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EDITORIAL

ALBANIA - INTERNATIONAL MONETARY FUND RELATIONS

ALBANIA'S MEMBERSHIP IN THE INTERNATIONAL MONETARY FUND

The International Monetary Fund (IMF), an organization of 188 countries, guided by the purposes set forth in the Articles of Agreement, works to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. The IMF's financial resources come mainly from each member country's quota, which is based broadly on the relative size and economic strength of the country.

Albania joined the IMF on October 15, 1991 upon the adoption of the IMF Membership Resolution for Albania. At the moment of its subscription, Albania's member country quota was SDR 25 million.

Its quota increased to SDR 60 million in January 2012, as a result of the entry into force of the 2008 Quota and Voice Reform of the IMF. Currently, with its increased quota, Albania has 1.341 votes (or 0.05 percent of total voting shares of all IMF's members).

Quota increase through the years

Payment date for quota increase	Quota
October 15, 1991	SDR 25,000,000
November 30, 1992	SDR 35,300,000
January 29, 1999	SDR 48,700,000
January 20, 2012	SDR 60,000,000

Box: Membership in the International Monetary Fund

For many years, Albania has been an isolated country, hardly recognised internationally due to its totalitarian regime. In early 1991, upon the change in the political system, Albania became a member of various international organizations like the IMF. Prior to joining the IMF, Albania was characterized by poor economic conditions, poverty and low living standards.

In this context, membership in the Fund would direct the country toward the objective of implementing economic development strategies for transitioning from a centrally-planned to a market-based economy. The first arrangement signed with Albania aimed at its macroeconomic stabilization and structural transformations towards a market-based economy. Hence, membership in the Fund was regarded as an important step for Albania.

Furthermore, membership in the Fund provides benefits to the economy, since it promotes international monetary cooperation, confidence in other financial institutions and financial markets, economic security to foreign investors, and access to investment loans.

In addition to benefits, each IMF member country must comply with the provisions under the Articles of Agreement and established rules. They must also pay the quota, which determine its maximum financial commitment to the IMF, its voting power, and its access to IMF financing.

IMF-SUPPORTED PROGRAMS FOR ALBANIA

The IMF provides financial assistance to a country that cannot find sufficient financing to make its international payments. For this reason, the Fund has created and developed a wide range of instruments or facilities tailored to address specific needs of its member countries. IMF loans are meant to help member countries tackle balance of payments problems, stabilize their economies, and restore sustainable economic growth. Also, the IMF provides concessional lending facilities to low-income member countries in order to develop their economy and reduce their poverty.

The first IMF lending instrument for Albania was the 12-month Stand-By Arrangement signed on August 26, 1992, equivalent to SDR 20 million, disbursed in three tranches. Repayment of this loan was made within 3 ¼ - 5 years of disbursement and ended in 1998.

Further to the Stand-By Arrangement, in July 1993, the IMF Executive Board approved a three-year loan for Albania under the Enhanced Structural Adjustment Facility (ESAF), equivalent to SDR 42,360,000, to support the 1993-1996 economic and financial programme, of which only SDR 31,060,000 were drawn.

On November 23, 1997, in the aftermath of the unrest, the IMF Executive Board approved a loan for Albania, equivalent to SDR 8,825,000, under the IMF's Emergency Post-Conflict Assistance (EPCA). Principal repayment on this loan was made in eight quarterly instalments, beginning five years after the loan disbursement.

Albania was granted an IMF three-year Poverty Reduction and Growth Facility (PRGF) loan, (1998-2001), equivalent to SDR 45 million (disbursed in 8 tranches), which was followed by a new IMF three-year PRGF loan (2002-2005), equivalent to SDR 28 million (disbursed in 7 tranches).

On January 27, 2006, the IMF approved the last three-year PRGF/EFF (Extended Fund Facility) arrangement for around SDR 17 million, which was disbursed in 7 tranches. The PRGF/EFF arrangement ended on January 31, 2009.

IMF-supported programmes for Albania (01.05.1984 – 30.04.2012) in 000/SDR

Type of Arrangement	Approval Date	Expiration Date	Amount approved	Amount Drawn
EFF	01.02.2006	31.01.2009	8,523	8,523
ECF	01.02.2006	31.01.2009	8,523	8,523
PRGF 3	21.07.2002	20.11.2005	28,000	28,000
PRGF 2	13.05.1998	31.07.2001	45,040	45,040
ESAF (PRGF 1)	14.07.1993	13.07.1996	42,360	31,060
EPCA	12.11.1997		8,825	8,825
STAND BY	26.08.1992	14.07.1993	20,000	13,125
	Total		152,445	143,095

ALBANIA'S RELATIONS WITH THE IMF UNDER ARTICLE IV

Upon completion of the three-year PRGF/EFF arrangement in 2009, Albania's relations with the IMF have focused on Article IV consultations of the IMF's Articles of Agreement. Article IV consultations are part of IMF surveillance. An Article IV mission visits the country every year or every two years to gather information and exchange views with local authorities. Conclusions of the mission are presented in a staff report submitted to the Executive Board, highlighting any potential risks to stability and economic growth, at the same time, providing advice on necessary policy adjustments. The latest Article IV consultation was conducted by an IMF mission that visited Albania in June 2011.

Since 1999, nine IMF missions under Article IV consultation with Albania have taken place. Their reports were published, respectively, in 1999, 2000, 2001, 2003, 2005, 2006, 2008, 2010 and the last one in 2011.

The published conclusions of the last mission (June 2011) under the Article IV consultation with Albania, highlight that:

1. The Albanian economy has shown admirable strength in the recent past. Albania has weathered the 2009 global financial crisis well, owing to sound policies implemented during the pre-crisis years.
2. The financial system overcame heightened stress in the immediate aftermath of the crisis and avoided a credit bust, though asset quality declined.
3. Throughout, inflation remained well anchored. The needed rebalancing of the economy has begun, with the exports picking up and the high current account deficit narrowing.
4. The monetary policy framework of an inflation target and flexible exchange rate is a fundamental strength of the Albanian economy. However, IMF experts underlined the need for a good combination of macroeconomic policies to anchor inflationary expectations and maintain growth prospects.
5. Directors commended the resilience of Albania's banking system during the crisis, although cautioned that heightened risks, including from possible regional spillovers, called for macro-prudential policy.

A key near-term priority is the swift resolution of the high level of non-performing loans. Directors encouraged the authorities to continue to enhance the monitoring of banks and the development of the local currency market.

