



ALBANIA

February 2015

SECOND AND THIRD REVIEWS UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR WAIVER FOR THE NONOBSERVANCE OF PERFORMANCE CRITERION, WAIVER OF APPLICABILITY OF PERFORMANCE CRITERIA, AND REPHASING OF FUTURE DISBURSEMENTS—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ALBANIA

In the context of the second and third reviews under the Extended Fund Facility and Request for Waiver for the Nonobservance of Performance Criterion, Waiver of Applicability of Performance Criteria, and Rephasing of Future Disbursements, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 20, 2015, following discussions that ended on November 25, 2014, with the officials of Albania on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on January 26, 2015.
- A **Staff Statement** of February 20, 2015 updating information on recent developments.
- A **Press Release** including a statement by the Chair of the Executive Board.
- A **Statement by the Executive Director** for Albania.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Albania*

Memorandum of Economic and Financial Policies by the authorities of Albania*

Technical Memorandum of Understanding*

*Also included in Staff Report

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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January 26, 2015

SECOND AND THIRD REVIEWS UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR WAIVER FOR THE NONOBSERVANCE OF PERFORMANCE CRITERION, WAIVER OF APPLICABILITY OF PERFORMANCE CRITERIA, AND REPHASING OF FUTURE DISBURSEMENTS

KEY ISSUES

Background: On February 28, 2014, the Executive Board approved a three-year Extended Arrangement with access equivalent to SDR 295.42 million (492.4 percent of quota). So far, two purchases equivalent to SDR 23.55 million (about €26.4 million) each have been made, and another totaling the equivalent of SDR 47.1 million will be made available upon completion of the second and third reviews.

Recent Economic Developments: Economic recovery is underway, but growth is below potential. High nonperforming loans (NPLs) make banks risk-averse. Credit growth remains sluggish despite monetary easing.

Program Performance and Risks: The program is on track. The second review was delayed because of the need to incorporate electricity reform in the program and to allow time for conditions surrounding the Bank of Albania (BoA) to normalize following the removal of BoA senior management. All end-June, end-September, and available end-December quantitative performance criteria were met. However, the continuous performance criterion on the accumulation of external arrears was not observed because of technical delay with one interest payment. An indicative target on new arrear accumulation was missed by a small margin. Inflation has been slightly below the inner band prescribed under the inflation consultation clause. Several structural benchmarks were not met; these are all expected to be completed in the first half of 2015. Program risks emanate from the complexity of energy reforms and the need for sustained political commitment. Staff proposes that the program move to three reviews a year, beginning with the fifth review, (rather than two as previously envisaged) to maintain a timely dialogue on prospective risks.

Policy Recommendations: Reversing the upward trend in public debt in 2015, while incorporating energy sector subsidies, will require significant fiscal consolidation. The authorities have embarked on ambitious energy sector reform to lower the fiscal burden, but challenges will persist for 4–5 years. Addressing the NPL problem is critical for reviving credit. Steadfast structural reforms are needed for sustained medium-term growth.

Approved By
**Masato Miyazaki and
 Aasim M. Husain**

Discussions were held in Tirana on August 26–September 9, and November 17–25, 2014. Staff team: Mr. Ilahi (head), Mr. Gaertner, Mr. Ioannou, Mr. Slavov (all EUR), Ms. Gerling (FAD), and Ms. Unsal and Mr. Ismail (both SPR). Mr. Reinke (Resident Representative) and Ms. Spahia (local economist) assisted the mission. Mr. Senatore (OED) joined some of the meetings. The mission met with the Prime Minister, Ministers of Finance and Economy, Bank of Albania Governor, other senior officials and parliamentarians, and representatives of banks and the private sector. HQ support was provided by Dustin Smith and Patricia Mendoza (EUR).

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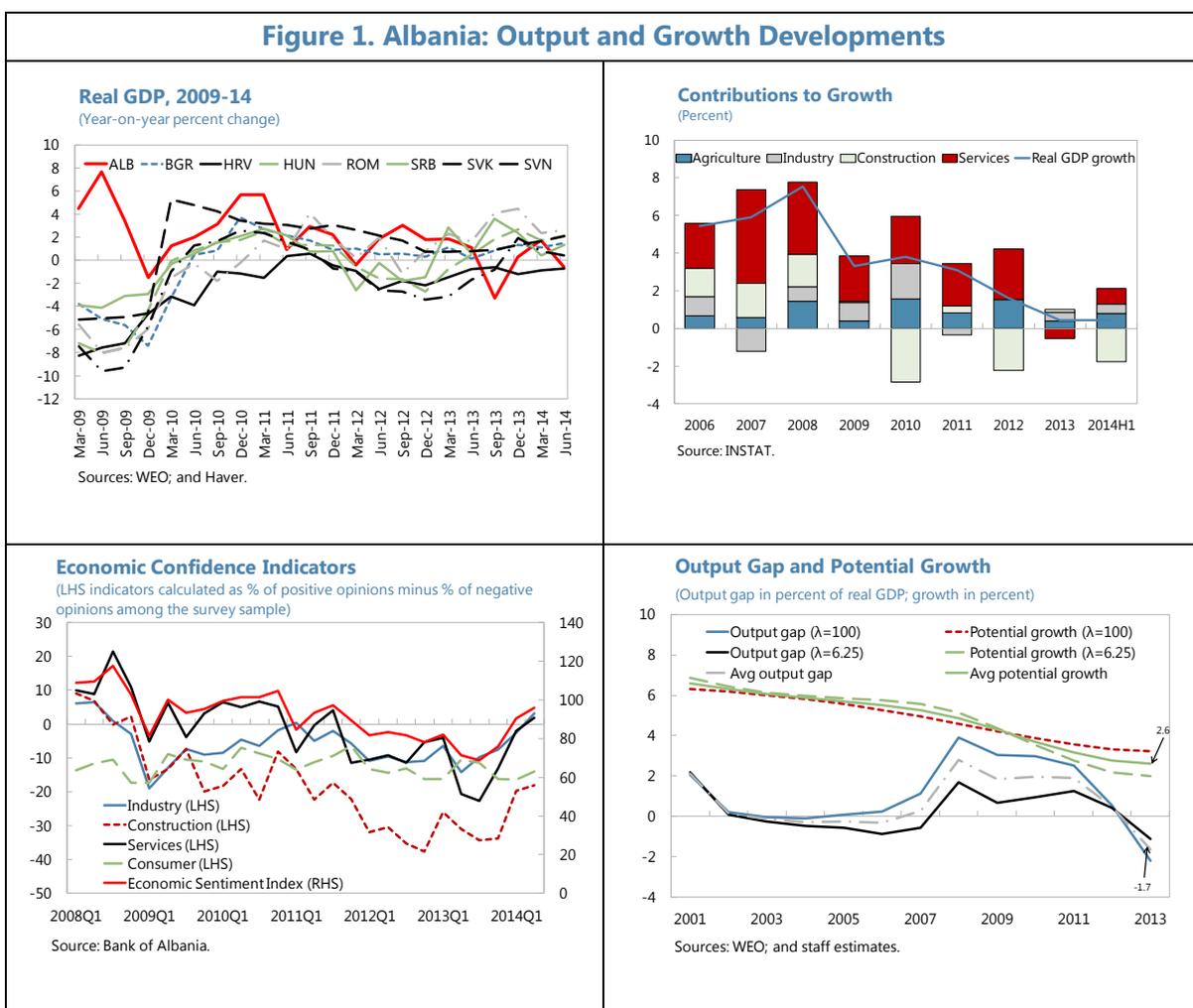
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CONTEXT AND DEVELOPMENTS

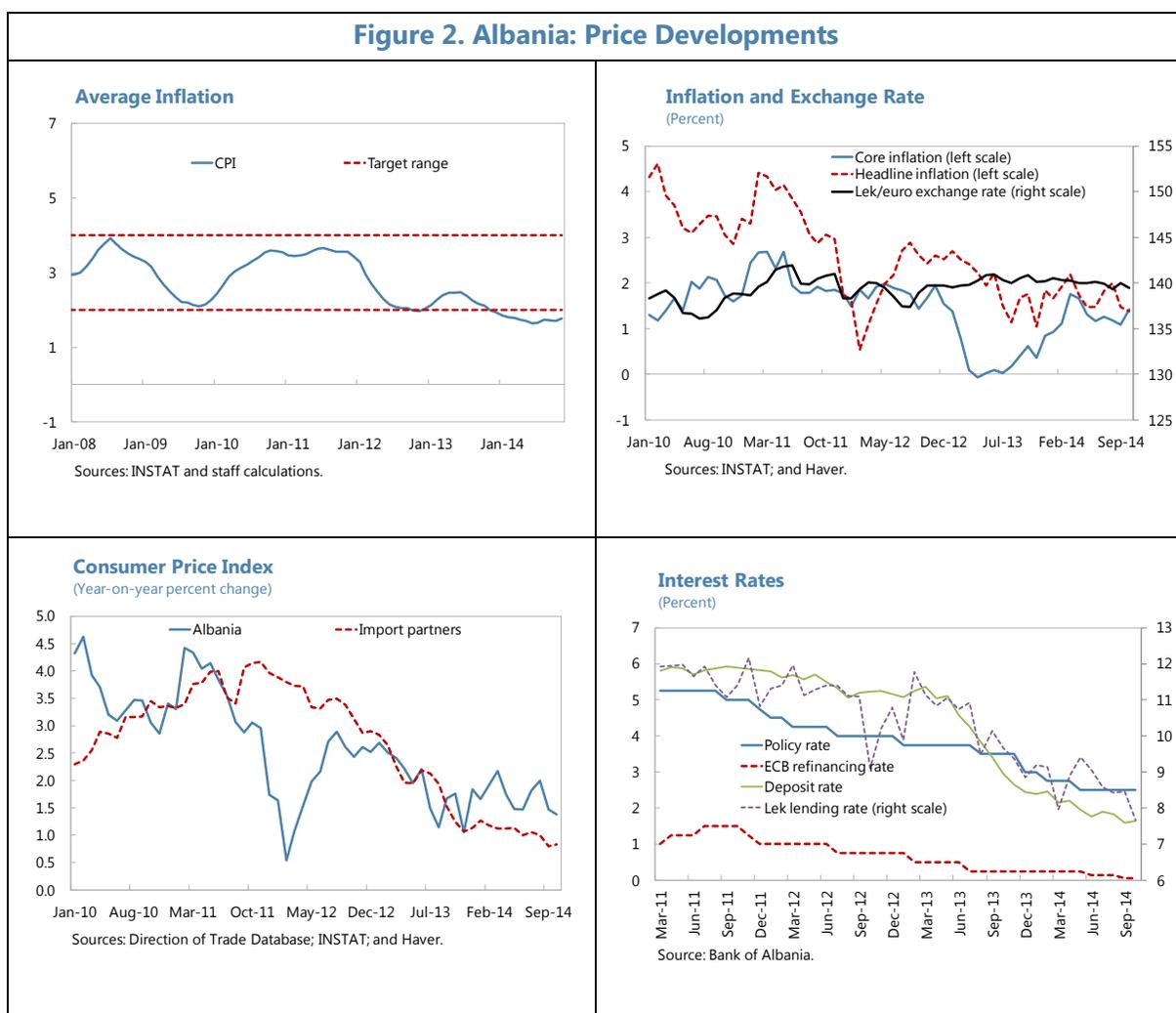
1. The economy is recovering. After a protracted slowdown, the economy is on track for a modest growth pickup. Macroeconomic imbalances are being tackled, but could take time to unwind. The opposition's four-month boycott of parliament ended in late December, but efforts to appoint a new BoA governor have not yet succeeded. In June, Albania became an EU candidate; accession negotiations will start at a later date. The EU integration process could catalyze structural reforms and investment in the medium term.

2. Economic recovery appears broad based (Figure 1 and MEFP ¶12). Real GDP is expected to have grown by 2 percent (yoy) in 2014. Though growth remains below potential, confidence is improving, with indications of a modest recovery in construction. Unemployment is stubbornly high, at 17 percent (2014:Q3), but employment has increased in the past year.



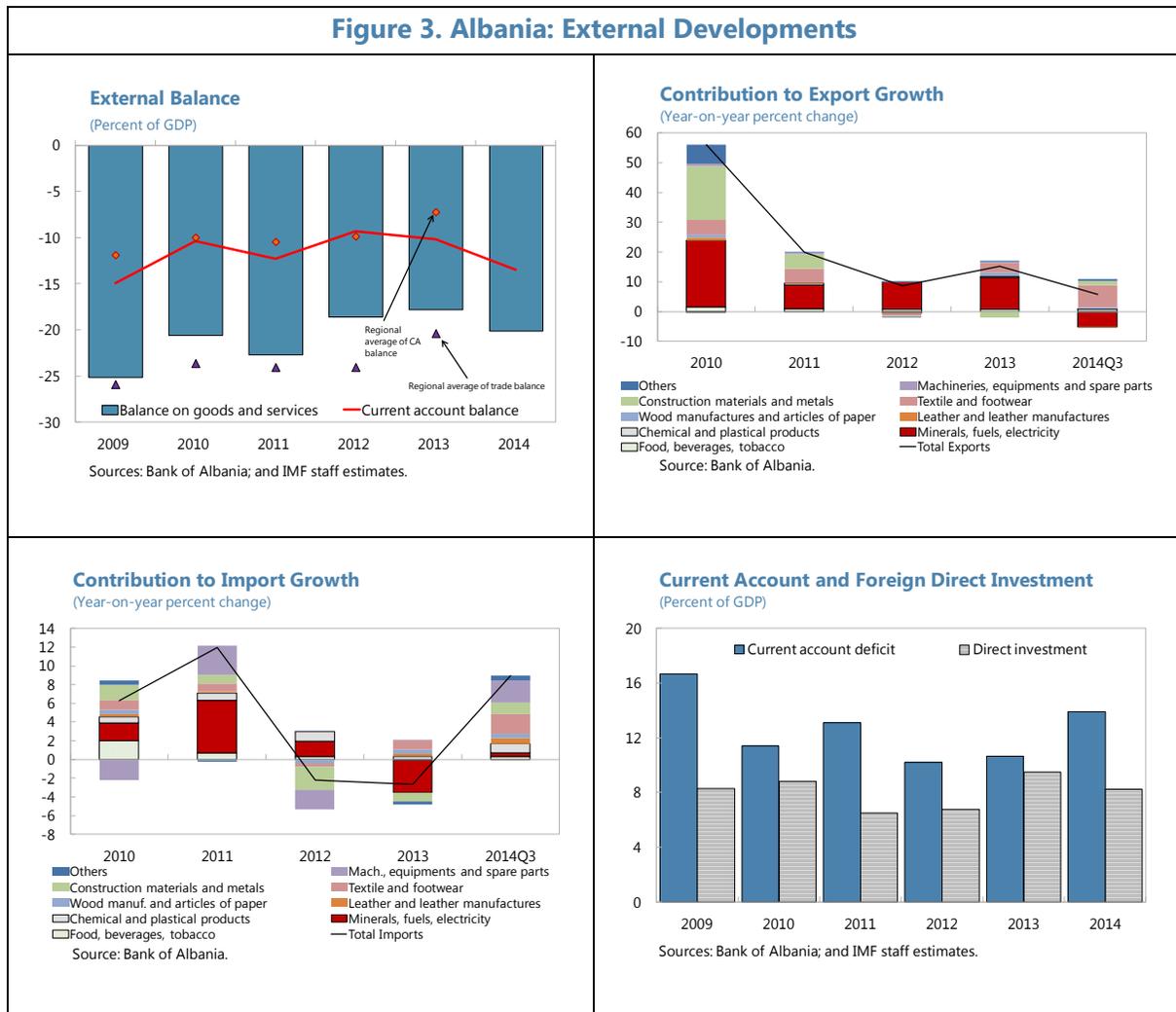
3. Inflation remained weak in 2014 despite monetary easing (Figure 2 and MEFP ¶14).

Average inflation declined to 1.6 percent in 2014, largely due to a strong harvest and low imported inflation. Core inflation has been rising since 2013:Q2 but remains low and stable. The BoA decreased its policy rate by 25 basis points in May and November to a historic low of 2.25 percent. Lek lending rates and T-bill yields have been declining steadily, considerably easing budget financing costs.



4. The external current account worsened in 2014 (Figure 3 and MEFP 13). While a boost in external demand has helped textile and agricultural exports, the trade deficit has widened because of a pickup in imports with the economic recovery and weather-related demand for imported electricity. A continued decline in remittances primarily from EU also contributed to the current account deterioration. The current account deficit was largely financed by FDI inflows. Reserve cover eased slightly, but the exchange rate remained stable.

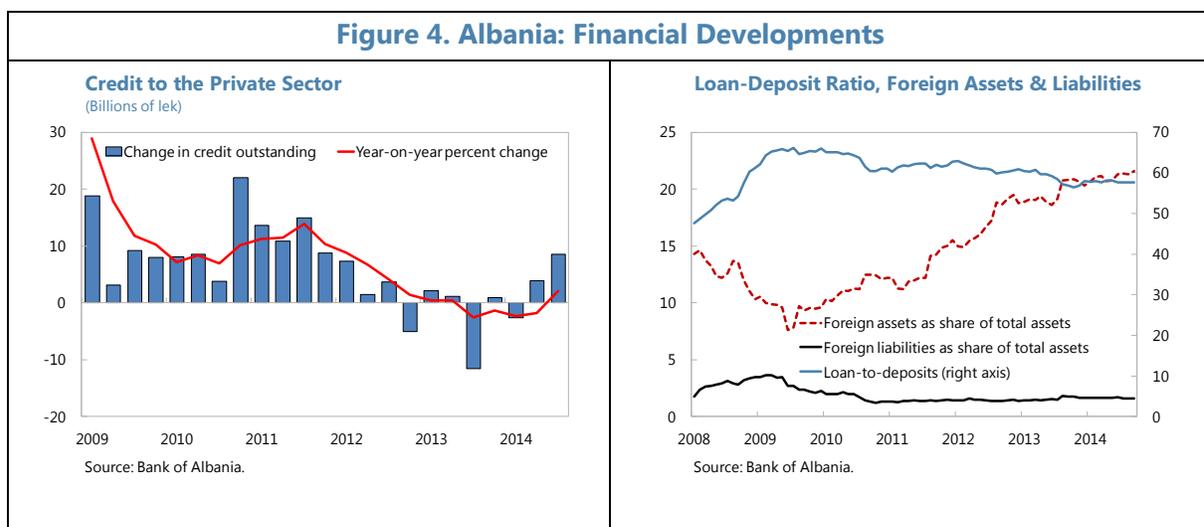
Figure 3. Albania: External Developments

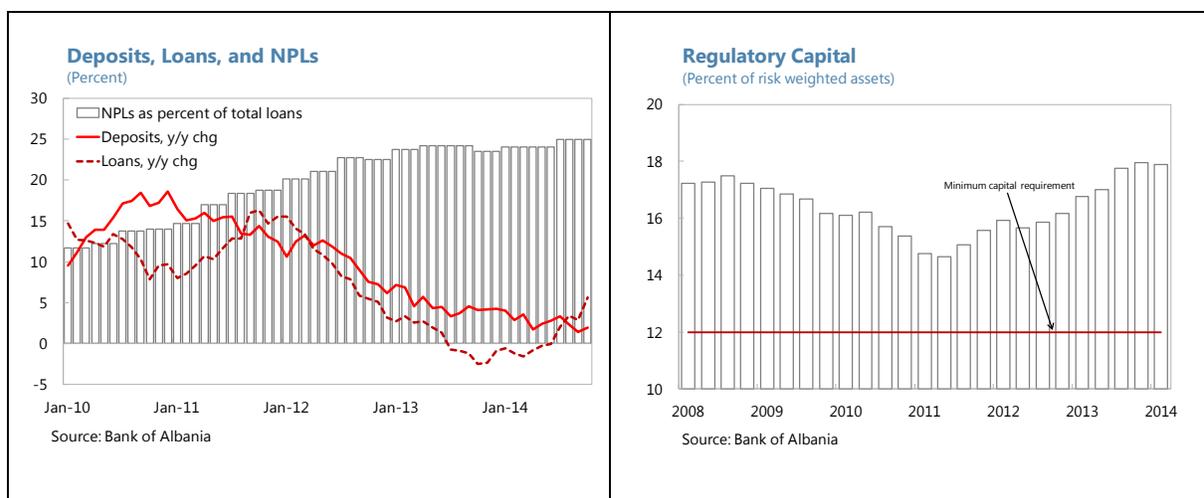


5. Credit to the private sector is recovering, but asset quality remains weak (Figure 4). Credit is estimated to have grown modestly in 2014, supported by ample liquidity and monetary easing. NPLs are high, though the pace of deterioration eased in 2014. This has helped with bank profitability. NPLs net of provisions have fallen under 8 percent of total loans, helping mitigate financial stability risks. System-wide capitalization and liquidity exceed regulatory minima.

6. The BoA has been conducting monetary and financial policies in a normal fashion under the Acting Governor. The previous governor and the internal auditor were removed from office in September on charges of dereliction of duty relating to a vault theft in which a mid-level employee is alleged to have stolen, over a 4-year period, the lek equivalent of \$6.5 million (about one thousandth of broad money and 0.05 percent of 2014 GDP). Criminal proceedings are currently in process. Discussions for the second review were subsequently delayed, but resumed once the authorities and parliamentary representatives publicly reaffirmed that the process of making high level appointments at the BoA and its oversight is consistent with its independence. The authorities also agreed to include the following as conditionality: discontinue the practice of advanced transfers of BoA profits; escalate the IT on BoA credit to government to a PC; hire an external advisor for the BoA Audit Committee; and commit to reforming the BoA law over the next year with a view to strengthening its governance and oversight. While governance gaps at the BoA remain, with the governor, one deputy governor and the internal auditor positions still lying vacant, there has been progress recently—four positions on the BoA supervisory board have been filled, and the President’s candidate for governor has received wide support.

