REPUBLIC OF ALBANIA

ECONOMIC AND FISCAL PROGRAM
2013 – 2015

JANUARY, 2013

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1. OVERALL POLICY FRAMEWORK AND OBJECTIVES

The Economic and Fiscal Program 2013 is based on the Budget Low for 2013[1], on the Macroeconomic and Fiscal Framework 2013 - 2015[2], on the Medium Term Budget Program 2013-2015[3], on the latest Monetary Policy Report, on the Public Finances Strategy and at the same time it is fully in line with the National Strategy for Development and Integration (NSDI) 2007 – 2013 and also in line with the next NSDI 2013 – 2020 which is actually in the drafting stage . Economic and Fiscal Program 2013 was approved by the Council of Ministers on 30th of January 2013.

The main objective of the economic policy during the medium term horizon, is to preserve macroeconomic stability and continuing the structural reforms in order to create the necessary conditions for the economy to operate at its potential growth. Both fiscal and monetary policies remain committed to preserve macroeconomic stability and to facilitate growth in the short term, as a precondition of providing high and sustainable economic growth in the future and a fast caching up with the average EU welfare levels. Coordination of the two policies is based on the exchange of information about government policy strategies and the fiscal measures affecting the economy in general and prices in particular.

Fiscal policy for 2013 will be oriented more toward the stimulating economic growth and offsetting negative effects from external environment. In the mid and long term consolidation of public finance in order to ensure sustainability will be the main priority of fiscal policy, in line with European Commission findings and recommendations[4] . The main quantitative targets of the fiscal policy framework for the medium term ahead, are[5]:

- *The ceiling of total net borrowing of government as a ratio of GDP is 3.5% for 2013*
- *The ceiling of total net borrowing of government as a ratio of GDP is 2.4% for 2014*
- *The ceiling of total net borrowing of government as a ratio of GDP is 2.2% for 2015.*
- *Capital expenditures for each year 2013 - 2015 will be no less than the overall fiscal deficit.*

For the period 2012-2014, Albania will continue to prioritize investments allocations to sectors such as education, infrastructure, health care, and agriculture.

The monetary policy objective is to achieve and maintain the price stability. The quantitative target of the monetary policy is to achieve an annual change of Consumer Price Index of 3%, with a tolerance band of +/- 1pp, over the medium term.

The monetary policy will continue to be conducted under a flexible exchange rate regime, where the value of Lek against other foreign currencies is freely determined in the foreign exchange market by its supply and demand.

[1] The Budget Low for 2012 was adopted by the Parliament on 17.12.2012, Ref. Nr. 119
[2] The Macroeconomic and Fiscal Framework 2013 – 2015 was approved by the Council of Ministers on 23.01.2012
[3] The Medium Term Budget Program was approved by the Council of Ministers on 2.11. 2011, Ref. Nr. 752
[4] Enlargement Strategy and Main Challenges 2012-2013
[5] As approved in the Organic Budget Low, Budget Low 2012, Macro-Fiscal Framework 2013 – 2015 and EFP 2012

The projected macroeconomic policy mix accompanied by structural reforms aiming the increase of competitiveness in several domestic products and services, is expected to reduce the current account deficit to more sustainable levels.

The implementation of key structural reforms will continue in the medium-term ahead, supporting the objectives of policy mix. In this regard, further measures will be taken, aiming at improving the legal and regulatory framework of business operation and improve the overall business climate, increase the competitiveness of domestic products and services, further improving the financial sector, reducing informal economy, completing reforms of the public administration, and improving the labor market.

2. ECONOMIC OUTLOOK

2.1 Recent economic developments

In 2011 Albanian economy continued to experience a positive growth of around 3.1%. Unfavorable external developments and increased uncertainties among economic agents restrained economic growth quite below its potential. Economic activity slowed down during the first half of the 2011 with the lowest growth recorded in the second quarter and regained some strength during the other half of the year, especially in the last quarter. Economic growth in 2011 was mainly generated by domestic demand, almost equally shared between investment and consumption, while the contribution of external demand was modest, especially if compared to the leading role that external demand had in 2010. Services sector led the economic activity during 2011 with a real growth of about 4.2%, followed by industry and agriculture increasing in real terms by 2.9% and then construction which barely returned to positive growth of 0.2% after almost two consecutive years of deep contraction.

In the beginning of 2012 Albanian economy went through the second most difficult period of time since the end of 2008. GDP recorded a slight unexpected contraction of -0.2% in the first quarter of 2012 compared to the same quarter of the previous year. After the negative growth of -1.5% recorded in the last quarter of 2009, this was the second trimester the economy has performed with a negative growth since the global crises hit. The contraction was mainly due to several one-off external factors simultaneously hitting the economy. Exceptionally bad weather conditions taking place in the first quarter 2012 created operational difficulties and hindered supply of some sectors, especially extracting and mine industry and some services sectors, such as trade and transport. At the same time, the inability of some manufacturing industries to adapt at certain fast regulatory changes which took place in electric power market during the first months of 2012 led to temporary suspension of production (especially steal and cement manufacturing industries). A sharp reduction in electrical power production of around 50% in the first quarter of 2012 as compared to the first quarter of 2011 due to deterioration of hydric situation until mid-April 2012 was another important factor contributing to negative growth. At the same time, the increased turmoil seen in the international markets during the end of 2011 and beginning of 2012 was perceived negatively by domestic economic agents which have intensified their prudent behavior toward consuming and investing, adding up to the negative aforementioned external shocks.

Consequently, the typical slow growth of around 3% established during the last three years under global crises pressure went to negative territory due to these negative external shocks in the first quarter. Industry had the sharpest decline in the first quarter of 2012 recording a negative growth of -19.3% in annual terms, followed by construction with a negative growth of 17.6%. Communication and transport services experienced also negative growth in the first quarter respectively by -4.8% and -1.7%, while agriculture, trade and other services continued to perform positively with respective growth rates of 4.5% (agriculture), 5.3% (trade and hotels) and by 11.1% other services.

As the negative effects of these one-off factors has wiped out, growth regained some strength and returned back on positive ground in the second and the third quarter, recording a growth of 2.1% and 2.7% respectively, or by 1.6% on a cumulative bases of three quarters (y-o-y). Exports of goods increased by 18.5% in the second quarter (year-on-year), in full contrast to a negative growth of -14.3% recorded in the first quarter of 2012 and increased by 7.3% on a cumulative basis of eleven months (y-o-y). The same pattern as exports of goods is shown for exports of services based on Balance of Payment statistics. Albanian services consumed by non-residents increased by 1.8% y-o-y in the second quarter of 2012, while experiencing a decline by -5.9% in the first quarter on the same basis of measurement. At the same time the import of services by Albanian residents has decreased in the first half of 2012 as compared to a year ago leading to a considerable improvement of net services exports and adding to the positive contribution of external demand into economic growth of 2012.

Despite improved dynamics in total exports of goods, exports of textile and footwear which is an important category of Albanian exports has continued to suffer from bad economic developments and reduced demand of the Albania's two main trading patterns, Italy and Greece. Textile and footwear exports declined by 3.7% during the cumulative period of eleven months in 2012 (y-o-y).

The production of electric power, steel, cement, minerals and other important industries which encountered serious difficulties in the first quarter has broadly stabilized afterwards. Consumption seems also to have increased somehow in the second quarter although it remains significantly subdued relative to historical trend. Retail trade index in value terms increased by 5.5% in the second quarter of 2012 y-o-y considerably above the decline of -7.7% recorded in the first quarter. Total VAT revenue collection has accelerated at 2% y-o-y in the second quarter of 2012 against 0.8% growth in the first quarter. Especially the VAT levied on domestic produced goods (collected by tax authorities) had a significant positive change in the second quarter increasing by 6.3% y-o-y as opposed to a sharp decline of -13.1% in the first quarter.

Despite of these positive indications as regards consumption in the second quarter, still it continues to remain significantly subdued due to high uncertainties surrounding consumer expectations. The consumers continue to remain very cautious in their spending behavior and tend to save more. That is mainly reflected by the Consumer Confidence Index which continues to record values below its long term average and continuously increasing deposit although at a gradually slowing pace.

There are no yet national accounts statistics on total investment in 2012 but from the indirect available indicators seems that investment is the most negatively affected component of the aggregate demand during 2012. Despite an increase of by around foreign direct investment of 20% during the nine months of 2012 and somewhat higher public investment in the second quarter compared to the same quarter of 2011, other related indicators point to a contraction of private and total investment. Lower capacity utilization in all sectors except services, lower business confidence index, sharp decline in capital imported goods, deep negative growth of construction and significant reduction of the rate of credit growth for investment purposes strongly imply for a possible negative growth in total investments during 2012 relative to one year ago. *In overall, we expect a positive growth rate of around 1.5% for year 2012.*

The labor market generally improved in 2011 as employment increased by 1.7% and unemployment rate fell to 13.3%, slightly decreasing from 13.5% recorded in 2010. All the increase in total employment was due to non-agriculture private sector employment which increased by around 6.7%, while employment in the public sector continued to shrink by 0.6% during 2011 and employment in the agriculture sector remained unchanged. The unemployment rate has been remained almost at the same level during the last two years. From the end of 2010 until the second quarter 2212 it has been at the range of 13.5% - 13.3% and has been reducing by 0.5 percentage points form the pick of 13.8% recorded in the first quarter of 2010. The unemployment rate in the second quarter 2012 was at 13.3%.

The external position of the Albanian economy during 2011 was under the influence of international macroeconomic developments. The slowdown in economic growth, the deterioration of the employment situation and the weakening of foreign demand led to a significant moderation in the growth rate of exports of goods and to a decline of exported services in 2011. The pickup of domestic demand and the liberalization of visa regime with Schengen countries led to increased imports of goods and services, mainly in the second half of 2011. On the other hand, the improved balance of the income account and the current transfers contributed positively in the current account. As a result of the foreign currency flows in these accounts, the current account balance resulted in a deficit of 1122.1 million Euros, 10.2% higher compared to the previous year. The current account deficit for 2011 was estimated at about 12.1% of nominal GDP, or about 0.8pp higher than the level of 2010. Foreign currency inflows in the capital and financial account resulted in about 927 million Euros, up 6.3% y.o.y. The surplus recorded in this account during the year 2011 financed about 82.6% of CA deficit.

Latest data on the balance of payments belong to the first half of 2012. During this period, the net position of the current account recorded a deficit of 445.9 million euro. After the expansion in 2011, the current account deficit narrowed by 15.2% during H1 2012. As a result, the deficit was estimated at 9.5% of nominal GDP, or about 2.1pp lower compared with 2011 H1. Similarly to 2011, but in the opposite direction, the dynamics of the current account deficit during the first half of this year was largely influenced by the performance of the trade balance in goods and services. The combined improvement of the net positions compared with those of the corresponding period the previous year, largely contributed to the narrowing of the current deficit. The reduction of the trade deficit in goods by 4.9% yoy and the surplus in the services account helped to narrow the net exports deficit by about 10.8% annually. On the other hand, during the first half of this year, the net balance of the income account recorded a deficit of 17.1

million euro, different from the surplus of 18.9 million recorded during the first half of 2011. The performance of the income account contributed towards increasing the deficit, but could not net out the contribution of net exports. The net balance of current transfers increased slightly by 1.4%. The slower pace of decline in remittances is observed during the first half where the net inflows recorded a slight decline of 2.1% yoy. The net flows of the capital and financial account recorded a surplus of 425.7 million euros in the first half of 2012, funding nearly 95.5% of the current account deficit registered during this period. Compared to the same period a year ago, the capital and financial flows declined by about 1% and amounted to about 9.1% of nominal GDP.

The annual inflation rate averaged 3.5% in 2011, remaining within the Bank of Albania's target band for inflation. At the beginning of the year the inflation rate and inflation expectations were above the upper bound of the target range, and toward the end of the year they declined toward its lower bound. The persistence of the negative output gap produced subdued inflationary pressures from the domestic side of the economy absorbing, in turn, increased pressures from the external environment. Following a historical low growth rate in the general price level in Q1 2012, inflation showed an upward tendency in last two quarters, in line with BoA forecast. Inflation increased from 1.1% in Q1 to 1.9% and 2.7% in Q2 and Q3[6]. The higher Q3 inflation was driven primarily by the deviation of the pattern of the seasonal factor, and the increase of oil prices. The prevailing tendencies of inflation are better captured by the developments in core inflation, and those of the domestically originated inflation by the net nontrade inflation. The former ranged between 2.95%-1.3% during 2011 and Q3 2012, against a historical average of 2.2% indicating the lack, and the decline over time of inflation expectations and domestic cost induced pressures. Net nontrade inflation declined from 2.3% on average for 2011 to 1.9 in Q3 2012 against a historical average of 2.3%.

Overall, the low inflation rates of this year have been determined by the continuing negative output gap in the presence of anchored inflation expectations. The expansion of the aggregate demand has not been sufficient to utilize the production capacities of the economy at historical levels restraining domestic costs, and implying weak cost-push inflationary pressures. On the other hand, external inflationary pressures were relatively contained as exchange rate remained stable in nominal effective terms an imported prices were relatively stable.

Monetary expansion rate in 2011 has slowed down gradually, most notable toward the end of the period. Broad money growth has marked on average an annual increase of 10.8%. Monetary data available until September 2012, point to the continuance of this trend throughout this year – remarkably more obvious in September – as M3 growth rate decelerated to 8.3% on average. The foreign currency component continues to remain the main driver of broad money growth on the assets side. On the other hand the slowing growth of broad money has reflected the low financing demand of the public sector and the sluggishness of the credit to the private sector, notably due to low demand for loans. The low demand from the economic agents has been spawned due to labor market developments and uncertainties regarding future developments. This trend has been followed by both households and businesses. Deposits data (and increase in T-bills held by nonbanks private agents) as well as periodical surveys point out that households have been more oriented towards saving during this period, while credit to households has been reduced by 2.6%. Likewise, credit to businesses has been gradually reduced throughout January-

[6] Low inflation rates for 2012 H1 were influenced by base statistical effect.

September'12 growing by 11.7% on average, while reflecting weak investment trends and low demand of businesses for loans. On the supply side, banks have followed prudent crediting policies given the increasing ratio of non-performing loans as well as the overall uncertainties with regard to future developments. However, the banking sector remains well capitalized characterized by ample liquidity, which in the long run reflects a solid and reliable banking system. Though remaining broadly in line with last year's expectations, during 2012 monetary aggregates developed a lower than expected credit growth with a shift of new credit almost entirely in domestic currency. The analysis of monetary sector confirms that the inflation pressures of monetary origin remain subdued in the medium run.

The performance of ALL in nominal effective terms, in 2011 and in the first 10 months of 2012 can be deemed stable. In 2011, ALL depreciated on average by 0.37% against the currencies in the NEER[7] basket. While during January – October'2012, ALL appreciated slightly, on average by 0.3% on annual terms. The dynamics of NEER index reflected a steadier supply/demand balance against Euro and the strength of US dollar against ALL in line with the recent developments of the Euro/USD exchange rate in the international FX markets.

During 2011, the average level of Euro/ALL and USD/ALL exchange rates were respectively 140.3 and 100.8. Meanwhile, in January-October of this year, the ALL showed a strong depreciation against US dollar (8.1%) and a slight appreciation against euro (1.1%) compared to the same period in 2011. Lower imports in the last months, coupled with the recovery of exports and the Euro depreciation against the major currencies – *in light of the current crisis development in the euro area* – seem to have contributed to the slight appreciation of ALL against euro.

2.2 Medium-term macroeconomic scenario

The baseline scenario of the macro-economic framework is based on the actual policy mix and assumes the implementation of main planned structural policies for the medium term ahead. It is based on a set of assumption as regard the external environment and it takes into account the rational behavior and interaction between economic actors within the internal and external economic environment considered as the most likely in the upcoming years. An extensive set of macroeconomic statistics and forecasts by different institutions such as, Institute of Statistics of Albania, Bank of Albania, Ministry of Finance of Albania, DG ECFIN-European Commission, International Monetary Fund, Eurostat, European Central Bank, etc., have been used. These statistics are mainly in the form of time series, with annual, quarterly and monthly frequency generally dating back to year 1996. The baseline scenario aims to display the most likely macro-economic situation for the medium-term 2012 – 2014 and it aims consistency between different economic accounts.

Real sector

During 2012, the macroeconomic developments have been characterized by stable macroeconomic and financial fundamentals and low economic activity. Weak real economic

[7] NEER –Nominal effective exchange rate is calculated against the currencies of Albania's five major trading partners, namely Italy, Greece, Germany, Turkey and China. A higher NEER implies the lek's depreciation.

performance partly reflected the slowdown in global economic activity and partly the impact of domestic factors. International economic activity weakened significantly, due to the protracted debt crisis in the euro area and the problems facing the European banking system. Domestic demand continued to be subdued as a result of uncertainty for the future, households' income position, relative tight lending conditions and government measures aiming at containing the fiscal balance targets. All these factors resulted in a modest annual growth of 1.6% for the first three quarters of 2012.

According to our now cast and forecast, the Albanian economy will register low positive growth rates of 1.5% for this year and accelerate somewhat at around 3.1% in 2013, 3.9% in 2014 and 4.1% in 2015.

During 2012, growth is expected to have been driven by exports, but expansion in this component is also expected to be slower than in the past, due to the deteriorating prospects for international economic activity. Nonetheless, based on the recent experience, the Albanian exports may continue to increase further in the coming years due to boosted competitiveness in terms of quality, cost and better geographic distribution. On the other hand, the trade deficit – excluding the electric energy exchanges – has been narrowing, mainly due to lower demand for imports, indicating among other things the preference of consumers towards domestic products. If this tendency persists, it will contribute to economic growth. Domestic demand is likely to remain subdued although we forecast an improvement relative to 2012. Against the background of uncertain economic prospects, precautionary considerations may continue to be strong; postponing expenditures and investments. Corporate investment is restricted by the prospects for business activity, limited foreign financing resources and the prudent approach of the banking system towards lending. Households' investment in real estate is limited by low lending activity as well. While meeting the deficit target, fiscal policy has to limit its contrition to domestic demand. Despite for 2013 a higher deficit is projected attempting to stimulate somewhat the economic activity, a sustainable decline in the fiscal deficit is key and unavoidable in the medium to long term future in order to stabilise and then gradually reduce the public debt and ensure public finance sustainability.

Looking ahead, the output gap is expected to gradually close after 2015 and growth is expected to be more broadly based as economic agents confidence is expected to improve in line with the recovery of the global economic activity and especially of Italy and Greece. Households and businesses will start to benefit from the stimulating monetary conditions, already in place.

The external balance of the economy may continue to improve in the coming years. This along with the stabilization of fiscal indicators will sustain the strengthening of the macroeconomic framework and will reduce risk premiums for the economy and contribute to foreign capital inflows. Also, the correction of imbalances in the external sector indicates the improvement of the gap ratio between savings and investments in the country.

Despite the positive growth rates, the economy is projected to continue to operate below potential in the short to medium run, implying low inflationary pressures from the demand side. Within this context, the BoA will continue to provide an anchor of stability and confidence and to stimulate the economy.

GDP: Aggregate demand

Final consumption is forecasted to grow in real terms with an annual average rate of 1.9% during the medium-term ahead (2013 – 2015). Specifically, the consumption real growth is forecasted at 0.5% in 2013 contributing by 0.5 p.p. on the economic growth for this year. During 2014 consumption growth is forecasted to accelerate at 3%, contributing by around 2.6 p.p. in the overall real economic growth and grow by 2.3% in 2015 or contributing by 2 p.p.