IMF ASSISTANCE

Over the years, the support provided, particularly by the IMF, has resulted positive and significant for Albania, recalling here the period of implementing transition reforms. In this context, the IMF has provided financial assistance to our country through various programmes, such as the SBA, EPCA, PRGF and PRGF/EFF, through missions giving advice on economic policies and providing technical assistance.

Missions and visits in the context of policy advice have established a continued and periodic cooperation on compiling and implementing policies, achieving and consolidating macroeconomic stability and accelerating structural reforms.

Also, worthy of note is that the IMF provides countries with technical assistance and training to strengthen their capacity for compiling and implementing effective policies. Technical assistance is provided in several areas, including fiscal policy, monetary and exchange rate policies, banking regulation and supervision, monitoring of financial system, and statistics. IMF assistance to the Bank of Albania is focused, among other, on policy formulation and implementation, central bank accounting, banking supervision, improvement of statistics compilation, and payment systems.

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

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Press Conference on the Monetary Policy Decision of the Bank of Albania's Supervisory Council,
25 January 2012

Today, on 25 January 2012, the Supervisory Council of the Bank of Albania reviewed and approved the quarterly Monetary Policy Report. Based on the analysis of Albania's latest economic and monetary developments and following discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to cut the key interest rate by 0.25 percentage points. Following this decision, the rate for One Week Repurchase Agreement fell to 4.50%. The key interest rate cut was driven by contained inflationary pressures over the policy-relevant horizon and expectations for a more prudent fiscal policy in the period ahead. The Supervisory Council deemed that this decision provides appropriate monetary conditions to meet the inflation target over the medium run. Moreover, this cut is expected to increase the monetary stimulus and promote economic activity in Albania.

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

The Albanian economy faced challenges in 2011 as regards economic growth and maintaining of macroeconomic balances. Additional attention to public finance stability in euro-area countries is reflected in added risk premiums in international financial markets and reduced willingness to invest in emerging economies. Measures for addressing financial market concerns have led to economic slowdown in our trading partners and are reflected in progressive deceleration of our export growth rates.

Moreover, higher food, fuel and primary commodity prices are translated into stronger foreign inflationary pressures, expanded trade deficit and, potentially, weaker domestic demand as a result of negative effects on Albanian households' financial balances.

Additionally, negative developments in the global arena are reflected in added uncertainties in the Albanian economy and negative impact on domestic consumption and investments. In spite of these shocks, the Albanian economy continued to grow in 2011, albeit at lower rates.

This growth has reflected structural improvements of the Albanian economy, overall sound balances of economic agents, utilisation of available capacities for macroeconomic stimulus and success to maintain macroeconomic balances.

Average annual inflation in the second half of 2011 was 2.9%, down by 1.1 percentage points from the first half of 2011. Downward inflation emerged in the second quarter and was then reinforced during the second half of the year. This resulted from reduced contribution of processed food, unprocessed food, and administered prices. In particular, food prices deviated from their seasonal behaviour in December, producing rapid curbing of annual inflation to 1.7%.

From the macroeconomic perspective, the downward inflation was influenced by both demand and supply factors, simultaneously. On the supply side, slowdown in primary commodity price inflation in global markets and relative stability of the exchange rate were materialised in lower imported inflation. On the demand side, the below-potential growth in the Albanian economy continued to keep spare capacities in output factors – labour and capital – materialising in downward pressures on wages, output costs and inflation. Economic agents' expectations remain anchored around Bank of Albania's target due to Bank of Albania's reliable monetary policy, as well. Anchored economic expectations have reduced the so-called second-round effects, in other words, transmission of temporary shocks from higher primary commodity prices in global markets and output costs, and higher consumer prices at home. They have provided higher flexibility for the Bank of Albania to pursue its stimulating monetary policy. Overall, these tendencies are expected to continue in the period ahead.

Reduction in inflationary pressures over 2011 and expectations for low inflation over 2012 led to further easing of monetary policy in the fourth quarter of 2011. The Bank of Albania cut the key interest rate twice, namely in September and November, to a record low 4.75%.

The Bank of Albania holds that the monetary stimulus increase will provide suitable financial conditions for compliance with its medium-term inflation target.

Furthermore, eased monetary conditions serve to boost domestic demand, which remains fragile against higher uncertainties surrounding the economy. In addition, it factorizes the prudent fiscal policy for 2012 and expects curbing of public spending contribution to economic growth.

According to latest data from INSTAT, the Albanian economy grew by 0.5% in the second quarter, a figure apparently slower than in the first quarter.

By sector, economic growth over this period was sustained mainly by positive performance of agriculture and individual branches of industry and services sectors. Value-added in agriculture was up 3.4%, providing significant contribution by this sector to the overall economic growth during the second quarter. On the other hand, the services sector's annual value-added was up by 1.8%, slowing down significantly from previous quarters' rates.

Transport and financial intermediation were the main drivers of this sector, whereas most of other branches of the services sector contracted, year

on year. Likewise, industrial sector shrank by 8.5% in the second quarter, after its positive performance in the last six quarters. The industrial sector deceleration during this quarter was largely influenced by slashed output in 'Electricity, gas and water', whereas extractive and processing industries continued their upward value-added. After its surge in the first quarter of 2011, the construction sector contracted again in the second quarter, posting annualised downgrade of 1.7%.

As regards aggregate demand, during the first half of the year, economic growth was supported mainly by the public sector and foreign demand contributions, whereas internal demand was lacklustre. Available data suggest that private consumption and investments were sluggish during the first half of the year, thus conditioning the below-potential growth in our economy during this period.

Private consumption continues to reflect consumers' reluctance to spend and their inclination to save. Domestic consumption has not totally reflected higher available income generated by higher wages and employment rates, or expanded funding resources, in the form of consumer loan growth during 2011. In particular, remittances shortfall during the first nine months of the year may have lessened consumption for a part of Albanian households. In addition, relatively high import prices, which burdened Albanian households' budget in the first half of the year, may have impacted consumption negatively. Against this performance of consumption during the first half, improved balances for major purchases – as suggested by the consumer confidence survey – and more consumer loans granted during the second half, suggest for higher consumption in the third and fourth quarters of 2011.

Subdued consumer spending and presence of spare capacities in the economy have dampened businesses' demand for new investments. In parallel, higher lending prudence by banks may have discouraged, in part, the demand for investment loans.

Foreign direct investments were down during the first quarter of the year. Higher capital expenditures in the last quarter are expected to increase the contribution of this component to aggregate demand at year-end. Also, improved lending terms in 2012 are expected to be translated into higher investment loans for the system and higher contribution of this component of aggregate demand to economic growth.