Figure 4. Albania: Financial Developments





PROGRAM PERFORMANCE

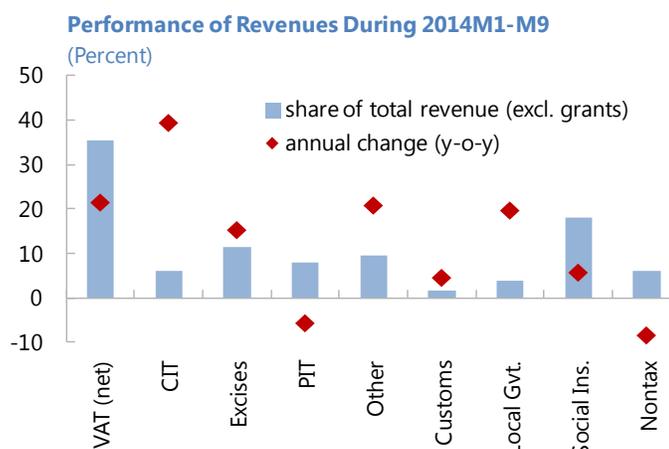
7. The program is broadly on track (MEFP Tables 1–2).

- Quantitative targets** (MEFP ¶7-9, and Table 1). All end-June, end-September, and available end-December performance criteria (PCs) were met. The authorities are seeking a waiver of applicability for the end-December PCs on the general government overall cash deficit and expenditure, for which data are not available; staff have no evidence that these PCs will not be met. The continuous PC on accumulation of external arrears was missed in April (see below). All end-June, end-September, and end-December indicative targets (ITs) have been met, with the exception of the IT on domestic arrears accumulation which was missed by a small margin (0.03 percent of GDP).
- Structural benchmarks** (MEFP ¶10–11, and Table 2a). The Council of Ministers approved a pension reform strategy in July, six months ahead of schedule. The structural benchmark (SB) on the development of a capacity building strategy for the tax authority is delayed to allow for the completion of a new IT system (in line with IMF technical advice). Difficulties with procurement procedures have delayed the purchase of a new IT server for the treasury system. Funding constraints have delayed the hiring of an external auditor to conduct verification of arrears payments on tax refunds to early 2015, while legal changes to enforce the introduction of multi-year commitment limits have been delayed to 2015 to incorporate other changes under the PFM reform strategy. Finally, changes to the regulatory framework for investment funds on asset valuation and liquidity requirement have been delayed until June 2015 to incorporate further technical assistance. All other SBs were met with delay (see below).

8. Fiscal performance was better than programmed in the first nine months of 2014 (MEFP ¶7 and Table 1).

- **The overall cash deficit target was comfortably met.**
- **Revenues are broadly in line with program targets.** VAT, local government, and nontax revenues exceeded

targets,¹ and PIT receipts declined broadly as programmed, following the introduction of progressivity. Excises fell short because of larger-than-expected advance purchases in end-2013, in anticipation of a rate increase.



- **Expenditure was well below target.** Under-execution in several expenditure categories more than offset small slippages on health outlays and social assistance and disability spending. Capital expenditure was about one-third less than programmed because of problems with the intra-government transfer of investment monitoring responsibility and staffing issues. Energy related spending was 0.5 percent of GDP (see Annex I).
- **Repayment of the 2013 stock of arrears was broadly in line with the arrears prevention and clearance strategy (APCS)** (MEFP Table 1). The authorities published a report on arrears paid on the finance ministry (MoF) website. A preliminary external auditor assessment, covering more than 70 percent of cleared contractor arrears, confirmed that clearance was broadly in line with the APCS. It found some weaknesses in contracting and procurement procedures, as well as inconsistent use of the first-in first-out principle, in part caused by difficulties in verifying older claims. The authorities will prepare an action plan to address these deficiencies in future.
- **There was a small accumulation of new external payment arrears** (MEFP ¶8, and Table 1). The government accumulated external interest arrears of US\$61,700 to a bilateral creditor because of irregularities in the authentication of signatories. The outstanding amount has since been repaid and the authorities request a waiver for the nonobservance of this PC on account of the corrective action taken, including tighter enforcement of existing regulations on contracting external debt.
- **New domestic arrears have accumulated, but the amounts have fallen sharply** (MEFP ¶9 and Table 1). A quarterly survey of five ministries and the tax authority (GDT) revealed that new arrears at end-June amounted to 0.1 percent of GDP and were near zero at end-September. These arrears arose from delays in registering bills/invoices or auditing refund requests. The authorities are reinforcing internal controls to ensure timely

¹ VAT refunds, paid out in cash or offset against tax liabilities, are broadly in line with historical experience.

submission of invoices to the Treasury, introducing commitment limits for outer years and conditioning the initiation of procurement procedures on funding guaranteed by Treasury. They also plan to reform the VAT refund process (see below).

9. Inflation was slightly below the inner band prescribed under the inflation consultation clause (MEFP ¶4, 28). Staff and the authorities concurred that the decline in inflation did not warrant policy action at this stage, apart from continuing with cautious monetary easing. Inflation is expected to rise above the lower end of the band over the medium term, as the output gap narrows and inflation in trading partners picks up. The BoA is also refining the use of forward guidance to align expectations with the monetary policy objective.

POLICY DISCUSSIONS

A. Outlook and Risks

10. The near term outlook is broadly unchanged from the first review.

- **Growth is expected to accelerate in 2015** (MEFP ¶15). Real GDP growth is expected to increase to 3 percent, driven by continued recovery of domestic demand and higher FDI in mining. Domestic demand will be supported by the easing of private sector liquidity constraints through continued arrears clearance and moderation of bank risk aversion. Improvements in confidence as macroeconomic imbalances ease, low interest rates, and a recovery of public investment will also help.
- **Inflation will remain modest.** With the output gap persisting in 2015, together with weak import prices and falling energy prices, inflation pressures will remain contained. Inflation is expected to hover within the BoA's inner band as domestic demand picks up.²
- **The current account will deteriorate further in 2015.** Imports will be higher because of large energy-related investments (e.g., the Trans Adriatic Pipeline, TAP). The underlying current account, which excludes such one-offs, would improve gradually. Reserve cover is expected to remain broadly unchanged, thanks to FDI flows and borrowing.

11. The medium-term outlook is generally favorable (Table 1). Growth is expected to increase to 4½ percent over the medium term, driven by: (i) higher investment reflecting EU accession prospects and ambitious structural reforms that improve the business environment and boost productivity, (ii) recovery in main trading partners, and (iii) acceleration of large energy-related projects. Reserves would remain at about four months of imports by 2019.

² The output gap is slightly lower than in the first review because of the revision to 2013 real GDP growth.

12. The balance of risks to the outlook is tilted down. There is considerable uncertainty about the pace of recovery of domestic and external demand. A weaker recovery could delay implementation of critical structural reforms. Insufficient fiscal consolidation could also undermine investor confidence and medium-term growth prospects. While the ongoing sharp oil price decline should have a positive impact on households, it is also likely to affect the petroleum sector, with a risk that the main investor could scale back investment and output.³

B. Fiscal Consolidation: Reversing Unfavorable Debt Dynamics

The authorities will continue fiscal consolidation in 2015 to return the public debt-GDP ratio to a sustainable level over the medium term. Significant risks remain.

13. The authorities reaffirmed that they will continue to gradually reduce the public debt burden to support sustainable growth and strengthen the economy's resilience to shocks (MEFP ¶12). While cognizant of the risks that excessive consolidation may have on the nascent recovery and social outcomes, the authorities reaffirmed their commitment to lower the public debt-GDP ratio to under 60 percent by 2018.

Fiscal Consolidation, 2013-19
(Percent of GDP, unless otherwise specified)

	2013	2014		2015		2016	2017	2018	2019
	Act.	EBS/ 14/71	Proj.	EBS/ 14/71	Proj. 1/					Proj.
Revenues	23.7	26.1	26.0	26.1	27.6	27.9	27.9	27.9	27.9
<i>of which</i> : Tax revenue	21.7	24.0	23.8	24.0	25.3	25.4	25.4	25.4	25.4
Expenditures	28.9	32.8	31.8	32.0	32.4	31.5	30.3	30.9	30.9
<i>of which</i> : Energy sector spending 2/			0.5		1.2	0.9	0.7	0.6	0.2
Unidentified measures (cumulative)				1.2	0.0	1.0	1.9	2.6	3.1
Overall balance	-5.2	-6.7	-5.7	-4.7	-4.8	-2.6	-0.5	-0.4	0.1
Overall balance excl. energy sector spending		...	-5.2	...	-3.6	-1.7	0.2	0.2	0.3
Public debt	70.0	72.1	71.0	71.6	70.7	67.7	63.4	59.3	54.9
Domestic debt	43.4	41.8	42.2	40.0	39.9	37.0	34.9	32.6	30.1
Foreign debt	26.6	30.4	28.8	31.5	30.8	30.7	28.5	26.7	24.8
Memo									
Nominal GDP (in bn leks)	1,366	1,396	1,414	1,476	1,492	1,596	1,718	1,849	1,992
Public debt (in bn leks)	957	1,007	1,004	1,056	1,056	1,080	1,089	1,096	1,094

Sources: IMF staff estimates and projections.

1/ Unlike EBS/14/71, the 2015 revenue and expenditure projections include the effect of measures.

2/ Energy spending includes energy sector subsidies, compensation for the poor, and net lending. Prior to 2014, energy subsidies were not recorded in the fiscal accounts, but handled through extra-budgetary guarantees.

³ The oil price decline should be broadly neutral for the BOP; Albania exports crude and imports refined oil, with the two broadly in balance.

14. The authorities will undertake significant efforts to achieve the required adjustment, while absorbing higher energy costs (Table 2, and MEFP ¶12-16). Staff and the authorities agreed that to achieve the envisaged reduction in the public debt-GDP ratio in 2015, the 2015 budget should target a drop in the overall deficit of about 1 percent of GDP relative to the 2014 projected outcome (which is expected to be significantly better than planned). The 2015 budget achieves this deficit reduction despite an increase in energy and interest expenditures of about 0.5 percent of GDP each relative to 2014.^{4,5} In the 2015 budget, tax revenues are expected to increase by 1.5 percent of GDP—comprising 0.9 percent in tax policy measures (see Box 1) and the remainder from tax measures already taken in 2014 but realizing full effect in 2015 and continued improvements in administration. Expenditures will continue to be restrained, and current spending (excluding energy and interest costs) would decline slightly. The authorities will also limit capital spending by about 0.3 percent of GDP compared to the level envisaged at the time of the first review, but would still permit a healthy increase compared to 2014. The lower amount of arrears clearance in 2015 relative to 2014, by about 1.2 percent of GDP would help with lowering the overall deficit in 2015 to 4.8 percent of GDP in 2015 from 5.7 expected in 2014. The authorities agreed with staff that to ensure fiscal targets are met, a weakening of the electricity reform effort would have to be compensated through additional fiscal measures.

Box 1. Fiscal Measures, 2015

The 2015 budget includes significant revenue and some expenditure measures to safeguard the deficit target.

Main Revenue Measures in 2015

Measure	Description	Yield	
		Billions of Leks	% GDP
Total		13.7	0.9
Increase in excise tax on cigarettes	Increase in the excise tax on cigarettes from 100 Lek/pack to 110 Lek/pack), including VAT impact.	2.0	0.1
Increase of circulation tax	Increase the circulation tax on petrol and diesel by 10 lek per liter (including VAT impact).	6.7	0.4
Increase of capital income tax	The tax from interest, sale of property, dividends, rent, etc would increase from 10 to 15 percent.	5.0	0.3

Source: IMF staff estimates.

In addition to the revenue measures, the authorities also plan to restrain capital spending in 2015 and over the medium term, as well as achieve savings from improved targeting of disability benefits.

⁴ The program incorporates subsidies to the energy sector in the form of new guarantees and non-energy sector guarantees because they have high probability of being called.

⁵ The authorities have reassessed and updated interest cost projections for 2015–19.

15. Pension reform will ringfence near-term risks and have a positive impact on fiscal sustainability over the longer term (MEFP ¶124). The new pension law aims to strengthen the link between contributions and benefits, while raising the retirement age, indexing benefits to inflation, and creating a social pension for nonparticipants over the age of 70. Fiscal savings are expected to be small initially, but will accumulate over the long term, depending on participation. The amendments to the supplementary pension scheme for high public officials—which remains overly generous—are still pending; these are important for equity reasons, as well as to improve the efficacy of the reform.

16. Ambitious structural fiscal reforms are also planned.

- **Tax administration** (MEFP ¶17–20, 23, and Table 2a). Reforms will focus on:
 - Replacement of GDT’s IT system, which is obsolete and subject to failure risk. The new system would automate procedures and help reduce fraud (SB).⁶
 - Reforming the VAT refund process by adopting risk-based auditing (SB).
 - Preparing the groundwork for a comprehensive reform of the property tax, by the creation of a fiscal cadastre that consolidates existing data (SB).
- **Public Financial Management** (MEFP ¶21 and Table 2). The authorities will:
 - Strengthen implementation of multi-year commitment limits by changing laws related to procurement, financial management and control, and budget (SB).
- **New arrears prevention** (MEFP ¶21). The authorities are confident that strengthened internal controls and planned PFM reforms will prevent the creation of new arrears, though they also acknowledge that complete elimination will take time, because of capacity constraints.

17. Clearance of the 2013 stock of arrears will proceed concurrently with the auditing and verification of payments (MEFP ¶22). The *ex post* auditing of the remaining nontax claims will continue in 2015, with 75 percent of arrears payments through January expected to be audited by end-April 2015 (SB). The verification by an external auditor of arrears payments on tax refunds is also expected to be complete by end-April 2015 (SB). The authorities will align the pace of arrears clearance with the audit and oversight checks envisaged in the APCS. The MoF auditors and the High State Audit will continue to monitor payments.

18. High fiscal risks from the impact of energy sector reform and property compensation claims are being addressed (MEFP ¶16).

⁶ Potential gains have not as yet been included in the revenue projections.

- **Revenue risks.** While the introduction of a new IT system at GDT could reap significant benefits, there is a risk that shortcomings and inadequate training may jeopardize revenue targets. To mitigate risks, the authorities have identified contingency reserve spending (about 0.1 percent of GDP), which will go ahead in H2 only if revenues are on track.
- **Energy subsidies.** Energy sector costs will be a fiscal drain over the medium term. While the authorities have begun implementing an ambitious power sector reform, developed with World Bank help, there is considerable implementation uncertainty (see Annex). To mitigate risks, the program now includes ITs on energy sector subsidies and distribution losses. The authorities will also take additional measures, if needed, to meet the end-year deficit target. Heavy dependence on hydropower means that rainfall shocks will continue to be a fiscal risk, and any additional support needed to compensate for poor rainfall will be assessed through future reviews.
- **Property compensation claims.** The European Court of Human Rights' (ECHR) decision to deny the authorities' petition to extend the deadline for executing cases already decided and for a moratorium on reviewing additional cases means that additional cases could be filed at the court. To mitigate risks from new rulings, the authorities will: (i) include in the 2015 budget a contingency reserve for higher-than-expected compensation claims amounting to 0.1 percent of GDP; and (ii) assess options, including reforming the current system of property compensation, to make it sustainable (MEFP ¶41).
- **Capital spending.** Commitments on existing unbudgeted investment projects (4–5 percent of GDP) far exceed the envelope of the medium term budget framework (MTBF). To minimize risks, the authorities agreed to prioritize all outstanding infrastructure projects using transparent criteria with the aim of cancelling or rescheduling low-priority projects (SB). They will also publish a list of all MTBF projects to signal their intention not to implement projects excluded from the list. They will include a clause in all new contracts stipulating that accelerating project work will constitute a contract violation.

C. High NPLs and Challenges for Monetary Policy and Financial Stability

Tackling high NPLs and encouraging the restructuring of private balance sheets are essential for easing bank risk aversion which currently hampers credit revival.

19. With inflation falling below the inner band of the BoA's inflation target, monetary easing is expected to continue in the near term, provided exchange rate pressures remain muted (MEFP ¶26–28). The impact of further easing on credit may be limited, however, because of high risk aversion of banks, weak private sector balance sheets, and extensive euroization.⁷ The

⁷ This is despite ample liquidity in the banking system (with a loan-to-deposit ratio below 60 percent).

BoA remains concerned that lowering the lek-euro interest rate differential below a certain level could lead to heightened exchange rate volatility, thereby aggravating financial stability risks (as about half of foreign currency denominated loans are unhedged). Balancing these considerations, staff and the authorities agreed that the BoA's stance of cautious easing should continue as long as inflation expectations remain anchored and financial stability concerns from exchange rate depreciation are contained.

20. The BoA is intensifying efforts to tackle high NPLs (Table 5, and MEFP ¶132–33). NPLs rose to 25 percent of gross loans at end-September from 24 percent at end-June, primarily reflecting higher NPLs at one bank that has expanded aggressively over the past several years. The BoA has heightened supervision and regulatory scrutiny accordingly. While the payment of government arrears may have yet to exert its full impact on the system-wide NPL ratio, because of loan reclassification lags, the BoA is also intensifying efforts to facilitate problem loan restructuring by developing recovery and resolution plans for large problem borrowers. Acceleration of collateral execution and mandatory loan write-offs, which comes into force in 2015, should help. In addition, the authorities are reviewing the commercial bankruptcy law in order to facilitate the restructuring of private balance sheets, and plan to request IMF TA. However, banks remain cautious about the lending environment in Albania and the slow progress in addressing the cumbersome judicial enforcement of creditor rights.

21. Continued vigilance is needed to preserve financial stability (MEFP ¶129–31). Financial stability risks are muted because of high provisioning against NPLs. Nonetheless, BoA continues to monitor individual banks' resilience to risks and uses stress tests to assess capital adequacy and liquidity. It is also reinforcing the supervisory process by focusing on governance and internal controls, implementing recommendations of the 2013 FSAP relating to risk-based supervision and crisis preparedness, and finalizing preparations for the adoption of more stringent capital adequacy requirements beginning in 2015.

22. Deleveraging risks do not appear to have been affected by the results of the ECB's recent assessment. Albania's banking system is dominated by foreign subsidiaries, and the results of the Comprehensive Assessment were generally benign for parents (notably from Austria, Greece, and Italy). However, Greek banks are continuing to implement restructuring plans agreed with the EU that require them to gradually scale back international operations. This could create pressure for consolidation in the banking system in the medium term. The BoA continues to be in close contact with home supervisors.

23. Nonbank supervision needs strengthening (MEFP ¶134–35). While the rapid growth of investment funds in recent years is a welcome sign of financial deepening, the illiquid domestic market calls for adequate regulation and close supervision. The authorities are revising the regulations on liquidity requirements and asset valuation in line with IMF and World Bank technical advice. Prompt appointments to the Albania Financial Supervisory Authority (AFSA) Board are also needed, as well as approval of the remaining legislation to ensure AFSA independence.

24. Safeguarding the BoA’s credibility is critical for fulfilling its mandate. Recent events at the BoA underscore the importance of the BoA continuing to operate normally and independently, and the need to promptly fill several high-level appointments. The BoA will also review its internal controls and vault procedures with the help of an outside expert, and implement the recommendations of the 2014 Safeguards Assessment mission (MEFP ¶136). Following the establishment of an audit committee, the BoA is in the process of hiring an external advisor to assist it. The authorities are signaling their support for BoA independence by elevating the ceiling on BoA credit to the government from an indicative target to a performance criterion under the program.

D. Advancing Structural Reforms to Boost Growth Potential

Strong growth performance hinges on tackling existing structural bottlenecks. Energy reform and secure property rights are critical for attracting investment and for reducing fiscal risks.

25. Improving the business environment is critical for attracting foreign investment (MEFP ¶137-38). Albania has registered a strong improvement in the 2014 *Doing Business* report. The creation of an investment council will help facilitate further improvements in business climate.

26. Energy reform, if implemented as planned, should gradually ease growth and fiscal risks (MEFP ¶139). Achieving the envisaged medium-term growth rate requires a sustainable energy model. The energy reform includes (i) institutional changes involving the three power companies and gradual liberalization of prices paid by medium-voltage customers, (ii) tariff adjustments, and (iii) improvements in electricity collections and legal enforcement (Appendix). The authorities will also review the current tariff methodology with a view to moving toward more frequent and automatic adjustments, based on market pricing. Targeted transfers will be provided to compensate the most vulnerable social groups. The initial results from a campaign to curb electricity theft have been encouraging, resulting in a substantial reduction in distribution losses in Q4 2014.

27. Securing property rights is a prerequisite for investment (MEFP ¶140-41). Uncertainties created by multiple claims over properties—due to expropriation under the communist regime and illegal construction—are an obstacle to investment. The authorities are working on an overhaul of the national property register to resolve existing uncertainties in titling.