Investment (Gross Fixed Capital Formation) during 2013 – 2015 is forecasted to experience an average annual real growth of 2.2%. In 2013 investment are forecasted to grow by 3% in real terms contributing by 0.9 p.p. in GDP growth; in 2014 it is forecasted to increase by 0.5% due to a lower public investment planed for that year – a considerable fiscal consolidation is planed for 2014 targeting a fiscal deficit of 2.4% of GDP down from 3.5% in 2013 – contributing by only 0.1 p.p. In 2015 investments are forecasted to increase by 3.2% led by private investment with a contribution of 0.9 p.p. in the real economic growth.

Net exports of goods and services are foreseen to continue an improvement of their net balance in the medium-term ahead. It is forecasted a reduction of goods and services deficit by 9.1% in 2013 as compared to 2012 contributing by 1.8 p.p. in the GDP forecasted growth of 3.1% for 2013 and continuing to reduce by 7% in 2014 and by 8.3% in 2015, contributing respectively by 1.1 p.p. and 1.2 p.p. in the economic growth for these two coming years. The improvement in net exports is foreseen to come from a stable increase of exports of goods and services but also reduction of imports of goods and its substitution with domestically produced ones is foreseen to be an important factor in this regard.

Changes in inventories are assumed with a neutral (zero p.p.) contribution in the aggregate demand and real GDP growth[8].

GDP: Aggregate supply

The projections of the aggregate demand and its components correspond consistently with the following projections of the aggregate supply disaggregated by its main sectors.

The agricultural production, assuming normal climate conditions, has been projected to grow annually by around 3.6% in average for the upcoming period 2013 – 2015, with an average contribution on GDP growth of 0.7 p.p.

Industrial production, including extracting and manufacturing industry, is forecast to grow in average by 3.6% per year for the medium term ahead, contributing in average by 0.4 p.p. on the forecasted GDP growth.

Construction for the upcoming medium term period is forecasted to return to positive growth rate. In average it is forecasted to increase in real terms by 2.6% during 2013 – 2015, contributing positively in the overall economic activity growth by an average of 0.2 p.p. per year.

[8] This assumption is also due to non accurate historical statistics for this component. In the national accounts figures (GDP by expenditures) produced by INSTAT, this item is merged with “statistical discrepancies” and there are not official estimations of pure “changes in inventories”.

Services are forecast to grow in average by 4.2% per year during the medium-term ahead 2013 – 2015, having an average contribution of 2.3 p.p. per year on the overall economic activity. The main contribution is expected form trade, hotel and restaurant. Transport also is expected to have an increasing contribution during the upcoming time horizon.

Based on the above projections of the aggregate demand and supply, the presented baseline scenario projects a real GDP growth of 3.1% in 2013; 3.9% in 2014; and 4.1% in 2015.

Main macroeconomic indicators

ITEM	UNIT	2008	2009	2010	2011	2012 Para.	2013 Para.	2014 Para.	2015 Para.
Population	Million	2.90	2.88	2.86	2.83	2.83	2.83	2.83	2.83
Inflation rate (Average)	%	3.4	2.3	3.6	3.5	2.1	3.0	3.0	3.0
GDP Deflator	%	4.7	2.0	2.6	3.0	2.2	1.4	0.5	0.5
Exchange rate (Average)	ALL/USD	83.9	95.0	103.9	100.9	109.8	109.5	109.7	109.0
Exchange rate (Average)	ALL/Euro	122.8	131.6	137.7	140.5	139.2	139.9	139.5	140.0
The conversion factor of PPP	ALL/USD	41.8	41.7	44.5	45.5	45.5	45.5	45.5	45.5
Real GDP Growth	%	7.5	3.3	3.8	3.1	1.5	3.1	3.9	4.1
Nominal GDP Growth	%	12.6	5.4	6.5	6.2	3.7	4.5	4.4	4.6
GDP	ALL Billion	1,089.3	1,148.1	1,222.5	1,297.7	1,346.2	1,407.0	1,469.2	1,537.1
GDP	USD Billion	13.0	12.1	11.8	12.9	12.3	12.8	13.4	14.1
GDP	Euro Billion	8.9	8.7	8.9	9.2	9.7	10.1	10.5	11.0
GDP per capita	Thousand ALL	375.2	398.7	428.1	458.3	475.4	496.9	518.8	542.8
GDP per capita	USD	4,472.8	4,197.8	4,119.2	4,541.8	4,329.6	4,537.7	4,729.6	4,979.9
GDP per capita	Euro	3,056.5	3,030.1	3,109.1	3,261.4	3,415.1	3,551.6	3,719.2	3,877.2
GDP per capita	USD-PPP	8,974.1	9,550.8	9,628.6	10,081.6	10,458.0	10,930.7	11,413.8	11,941.2
Unemployment rate	%	12.7	13.8	13.5	13.3	13.5	13.1	12.2	10.9
Total Revenues	% of GDP	26.7	26.0	26.6	25.5	24.7	25.6	25.6	25.4
Total Expenditures	% of GDP	32.3	33.1	29.7	29.0	28.4	29.1	28.0	27.6
Overall Fiscal Balance	% of GDP	-5.5	-7.0	-3.1	-3.5	-3.7	-3.5	-2.4	-2.2
Primary Fiscal Balance	% of GDP	-2.7	-3.9	0.3	-0.4	-0.5	0.1	1.2	1.4
Current Fiscal Balance	% of GDP	3.1	1.3	2.4	1.9	1.1	1.6	1.5	1.2
Total Net Borrowing	% of GDP	4.9	4.6	3.1	3.5	3.6	3.4	2.4	2.2
Total Public Dept	% of GDP	54.7	59.4	58.5	59.5	61.9	63.8	63.8	63.4
General Government Public Dept	% of GDP	51.3	55.5	54.8	55.8	57.4	58.4	58.3	57.9
Public Dept out of Fiscal Indicators	% of GDP	3.4	4.0	3.7	3.7	4.5	5.5	5.5	5.5
Current Accounts	% of GDP	-15.6	-15.1	-11.5	-12.1	-10.3	-9.5	-8.2	-7.1
Trade Balance	% of GDP	-27.4	-26.4	-23.5	-24.3	-21.8	-20.0	-18.6	-17.1
Services Balance	% of GDP	0.8	2.0	2.6	1.5	2.4	3.9	4.4	4.5
Balance of Payments	% of GDP	2.1	-0.3	2.0	-0.3	1.3	1.5	1.2	1.6

Source: INSTAT, Bank of Albania, Ministry of Finance, World Bank

Inflation, monetary and exchange rate policy

The monetary policy objective of Albania (Bank of Albania) remains the achievement and maintenance of price stability. This objective is defined in quantitative terms as the 3.0% annual change of CPI with a tolerance interval of +/- 1.0 pp over the medium term. The monetary policy decisions are based on the extensive analysis of economic variables and the deviation of medium-term inflation forecast from target. The suitability of the monetary conditions and monetary policy decisions are assessed based on projections for price developments and real sector indicators, taking into account the balance of risks involved. Additionally, the Bank of Albania continues to use information from monetary aggregates as indicators of longer run inflationary pressures. The main monetary policy instrument is the refinancing operation with a maturity of 7 days with an interest rate (policy rate) reviewed monthly by the Supervisory Council. Apart from interventions in the money market, other instruments of monetary policy are permanent facilities and required reserves. Current monetary policy regime is associated with a floating exchange rate. Bank of Albania may intervene in the foreign exchange market for the purpose of increasing foreign reserves, and to avoid excessive volatility in exchange markets. Foreign exchange market interventions do not affect the monetary policy of Bank of Albania in achieving its main objective. In general terms, the monetary and exchange rate policy strategy for the period 2012-2014 maintains the key principles and arrangements pursued during recent years, as laid out in the Monetary Policy Document 2012-2014.

Consistent with the overall economic picture of low inflation and weak growth, the monetary policy was stimulating during 2012. The policy rate has been cut in five consecutive turns with a cumulative of 125 basis points - from 5.25% to an historical low of 4.00%. The policy rate cuts, along with continued liquidity injections and low demand from the public sector have aimed to control risk premia, to decrease financial costs and to increase financial intermediation in domestic currency. The latter has been encouraged also by the abolishment of the remuneration of the foreign component of the required reserve (valid since July 2011).

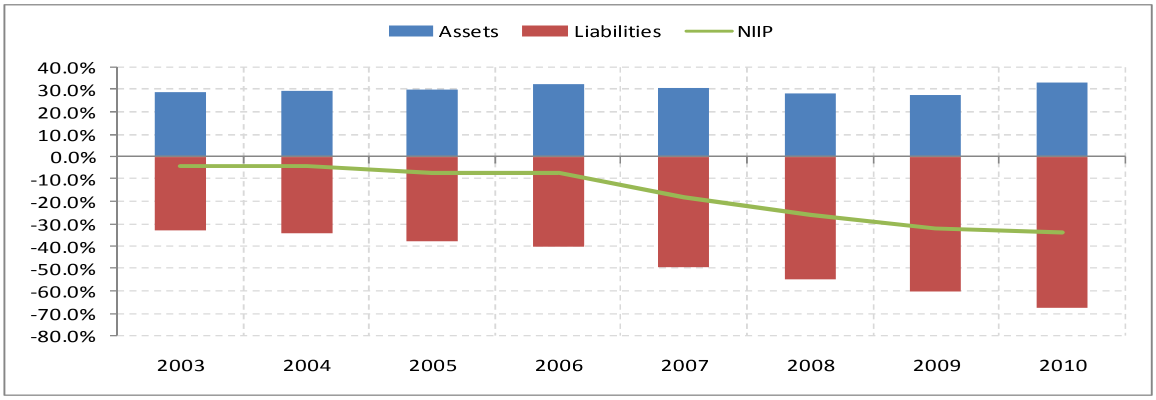
At the monetary policy horizon, headline inflation will be slightly under the BoA's inflation target. Our baseline scenario for inflation is determined by the effects of persistently weak demand, the expectations for relative low external inflationary pressures and stable exchange rate and anchored medium term inflation expectations. Monetary pressures are also expected to be weak, in conformity with the slow expansion of monetary aggregates. In this context, the monetary policy is expected to continue to be accommodative as long as future developments of the domestic and world economy do not shift the balance of risks for inflation above the Bank of Albania's target. In implementing its monetary policy, the Bank of Albania will continue to use the existing market instruments of monetary policy. Beyond 2013 inflation is expected to be on target on average.

External sector and its medium-term sustainability

Against a lower than previously expected economic growth in Albania as well as pessimistic developments in the neighboring Euro zone countries, we assess that current account deficit will continue its contraction and amount to €958 million in 2013 (or 9.5% of GDP), €859 million in 2014 (or 8.2% of GDP) and €787 million in 2015 (or 7.1% of GDP). The deficit reduction is foreseen to result mainly from an improvement in the balance of goods and services.

The evolution of Albania's net international investment position shows that the rapid increase in the stock of financial liabilities exceeded the moderate growth of the external financial assets stock. In terms of ratio to nominal GDP, the stock of external financial assets increased to 33.5% of GDP in 2010 whereas the stock of financial liabilities increased to 67.3% of GDP therefore recording a net IIP of -33.8% of GDP. The major increase in the stock of liabilities came mostly due to the increase in foreign direct investments during the past years. The share of direct investment to total liabilities has gone from 23% in 2003 to 44.2% in 2010. On the other side, foreign exchange (mostly securities in the form of bond and notes) make up for almost 60% of total stock of assets at the end of 2010.

Stock of financial assets, financial liabilities and NIIP in terms of nominal GDP



Source: Bank of Albania

The Constant Market Share approach (CMS) decomposes a country's export growth into parts attributed to the general rise in world exports, the commodity composition, the market distribution, and the effect of competitiveness changes. The characteristic feature in this method is the assumption that a country's export share in a given market would remain unchanged over time.

Following the application of the CMS by Mulyanti (2003) the results for Albania are summarized in the following table.

Decomposition of Albanian Exports using the CMS methodology

	2005-2008		**2008-2010**		**2011**	
	Mil €	% total	Mil €	% total	Mil €	%total
World Export Growth	56.28	14.6%	52.39	20.5%	98.97	42.3%
Commodity composition	-7.84	(2.0%)	-1.26	(0.5%)	10.28	4.4%
Market Distribution	-3.91	(1.0%)	-29.51	(11.5%)	49.21	21.0%
Competitiveness	341.15	88.4%	234.02	91.5%	75.56	32.3%
Total	385.68	100%	255.64	100%	234.02	100%

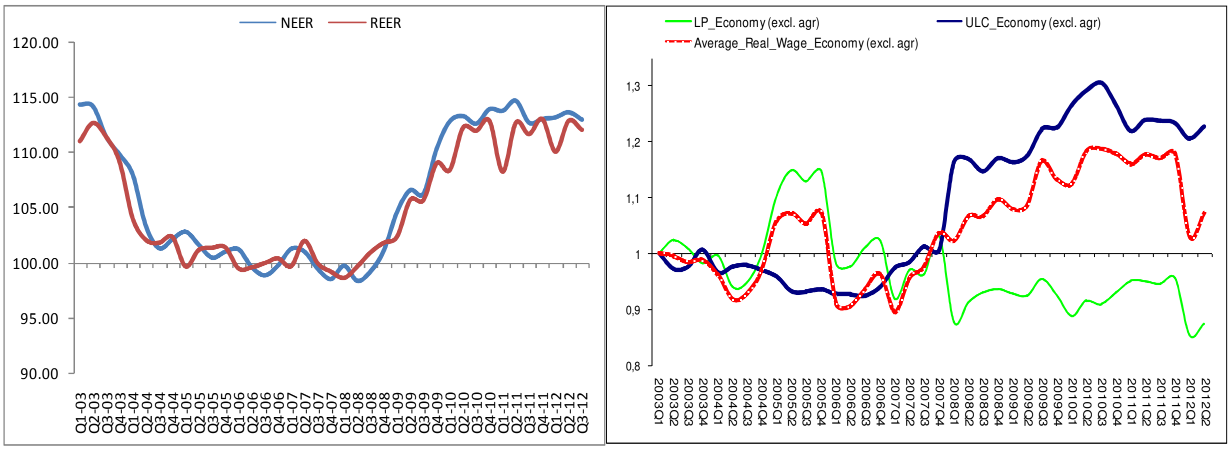
According to this decomposition of Albanian exports, the world export growth has been leading the direction of export changes in 2011, while still contributing positively to the overall performance since 2005. The commodity composition effect and market distribution effect have shown positive signs in 2011 mainly due to the exports re-orientation process and the slight increase in diversification of the export products. In addition, competitiveness of Albanian exports, while still contributing positively to the overall export performance, has decreased in 2011.

In line with the World Bank[9], "CMS however does not identify the reasons behind a change in a country's export performance. The competitiveness effect can reflect both productivity and labor

[9] See http://go.worldbank.org/KQCHUD4JN0 for a discussion on CMS.

costs advantages. It can also include other variables such as the innovation capacity, quality improvements or increased total factor productivity". Thus we further develop the analysis by taking a look at the latest data from REER, Unit Labour Cost and Labour Productivity. NEER and REER indices show increasing values implying a depreciating trend for local currency. This trend may have increased the demand for the "cheap" Albanian exports in the foreign markets. In addition, developments in LP trend, signal low probability for heating economy in the future periods, whereas ULC trend continues to suggest low inflationary pressures from wages.

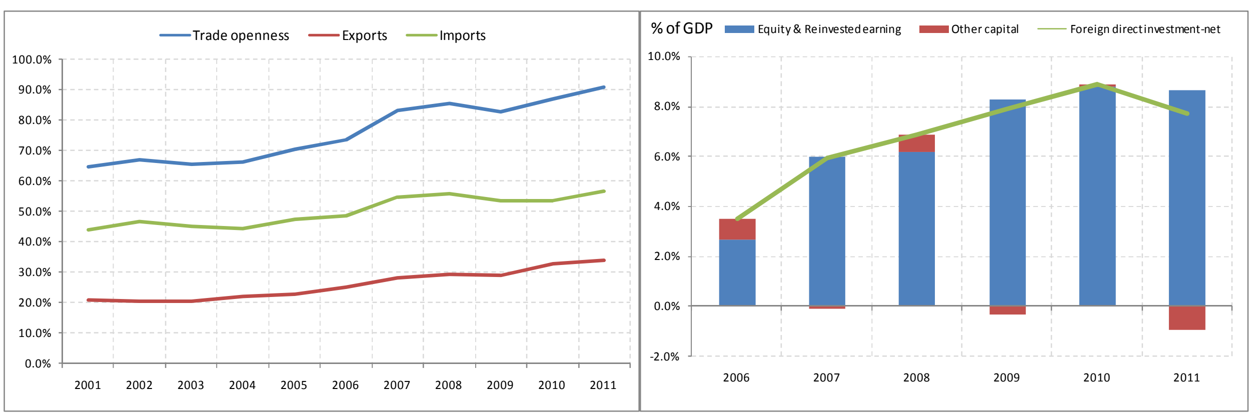
NEER and REER index (2006=100) left; LP (non agr), ULC (non agr) and average real wage right



Source: Bank of Albania

The indicator of trade openness during the period 2001-2011 shows an increasing trend while reaching its maximum value of 90.7% in 2011. Both exports and imports of goods and services increased their ratio to nominal GDP during the last decade.

Trade openness, export and imports(left;%GDP);Net FDI (right;%GDP)



Source: Bank of Albania

During the recent years, the flows of foreign direct investment in the country witnessed a progressive increase although under pressure from the general economic and financial crisis that affected the international markets. Nevertheless, in late 2011, the flow of FDI was estimated at 7.7% of GDP, about 1.2% lower compared to the level recorded in 2010. Developments in FDI in the country reflect the preference of foreign investors in our country in terms of lower production costs and potentially higher profit margins. The majority of the foreign direct investments was in the form of equity & reinvested capital whereas the transactions in the form of other capital fluctuated from year to year.

During the recent years, measures were taken in order to improve the investment environment of the country considering the problems faced with the business environment and competitiveness of the country. In order to support private sector development, a comprehensive regulatory framework was undertaken based on the reduction of administrative burden and cost of doing business. Moreover, the effort to promote FDI by strengthening institutional arrangements are also supported and assisted by international organizations such as World Bank/FIAS, UNDP and UNCTAD.

Liberalized economic framework, macroeconomic policy and improved conditions for doing business in Albania will continue to create an investor-friendly business environment for attracting FDI. Lowering corporate tax rates and tariffs and relatively stable exchange rate developments are expected to favor FDI flows to the country. The country has seen an FDI increase in manufacturing since 2008, encouraged by competitive production costs and proximity to EU markets.

In a wider scope, FDI inflows for the Albanian economy will still depend to a large extent on the ongoing privatization process, and one or a few successful privatizations of state-owned enterprises can already be decisive for FDI development as a whole in 2012 and 2013.

The remaining uncertainty in European financial markets could affect the FDI flows to developing countries, including Albania, in 2012. However, tensions in the euro area seem to be diminishing and this could bring more optimism to foreign investors for investing in the country during 2013.