Fiscal policy was stimulating in 2011, materialised in positive contribution of public spending to aggregate demand. Public spending and budget deficit growth rates moderated after the first quarter, settled at low levels in the second and third quarters, and accelerated in the last quarter of the year. At end-November, budget deficit was ALL 38 billion, reflecting 5.4% public spending increase and 0.7% budget revenues increase in this period. Acceleration of annualised budget spending in the last two months of the year owes primarily to higher capital expenditures in this period.

Added prudence to fiscal stability, which characterises the 2012 budget, is expected to be reflected in lower contribution by the public sector to economic growth for 2012. Nonetheless, the Bank of Albania deems that this is an appropriate step to maintain macroeconomic stability and reduce risk premiums in the economy. Budget deficit narrowing in 2012 and its funding with domestic resources would generate more room for expanding the private sector credit in this period.

Albanian economy continued to benefit from foreign demand in 2011, though at more moderate levels than in 2010. Annual Albanian export growth over the first eleven months of the year was 19.9%, implying slower rates compared with the corresponding period of a year earlier. On the other hand, imports accelerated their annual growth to 12.2%. Trade deficit widened by 8.1%, year on year, largely illustrating negative effects of price rise in global markets. A more detailed analysis of the trade deficit reveals that about 50% of its increase is created by the balance of electric energy exchange.

Moreover, in real terms, according to third quarter's data, net export deficit narrowed and contributed positively to aggregate demand.

Annualised contraction of the net export deficit has resulted from decline in imports of goods and services by about 4.2% in real terms and exports upsurge by about 8.6%.

Monetary indicators were in line with real sector developments. Our analysis and assessments suggest that higher monetary supply is in accordance with economic agents' demand for real money, while monetary inflation pressures on the economy are contained. Growth in M3 aggregate was slower in the second half of 2011 due to lower money creation in foreign currencies. During July-October, the annual average growth in monetary assets of the economy was 10.4%. Contribution of private sector's demand for loans remained unchanged. At the end of November, its annualised growth was 10.9%. Crediting remains under the influence of low demand for loans and more prudent lending policies by banks. Economic agents' behaviour is affected by the uncertainty about the future, which, in turn, conditions spending and investments in the economy.

On the other hand, credit supply is tight, as lending standards performance shows.

Financial markets during the second half of 2011 were calm and reflected relatively downward premiums on liquidity risk and inflation. Successive key rate cuts were swiftly reflected in the interbank market. In the primary market, government security yields dropped, reflecting the key interest rate cut and the public sector's low demand for loans. Moreover, transmission of monetary policy signals is expected to be extended fully to loan and deposit markets, in accordance with the transmission mechanism time lags.

The Bank of Albania deems that most of above-analysed tendencies will be present during 2012, as well. According to our core projections, the Albanian economy will continue to grow during the year ahead, albeit below its potential. The country's economic activity will be conditioned by the solution to the euro-area crisis, economic growth in our trading partner countries, and foreign investor's attitude to risk.

On the other hand, economic challenges in our trading partner countries may be transformed into positive opportunities for the Albanian economy.

Albanian economy attractiveness with low unit labour costs, macroeconomic stability and financial soundness of businesses, households and the banking system may be reflected in more foreign direct investments. While our projections factorise lower foreign demand contribution, in baseline scenarios, the widening of Albanian export market remains a potential scenario, as well. Economic growth projections presume positive consumption and investments growth at home, in response to improved lending terms. The latter are expected to reflect Bank of Albania's eased monetary policy and reduced risk premiums in the financial system. Moreover, reduction of room for fiscal stimulus and maintaining of stable fiscal parameters will enable the private sector to create spare funds and cut down risk premiums for the economy. Factorising our expectations for below-potential economic growth and lower imported inflation, as well as the anchoring of the economy's expected inflation around the target, our projections suggest that, with 90% probability, consumer price inflation will range 1–3% during 2012.

Taking into consideration the above information, the Supervisory Council assessed that inflationary pressures remain subdued over the policy-relevant horizon. Moreover, economic agents' expectations on inflation remain anchored to Bank of Albania's target band. At the conclusion of discussions, the Supervisory Council decided to cut the key interest rate by 0.25 percentage points to 4.50%. This decision serves to comply with the medium-term inflation target and provides the appropriate monetary conditions to stimulate Albania's economic activity.

Monitoring the conformity of monetary conditions with its inflation target, in this development scenario, Bank of Albania's monetary policy is expected to continue to stimulate the economy over 2012.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Regional Meeting of the Bank of Albania in Fier District
31 January 2012

Dear guests,

It is an honour and great privilege for me to be here with you today to share some reflections and ideas on the current development stage of the Albanian economy in general, and your region in particular. Regional meetings have now become a consolidated tradition in our public communication philosophy. We believe that meetings of this kind serve to accomplish Bank of Albania's objectives by ensuring a better explanation of the monetary policy. Besides enhancing our decision-making transparency, this direct communication embodies another function, that is public education. We ultimately believe that this communication contributes to a greater efficiency in transmitting the monetary policy decisions to the economy.

I cannot, however, refrain from sharing some of my personal impressions on Fier and its people which I have gained over the years.

Your city is an important crossroad connecting lower Albania to the south, including the Ionian Riviera. I think this is a strong point in favour of Fier, a comparative advantage relative to many other cities in Albania.

Fier opens wide into the Adriatic Sea, beginning from the embouchure of Seman River in the north to that of Vjosa River in the south. The whole territory is part of Myzeqe lowlands, i.e., the most fertile lands in Albania, while worth noting is that it represents the oil-bearing region in our country. Moreover, the people of Fier have historically been distinguished as hard-working, peace-loving and hospitable. I am really happy to be here today.

Dear guests,

The Albanian economy has progressed positively, being manifested in positive economic growth, low inflation, stable national currency, and fiscal and financial sustainability.

The Albanian financial sector - dominated by the banking system - has increased its financial intermediation, materialised in the growth of deposits and lending to the economy. On the other hand, it enjoys full financial soundness, reflected primarily in its capital adequacy, liquidity position and profit.

Throughout this time, the Bank of Albania has closely monitored the banking system developments and has carried out stress-testing exercises, which show

that all banks are resilient to shocks in extreme adverse scenarios and can operate smoothly. On the other hand, the Bank of Albania has also been very attentive to the performance of the economy.

As you might have heard, last week, the Supervisory Council of the Bank of Albania cut the key interest rate by 0.25 percentage points. This was the third cut, driven by a well-defined aim to support and boost the economic activity in Albania. Due to the unprecedented financial crisis facing the global economy in general, and the euro area economy in particular, Albania's economic growth remains below its potential economic growth, or in simpler words, our economy would grow if it used all its production capacities.