PROGRAM MODALITIES AND RISKS

28. Staff proposes updated program conditionality (MEFP Tables 1–2).

Quantitative targets:

- **New PCs.** Staff proposes that the IT on BoA credit to the government be elevated to a PC to underscore the authorities' commitment to BoA independence.
- **New ITs.** Staff proposes that the 2015 program include the following new ITs:
 - Ceiling on the amount of energy sector subsidies issued by the government, to ring fence fiscal risks posed by the energy sector.
 - Ceiling on the amount of non-energy guarantees, to enhance transparency.
 - Targets for the energy distributor's distribution losses to underpin energy reform and reduce fiscal risks.
- **Rephasing**
 - Given delays associated with the completion of the second review, the authorities request that completion of the second and third reviews be based on controlling PCs for end-December. Staff recommends that the Board approve a waiver of applicability of end-December PCs on the general government overall cash deficit and expenditure, which were met at end-September. Notwithstanding the unavailability of information to assess observance of these PCs for end-December, the program will continue to be successfully implemented and there is no clear evidence that the PCs will not be met.
 - Staff proposes that beginning with the fifth review, the program move to three reviews a year, rather than to semiannual reviews after mid-2015 as envisaged at the time of the first review, to ensure timely dialogue on program risks (Table 6).
- **Adjustors**
 - To account for lumpiness in energy sector subsidies, the ceiling on the cash deficit and expenditure PCs will now include a symmetric adjustor for the amount of energy subsidies issued in the course of the year. The adjustor will not apply to the end-year amount of energy subsidies.
 - The ceiling on the expenditure PC will be adjusted upward/downward by 50 percent of privatization receipts, up to 15 billion lek, as is already the case with the cash deficit PC.

- The ceiling on the expenditure PC will be adjusted upward by additional one-off revenues up to 3 billion lek, and by the excess of project grants over the programmed amount, up to 15 billion lek.

Structural benchmarks:

- **Modification of existing SBs.** The authorities request modification of the SB related to the development by the GDT of a corporate strategy for medium and long-term capacity building which is now envisaged in March 2015, in line with IMF TA.
- **New SBs.** Staff proposes new SBs to reduce fiscal and growth risks. New SBs focus on PFM, tax administration, the financial sector, and the energy sector (MEFP Table 2b).

29. The program is fully financed. The World Bank will provide a Policy Based Guarantee to enable the authorities to secure a commercial bank loan of €250 million in 2015:Q1, while the authorities have begun preparations to roll over the €300 million Eurobond that matures in November 2015. The EU has also committed a €40 million grant for balance of payments support over 2015-18, to be disbursed in four equal tranches linked to the implementation of Albania's recently adopted PFM reform strategy.

30. Albania is expected to meet repayment obligations to the Fund (Table 7). By the end of the proposed extended arrangement, Fund credit outstanding is projected to be 2.7 percent of GDP, or 14.0 percent of gross reserves. After peaking at 42.0 percent of GDP in 2017, external debt will decline to 36.0 percent of GDP by 2019, with external public debt falling from 29.5 to 22.2 percent of GDP. The authorities have demonstrated a strong commitment during the first year of the program, including a willingness to move ahead with difficult structural reforms. Albania also has a strong record of repaying the Fund.

31. Risks to the program are elevated. Political and social tensions could rise ahead of local elections in mid-2015 and affect implementation of the ambitious reform agenda. Savings from the energy sector reform are subject to implementation risk, and will require sustained political commitment over the medium term. A weaker than expected economic recovery could test the authorities' willingness to adopt the fiscal measures needed to achieve the targeted debt reduction. Other program risks include uncertainty about growth prospects in partner countries, higher than expected judgments by the ECHR, and further deterioration in NPLs. Factors mitigating these risks include the prospect for EU accession which provides a catalyst for reform, and extensive TA by the Fund and other donors. Program targets would also be adjusted during reviews should risks materialize.

STAFF APPRAISAL

32. The economic recovery appears on track but downside risks persist. Even if the growth forecast materializes, activity will remain below potential. To have a significant impact on living standards and reduce macroeconomic imbalances, Albania will need much higher growth rates over the medium term. The authorities should persevere with their reform program to boost growth potential, as the targeted reduction in the public debt ratio in 2016–17 relies on a pick-up in economic growth.

33. Program implementation has been good during the first year. Program targets were broadly met, with comfortable margins. Nevertheless, the fiscal over-performance was largely the result of sharp under-execution in capital expenditure. Such unintended fiscal retrenchment undermines the economy's recovery. The authorities should take steps to strengthen their capacity to execute investment projects to safeguard growth potential. Program risks related to implementation of structural reforms remain significant.

34. The agreed 2015 budget signals the authorities' continuing commitment to restore debt sustainability. The programmed reduction of public debt-GDP in 2015, the first since 2010, underscores the authorities' ongoing efforts to reduce public debt to sustainable levels. These efforts are necessary and welcome, particularly at a time when they are also implementing a difficult energy sector reform.

35. Urgent action is needed to tackle fiscal risks. Uncertainties stem primarily from the impact of energy sector reform, the size of property compensation claims, and the large stock of unbudgeted investment projects which could lead to future arrears. Staff supports the authorities' commitment to tackle these risks.

36. Power sector reform is vital for fiscal sustainability. The energy sector has contributed to the rapid increase in public debt in recent years. The authorities' commitment to reforms is encouraging, but sustained implementation will be critical, especially given the history of failed attempts. Staff welcomes the authorities' decision to provide targeted support to the poor to compensate for tariff reform.

37. High NPLs threaten growth prospects and should be addressed forcefully. Banks exhibit high risk aversion largely because they see elevated NPLs as a sign of weakness in private balance sheets. In these circumstances, it would be difficult for Albania to grow out of its NPL problem. If NPLs are not addressed in a comprehensive and forceful manner, they could result in years of sluggish credit and weak economic growth. Recent legal and regulatory reforms to address NPLs are welcome, but the authorities should ensure these are fully implemented. NPLs should also continue to be closely monitored to ensure that each bank meets capital and liquidity requirements.

38. Staff supports the authorities' request for the completion of the second and third reviews under the Extended Arrangement, waiver of applicability of performance criteria, and rephasing of future disbursements (see para. 32), in light of the progress achieved so far and policy commitments going forward. Further, staff supports the authorities' request for waiver for the nonobservance of the performance criterion on accumulation of new external payment arrears based on corrective actions taken.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2009–19

	2009	2010	2011	2012	2013	2014		2015	2016	2017	2018	2019
						Prog.	Rev. Prog.	Prog.	Projections			
Real sector												
Real GDP 1/	3.4	3.7	2.5	1.6	1.4	2.1	2.1	3.0	4.0	4.5	4.5	4.7
Consumer Price Index (avg.)	2.3	3.6	3.4	2.0	1.9	2.2	1.6	2.2	2.6	2.9	3.0	3.0
Consumer Price Index (eop)	3.5	3.6	1.7	2.4	1.9	2.3	0.7	2.4	2.8	3.0	3.0	3.0
GDP deflator	2.4	4.5	2.3	1.0	0.8	1.7	1.4	2.5	2.8	3.0	3.0	2.9
Saving-investment balance												
Foreign savings	15.0	10.4	12.3	9.4	10.2	11.0	13.3	14.3	14.3	12.7	10.0	8.3
National savings	17.6	21.3	21.5	20.7	18.4	13.9	17.6	19.0	20.2	20.8	21.7	22.4
Public	0.9	1.2	1.6	0.8	-0.8	0.2	0.2	0.6	0.4	-0.4	-1.8	-2.4
Private	16.7	20.0	19.9	20.0	19.2	13.7	17.4	18.4	19.8	21.2	23.5	24.8
Investment	32.6	31.7	33.8	30.1	28.5	24.9	30.8	33.4	34.5	33.5	31.7	30.6
Public	9.2	6.0	6.1	5.1	4.8	4.8	4.0	4.5	4.5	4.5	4.5	4.5
Private	23.4	25.7	27.7	24.9	23.8	20.1	26.9	28.8	30.0	29.0	27.2	26.1
Fiscal sector												
	(Percent of GDP)											
Total revenue and grants	26.1	25.9	25.4	24.7	23.7	26.1	26.0	27.6	27.9	27.9	27.9	27.9
Tax revenue	23.7	23.3	23.4	22.5	21.7	24.0	23.8	25.3	25.4	25.4	25.4	25.4
Total expenditure	32.8	28.9	28.9	28.2	28.9	32.8	31.8	32.4	31.5	30.4	31.0	30.9
Of which: Repayment of end-2013 stock of unpaid bills and arrears						2.5	2.5	1.3	1.0			
Primary	29.7	25.6	25.8	25.1	25.7	29.5	29.0	29.1	28.3	27.2	28.0	28.2
Interest	3.2	3.4	3.2	3.1	3.2	3.3	2.8	3.3	3.2	3.2	3.0	2.8
Unidentified measures (cumulative)						0.0	0.0	0.0	1.1	2.0	2.7	3.2
Overall balance	-6.7	-3.1	-3.5	-3.4	-5.2	-6.7	-5.7	-4.8	-2.6	-0.5	-0.4	0.1
Primary balance	-3.6	0.3	-0.4	-0.3	-2.0	-3.4	-2.9	-1.5	0.7	2.7	2.6	2.9
Financing	6.7	3.1	3.5	3.4	5.2	6.7	5.7	4.8	1.7	0.5	0.4	-0.1
Of which: Domestic	6.8	-0.4	2.0	2.0	4.4	2.4	2.7	0.8	0.8	0.3	-0.1	-0.5
Of which: Foreign	0.4	3.8	1.5	1.4	0.8	4.3	3.0	4.0	0.9	0.2	0.5	0.3
Public Debt	59.7	57.7	59.4	62.0	70.0	72.1	71.0	70.8	67.7	63.4	59.3	54.9
Domestic	36.3	32.9	33.7	35.2	43.4	41.8	42.2	39.5	36.7	34.4	31.9	29.1
Of which: Unpaid bills and arrears					5.2	2.6	2.6	1.1	0.0			
External	23.4	24.8	25.7	26.8	26.6	30.4	28.8	31.3	31.0	29.0	27.4	25.8
Monetary indicators												
	(Growth rate in percent, unless otherwise indicated)											
Broad money growth	6.8	12.5	9.2	5.0	2.3	4.1	3.8	5.5	7.0	7.6	7.5	7.3
Private credit growth	10.3	10.1	10.4	1.4	-1.4	2.6	3.0	5.4	6.1	7.9	8.3	8.5
Velocity (nominal GDP/broad money)	1.3	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Interest rate (3-mth T-bills, end-period)	6.3	5.3	5.3	5.0	3.4	...	3.1	...	...	...	...	...
BoA repo rate (in percent)	5.3	5.0	4.8	4.0	3.0	...	2.3	...	...	...	...	...
External sector												
Trade balance (goods and services)	-25.1	-20.6	-22.7	-18.7	-17.8	-17.5	-19.7	-20.7	-20.6	-18.9	-16.0	-14.2
Current account balance	-15.9	-11.3	-13.2	-10.2	-10.6	-11.7	-14.0	-15.2	-15.1	-13.4	-10.6	-8.9
Gross international reserves (in billions of Euros)	1.6	1.9	1.9	2.0	2.0	2.1	2.1	2.3	2.4	2.5	2.6	2.7
(In months of imports of goods and services)	4.1	4.3	4.6	4.6	4.3	4.4	4.3	4.3	4.3	4.3	4.3	4.3
(Relative to external debt service)	2.5	3.6	7.8	6.6	6.7	5.4	6.6	3.4	5.9	5.4	5.1	4.7
(In percent of broad money)	26.1	27.0	24.8	24.5	24.6	24.7	25.2	25.4	25.1	24.3	23.5	22.7
Change in REER (eop, in percent; +=appreciation)	-5.3	-4.7	-0.9	-0.2	1.0	...	...	...	...	...	...	...
Memorandum items												
Nominal GDP (in billions of lek) 1/	1144	1240	1301	1335	1366	1396	1414	1492	1596	1718	1849	1992
Output gap (percent, - = gap)	0.8	1.1	0.9	0.2	-0.6	-2.4	-1.0	-1.0	-0.6	-0.1	0.3	0.8

Sources: Albanian authorities; and IMF staff estimates and projections.

1/ In July 2014, INSTAT revised real GDP numbers for 2008-2012 and quarterly GVA numbers for 2013. The revisions reflect improvements in data sources and compilation methods, and closer alignment with ESA2010/SNA2008 standards. The revisions were conducted under the guidance of IMF statistical TA.

Table 2a. Albania: General Government Operations, 2009–19
(Percent of GDP)

	2009	2010	2011	2012	2013	2014		2015		2016	2017	2018	2019
						EBS/ 14/71	Rev. Prog.	EBS/ 14/71	Prog.				
Total revenue and grants	26.1	25.9	25.4	24.7	23.7	26.1	26.0	26.1	27.6	27.9	27.9	27.9	27.9
Tax revenue	23.7	23.3	23.4	22.5	21.7	24.0	23.8	24.0	25.3	25.4	25.4	25.4	25.4
VAT	9.6	9.2	9.2	8.7	7.9	8.5	8.9	8.5	9.1	9.1	9.1	9.1	9.1
Profit tax	1.5	1.4	1.5	1.3	1.1	1.6	1.5	1.6	1.6	1.6	1.6	1.6	1.6
Excise tax	2.9	3.1	3.1	2.7	2.8	3.5	3.1	3.5	3.5	3.6	3.6	3.6	3.6
Personal income tax	2.3	2.2	2.2	2.1	2.2	2.0	2.0	2.0	2.4	2.4	2.4	2.4	2.4
Customs duties	0.7	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other taxes	1.2	1.5	1.6	2.1	2.1	2.6	2.4	2.6	2.9	2.9	2.9	2.9	2.9
Local government revenue 1/	1.1	1.0	0.9	0.8	0.8	0.7	0.9	0.7	0.9	0.9	0.9	0.9	0.9
Social insurance contributions	4.4	4.3	4.4	4.3	4.4	4.6	4.5	4.6	4.6	4.6	4.6	4.6	4.6
Non-tax revenue	2.0	2.2	1.7	1.8	1.6	1.5	1.6	1.5	1.5	1.7	1.7	1.7	1.7
Grants	0.4	0.4	0.3	0.4	0.4	0.6	0.6	0.6	0.8	0.8	0.8	0.8	0.8
Total expenditure	32.8	28.9	28.9	28.2	28.9	32.8	31.8	32.0	32.4	31.5	30.4	31.0	30.9
Current expenditure	24.8	24.3	23.5	23.6	24.1	25.0	25.3	25.6	25.9	25.5	25.4	26.0	26.2
Personnel cost	5.5	5.3	5.2	5.2	5.2	5.3	5.2	5.1	5.1	5.1	5.1	5.1	5.1
Interest	3.2	3.4	3.2	3.1	3.2	3.3	2.8	4.1	3.3	3.2	3.2	3.0	2.8
Operations & maintenance	2.8	2.8	2.5	2.5	2.4	2.5	2.7	2.5	2.7	2.7	2.7	2.7	2.7
Subsidies	0.2	0.3	0.3	0.1	0.1	0.1	0.7	0.1	1.1	0.7	0.7	1.5	1.9
Energy	...	...	...	...	...	...	0.5	...	0.9	0.6	0.3	0.3	0.1
Nonenergy	...	...	...	...	...	...	0.0	...	0.1	0.0	0.2	1.1	1.7
Other	...	...	...	...	...	...	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social insurance outlays	8.5	8.6	8.8	9.0	9.3	9.8	9.6	9.8	9.6	9.6	9.6	9.6	9.6
Local government expenditure	2.9	2.5	2.2	2.0	2.2	2.4	2.6	2.4	2.5	2.5	2.5	2.5	2.5
Social protection transfers	1.8	1.5	1.4	1.5	1.7	1.6	1.7	1.6	1.6	1.6	1.6	1.6	1.6
Of which: Compensation for the poor (electricity, other)	...	...	...	...	...	...	0.0	...	0.1	0.1	0.1	0.1	0.1
Capital expenditure	7.9	5.1	5.4	4.6	4.8	4.8	4.0	5.0	4.5	4.5	4.5	4.5	4.5
Lending minus repayment	0.2	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.3	0.2	0.2	0.0
Reserve and contingency funds 2/	0.0	0.0	0.0	0.0	0.0	0.5	0.1	0.0	0.4	0.3	0.3	0.2	0.2
Repayment of end-2013 stock of unpaid bills and arrears	...	...	...	...	...	2.5	2.5	1.4	1.3	1.0	0.0	0.0	0.0
Unidentified measures (cumulative)	...	...	...	...	...	0.0	0.0	1.2	0.0	1.1	2.0	2.7	3.2
Overall balance	-6.7	-3.1	-3.5	-3.4	-5.2	-6.7	-5.7	-4.7	-4.8	-2.6	-0.5	-0.4	0.1
Financing	6.7	3.1	3.5	3.4	5.2	6.7	5.7	3.6	4.8	1.7	0.5	0.4	-0.1
Domestic	6.8	-0.4	2.0	2.0	4.4	2.4	2.7	1.9	0.8	0.8	0.3	-0.1	-0.5
Privatization receipts	2.7	0.4	0.0	0.1	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	3.9	-0.9	2.2	1.9	3.4	2.4	2.7	1.9	0.8	0.8	0.3	-0.1	-0.5
Of which: banks	...	...	...	...	...	1.2	1.3	0.9	0.4	0.4	0.2	0.0	-0.2
Other	0.2	0.1	-0.2	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.4	3.8	1.5	1.4	0.8	4.3	3.0	1.7	4.0	0.9	0.2	0.5	0.3
Accumulation of arrears 3/	-0.5	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap (+=-gap) 4/	...	...	...	...	...	0.0	0.0	1.2	0.0	0.9	0.0	0.0	0.0
World Bank	...	...	...	...	...	0.0	0.0	0.7	0.0	0.7	...	...	...
Residual financing (e.g., EU)	...	...	...	...	...	0.0	0.0	0.5	0.0	0.2	...	...	...
IMF	...	...	...	...	...	0.0	0.0	0.0	0.0	0.0	...	...	...
Memorandum Items:													
Primary balance	-3.6	0.3	-0.4	-0.3	-2.0	-3.4	-2.9	-0.6	-1.5	0.7	2.7	2.6	2.9
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears	...	...	...	...	...	-4.2	-3.3	-3.4	-3.5	-1.5	-0.5	-0.4	0.1
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears, and energy sector subsidies	...	...	...	...	...	...	-2.8	...	-2.3	-0.6	0.2	0.2	0.3
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears, and new guarantees	...	...	...	...	...	...	-2.7	...	-2.5	-0.9	0.1	1.0	1.9
Current balance excl. grants	0.9	1.2	1.6	0.8	-0.8	0.2	0.1	1.0	0.6	2.5	3.6	3.6	3.9
Public Debt	59.7	57.7	59.4	62.0	70.0	72.1	71.0	71.6	70.8	67.7	63.4	59.3	54.9
Domestic	36.3	32.9	33.7	35.2	43.4	41.8	42.2	40.0	39.5	36.7	34.4	31.9	29.1
Of which: Unpaid bills and arrears	...	...	...	...	...	5.2	2.6	2.6	1.1	1.1	...	...	...
External	23.4	24.8	25.7	26.8	26.6	30.4	28.8	31.5	31.3	31.0	29.0	27.4	25.8
Direct government external debt	19.9	21.6	22.6	23.9	24.3	27.8	26.8	28.8	29.5	29.5	27.6	25.2	22.2
Government guaranteed external debt	3.5	3.2	3.0	2.8	2.3	2.5	2.0	2.7	1.8	1.5	1.4	2.2	3.6
GDP (in billions of leks)	1144	1240	1301	1335	1366	1396	1414	1476	1492	1596	1718	1849	1992

Sources: Albanian authorities; and IMF staff estimates and projections.

1/ It includes the property tax, the simplified profit tax for small businesses, and other local taxes.

2/ Spending contingencies are reported according to their economic classification at outturn.

3/ As reflected in official data and not accounting for arrears accumulated outside of the budget prior to 2014.

4/ Following the approval of the program, Fund purchases are reported under foreign financing. Similarly, funding by the World Bank for 2014 has been secured and is reported in foreign financing.