Financial sector

General trends in activity The financial system and the banking sector are assessed as "stable" throughout the first nine month of 2012. They further expanded the operations and increased the share in the national economy. Within the financial system, the banking sector continues to dominate. Profit indicators have improved compared to the previous periods. Capitalization and operated liquidity position of assets has been appropriate. Referring to the capital, Albanian banks are well capitalized, compared to international indicators. However, banks should assess carefully their needs for additional capital in the future. Referring to the market risks, banking sector has resulted relatively protected against direct risk, of adverse movements in the exchange rates as well as interest rate. The banking sector remains exposed to impacts of its customers' sensitiveness to movements in interest rates and exchange rates. Banking sector liquid assets denominated in domestic and main foreign currencies are above the minimum regulatory levels.

At the end of September 2012, the level of financial intermediation in Albania, measured as the ratio of financial sector[1] assets to GDP, is estimated at 94.7 per cent, from 92.8 per cent in the end of June 2012 and 89.5 per cent at the end of 2011. Financial institutions' assets grew about

[1] The financial system consists of banks, non-bank financial institutions, savings and loan associations (SLAs), insurance companies, private supplementary pension funds and investment funds.

2.5 per cent compared to end-June 2012 and 6.8 per cent to end-2011. Non-bank financial sector continues to have a small share in the total assets of the financial system at around 5.9 per cent of the financial system assets, an increasing share as compared to 5.3 per cent at end-2011. The banking sector remains the dominant segment of financial intermediation in Albania. Its assets at the end of September 2012, accounted for about 89.1 per cent of GDP from 87.2 per cent in June 2012 and 85.3 per cent in the same period last year.

In the first nine months of 2012, the assets of the banking sector went up to the level of 1,189 billion ALL. Growth in banking sector assets eased to the still high level of 8.6 per cent compare to the same period of the last year (from an annual increase of 13.1 per cent in December 2011 and 12.9 per cent in September 2011), reflecting the tight liquidity conditions facing the retail and the corporate segments and the ongoing economic slowdown. The increase in the activity of the banking sector was also supported by the well-functioning infrastructure of the payment systems. The financial market activity has been supported by the smooth functioning of AECH and AIPS payment systems, which are managed by the Bank of Albania.

Net financial result The net financial result of the banking sector was 3.1 billion ALL at end of September 2012, more than 2 times higher than the same period last year. This increase in net income owes mainly to the considerable decline in provisions for other assets. Asset loss charges declined by 56.8 per cent compared to September 2011, despite acceleration in non-performing loans (NPL) creation, likely due to changes in provision-requiring assets and over-provisioning in the previous quarters.

The financial result continues to have a high concentration in the largest banks (of Group 3) and it would be preferred that it extended to a larger number of banks in order to be more stable.

The banks' profitability measured as return on equity has improved during the last year. Although a higher Return on Equity (RoE) value is generally viewed as positive, an increase in RoE does not necessarily mean a stronger financial system (i.e. when not adjusted for risk – the trend in risk weighted assets). The change in RoE during the first nine months of 2012, was caused almost exclusively by an increase in the banking system`s net profit, the rise in risk-weighted assets being negligible. The same development is evinced for RoA, showing twice the level of a year ago.

Return on Average Assets (RoAA) and Return on Average Equity (RoAE) – profitability indicators – remained positive throughout 2012, to 0.36 and 4.23 per cent, respectively, almost doubled compared to the previous year due to increased net profit.

Currency composition and position toward non-residents At the end of September 2012, banking sector assets denominated in foreign currency amounted to ALL 678.8 billion (of which loans in FC were around ALL 383.6 billion), representing an increase of 5.4 per cent over the end of June and of 11.9 per cent year-on-year.

Foreign currency denominated liabilities amounted to ALL 638.4 billion, representing an increase of 5.4 per cent over the end of June and an increase of 12 per cent year-on-year; banking sector liabilities to non-residents, are estimated to amount to ALL 78.8 billion, representing a decrease of 1.2 per cent over the end of June 2012 and 13.8 per cent year on year.

Deposits Despite moderating economic activity, banking sector deposits continued to grow over the period under review, though at lower rates than in the previous period. Growth in customer deposits eased slightly to the still high level of 10.2 per cent compare to the same period of the last year from 13.1 per cent annual increase in December 2011. Indeed, household deposits, representing almost 90 per cent of total deposits, continued to lose steam - up 10.9 per cent annual increase in September against 15.3 per cent in December 2011 - while corporate deposits, albeit weak growth up 9.3 per cent (y-o-y) in September against 5.7 per cent annual growth in December 2011.

From a currency perspective, the moderation in deposit growth was driven by local currency denominated deposits (representing 48 per cent of total deposits), which posted their lowest rate of growth during the past 3 years (5.7 per cent annual increase in September 2012). Overall deposit growth would have eased further if FX-denominated deposits had not continued to post solid growth (up 14.7 per cent annual increase in September against 15.7 per cent in December), driven also by repatriations by emigrants in Greece.

In terms of their maturity, we note that 64 per cent of bank deposits are relatively of short maturity up to 6-months. The recent deposit growth has been concentrated in 6-12 months maturity. During this year, new ALL time deposits declined by 19 per cent towards the corresponding period in 2011. In the end of September, the ratio of domestic currency deposits to total deposits accounted for 48 per cent, falling by 2.1 pp from the same period in 2011. In the first 9 months of 2012, new EUR and USD deposits were respectively 12.9 and 17.1 pp lower than the same period a year ago. Although the bulk of these deposits consist of short maturity of up to 3 months, the composition has recently changed in favor of longer maturity of new deposits. New ALL deposits have reflected the trend of the interest rates, and their decline is at the same time a result of higher values in the government bonds` yields.

Deposits remain concentrated in the largest banks of the banking sector, and the degree of their concentration has increased year-over-year10.

In the future, we expect deposit growth to be positive, even though its pace could slow down. We believe that deposit growth will be supported by a gradual but steady economic recovery, which would enable growing disposable income from households.

Credit composition and quality Credit activity reached 40.9 per cent of GDP in September 2012. Private sector credit growth continued its downward trend, standing well below historical values of 5.5 per cent in September 2012, down from 13 per cent in December 2012 (y-o-y) and a recent peak of 14.8 per cent in September 2011. This deceleration was broad-based, reflecting both: i) weaker credit demand, due to deteriorating consumer sentiment and business confidence in view of weaker-than-before economic expectations; and ii) weaker credit supply through tighter credit standards, due to the continuing deterioration in asset quality.

Corporate lending, amounting to 74 per cent of total loans, continued to slow (up to 9.3 per cent y-o-y in September from 18.8 per cent y-o-y in December 2011 and 19 per cent y-o-y in September 2011) with the bulk allocated towards trading sector (sharing 34 per cent of outstanding corporate loans in September 2012), construction sector (18 per cent), manufacturing industry (17 per cent) and production of utilities (10 per cent), while household loans continued to decline at a faster pace (down 3.9 per cent y-o-y in September against -0.4 per cent in December 2011).

[10] The Herfindahl Index – which indicates the degree of concentration – was 1580 in September 2012, higher than a year ago (1510).

From a currency perspective, the local currency component, representing 36 per cent of total loans, moderated further to 16 per cent annual increase in September from 21 per cent annual increase in December 2011. The foreign currency component also continued to slow (up 0.4 per cent y-o-y in September from 9.3 per cent in December 2011 and 13.6 per cent y-o-y in September 2011), due not only to banks' reluctance to grant low-cost foreign exchange lending to un-hedged borrowers (household loans in foreign currency declined by 6 per cent in September 2012 and 3 per cent y-o-y in December 2011), but also due to lower corporate demand for foreign currency loans.

The high level of foreign currency-denominated constrains the room for maneuvers of monetary policy and could be a potential source of instability in the financial system, since it could expose banks to currency mismatches or indirect credit risks loans represents a clear risk as unfavorable exchange rate movements could strain the banks' solvency.

In the future, we expect credit expansion to remain below the historical values, despite sufficient bank liquidity, stable financing sources and adequate capital position. We expect banks to maintain tight credit standards in view of credit quality concerns, despite some improvement in outlook of economic growth.

Non-performing loans ratio during 2004-2012

NPL (%)	2004	2005	2006	2007	2008	2009	2010	2011	First 9-months 2012
System	4.2	2.3	3.1	3.3	6.6	10.5	13.9	18.8	22.7
Private sector	5.4	2.6	3.5	3.6	7.6	12.3	15.5	20.8	26.0
Household sector	1.5	1.7	2.2	3.0	5.5	8.2	11.7	15.8	17.4
Domestic currency	1.9	1.7	2.8	3.9	7.5	10.1	14.4	16.9	19.5
Foreign currency	4.7	2.5	3.1	3.1	6.3	10.6	13.8	19.6	24.4

Loan quality continued its downward trend in the first nine months of 2012, where the ratio of nonperforming loans to total loans, on gross basis, rose to 22.7 per cent versus 21.1 per cent in June 2012 and 18.4 per cent in the same period previous year. The quality of loans has deteriorated for both, businesses and households groups, and similarly for domestic and foreign currency loans. Against a background of deteriorated loan quality, the banking sector has been prompt to raise the provisions. In September 2012, the non performing loans coverage ratio (provisions for non-performing loans to nonperforming loans) was 53.4 per cent, from 50.8 per cent in the same period the previous year. Regarding the collateralization of loans, the latest data showed that the value of collateral guaranteed loans accounted for 83.9 per cent of loan portfolio in September 2012 from 78.7 per cent the year before.

Liquidity situation During January–September 2012, liquidity situation in banking system has been satisfactory. The liquid assets represented 29 per cent of the total assets of the banking sector, from 26.3 per cent the same period last year. The liquidity ratio in total (liquid assets to short term liabilities) increased to 35.8 per cent from 33.1 per cent in December 2011 and 31.3 per cent the same period previous year. The greatest growth was experienced by liquidity ratio in foreign currency, increasing to 27.4 per cent in September 2012, from 26.5 per cent in June 2012, whereas the ratio in ALL continues to remain at high levels (45 per cent y-o-y in September 2012). The banks took appropriate measures to comply with the new ratios (especially and more importantly regarding the foreign currency ratio) where by the end of September 2012 all of them did comply with the overall ratio.

The loan to deposit ratio stands at 58 per cent, slightly lower than 59 per cent of June 2012 and of 61 per cent at the end of December 2011, demonstrating a strong structural liquidity of the Albanian banking system. Along with the increase of the clients' deposits, some banks have shown a decrease in the usage of the credit lines from their parent banks, which in September 2012 stood at 1 per cent of the total assets of the system, compared to 1.2 per cent of the total assets in June 2012, 1.5 per cent in the end of 2011 and 1.7 per cent compare to the same period previous year.

Although, financing from parent banks remain a very important source of financing for some banks, especially Greek banks subsidiaries in Albania, credit lines in September 2012 decreased gradually comparing with the same period previous year. These funds in September 2012 were about ALL 54.9 billion from ALL 66 billion the same period previous year. Greek banks were able to absorb a significant part of deposit inflow in the banking system. In general, the liquidity position of Greek banks subsidiaries has improved and remains at satisfactory levels.

Capital position During the first half of 2012 the capital adequacy ratio of Albanian banking sector has shown a downward trend, while in the third quarter of 2012 this ratio increased again. As for September 2012, this ratio stands at 15.9 per cent, or 0.2 percentage points higher than the level of June 2012, reflecting a higher growth rate of regulatory capital compared to risk weighted assets (2.6 per cent vs. 1.4 per cent). In the near future is expected that this ratio may be stable or increase slightly as the banks would prefer to invest less in risky assets.

Stress-tests The stress-testing exercise conducted for the period 2012-2013 assesses the impact of macroeconomic situations on the banking sector's financial condition, excluding the possibility of increase in paid-in capital during the period under review. In practice, the situation deteriorates gradually and the banks have time to take appropriate measures by injecting capital. This analysis includes the baseline scenario which is built on economic and financial indicators forecast, generally based on their historical performance and the adverse scenarios that assumes a 'stressed' situation of low probability of occurrence[11], based on three probable shocks to the Albanian economy: a) Further slowdown in lending; b) Increase in market interest rates, and c) Depreciation of the national currency.

The stress-testing results reveal that the overall banking sector is resilient to assumed shocks. The banking sector capitalization level remains above the minimum required ratio in the event of

[11] Research Department, Bank of Albania.

the baseline scenario. In the event of the adverse scenarios, which include the respective assumptions of decline in GDP growth rate, credit slowdown and exchange rate depreciation, individual banks and the banking sector may need additional capital. In the face of pressures from international developments and domestic economic activity, banks should cautiously monitor their activity to maintain an appropriate capital level in any case.

We also conduct contagion risk scenarios, to assess the exposure of the banking sector towards their parent banks abroad. The results of the stress indicate that the exposure for the Greek bank subsidiaries has decreased while the exposure of the Italian banks operating in Albania continues to be relevant.

Risks Going forward, credit risk remains a major cause for concern. A high level of NPL and tight lending conditions could slow economic growth which, in turn, would create a potential negative feedback circles. Moreover, in the wake of the significant proportion of un-hedged FX-denominated loans, sizeable lek depreciation would make repayments more difficult thereby threatening the stability of the banking sector.

To deal with the rising non-performing loans, Bank of Albania has performed thorough qualitative and quantitative assessment of the restructured loans portfolio in the banking system. A reporting system and a database have been established in this context. During this period, the portion of restructured loans has increased gradually and their portion returning to quality ones is encouraging. BoA has cautiously advocated the use of restructuring as an effective practice to manage problem loans in the banking system.

Bank of Albania assesses that the banking system capital adequacy and liquidity levels should remain carefully analyzed. Banks should carry out accurate assessments regarding their needs in accordance with their risk profile. Apart from that, the following measures and proposals are identified for creating the premises to support the credit activity.

First of all, banks are required to continue improving the monitoring process in the following areas:

- strengthening relevant structures for assessing the quality of the borrower and loan collection
- accelerating actions to enable a valid borrower's loan restructuring
- proactively recognize loan losses and create provisions against credit risk
- Effectively write-off lost loans and enable the maximum recovery value of the loan through collateral foreclosure procedures.

If carried out in a professional and transparent way, these actions will deliver resources to the banking sector and will better support the credit activity.

Bank of Albania is encouraging other public authorities to accelerate the necessary legal and financial incentives that could improve banking business environment such as the collateral foreclosure framework with special treatment for banks' loans practices. The reform on private enforcement entities should be followed by additional operational improvements, such as increasing the efficiency, accuracy and consistency of court decisions, providing financial knowledge programs for judges, improving the infrastructure for better outcomes of auctions and even encouraging the out of court approach to settle the claims among parties. Bank of Albania also encourages institutions specialized on non performing asset management to enter the market.

Measures to mitigate impact from international economic crisis In view of the adverse developments in the Euro zone, the Bank of Albania has undertaken several measures to protect the domestic banking system against the contagion effects and preserve the country's financial stability. This proactive stance, as well as low exposure to potentially toxic Euro zone sovereign assets has ensured the banking system's resilience towards pressures stemming from increasing stress in Greece and Italy.

In this regard, the regulatory and supervisory framework dealing with bank liquidity has been enhanced by means of more conservative regulatory limits, differentiated by type of assets and currency.

In addition, to take on more comprehensive competencies in addressing systemic risk situations, the BoA proposed a number of relevant amendments to the Banking Law, which were approved by the Parliament in November 2011. The following lists some important amendments:

- introduction of the systemic risk concept;
- granting of powers to the BoA to order the sale of a part or of all assets of a poorly performing bank to another bank chosen by the BoA for purposes of addressing systemic risk
- introduction of the concept of bridge bank, to allow the management of poorly performing banks' assets;
- creation of legal space to enable an efficient transformation of branches of foreign banks into subsidiaries (worth noting here in particular is the obligatory transformation on the decision of the BoA when the latter deems it necessary for purposes of addressing systemic risk).

In addition, the new regulation "On the creation, licensing and operation of the bridge bank" has been approved by has been approved by decision no.27, dated 16.05.2012 of the BoA Supervisory Council. The purpose of this regulation is to set out the main criteria and rules of the supervisory authority in case of establishment the bridge bank. The regulation is prepared in accordance with the new amendments of the Law on Banks, as the new concept of the "bridge bank" has been introduced.

Furthermore, Parliament adopted some amendments to the law on deposit insurance in July 2012, to strengthen the financial resources of Deposit Insurance Agency.

Other measures of the BoA were the requirement of systemically important banks to prepare their respective Recovery and Resolution Plans and submit them to the BoA within the year 2012, in order to meet recent global financial initiatives. These requirements are largely based on the FSB standards regarding Recovery and Resolution Planning. In the meantime, to facilitate the banks' planning process and steer their efforts towards the desired objectives, the BoA has started a constructive dialogue with them. In this context, banks are involved in preparing recovery options to respond to potentially adverse individual or systemic situations affecting their capital and liquidity positions, aiming at reducing systemic externalities and enhancing the financial system's resilience. On the other hand, the identification of appropriate resolution strategies as part of the plans is going to further support the set of enhanced supervisory competences on the treatment of problem banks, granted to the BoA through the recent legal amendments.

2.3. Alternative scenarios and risks

Against a baseline scenario of the output growth slowly closing during 2015, there are considerable risks which would condition the growth rates on the lower side. These risks cover both the developments in factors of production in the economy implying ultimately lower long run growth rates and cyclical imbalances of the economy and challenges of policies trying to close these imbalances without creating new ones.

A first risk is related to the inability of domestic demand to pick up despite the easing of short term uncertainties regarding short term developments. The low contribution of domestic consumption and the lack of stimulus for investment expenditures could lead to a lower creation of income flows which will translate in lower new capital, also discouraging the creation of know-how of the labor force. This could lead not only to a lower growth scenario but also to lower potential growth in the more distant future. Sluggishness in the labor market could translate into increasing long run unemployment and decrease (or hamper the growth) of the labor force. At lower growth rates, sustaining a consolidation of public finances and rebuilding room for fiscal maneuver would be even more challenging

Despite the good performance of the external trade in 2012, the further narrowing of the trade deficit may not materialize if adverse shocks hit the energy sector; continued weaknesses in Italy and Greece constrain exports particularly in the fason industries and the perceived import substitution with domestically produced goods reverses quickly.

A third risk relates to possible deleveraging of the economy as banks continue to restrain credit in the face of rising NPLs, mother bank policies and a continuing drop in the demand for loans by the private agents.

3. GENERAL GOVERNMENT BALANCE AND DEBT

3.1 Policy strategy and medium-term objectives

Tax policies

Important changes in tax legislations have taken place during 2012, and these are expected to affect revenues in the following years. We briefly analyze them below.

New law on Excise in Albania, effective from October 1st. Law 61/2012 sets new rules and procedures for excise administration and collection, unifying these tasks at the Customs Administration. The new law is (almost completely) approximated to the harmonized EU legislation on excise duties, regarding not only procedures but also the tax structure for excise goods.

March 2012 has been the “go live” deadline for the fiscal stamps project, implemented by the concessionary company contracted. The project involves not only production of highly secure stamps, but also monitoring and tracing of those stamps, with the objective of reducing informal trading of excise goods. We expect that after this consolidation period of the project implementation and the transition period of the taking over of excise administration by Customs, the new measures will significantly impact revenues during 2013-2015.