Through our analyses we strive to identify the reasons behind this performance, the consequences and the measures that would help smooth out this concern. In the following, I would like to elaborate on some of our conclusions.

I would begin the analysis of the economic and financial situation in Albania by dwelling on what we have considered as the major cause and source of risks for the future: the severe global crisis. The situation in our trading partners is a product of developments in the global economy, which is facing a hard period in terms of macroeconomic and financial stability. High debt levels of governments and individuals have curbed the capacity of many advanced economies to spend and make investments, thus affecting the economic activity and their capacity to pay off debts.

Many reputable representatives from the academia and the business attribute the cause of the crisis (debt-burdened balance sheets of the governments and individuals) to globalization and the competition it generates. Due to the rising costs, advanced economies have generally lost their historical advantages in producing goods and services, replacing the absent income with debt, which now they have to pay off.

Why are these developments important to the Albanian economy?

First, it is necessary to understand that these advanced economies are our major trading partners. They are the main users of our exports and, at the same time, the source of imported consumer goods and fuels.

Second, these economies are the major investors in the Albanian economy and the financial system.

Third, these countries are hosting the Albanian migrants.

Fourth, we believe that another effect relates to the psychological factor, which emerges in the form of consumers' and firms' hesitation to consume and invest.

Subsequently, the difficulties facing our neighbouring partner countries are converted into difficulties for the Albanian economy. Any cuts in consumer

and investment spending, be it private or public, will later yield cuts in these countries' investments in Albania, lower demand for exports, lower remittances; in short, the fall in all aggregate demand components in Albania. This would generate fall in output, creation of spare capacities, deterioration of firms' and consumers' balance sheets, and a number of other adverse phenomena. At present, the Albanian economy generates nearly as much as half of its potential growth. This gap, which in our terminology is known as "output gap", is partly explained by the difficulties facing our trading partners.

In addition to the above-mentioned factors, the lower economic growth rate also attributes to the sluggish activity in some industries, which, until two years ago, generated a considerable portion of the economic growth.

These industries operate in the non-tradable sector, implying that the created product remains in the domestic economy, that is, it cannot be traded in global markets. To be clearer, I refer to the construction sector and the entire chain of economic activities fuelling it.

The sluggish economic activity, or the presence of the negative output gap, leads to conclusion that there are spare production capacities in the economy. According to latest analyses, these spare capacities have led to lower inflationary pressures on the economy. Against this background, the Bank of Albania has pursued an accommodative policy, trying to lower the financial intermediation costs (and affecting the cost of credit indirectly), in order to boost investment and consumption and, subsequently, economic activity. We have also supplied the banking system and the Albanian economy with the necessary monetary liquidity, in view of meeting the needs of commercial and economic activity. In addition, through our successful monetary policy, we have accomplished our low inflation objective and have guaranteed a stable macroeconomic and financial environment. This stability, which is the core mission of a modern central bank, allows households, businesses and financial institutions to make financial decisions and take business initiatives amid higher future certainty.

The credibility of the central bank and our monetary policy is now a tangible reality for Albania. It is reflected in the trust of our economy in the national currency and its purchasing power in the future. The investment made by the Bank of Albania to boost public confidence has required a lot of efforts, but they get rewarded multiple times with greater opportunities to stimulate the economy without prejudice against inflation outlook. Against this background, the Bank of Albania has provided the necessary economic stimulus, while there is still room for other additional monetary stimulus in the medium run. The accommodative policies generally aim at boosting economic activity and domestic demand, in order to keep consumer prices within Bank of Albania's target in the medium run.

We have also other reasons to support economic growth. We believe that if the economy grows at its potential rate, there will be substantial impact on improvement of public and private sectors' and individuals' financial balance

sheets. Their capacity to pay off past-due financial liabilities will subsequently improve, and their creditworthiness will enhance.

I think this is one of the challenges that, on the one hand, would restore the macroeconomic equilibrium to the pre-crisis level and, on the other, would guarantee the financial stability in the long run.

I would like to dwell now on another argument, which relates to the current crisis, but also has significant potential for development if identified and addressed in due time.

In spite of negative effects, the global crisis provides some opportunities, which I believe time is ripe to identify promptly and get the most benefit from them.

Let me state a fact from last year, which I think illustrates my observation better. There is an observation that the Arab Spring is one of the factors that led to increase of re-export industry in Albania. Not only wasn't it hit by the crisis, but it also grew its activity further. One could rightly say that the Arab Spring comes only once in a lifetime.

This is true but what I see as a comparative advantage of our economy in relation to economies of many countries that traditionally make active processing of the orderer's materials (re-export industry) is the cheap labour force. Countries like China, Turkey, Vietnam etc, have raised the labour cost, while it has to be admitted that they have a high level of productivity. Hence, what we need to do is to qualify the labour force of these sectors in order to increase productivity. I think that the qualification of the labour force, the increase of human capital and the formulation of more stimulating policies to support these sectors represent a resource and potential we have to rely on to create competitive advantages.

The absorption of higher capital for the country's development is another opportunity the global crisis provides us with. It is a well-known fact now that technology and financial capital tend to move towards sectors, branches and countries that offer higher return on investment. In my personal opinion, but also based on a thorough analysis of the Albanian economy, Albania is a great destination in this respect.

There is undoubtedly a high perceived risk in the global markets, not only for Albania but also for all the countries in the region. We should, however, make our competitive advantages clear to the global markets and continue to work on the structural reform in order to release more development potentials and energy.

Another lesson drawn from the crisis is that consumption should be re-oriented from imported goods to domestic production. I have also emphasized earlier that the list of imports should get shorter, substituting them with domestic products, which has to be the priority of the new economic growth model in Albania.

To this end, time is ripe perhaps to give priority to the organisation of financing schemes to support the traded sector. More specifically, I refer to development of financial institutions that support the agriculture sector, agro-business industry, extractive and processing industry, where the Albanian economy offers competitive advantages. The economic benefits provided by these financial institutions to domestic production go beyond the low financing cost. These are specialised institutions and they are very well-acquainted with emerging economies and relevant sectors. In addition to providing financing, they are equipped with and offer technical and financial expertise to enhance the efficiency, transparency and management, and increase employment in the sectors they support; to boost domestic production; to increase employment and, ultimately, to stimulate the balancing of external sector deficits.

Re-orienting the free labour force, capital and the private and public interest towards these advantages offers a simultaneous solution to a number of concerns facing the Albanian economy. This re-orientation is the essence of the economic growth model and should be the main objective of economic policies and stimulus at a local-level as well.