Table 2b. Albania: General Government Operations, 2009–19
(Billions of leks)

	2009	2010	2011	2012	2013	2014		2015		2016	2017	2018	2019
						EBS/ 14/71	Rev. Prog.	EBS/ 14/71	Prog.				
Total revenue and grants	298.5	320.7	330.4	330.4	323.7	364.7	367.9	385.2	411.5	445.0	479.0	515.6	555.4
Tax revenue	270.8	288.6	303.9	300.9	296.4	335.0	336.8	353.9	377.1	405.3	436.3	469.6	505.8
VAT	110.1	114.0	119.2	116.5	108.5	118.4	125.8	135.3	145.0	156.0	167.9	180.9	180.9
Profit tax	17.1	17.6	19.7	16.9	15.1	23.0	21.9	24.3	23.5	25.2	27.1	29.2	31.4
Excise tax	33.5	38.8	40.4	36.4	38.2	48.4	44.5	51.1	51.7	57.0	61.4	66.0	71.1
Personal income tax	26.8	27.1	28.0	28.0	29.6	28.5	28.2	30.1	35.3	37.8	40.7	43.8	47.1
Customs duties	7.9	7.3	6.9	6.1	5.8	5.9	5.9	6.2	6.2	6.6	7.1	7.6	8.2
Other taxes	13.4	18.3	21.4	28.7	28.5	36.4	34.2	38.4	42.7	45.7	49.2	53.0	57.0
Local government revenue 1/	12.1	11.9	11.8	10.9	10.8	10.7	12.8	11.0	13.5	14.4	15.5	16.7	18.0
Social insurance contributions	49.8	53.6	56.6	57.4	60.0	63.8	63.5	67.5	68.9	73.7	79.3	85.4	91.9
Non-tax revenue	23.2	27.5	22.7	24.0	21.6	21.2	22.6	22.3	24.4	26.9	28.9	31.2	33.6
Grants	4.4	4.6	3.8	5.6	5.7	8.5	8.5	9.0	12.0	12.8	13.8	14.9	16.0
Total expenditure	375.7	358.7	376.2	376.2	394.1	458.5	449.0	472.1	483.6	503.3	521.7	573.0	616.2
Current expenditure	283.4	300.9	305.6	314.6	328.6	349.6	357.0	378.6	387.2	406.7	436.1	481.5	522.3
Personnel cost	62.4	65.8	67.4	69.4	70.7	74.0	73.7	75.3	76.3	81.6	87.9	94.6	101.9
Interest	36.3	41.6	41.1	41.5	43.3	46.4	39.7	60.5	49.3	51.7	54.4	55.4	55.4
Operations & maintenance	32.1	34.3	33.0	33.5	32.4	35.3	37.5	37.3	39.7	42.4	45.7	49.2	53.0
Subsidies	2.0	3.5	3.3	1.9	1.6	1.6	9.2	1.7	16.5	11.3	11.8	28.0	38.1
Energy	...	...	...	...	...	...	7.0	...	13.1	8.8	5.8	4.8	1.3
Nonenergy	...	...	...	...	...	...	0.6	...	1.7	0.6	4.0	21.0	34.5
Other	...	...	...	...	...	1.6	1.6	1.7	1.8	1.9	2.0	2.2	2.3
Social insurance outlays	96.7	106.2	113.9	120.3	127.6	136.3	135.9	144.2	143.7	153.7	165.4	178.0	191.7
Local government expenditure	33.6	30.8	28.1	27.3	29.8	33.1	37.2	35.3	37.2	39.7	42.7	46.0	49.5
Social protection transfers	20.4	18.7	18.7	20.7	23.2	22.9	23.8	24.2	24.5	26.2	28.2	30.4	32.7
Of which: Compensation for the poor (electricity, other)	...	...	...	...	...	...	0.0	...	1.6	1.7	1.8	2.0	2.1
Capital expenditure	90.4	63.4	70.6	61.7	65.5	67.3	56.1	73.5	67.9	71.6	77.1	83.0	89.4
Lending minus repayment	1.8	-5.6	0.0	0.0	0.0	0.0	0.0	0.0	3.0	4.0	4.0	4.0	0.0
Reserve and contingency funds 2/	0.0	0.0	0.0	0.0	0.0	6.6	0.9	0.0	5.5	4.5	4.5	4.5	4.5
Repayment of end-2013 stock of unpaid bills and arrears	...	...	...	...	...	35.0	35.0	20.0	20.0	16.5	0.0	0.0	0.0
Unidentified measures (cumulative)	...	...	...	...	...	0.0	0.0	17.2	0.0	17.2	34.3	49.9	63.2
Overall balance	-77.2	-38.0	-45.7	-45.9	-70.4	-93.8	-81.1	-69.7	-72.1	-41.0	-8.4	-7.5	2.3
Financing	77.2	38.0	45.7	45.9	70.4	93.8	81.1	52.5	72.1	27.1	8.4	7.5	-2.3
Domestic	78.0	-5.5	26.1	26.5	59.6	33.8	38.2	27.9	11.8	13.4	5.3	-1.2	-9.2
Privatization receipts	30.7	4.5	0.4	1.2	16.7	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	45.1	-11.4	28.2	24.8	46.3	33.4	38.1	27.9	11.8	13.4	5.3	-1.2	-9.2
Of which: banks	...	...	...	...	...	16.7	19.1	14.0	5.9	6.7	2.6	-0.6	-4.6
Other	2.2	1.5	-2.5	0.5	-3.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	4.7	47.6	19.7	19.4	10.8	60.0	42.9	24.6	60.3	13.7	3.1	8.7	6.9
Accumulation of arrears 3/	-5.5	-4.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap (+gap) 4/	...	...	...	...	...	0.0	0.0	17.1	0.0	13.9	0.0	0.0	0.0
World Bank	...	...	...	...	...	0.0	0.0	10.1	0.0	10.4	...	...	...
Residual financing (e.g., EU)	...	...	...	...	...	0.0	0.0	7.0	0.0	3.5	...	...	...
IMF	...	...	...	...	...	0.0	0.0	0.0	0.0	0.0	...	...	...
Memorandum Items:													
Primary balance	-40.9	3.6	-4.6	-4.4	-27.1	-47.4	-41.4	-9.2	-22.8	10.7	46.1	47.9	57.7
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears	...	...	...	...	...	-58.8	-46.1	-49.7	-52.1	-24.5	-8.4	-7.5	2.3
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears, and energy sector subsidies	...	...	...	...	...	...	-39.0	...	-34.4	-10.0	3.3	3.3	5.7
Overall balance excl. repayment of end-2013 stock of unpaid bills and arrears, and new guarantees	...	...	...	...	...	...	-38.5	...	-37.4	-15.1	1.4	18.4	38.1
Current balance excl. grants	10.7	15.2	21.0	10.2	-10.7	3.3	2.0	14.9	9.5	40.5	61.2	66.9	77.9
Public Debt	682.6	715.5	772.7	828.3	956.6	1006.7	1003.7	1056.3	1055.8	1080.4	1088.7	1096.2	1093.9
Domestic	415.0	407.5	438.8	470.6	592.7	582.9	596.9	590.8	588.7	585.7	590.9	589.7	580.5
Of which: Unpaid bills and arrears	...	...	...	...	...	71.5	36.5	36.5	16.5	16.5	0.0	...	...
External	267.5	308.0	333.9	357.6	363.9	423.7	406.8	465.5	467.1	494.7	497.8	506.5	513.4
Direct government external debt	227.3	268.1	294.3	319.8	332.5	388.1	378.4	425.7	440.4	471.0	473.7	466.3	441.6
Government guaranteed external debt	40.3	39.9	39.7	37.8	31.4	35.6	28.4	39.7	26.7	23.8	24.1	40.2	71.8

Sources: Albanian authorities; and IMF staff estimates and projections.

1/ It includes the property tax, the simplified profit tax for small businesses, and other local taxes.

2/ Spending contingencies are reported according to their economic classification at outturn.

3/ As reflected in official data and not accounting for arrears accumulated outside of the budget prior to 2014.

4/ Following the approval of the program, Fund purchases are reported under foreign financing. Similarly, funding by the World Bank for 2014 has been secured and is reported in foreign financing.

Table 3a. Albania: Balance of Payments, 2009–19
(Percent of GDP)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	Projection										
Current account	-15.9	-11.3	-13.2	-10.2	-10.6	-14.0	-15.2	-15.1	-13.4	-10.6	-8.9
Balance of goods and services	-25.1	-20.6	-22.7	-18.7	-17.8	-19.7	-20.7	-20.6	-18.9	-16.0	-14.2
Trade Balance (goods)	-26.5	-23.2	-24.2	-20.9	-17.7	-25.4	-26.2	-26.3	-25.1	-23.0	-21.9
Exports	8.6	13.0	15.2	15.9	18.0	11.8	11.3	11.4	11.6	11.9	12.3
Of which: Energy	1.1	2.3	3.2	4.2	5.6	4.5	4.0	4.0	4.0	4.1	4.1
Imports	35.2	36.2	39.4	36.8	35.7	37.1	37.5	37.6	36.7	34.9	34.2
Of which: Energy	6.6	4.3	5.2	7.1	7.7	6.2	6.1	4.8	4.6	4.4	4.1
Services (net)	1.4	2.6	1.5	2.2	-0.2	5.6	5.6	5.7	6.2	7.0	7.7
Income balance	-1.6	-1.0	-0.3	-0.7	0.2	-0.9	-1.2	-1.1	-1.1	-1.1	-1.0
Of which: Interest due	0.5	0.6	1.0	1.0	0.5	0.9	1.2	1.1	1.1	1.1	1.1
Current transfers	10.8	10.3	9.8	9.2	7.0	6.6	6.7	6.7	6.6	6.5	6.3
Capital and Financial account	11.8	9.7	10.3	8.1	8.6	9.9	7.0	11.7	11.3	8.8	7.1
Capital transfers	1.0	1.0	0.9	0.9	0.5	0.7	0.9	0.7	0.7	0.6	0.6
Direct investment, net	7.9	8.8	6.6	6.8	9.5	8.3	10.2	11.3	10.3	8.1	7.2
Private borrowing, net	0.7	1.0	2.6	0.5	-0.2	1.3	1.3	1.3	1.3	1.3	1.3
Government Medium- and long-term loans, net	3.5	2.5	1.6	2.1	1.1	1.2	-2.0	0.3	0.0	-0.3	-1.1
Project loans	4.0	5.1	2.2	2.8	1.8	2.3	2.2	1.8	1.6	1.3	0.7
Amortization (includes Eurobond bullet payment)	-0.5	-2.7	-0.6	-0.6	-0.8	-1.1	-4.2	-1.4	-1.5	-1.5	-1.7
Government Guaranteed Borrowing, net	0.4	-0.1	0.0	-0.1	-0.2	-0.2	-0.1	-0.2	0.0	0.8	1.5
Disbursement	0.6	0.1	0.2	0.1	0.1	0.0	0.1	0.0	0.2	1.1	1.6
Amortization	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1
Other flows	-1.8	-3.4	-1.3	-2.0	-2.1	-1.3	-3.2	-1.8	-1.1	-1.7	-2.3
Of which: Changes in commercial bank NFA	-1.9	-1.5	-1.0	-2.1	-2.4	-2.0	-2.5	-2.5	-2.5	-2.3	-2.1
Errors and omissions ^{2/}	3.8	3.0	2.6	2.9	3.1	3.0	2.9	2.8	2.7	2.6	2.5
Net balance	-0.3	1.3	-0.3	0.8	1.1	-1.0	-5.3	-0.6	0.6	0.8	0.7
Available financing	0.3	1.3	0.3	-0.8	-1.1	1.0	5.3	0.6	-0.6	-0.8	-0.7
Change in net reserves (increase = -) ^{3/}	0.3	-2.0	0.3	-0.8	-1.1	-1.2	-1.3	-1.1	-0.9	-0.8	-0.7
IMF (budget support)	...	...	...	...	...	0.5	1.4	0.9	0.3	0.0	0.0
World Bank (DPL)	...	...	...	...	...	1.7	0.0	0.0	0.0	0.0	0.0
World Bank (PBG)	...	...	...	...	...	0.0	2.3	0.0	0.0	0.0	0.0
Commercial loans (eurobond)	...	3.3	0.0	0.0	0.0	0.0	2.8	0.0	0.0	0.0	0.0
Prospective financing ^{4/}	...	...	...	...	...	...	...	0.9	...	...	...
Expected EU Macro-Financial Assistance	...	...	...	...	...	...	...	0.2	...	...	...
IFIs (World Bank inc. PBG, EU)	...	...	...	...	...	...	...	0.7	...	...	...
Other	...	...	...	...	...	...	...	0.0	...	...	...
Memorandum items:											
Exports of Goods and Services (percent of GDP)	28.4	32.5	34.0	33.4	35.0	36.3	36.0	36.1	36.5	37.0	37.6
Imports of Goods and Services (percent of GDP)	53.6	53.2	56.8	52.1	52.9	56.1	56.7	56.7	55.3	53.0	51.8
Current Account (percent of GDP)											
excluding TAP, Statkraft related imports	-15.9	-11.3	-13.2	-10.2	-10.6	-13.4	-13.1	-12.1	-11.1	-10.0	-8.9
Balance of goods and services											
excluding TAP, Statkraft related imports	-25.1	-20.6	-22.7	-18.7	-17.8	-19.2	-18.6	-17.6	-16.6	-15.4	-14.2

Sources: Ministry of Finance; Bank of Albania; donors; and IMF staff estimates and projections.

1/ Historical data 2009-13 reflect old BPM5 estimates which include insourcing services as goods. 2014 onwards reflect BPM6 based data and projections.

2/ Includes unidentified flows of private transfers, which are projected to decline gradually over the medium term with the decline in remittances as a share of GDP.

3/ Net of valuation changes in 2009–13. In projections for 2014–19, valuation effects are assumed to be zero.

4/ Following the approval of the program, Fund purchases are reported under available financing. Similarly, funding by the World Bank for 2014–15 has been secured and is reported in available financing.

Table 3b. Albania: Balance of Payments, 2009–19
(Millions of euros)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	Projection										
Current account	-1,383	-1,019	-1,225	-978	-1,036	-1,411	-1,612	-1,711	-1,634	-1,398	-1,256
Balance of goods and services	-2,183	-1,851	-2,107	-1,786	-1,737	-1,995	-2,196	-2,339	-2,305	-2,107	-2,007
Trade Balance (goods)	-2,304	-2,083	-2,242	-1,999	-1,720	-2,563	-2,788	-2,982	-3,061	-3,024	-3,101
Exports	751	1,172	1,406	1,526	1,756	1,188	1,201	1,289	1,416	1,567	1,737
Of which: Energy	92	210	297	407	545	458	428	452	487	532	579
Imports	3,054	3,254	3,647	3,525	3,476	3,751	3,989	4,271	4,477	4,591	4,837
Of which: Energy	574	385	477	682	754	631	649	539	558	572	587
Services (net)	121	232	135	213	-18	568	592	644	756	917	1,093
Income balance	-138	-90	-25	-72	21	-86	-131	-129	-140	-139	-135
Of which: Interest due	45	50	92	94	51	91	126	122	137	146	150
Current transfers	938	922	906	880	680	670	715	757	811	848	887
Capital and Financial account	1,022	872	954	779	838	1,004	741	1,328	1,377	1,162	1,007
Capital transfers	85	86	85	81	48	70	90	85	85	85	85
Direct investment, net	689	789	609	648	923	835	1,080	1,280	1,259	1,063	1,015
Private borrowing, net	62	88	237	48	-15	130	137	146	157	169	182
Government Medium- and long-term loans, net	302	222	152	205	105	120	-214	36	4	-36	-153
Project loans	344	461	206	268	180	234	230	199	189	166	94
Amortization (includes Eurobond bullet payment)	-42	-239	-54	-62	-74	-114	-444	-164	-186	-202	-247
Government Guaranteed Borrowing, net	37	-8	-4	-12	-17	-19	-11	-19	2	106	206
Disbursement	52	12	16	10	5	4	13	4	26	138	225
Amortization	15	20	21	22	22	22	24	24	24	32	19
Other flows	-152	-303	-125	-191	-206	-132	-341	-199	-130	-225	-328
Of Which: Changes in commercial bank NFA	-167	-136	-90	-197	-230	-200	-270	-280	-300	-300	-300
Errors and omissions 2/	331	267	243	276	301	303	308	318	330	342	354
Net balance	-29	121	-29	77	103	-104	-563	-65	73	105	105
Available financing	29	121	29	-77	-104	104	563	73	-73	-105	-105
Change in net reserves (increase = -) 3/	29	-179	29	-77	-104	-118	-135	-124	-106	-105	-105
IMF (budget support)	...	...	...	...	...	53	153	98	33	0	0
World Bank (DPL)	...	...	...	...	...	168	0	0	0	0	0
World Bank (PBG)	...	...	...	...	...	...	245	...	...	...	...
Commercial loans (eurobond)	...	300	0	0	0	0	300	0	0	0	0
Prospective financing 4/	...	...	...	...	...	...	...	99	...	...	...
Expected EU Macro-Financial Assistance	...	...	...	...	...	...	...	25	...	...	...
IFIs (World Bank inc. PBG, EU)	...	...	...	...	...	...	...	74	...	...	...
Other	...	...	...	...	...	...	...	0	...	...	...
Memorandum items:											
Nominal GDP	8,683	8,978	9,261	9,573	9,734	10,100	10,631	11,348	12,205	13,137	14,161
Gross international reserves	1,645	1,904	1,913	1,972	2,015	2,148	2,278	2,398	2,498	2,598	2,698
(months of imports of goods and services)	4.1	4.3	4.6	4.6	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Balance of goods and services (percent of GDP)	-25.1	-20.6	-22.7	-18.7	-17.8	-19.7	-20.7	-20.6	-18.9	-16.0	-14.2
Current account (percent of GDP)	-15.9	-11.3	-13.2	-10.2	-10.6	-14.0	-15.2	-15.1	-13.4	-10.6	-8.9
Debt service (percent of exports of goods and services) 5/	2.8	2.2	1.3	0.5	-0.1	2.9	12.7	4.6	4.5	4.5	4.1
Debt service (percent of central government revenues) 5/	3.2	2.9	1.8	0.6	-0.1	4.4	18.8	6.8	6.7	6.9	6.3
Total external debt stock (percent of GDP) 6/	33.8	33.6	34.8	35.6	34.3	36.7	39.8	40.5	42.0	39.3	36.0
Exports of Goods and Services (millions of Euros)	2,469	2,922	3,153	3,199	3,411	3,667	3,832	4,093	4,450	4,860	5,323
Imports of Goods and Services (millions of Euros)	4,652	4,773	5,260	4,985	5,149	5,662	6,028	6,432	6,755	6,968	7,330
Volume of Exports of Goods and Services (percent change)	0.9	10.8	1.7	-2.3	5.5	14.2	5.6	4.8	6.7	7.1	7.4
Volume of Imports of Goods and Services (percent change)	-2.1	-8.0	3.3	-7.7	4.1	11.8	7.4	5.7	4.2	2.2	4.1
Terms of trade (percent change) 7/	-1.9	-4.2	-0.5	1.1	1.9	-4.3	-0.1	0.9	1.0	1.1	1.0

Sources: Ministry of Finance; Bank of Albania; donors; and IMF staff estimates and projections.

1/ Historical data 2009-13 reflect old BPM5 estimates which include insourcing services as goods. 2014 onwards reflect BPM6 based data and projections.

2/ Includes unidentified flows of private transfers, which are projected to decline gradually over the medium term with the decline in remittances as a share of GDP.

3/ Net of valuation changes in 2009-13. In projections for 2014-19, valuation effects are assumed to be zero.

4/ Following the approval of the program, Fund purchases are reported under available financing. Similarly, funding by the World Bank for 2014-15

has been secured and is reported in available financing.

5/ Public and publicly guaranteed debt only.

6/ Public and private external debt, including arrears. Debt stock converted into Lek at the e-o-p exchange rate.

7/ Fund Staff estimates and projections.

Table 4a. Albania: Monetary Survey, 2009–15
(In billions of leks, unless otherwise indicated; end-period)

	2009	2010	2011	2012	2013	2014		2015
						Prog.	Rev. Prog.	
Net foreign assets	244	339	389	451	479	511	518	576
Bank of Albania	214	253	256	267	274	288	286	305
Commercial banks	30	87	133	185	205	222	232	271
Net domestic assets	627	641	681	672	670	686	674	682
Ceiling on general government guarantees								
Claims on central government, net	336	341	359	351	363	380	382	395
Bank of Albania	66	55	54	52	43	43	42	42
Commercial banks	270	285	305	299	320	337	340	353
Claims on public enterprises	12	9	19	24	25	25	25	25
Claims on the private sector	422	465	513	521	513	527	529	553
In leks	133	149	177	192	195	200	201	210
In foreign currency	289	316	336	328	318	326	328	343
Other items, net	-144	-174	-212	-223	-235	-246	-262	-291
Broad money	871	980	1,070	1,123	1,149	1,196	1,192	1,259
Currency outside banks	209	195	195	193	199	207	209	220
Deposits	662	785	875	931	950	989	984	1,038
Domestic currency	369	409	452	477	494	515	512	540
Foreign currency	293	376	423	454	456	474	472	498
Memorandum items:								
Broad money growth (% change)	6.8	12.5	9.2	5.0	2.3	4.1	3.8	5.5
Reserve money growth (% change)	4.8	-0.5	2.2	2.7	3.5	3.8	3.4	5.3
Private sector credit growth (% change)	10.3	10.1	10.4	1.4	-1.4	2.6	3.1	4.5
Broad money (as percent of GDP)	76.2	79.1	82.3	84.1	84.1	85.7	84.3	84.3
Private sector credit (as percent of GDP)	36.9	37.5	39.5	39.0	37.6	37.7	37.4	37.1
Velocity (nominal GDP/broad money)	1.3	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Money multiplier (absolute values)	3.1	3.5	3.7	3.8	3.7	3.7	3.7	3.7
Currency (as share of broad money)	24.0	19.9	18.2	17.2	17.3	17.3	17.5	17.5
Foreign currency deposits/total deposits	44.3	47.9	48.3	48.8	48.0	48.0	48.0	48.0
Gross reserves (millions of euros)	1,645	1,904	1,913	1,972	2,015	2,102	2,148	2,278

Sources: Bank of Albania; and IMF staff estimates.

Table 4b. Albania: Summary of Accounts of the Central Bank, 2009–15
(In billions of leks, unless otherwise indicated; end-period)

	2009	2010	2011	2012	2013	2014		2015 Prog.
						Prog.	Rev. Prog.	
Net foreign assets	214	253	256	267	274	288	286	305
Assets	236	275	276	288	294	308	313	332
Liabilities	22	22	21	22	20	19	27	26
		1						
Net domestic assets	70	31	34	31	34	31	33	30
Ceiling on general government guarantees								
Domestic credit	100	70	81	75	66	64	65	62
Net claims on central government	66	55	54	52	43	43	42	42
Assets	77	64	64	65	65	65	64	64
Liabilities	11	9	10	13	22	22	22	22
Other credit	34	14	27	24	23	21	23	21
Private sector	2	2	2	2	2	2	2	2
Commercial banks	32	13	25	22	22	19	21	19
Other items, net (assets = +)	-30	-39	-47	-44	-32	-32	-32	-32
Reserve money	285	283	290	298	308	320	319	336
Currency in circulation	209	195	195	193	199	207	209	220
Bank reserves	76	88	95	105	109	113	110	115
Other nonbank deposits	0	0	0	0	0	0	0	0

Sources: Bank of Albania; and IMF staff estimates.