A new VAT law draft is under discussion, by experts in the Ministry of Finance and stakeholders. Financially supported by IPA 2007 funds and with technical assistance from French experts, this draft law is formulated to be in accordance with EU Directive 2006/112/EC. The policy objective of drafting a new VAT law is to enhance market competition and reduce at minimum trade barriers for goods and services, with the view of a future involvement in the Intra Community market. Entry into force is foreseen not earlier than mid-2013 because of the issues that needs to be discussed and defined and the preparatory workload that needs to be done by Tax administration for proper implementation of the new provisions.

New draft customs code, which is being developed in full compliance with European Union Regulation 450/2008, aims at facilitating business, ensuring a high level of protection for security and thus respond to the challenges Albania will face on European Union economic reality. Draft legislation aims modernizing and simplifying customs regulations through a paper-free customs environment for the customs authority and for the economic operator; the use of modern technology; all these constitute the basis for a simple and efficient clearance. The new Customs Code based especially in integrated computer systems, offers:

- simplification of customs rules;
- improvement of customs controls, which are performed primarily based on a risk analysis as part of risk management framework;
- facilitation of customs clearance procedures, which will be fully computer-generated and will provide most of simplifications;
- efficiency in the implementation of customs procedures which have been reorganized in the "special procedures" to enable a restructuring of transit (national and foreign), storage (temporary storage, customs warehousing, free zones), special usage (temporary admission and end-use) and processing (processing active and passive)

Annual declaration for personal income; Implemented for the first time during 2012, The deadline for filing and payment by individuals was September 30. However, according to the current legislation, the obligation does not rise for all individuals who realize incomes during the preceding year (a threshold of 2 million ALL is defined), meaning this is a simplified scheme, that is expected to evolve, according to the success of implementation. This is basically a measure for data collection and controls improvements at first, but in the medium term will contribute reduce informality and increase revenues collected from PIT.

On the administration side, progress has been made to continuing formalization of the economy, fight against tax evasion and smuggling, two concession agreements are in process of negotiation:

- Service concession to marking and monitoring of fuel in Republic of Albania (RA)
- Granting the concession of container other vehicles scanning service

Concession service of marking and monitoring of fuel in RA aims to ensure and guarantee the payment of taxes under the legislation of the Republic of Albania for the marketing of fuels in the Albanian territory, through market control (excise, VAT, tax Carbon). This control is made possible precisely by the fuel marking system provided by the sponsoring company which, not only verifies if the fuel composition has changed after the payment of taxes, but whether fuel circulation is marked, so the tax is paid, or fuel is not marked, so it is smuggled into the Albanian market.

Providing the service concession to scan containers and other vehicles has for object the designing, financing, implementation and control management of the containers destined for import, export or transit regime which are in all the territory of the Republic of Albania. This control is proposed to be realized through the installation and use of certain equipment "scanner" to a high-tech inspection, which allows control of the vehicle without the need to intervene physically. This project aims inter alia to ensure and guarantee a full tool support for the Albanian customs and border system, through the application of contemporary methods enabling: detection of evasion of income, including fees misstatement.; discovery of contraband goods and products; detecting narcotic goods and products; movement of illegal arms and ammunition and in particular for the detection of evasion of excise goods (tobacco, alcohol, oils, fuels, etc.).

In the context of IMF assistance a new Strategic Plan of 2012-2015 and DPT-Draft Compliance Strategy 2012-2015 was completed and approved during 2012This strategy includes five key elements of tax administration: tax debt, the register of taxpayers; risk procedures, reimbursement of VAT and credit balance.

3.2 Budget implementation in 2012

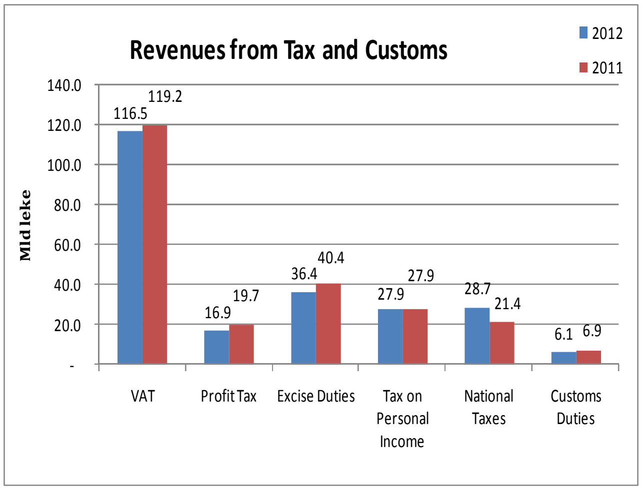
According to preliminary data from Ministry of Finance Treasury, total revenues of the consolidated budget of 2012 reached 329.9 billion leke (refer to Table 1). Total revenues decreased by 0.2 % on annual basis.

Billion leke	Jan-Dec '11	Jan-Dec '12	Normative Act 2012
TOTAL REVENUES	330.5	329.9	332.8
TOTAL EXPENDITURES	376.2	375.2	382.3
Of which: Current Expenditures	305.6	314.6	313.2
Capital Expenditures	70.6	60.6	64.7
FISCAL DEFICIT	-45.7	-45.3	-49.5
PRIMARY DEFICIT	-4.6	-3.8	-7.3

Total expenditures reached the level of 375.2 billion leke (refer to Table 1), being 0.3% lower than the previous year, and 7 billion leke less than the planned figure at Normative Act for 2012 Budget.

The government fiscal deficit, calculated as difference between total revenues and total expenditures, was 45.3 billion lek at the end of 2012, which is 4.2 billion less than what was planned according to Normative Act, while primary fiscal deficit reached 3.8 billion leke. The deficit was primarily financed by domestic resourses (mostly domestic borrowing) as follows: revenues from privatization reached 1.2 billion leke; 24.8 billion leke of net domestic borrowing and 18.9 billion leke coming from net foreign financing.

Tax revenues for 2012 reached 300.9 billion leke, at a level of 98.5% of the amount planned according to Normative Act for 2012. Tax revenues decreased by 1% on annual basis. Revenues collected by tax and customs reached 232.6 billion leke in 2012, lower than the previous year by 1.2% or 3 billion.



Revenues from values added tax reached around 116.5 miliarde, with a decrease of 2.2% compared to the previous year. Domestic VAT was at th level of 24.8 billion, which is significantly lower than the result of 2011 by 5.7%, while VAT collected on imports was slightly higher than the previous year by 0.3% or 234 million lek. Revenues from excise duties reached 36.4 billion leke for 2012, significantly lower compared to the previous year by 9.9% or 4 billion. Starting from October 1st 2012, excise is administered and collected entirely by custom administration.

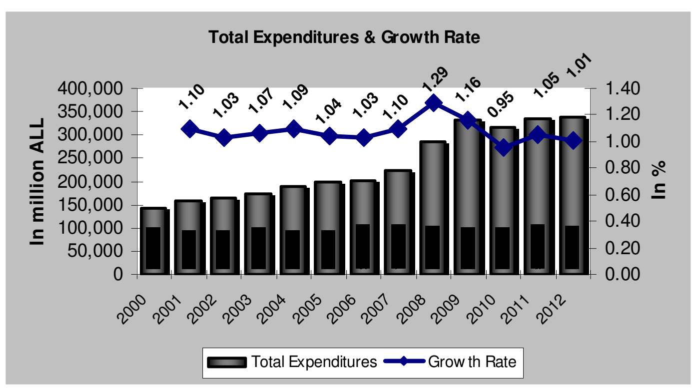
Revenues collected from profit tax were 16.9 billion, following a decreasing trend compared to 2011, by a considerable 14.5% or 3.2 billion. Revenues from personal income tax were almost at the same level of 2011, being around 28 billion leke. Revenues from national taxes performed quite well, increasing by 34% or 7.3 billion lek compared to the previous year; revenues from customs duties were 6.1 billion, 11% less than in 2011.

Revenues from local taxes reached 10.9 billion lek in 2012, which is 3.5 billion leke or 7.9% less than the previous year.

Revenues from special funds were at the level of 58.5 billion leke, increasing annually by 29 perqind

Non tax revenues reached 24 billion lek at the end of 2012, increasing by 1.3 billion on annual basis.

Total budget expenditures, at the end of November 2012, amounted to about ALL 336.8 billion from ALL 349.8 billion target set for this period or nearly 96.3 percent of the period's forecast, with a shortfall of around ALL 13.0 billion. Compared with the 2012 annual plan, these expenditures were realized in about 84.9 percent, while compared to the same period of 2011, budget



expenditures are about ALL 3.3 billion less or about 1.0 percent lower.

Current expenditures by the end of November 2012, have reached the level ALL 283.7 billion. Compared with the annual plan these expenses were realized at about 88.0 percent, while compared to the same period of 2011, these expenses result in approximately ALL 8.7 billion higher or about 3.1 percent more.

Within current expenditures, personnel expenses, which represent about 22.0 percent of total current expenditures realized during the period January-November 2012, are realized almost at the level of the period's forecast. These expenses, against the annual plan at the end of November, were realized at about 88.1 percent, while in comparison with the same period of 2011, personnel expenses are about ALL 1.7 billion higher or about 2.8 percent more. Wages are about 1.4 percent over the period's planned level, while social insurance contributions are almost at the planned level, being respectively wages expenditures at about 92.2 percent and social insurance expenditures at about 90.0 percent.

Interest Payments, which represent about 13.4 percent of total current expenditures realized during the period January-November 2012, resulted in a saving of around ALL 5.5 billion, from which ALL 3.8 billion in the domestic interests and about ALL 1.8 billion in foreign interests. Against the annual plan, interests are carried out at about 76.9 percent, meanwhile compared to 2011, they are about ALL 803 million higher or 2.2 percent more.

Operating and Maintenance Expenditure during the period January-November 2012 amounted to approximately ALL 30.3 billion, being about ALL 4.7 billion above the projected level. It should be taken into account even the expenditures from the reserve fund of the Council of Ministers and from the contingency fund.

Expenditures on subsidies at the end of November 2012 were around ALL 1.8 billion or about ALL 366 million above the forecast. Here it should be taken into account that about ALL 208.8 million were transferred from the Contingency Fund, in the form of a subsidy to local government units, in order to compensate the value of small business' tax, regarding the fiscal devices and taximeters' reimbursement.

Expenditures for Special Funds during January-November 2012 resulted at around ALL 1.8 billion leks less or 1.6 percent below the period's forecasted level. Compared to the annual plan, special funds expenditure are realized at level 88.5 percent, from which, social insurance expenditures are realized at around 90.2 percent of the annual plan, health insurance expenditures at around 89.3 percent, while expenditures for owners' compensation at around 66.7 percent. Compared to the 2011, social insurance expenditures are about ALL 4.3 billion higher or about 7.7 percent more, health insurance expenditures are about ALL 1.6 billion higher or about 6.8 percent more, while expenditures for owners' compensation are around ALL 305 million less.

Local government expenditures represent about 8.7 percent of current expenditures. For the period January-November 2012 they reached the level ALL 24.6 billion, almost at the planned level for this period. Compared to the annual plan, these expenditures were about 83.5 percent of it, while compared with 2011 these expenditures are about ALL 492 million lower or about 2.0 percent less.

Unemployment expenditures are realized at around 103.0 percent of the period's forecast or about 91.0 percent of the annual forecast. At the same time, this level is about ALL 123 million more than 2011's same period or about 15.6 percent higher. Economic Assistance during the period January-November 2012 resulted at around ALL 488 million more or about 3.2 percent over the period's forecast (or about 92.3 percent of the annual plan). Compared to the 2011's same period, this item is almost ALL 0.9 billion higher or 5.9 percent higher.

Capital expenditures by the end of November 2012 were executed at 76.0 percent of the annual plan. The domestically financed investments are realized at 87.0 percent, while foreign financed investments are realized at 68.9 percent of the annual plan. Compared to the 2011's same period, domestic investments are about ALL 12.9 billion lower or about 35.0 percent less, while foreign investments are about ALL 7.7 billion higher or 35.7 percent more. Consequently, total investments by the end of November 2012 were about 9.2 percent lower or ALL 5.4 billion less than the 2011's same period. The structure of capital expenditures realized during the period January-November 2012 is about 45.1 percent domestically financed and about 54.9 percent foreign financed.

3.3 Medium-term budgetary outlook

Budget revenues

Based on the approved budget for 2013, as well as Macroeconomic and Fiscal Framework adopted for the period 2014-2016 and tax policies for the three years ahead, total revenues and respective items for 2013-2013 are presented in the following tables (in nominal terms, as a percentage ratio of GDP as well as the nominal percentage growth year on year).

In milion ALL

No.	ITEM	2008	2009	2010	2011	2012 Normative Act	2013 Budget	2014 MTBP	2015 MTBP
	TOTAL REVENUE	**291,238**	**298,981**	**324,721**	**330,469**	**332,758**	**360,661**	**376,272**	**391,508**
I.	**Grants**	**4,228**	**4,430**	**4,605**	**3,811**	**4,020**	**11,995**	**12,489**	**13,016**
II.	**Tax Revenue**	**264,421**	**270,830**	**288,564**	**303,927**	**305,508**	**328,088**	**340,435**	**356,193**
II.1	***From tax offices and customs***	**205,292**	**208,870**	**223,019**	**235,509**	**235,922**	**255,169**	**265,198**	**277,477**
1	*V. A. T*	107,094	110,062	113,998	119,189	119,040	128,206	132,727	138,482
2	*Profit Tax*	18,108	17,149	17,606	19,712	16,553	17,747	18,339	19,113
3	*Excise Tax*	32,510	33,504	38,788	40,403	36,492	42,484	42,514	44,521
4	*Personal Income Tax*	24,498	26,820	27,058	27,967	28,128	29,328	30,806	32,229
5	*National Taxes and others*	14,423	13,405	18,295	21,388	29,657	31,130	34,372	36,587
6	*Custom Duties*	8,660	7,929	7,274	6,850	6,053	6,274	6,440	6,545
II.2	***Revenues from Local Gov.***	**11,307**	**12,149**	**11,898**	**11,791**	**11,073**	**12,003**	**12,258**	**12,973**
1	*Local Taxes*	7,137	8,154	7,684	7,279	6,580	6,925	7,240	7,660
2	*Propety tax (bildings)*	1,586	1,509	1,896	1,942	2,690	3,074	3,051	3,255
3	*Small Business Tax*	2,584	2,486	2,318	2,570	1,803	2,004	1,967	2,058
II.3	***Social Ins. Contributions***	**47,822**	**49,812**	**53,647**	**56,627**	**58,513**	**60,916**	**62,979**	**65,742**
1	*Social Insurance*	42,547	44,344	45,041	48,839	50,577	51,799	54,988	57,529
2	*Health insurance*	5,275	5,467	6,432	6,152	6,436	7,617	6,991	7,314
3	*Revenue for owners compensation*	0	0	2,174	1,636	1,500	1,500	1,000	900
III.	**Nontax Revenue**	**22,588**	**23,720**	**31,552**	**22,731**	**23,230**	**20,578**	**23,348**	**22,299**
	GDP nominal	**1,089,293**	**1,148,082**	**1,222,462**	**1,297,710**	**1,346,169**	**1,407,016**	**1,469,199**	**1,537,084**

Source: Ministry of Finance

in % of GDP

No.	ITEM	2008	2009	2010	2011	2012 Normative Act	2013 Budget	2014 MTBP	2015 MTBP
	TOTAL REVENUE	**26.7**	**26.0**	**26.6**	**25.5**	**24.7**	**25.6**	**25.6**	**25.5**
I.	**Grants**	**0.4**	**0.4**	**0.4**	**0.3**	**0.3**	**0.9**	**0.9**	**0.8**
II.	**Tax Revenue**	**24.3**	**23.6**	**23.6**	**23.4**	**22.7**	**23.3**	**23.2**	**23.2**
II.1	***From tax offices and customs***	**18.8**	**18.2**	**18.2**	**18.1**	**17.5**	**18.1**	**18.1**	**18.1**
1	*V. A. T*	9.8	9.6	9.3	9.2	8.8	9.1	9.0	9.0
2	*Profit Tax*	1.7	1.5	1.4	1.5	1.2	1.3	1.2	1.2
3	*Excise Tax*	3.0	2.9	3.2	3.1	2.7	3.0	2.9	2.9
4	*Personal Income Tax*	2.2	2.3	2.2	2.2	2.1	2.1	2.1	2.1
5	*National Taxes and others*	1.3	1.2	1.5	1.6	2.2	2.2	2.3	2.4
6	*Custom Duties*	0.8	0.7	0.6	0.5	0.4	0.4	0.4	0.4
II.2	***Revenues from Local Gov.***	**1.0**	**1.1**	**1.0**	**0.9**	**0.8**	**0.9**	**0.8**	**0.8**
1	*Local Taxes*	0.7	0.7	0.6	0.6	0.5	0.5	0.5	0.5
2	*Propety tax (bildings)*	0.1	0.1	0.2	0.1	0.2	0.2	0.2	0.2
3	*Small Business Tax*	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
II.3	***Social Ins. Contributions***	**4.4**	**4.3**	**4.4**	**4.4**	**4.3**	**4.3**	**4.3**	**4.3**
1	*Social Insurance*	3.9	3.9	3.7	3.8	3.8	3.7	3.7	3.7
2	*Health insurance*	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
3	*Revenue for owners compensation*	0.0	0.0	0.2	0.1	0.1	0.1	0.1	0.1
III.	**Nontax Revenue**	**2.1**	**2.1**	**2.6**	**1.8**	**1.7**	**1.5**	**1.6**	**1.5**
	GDP nominal	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Ministry of Finance

Nominal y-o-y growth in %

No.	ITEM	2008	2009	2010	2011	2012 Normative Act	2013 Budget	2014 MTBP	2015 MTBP
	TOTAL REVENUE	**15.8**	**2.7**	**8.6**	**1.8**	**0.7**	**8.4**	**4.3**	**4.0**
I.	**Grants**	**230.3**	**4.8**	**4.0**	**-17.2**	**5.5**	**198.4**	**4.1**	**4.2**
II.	**Tax Revenue**	**15.9**	**2.4**	**6.5**	**5.3**	**0.5**	**7.4**	**3.8**	**4.6**
II.1	***From tax offices and customs***	**16.1**	**1.7**	**6.8**	**5.6**	**0.2**	**8.2**	**3.9**	**4.6**
1	*V. A. T*	22.0	2.8	3.6	4.6	-0.1	7.7	3.5	4.3
1.1	*from Tax office*	*34.0*	*1.6*	*-10.7*	*-10.1*	*-3.9*	*4.3*	*6.2*	*4.0*
1.2	*from Customs*	*17.5*	*3.3*	*9.6*	*9.6*	*0.6*	*4.8*	*6.9*	*4.4*
2	*Profit Tax*	-14.1	-5.3	2.7	12.0	-16.0	7.2	3.3	4.2
3	*Excise Tax*	13.2	3.1	15.8	4.2	-9.7	16.4	0.1	4.7
4	*Personal Income Tax*	65.0	9.5	0.9	3.4	0.6	4.3	5.0	4.6
5	*National Taxes and others*	-0.7	-7.1	36.5	16.9	38.7	5.0	10.4	6.4
6	*Custom Duties*	-12.1	-8.4	-8.3	-5.8	-11.6	3.7	2.6	1.6
II.2	***Revenues from Local Gov.***	**20.7**	**7.4**	**-2.1**	**-0.9**	**-6.1**	**8.4**	**2.1**	**5.8**
1	*Local Taxes*	0.0	14.2	-5.8	-5.3	-9.6	5.2	4.5	5.8
2	*Propety tax (bildings)*		-4.8	25.6	2.4	38.5	14.3	-0.8	6.7
3	*Small Business Tax*	15.8	-3.8	-6.8	10.9	-29.9	11.2	-1.8	4.6
II.3	***Social Ins. Contributions***	**13.9**	**4.2**	**7.7**	**5.6**	**3.3**	**4.1**	**3.4**	**4.4**
1	*Social Insurance*	13.3	4.2	1.6	8.4	3.6	2.4	6.2	4.6
2	*Health insurance*	19.1	3.7	17.6	-4.4	4.6	18.3	-8.2	4.6
3	*Revenue for owners compensation*				-24.7	-8.3	0.0	-33.3	-10.0
III.	**Nontax Revenue**	**2.2**	**5.0**	**33.0**	**-28.0**	**2.2**	**-11.4**	**13.5**	**-4.5**
	GDP nominal	**12.6**	**5.4**	**6.5**	**6.2**	**3.7**	**4.5**	**4.4**	**4.6**

Source: Ministry of Finance

Budget Expenditure

Budget Expenditure for 2013 relies on the budgeting procedures based on policy objectives and outputs during the preparation of MTBP 2013-2015. According to the 2013 Annual Budget Law No.119/2012 dated 17.12.2012, total expenses for 2013 are set out at the level of ALL 409.6 billion or 28.6 percent of GDP, registering an increase of about 7 percent compared to the 2012 Normative Act. During 2013, the total budget expenses will aim to achieve:

- Maintaining budget deficit at the level of 3.4% percent of GDP;
- Maintaining a level of capital expenditures of 5 percent of GDP;
- Differentiated increase of salaries for priority sectors at a range of 2-5 percent (education and health at a range of 3-4 percent);
- Increase of benefits for pensioners, at a rate of 4 percent for urban pensions and 5 percent for rural pensions.