The economic activity of Fier region is a perfect example of successful trade orientation. Fier has generally recorded growth above the average of the Albanian economy and is ranked the second (after Tirana prefecture) in terms of its contribution to real GDP growth and share in total GDP.

At the same time, its current employment rate is about 4% higher than the average employment in the Albanian economy. These economic indicators provide evidence for direct outcome of competitive advantages that Fier region offers compared to the other economic regions in Albania.

This performance is grounded on a number of characteristics that guarantee the diversity in industry-level production at high tradability. In other words, Fier offers the following competitive advantages:

Favourable geographical location: Fier is situated in the western part of the Republic of Albania. In Antiquity, the ancient city of Apollonia was the second largest city in the Illyrian territory and the starting point of Via Egnatia, which connected Rome and Byzantium. This favourable geographical location has offered the city and the suburb areas a priority in the economic, commercial and cultural development since the antiquity.

Natural resources: Favoured by its geographical location in the western lowlands, Fier is rich in arable lands and natural resources, mainly oil and bitumen.

Industrial concentration and diversity: Fier has always been and remains an area with diversified industrial production in oil extraction and processing, construction, agriculture and processing of agricultural products. The concentration of industrial and agricultural plants has, therefore, led to concentration of human and financial capital.

The district of Fier has generated about 6.1% of total deposits in the banking system, while the amount of loans received accounts for only 28% of total deposits at a district-level. This level of intermediation explains it all. It seems that the banking sector's attention and support to this district is not in direct proportion to capacities. This situation attributes to lack of attention by both businesses and banks. It is imperative that businesses and banks sit together and discuss the opportunities for new ideas and projects of mutual benefit. In conclusion, I would like to bring another matter of concern to your attention. While preparing for this meeting, we faced difficulties in finding useful statistical information on the demographic and economic activity of Fier district. Taking into account the opportunities it has to offer, the reported statistics do not make this district distinguishable or comparable to the other regions inside or outside Albania.

It would be of interest, for instance, to have detailed information on free capacities in agriculture and industry; average profitability; non-utilized labour market resources, level of education and human capital; unit labour costs, and capital and final product cost per unit; prices of other factors of production, and so on. The lack of these indicators makes it hard, and even impossible, to evaluate and compare the business plans that may potentially be introduced to financial institutions or other national or international partners.

It should not be forgotten that in the global era, the real competition for Fier region does not stand in the other regions of Albania, but in similar one in European and emerging economies. At present, we do not compete with these economies as we are not and won't be able to be part of the global market as long as we are not "quoted" in real time, using the same methodology and figures that allow the comparison of costs and opportunities.

The creation of these indicators, their calculation and rating in relevant markets would create the conditions for real assessment of the competitive advantages that this district offers. The help that local authorities can give in identifying the competitive advantages and the provision of local statistics are perhaps the best investment they can make for the regional and national development.

Today, more than ever before, all the attention of global economy is oriented towards the markets, as the best estimators of the competitive advantages in the global economy. The developments in these markets are bringing about the reconfiguration of economic powers at a global level.

The new commercial and financial trends appear to be in favour of the utilisation of natural resources and competitive advantages, through investments in emerging economies, to later import them in the form of final products, ready for consumption. These are advantages for the Albanian economy, which, with the major structural reforms taking place (privatizations, natural and human resources, creativity and the entrepreneurial spirit), enjoys all the opportunities and should play an active role in the regional market and beyond, in the global market. I am optimistic and I do believe in our economy and its potentials.

Thanking you for your attention, I welcome any comments.

OPENING REMARKS BY THE GOVERNOR OF THE BANK OF ALBANIA, MR. ARDIAN FULLANI

At the Inaugural Reception of Financial Sector Development Program
9 February 2012

Dear Mr. Spindler,
Dear Mr. Williams,
Dear Ms. Timofeeva,
Dear participants,

It is a special pleasure for me to be here in this ceremony, which marks the commencement of a new phase of cooperation with the Financial Services Volunteers Corps (FSVC). This is evidence of the successful existing cooperation and our commitment to further it in the future.

The Bank of Albania has benefited largely from the cooperation with the FSVC. In concrete terms, this cooperation has focused primarily on strengthening the institution's oversight function. The assistance from the FSVC has addressed specific training needs for Bank of Albania's supervision staff and has complemented with concrete activities other development projects we have had with the International Monetary Fund and the World Bank.

More specifically during this period, we have been assisted to draft and implement the Supervision Development Plan in 2004-07, in the framework of cooperation with the World Bank.

Later, cooperation challenges and needs became more concrete and specific against the background of the proliferation of the international financial crisis, re-conceptualization of international banking supervision standards and re-assessment of the role of other public authorities working to maintain the financial stability.

During 2008-09, the Bank of Albania started revising the regulatory and operational procedures to make them more comprehensive and solid with a view to tackle extraordinary financial situations. In this context, the FSVC has assisted us with expertise to amend and upgrade the relevant manuals. In 2010, the assistance of FSVC was requested to perfect operational risk supervision and assess IT infrastructure adequacy. In addition, during the same year, the FSVC assisted us to revise the credit risk manual. In 2011, cooperation between the Bank of Albania and the FSVC focused on increasing the assessment of banking, liquidity and market risks.

Moreover, the assistance of FSVC has proven very useful for the regulatory and operational empowerment of the Albanian Deposit Insurance Agency (ADIA).

I would like to underscore the appreciation of the ADIA and the Bank of Albania, as its supervisory authority, for the invaluable contribution of FSVC experts on drafting ADIA's Strategic Development Plan 2002-05; preparing payment procedures in the compensation process during 2008; drafting amendments to the Law "On Deposit Insurance" in 2009; identifying further legal and regulatory improvements to enhance ADIA's capacities on insurance of liquidities.

I would also like to point out that the FSVC's assistance has been evident and effective. It has always been adapted to the Bank of Albania and ADIA's concrete needs and provided swiftly. The deployed experts were professionals with considerable financial and legal experience in key institutions such as the Federal Insurance Deposit Corporation. The expertise has proven fairly useful for many of our staff and, at times, was provided as on-the-job training. For example, FSVC experts joined Bank of Albania's Supervision Department inspectors in their on-site examinations. I am confident that these qualities of FSVC's assistance will be maintained in the future.

A result of this fruitful cooperation is our shared commitment to extend it to the medium run. The parties have been in constant contact to identify the fields for future cooperation and I reckon that this process is being finalized in terms of project design and relevant details on development methodology and expected results. A preliminary assessment reveals that the scope of our future cooperation has expanded. Projects will continue to serve the objective for ongoing supervision capacity building in the fields of improvement of contingency plans, implementation of latest amendments to international banking supervision standards, risk assessment and improvement of regulatory requirements for responsible management by banking and financial institutions. The assistance may be expanded to include underlying standards for payment systems and use of e-money, thus laying the grounds for the adoption of relevant requirements arising from EU directives. The cooperation of the FSVC with ADIA will focus on the implementation of the Strategic Development Plan 2012-14 and will address, more concretely, the modernization of the IT infrastructure and reporting system as well as other ancillary processes.