Table 5. Albania: IMF Core Indicators of Financial Soundness, December 2007–September 2014

	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
I Capital-based																
(i) Regulatory capital as a percent of risk-weighted assets	17.1	17.2	16.2	15.4	15.6	15.9	15.7	15.9	16.2	16.8	17.0	17.8	18.0	17.9	17.5	17.6
(ii) Regulatory Tier 1 capital as a percent of risk-weighted assets	16.0	16.3	15.3	14.5	14.3	14.7	14.5	14.5	14.6	15.2	15.4	14.8	14.9	14.8	14.5	14.5
(iii) Capital as a percent of total assets																
Regulatory Tier 1 capital as a percent of total assets	5.8	6.7	8.7	8.6	8.1	8.3	8.0	7.9	7.9	8.2	7.9	7.7	7.7	7.6	7.5	7.6
Regulatory capital as a percent of total assets	6.2	7.0	9.2	9.1	8.8	9.0	8.6	8.6	8.8	9.0	8.8	9.2	9.3	9.2	9.0	9.2
Shareholders' equity as a percent of total assets	7.6	8.6	9.6	9.4	8.7	8.7	8.6	8.5	8.6	8.6	8.5	8.3	8.4	8.4	8.3	8.5
(iv) Nonperforming loans net of provisions as a percent of capital																
As a percent of regulatory Tier 1 capital	12.0	27.2	29.9	38.1	56.6	58.8	60.5	64.9	61.8	62.8	62.5	54.7	48.5	50.7	49.0	53.0
As a percent of regulatory capital	11.2	25.7	28.2	35.9	52.0	54.2	55.8	59.5	55.6	57.0	56.4	45.4	40.2	41.8	40.5	43.8
As a percent of shareholders' equity	9.1	21.1	27.1	34.8	52.6	56.0	56.3	60.8	56.9	59.4	58.4	50.7	44.8	45.8	44.2	47.3
(v) Return on equity (ROE) (annual basis)	20.7	11.4	4.6	7.6	0.8	8.0	4.8	4.2	3.8	5.2	2.9	-1.7	6.4	17.2	10.4	11.0
(vi) Net open position in foreign exchange as a percent of capital																
As a percent of regulatory Tier 1 capital	1.8	4.5	4.1	5.3	4.3	4.3	6.5	4.5	4.1	4.0	4.5	5.2	4.9	7.8	5.9	8.3
As a percent of regulatory capital	1.7	4.3	3.9	5.0	3.9	4.0	6.0	4.1	3.7	3.6	4.0	4.3	4.1	6.5	4.9	6.8
As a percent of shareholders' equity	1.4	3.5	3.7	4.9	4.0	4.1	6.1	4.2	3.8	3.8	4.2	4.8	4.5	7.1	5.3	7.4
II Asset-based																
(vii) Liquid assets as a percent of total assets (Liquid-asset ratio) 1/	49.8	42.8	27.6	25.9	26.5	29.0	35.9	29.0	29.4	29.4	27.4	29.2	27.6	30.9	32.7	32.4
(viii) Liquid assets as a percent of short-term liabilities 1/	55.6	104.7	32.6	30.6	33.1	36.1	36.0	35.8	34.9	34.9	33.8	36.5	34.7	39.1	41.4	41.2
(ix) Return on assets (ROA) (net income to average total assets, annual)	1.6	0.9	0.4	0.7	0.1	0.7	0.4	0.4	0.3	0.4	0.3	-0.1	0.5	1.5	0.9	0.9
(x) Nonperforming loans (gross) as a percent of total loans	3.4	6.6	10.5	14.0	18.8	20.1	21.1	22.7	22.5	23.7	24.2	24.2	23.5	24.0	24.1	25.0
III Income and expense-based																
(xii) Interest margin to gross income	92.7	106.5	119.6	118.9	147.7	119.7	129.5	130.6	130.4	123.6	131.2	148.3	112.6	95.4	106.0	109.6
(xiii) Noninterest expenses to gross income	58.5	69.6	83.0	75.5	91.3	71.7	80.4	82.2	85.0	78.7	87.5	98.3	74.7	54.7	66.0	95.7
IV Memorandum items																
Other (noncore) indicators:																
Customer deposits as a percent of total (non-interbank) loans	215.5	162.6	154.3	166.4	163.2	164.0	168.1	172.3	171.6	171.9	173.9	180.9	180.8	183.0	183.3	181.9
Foreign currency-denominated loans to total loans	72.5	72.6	70.2	69.8	67.9	68.2	67.1	66.5	64.5	64.8	64.5	63.7	63.0	62.6	62.1	62.1
Foreign currency-denominated liabilities as a percent of total liabilities	46.9	48.5	48.9	51.0	51.9	52.1	52.3	53.7	52.6	52.4	51.8	52.9	52.8	52.5	52.4	52.7
Other indicators:																
Risk weighted assets as a percent of total assets	36.4	40.8	56.7	59.2	56.5	56.3	55.2	54.5	54.2	53.7	51.7	52.0	52.1	51.5	51.6	52.5
Total loans as a percent of total assets	39.4	47.6	50.8	49.6	50.5	50.2	49.4	48.5	48.6	48.6	48.1	46.0	45.9	45.2	45.2	45.4
Total loans as a percent of shareholders' equity	516.4	555.1	530.2	527.0	581.9	578.8	575.5	573.6	567.4	562.4	566.7	555.0	548.8	536.2	544.9	531.1

Source: Data provided by Bank of Albania.

1/ Definition of liquid assets and short term liabilities were changed in October 2009.

Table 6a. Albania: Current Schedule of Reviews and Purchases 1/

Date	Amount (millions of SDR)	In Percent of Quota	Conditions
February 28, 2014	23.55	39.3	Board approval of arrangement
June 27, 2014	23.55	39.3	Observance of end-March 2014 and continuous performance criteria and completion of first review
September 15, 2014	23.55	39.3	Observance of end-June 2014 and continuous performance criteria and completion of second review
December 15, 2014	23.55	39.3	Observance of end-September 2014 and continuous performance criteria and completion of third review
March 27, 2015	28.88	48.1	Observance of end-December 2014 and continuous performance criteria and completion of fourth review
June 28, 2015	28.88	48.1	Observance of end-March 2015 and continuous performance criteria and completion of fifth review
December 10, 2015	28.88	48.1	Observance of end-September 2015 and continuous performance criteria and completion of sixth review
June 28, 2016	57.29	95.5	Observance of end-March 2016 and continuous performance criteria and completion of seventh review
December 15, 2016	57.29	95.5	Observance of end-September 2016 and continuous performance criteria and completion of eighth review
Total	295.42	492.4	

1/ Albania's IMF quota: SDR 60 million.

Table 6b. Albania: Proposed Schedule of Reviews and Purchases 1/ 2/

Date	Amount (millions of SDR)	In Percent of Quota	Conditions
February 28, 2014	23.55	39.3	Board approval of arrangement
June 28, 2014	23.55	39.3	Observance of end-March 2014 and continuous performance criteria and completion of first review
September 15, 2014	...	...	Observance of end-June 2014 and continuous performance criteria and completion of second review
December 15, 2014 ^{3/}	47.1	78.5	Observance of end-September 2014 and continuous performance criteria and completion of second and third reviews
April 15, 2015	28.88	48.1	Observance of end-December 2014 and continuous performance criteria and completion of fourth review
July 15, 2015	28.88	48.1	Observance of end-April 2015 and continuous performance criteria and completion of fifth review
November 15, 2015	28.88	48.1	Observance of end-August 2015 and continuous performance criteria and completion of sixth review
March 15, 2016	28.65	47.75	Observance of end-December 2015 and continuous performance criteria and completion of seventh review
July 15, 2016	28.65	47.75	Observance of end-April 2016 and continuous performance criteria and completion of eighth review
November 15, 2016	28.65	47.75	Observance of end-August 2016 and continuous performance criteria and completion of ninth review
February 15, 2017	28.63	47.71	Observance of end-November 2016 and continuous performance criteria and completion of tenth review
Total	295.42	492.4	

1/ Albania's IMF quota: SDR 60 million.

2/ At the time of the last review ((IMF Country Report 14/211), the program envisaged moving from a quarterly review schedule to a semiannual review schedule following the fourth review. The proposed rephasing envisages reviews every four months following the fourth review.

3/ Purchases sum the total available upon completion of the second and third reviews.

Table 7. Albania: Indicators to Capacity to Repay to the Fund, 2012–19 ^{1/ 2/}
 (under Obligated Repurchase Schedule)
 (In millions of SDRs)

	2012	2013	2014	2015	2016	2017	2018	2019
	Projections							
Fund repurchases and charges								
In millions of SDRs	6.8	6.8	6.1	6.2	6.1	7.3	10.5	20.6
In millions of euro	8.0	7.6	6.9	7.0	6.9	8.2	11.8	23.3
In percent of gross international reserves	0.4	0.4	0.4	0.3	0.3	0.4	0.5	0.9
In percent of exports of goods and services	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.4
In percent of GDP	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2
In percent of external public debt	0.3	0.3	0.2	0.2	0.2	0.2	0.3	0.6
In percent of quota	11.3	11.3	10.1	10.3	10.2	12.1	17.4	34.4
Fund credit outstanding (end of period)								
In millions of SDRs	23.2	16.4	57.7	187.1	270.1	296.8	291.7	277.3
In millions of euro	27.2	18.4	66.0	213.4	307.2	336.5	330.0	312.8
In percent of gross international reserves	1.4	0.9	3.3	10.3	14.0	14.7	13.8	12.7
In percent of exports of goods and services	0.9	0.5	1.8	5.6	7.5	7.6	6.8	5.9
In percent of GDP	0.3	0.2	0.7	2.0	2.7	2.8	2.5	2.2
In percent of external public debt	1.0	0.7	2.3	6.4	8.6	8.4	8.3	8.2
In percent of quota	38.7	27.3	96.1	311.8	450.2	494.6	486.2	
Memorandum items:								
Gross international reserves	1691	1803	1730	1822	1926	2017	2115	2188
Exports of goods and services	2727	3039	3205	3360	3599	3924	4297	4718
GDP	8163	8672	8826	9321	9978	10763	11614	12553
External public debt	2233	2351	2541	2928	3158	3554	3509	3376
Quota	60.0	60.0	60.0	60.0	60.0	60.0	60.0	60.0

Source: Fund staff estimates.

1/ Projections are based on current interest rates for PRGF and the EFF.

2/ End of year value.

Annex I. Albania's Energy Reform: Checkered History, but Promising Prospects

- Difficulties in Albania's electricity sector have been pervasive for many years.** The sector suffers from heavy distribution losses—because of both poor grid infrastructure and widespread theft—and a low collection rate. Domestic output relies entirely on hydropower, which creates significant weather-related vulnerability. As a result, the sector has come to rely heavily on public financial support.
- Earlier power sector reforms have had little success.** Reducing quasi-fiscal electricity losses was a key component of Albania's PRGF-EFF arrangement (2006–2009), but the reform fell short because of the authorities' reluctance to crack down on illegal use and nonpayment. Tariff adjustments were frequently delayed, leaving rates well below cost recovery and exacerbating financial pressures.
- The privatization of the distribution company in 2009 also failed to meet expectations.** The new owner (a Czech utility, CEZ) was not successful in reducing losses or improving collections either, and quickly found itself at odds with the government over tariff adjustments and non-payment of bills by budgetary institutions. Investments to upgrade outdated distribution infrastructure and expand metering also did not move ahead as planned, and distribution losses exceeded 50 percent by 2012. In late 2012, the authorities revoked CEZ's operating license; following arbitration, the state formally resumed ownership of the distribution company in mid-2014. However, this has again left the government as the sole financial backstop for the sector—guaranteed loans are set to exceed 3 percent of GDP by end of 2014.

4. The authorities are committed to a comprehensive reform plan, supported by the World Bank. There is a clear political commitment at the highest level of government to take unpopular measures to reform the sector. Initial efforts to reduce theft, improve collections and increase tariffs have yielded some encouraging results to date. The plan focuses on three key areas, with a target to make the sector self-sustaining by 2019:

- Reducing distribution losses and improving collection.** In October, a campaign was launched to enforce criminal penalties for electricity theft and disconnect service for nonpayment, backed by legal changes that make electricity theft punishable by imprisonment. This will be supported by targeted investments, under a World Bank supported project, in metering, grid infrastructure, and upgrades to the commercial billing and collection system. Distribution losses in 2014 are estimated at 38 percent; the authorities aim for 15 percent by 2019.

	Energy Sector Support (Percent of GDP)					
	2014	2015	2016	2017	2018	2019
Energy sector support	0.5	1.2	0.9	0.7	0.6	0.2
Subsidies (for KESH, OshEE)	0.5	0.9	0.6	0.3	0.3	0.1
Foreign financed	0.5	0.9	0.6	0.3	0.3	0.1
Baseline losses	0.5	0.5	0.5	0.3	0.2	
KESH overdraft 1/		0.3				
KESH arrears to small HPPs 2/		0.1	0.1	0.1	0.1	0.1
New external guarantees	0.0	0.0	-	-	-	-
Compensation of the poor	-	0.1	0.1	0.1	0.1	0.1
Net lending		0.2	0.3	0.2	0.2	

Note: 1/ Total outstanding is 10.5 bn (as of Oct 2014). 2/ Total outstanding is 6.5bn (as of Oct 2014).

Source: Albanian authorities and IMF staff estimates.

- **Tariff adjustments.** An immediate adjustment to cost recovery would require an excessively large one-time increase. The authorities plan to move tariffs to cost recovery in several steps, with the first increase set to go into effect at the start of 2015. In 2015 there will also be restructuring of the household tariff to eliminate the widely abused subsidized lower block, an increase in the average tariff for commercial users, and a move toward market pricing for wholesale purchases from independent power producers. Tariff adjustments in 2015 and beyond will be combined with increased targeted transfers, to compensate the most vulnerable social groups.
- **Market liberalization.** A new power sector law will go into effect in 2015:Q1 that sets in place a schedule for the sector's further liberalization, in line with EU's 2009 Electricity Directive. All medium voltage customers will be moved out of the regulated tariff structure by end-2017, beginning with 35KV customers on January 1, 2016. By 2018, the share of de-regulated consumption is expected to increase from 13 to 40 percent.

Appendix I. Letter of Intent

Tirana, January 27, 2015

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C., 20431

Dear Ms. Lagarde:

1. The Extended Arrangement approved on February 28, 2014, by the Executive Board of the International Monetary Fund (IMF) is the main anchor of our economic policies. The attached Memorandum of Economic and Financial policies (MEFP) reviews progress in implementing the program, and outlines the policies that the government and the Bank of Albania will pursue during 2015.
2. Performance under the program has been satisfactory so far. All end-June and end-September quantitative performance criteria were met. However, the continuous performance criterion on the accumulation of external arrears was missed because of irregularities in the authentication of signatories. The outstanding amount has since been repaid. We are currently awaiting data to assess two end-December performance criteria (a waiver of applicability is being requested for the ceilings on general government overall cash deficit and expenditure); we expect these to be met. The indicative target on accumulation of new arrears was missed by a small margin, and inflation was slightly below the inner band prescribed under the inflation consultation clause. We are reinforcing internal controls and implementing ambitious PFM reforms to ensure that the government meets its payment obligations on a timely basis. Moreover, the Bank of Albania and Fund staff agreed that given the policy of cautious monetary easing and forward guidance, there is no need for other policy action regarding inflation. The Bank of Albania expects inflation to converge to the medium-term target and is expanding the use of forward guidance to align expectations to its monetary policy objective. As regards structural reforms, one structural benchmark related to the hiring of an external auditor to conduct verification of arrears payments on tax refunds has been delayed due to funding constraints. Another structural benchmark related to the development of a corporate strategy for medium- to long-term capacity building in GDT has been delayed because of the other work priorities related to the implementation of a new IT system. A third structural benchmark on the purchase of a new IT server for the treasury system was not met, as procurement delays have persisted. All other SBs were met, albeit with delay or partially implemented. These delays were to a considerable extent beyond our control.

3. Policy priorities for 2015 focus on pursuing fiscal consolidation while continuing with the payment of arrears, safeguarding financial sector stability and reviving credit growth, and implementing growth-enhancing reforms. In this context, we are committed to pursuing, among other things, an ambitious energy sector reform, as well as fiscal reforms in the areas of public financial management, tax administration, and expenditure policy.
4. Implementation of our program will be monitored by the Fund through reviews, quantitative performance criteria and indicative targets, as well as structural benchmarks, as described in the attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU). The reviews will assess progress in implementing the program and reach understandings on any additional measures that may be needed to achieve its objectives.
5. While we are confident that the policies described in the MEFP are adequate to achieve program objectives, we stand ready to take additional measures that may be required for this purpose. In accordance with the Fund's policies, we will consult with the Fund on the adoption of such measures in advance of revisions to the policies contained in this letter and the MEFP.
6. The government of Albania will provide the IMF with such information as it may request to monitor progress in economic and financial policy implementation.
7. In view of the strong program performance to date and the strength of policy commitments in the period ahead, we request that the Executive Board of the IMF complete the second and third reviews under the Extended Arrangement. The Albanian authorities also request: 1) a waiver for the nonobservance of a continuous performance criterion on the basis of the corrective action taken; 2) a waiver of applicability for the two performance criteria on general government overall cash deficit and expenditure, given the unavailability of end-December data for assessing quantitative targets; 3) rephrasing of future disbursements to better align missions with our internal work cycle; and 4) the purchase of SDR 47.1 million, following completion of the second and third reviews by the IMF's Executive Board. Finally, the authorities would like to request that the ceiling on Bank of Albania credit to the government be elevated to a quantitative performance criterion, starting with the end-April 2015 test date.
8. The Albanian authorities wish to make this letter available to the public, along with the attached MEFP and TMU, as well as the IMF staff report on the second and third reviews under the EFF. We therefore authorize their publication and posting on the IMF website, subject to Executive Board approval. These documents will also be posted on the official websites of the Albanian government.

Sincerely,

/s/
Shkelqim Cani
Minister of Finance

/s/
Elisabeta Gjoni
Acting Governor, Bank of Albania

/s/
Arben Ahmetaj
Minister of Economic
Development

Attachments: Memorandum of Economic and Financial Policies
 Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

1. This Memorandum lays out the government of Albania's policy priorities in the period ahead, supported by the IMF's EFF. Our policies seek to generate sustained medium-term growth that results in tangible gains, including employment generation and an improvement in the standard of living of Albanians. Achieving these goals will require continued efforts to enhance macroeconomic stability, notably, reducing debt-related vulnerabilities, by putting public finances on a sustainable footing, and unlocking structural constraints to medium-term growth.

RECENT ECONOMIC DEVELOPMENTS

2. The economy is beginning to recover. Real GDP is expected to have grown by 2.1 percent in 2014, mostly in the second half of the year. The expansion is associated with higher petroleum production, and a pickup in agriculture, trade, and manufacturing. Arrears clearance, lower interest rates, and a strong export performance in textiles and footwear have yielded a modest pickup in private demand. After a slow start early in the year, public investment picked up subsequently, while electricity production has benefitted from a turnaround in rainfall conditions.

3. External imbalances are expected to have widened in 2014. The current account deficit is estimated to have reached 14.0 percent of GDP, a 3.4 percentage point increase compared to last year, mainly because of higher demand for electricity imports due to weak rainfall in the first quarter, and higher intermediate imports. Exports of goods increased thanks to higher agriculture and textile exports. Petroleum exports, however, declined because part of the production was channeled to the recently refurbished local refinery. Remittances have continued on a declining trend, in relation to GDP. The current account deficit was financed largely by higher FDI and borrowing. Gross international reserves are sufficient to cover around 4.3 months of imports of goods and services.

4. Inflation continues to be modest. Average CPI inflation was 1.6 percent in 2014, remaining below the Bank of Albania's (BoA) medium-term target of 3 percent (with a tolerance band of ± 1 percentage point). There has been a modest pickup in inflation since 2013:Q4, but it continues to be constrained by weak price pressures from foreign trading partners, the negative output gap, and

modest wage growth. The BoA lowered its policy rate by 25 basis points in November, to a new record low of 2.25 percent.

OUTLOOK

5. Economic recovery is expected to continue in 2015, though low inflation will likely persist. Although the external environment remains weak, a continued recovery in private demand, boosted by further progress on arrears clearance and a modest pick-up in lending, is expected to help support growth. Survey results predict a steady improvement in economic confidence, as well as improving lending conditions, that should support stronger private investment. With better administrative capacity, following the transition problems experienced early in 2014, public investment is expected to recover in 2015. Still, inflation is likely to remain below the BoA target in 2015, as the economy continues to be below potential, and weak price pressures from foreign trading partners persist.

6. The external account deficit is likely to remain high in 2015. With the economy continuing to recover, imports, including those related to large infrastructure projects (TAP and Statkraft), are likely to outpace improvements in export capacity in 2015. The current account deficit will continue to rise to about 15 percent of GDP but will be financed primarily by FDI, including for large investment projects. Over the medium term, the external current account deficit will decline somewhat because of improvements in export capacity, import substitution, and lower import needs of big FDI projects.

PROGRAM IMPLEMENTATION

7. All end-June and end-September performance criteria (PCs) have been met. The PC on the general government cash deficit, excluding arrears payment, was met, thanks to good revenue performance and the under-execution of current spending (e.g., operations and maintenance, local government, and interest) and public investment (the expenditure ceiling PC was also met). We commit to achieving the end-2014 fiscal deficit and expenditure targets. The lower inner inflation band under the Inflation Consultation Clause was missed because of weak price pressures from foreign trade partners, and the persisting output gap.