Personnel expenditures for 2013 are based in a policy of increasing efficiency and effectiveness in the use of human resources. In 2013, they are forecasted at a level of 5 percent of GDP. This level is mainly due to the reduction in the number of military personnel in the Ministry of Defense and the establishment of Albanian Road Authority, which decreased the number of total budgetary employees to 87.710 from 88.640 employees in 2012. Also, the personnel expenditures forecast have taken into consideration the policy of wage increase starting from 15 July 2012. The policy of wages increase will continue also in 2013 and it will consist in a differentiated increase of salaries for priority sectors, which will be supported by the Contingency for new Policies by ALL 1 billion. In addition, as in year 2012, in personnel expenditures has been identified as a separate component the Bonus Fund, which during 2013 is foreseen at level ALL 1.2 billion. It will be used only after the prior approval from the Ministry of Finance, in accordance with the revenue performance and criteria set with the Council of Ministers Decision no.929, date 17.11.2010 regarding the "Use of the Bonus Fund", amended.

The estimation for interest expenditures has been based on the Debt Strategy of Ministry of Finance and the level foreseen in a stable macroeconomic situation. For 2013 these expenditures will reach the level 3.6 percent of GDP, from 3.1 percent of GDP it registered in the 2012 Normative Act.

Operational and maintenance expenses for 2013 are foreseen at the level of ALL 32.9 billion or 2.3 percent of GDP, from ALL 31.2 billion it was in 2012 Normative Act. They will continue to be oriented towards the increase of expenses for the functioning and maintenance in priority sectors such as infrastructure, education, health and agriculture, by applying a differentiated rate of increase for these sectors.

The subsidy expenditures rely on the existing policy of subsidies and on the policies for their gradual reduction. Based on the recommendations for a gradual over-time reduction of subsidies, all the institutions have been required to undertake reforms to the effect of a better management of the respective sectors and improvement of their financial performance. In 2013 these expenditures are foreseen to keep the level of 0.1 percent of GDP.

Local Budget Expenditures in 2013 are foreseen at the level of ALL 29.3 billion or 2 percent of GDP, increasing by almost ALL 2 billion compared to 2012 Normative Act.

Expenditures for Social Assistance and Disability for 2013 are foreseen to increase from ALL 17 billion in the 2012 Normative Act to ALL 17.4 billion. In this forecast is taken into consideration the policy of the differentiated increase of the components of these expenditures. The size of the increase shall go towards the disability allowances, as a consequence of its indexing, increasing of the number of beneficiaries and improvement of procedures of obtaining such a status. From the other hand, the Economic Assistance, as a result of the legal and administrative improvements shall decrease (in relative terms). Meanwhile, the Ex-prisoner's Compensation is foreseen to considerably increase to about ALL 3 billion, compared to ALL 1.7 billion it was in 2012 Normative Act.

For 2013, the item "Reserve fund + Contingency" is foreseen at level ALL 2.2 billion. It is constituted by the Reserve Fund of CoM of about ALL 1.4 billion and by the Contingency for Financing the Deficit at the level of ALL 800 million.

Capital Expenditures for 2013 are foreseen at level of ALL 70.9 billion or 5 percent of GDP, with an increase of about ALL 6.2 billion or 9.6 percent. More specifically, domestically financed investments will register ALL 25.4 billion, while those foreign financed are foreseen at level ALL 45.5 billion. Moreover, we will still prioritize those projects which continue from previous years, as well as those defined as strategic for country's economic and social development, in accordance with the Government Program and NSDI. Both domestic and foreign investments will continue to be oriented towards priority sectors such as: infrastructure, education, health, agriculture and rural development.

For 2013, the budget deficit will be at level 3.4 percent of GDP. Its domestic financing is foreseen at level 2.0 percent of GDP, while its foreign financing will be at level 1.4 percent of GDP.

Medium Term Budget Programming (2014-2016)

It should be mentioned here that the below estimations refer to the new Macroeconomic and Fiscal Framework approved in January 2013. In this context, by the end of 2016 general budget expenditures are foreseen to reach the level ALL 446.4 billion or 27.7 percent of GDP. The resources shall be mainly used to:

- Considerably reduce the budget deficit to 2.0 percent of GDP;
- Differentially increase the level of wages and pensions;
- Maintain a sustainable level of public investments equal to 3.7 percent of GDP.

Personnel expenditures for the period 2014-2016 are foreseen to be in line with the policies of differentiated increase of salaries in priority sectors. Thus, during this triennial period they are foreseen to keep the level of 5.0 percent of GDP.

Operational and maintenance expenditures for the period 2014-2016 are foreseen to keep the constant level of 2.3 percent of GDP. They will be oriented towards the increasing of functioning and maintenance expenditures, thus aiming at reducing to a maximum the purely administrative expenses, in line with the recommendations.

The subsidies expenditures have been forecasted based on the existing policy of subsidies and on the policies for their further reduction. In reliance on the international institutions recommendations for a reduction of subsidies, all the institutions have been required to undertake reforms to the effect of a better management of the respective sectors and improvement of their financial performance. In 2014-2016 they are foreseen to remain at the level of 0.1 percent of GDP.

During the 2014-2016 period, expenditures for economic assistance and disability are foreseen to keep the level of 1.2 percent of GDP.

For 2014, the "Reserve fund + Contingency for financing the deficit" is forecasted to be at the level of ALL 7 billion. Meanwhile, it is foreseen to progressively increase to level ALL 10.5 billion in 2015, and ALL 13 billion in 2016. Most part of it is dedicated to the Contingency for financing the deficit, justifying so its increasing forecasted level.

The estimation for interest expenditures has been based on the debt strategy of Ministry of Finance and the levels foreseen for domestic and foreign financing of this debt. For the period 2014-2016 these expenditures are foreseen to keep the constant level of 3.6 percent of GDP.

The local budget expenditures for the period 2014-2016 shall remain at the level of 2.0 percent of GDP.

By the end of the period 2014-2016, capital expenditures are foreseen to be at the level of 3.7 percent of GDP. We will still prioritize those projects which continue from previous years, as well as those defined as strategic for country's economic and social development, in accordance with the Government Program and NSDI.

Public Sector Investment Objectives

For the period 2014-2016, the government will continue to orient the investment allocations toward priority sectors such as: education, health care, infrastructure, agriculture and rural development. More in detail, the main directions of budget financing by sectors, consist in:

Education – Capital expenses in this sector, in the period 2014-2016, shall mainly be focused in financing the pre-university education for:

- Construction of new schools;
- Re-construction of existing schools;
- Providing equipped laboratories;
- Providing internet to schools.

It is worth mentioning that the amount allocated for constructions and re-constructions of the pre-university education schools are part of the Regional Development Fund, where local government units compete and are selected based on their project proposals according the central government criteria.

Health care – The investments in this priority sector for the period 2014-2016, shall focus mainly on:

- Construction and re-construction of hospital premises;
- Construction and re-construction of primary care premises;

- Purchase of medical equipment and apparatuses.

Infrastructure – Initially, it is worth highlighting the fact that the capital expenses in this sector have the biggest share of the total capital expenses for the period 2014-2016. The main directions of investments in this sector include:

- Investments in the national roads sector, such as the construction and rehabilitation of the main networks, as well as repairing and re-asphalting of national networks. Priorities of these investments are the constructions of the main transportation roads' corridors, as: completion of the road and tunnel Tiranë-Elbasan, completion of the new Tirana ring road, Vlora, Rrogozhina, Shkozet, Durrës, Fier Bypasses, etc;
- Investments in the extension and improvement of the Water and Sewage Utilities networks;
- Investments in the infrastructure of Durrës and Vlora ports.

Agriculture – The main directions of investment in this sector include:

- Rehabilitation and maintenance of irrigation infrastructure, in the Western Lowland and in the area of the country, increasing the sustainability of water resources and dam safety;
- Rehabilitation and maintenance of drainage infrastructure and flood protection (including: the main drainage canals, main drainage collectors, culture, and their estuaries to the sea), mainly in the Western Lowland Shkoder, Durres, Lushnje, Berat and Korca;
- Construction, rehabilitation and maintenance of levee protection in the most vulnerable, mainly in rivers of Buna, Black Drin, Mat, Seman, Osumi, Drinos, mountain streams, dike channels by high waters improved security protection.

Rural Development – A major impact on regional development of rural areas and integration of sectional policies of central government at regional level, there will also be allocating funds under the Development Fund of Regions. Distribution of this fund for public investment is closely linked with the support that has been given Government's strategy for reform and economic development in central and local level. This fund is used to finance projects that are within local government and apply them as priority sectors mentioned above.

3.4 Debt levels and developments

Debt management and projection of expected indicators in the course of 2012

The public debt of the Central Government later 2012 is estimated to be 827 628 million ALL or 61.48% of GDP. This debt is composed of the internal debt, estimated to be 34.94% of GDP and of the foreign debt being 26.54 % of GDP.

The policy of financing the budget deficit has been instrumental to the liquidity management, referring to the budget revenues trend as well as to the fast dynamics of expenditure, which has brought about meeting the needs for borrowing in the domestic market to a considerable extent within the first six month period of the year.

The guarantees apparently do not make up any considerable share in our debt. No new guarantee emitted in the foreign market occurred in the course of 2011, while a guarantee worth 3.1 billion

ALL for KESH sha was emitted in the domestic market. The guarantees remain, in the course of the 9-month period of 2012, at the same level in absolute terms as later 2011.

While the increases of guarantees occurred in the last semester amounting to 7 billion ALL for providing a guarantee for the power from KESH sha.

In Million ALL	2007	2008	2009	2010	2011	9M \2012
Domestic Debt Stock of Central Government	369,536	395,504	409,501	401,821	429,925	447,989
Foreign Debt Stock of Central Government	120,093	163,832	227,271	268,125	294,319	317,519
Total Debt Stock of Central Government	489,629	559,336	636,772	669,946	724,244	765,508
Domestic guarantees	0	4,952	5,527	5,551	8,657	8,707
External guarantees	27,402	31,595	40,247	39,874	39,659	39,614
Total guarantees	27,402	36,547	45,774	45,425	48,316	48,321
GDP	967,670	1,089,293	1,148,082	1,222,462	1,297,710	1,346,169
Domestic Debt Stock of Central Government/GDP	38.19%	36.31%	35.67%	32.87%	33.13%	33.28%
Foreign Debt Stock of Central Government/GDP	12.41%	15.04%	19.80%	21.93%	22.68%	23.59%
Total Debt Stock of Central Government/GDP	50.60%	51.35%	55.46%	54.80%	55.81%	56.87%
Domestic guarantees/GDP	0.00%	0.45%	0.48%	0.45%	0.67%	0.65%
External guarantees/GDP	2.83%	2.90%	3.51%	3.26%	3.06%	2.94%
Total guarantees/GDP	2.83%	3.36%	3.99%	3.72%	3.72%	3.59%

Domestic Debt Analysis

Dynamics of domestic debt stock composition

The internal debt stock makes up a considerable percentage in the total of the debt portfolio. The short-term instruments later September 2012 make up round 54.07 % of the total of the internal debt portfolio, while the long-term instruments amount to 44.02% of the portfolio.

The bulk of the new borrowing during 2012 continues to be made up of the 3, 5 and 7 year bonds, as well as the 12-month treasury bills.

However, difficulties in the re-composition of the debt portfolio and in meeting the objectives for reducing the short-term instruments as opposed to the increase of long-term instruments emerged in the course of the first half of the year. The remainder of the year went on with a fall of financing the short-term instruments and an increase of the share of bods. In concrete terms, later September a new borrowing emerges worth of 5.49 billion in treasury bills and a worth of 12.49 billion borrowing in bonds.

Debt holders

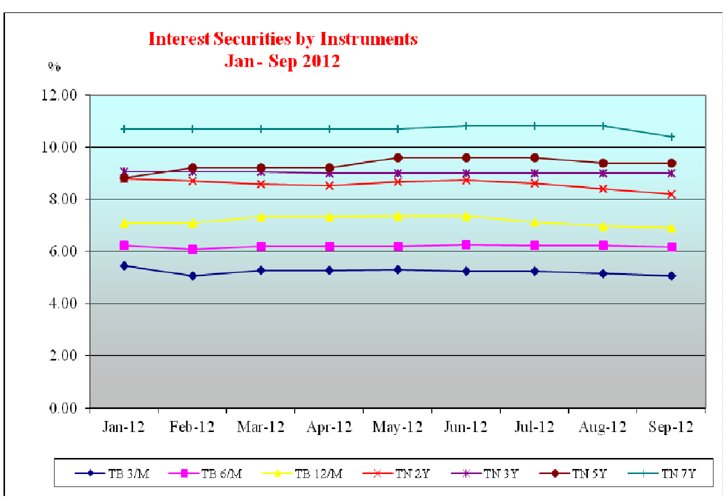
The positive tendency of increasing the number of participants in the primary market of the government securities continued even in the course of this year, thus bringing about a diversification of the portfolio from the perspective of its holders.

Domestic Debt Analysis

	2008	2009	2010	2011	9M 2012
BOA	17.75%	17.66%	15.40%	14.30%	13.49%
Raiffeisen Bank	36.88%	34.57%	34.90%	34.20%	28.91%
Other Banks	34.58%	34.33%	34.40%	34.85%	37.69%
Non-Banks	2.46%	2.68%	3.21%	3.73%	4.25%
Individuals	8.33%	10.76%	12.08%	12.92%	15.66%

**the data are in purchase price*

Interest rate analysis



The interest rates for the state financial instruments during the nine first months of 2012 have demonstrated fluctuations, despite not being considerable. With regard to the treasury bills, they have demonstrated increasing tendencies in the course of the period January - June (segment of 12-month bills), while going on decreasing in the two upcoming months, however, being below the average of the interest rates of the preceding year.

In June 2012, the issue of 7-year bonds occurred, which issue was with fixed interests (10.85) and variable interests (10.82). The issue interests of this type of instrument was almost comparable to those of 2008, where this instrument was issued for the last time. In graph 1. is displayed the dynamics of the interest rates of instruments during the 9-month period of 2012:

Portfolio composition depending on interest type

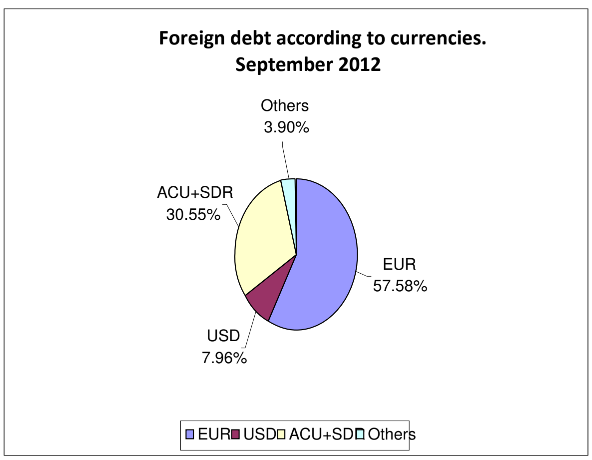
It is evident that the ratio between the variable interest instruments and fixed interest instruments has fluctuated in the course of the first nine-month period 2012 experiencing a slight increase of floating interests to 16.8% as against 15.8% earlier 2012.

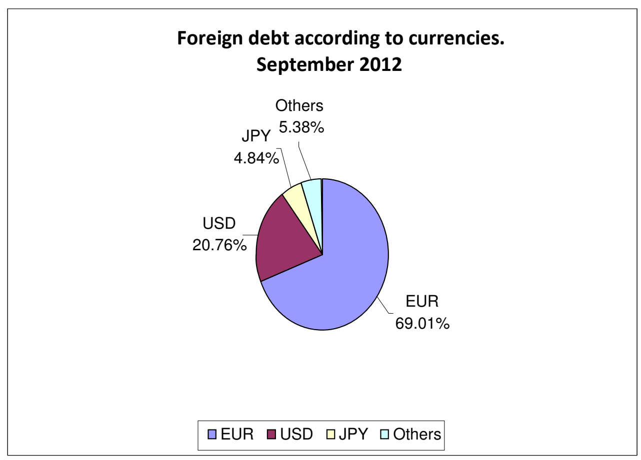
Foreign debt analysis

Portfolio composition according to the currency type

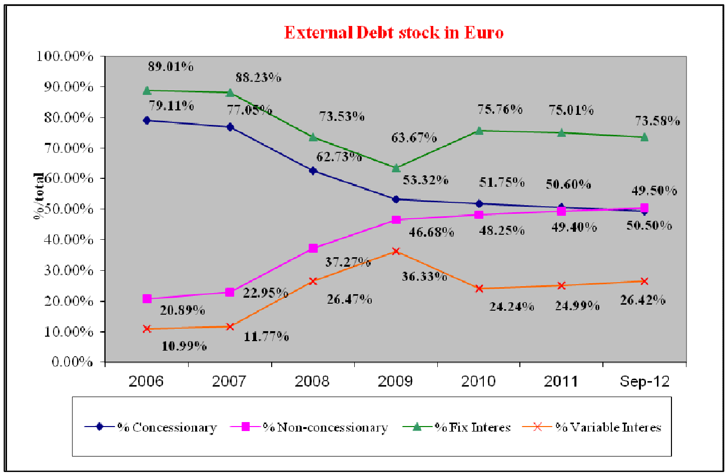
The bulk of the foreign debt stock consists in Euro (round 57.58%), this being a tendency inherited from the proceeding years. This consists an advantage for us since it indicates the compliance with one of the main objectives contained in the medium-term strategy to focus foreign borrowing towards this currency. The debt stock in SDR and ACU is also at high levels, round 30.55%.