Appreciating the distinct qualities of FSVC's assistance and taking into account the enhanced capacities of Albanian institutions to take in this assistance effectively, I deem that this cooperation should be supported and forego the concrete realization of future development objectives. In this context, the assistance may be tailored to support the design of a holistic project; not channelled in certain segments of its development, but focused, especially, on its implementation phase. This would require the FSVC and the Bank of Albania or the ADIA to define respective programs and other necessary requisites so that foreign experts may provide longer term assistance to ensure consistency of the training content and quality. This process would be carried out also by a thorough ex-post assessment of these projects.

Finally, I avail myself of this opportunity to thank the US Government and other donors, USAID Mission in Albania, FSVC's Board of Directors and its

staff in Tirana for raising the necessary financial resources to support this cooperation program. I would like to reiterate the commitment of the Bank of Albania for a fruitful and effective cooperation.

Thank You!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the press conference on the Monetary Policy Decision of the
Bank of Albania's Supervisory Council
29 February 2012

Today, on 29 February 2012, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the analyses of Albania's latest economic and monetary developments and following discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 4.50%. The Supervisory Council deemed that this decision provides appropriate monetary conditions to meet the inflation target over the medium term. Moreover, it provides the necessary monetary stimulus to the economy in Albania.

Let me now proceed with an overview of economic developments and main issues that were discussed at today's meeting.

Annual inflation rate was 1.6% in January, slightly down by 0.1 percentage points compared with the previous month. The annual inflation rates have been pursuing a downward trend since the second half of 2011, reflecting the mitigation of inflationary pressures from the supply side: cancelling out of effects from administered price rise; increase of domestic agricultural production; and slowdown of imported inflation. The downward annual inflation in January reflected the further decrease of imported inflation from the external sector of the economy, materialised in lower contribution of the prices of processed goods and foods. Prices of unprocessed foods continued to contribute to downward annual inflation, while the contribution of other categories was relatively stable.

Inflationary pressures from the demand side remain low and are conditioned by the continued negative output gap and lack of cost-related pressures on the economy. Moreover, low increase of consumer prices has reflected economic agents' expectations on inflation.

According to INSTAT data, Albania's economic growth improved over the third quarter of 2011, posting an annual growth of 2.6% over this quarter. On the production side, growth was supported by branches of the industrial sector and services. On the demand side, economic growth continues to be driven by foreign demand, while domestic demand remains sluggish. A similar growth model is assessed to have taken place in the fourth quarter of 2011. Based on the analysis of aggregate demand components, the Bank of Albania judges that foreign demand was the main driver of demand increase during 2011. Although not at the levels of the previous year, exports continue to grow. Latest foreign trade data point to our exports annual growth by 20.7%

in December. On the other hand, imports accelerated their growth rates in this month, posting an annual growth of 14.5%. This performance is reflected in the widening of the trade deficit by 12.0%, year on year. To a large degree, the trade deficit reflects price developments in international markets. In real terms, the trade deficit is assessed to have narrowed during 2011.

Indirect data show that consumption was poor over the second half of 2011. In the fourth quarter, however, it showed improvement. Indirect data obtained from the import of consumer goods, fiscal indicators and consumer confidence indices signal the recovery of consumption during this period. On the other hand, the presence of uncertainties for the future amongst Albanian consumers continues to discourage consumption and dictate the consumer's behaviour towards saving.

Private investment is assessed as improved in the fourth quarter for certain branches of the economy, while across the economy sectors improvement remains low. Furthermore, below potential growth and low capacity utilisation rates have reduced incentives for new investments.

The contribution of fiscal expenditures to aggregate demand growth was positive over 2011, reflecting a moderate fiscal stimulus, especially during the first and fourth quarters of the year. The fiscal policy was prudent with a view to keeping fiscal indicators within sound parameters. Budget deficit was ALL 45.7 billion for 2011, remaining within the envisaged level. Its performance reflected low rates in terms of both fiscal income and expenditures, recording an annual growth of 1.8% and 3.7%, respectively, in 2011.

Monetary indicators performance suggests the existence of contained monetary inflationary pressures.

The annual growth rate of M3 monetary aggregate was 9.2% in December, in line with the deceleration over the second half of 2011.

According to our analysis, the expansion of money is in conformity with the demand for real money in the economy. The expansion of money has been sustained by the increased demand of the public sector for funds at end-2011, as well as the stable contribution of the demand by the private sector. The latter continues to reflect developments in the real economy, being conditioned mainly by weak demand for loans by businesses and households. In December, the loan portfolio of the banking system to the private sector was 10.4% higher than a year earlier. Similar to the most part of 2011, it has reflected the demand of the private sector to fund its liquidity, consumption and investment needs, materialising also the hesitation of the private sector to commit to long-term projects. In addition to demand factors, the supply of loans is assessed to have been more tightened in the second half of 2011, reflecting the added prudence of the banking system in lending.

Latest developments in financial markets are influenced by the normal and quiet performance of demand and supply, which is in line with the monetary policy signals. The key interest rate cut to 4.50% is reflected in eased

borrowing costs for banks, while it is expected to be completely transmitted to other higher-maturity market segments. Overall, risk, liquidity and inflation premiums in financial markets remain contained.

Projections for the expected performance of the economy support the assessment for positive, though below potential, growth in the Albanian economy for the year ahead. Foreign demand is expected to continue to provide positive, but more moderate, contribution to aggregate demand increase.

Likewise, the impulse by the fiscal sector is expected to be lower than in the past year. Under these circumstances, the growth speed and rate of the economy at home will be largely determined by the performance of private domestic demand components: consumption and investments.

Our analyses reveal the existence of room for higher growth in the future. This growth will be supported also by stimulating monetary and financial conditions, in response to the monetary policy of the Bank of Albania.

Taking into account the above overview, the Supervisory Council of the Bank of Albania deemed that inflationary pressures remain subdued over the policy-relevant horizon. The output gap will continue to be negative in the period ahead, materialising in low inflationary pressures originating from domestic demand. Moreover, inflationary pressures from developments in the global economy are expected to be downward, whereas inflation expectations remain anchored.

The expected performance of real and monetary indicators is reflected in projections for the inflation, which is expected to range within Bank of Albania's target for the period ahead.