8. The continuous PC on the non-accumulation of external arrears was missed. The government accumulated a small amount of external interest arrears (US\$61.7 thousand) because of perceived irregularities in the authentication of signatories, which have since been sorted out, and the payment, due in April, was eventually made in early October. We request a waiver for the nonobservance of a PC on the basis that this was a temporary oversight and has since been corrected. In addition, we have tightened enforcement of the existing regulations on contracting external debt.

9. Most quantitative Indicative Targets (IT) for end-June and end-September were also met. These include the IT on the increase in the BoA credit to the general government, and the floor on clearance of central government domestic arrears. We expect these ITs to have been met for end of December as well. However, the ceiling on accumulation of central government domestic arrears was not met. The results of a survey of five central government ministries (Health, Justice, Transport and Infrastructure, Defense, and Education and Sport) and the General Directorate of Taxation (GDT) show an accumulation of 1.1 billion lek of new arrears. The arrears accumulated in the third quarter amounted to 0.4 billion lek (about 0.03 percent of GDP). The bulk of government arrears were accumulated by the GDT and the Ministry of Transport (Albania Road Authority). All arrears accumulated in the first and second quarters were repaid in the subsequent quarters and the stock of new arrears accumulated in 2014 currently stands at zero. We will take measures to prevent future recurrence (see below), but concrete results may take time.

10. The original timeline for the auditing of arrears proved overambitious. The requirements of completing the first audit by the external auditor, initially envisaged for July, and auditing 20 percent of outstanding nontax claims, envisaged for September, were completed in November. There was a donor-related delay in the contracting of the auditor, which took place in July rather than May. The auditors' preliminary report exceeded the requirements of the two structural benchmarks (SB) because it covered about 70 percent of the nontax claims (in value) as of mid-November 2014. The preliminary report did not find major and systematic problems with the clearance process but in certain cases identified problems related to contracting and procurement at the time the projects were signed. There were challenges in following the first-in first-out principle in part because of difficulties in verifying older claims. We will review the auditors' recommendations and will prepare an action plan for the Arrears Committee to address these deficiencies by mid-

February (the action plan, once adopted, will be posted on the MoF website). The SB on the contracting of an external auditor to conduct verification of arrears payments on tax refunds has been delayed because of funding constraints, which have since been resolved. We will finance the work of the auditor with our own resources and will sign the contract by end-March 2015. The SB on the purchase of a new IT server for the treasury system, initially scheduled for end of September 2014, has been delayed until the first quarter of 2015 due to procurement delays.

11. Although other SBs experienced delays, these were for the most part warranted.

- We have finalized preparations in the treasury system (AGFIS) for the disaggregation of multi-year commitments by individual outer-year allocations, and registration of multi-year commitment limits controlled with the respective allocations. As a result, we have introduced multi-year commitment limits in the 2015 budget submitted to Parliament. However, as envisaged under the recently adopted PFM strategy supported by donors, the changes in the Procurement Law, the Financial Management and Control Law, and the Budget Law have been delayed until end-2015.
- The development of a corporate strategy for medium- to long-term capacity building at GDT, supported by IMF TA, has been delayed to March 2015 to avoid interfering with the installation of new IT software.
- The SB on the approval of a pension reform strategy was met well ahead of schedule, and the new law has become effective on January 1, 2015.
- Finally, changes to the regulatory framework for investment funds on asset valuation and liquidity requirements, initially expected by the end of September 2014, have not been completed due to the need for additional technical assistance from the IMF and World Bank. We expect these changes to be completed by June 2015.

ECONOMIC POLICIES FOR 2015

A. Fiscal Consolidation

12. We commit to continuing with fiscal consolidation, as planned, to lower debt-related vulnerabilities that hamper growth and cause macroeconomic instability. We commit to achieving the 2015 program deficit target, including new guarantees (excluding rollover), of 4.8 percent of GDP, as well as the programmed ceiling on expenditure. Doing so will allow us to bring down public debt as a share of GDP for the first time since 2010, despite the significant energy-related spending next year. Over the medium term, we are committed to lowering the public debt-to-GDP ratio (including guarantees and local government debt) to less than 60 percent by 2018 (below 64 percent by the end of the program in 2017). We also commit to limit new non-energy sector guarantees in 2015-17 to anchor the expected decline in public debt. We will work closely with our international partners, including the IMF, to strengthen our medium-term budget framework.

13. At the same time, we are implementing measures to support critical employment-generating sectors of the economy. In particular, the government has exempted from custom duties some agricultural inputs (e.g., wheat, flour, maize, poultry, animal food preparation, at the cost of 0.2 billion lek), and increased subsidies to the textile sector (0.2 billion lek). In addition, employment in public administration (e.g., police, teachers) will increase to meet pressing needs (2.5 billion lek).

14. To achieve the fiscal deficit objectives, we have adopted a package of fiscal adjustment measures. On the revenue side, the measures include:

- i) increase in the excise tax on cigarettes from 90 lek to 110 lek (savings of 4 billion lek, including VAT impact);
- ii) increase in the circulation tax (national tax) on gasoline and diesel by 10 lek per liter (savings of 6.7 billion lek, including VAT impact); and
- iii) increase in the withholding tax for interest, rent, dividends, and capital gains from 10 percent to 15 percent, in line with the tax on other personal income (savings of 5 billion lek).

On the spending side, we plan to achieve savings from improved targeting of disability benefits and through restraint in capital spending relative to levels we had envisaged at the time of the first EFF review. Moreover, we have revised downwards our interest spending projections to more accurately reflect spending needs over the medium term. In addition, local government debt will stay at the 2014 level during 2015–19 to support the fiscal effort. All these measures will become effective on January 1, 2015, and have been incorporated in the 2015 budget approved by Parliament in December 2014.

15. We recognize that energy sector spending (in the form of public guarantees) poses a heavy fiscal burden. Public guarantees to the sector have increased to 3.2 percent of GDP, with a large share accruing over the past three years, contributing to the increase in public debt. The financial gap in the electricity sector is projected at US\$150 million in 2014, reflecting the low level of collection, large network losses, and tariffs that are set below cost recovery. Because of these chronic structural problems and costs associated with electricity sector reform, guarantees to the sector will continue to exert significant budget pressure over the medium term. We commit to implementing an ambitious set of structural reforms in the sector (see below) that will remove the need for government guarantees by 2020. Although the energy sector's financial gap is expected to decline over time as a result of reforms, the government will be obliged to assume the fiscal burden in the meantime. We therefore aim to limit new energy guarantees (excluding rollover) to 13.1 billion lek in 2015, 8.8 billion in 2016, 5.8 billion lek in 2017, 4.8 billion lek in 2018, 1.3 billion lek in 2019, and zero in 2020. To better track the impact of government guarantees on the government's fiscal position, we will monitor the overall fiscal balance including government guarantees and show explicitly as a memorandum item in budget execution reports the amount of government guarantees to electricity companies, in line with the practice we have recently adopted when submitting the 2015 budget to Parliament. We will also publish on the Ministry of Finance's (MoF) website details on all guarantees on a monthly basis. If government guarantees exceed the annual programmed amount, we commit to taking additional budgetary measures to offset the impact on the fiscal balance, including guarantees.

16. We are addressing emerging and potential risks to the baseline fiscal framework.

- **Electricity sector:** Notwithstanding the energy sector reform, the prospect of uncertain rainfalls would continue to pose fiscal risk. We will assess the situation in the context of future program reviews through a revised budget.

- **Property compensation:** In addition to payments of 1.0 billion lek in 2014 as compensation for outstanding cases brought against the Albanian government in the European Court of Human Rights (ECHR) in Strasbourg, the Court has begun to process another group of cases which are expected to be decided in 2015; total compensation for these claims could be 3 billion lek. In view of the precedents established by recent cases, additional claims for property compensation may be filed.
- **Capital expenditure risks:** The amount of outstanding (open) but unbudgeted investment projects exceeds the government's ability to absorb them in its Medium-Term Budget Framework (MTBF). To minimize risks, we plan to prioritize all outstanding infrastructure projects (which constitute the vast majority of unfunded projects) using transparent criteria with the aim of cancelling or rescheduling low-priority projects. As a first step, we will conduct a feasibility study of all these projects. Then a ranking of these projects will be approved by the Council of Ministers and posted on the MoF's and Ministry of Economy's websites. The MoF will also publish a list of all projects that will be part of its MTBF to signal its intention not to implement projects excluded from the list. We also plan to add a clause in all new contracts included in the budget stating that acceleration of project work without the MoF's approval will constitute violation of the contract and render null and void any obligations to pay for such work. Finally, we are implementing a module in EAMIS to enhance the tracking and monitoring of investment projects to ensure that contract work proceeds in line with budgetary commitments.
- **Revenue risks:** The 2015 budget includes a contingency of 0.1 percent of GDP in the event of revenue shortfalls. Appropriations allocated under this category will be saved if revenues underperform to safeguard program targets. Any decision to release these funds will be made in consultation with Fund staff, in the context of a supplementary budget request to Parliament in the second half of the year.

17. Tax administration reforms are advancing. We are finalizing preparations for the updating of the IT system at GDT; 8 modules out of 11 have been completed, e-filing is well advanced, and installation of the IT hardware at the central server site (NAIS) is expected by February. The GDT is also preparing a new corporate strategy for medium and long term capacity building and the establishment of a Risk Management Unit (RMU) in GDT. Extensive training is ongoing, including through the Fiscal Academy. The strategy will be drafted by the MoF staff in cooperation with the Fiscal Academy and GDT. The Risk Management Unit is currently active at GDT but will be reviewed in light of the structural changes expected before the end of March 2015.

18. A key priority in 2015 is the reform of the tax refund scheme. The responsibility for tax refund payments, which has been transferred from the GDT and GDC to Treasury since early 2014, will be refined further to ensure that refunds are paid accurately and on time. The new VAT law which passed in July 2014 and became effective on January 1, 2015, eliminates the requirement for compulsory audit of VAT refunds, and establishes risk criteria as the basis for undertaking an audit. Risk-based auditing is expected to begin by June 2015. Prior to that, the risk module for VAT refunds is expected to be operational by March 2015. Restructuring of GDT administration will lead to the creation of a dedicated Refund Unit to coordinate refund efforts on a country basis, and to dedicated functions at regional offices to undertake operational functions related to VAT refunds. Legal changes will also be needed to ensure that the Refund Unit/Directorate has the final authority to decide on refunds.

19. Work by the external consultant on customs administration will continue. The external consultant has assisted the General Directorate of Customs (GDC) in full and partial inspections and detections. A new code of conduct for customs was approved in November 2014. The big boost in collections expected at the time of signing has not yet been realized. The main problem lies in inconsistent application of valuation rules and procedures, and informality.

20. Closer coordination between GDT and GDC would enhance tax administration efforts. To leverage each other's potential and thus improve tax compliance, the GDC and GDT will strengthen cooperation. They will take measures to improve compatibility of their IT systems to enable access to each other's databases. They will also establish joint controls and audits of excisable taxpayers by end of June. Nevertheless, the merger of the two departments is a medium-term objective; any decisions related to this objective will be taken in consultation with the IMF.

21. We are reinforcing public financial management to prevent accumulation of new arrears. We plan to extend AGFIS to 15 budget institutions (including line ministries accounting for 60 percent of the budget) and one local government by the end of September 2015. Several of the new functional configurations will become operational in early 2015, with the rest scheduled to begin by September 2015. Progress however is contingent upon the upgrade of the AGFIS server, which is expected to be completed by the end of July 2015. Changes in the procurement, financial management and control, and budget laws will also further strengthen the MTBF, following the introduction of multi-year commitment limits.

22. Arrears payments will continue to advance in tandem with progress in auditing and verification of paid arrears. The High State Audit will continue to participate in regular meetings of the arrears clearance committee. In addition, the audit by the external auditor of non-tax claims paid will continue. We expect to have 75 percent of non-tax claims paid through end of January 2015 to be audited by April 2015. Similarly, the verification of arrears payments on tax refunds is expected to be completed by April 2015. We will limit the amount of arrears clearance in the first trimester of 2015 to 10 billion lek. Following the findings of the auditors' reports and after consultation with IMF staff, the clearance process may be accelerated beyond the annual budget allocation, currently amounting to 20 billion lek. However, if at any stage of the process there are indications that the arrears clearance process is not proceeding in accordance with the Arrears Prevention and Clearance Strategy (APCS), the arrears clearance process will stop pending consultation with IMF staff. Total arrears payments under the APCS will be limited to 72 billion lek. Any arrears above this amount will be paid using our own resources.

23. We commit to introducing a valuation-based property tax by end-2016. A working group has been established and different options are being reviewed. The reform will be undertaken in consultation with TA from the IMF. As a first step, we plan to introduce a fiscal cadastre to assess tax for each property by end-2015.

24. Pension reform, approved by Parliament in July 2014, has become effective in 2015. Key features include equalizing the minimum contributory wage with the official minimum wage, and increasing the contributory period and retirement age, while removing the benefit ceiling. The new law also indexes pension benefits to inflation. Persons above the age of 70, who do not qualify for pension, would receive a means-tested social pension. A draft law that will also increase the retirement age and contribution rates for the supplementary pension scheme for high government officials has also been prepared and will be approved by Parliament in the first quarter of 2015.

25. We are intensifying efforts to reform the current system of disability benefits. Spending on disability benefits has risen sharply in recent years, in part because of weak controls and fraud. We are working with the World Bank on a medium-term project to reform disability benefits. It envisages the revision of assessment criteria by introducing a social model component, establishing a new multi-disciplinary commission to assess eligibility, and introducing a management information system (MIS) to cross check accuracy of applicants' eligibility. This reform will begin in 2015, but will take time to complete and yield savings. Therefore, for 2015 we have issued and published a decree

that reduces the additional disability benefits for those pursuing higher education degrees, and the support provided to families which have more than one person with disability (currently 50-100% of the disability benefit). The estimated savings from these reforms are 1.1 billion lek.

B. Monetary and Exchange Rate Policy

26. The BoA remains committed to preserving price stability under an inflation-targeting framework. As defined in our medium-term strategy, the BoA aims to achieve average CPI inflation of 3 percent over the medium term, with a tolerance band of ± 1 percentage point to account for supply-side shocks and inflation inertia. The monetary policy decision-making process will be guided by the deviation of forecasted inflation from this objective, while striving to avoid excessive volatility in the real and financial sector. While the target applies to headline inflation, we will also monitor core inflation as a measure of underlying inflationary pressures. The inflation performance will continue to be monitored under the program through an Inflation Consultation Clause (see TMU).

27. The exchange rate remains fully flexible and determined entirely by market forces. The BoA relies on indirect instruments to steer financial market interest rates and conducts its monetary policy through open market operations. This regime complements our price stability objective and supports our operational framework for monetary policy. The BoA will also aim to maintain adequate reserve coverage over the program. For the duration of the program we will not, without Fund approval, introduce or intensify restrictions on the making of payments and transfers for current international transactions, nor introduce or modify any multiple currency practices or conclude any bilateral payments agreements that would violate our obligations under Article VIII of the IMF's Articles of Agreement. Also, we will not introduce or intensify import restrictions for balance of payments reasons.

28. Monetary policy is likely to remain accommodative over the near term. The BoA will continue to assess its monetary policy stance in the context of the inflation outlook and the strength of the transmission mechanism. Inflationary pressures remain weak, given below-potential growth, low inflation abroad, and inflation expectations skewed to the downside. In these circumstances, monetary policy is likely to remain accommodative, augmented by the BoA's forward guidance to the financial markets. The monetary policy transmission mechanism remains hampered by the uncertainties around the economic outlook and high risk aversion among the real and the financial sector agents. However, the improved performance of the banking system and ameliorated

conditions in external financial markets, coupled with the higher confidence in the economy, are expected to strengthen the transmission of monetary stimulus in the economy.

C. Safeguarding Financial Sector Stability

29. The BoA is proceeding with implementing the recommendations of the 2013 FSAP. The FSSA found that the BoA has ensured a high level of compliance with the Basel Core Principles for Effective Banking Supervision. Several of the specific recommendations have been implemented under the World Bank's Development Policy Loan (DPL). In particular, the BoA has implemented legal and regulatory changes aimed at strengthening the banking system's resilience. In the first quarter of 2014, the BoA's Supervisory Council approved a new regulation on managing the risk of banks' large exposures, a new guideline for systemic banks on preparing recovery plans, as well as changes to the supervisory policy consolidating the risk-based approach to supervision. The BoA is continuing efforts to strengthen its stress-testing toolkit in line with FSAP recommendations.

30. The BoA is further reinforcing supervision. The overall supervisory process and on-site examinations in particular have focused on imposing an enhanced quality of governance and risk administration in the banking system, emphasizing the role of internal policies, systems, and controls. The BoA will continue to monitor the banks' resilience to risks, in order to maintain an adequate capitalization and liquidity position, ensuring the stability of the banking system.

31. Preparations for adoption of more stringent capital adequacy requirements are ongoing. Since the beginning of 2014, the BoA has established parallel requirements for regulatory reporting on capital adequacy by banks based on the new regulation (standardized approach Basel II), paving the way for its smooth adoption by the end of the year.

32. We plan to undertake additional measures to facilitate problem loan restructuring. These include cooperation with the World Bank to facilitate loan restructuring through developing recovery and resolution plans for large problem borrowers. We are also working on a review of the commercial bankruptcy law, for which we plan to seek IMF technical assistance, in order to facilitate private balance sheet restructuring.

33. Recent regulatory and legal changes to facilitate collateral execution and increase loan write-offs are showing modest results. The changes to the civil procedures code, which came into effect in September 2013, intended to minimize execution suspension gaps. This has contributed to

an increase in recoveries (value of collateral collected) by 36 percent in the twelve months through September. However, the volume of loans that remains in the process of execution is very large, at 20 percent of the total outstanding. The amendment to the Tax Law in April 2014 (a tax guideline had been issued in June 2013) to remove legal and technical issues impeding loan write-offs, has had a relatively limited effect, with an increase of loan write-off by 2.3 percent (or 0.15 percent of the NPL portfolio). A new regulation requiring mandatory write-off of loans categorized as “lost” for more than three years came into force at the beginning of 2015 and is expected to reduce NPLs by 3 percentage points.

34. The authorities remain committed to implementing the amendments of the Albania Financial Supervisory Authority’s (AFSA) law to ensure its independence. Parliament approved several candidates to fill vacancies on the AFSA Board in late December 2014; the remaining positions are expected to be filled in early 2015. Once this process is completed, we expect that many technical regulations which are currently pending will be approved, especially the introduction of the new insurance law. The process is also dependent on approval of the amendments to the civil servant law. We remain committed to finalizing these reforms in line with FSAP recommendations.

35. We are continuing efforts to strengthen the regulatory framework for investment funds. The Board of the AFSA has approved the capital requirement regulation as well as the disclosure regulation. However, changes to the regulations on liquidity requirements and asset valuation have moved more slowly than planned, due in part to the complexity of the reform and the need to for additional technical work to assess the pace of implementation. We are continuing to work with IMF and World Bank technical experts to formulate the new regulations. In the meantime, we will not issue or approve any new entrants into the investment fund sector until all regulatory changes are in place. We expect to have the new regulations in place by June 2015.

36. The BoA is taking measures to implement recommendations of the 2014 safeguards assessment. In particular, the Supervisory Council has established an audit committee comprising five members of the Supervisory Council (excluding the Governor and Deputy Governors) with a mandate of three years (with the right of re-appointment). The Audit committee will assist the Supervisory Council in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control, the audit processes, and the bank’s process for monitoring compliance with laws, regulations, and code of conduct. It will meet regularly, including with the BoA’s external auditor at the planning stage and conclusion of the external audit, without the Governor or Deputy

Governor present. The chairman and deputy chairman of the Supervisory Council, the Inspector General, employees of the BoA, and representative of the external auditor may participate in the meetings of the Audit committee, but without voting rights. In addition, we have completed the terms of reference for the hiring of an external technical expert to assist the Audit Committee and we expect the contract to be signed by the end of February. The external expert should have extensive audit or accounting experience with a reputable international audit firm. Once a new Inspector General is appointed, internal and external assessments of the internal audit function are planned for 2015.

D. Structural Reforms

Business climate

37. The government is committed to creating a business friendly environment. It has established the National Economic Council, as an advisory body for the government, which includes representatives from the business community, key ministries, and multilateral partners. It is now finalizing steps to create an investment council, funded by the EBRD, which will address business community concerns. The inter-ministerial working group created to implement “Doing Business” reforms, with support by the IFC, worked on a range of reforms, including paying taxes, starting a business, access to electricity, and registering property. As a result of these efforts, Albania has recorded the biggest improvement (from 108th to 60th place) among all countries in its Doing Business rank. Reforms will continue next year focusing on resolving insolvency, starting a business, paying taxes, registering property, enforcing contracts, and trading across borders. The high-level government working group is already working on a range of measures to facilitate and improve performance in these indicators.

38. Additional progress will be made in simplifying business registration procedures. The National Registration Center (NRC) is currently testing the online business registration procedures; these could become operational in early 2015. We are also assessing the feasibility of creating a single service window for businesses by merging the NRC and the National Licensing Center (NLC) into a single entity.