Should we continue breaking down these two currencies into their constituent currencies, the dominating percentage of Euro will be deepened, amounting to 69.01%. Compared to one year earlier, we see the same levels of the specific weight of the debt stock in Euro and a modest strengthening of the specific weight for USD.





The foreign debt stock contracted in non-concessionary terms continues to increase compared to the concessionary interests debt. The explanation of the contracting with foreign financing and with increasingly commercial interests is the categorisation of Albania currently not as a low-revenue country. For the first time, for the 2012 nine-month period, the concessionary debt is just 1% lower than the commercial debt, signalling the tendency of foreign financing with increasingly commercial terms. In the course of 2012 as well as in 2011, the domination of the credits signed with fixed interest is evident. The share of foreign financing in fixed interests is reported to be 73.6%, although a decline in the course of the period 2010 - September 2012 is evident. The floating interest debt is at the extent of 26.4%, thus recognising a modest increase in the course of this period.



With regard to the foreign debt, its stock later 2012 9-month period was at the level of 2.546 million Euro, out of which 2.263 million Euro is state debt and 283 million Euro is a secured debt. The positive dynamics in the implementation of projects in the power sector, road infrastructure sector, water and sewage utility as well as health care should be specifically mentioned.

Debt service development

The debt interests at the end of the 2012 nine-month period turn out to be 35.305 million ALL out of which 82% (29.027 million ALL) belong to the debt interests and the remainder belongs to the foreign debt repayment. The debt service amounted later September 2012 to 2.62% of GDP, thus split up into foreign debt interests (0.22%), domestic debt interests (1.94%) and principal repayment (0.47%).

In million All	**2008**	**2009**	**2010**	**2011**	**Sept-12**
Debt Service Total (I+II)	**35.555**	**42.061**	**48.116**	**48.734**	**35.305**
Debt Interests Total (I)	**31.307**	**36.301**	**41.604**	**41.121**	**29.027**
Domestic Debt Interests	28.386	31.408	35.583	34.253	26.058
Foreign Debt Interests	2.921	4.893	6.021	6.868	2.969
Foreign Debt Principal (II)	**4.248**	**5.760**	**6.512**	**7.613**	**6.278**
GDP	**1,089,293**	**1,148,082**	**1,222,462**	**1,297,710**	**1,346,169**
Debt Interests Total/GDP	2.87%	3.16%	3.40%	3.17%	2.16%
Domestic Interests Total/GDP	2.61%	2.74%	2.91%	2.64%	1.94%
Foreign Debt Interests/GDP	0.27%	0.43%	0.49%	0.53%	0.22%
Foreign Debt Principal/GDP	0.39%	0.50%	0.53%	0.59%	0.47%
Debt Service Total/GDP	**3.26%**	**3.66%**	**3.94%**	**3.76%**	**2.62%**

**in million ALL*

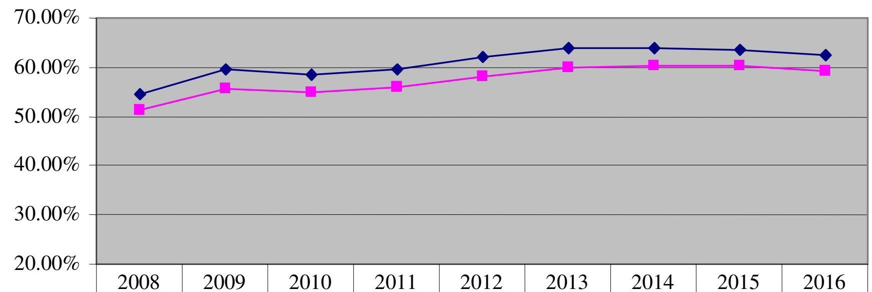
Debt Management Strategy and medium-term assumptions.

The debt stock level and its projection relying on the macroeconomic and fiscal projections contained in the macro-frame 2014-2016 (approved in January 2013) appear as follows:

Basic Scenario

According to this scenario, a debt stock worth is estimated exceeding the level of 60% of the GDP, which later 2012 goes on with higher level projects for the upcoming years. Under the circumstances of insecurity and risks accompanying this period, it is indispensable to project and take account of the indispensable reserves, as a consequence of which a further lowering of the budget deficit is foreseen.

Debt stock dynamics.
(Basic Scenario)

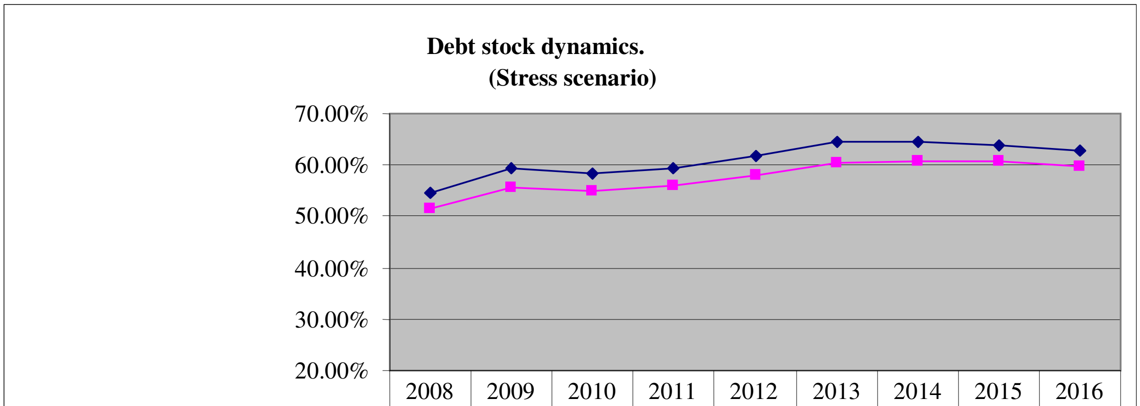


	2008	2009	2010	2011	2012	2013	2014	2015	2016
Central Debt Stock/GDP	54.69%	59.44%	58.52%	59.52%	61.93%	63.83%	63.80%	63.38%	62.32%
State Debt Stock/GDP	51.34%	55.45%	54.80%	55.79%	57.99%	59.89%	60.26%	60.23%	59.31%

Central Debt Stock/GDP   State Debt Stock/GDP

Stress scenario

In the stress scenario that we have developed, we have assumed that the nominal growth of GDP shall be 4% for every following year, while the exchange rate Euro/ALL shall be the average exchange rate of 2012 plus two standard deviations for 2013 plus three standard deviation for 2014 and onwards. The eventual guarantees which might be emitted for the power sector have been taken account of in this sector.



	2008	2009	2010	2011	2012	2013	2014	2015	2016
Central Debt Stock/GDP	54.69%	59.44%	58.52%	59.52%	61.93%	64.44%	64.42%	64.00%	62.92%
Debt Stock State/GDP	51.34%	55.45%	54.80%	55.79%	57.99%	60.47%	60.84%	60.81%	59.88%

Central Debt Stock/GDP   State Debt Stock/GDP

Debt Strategy

(Basic) Strategy

This strategy focuses on the short-term and long-term domestic borrowing, complemented with foreign financing for the development projects which make up a considerable weight in the new borrowing.

As a result of this strategy, the domestic re-financing risk shall be improved considerably, which is also indicated by the following data.

The average maturity days are estimated to reach the level of 445 days (in 2013), compared to 386 days (2012), if we evaluate just the domestic market. The weighted average yield is evaluated to be 8.34% (in 2013) as a consequence of emissions of the hosrt term instrhments and mainly long-term ones for 2013.

Main objectives of the strategy

Referring to the analysis of the debt portfolio, it is evident that this portfolio is with high risk. This is due to the fact that the short-term internal borrowing continues to consist a considerable share of the portfolio, which requires refinancing in a relatively short time and, on the other hand, the borrowing in foreign currency, having increased, is characterised by the exchange rate risk. The cost/risk simulations indicate the importance of reducing the debt, otherwise the financial negative effects shall be more considerable, thus causing high payments for the debt service.

The best option in terms of cost and lowering the risk is the basic strategy, which has a relatively low cost in the long term aspect and lower exchange rate risk.

Based as above, this is exactly the strategy being recommended for ensuring the borrowing and debt management during 2013. With regard to financing the domestic financing through this strategy, a financing to the extent of 22% in long term instruments and 78% in short-term instruments in the total of 2013 emissions shall be provided. In the meantime, the treasury bills and bonds ratio to the stock shall be 53% to 47%.

3.5 Quality of public finances

Deepening the institutionalization of the Medium Term Budget Program With regards to budget expenditures, Albanian government has, since 2001, submitted the Medium Term Budget Program (MTBP), aiming at strengthening the link between government policies and allocation of budget funds, while achieving value for money. All the line ministries were part of the medium term budget program since 2006, while central budget institutions were involved for the first time in 2009. MTBP aims at the gradual shift from the input-based budget to program and performance based budgeting. According to law “On Management of Budgetary System on Republic of Albania”, local government units are required to prepare and approve their medium term budgets (for three years). In this context local government units should have an intensive communication with the central government (especially with the Ministry of Finance), to exchange data and information relating the constructions and consolidation of the intergovernmental fiscal relations. All the local government units were part of the medium term budget program, since 2009. Efforts and work carried out in relatively short time has had positive effects on the process. For the year 2012, these effects have consisted, in increasing responsibilities and accountability of local government units to carry out this task, in increasing the local capacity to prepare qualitative medium term budgets, and in consolidation of cooperation between central and local government, with the aim of enhancing of public funds, that would mean increasing services and public investments in favor of communities. The year 2012 was the fourth year of preparing the medium term budget from all local government units. Through this process the future vision of local government units will be clear and also they will have priorities, projects and investment plans. The preparation of medium term budgeting 2014-2016, from local government units, shall continue to be coordinated and integrated closely with regional and national policies and planning processes, particularly in the context of local and regional development based on potentials and possibilities.

Enhancing and institutionalizing the inter-governmental fiscal relations In the context of decentralization and strengthening of local financial autonomy, current small business tax administration is transferred to local tax structures. In doing so, especially the rural area taxpayers are much closer to tax collection and administration authorities. Also, were transferred to the local level, significant tax who have contributed not only to the growth of national income but have served and serve as effective instruments to make local fiscal policy, which simultaneously are local development policies. Vehicle registration tax has become detached tax, whose base is connected to the effect that no movement of vehicles on the environment. Local government units receive a percentage of this tax according to the law, 18 percent of the revenues from this tax should be allocated to local government. Also one other tax that is shared between central and local government is mining rent tax. This tax has positive effects on the local government units that have businesses that extract mineral resources. Local government units benefit 25 per cent of the revenues from this tax. Government's target for 2013 is to continue accelerating the process of decentralization reform in key areas. Consolidation and expansion of local revenue represents not only one of the objectives of securing sustainability of the decentralization reform. This objective will be achieved by increasing the efficiency in the collection of local taxes, mainly on small business tax, tax on construction and agricultural land tax and also strengthening the effectiveness in the management of local assets, as an important tool to increase revenue and local infrastructure investments. Transfer of assets owned by units of local government is a process that will continue during 2013. This process creates opportunities for increased financial income through the use of their own or from third parties or through the increase of collateral guarantee on borrowing that will be used to finance public investment. Fiscal decentralization reform will focus on the accuracy of fiscal relations between central and local government. Local budgeting process so far has been carried out on an occasional basis. The mechanism of determining the conditional and unconditional transfers is not yet predictable and not entirely transparent, where too often become the subject of discussion and negotiation (bureaucratic and political) between local government bodies and the relevant line ministries. For this purpose, horizontal draw will be further improved, in order to better reflect demographic and economic dynamics of different regions of the country, and the disparities between them. In the field of local and regional development, from the 2010 budget, competitive grants scheme was converted into a new scheme called "Regions Development Fund". The creation of the fund has increased the degree of decentralization, encouraging local communities, and institutions for carrying out a policy of administrative reform aimed at increasing the local units, making it the unit capable of absorbing the funds. In the context of the Law No. 9936, dated 26.06.2008 "On Budget System Management in the Republic of Albania", efforts will focus on the definition of local skills and strengthen the relations between the Central Government (Ministry of Finance) and the local government in the formulation of fiscal policy and proposed reforms concerning decentralization in the context of MBP's. To improve and clarify the legislative framework for local budget implementation process. Main areas of intervention of the Ministry of Finance are: (i) treasury procedures, especially those that are related to major differences that have relation between the quantity of conditional grant provided to local governing units and the actual quantity; (ii) release time and clarity of the instructions of the Ministry of Finance and the details regarding the budget process; (iii) the rules for the implementation of the budget in accordance with the single treasury account system; (iv) financial reporting and accounting system and clarifying issues concerning the "pursuit" of local budgets devices and their use in accordance with the approved budget. Improvement of the legislative framework of local taxes is considering the possibility of reviewing the basic level on property tax collection and tax administration on small business and the possibility of the adoption of a provision to allow local government to change tax rates based on inflation. Fiscal decentralization reform has a positive effect on the growth of local revenues from taxes and fees against the transfer paid to the state budget. Fiscal autonomy of local governments has increased from year to year. For 2013 the structure of local government revenue sources is 51.6 per cent of the taxes and fees and 48.4 per cent from the state budget (unconditional transfers). For 2013, improvements have been made unconditional transfer distribution criteria. Also, the unconditional transfers to local government units for the year 2013 increased 2 per cent compared with 2012. In order to increase the effectiveness of the use of public funds at the local level with the 2013 budget law, local government units are set standard conditions for the use of funds for personnel costs by encouraging the use of as many local funds for investments and public services. The implementation of the fiscal framework on local borrowing. Based on Law

No. 9869, dated 04.02.2008, "On local government borrowing" local government units have begun to apply and receive the loan. Under this law, the government is committed to: (i) coordination of national and local debt policy (in such a way that the central government to maintain control of nature and expanding local fiscal obligations); (ii) providing a local prudential borrowing (in terms of risk management in the context of public finance); (iii) the system of guarantees for local borrowing; (iv) monitoring and control mechanisms.

Local funding In order to consolidate the national finances during 2013 and onwards, the government's efforts will focus on identifying the problems concerning the need for a regulatory framework for local finances, which will aim to define the procedure for the design and implementation of the budget local unconditional transfer financing scheme for local government, accounting issues and internal and external audit, assisting local units that want to borrow, transparency etc. This process will be subject to discussions with various interest groups and at the end of this process will develop a special law for "Local Finance".

3.6 Institutional features of public finances

During this year the Central Harmonization Unit for Financial Management and Control (CHU/FMC) within the Ministry of Finance, has developed the second phase of “The 5-year Plan for Implementation of a Modern System for Financial Management and Control Concepts in the Public Sector for the period 2011-2016”.

The Ministry of Finance presented to the Council of Ministers and the Supreme Audit Institution within May 2012 “Annual Report on Functioning of Internal Financial Control System in the General Government Entities for the period January-December 2011”. Based on individual reports on the quality of internal control systems presented by general government units, after an analysis done during the monitoring process from the CHU / FMC and CHU/IA, official letters were sent to the Ministers for each Line Ministries and to the Mayors of 12 important municipalities. The analysis were focused on the positive sides and weaknesses identified in relation to financial management and control systems that exist in these institutions, as well as recommendations for future improvements in some aspects related to the internal control components.

The appointment of Authorizing officers in public entities, according to FMC Law requirements (Law 10296, dated 08/07/2010), has been carefully monitored by the CHU/FMC and support has been provided to several institutions in order to clarify the criteria to be fulfilled for the above function.

Throughout this period, since the entry into force of the Law of FMC and so far, have been assisted several central institutions in the preparation of the Risks Register such as, the Ministry of Finance, Ministry of Public Works and Transport, General Prosecutor Office, Judicial Budget Administration Office, Ministry of Health, State Information Service etc.

Objectives for the following period (year 2013) will consist of:

Implementation of Pilot Project “Support to the Ministry of Finance of Albania regarding Improved Financial Management and Control of Public Funds”, to the Ministry of Public Works and Transport and Albanian Road Authority;

Starting the Pilot Project "Implementation of Managerial Accountability Concept in Local Governments Entities";

Ongoing awareness workshops that will involve the large scale of the participants;

Monitoring the assignment of Executive Officers (Finance Managers);

Training seminars for managers, finance managers and specialists about the risk management and audit trail in collaboration with ITAP;

4. STRUCTURAL REFORM OBJECTIVES

4.1 Obstacles to growth and the structural reform agenda

Policies for Private Sector Development

The main objective of the government policy for developing the private sector has consisted in the entire reforming of the legal and regulatory framework in the field of business aiming with priority at improving the business environment, the reduction of the administrative barriers, as well as implementing the European Charter for SMEs (SBA). The main policies envisaged for the development of the private sector, which extend their effects along EFP 2013-2015 period, are as follows:

Implementation of Strategy for Business Inovation and Technology. The strategy is prepared with support of IPA 2007 and it is approved with CoM Decision 104, date 09.02.2011. For implementation of this strategy it is approved the Strategic Program for Inovation and Technology of SMEs for the period 2011-2016, being focused on developing and implementation of four important programmes: Inovation Fund, Business Inovation Services, Business Incubators Program, and Program for Cluster Development. To support the implementation of the strategy and the programs, close to AIDA it is established the Center of Business Intermediation and Inovation (BRIC). BRIC will serve as the main intermediator and facilitator for promotion of inovation and technological development in business enterprises by ensuring the linkage of the businesses with other institutions such as AKTI, AKSHI, universities, excellence centers, AIDA, etc.

Reduction of time and steps for starting a business. Currently only 5 steps are needed for starting a new business compared to 10 steps needed one year before, and only 5 days compared to 36 days needed one year before. The companies are currently using only one identification number which is provided by NCR upon making their registration which is simultaneously generated at the tax office, social insurance office and labour office. This practice has reduced with four steps the procedure for starting a business.

A draft decision for CoM it is prepared, where there are cleraly defined the categories of licenses /permitions/authorizations/administrative acts required for a project in the field of energy which simplify and make more clear the procedures to be followed for having a license/permition /authorization /administrative act. Based on this act, the time and the cost needed to get each of above mentioned documents will be further reduced.

Financial measures and schemes for supporting business; To improve the financing environment and support the policies for the SME development, a number of measures are taken toward credit guarantee schemes.

Credit scheme for SMEs (Italian – Albanian Program). Since the oficial launching in january 2009 the credit line for SMEs has been very succesful. Up to 31 july 2012, from the credit line of 25 milion euro there are financed 73 projects of albanian SMEs, with a total financing of 16.241.755 euro. Among the financed projects, 10 of them are "start up" projects.

European Fund for Southeast Europe (EFSE). Thif is one of the largest creditors of micro and small enterprises in the finantial sector. EFSE has extended a credit of 20 million euro in National Commercial Bank (NCB). By June 2012 NCB had approved a total credit of 23,8 million euro for 332 customers of which 21,2 million euro were disbursed for 300 customers. With 17,9 million euro being paid back, this scheme is considered with a high repayment performance.

Fund for Creative Economy: with proposal of Ministry of Economy, Trade and Energy, the Council of Ministers has approved on 5.9.2012 the decision "For the creation of the Fund for Creative Economy", which aims the supporting of the sustainable economic activities and creation of jobs in the handicraft sector, and addressing elements of: (i) Product development; (ii) Marketing; and (iii) Qualifications and capacity building in the handicraft sector.