At the conclusion of discussions, the Supervisory Council decided to keep the key interest rate unchanged at 4.50%. This decision serves to comply with our medium-term inflation target and provides appropriate monetary conditions to stimulate Albania's economic activity. The Bank of Albania remains heedful to future economic and financial developments at home and abroad as well as diligent to accomplish its mandate.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the press conference on the Monetary Policy Decision of the Bank of Albania's Supervisory Council
28 March 2012

Today, on 28 March 2012, the Supervisory Council of the Bank of Albania reviewed and approved the Monthly Monetary Policy Report. Based on the analysis of Albania's latest economic and monetary developments and following discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to cut the key interest rate by 0.25 percentage points, bringing it down to 4.25%. This decision was motivated by further decline in the balance of inflationary pressures, as well as by the need for increased macroeconomic stimulus to the economy under the conditions of a more prudent fiscal policy for the period ahead.

The Supervisory Council deemed that, following the successive easing of the monetary policy, the latest key interest rate cut will provide more appropriate monetary conditions to meet the inflation target and stimulate economic activity in Albania.

Let me now proceed with an overview of economic developments and main issues discussed in today's meeting.

Annual inflation in February was 0.6%, recording sharp decline, from 1.6% on a month earlier. The rapid deceleration of inflation was a result of the annual decline in food prices during this month and the high base of comparison with the corresponding month a year earlier. Overall, factors that affect inflation showed low intensity and prices of other goods of the basket do not signal for inflationary pressures on the economy.

From the macroeconomic perspective, the downtrend of annual inflation is dictated primarily by rapid decline of pressures on the supply side, notably: slowdown of commodity price rise in international markets and low inflation in our major trading partners; cancelling out of the administered price rise effect; and stability of the national currency. Although our analyses and projections factorised these developments, their influence was higher than expected. On the other hand, inflationary pressures originating from the aggregate demand continued to be low, in the context of below-potential economic growth and anchored inflation expectations.

Figures on real economy developments in early 2012 are scarce. Indirect statistical data, available for the monetary, fiscal and trade sectors of the economy, signal for slow economic growth in the first quarter of the year.

As expected, aggregate demand was less sustained by the fiscal stimulus, in response to the prudent fiscal behaviour for 2012. Similarly, the contribution of foreign demand, during this period, is assessed as low, owing to economic slowdown in our trading partner countries. Moreover, despite signals for its recovery, the domestic private demand remains slow, given the consumers and private businesses hesitation to spend and invest.

Fiscal sector data for January reveal positive budget balance for this year, about ALL 1.6 billion. The fiscal surplus has reflected the simultaneous decline of public income and expenditure, by 5.3% and 5.5%, respectively, year on year. As regards expenditures, capital expenditures decreased, whereas current expenditures increased during this period.

Foreign trade data point to about 8.7% annual contraction of Albanian exports, in January, while imports annual growth rates slowed down to 4.5%. These foreign trade developments were materialised in a wider trade deficit, which expanded by about 13.8% from a year earlier. The performance of this indicator during the first two months of the year may be subject to transient factors. Its future dynamic and developments will be monitored. Foreign demand has been the main driver of our aggregate demand over the last two years and, in Bank of Albania's view, will continue to provide small positive impact in 2012.

Monetary developments were in line with the real-economy performance. Their analysis confirms the existence of low monetary inflationary pressures on the economy. Broad money, i.e., the M3 monetary aggregate, decelerated its annual growth to 8.1% in January.

On the demand side, this performance was affected by low demand for funds by the public and private sectors in January. Annual private sector credit pursued the downtrend that had started in the last quarter of 2011, settling at 9.9% in January. Its performance has reflected the lower demand for credit by both businesses and households. Private sector credit is oriented towards funding the working capital and consumption, illustrating the private agents' reluctance to invest and banks' high prudence to lend. Furthermore, deposits in the system have shifted towards longer maturity terms, thus illustrating the Albanian consumers' propensity to save.

Latest developments in financial markets have reflected contained liquidity and inflation premiums. In the interbank market, short-term interest rates were downward, following the successive key interest rate cuts.

Furthermore, government security yields in the primary market were slightly up. This increase is mostly due to the interaction of demand and supply factors in this market and does not signal for risk premium increase in the economy. Interest rates in the deposit and credit markets followed Bank of Albania's easing monetary policy over the last six months, while its transmission is expected to be more complete in the future, conform to the time lag that characterises the monetary policy transmission mechanism.

Projections for the expected economic outlook in the future sustain our earlier assessments for positive, but below potential, growth in the Albanian economy in the period ahead. However, risks about this scenario have increased, mainly as a result of unfavourable developments in the global economy and financial markets.

Overall, the economy in our trading partner countries is expected to be sluggish and lending terms in the euro area are expected to be tight for the period ahead. Moreover, the space for fiscal stimulus has narrowed, as a result of orientation of the fiscal policy towards maintaining fiscal parameters stability. Under these circumstances, Albania's economic growth will be determined mainly by the performance of consumption and private investment. The latter is expected to be driven by eased domestic lending terms during 2012, but will suffer, at the same time, from the uncertainty and hesitation of consumers and private businesses. The Bank of Albania deems that the second half of 2011 marked a turning point towards a more normal consumer behaviour, which should be encouraged and supported in 2012.

Taking into consideration the information set out above, the Supervisory Council holds that pressures on consumer prices at home remain low over the policy-relevant horizon and shifted down over the past months. On the demand side, below-potential economic growth will continue to generate low inflationary pressures as shocks from the supply side are expected to be moderate.

Concluding the discussions, the Supervisory Council decided to cut the key interest rate by 0.25 percentage points, to 4.25%. This decision aims to provide appropriate monetary conditions to meet the medium-term inflation target. Moreover, the easing of monetary policy provides higher support for the development of the private sector's demand in our economy.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the monetary policy decision of the Supervisory Council
of the Bank of Albania
25 April 2012

In its meeting of 25 April 2012, the Supervisory Council of the Bank of Albania reviewed and approved the quarterly Monetary Policy Report.

Based on the analysis of Albania's latest economic and monetary developments and following discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to leave the key interest rate unchanged at 4.25%. This decision reflects the balance of inflationary pressures and the need to maintain the macroeconomic stimulus to the economy, under the conditions of a more prudent fiscal policy during the year.

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

During the first quarter of 2012, the Albanian economy continued to maintain the parameters of macroeconomic stability even in the context of the ongoing global crisis.

International financial markets are characterised by high risk premiums and, despite measures taken to solve the public debt crisis in the euro area, signals for a normal progress in the short run are absent. These developments, as expected, have provided a reining impact on our economy, which is mainly reflected in the continuation of below-potential economic growth.