Energy Sector

39. In addition to addressing the fiscal risks in the energy sector, we are moving forward with an integrated approach to addressing problems in the sector:

- *Institutional changes.* We have prepared a draft power sector law that will restructure the institutional relationship between the three public power companies responsible for generation, transmission and distribution (KESH, OST, and OSHEE), and move toward further market liberalization, in line with the EU's 2009 Electricity Directive. Specifically, the responsibility for wholesale purchases from independent producers will shift from KESH to OSHEE. The draft law also sets in place a schedule for moving all medium-voltage customers out of the regulated tariff structure by end-2017, beginning with 35KV customers by end-2015 (on completion, the share of de-regulated consumption would increase from 13 to 40 percent). The draft law also clarifies the responsibilities and full independence of the energy sector regulatory authority (ERE). The draft law was submitted to Parliament in December 2014, and implementation will begin in the first quarter of 2015. The shift of 35KV customers out of the regulated tariff structure is a SB under the program for December 2015.
- *Tariff adjustments.* The three public power companies submitted applications to ERE for tariff adjustments, which were approved by ERE and went into effect in January 2015, as follows:
 - restructuring of the retail tariff for households by eliminating the subsidized lower block. As a result, the current tariff for 2012–2014 of 7.7 lek/kWh for consumption of up to 300 kWh and 13.5 lek/kWh for consumption above that threshold was replaced with a single tariff of 9.5 lek/kWh;
 - increase in tariffs for commercial users ranging from 10 to 39 percent; and
 - adjustment in the purchase price for electricity from independent power producers to reflect current import prices, based on a benchmark price from the Budapest power exchange.

We certify that these changes are consistent with the estimated funding gap included in the fiscal framework. We will also undertake a review of our current tariff methodology, with a view to moving toward more frequent and automatic adjustments based on market pricing, in cooperation with the World Bank.

- *Improvements in electricity collections and legal enforcement.* In October 2014, we launched a campaign to enforce criminal penalties for electricity theft and disconnect service for nonpayment of bills. The criminal code has been revised to make power theft and damages to the electricity system infrastructure punishable by imprisonment rather than just an administrative offence. As a result, we were able to reduce electricity distribution losses in

October 2014 to 35 percent, compared with 45 percent in October 2013. For 2014 as a whole, we expect distribution losses to have averaged 38 percent; we are committed to further reducing distribution losses by about 5 percentage points per year, to 15 percent by 2019. The level of distribution losses will be monitored as an indicative target under our program with the IMF. We are also committed to improving our collection rate on amounts billed from 83.4 percent in January–October 2014 to 93 percent in 2019. Our efforts in this area will be supported by a World Bank project that will finance targeted investments in priority areas to accelerate cash collection and reduce losses, including metering, grid infrastructure, and upgrades to the commercial billing and collection system. The government is also committed to ensuring that budgetary, non-budgetary, and local government institutions make timely payment of electricity bills. These efforts will be supported by a restructuring of the state electricity companies with a view to improving efficiency. In this regard, the distribution company will have a performance management contract. We are currently in consultation with an expert who submitted a report in mid-December 2015. We expect a contract to be signed in mid-2015.

Property rights

40. Reform of the land registry/cadastre is critical for securing property rights and attracting investment. Given the multiplicity of conflicting claims, we are committed to resolving existing uncertainties in titling and property rights. By mid-2015, we plan to prepare a strategy to clarify the legal environment and verify ownership in the land registry and cadastre.

41. Reform of the property compensation system is essential. In view of the precedents established by recent court cases in Strasbourg, additional claims may be filed unless we come up with a credible domestic remedy. We understand the importance of acting quickly to avoid significant fiscal and reputation risks, and are currently preparing an action plan to be finalized by end of June 2015 in order to determine available options, including revision of the legal framework on property compensation. An interagency working group, headed by the Deputy Prime Minister, is working to assess the total cost of compensation claims and identify available land for compensation in kind. In this regard, the government has recently adopted a decision that transfers ownership of state-owned land from local governments to the Agency for Restitution and Compensation of Property for use by the restitution fund.

Local government reform

42. Local government reform is proceeding as planned. The Parliament approved a local government law in July 2014. According to the Law, the number of local government units will decrease to 61 from the 373 communes and municipalities currently in place. The number of regional councils will remain unchanged at 12. This is expected to be implemented after local elections in mid-2015, and once in place, it could result in savings of about 4 billion lek annually. In addition, an inter-ministerial working group is preparing the new national decentralization strategy which aims to increase the number of functions and competencies of local government, while minimizing risks to fiscal sustainability.

Public administration reform

43. Improving the quality of services provided by the public sector is a priority. We are taking measures to make the public administration more efficient and professional, including by continued training. Having in place a professional public administration will be critical in preparation of EU accession negotiations and for combating crime. In addition, we intend to strengthen capacity at the local level, in order to improve services, transparency, and accountability.

E. Statistics

44. INSTAT will continue efforts to improve the quality of statistics. A revised time series of annual GDP by production and expenditure approaches was published in June 2014 that incorporated improvements in compilation and methodology in line with assistance from the IMF and EU. In addition, INSTAT is in the process of: 1) setting up an efficient system of administrative data exchange for statistical purposes; 2) improving data processing and verification procedures; 3) establishing and promoting electronic data reporting; and 4) improving compilation of the short-term indicators of economic activities. Our objective is to meet the requirements of the EU ESA 2010 Transmission Program and Special Data Dissemination Standard of the IMF.

PROGRAM MONITORING

45. We anticipate that the fourth program review will take place on or after April 15, 2015, and require observance of the conditionality for end-December 2014. Thereafter, reviews will occur every four months starting on or after July 15, 2015, and require observance of the conditionality for the most recent test date. The final review will take place on or after February 15, 2017 and require observance of the conditionality for end-November 2016.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets for 2014–15
(In billions of leks, unless otherwise indicated)

	2014											2015			
	Mar			Jun			Sep			Dec			Apr	Aug	Dec
	Prog.	Prog. Adj.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Proj.	Act.	Prog.	Prog.	Prog.
I. Quantitative Performance Criteria															
1. Floor on net international reserves of the BoA (EUR million)	1289		1463	1330		1495	1330		1525	1330		1539	1507	1507	1507
2. Ceiling on general government overall cash deficit (cumulative) 2/ 3/	16.0	16.0	0.8	20.3	20.3	3.1	31.6	31.6	4.7	58.8	38.5	...	16.9	32.7	52.1
3. Ceiling on general government expenditure (cumulative) 3/	...		...	194.9		178.3	300.9		271.4	423.5	406.4	...	141.6	292.9	463.6
4. Ceiling on the increase of Bank of Albania credit to the general government (cumulative) 4/	0.0		-0.1	0.0		0.0	0.0		0.0	0.0	0.0	...	0.0	0.0	0.0
II. Continuous Performance Criteria															
5. Accumulation of new external payment arrears by the general government (EUR million)	0.0		0.0	0.0		0.04	0.0		0.0	0.0	0.0	...	0.0	0.0	0.0
III. Inflation Consultation															
6. 12-month percent change in consumer prices															
Upper outer band	5.0			5.0			5.0			5.0			5.0	5.0	5.0
Upper inner band	4.0			4.0			4.0			4.0			4.0	4.0	4.0
Actual/center point	3.0		1.9	3.0		1.6	3.0		1.7	3.0		1.3	3.0	3.0	3.0
Lower inner band	2.0			2.0			2.0			2.0			2.0	2.0	2.0
Lower outer band	1.0			1.0			1.0			1.0			1.0	1.0	1.0
IV. Indicative Targets															
7. Ceiling on subsidies to the energy sector	...		...	...		...	...		...	...	...	...	4.4	8.7	13.1
8. Average distribution losses by energy distribution company (OSHEE) (percent, cumulative from beginning of year)	...		...	...		...	...		...	...	...	37.8	37.0	34.5	34.0
9. Ceiling on contracting of nonenergy guarantees	...		...	...		...	...		...	...	...	...	0.0	0.0	0.0
10. Ceiling on accumulation of central government domestic arrears (as reported by MoF's quarterly survey on arrears accumulation)	0.0		0.4	0.0		1.1	0.0		0.4	0.0	0.0	...	0.0	0.0	0.0
11. Floor on clearance of central government domestic arrears 5/	0.0		1.0	1.0		19.1	1.0		25.9	14.2	35.0	...	5.0	10.0	15.0

Source: Albanian authorities; and Fund staff estimates and projections.

1/ All adjustors are described in the Technical Memorandum of Understanding (TMU).

2/ Data revisions have led to a downward adjustment of the end-March cash deficit by 1.2 billion (from 2.0 billion in EBS/14/71 to 0.8 billion now), or 0.08 percent of GDP.

3/ Excluding arrears payment. The assessment of performance in 2014 will also exclude new energy and nonenergy guarantees (which were not part of the original PC but are now included in the fiscal framework).

4/ Indicative target through December 2014.

5/ General government for March 2014.

Table 2a. Albania: Structural Benchmarks for 2014–15 under the Extended Fund Facility Arrangement

Conditionality	Test Date	Status	Remarks
Structural Benchmarks			
I. Public Financial Management			
<i>Arrears Clearance</i>			
1. Contract an external auditor with a mandate to conduct risk-based audits of arrears payments.	End-May 2014	Met with delay.	Contract signed in July.
2. Publish a report on arrears paid (on a quarterly basis) on the MoF website (starting in June 2014).	Continuous	Met.	
3. The external auditor to complete first audit of arrears payment.	July 15, 2014	Met with delay.	Audit completed in November; delay related to late signing of auditor's contract.
4. The external auditor to complete auditing of 20 percent of outstanding non-tax claims paid during January–June 2014.	End-Sept. 2014	Met with delay.	Audit completed in November; delay related to late signing of auditor's contract.
5. Contract an external auditor to conduct verification of arrears payments on tax refunds (see TMU).	End-Sept. 2014	Not met.	Delay due to funding constraints. Now expected in March 2015.
6. MoF to purchase a new IT server for the treasury system.	End-Sept. 2014	Not met.	Now expected in March 2015.
<i>Arrears Prevention</i>			
1. MoF to report quarterly survey results on new arrears accumulation (starting with the period from January–March 2014) among five key ministries (Ministries of Transportation, Health, Education, Defense, and Justice), and GDT (starting with the period from April–June 2014).	Continuous	Met.	

Table 2a. Albania: Structural Benchmarks for 2014–15 under the Extended Fund Facility Arrangement (Concluded)

Conditionality	Test Date	Status	Remarks
2. MoF to expand the reporting of quarterly survey on arrears accumulation to five additional ministries (Ministries of Interior, Agriculture, Finance, Economy, and Social Welfare) (starting with the period from October–December 2014) and publish it on the MoF's website.	Continuous		
3. Introduce multi-year commitment limits (the limits on commitments made in the current year for both the current year and each outer-year) in the 2015 budget, and change the Procurement Law, the Financial Management and Control Law, and the Budget Law accordingly.	End-Dec. 2014	Not met.	Multi-year commitment limits introduced in November. Changes in laws delayed to 2015 in line with PFM strategy supported by donors.
<i>II. Tax Administration</i>			
1. The GDT to develop a corporate strategy for medium- to long-term capacity building.	End-Dec. 2014	Not met.	Now expected in March 2015.
2. Establish and commence operations of a permanent Risk Management Unit (RMU) in GDT (see TMU).	End-March 2015		RMU has been set up in October 2014. Risk modules under implementation.
<i>III. Expenditure Policy</i>			
1. Council of Ministers to approve a pension reform strategy.	End-Dec. 2014	Met.	Approved in July 2014.
<i>IV. Financial Sector</i>			
2. In agreement with BoA and Albanian Financial Supervisory Authority (AFSA), amend the regulatory framework for investment funds on asset valuation, liquidity requirement, and capital adequacy requirement.	End-Sept. 2014	Not met.	Capital adequacy requirement was amended. Other changes expected in June 2015.

Table 2b. Albania: Proposed Structural Benchmarks for 2014–15 under the Extended Fund Facility Arrangement

Conditionality	Test Date	Status	Remarks
Structural Benchmarks			
<i>I. Public Financial Management</i>			
1. The MoF to prepare and publish an action plan with measures to address weaknesses identified in the auditor's report on non-tax claims payments.	Feb. 15, 2015		
2. The government to prepare a report on the prioritization of all outstanding infrastructure projects, including a ranking approved by the CoM using transparent criteria; both the report and criteria for ranking will be published on the MoF and MoE websites.	End-June 2015		
3. External auditor to complete the audit of 75 percent of outstanding non-tax claims paid through January 2015.	End-Apr. 2015		
4. External auditor to complete verification of arrears payments on tax refunds.	End-Apr. 2015		
5. Roll out the AGFIS to 15 budget institutions (60 percent of budget).	End-Sept. 2015		
6. Change the Procurement Law, the Financial Management and Control Law, and the Budget Law related to multi-year commitment limits (the limits on commitments made in the current year for both the current year and each outer year).	End-Dec. 2015		
<i>II. Tax Administration</i>			
1. Install the new IT software at the central server site (NAIS) and commence testing.	End-Feb. 2015		
2. Commence auditing of tax refunds on a risk basis.	End-June 2015		
3. Create a fiscal cadastre to assess tax for each property.	End-Sept. 2015		
4. The GDT to develop a corporate strategy for medium- to long-term capacity building.	End-Mar. 2015		
<i>III. Financial Sector</i>			
1. Hire an external expert to assist the Audit Committee of the Bank of Albania.	End-Feb. 2015		
2. Albanian Financial Supervisory Authority (AFSA) to amend the regulatory framework for investment funds on asset valuation and liquidity requirement.	End-June 2015		
<i>IV. Energy Sector</i>			
1. Prepare a quarterly survey of the gross consolidated arrears of the electricity sector (KESH, OST, OSHEE) to the private sector (starting with the period January-March 2015).	Continuous		
2. Remove 35KV medium-voltage consumers from the regulated tariff system.	End-Dec. 2015		

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) defines the indicators used to monitor developments under the program, according to the understandings between Albanian authorities and IMF. The TMU also defines the associated reporting requirements.
2. The exchange rates for the purposes of the program of the lek to the euro is set at lek 140.25 = €1, to the U.S. dollar at lek 103.17 = \$1, and to the SDR at lek 158.05 = SDR 1. The gold price in euro is set at 920.18 oz = €1. These are the rates shown on the Bank of Albania's website as of November 30, 2013.¹
3. For the purpose of the program, the central government includes the central government and extra-budgetary funds. The general government includes the central government, the local governments, the Social Security Institute (SSI), and the Health Insurance Institute (HII).
4. The fiscal year starts on January 1 and ends on December 31.

I. QUANTITATIVE PERFORMANCE CRITERIA

A. Floor on Net International Reserves of the BoA

Definition

5. Net international reserves (NIR) are defined as reserve assets minus reserve liabilities of the Bank of Albania. **Reserve assets** are readily available claims of the Bank of Albania on nonresidents denominated in foreign convertible currencies, and held for the purpose of meeting balance of payments financing needs, intervention in exchange markets, and other purposes. They include Bank of Albania holdings of monetary gold, SDRs, Albania's reserve position in the IMF, foreign currency cash, securities, and deposits abroad. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).
6. **Reserve liabilities** are defined as foreign exchange liabilities to residents and nonresidents of the Bank of Albania, irrespective of their maturity. They include: foreign currency reserves of commercial banks held at the Bank of Albania; foreign currency deposits of the government held at the Bank of Albania; all credit outstanding from the IMF that is a liability of the Bank of Albania; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or

¹http://www.bankofalbania.org/web/Time_series_22_2.php?evn=agregate_detaje&evb=agregate&cregtab_id=644&periudha_id=1

official export credit agencies. Reserve assets and reserve liabilities will both be expressed in euros, at the program exchange rate.

Reporting

7. Data will be provided by the BoA to the Fund with a lag of no more than five days past the test date.

Adjustor

8. **The floor on net international reserves** of the BoA will be adjusted downward by any shortfall in external budget support relative to the programmed amount. Budget support is defined as non-project financial assistance that is provided to the central government. The programmed amount of budget support is lek 31.1 billion for 2014 and lek 76.2 billion for 2015.

B. Cumulative Ceiling on General Government Overall Cash Deficit Excluding Arrears Payments

Definitions

9. The **overall cash deficit of the general government** will be measured from the financing side (below the line) at current exchange rates, based on the template below:

CASH BALANCE	Code
Financing (Cash)	
Domestic	
Privatization receipts	B/1160000-116ZZZZ
Domestic borrowing	
Central	000-009/1600000-169ZZZZ
Local	010-999/1600000-169ZZZZ
Other	
Change in balance of TSA bank account	001/010-ZZZ/5120100/TH000; 001/5120100/TH008; 001/5120100/TH009; 001/5120100/TH010; 5120100/TH011
Change in balance of S&HII's bank account	5000000-54ZZZZZ/5800000-58ZZZZZ
Trust accounts (3020)	4660000-466ZZZZ
On-Loan's Principal (3030)	2500200
Liability to SSI (3015) (receipts (3016) minus payments (3017))	4351291; 4351298-4351299
Variance Accrual-Cash [4030=4019 (4011->4018)-4029(4021->4028)]	More detailed codes submitted to staff
Float (3060)	001/5200000/B0000-52ZZZZZ/BZZZZ
Transitory accounts - Guaranties on Custom Duties (3021)	4701100
Others-Float (mean time)	

Foreign	
Long-term Loan(Drawings) (1010=2600(00/1700000-99/174ZZZZ)/1030/1040)	
Change of statistical account (1040)	More detailed codes submitted to staff
Repayments 1030= (2081->2082)	More detailed codes submitted to staff
Memo: arrears clearance	

10. In determining the overall cash balance, the following considerations will apply:²

- Privatizations: Privatization receipts should be reported on a gross basis.
- Domestic borrowing: Domestic borrowing is reported on a net basis and is determined on the basis of the residency criterion. It covers bank loans, securities issued, overdraft accounts, and other debt instruments, less government deposits.
- Other: "Other" refers to the change in the Single Treasury Account, the accounts of Special Funds, and other transitory accounts.
- Foreign borrowing: Foreign borrowing is reported on a gross basis and is determined on the basis of the residency criterion. It covers disbursements by international financial institutions, bank loans, securities issued, overdraft accounts, and other debt instruments.
- Change of Statistical Account: This item covers balances held by nonresidents in financial institutions for project-related spending.
- Repayments: This item refers to all payments to nonresidents related to disbursements by international financial institutions, bank loans, securities, overdraft accounts, and other debt instruments.

11. The overall cash deficit estimated below the line will also include all new issues of government guarantees (excluding rollover) for the energy and non-energy sectors.

12. Excluded from the calculation of the overall cash deficit of the general government are the arrears payments to be made in the context of the Arrears Prevention and Clearance Strategy (APCS). The amount of arrears paid will be identified using the verified arrears list and matching the list with the Treasury payment records. A summary of the total amount of arrears paid under the clearance strategy, as defined above, will be provided on a monthly basis.

² All cash balance data come from Treasury.

Reporting

13. Data, including new guarantees and the amount of arrears payments under the APCS, will be provided to the Fund using current exchange rates with a lag of no more than 30 days after the test date for March, June, and September test dates. For December test dates, data should be provided no more than 60 days after the test date.

Adjustor

14. The **ceiling on the overall cash deficit** of the general government will be adjusted upward (downward)—that is, the deficit target will be increased (reduced)—by:

- 50 percent of the privatization receipts, up to total privatization receipts of lek 15 billion in a given year. The programmed amount of privatization receipts in 2015 is zero.
- the excess (shortfall) of new energy guarantees, excluding rollover, issued during the course of the year up to a maximum of the annual budgeted allocation (lek 13.08 billion in 2015). The adjustor will not apply to the end-year amount of new energy guarantees, excluding rollover. Energy guarantees are defined as guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE. The programmed amount of new energy guarantees is lek 4.36 billion for April 2015 and lek 8.72 billion for August 2015.

C. Cumulative Ceiling on General Government Expenditure Excluding Arrears Payment

Definitions

15. General government expenditure is defined as general government spending on personnel, interest, operations and maintenance, subsidies, social insurance outlays, local government expenditures, other expenditures (social protection transfers), capital expenditure, reserve and contingency funds, and net lending, as reported in the government's monthly fiscal indicators table. For the purpose of this target, arrears payments are excluded from the calculation. The amount of arrears payment is identical to the number used in the calculation of the performance criterion on cash deficit (Section B).

Reporting

16. Data will be provided to the Fund using current exchange rates with a lag of no more than 30 days after the test date for March, June, and September test dates. For December test dates, data should be provided no more than 60 days after the test date.

Adjustor

17. The **ceiling on expenditure** of the general government will be adjusted upward (downward)—that is, the expenditure ceiling will be increased (reduced)—by:

- 50 percent of the privatization receipts, up to total privatization receipts of lek 15 billion in a given year. The programmed amount of privatization receipts in 2015 is zero.
- the excess (shortfall) of new energy guarantees, excluding rollover, issued during the course of the year up to a maximum of the annual budgeted allocation (lek 13.08 billion in 2015). The adjustor will not apply to the end-year amount of new energy guarantees, excluding rollover. Energy guarantees are defined as guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE. The programmed amount of new energy guarantees is lek 4.36 billion for April 2015 and lek 8.72 billion for August 2015.

18. The **ceiling on expenditure** of the general government will be adjusted upward—that is, the expenditure ceiling will be increased—by:

- Excess of one-off revenues over programmed amounts, up to a maximum of lek 3 billion. One-off revenues are defined as revenues that accrue only in the current year (e.g., one time fees from mobile operators).
- The excess of project grants from the programmed amount, up to a maximum of lek 15 billion in a given year. The programmed amount of project grants in 2015 is lek 10 billion.

II. CONTINUOUS PERFORMANCE CRITERIA

A. Accumulation of New External Payment Arrears by the General Government

Definitions

19. External **debt** is determined according to the residency criterion. The term “debt”³ will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

- Loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

³ As defined in Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, Decision No. 6230-(79/140), as amended.

- Suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and
- Leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property. For the purpose of the program, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

20. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

21. Under this definition of debt set out above, external payments arrears consist of arrears of external debt obligations (principal and interest) falling due after the due date and grace period, as specified in the contract, has passed. Arrears resulting from nonpayment of debt service for which a clearance framework has been agreed or rescheduling agreement is being sought are excluded from this definition.

22. The external arrears of the general government will be calculated based on the schedule of external payments obligations reported by the MoF. Data on external arrears will be reconciled with the relevant creditors, and any necessary adjustments will be incorporated in these targets as they occur.

23. The authorities will not accumulate any external arrears. This performance criterion does not cover arrears on trade credits.

24. The performance criterion will apply on a continuous basis.

Reporting

25. The MoF will provide the final data on the external arrears of the general government to the Fund, with a lag of not more than two weeks after each month.

Adjustor

26. The performance criterion on the accumulation of new external payment arrears by the general government will exclude any arrears relating to obligations prior to 2014 and which existed prior to the program but are now recognized.

III. INFLATION CONSULTATION

27. **The quarterly consultation bands apply to the 12-month rate of inflation** in consumer prices (as measured by the headline consumer price index (CPI) published by the INSTAT). Should the observed year-on-year rate of CPI inflation (quarterly average) fall outside the outer bands, the authorities will complete a consultation with the IMF on their proposed policy response before requesting further purchases under the program. In addition, the BoA will conduct discussions with IMF staff should the observed year-on-year rate of CPI inflation (quarterly average) fall outside the inner bands specified for the end of each quarter.

IV. INDICATIVE TARGETS

A. Ceiling on Subsidies to the Energy Sector

Definition

28. Subsidies **to the energy sector** are defined as new guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE, excluding rollover.

Reporting

29. Data will be provided to the Fund by the Ministry of Finance on a monthly basis with a lag of no more than thirty days.

B. Ceiling on Average Distribution Losses by OSHEE

Definition

30. **Average distribution losses** are defined as the amount of electricity billed to consumers by the energy distribution company (*Operatori i Shperndarjes se Energjise Elektrike, OSHEE*), as a share of the total amount of electricity entering the distribution system. These are measured on a cumulative basis for each calendar year.

Reporting

31. Data will be provided to the Fund by the Ministry of Energy on a monthly basis with a lag of no more than thirty days.

C. Ceiling on Contracting of Nonenergy Guarantees

Definition

32. **Nonenergy guarantees** are defined as new guarantees issued by the general government, excluding those issued for the benefit of the electricity operators KESH, OST, and OSHEE.

Reporting

33. Data will be provided to the Fund by the Ministry of Finance on a monthly basis with a lag of no more than thirty days.

D. Ceiling on Accumulation of Central Government Domestic Arrears

Definition

34. Central **government domestic arrears** consist of domestic expenditure arrears of the central government and domestic tax refund arrears. Domestic expenditure arrears are defined as payments to residents determined by contractual agreements that remain unpaid 60 days after the due date specified by the contract, or, in the absence of a contractual definition, as determined by the law.

35. Domestic **tax refund arrears** are defined as obligations on any valid tax refund claims in accordance with tax legislation that remain unpaid 90 days after the claim is submitted.

36. For the purpose of this target, the accumulation of domestic arrears will be monitored through MoF's quarterly survey on arrears accumulation. The first survey, to cover the period from January-March 2014, will include the following part of the central government: Ministries of Transportation, Health, Education, Defense, and Justice. The next survey, to cover April-June 2014, will be extended to cover the General Directorate of Taxation. The Ministries of Interior, Agriculture, Finance, Economy, and Social Welfare will also be added in the survey for October-December 2014. These surveys will continue to be conducted quarterly on a continuous basis, with all Ministries to be included in the survey, beginning with April-June 2015. Tables 1 and 2 below contain templates for the survey form sent to the ministries and the GDT respectively, to be filled out on a quarterly basis. The recording of invoices and tax refund claims should be cumulative—the recording in each quarter should include all invoices/refund claims that have not been paid from the previous quarters, starting with 2014:Q1. The MoF should verify that the invoices/refunded claims reported in the survey are not already included in the arrears clearance database.

Table 1. Template for Quarterly Survey on Expenditures Arrears Accumulation

(1) Economic Code	(2) Name of Supplier/ Creditor	(3) Commitment Number from Treasury System	(4) Commitment Amount	(5) Invoice/Claim Details			(6) Age of Invoice (Due Date) Enter Amount			(7) Reason for Delayed Payment
				Number (from Treasury System)	Date	Amount	30-59 days	60-90 days	+90 days	
Invoices recorder in the Treasury System										
Invoices not in the Treasury System										
Totals										

Table 2. Template for Quarterly Survey on VAT Tax Arrears Accumulation

(1) Name of Company	(2) Tax Identification Number	(3) Date of Assessment	(4) Refund Details			(5) Age of Claim Enter Amount:			(6) Reason for Delayed Payment
			Number	Date	Amount	30-59 days	60-90 days	+90 days	
Totals									

Reporting

37. The MoF should send to the Fund the consolidated data from the survey with a lag of no more than 75 days after each quarter.

E. Clearance of Central Government Domestic Arrears

Definitions

38. Central government domestic arrears consist of domestic expenditure arrears of the central government and domestic tax refund arrears. Domestic expenditure arrears are defined as payments to residents determined by contractual agreements that remain unpaid 60 days after the due date specified by the contract, or, in the absence of a contractual definition, as determined by the law. Domestic tax refund arrears are defined as obligations on any valid tax refund claims in accordance with tax legislation that remain unpaid 90 days after the claim is submitted. For the purpose of this target, domestic arrears consist of arrears submitted before December 31, 2013, that fall into the following categories:

- central government contracts;
- central government utility bills;
- disability benefits from social assistance program;
- special funds, including payments for ex-persecuted prisoners and expropriations related to public construction work, and other special payments approved by the Council of Ministers;
- court orders, excluding cases in land restitution and compensation;
- local government contracts financed by central government;
- child registration subsidies;
- civil emergency;
- VAT refunds; and
- CIT returns.

39. The limit on clearance of central government domestic arrears consists of a floor for the amount of arrears payment.

40. Data will be collected through payments identified as made through the Treasury system under the arrears clearance strategy.

Reporting

41. Data will be provided by the MoF to the Fund with a lag of no more than four weeks after the test date.

F. Cumulative Ceiling on the Increase of Bank of Albania Credit to the General Government

Definitions

42. **Credit of the central bank to the general government** is defined as outstanding claims of the Bank of Albania on the general government, including overdrafts, direct credit, and holdings of government securities excluding repo operations, advance distribution of profits, other technical receivables, and holdings of the Bank of Albania pension fund. For the purpose of this target, government securities will be valued at their original purchase price.

43. This indicative target will be elevated to a quantitative performance criterion, starting with the end-April 2015 test date.

Reporting

44. Data will be provided by the BoA to the Fund on a quarterly basis with a lag of no more than fifteen days.

V. STRUCTURAL BENCHMARKS

The structural benchmarks shall include those listed in Table 2 of the MEFP. Additional details on selected measures are provided below.

45. **Contract an external auditor with a mandate to conduct ex-post risk-based audits of expenditure arrears payments.** The MoF should submit the Terms of Reference for the external auditor to the IMF for review before starting the tendering process.

46. **Contract an external auditor to conduct verification of arrears payments on tax refunds.** The MoF should submit the Terms of Reference for the external auditor to the IMF for review before starting the tendering process.

47. **Introduce multi-year commitment limits in the 2015 budget, and change the Procurement Law, the Financial Management and Control Law, and the Budget Law accordingly.** Commitment is an obligation to make a future payment subject to the fulfillment of certain conditions (contractual or otherwise). Commitment limits specify the amounts that can be committed in the current year for both the current year and each outer-year per line item of the budget. The sum of the commitment limits for an outer-year should be lower than the cash spending ceiling for that year, to leave sufficient room for the amounts that can be committed within that year.

48. The GDT to develop a corporate strategy for medium- to long-term capacity building.

The strategy should be developed in consultation with IMF TA.

49. Establish and commence operations of a permanent Risk Management Unit (RMU) in GDT. The RMU should be tasked with leading the tax administration's day-to-day work in two major areas: (i) identifying, analyzing, and prioritizing major taxpayer compliance risks that need mitigation through compliance efforts; and (ii) developing integrated compliance strategies for compliance efforts that are designed specifically to mitigate the major risks prioritized under (i).

50. In agreement with BoA and Albanian Financial Supervisory Authority (AFSA), amend the regulatory framework for investment funds on asset valuation, liquidity requirement, and capital adequacy requirement. The amended regulations should:

- a) require that the calculation of the unit value represent the proportionate share of the aggregate market value of the underlying assets of the fund;
- b) introduce capital adequacy requirements aligned with relevant E.U. regulations; and
- c) introduce liquidity requirements consistent with recent E.U. regulatory developments and the current level of development of the Albanian market.

51. Rollout the AGFIS to 15 budget institutions (60 percent of budget).

52. The government will expand the AGFIS to the following institutions: Council of Ministers, Ministry of Transport and Infrastructure, Road Authority, Ministry of Finance, National Agency of Information Society, Municipality of Tirana, Ministry of Welfare, Ministry of Education, Ministry of Agriculture, Agricultural and Rural Development Agency, Ministry of Health, Ministry of Interior, Ministry of Justice, Ministry of Defense, and Ministry of Energy.

VI. MONITORING AND REPORTING REQUIREMENTS

53. To facilitate the monitoring of program performance, the authorities will provide the following information on a monthly basis (except where noted).

The Bank of Albania will supply to the Fund:

- i) the balance sheets of the Bank of Albania;
- ii) the consolidated accounts of, separately, the commercial banks, and the Savings and Loan Institutions (SLIs);
- (iii) the monetary survey;
- (iv) banking sector prudential indicators;
- (v) the net foreign assets of the Bank of Albania and their components;
- (vi) comprehensive information on reserve assets that are pledged, collateralized, or otherwise encumbered;
- (vii) the foreign exchange cash flow of the Bank of Albania, including the level of NIR;
- (viii) daily average exchange rates;
- (ix) quarterly balance of payments data and updates of balance of payments estimates; and

- (x) inflation forecast on a monthly basis.

The Ministry of Finance will supply to the Fund:

- (i) the summary fiscal table, including the overall budget deficit, on a modified cash basis;
- (ii) issuance of treasury bills and bonds by the MoF, including gross value and cash received;
- (iii) privatization receipts;
- (iv) information on the contracting and guaranteeing of new debt;
- (v) information on the stock of short-, medium- and long-term debt;
- (vi) information on official grants for projects or budget support purposes;
- (vii) information on the stock of expenditure arrears identified in the Arrears Prevention and Clearance Strategy and progress in arrears repayment;
- (viii) information on the accumulation of new arrears in central government ministries;
- (ix) information on the implementation of stronger procurement and commitment controls; and
- (x) information on new energy and nonenergy guarantees issued by the general government.

The General Directorate of Customs will supply to the Fund:

- (i) detailed monthly data on customs revenues collected.

The General Directorate of Taxation will supply to the Fund:

- (i) detailed monthly data on tax revenues collected;
- (ii) information on progress in implementing business restructuring and IT reforms; and
- (iii) information on the stock of VAT refunds claimed, refund arrears, and refunds paid out every month will be supplied within one month of the end of the reporting period.

The Albanian Statistical Agency (INSTAT) will supply the Fund:

- (i) The consumer price index (CPI index) at the aggregated level and at the level of each individual item making up the basket;
- (ii) the producer price index;
- (iii) the construction cost index;
- (iv) all short term indicators as they become available as defined in INSTAT's quarterly publication "Conjoncture"; and
- (v) in addition, INSTAT will communicate to the Fund on a regular basis the preliminary estimates for quarterly GDP. It will also communicate as early as possible the preliminary estimates for annual GDP disaggregated by 22 sectors and distinguishing between the observed and unobserved economy.

Statement by the IMF Staff Representative on Albania
February 20, 2015

This statement provides information that has become available since the issuance of the Staff Report. The information does not alter the thrust of the staff appraisal.

1. **Albania's Parliament appointed a new Governor of the Bank of Albania (BoA) on February 5.** Mr. Gent Sejko secured broad cross-party support in parliament for his nomination.
2. **The BoA has continued its gradual monetary easing, most recently by lowering its policy rate by another 25 basis points on January 28.** The central bank has lowered its policy rate by a cumulative 325 basis points since mid-2011, in order to counter slack in the economy and, more recently, disinflationary pressures from abroad.
3. **The latest financial soundness data indicate that nonperforming loans have declined from 25 percent in September to just under 23 percent in December 2014.** The decline in the NPL ratio appears to be driven by a broad-based reduction in banks' NPL portfolios, as well as a pick-up in credit growth.



INTERNATIONAL MONETARY FUND



Press Release No. 15/70
FOR IMMEDIATE RELEASE
February 23, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second and Third Reviews under Extended Fund Facility Arrangement for Albania and Approves €58.8 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the second and third reviews of Albania's economic performance under a program supported by the Extended-Fund Facility (EFF). The completion of the review enables the authorities to draw an additional amount equivalent to SDR 47.1 million (about €58.8 million), bringing the total disbursements to SDR 94.2 million (about €117.7 million).

Following the Executive Board's discussion on Albania, Mr. Min Zhu, Deputy Managing Director and Acting Chair, stated:

"Albania's economic recovery appears to be on track even as downside risks persist. The authorities deserve credit for a broadly successful policy implementation during the first year of the arrangement under the Extended Fund Facility. Perseverance in implementing the structural reform agenda will be crucial in order to reduce macroeconomic imbalances and raise living standards.

"The authorities' commitment to strengthen debt sustainability, as reflected in their 2015 budget, is welcome. It will be important to address the fiscal risks stemming from property compensation claims and the large stock of unbudgeted investment projects.

"The authorities' initial steps to reform the power sector are encouraging. Sustained implementation of these reforms over the medium term will be needed, as they are vital for fiscal sustainability. The authorities' decision to compensate the most vulnerable social groups for electricity tariff adjustments is welcome.

"The authorities' policy of gradual monetary easing is appropriate in countering disinflation pressures while avoiding risks to financial stability. Ensuring the central bank's independence and strengthening its oversight will be important for safeguarding its credibility.

“The large stock of nonperforming loans should be addressed comprehensively and forcefully in order to revive bank credit to the private sector. Continued vigilance is needed to ensure that each bank meets capital and liquidity requirements and manages risks appropriately,” Mr. Zhu said.

The Executive Board approved a 36-month arrangement under the EFF for Albania on February 28, 2014 (see [Press Release No. 14/81](#)) in an amount equivalent to SDR 295.42 million (about €369 million, 492.4 percent of the country’s quota in the Fund).

**Statement by Carlo Cottarelli, Executive Director for Albania
and Marco Senatore, Advisor to Executive Director
February 20, 2015**

On behalf of the Albanian authorities, we thank staff for their helpful and constructive cooperation during the mission to Tirana and for the informative document which has been prepared.

The authorities are committed to carry ahead the wide-ranging reforms envisaged by the Extended Arrangement with the Fund, with particular reference to tax administration, pension reforms and arrears payment, while addressing the issue of nonperforming loans (NPLs) in the financial sector and problems in the energy sector.

The positive performance under the program reflects the commitment of Albanian authorities to such reforms and to the cooperation with the Fund which is needed to successfully pursue them.

Economic developments and outlook

After the continuous slowdown experienced in the last few years, an economic recovery has begun, and real GDP growth is estimated to have reached 2.1 percent in 2014. This is the result not only of higher petroleum production but also of a broad-based pickup in agriculture, trade, and manufacturing.

The current account deficit is estimated to have increased to 13.3 percent of GDP, mainly due to higher electricity imports and declining petroleum exports. The positive financial account received a significant contribution from direct investments, which are expected to have remained stable, at around 8 percent of GDP.

For 2015, a significant contribution to growth (GDP is projected to increase by more than 3 percent in real terms) should come from recovery of private demand. Confidence is expected to improve also due to low interest rates and a recovery of public investment.

Fiscal policy

In 2014 the public debt-to-GDP ratio in Albania is projected to have increased slightly, to about 71 percent. Such figure, which represents a historical peak, includes unpaid bills and government arrears (about 2.6 percent of GDP, compared to 5.2 percent in 2013). The estimated deficit for 2014 is of 5.7 percent of GDP but preliminary data which became available after the mission suggest that deficit may have been lower.

The measures to clear arrears envisaged under the EFF program aim at providing liquidity to the real sector. Indeed, in Albania arrears represent a significant obstacle for

economic growth, as they contribute to the high level of NPLs and constrain credit growth. Against this backdrop, the authorities are reinforcing public financial management to prevent the accumulation of new arrears (through the extension of the AGFIS treasury system to 15 budget institutions), while clearance of the existing stock will continue, together with progress in auditing and verification of paid arrears. More generally, the authorities are committed to fiscal consolidation, in order to reduce the debt ratio below 64 percent by the end of the program in 2017 and below 60 percent of GDP by 2018. They are also committed to the attainment of the fiscal deficit target for 2015 (4.8 percent of GDP including new guarantees).

To this aim, the 2015 budget envisages measures such as: a) increase in the excise tax on cigarettes, b) increase in the circulation tax on gasoline and diesel and c) increase in the withholding tax (from 10 percent to 15 percent, in line with the tax on other personal income) for interest, rent, dividends and capital gains. On the spending side, savings will be achieved from improved targeting of disability benefits and restraint in capital spending, as envisaged at the time of the first EFF review. Moreover, local government debt will not increase.

Tax administration (an area where the Fund has provided technical assistance to the authorities) is being improved, as the General Directorate of Taxation (GDT) is preparing a new corporate strategy for medium and long term capacity building and the establishment of a Risk Management Unit (RMU) in GDT. Moreover, the IT system is going to be updated.

Tax refund scheme will also be improved in 2015, in order to ensure that refunds are paid accurately and on time. To this aim, the new VAT law became effective on January 1, 2015, establishing risk criteria as the basis for undertaking an audit of VAT refunds. Moreover, a pension reform has been approved by Parliament in July 2014, with an increase in the contributory period and retirement age, as well as with the removal of the benefit ceiling.

Monetary policy

On February 5, 2015 Mr. Gent Sejko was appointed by the Parliament as the new Governor of the Bank of Albania (BoA). Monetary policy is aimed at preserving price stability under an inflation-targeting framework, while the exchange rate remains fully flexible and determined entirely by market forces.

Against this backdrop, given weak inflationary pressures and inflation expectations skewed to the downside, on January 28, 2015 the Supervisory Council of the BoA lowered the policy interest rate by 0.25 percentage points to 2 percent. The accommodative stance includes also forward guidance to financial markets.

The transmission mechanism of monetary policy is expected to be improved as the performance of the banking system strengthens, confidence in the economy increases and external financial market conditions improve.

Financial sector

The implementation of the 2013 FSAP recommendations is going ahead, through the active commitment of the BoA and the Ministry of Finance. Several recommendations have been implemented under the World Bank's Development Policy Loan. In 2014 the BoA's Supervisory Council approved a new regulation on managing the risk of bank's large exposures, a new guideline for systemic banks on preparing recovery plans, and changes consolidating the risk-based approach to supervision. The BoA's stress-testing toolkit is being improved.

The banking sector is well-capitalized and liquid. Moreover, several measures have been undertaken to address the issue of NPLs, which are relatively high. In particular, the civil procedure code has been modified to minimize execution suspension gaps. The amendment to the Tax Law was approved in April 2014, in order to remove impediments to the loan write-offs from banks' balance sheets. Moreover, at the beginning of this year a new regulation, requiring mandatory write-off of loans categorized as "lost" for more than three years, came into force and should help reduce NPLs by 3 percentage points in 2015. A contribution to the reduction of NPLs is also coming from arrears clearance.

The regulatory framework for the nonbank financial sector will also be strengthened, and to this aim the operational and financial independence of the Albanian Financial Supervisory Authority (AFSA) is being improved. The regulatory framework for investment funds is also being strengthened, in order to introduce liquidity and capital requirements and require the calculation of net asset value on a mark-to-market basis.

Structural reforms

With a view to increasing the growth potential of Albania, the authorities are undertaking structural reforms in several areas.

Measures introduced to improve the business climate include the establishment of the National Economic Council, an advisory body which includes representatives from the business community, key ministries and multilateral partners. Several issues have also been addressed by an inter-ministerial working group, including starting a business, paying taxes and registering property. Through these initiatives, Albania recorded the biggest improvement (from 108th in 2014 to 68th place in 2015) among all countries in its Doing Business rank.

In the energy sector, a draft law was submitted to Parliament in December 2014, with a view to restructuring the relationship between the three public power companies, as well

as ensuring full independence of the energy sector regulatory authority (ERE). Moreover, in January 2015 tariffs were adjusted, in particular eliminating the subsidized lower block for retail tariff for households, increasing tariffs for commercial users and adapting purchase price for electricity to current import prices. In October 2014, the authorities launched a campaign to enforce criminal penalties for electricity theft and disconnect service for nonpayment of bills. Also due to such initiative, electricity distribution losses have declined. Another priority is now the increase in collection rate on amounts billed, which will benefit from a World Bank project. In general, structural reforms in the energy sector should remove the need for government guarantees by 2020.

For the agricultural sector, a strategy will be prepared by mid-2015, to clarify the legal environment and verify ownership in the land registry and cadastre.

The authorities are also committed to making the public administration more efficient and professional, including through continued training and improved capacity at the local level. Finally, local government reform is proceeding as planned.