Inovation Fund: with CoM decision 667, date 20.09.2011, it is approved the creation of the inovation fund for the period 2011 – 2014 with a value of 40 million lek for a 3 year period. This fund will be managed from BRIC/AIDA and will support with grants the auditing and internationalization of technology for the companies. The grant offered to the companies amounts up to 400,000 lek and covering up to 50% of the project. Also, it is prepared the regulation for functioning of the inovation scheme which is approved from AIDA.

Cometitiveness fund: it is established to increase the competitiveness of SMEs. In the overall ordering for 2011, Albania has been ordered 89th from 144 contries/economies with a decrease of 11 points compared to the previous year. Albania has been listed in the group of countries which are in the second phase of the competitiveness development (also known as "the phase of promotors of the efficiency of economy"). In the three dimensions of development (Basic requirements, Efficiency promoters, and Inovation and sophistication factors), Albania has achieved the highest points in the first factor (4.2 points) beeing ordered at 87th place. In the Strategy for Development of Business and Investment 2007 – 2013, a special attention is given to the programmes for increasing the competitivenes of SMEs, and preparing of a strategic program and an action plan for transferring the technology and inovation. To support the SMEs competitiveness it is established the Albanian Fund of Competitiveness, being approved for a period of 6 years for the period 2007 – 2013 and implemneted from AIDA. Since the begining, under this scheme there have been supported 105 companies.

Competitiveness and Inovation Program (CIP) for SMEs: Participation of Albania in the Competitiveness and Innovation Programme – CIP for the period 2007-2013 is approved with the decision of European parliament No 1639/2006/EC. Within the CIP program, there are 3 main sub-programs (pillars) focusing on SMEs and in the technologies that protect environment, such as: (i) Entrepreneurship and Innovation Program (EIP), (ii) ICT Policy Support Programme, and (iii) Intelligent Energy-Europe Programme (IEE).

Activities for the community project CIP-EIP: Albania participates in the program on the Ambassadors of European Women Network, and European Network of Mentors for Women Entrepreneurs, European week of SMEs. Albania paricipates for the third time in European week of SMEs. During 18 – 19 October 2012 a number of activities have been carried out for promoting of female entrepreneurship.

Main directions for private sector development 2013 – 2015

- Implementation of the Business and Investments Strategy for the period 2007 – 2013;
- Implementation of Innovation and Business Technology Strategy and the Action Plan 2011 - 2016;
- Implementation of European Principles of the Small Business Act;
- Strengthening of capacities and improving services of AIDA for foreign and domestic investors;
- Strengthening the capacities of BRIC (AIDA) and participation in European network of enterprises;
- Establishment and making functional the economic zones (industrial parks, free zones);
- Implementation of 3-year Albanian - Italian Program for supporting SMEs through soft credit line and credit guarantee fund;
- Transposing the Directive 2005/56/EC "On cross-border mergers";
- Implementation of the financial programs of Competitiveness Fund and Export Credit Guarantees Fund;
- Implementation of the Innovation Fund and the Fund for the Creative Economy;
- Evaluation of policies for investments reforms according to the methodology of OECD (IRI 2010);
- Strengthening public–private dialogue and enhancing the role of Consultative Council of Business;
- Strengthening and expanding the role of women in private eneterpreneurship;
- Supporting the social business and increasing of the corporate social responsibility;
- Supporting of the creative industries;
- Support for start-up.

To support the implementation of the above mentioned measures, in the framework of the Medium-Term Budget Program 2013 – 2015, in the bugget of Ministry of Economy, Trade and Energy there are planned 1 941 milion leke, of which 941 milion leke to be financed from the state budget and the rest from the donators.

4.2 Key areas of structural reform

4.2.1 Product and capital markets

Banking system supervision

During 2012 Supervision Department of Bank of Albania was involved in adapting changes to the existing regulatory framework that aims alignment with Basel Committee standards, EU directives and best practices in the field of banking regulation and supervision.

In November 2012, some amendments “On the core management principles of banks and branches of foreign banks and the criteria on the approval of their administrators" were approved. The purpose of the review was a further improvement of supervisory authority requirements related to the effective and responsible management of banks and branches of foreign banks, mainly in aspects which focus on risk management systems and the respective structures, remuneration policies, etc

The major and the most important project still in course is that of implementing Pillar 1 of Basel II Capital Framework. Taking into account the level of development of our banking system, Bank of Albania has chosen a gradual approach toward full implementation of Basel II. In the following months, a new regulation “On capital adequacy ratio” is foreseen to be approved by Supervisory Council of Bank of Albania” which will introduce the standardized approach for credit and market risk capital requirement and basic indicator and standardized approach for operational risk capital requirement purposes. The banks will be given the indispensable time to adapt their internal systems to the requirements of this regulation and to build the necessary human capacity.

The entering in force of abovementioned regulation will demand the reviewing of two the existing regulations: (1) “On Large Exposures” and (2) ”On the open foreign exchange positions risk management”. The changes in these regulations are intended to be introduced during 2013.

Bank of Albania plans also to implement Pillar II of Basel II Capital Framework. In the course of twinning project with Bank of Italy (2011-2012) a draft of ICAAP guidelines were drawn up, and a new risk assessment system that comprised the major risks of banking system was designed. The time when the ICAAP will be obligatory for the banks will depend on the approval of the regulation “On capital adequacy ratio” while the new risk assessment system will be used by Bank Albania after it will be tested.

In 2011, the Law “On Banks on the Republic of Albania” was amended. One of the changes introduced was that of redesigning the term "banking activity" in accordance with the provisions of the directive 2006/48/EC “Relating to the taking up and pursuit of the business of credit institutions”, allowing the non-bank financial institutions to issue electronic money, an activity that before was an exclusivity of the banks. In order to accommodate the amendments in Bank of Albania regulatory framework was considered as adequate adding some special requirements for the licensing and the supervision of the electronic money institutions in the following regulations:

- “On the granting of license to non bank financial subjects”
- “On risk management in the activity of non bank financial institutions”

- “On electronic payment instruments”

The revision of these regulations is still in process and is foreseen to be finalized by the end of 2012. No budgetary expenditures will be needed by Bank of Albania, while the approval of this project means that entities will have to face specific costs such as: Initial capital to be licensed or for setting up a special system for accounting and reporting of data to the authorities.

Another focus of Bank of Albania in 2013 will be the reviewing of the regulation “On the consolidated supervision”.

Market liberalization, Entry of private operators

The amendment of the law no 9072, dated 22.05.2003 «On power sector», approved by parlament on 26.11.2011, constitutes an important step for liberalization of electricity market. According to this law, all consumers which are directly conected in the network of 110 kV or are consuming more than 50 million kwh a year are considered as qualified consumers. In 2012 it is prepared a new law for energy sector, which together with the amendaments, it is expected to be approved within January 2013. The approvement of this law opens the way for further liberalisation of electricity market, aiming a full opening of the market within 2015, which is in accordance with the objectives of the Energy Community Treaty.

In the framework of liberalization of the market of electricity production and the opening of this market to the private operators, during 2012 there are signed 11 new contracts for construction of 11 HECs with a total value of 62,3 million Euro. Up to now, there are signed in total 124 contracts for construction of 360 HECs with an installed capacity of 1,520 kW in total and with an investment value of two billion euro in total. From this, 54 HECs are already put in operation, 46 HECs are under construction of which 10 HECs are expected to enter in operation within 2012. Based on future projections of the demand for electricity, it is estimated that by putting in operations of these plants the internal demand for electricity will be satisfied and the sicurity of supply with electricity will be guaranteed in the long run, as well as a part of production will be exported in regional market. Out of concessions mentioned above, the electricity production market incudes also 14 HECs with an installed capacity of 2,044 kW, being owned from private sectot (privatised).

To support the oppening of the market, substantial investmens are done for increasing the capacities of transmission and interconection networks. In 2011 it is completed the construction of interconection line with Montenegro and an agreement between two contries was signed. In 2012 it is proceeded with tendering of construction works for interconection line with Kosova (in process) and with preparation of the fizibility sudy for construction of the interconection line with FYROM (Investement Fund for Western Balkans) as well as with identifying of the financing resources required.

Privatisation of strategic operators

Privatisation of KESH sha. The privatsation of the operator of the distribution system (OSSH) is done in 2009. Following the goverment policy for extending the privatisation in the production sector, in 2011 the work has continued with preparation of the strategy of privatisation and with the privatisation procedures. In 2011 it has been approved the law for the privatisation of four HECs under ownership of KESH sha, namely the plants of Ulez, Shkopet, Bistrica 1 and Bistrica 2. Based in the law, those companies are restructured in two new separate companies, the «HEC

Ulez-Shkopet» and the HEC «Bistrica 1 and Bistrica 2». In september 2012 was organised the auction for their privatisation, without success. The work has continued with the revising of the documents and re-openning of the international tender for privatisation of 100% of the shares within 2012. The deadline for accepting the bids is scheduled 21.12.2012.

Privatisation of "Albpetrol" sh.a.: The privatisation of the public company "Albpetrol" sh.a., which operates in the sector of oil and gas production, so far has been implemented through granting of certain rights, titles and interests, for the existing oilfields, to foreign companies operating in the field of research and production, and being based on hydrocarbon agreements and in the Law no 7746, dated 28.07.1993 "On hydrocarbons". This process is still being applied in accordance with the provisions of each specific agreement that the company "Albpetrol" sh.a has with the foreign companies currently operating in the hydrocarbon sector.

Privatisation of Albtelecom; The privatsation of the remaining share is in the phase of the tendering procedures. Two companies have shown interest for the remaining share, a Croatian company and the Albtelecom, which holds 76% of the share. Following the auction procedures, the interested companies have signed a confidentiality agreement for providing the necessary information for the company Albtelecom sha and for the process of the auction.

Challenges and Priorities 2013 – 2015

The liberalisation of the market and significant investments for the development of the infrastructure of the transmission and inteconection systems, as well as a stable and uninterrupted supply of consumers with electricity, are the main achievings so far. The changes in the legal framework which are done during 2011 are in full accordance with the recomendations of Europan Commission, and opening the way to the competition in the internal market as well as eliminating the monopoly situation in this market. A direct result of those policies has been a stable and uninterrupted supply of consumers with electricity.

The main challenges for the period 2013-2015 and on are refferred to the further improvement and development of the structure of the supply with primary energy resources, the increase of the domestis generation capacity, the reduction of the losses in the networks and increasing of the energy exchange capacities with neighbouring countries, the linkage of Albania with the international network of gas, and the full liberalization of the energy market by 2015. The main priorities for the period 2013 – 2015, which are part of the longterm priorities of Albania for developing energy sector, are closely linked with implementation of the following programs and projects:

The construction of small, medium and large HECs; investments are expected to improve significantly the balance of energy production and of the energy exchange, with a direct impact both in economy and the state budget. The main investments are: construction of HECs in Devolli river (280 MW), in Osumi river (152 MW), in Vjosa river (350 MW), in Drini river/Skavica (200 MW). By implementing those projects Albania mets internal market demand for electricity, and became a net exporter of the energy.

The linkage with regional network of gas; investments in this field will improve the structure of the supply and the diversification of the resources, as well as the revenues in the state budget. By 2020 it is aimed that 15% of the total consumption of energy will be covered by natural gas. Albanian goverment is working intensively for implementation of TAP project, which during 2012 has had a significant progres. TAP project will be financed from AKSPO (Switzerland), Statoil (Norway) and Rurgas (Germany).

Transmission and interconection networks development; the investment scheme is conceived to afford the increasing demand of consummers as well as to satisfy the present demand for importing the energy and future capacities for exporting the energy. A priority for the period 2013 – 2015 is the construction of the interconection line with Kosovo. Another priority is the construction of interconection line with FYROM, which will close the investment masterplan for the interconection network. For this project, the preparation of the feasibility study is under the proces and goverment is working for mobilising of financial resources. Regarding the transmission network, so far there are identified 20 projects, of which 7 projects are considered as prioritary and for which the preparation of the fesibility studies are underway and their implementation is expected to begin within the programme period.

Energy efficiency /other measures; Other measures for increasing the security of consumers supply and market functioning, include the measures for promotion of production of electricity from renewable resources (solar panels, wind energy /plants, etc), the increase of the energy efficiency (up to 9% in 2018) through implemnetation of the National Action Plan for Energy Efficiency and the approval of the new legal framework for energy efficiency.

The cost of measures to support the policies in the energy sector are foreseen in detail in the medium term budget program 2013 – 2015. On the other side, it is to mention that all the projects being implemented in the energy sector in the field of electricity production, including the projects for upgrading and rehabilitation of the electricity distribution system, there are totally going to be implemented by private sector and practically do not present any relevant cost for the state budget.

The developing of the economic zones is based in the private-public policies and concession practices BOT (building, operating and transferring), for a period of 25 years and under a symbolic tariff of 1 Euro. The legal basis the law no 9663, dated 18.12.2006 “On concessions”, as amended, and the law no 9789, dated 19.07.2007 “On establishment and functioning of economic zones”. There have been done several amendments to the existing legal framework in this field and many contracts toward foreign and domestic investors have been executed during 2012.

Mining and industry development; For the period 2013-2015 conform strategy’s indications for development of mineral sector, priority will be given to implementation of several mineral projects, aiming a better linking of the extraction and processing activities.

State aid in the enterprise sector; **T**he main priority during 2013-2015 is the legal framework approximation. Other priorities are referred to the preparation of a number of guidelines for state aid in the broad band sector, for regional state aid for large investment projects, for giving the state aid in the form of guarantees, etc. Other priorities for the period 2013 – 2015 and on, are: (i) ensuring the transparency in using the public funds through the controlling of the schemes and the individual aids and publishing in official gazette and internet to increase access for interested parts; (ii) increasing the institutional capacities of the responsible structures, especially through their training; (iii) increase awareness of responsible institutions to respect the legal obligations in giving the state aid. The supporting of innovative enterprises for increasing their competitiveness will also remain a priority for the next three years.

4.2.2 Labor market

The development of the labor market and employment promotion constitutes one of the key components of state policies to increase employment rates and, consequently, reduce poverty. National Strategy of Employment and Vocational Training, which has been approved by the Government at the end of 2007, has laid down concrete and achievable targets for the development of the labor market, improvement of the quality of employment services, implementation of modern standards regarding orientation and inclusion of jobseekers in the labor market, cooperation and support of business and other economic and social operators.

Employment offices have treated during 10 months of 2012 about 141,508 unemployed jobseekers. The registered unemployment rate at the end of 10 months is 13% or 0.3% less than the unemployment rate at the end of 2011. About 36% of the registered unemployed jobseekers benefited escalated services such as labor market information, vocational training guidance, participation in programs of employment promotion and self-employment assistance. 10,931 unemployed jobseekers, of whom 51% are women and 50% of them are aged up to 30 years, were employed over 10 months through job matching.

Employment promotion programs received an allocation of 90 million ALL for 2012. Four programs, with a total of 72 projects and with the participation of 919 unemployed jobseekers, were implemented during 10 months.

Vocational Training Program: Public Vocational Training Centers have certified over 6,981 individuals, of whom 50% are women.

Unemployment benefits program aiming at the creation of conditions for their return into the labor market. 9, 213 unemployed jobseekers received unemployment benefits.

Returnees: About 1,349 returnees seeking to integrate the Albanian labor market received employment services over the past 10 months.

Modernization and unification of the employment services The work is continuing in regard to the development of information technology (IT) in the employment services and, in regard to the application of a system of computerization of employment services, a process which will be completed by 2012.

Improved monitoring and evaluation of the employment services performance Work is continuing to improve the monitoring structure with performance indicators through IPA 2010 for all employment offices. According to this structure, the performance indicators will be established and they will help to monitor not only the outcomes, but also the activities, which are carried out by the Employment Offices to support them.

Improvement of the legal framework in the field of labor market in 2012 Joint Instruction “On the functioning of the boards of the vocational education and training institutions" was drafted and approved in 2012.

Improvement of the situation in the informal labor market The aim of the labor inspection policy is to improve working conditions, improve the quality of life by providing the most effective implementation of OSH legislation in the daily practice by means of increasing the number of administrative inspections and controls in different sectors of the economy, and therefore manage to reach the figure of 15,500 inspections by 2015. Progressive improvement and harmonization of the Albanian legislation in line with those of the European Community in the field of health and safety at work and labor relations will be achieved through the adoption of regulations, pursuant to the Law on safety and health at work. The policy paper of health and safety at work for the period 2013-2020 will be drafted in 2013. The objective is to contribute to capacity building of the State Labor Inspectorate through 4 main interventions: a) training; b) cooperation with the international community; c) provision of appropriate working tools; d) strengthening of social dialogue.

Equal Opportunities Reviewing of Albanian legislation from a gender perspective is carried out in accordance with international documents. Ministry of Labor, Social Affairs and Equal Opportunities has taken the initiative to review the Albanian legislation from a gender perspective in order to ensure compliance with the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW), EU legislation, as well as, the alignment of this legislation with laws on domestic violence, gender equality and anti-discrimination.

4.2.3 Administrative reform

In relation to the state functional reform, during 2013 – 2015, the aim is to:

- Align all the structures of public administration institutions with the standards approved in legal and sublegal acts mentioned above;
- Align the way of organizing, functioning, the powers and reporting of state administration institutions, according to the standards set forth in the Law no. 90/2012.

Deepening and extending the civil service reform

In support of the Albanian government program, for deepening and expanding the civil service reform, and that of human resources management reform, the work for 2012 has been focused on strengthening the capacity of public administration.

For the coming period (2013 – 2015), after the approval of the draft-law “On the civil servant”, the work will focus on:

- Approval of sublegal acts under this law, which will detail the procedures set forth therein;
- Training of employees with a view to help employees responsible for the implementation of new procedures;
- Make fully operational the Albanian School of Public Administration;
- Implementation of new civil service legislation.

Salary reform

Closely related to the civil service and public administration reform as a whole, in 2012 the salary reform was carried out. Specifically, this reform was carried out for this year, in the following directions:

- Differentiated increase of salary levels for the system of pre-university education;
- Differentiated increase of salary levels for the health system;
- Salary increase for the rest of the civil servants/employees of the public administration.

In the coming years, the main objectives are:

- Full restructuring of the salary system for support staff (grade system employees);
- Linking the evaluation system and training of civil servants and other employees of public administration with their salary, with the aim of making functional their horizontal career scheme;
- Indexation of wages for the rest of the public administration employees.

4.2.4 Additional reform areas

Legal and administrative framework

For the purpose of the improvement of commercial legislation and procedures for the review of commercial agreements (closely linked with the enforcement of laws and contracts), during the period 2011-2012 the Ministry of Justice has launched the following initiatives which will be intensively implemented during 2013:

Legal initiatives Law No. 49/2012, dated 03.05.2012 “On organization and functioning of administrative courts and adjudication of administrative disputes”, through which administrative courts are established is approved upon the initiative of the Ministry of Justice. The establishment of these courts may reduce the number of cases at first instance and appellate courts may reduce time of trial and ensure for the citizens and businesses the implementation of a due legal process within reasonable time limits.

During the plenary session of the Assembly held on 27 September 2012, it was unanimously approved the initiative of the Ministry of Justice on *amendments to the law on lawyers’ profession*, which has introduced new measures for the discipline of lawyers, providing for a more simple procedure for the punishment of lawyers who violate law or the right to a due legal process.

