was also mentioned when discussing the steps to improve on statistics. Thus, the process of education has involved also Bank of Albania itself, apart from other authorities and the public. Bank of Albania has also offered financial support for this. The most recent example of training at BoA is the 6-month school of Professional Education in Applied Statistics and Econometrics offered to its employees through the University of Tirana and with the joint financial support from USAID.

6. Increasing central bank independence.

7. Getting involved in other issues which are not Bank of Albania's direct concerns, but which affect the existence of required conditions to adopt IT. An example of this is the representation in the team responsible for the project of improvement of statistics and full implementation of GDDS criteria. Annual contracts are signed with INSTAT, the national statistical agency, to facilitate the distribution of statistical data to users and to improve the quality of these data. Seminars and trainings are organized in cooperation with regard to real sector data (responsibility of INSTAT).

In order to comply with or improve each of the above-mentioned preconditions, a period of 2 – 3 years or more is needed. This time interval is based above all on Bank of Albania's uncertainty about the commitment of other authorities to adopt this regime and about public reaction; on the need to build a macroeconomic model (including a trial period); on the increase of financial market efficiency with regard to absorbing informal assets, on further strengthening banking supervision, on the ability to collect new reliable statistical information and to increase the existing time series accurately; on improving money market so that an efficient instrument to control money becomes available, etc..

6. Conclusions

Having a full set of statistical information which is timely and accurate is gaining great importance, as economic policies are developing to respond to more complicated economic structures that are shaping the transition countries today. Unfortunately, in the case of Albania, there is still much more to be done with respect to the provision of appropriate statistics. Focusing on the monetary policy, this one can rely only on monetary and banking statistics, produced by the bank. Improvements have been made with regard to compilation and presentation of the statistics bringing them close to international standards (IMF's) and thus ensuring a degree of comparison with other countries. Encouraging steps are taken regarding the forecasting techniques which involve testing models by using econometric methods. Research work has been expanded in this area. All this have helped the governing bodies formulate an adequate monetary policy over the last years. So far, the monetary policy followed by the Bank of Albania has been able to serve the bank's main objective, i.e. price stability. The inflation rate over the past years has been at around 3 per cent.

However, we have seen that the development of monetary policy; its transition from using direct instruments to indirect instruments, the contemplation to change to an inflation target regime, put pressure on the demand for statistics and such, on the necessity to improve those further. The importance of this increases more given our long term ambition to join EU, and thus to bring our statistics at that level. As we have exposed our priorities how to reach there, we have also argued that it is a hard way.

ANEX I. Performance Criteria

For as long as Albanian authorities are willing and accept to sign contracts with IMF, they are obliged to meet some quantitative restrictions whose purpose is to control domestic assets of banking system and central bank assets. In this context, these restrictions are vested with the quality of monetary quantitative objectives similar to the intermediary objective for broad money.

As aforementioned, Albania signed the first agreement with IMF in the second half of 1992 and since then it started to apply quantitative restrictions for the first time. The aim of these restrictions was to set upper an lower limits for indicators such as: net foreign assets of Bank of Albania (floor), net domestic assets of banking system (ceiling) divided in net claims on government and claims on economy. The so-called the criteria to achieve success are still used today, though somehow differently from the way used in the first years of transition.

Table 1. Meeting the quantitative targets during 2002

	Dec-01	Mar-02	Jun-02	Sep-02	Dec-02	Mar-03	Jun-03
NFA (in millions of USD)							
Target	542.6	536.6	530.6	546.6	558.6	560.6	582.2
Actual	542.6	547.5	550.1	570.9	562.2	596.2	606.5
Difference	0.0	10.9	19.5	24.3	3.6	35.6	24.3
NDA (in billions of Lek)							
Target	78.1	83.6	89.1	90.1	95.1	97.1	98.1
Actual	78.1	84.8	87.6	83.5	87.1	76.5	68.9
Difference	0.0	1.2	-1.5	-6.6	-8.0	-20.7	-29.3
Net Credit to Government (in billions of Lek)							
Target	237.5	238.5	244.2	247.0	257.0	263.7	267.7
Actual	237.5	240.5	246.8	247.0	259.6	263.1	263.1
Difference	0.0	2.0	2.6	0.0	2.6	-0.6	-4.6

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