It is established the Licensing Commission of Mediators, which has granted licenses for 53 natural persons and one juridical person with 21 mediators. Data of Commission-licensed mediators are entered in the registry of licenses at the Ministry of Justice. Further, the Commission submitted to the District Court of Tirana the list of licensed mediators which it will be expanded during 2013.

The fight against economic crime and corruption

The fight against corruption and economic crime in the judicial system is a strategic priority and oriented primarily to the undertaking of realizable measures in time and quality, with preventive and punishing character. The measures in the fight against corruption and economic crime even during 2013 will be focused on:

- Strengthening of punishing power of the law against perpetrators of corruptive criminal offenses.
- Promotion and transfer of judges through theirr effective and fair evaluation
- Improvement of judges' inspection system by Ministry of Justice and High Council of Justice
- Exercise of professional inspections against judges according to thematic programs and complaints of citizens.
- Harmonization of statistical data on criminal offenses related to corruption and organized crime including their registration by police, Prosecutor's Office and court.
- Access in online registers

Tax field

The Tax Administration has developed a new Compliance Strategy for the period 2012-2015. This Strategy is appropriate to the economic environment changes as a response to government policies for:

- The risks that the economy faces
- The complexity and sophistication of taxpayers in relation to the global economy
- EU standards for Tax Administrations

The main goal of this Strategy is to achieve increased voluntary compliance implementing by force at the same time, legal punishment against those who fail to meet their obligations.

This new approach is in accordance with the EU Compliance Model and is based on international best practice. The purpose of the Tax Administration is to ensure:

- Punishment only for those who deliberately do not meet their obligations.
- Assistance to those taxpayers who make every effort to meet their obligations, but who lack training or knowledge of fiscal laws and regulations.
- Reward of businesses that meet their obligations, limiting as much as possible the contacts they have with the tax administration and leaving free time to business owners in order to increase employment positions and earnings level.

During the implementation of the new Strategy for the next four years, the Central Tax Administration has identified five primary priorities. These priorities constitute the base of an operational plan of the compliance for the 2012 and for the next years. The operational plans enable the measurement of the performance against keys strategies outlined in the Strategic 2012-2015 Plan.

Two of the strategic documents are for external use (a) the 2012-2015 Strategic Plan and (b) the 2012-2015 Compliance Strategy, while the third document is only for internal use (the Operational 2012 Plan of Compliance). Any strategy of the strategic documents is broken down into tasks (rules), which in the future will be the base of the informative program, according to the user's requirements. Medium terms objectives are part of the 2012-2015 Strategic Plan set in 5 strategic goals. They are separated in a) priorities (5 objectives, which are considered as national risks of administration) and b) progressives (10 objectives, which are considered as national risks in a medium term period). The work analysis from the beginning of 2012 is based on these 15 strategic objectives. The annual work report will conserve the same structure as well as the Operational Plan of Compliance

In the agriculture field (Ministry of agriculture)

Albania continued to support agricultural restructuring through improvements in business environment, infrastructure development and support to investments.

National Support to Agriculture and Rural Development for 2012 is been implemented through 21 measures and a budget of 8.000.000 Euro.

The sustained government supports to the sector have positive impact on increasing competitiveness of agricultural holdings. The agriculture growth has been maintained mainly by productivity increase. The capacity build in the designing and implementation of the national agricultural support schemes were important for establishment of basic implementing structures for rural development programmes and for preparation for IPARD.

The ministry has designated the institutions required - Managing Authority and Albanian Rural Development Agency (ARDA) as IPARD Agency and provided the necessary resources for their capacity building. ARDA has been developing procedures and administrative capacity to become fully functional IPARD Agency. We have prepared Draft IPARD Programme in close consultation with DG Agrit services and with the GIZ technical assistance support. The Programme is focused on two core measures:

- support to agricultural investments in four priority sectors
- modernisation of the related food processing industry sectors

The progress made in capacity building has been acknowledged in the last Commission progress report.

In order to speed up the capacity building process, the Commission committed to start in 2012 an IPARD like grant scheme for farmers and food processing industry, based on the Draft IPARD Programme. The grant scheme will be financed under IPA Component 1. The IPARD like grant scheme is designed to address a dual objective. On the one hand, targeted funds will reach farmers and agro-processing industry and will contribute to improving the quality of life in rural areas by increasing the competitiveness of the agricultural and agro-food sector. On the other hand, through implementing IPARD-like measures in an IPARD-compliant way, the staff of the management and control system, potential applicants, advisory services and lending institutions will gain awareness on and experiences in prospective implementation of IPARD.

In the Social Security field

Fundamental objectives of the SII mid-term budgetary program 2013-2015 focus on improving the overall social insurance system, SII modernization and increasing efficiency in terms of management of compulsory social insurance fund as well as of supplementary and special government programs. In 2013, the focus will be relating the following:

- much more coverage for the population with compulsory social insurance elements in accordance with requirements of the ILO Convention on Social Security, financially guaranteed and maintained at reasonable lines
- intensify institutional efforts to improve the financial sustainability of the social insurance scheme and implementation of a balanced social insurance system for all classes of beneficiaries which adequately responds to the social and economic development of the country
- well-managed contributory incomes and fair distribution of benefits in the right place and time
- higher efficiency in managing the Social Insurance Funds; bringing insured persons and respective services to the focus of the SII activity, as well as enhanced strives to meet requirements of applicants within the fixed deadlines
- continuation of work towards the SII institutional consolidation in order to be able to integrate and apply the EU standards

5. SUMMARY DATA

Table 1a: Macroeconomic prospects

Albania

Percentages unless otherwise indicated	ESA Code	Year 2011	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015
		Level (bn EUR)	**Rate of change**				
1. Real GDP at market prices	B1*g	8.652	3.1	1.5	3.1	3.9	4.1
2. Current GDP at market prices	B1*g	8.878	6.2	3.7	4.5	4.4	4.6
Components of real GDP							
3. Private consumption expenditure	P3	6.757	3.0	0.4	0.4	3.3	2.5
4. Government consumption expenditure	P3	0.817	-4.1	-3.0	2.1	0.5	0.8
5. Gross fixed capital formation	P51	2.869	2.6	-5.5	3.0	0.5	3.2
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	-0.075	0.0	0.0	0.0	0.0	0.0
7. Exports of goods and services	P6	2.865	8.9	-1.5	8.5	7.4	7.0
8. Imports of goods and services	P7	4.581	4.9	-6.4	2.0	2.9	2.8
Contribution to real GDP growth							
9. Final domestic demand		10.4	2.8	-1.7	1.3	2.8	2.9
of valuables	P52+P53	-0.1	0.0	0.0	0.0	0.0	0.0
11. External balance of goods/services	B11	-1.7	0.3	3.2	1.8	1.1	1.2

Table 1b: Price developments

Albania

Percentage changes, annual averages	ESA Code	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015
1. GDP deflator		3.0	2.2	1.4	0.5	0.5
2. Private consumption deflator		7.5	2.7	0.5	0.2	0.4
3. HICP		na	na	na	na	na
4. National CPI change		-0.1	-1.4	1.0	0.0	0.0
5. Public consumption deflator		2.9	2.5	2.5	2.4	2.5
6. Investment deflator		0.9	0.7	0.2	0.2	0.3
7. Export price deflator (goods & services)		1.1	1.1	3.8	3.2	2.5
8. Import price deflator (goods & services)		7.2	1.5	1.1	2.1	2.1

Table 1d: Sectoral balances

Albania

Percentages of GDP	ESA code	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-11.5	-12.1	-10.3	-9.5	-8.2
of which:						
- Balance of goods and services		-20.8	-22.8	-19.4	-16.1	-14.2
- Balance of primary incomes and transfers		8.4	9.8	8.3	5.8	5.3
- Capital account		1.0	0.9	0.9	0.8	0.8
2. Net lending/borrowing of the private sector	B.9/ EDP B.9	-7.9	-8.5	-6.8	-7.1	-6.0
3. Net lending/borrowing of general government		-3.5	-3.7	-3.5	-2.4	-2.2
4. Statistical discrepancy		0.0	0	0	0	0

Table 1e: GDP, investment and gross value added

Albania

	ESA Code	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015
GDP and investment						
GDP *level* at *current* market prices (in domestic currency)	B1g	1297.7	1346.2	1407.0	1469.2	1537.1
Investment ratio (% of GDP)		32.0	29.3	29.0	27.9	27.6
Growth of Gross Value Added, percentage changes at constant prices						
1. Agriculture		3.3	5.4	3.6	3.7	3.5
2. Industry (excluding construction)		2.9	-2.2	2.7	3.8	4.3
3. Construction		0.2	-13.2	1.3	3.1	3.5
4. Services		4.1	4.0	3.6	4.4	4.7

Table 1f: External sector developments

Albania

Billion Euro unless otherwise indicated		Year 2011	Year 2012	Year 2013	Year 2014	Year 2015
1. Current account balance (% of GDP)	% of GDP	-12.1	-10.3	-9.5	-8.2	-7.1
2. Export of goods	million EUR	1405.500	1509.014	1735.691	1953.030	2204.880
3. Import of goods	million EUR	3647.100	3612.967	3747.321	3913.622	4079.827
4. Trade balance	million EUR	-2241.600	-2103.953	-2011.629	-1960.592	-1874.947
5. Export of services	million EUR	1747.400	1660.090	1815.886	1993.782	2107.834
6. Import of services	million EUR	1612.700	1428.846	1424.903	1533.899	1615.769
7. Service balance	million EUR	134.700	231.243	390.983	459.883	492.065
8. Net interest payments from abroad	million EUR	-83.500	-87.686	-288.780	-331.409	-371.876
9. Other net factor income from abroad	million EUR	131.100	103.099	111.548	117.827	123.695
10. Current transfers	million EUR	937.400	865.564	839.492	854.942	847.416
11. Of which from EU	million EUR	n.a	n.a	n.a	n.a	n.a
12. Current account balance	million EUR	-1121.900	-991.732	-958.387	-859.349	-783.648
13. Capital and financial account	million EUR	1111.340	960.463	949.898	830.918	807.250
14. Foreign direct investment	million EUR	803.649	948.287	1001.324	1072.736	1146.139
15. Foreign reserves	million EUR	1796.400	1920.400	2066.404	2192.909	2370.892
16. Foreign debt	million EUR	3947.716	4172.520	4369.468	4533.532	4715.086
17. Of which: public	million EUR	2093.170	2273.500	2412.338	2528.768	2565.530
18. O/w: foreign currency denominated	million EUR	2093.170	2273.500	2412.338	2528.768	2565.530
19.O/w: repayments due	million EUR	n.a	n.a	n.a	n.a	n.a
20. Exchange rate vis-à-vis EUR (end-year)	NCU/EUR	138.25	139.20	140.10	139.20	139.90
21. Exchange rate vis-à-vis EUR (annual average)	NCU/EUR	140.52	139.20	139.90	139.50	140.00
22. Net foreign saving	% of GDP	12.1	10.2	9.5	8.2	7.1
23. Domestic private saving	% of GDP	17.4	17.5	17.9	18.3	19.4
24. Domestic private investment	% of GDP	25.8	23.8	23.1	23.2	23.4
25. Domestic public saving	% of GDP	2.4	1.6	1.5	1.4	1.2
26. Domestic public investment	% of GDP	6.2	5.5	5.8	4.7	4.2

Table 1g: Sustainability indicators

Albania

	Dimension	Year 2008	Year 2009	Year 2010	Year 2011	Year 2012
1. Current Account Balance	% of GDP	-15564.2	-15145.0	-11472.1	-12147.9	-10255.0
2. Net International Investment Position	% of GDP	-26235.9	-32016.2	-33808.1	0.0	0.0
3. Export market shares	%, yoy	na	na	na	na	na
4. Real Effective Exchange Rate [1]	%, yoy	na	na	na	na	na
5. Nominal Unit Labour Costs	%, yoy	na	na	na	na	na
6. Private sector credit flow	% of GDP	0.0	0.0	0.0	0.0	0.0
7. Private sector debt	% of GDP	0.0	0.0	0.0	0.0	0.0
8. General Government Debt	% of GDP	80.6	97.2	98.9	101.6	104.6

Table 2: General government budgetary prospects

Albania

	ESA code	Year 2011 Level (bn NCU)	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015
			% of GDP				
Net lending (B9) by sub-sectors							
1. General government	S13	-45.831	-3.5	-3.7	-3.5	-2.4	-2.2
2. Central government	S1311	29.400	2.3	2.3	2.6	3.7	3.9
3. State government	S1312	0.000	0.0	0.0	0.0	0.0	0.0
4. Local government	S1313	-16.328	-1.3	-1.2	-1.2	-1.2	-1.2
5. Social security funds	S1314	-58.903	-4.5	-4.8	-4.9	-4.9	-4.9
General government (S13)							
6. Total revenue	TR	330.469	25.5	24.7	25.6	25.6	25.4
7. Total expenditure[1]	TE	376.300	29.0	28.4	29.1	28.0	27.6
8. Net borrowing/lending	EDP.B9	-45.831	-3.5	-3.7	-3.5	-2.4	-2.2
9. Interest expenditure	EDP.D41 incl. FISIM	41.121	3.2	3.1	3.6	3.6	3.6
10. Primary balance[2]		-4.710	-0.4	-0.5	0.1	1.2	1.4
11. One-off and other temporary measures [3]		0.000	0.0	0.0	0.0	0.0	0.0
Components of revenues							
12. Total taxes (12 = 12a+12b+12c)		214.121	16.5	15.3	15.9	15.7	15.7
12a. Taxes on production and imports	D2	166.442	12.8	12.0	12.6	12.4	12.4
12b. Current taxes on income and wealth	D5	27.967	2.2	2.1	2.1	2.1	2.1
12c. Capital taxes	D91	19.712	1.5	1.2	1.3	1.2	1.2
13. Social contributions	D61	54.991	4.2	4.2	4.2	4.2	4.2
14. Property income	D4	1.942	0.1	0.2	0.2	0.2	0.2
15. Other (15 = 16-(12+13+14)) [4]		59.415	4.6	5.0	5.3	5.5	5.3
16 = 6. Total revenue	TR	330.469	25.5	24.7	25.6	25.6	25.4
p.m.: Tax burden (D2+D5+D61+D91-D995) [5]		269.112	20.7	19.6	20.1	20.0	19.9
Selected components of expenditures							
16. Collective consumption	P32	115.771	8.9	8.5	8.6	8.4	8.3
17. Total social transfers	D62 + D63	132.639	10.2	10.5	10.6	10.5	10.5
17a. Social transfers in kind	P31 = D63	0.000	0.0	0.0	0.0	0.0	0.0
17b. Social transfers other than in kind	D62	132.639	10.2	10.5	10.6	10.5	10.5
18 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	41.121	3.2	3.1	3.6	3.6	3.6
19. Subsidies	D3	3.301	0.3	0.1	0.1	0.1	0.1
20. Gross fixed capital formation	P51	81.006	6.2	5.5	5.8	4.7	4.2
21. Other (21 = 22-(16+17+18+19+20) [6]		2.463	0.2	0.5	0.3	0.7	0.9
22. Total expenditures	TE [1]	376.300	29.0	28.4	29.1	28.0	27.6
p.m. compensation of employees	D1	67.446	5.2	5.0	5.0	4.9	4.8

Table 4: General government debt developments

Albania

% of GDP	ESA code	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015
1. Gross debt [1]		59.5	61.9	63.8	63.8	63.4
2. Change in gross debt ratio		1.0	2.4	1.9	0.0	-0.4
Contributions to change in gross debt						
3. Primary balance [2]		0.4	0.5	-0.1	-1.2	-1.4
4. Interest expenditure [3]	EDP D.41	3.2	3.1	3.6	3.6	3.6
5. Stock-flow adjustment		-2.5	-1.3	-1.6	-2.4	-2.6
of which:						
- Differences between cash and accruals [4]		0.0	0.0	0.0	0.0	0.0
- Net accumulation of financial assets [5]		0.0	0.0	0.0	0.0	0.0
of which:						
- Privatisation proceeds		0.0	0.0	0.0	0.0	0.0
- Valuation effects and other [6]		0.0	0.0	0.0	0.0	0.0
p.m. implicit interest rate on debt [7]		5.7	5.5	6.1	5.9	5.9
Other relevant variables						
6. Liquid financial assets [8]		0.0	0.0	0.0	0.0	0.0
7. Net financial debt (7 = 1 - 6)		59.5	61.9	63.8	63.8	63.4

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Albania

% of GDP	ESA code	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015
1. Gross debt [1]		59.5	61.9	63.8	63.8	63.4
2. Change in gross debt ratio		1.0	2.4	1.9	0.0	-0.4
Contributions to change in gross debt						
3. Primary balance [2]		-0.4	-0.5	0.1	1.2	1.4
4. Interest expenditure [3]	EDP D.41	3.2	3.1	3.6	3.6	3.6
5. Stock-flow adjustment		-2.5	-1.3	-1.6	-2.4	-2.6
of which:						
- Differences between cash and accruals [4]		0.0	0.0	0.0	0.0	0.0
- Net accumulation of financial assets [5]		0.0	0.0	0.0	0.0	0.0
of which:						
- Privatisation proceeds		0.0	0.0	0.0	0.0	0.0
- Valuation effects and other [6]		0.0	0.0	0.0	0.0	0.0
p.m. implicit interest rate on debt [7]		5.7	5.5	6.1	5.9	5.9
Other relevant variables						
6. Liquid financial assets [8]		0.0	0.0	0.0	0.0	0.0
7. Net financial debt (7 = 1 - 6)		59.5	61.9	63.8	63.8	63.4

Table 4a: Contingent liabilities

Albania

% of GDP		Year 2012	Year 2013
Public guarantees	% of GDP	3.9	3.9
Of which: linked to the financial sector	% of GDP		

Table 5: Divergence from previous programme

Albania

	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015
1. GDP growth (%, yoy)					
Previous update	3.0	4.3	5.0	4.9	
Latest update	3.1	1.5	3.1	3.9	4.1
Difference (percentage points)	0.1	-2.8	-1.9	-1.0	4.1
2. General government net lending (% of GDP)					
Previous update	-3.5	-3.0	-3.0	-2.5	
Latest update	-3.5	-3.7	-3.5	-2.4	-2.2
Difference	0.0	-0.7	-0.5	0.1	-2.2
3. General government gross debt (% of GDP)					
Previous update	58.9	59.6	59.5	59	
Latest update	59.5	61.9	63.8	63.8	63.4
Difference	0.6	2.3	4.3	4.8	63.4

Table 6: Basic assumptions on the external economic environment [1]

Albania

	Dimension	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015
Short-term interest rate [1]	Annual average	0.7	0.6	0.3	0.5	0.5
Long-term interest rate	Annual average	1.9	1.5	1.7	2	2.1
USD/EUR exchange rate	Annual average	1.25	1.29	1.3	1.3	1.3
Nominal effective exchange rate	Annual average					
Exchange rate vis-à-vis the EUR (NC/EUR)	Annual average	140.5	139.2	139.9	139.5	140.0
Global GDP growth, excluding EU	Annual average	4.4	3.9	4	4.5	4.9
EU GDP growth	Annual average	1.5	-0.3	0.4	1.6	1.9
Growth of relevant foreign markets	Annual average	0.4	-2.3	-0.5	0.8	1.1
World import volumes, excluding EU	Annual average	8.7	5.3	5.1	6.2	7
Oil prices (Brent, USD/barrel)	Annual average	107.3	112.5	109.1	103.1	103.4