Annual inflation slowed down significantly in the first quarter of the year. On average, it was 1.1% in this period, down by 1.8 percentage points from the previous quarter.

The rapid decline in annual inflation rates, which started in the third quarter of the past year, is driven mainly by the slowing food price rise during this period and the steady prices of other consumer goods.

Inflation performance has reflected the simultaneous action of supply and demand factors. On the supply side, the slowing international commodity prices and inflation in our trading partners, combined with the stable exchange rate, have transmitted lower imported inflation rates to our economy. Likewise, contribution of administered prices has been lower.

Inflation expectations have been anchored and production cost pressures contained.

On the demand side, pressures remain low, conditioned by the continuation of the negative output gap.

Reduction of current inflation rates, shifting down of inflationary pressures balance and the increase of aggregate demand below its potential, under the conditions of a controlled fiscal policy, have made room for further increase in the monetary stimulus to the economy during the first quarter of the year. The Bank of Albania has lowered the key interest rate twice, bringing it down to the historic low of 4.25%. Such a decision, besides being in line with the maintaining of price stability over the medium term, provides the appropriate conditions for boosting private demand at home.

According to recent data from INSTAT, the Albanian economic growth accelerated in the fourth quarter of the previous year, posting 3.8% annual growth. The economic activity upturn was driven mainly by output increase in the services sector. Value added of this sector surged 7.5% in annual terms, with a higher contribution by the branch of trade, transport and other services. Similarly, the construction and agriculture sectors posted positive but low annual growth rates, 1.2% and 1.9%, respectively. Positive contribution to economic growth was also provided by extractive industry and processing industry, but they did not manage to offset the significant contraction in 'Electricity, gas and water', hence resulting in negative contribution by the industrial sector to the domestic product growth.

From the perspective of aggregate demand components, economic growth in Albania continued to be driven by foreign demand in the last quarter of the past year. Notwithstanding unfavourable developments in the global economy, net exports in real terms showed higher growth rates over this period. Besides the foreign demand, the public sector demand also provided a high contribution in the fourth quarter of the past year, in the form of increased capital expenditure. In turn, private consumption and investments, while showing signals of recovery, were assessed as slow during the fourth quarter of 2011.

Real-economy statistics on the first quarter of 2012 are partially available. Indirect data suggest that aggregate demand has carried forward positive growth rates, but growth remains significantly below the potential of the Albanian economy.

Macroeconomic factors determining private consumption and investments, and a prudent fiscal policy sustain the assessment for a contained increase in the domestic demand over the first quarter of the year. Moreover, in the absence of complete and real-term data on the external sector developments, assessments suggest that the contribution of foreign demand to economic growth will be lower than in the past year.

Fiscal policy was subject to a consolidation nature over the first quarter of 2012, in line with its objectives to keep budget deficit and public debt in check. The contained fiscal approach was reflected in minimum public expenditure in the

first quarter of the year, with an annualised rate of 0.7%. Furthermore, low growth rates of fiscal revenues continued their trend, settling at 1.2% in this quarter.

Budget deficit was ALL 11.5 billion, or about 2.5% down compared to the first quarter of the previous year.

Developments in foreign trade over the first two months of the year point to contracted trade exchange in annual terms. Value of exports in these two months dipped by 20.5% against the corresponding period of a year earlier, reflecting the moderation of foreign demand and price developments in global markets. On the imports side, their growth rates decelerated significantly, reaching a nominal annual growth of 1.8% during this period.

These developments were reflected in a widening trade deficit in the first two months of the year by an annualised rate of 21.9%. This deficit was determined mostly by electricity trade exchanges. Excluding this effect, merchandise imports would be lower from a year earlier and the trade deficit would be down by about 9.2%, y-o-y.

The monetary analysis reveals the existence of contained monetary pressures on the economy. The underlying pace of monetary expansion is assessed as in line with the demand of economic agents for real money. The annual growth of M3 was 9.1% in February, unchanged from the end of the previous year. Money expansion in the economy was supported more by the foreign currency component, while domestic demand for money slowed down. The public sector showed lower demand for funding, in line with fiscal developments in the first quarter of the year.

Furthermore, private sector demand for money increased at moderate rates, as evidenced by the slow growth rates of the private sector credit, 9.2% as at end-February.

The slowdown in lending has also reflected the households' and businesses' low demand for bank loans and the banks' higher prudence in lending, which was materialised in tightened credit conditions. Notwithstanding this performance, the supply-side factors determining the lending performance create appropriate conditions for further credit growth. The Albanian banking system remains well capitalised and liquid, capable of satisfying the private sector's credit demand.

Financial markets in the first quarter of 2012 were serene, reflecting relatively low premiums of liquidity and inflation risks. The interbank interest rates followed swiftly the latest key interest rate cuts.

The transmission of eased monetary policy signals is also observable in the deposit market, while it is expected to be transmitted in the future in other market segments as well, conform to the transmission mechanism time lag. In the primary market, government security yields showed an upward trend, reflecting developments in the relevant structural factors of the demand and supply, without signalling any added risk or inflation premiums.

Verified developments, insofar, change the basic projections for economic developments in the future. Year 2012 is expected to be influenced by unfavourable developments in the global economy, which may affect the Albanian economy as well. Foreign demand is expected to provide lower contribution over the course of the year, impacted by economic slowdown in our trading partners.

Fiscal policy orientation towards further consolidation of fiscal parameters restricts the space for a substantial fiscal stimulus to foster the economic activity. Under these circumstances, private domestic demand remains determinant for the aggregate demand increase in the future. Overall, analyses suggest a better performance of private consumption and spending, also supported by the eased monetary policy stimulus.

Estimates of the Bank of Albania suggest that, over the course of the year, the below-potential demand growth will continue to exercise low inflationary pressures from the demand side. Also, the balance of supply-side inflationary pressures is assessed as contained, given the reduced imported inflation and anchored inflation expectations.

Taking into account the insofar developments and expectations for the future, Bank of Albania projections show that, with 90% probability, consumer price inflation for 2012 will range within the 0.7–2.8% band. Materialisation of this baseline scenario will be reflected in retaining the stimulating nature of the monetary policy over the course of the year. Moreover, the Bank of Albania remains heedful to future developments and ready to respond timely and duly, so as to comply with its inflation target.

Based on the above information, the Supervisory Council holds that pressures on consumer prices at home remain low over the policy-relevant horizon; they have been, however, downward over the recent months.

On the demand side, the below-potential economic growth will continue to generate low inflationary pressures, while supply-side shocks are expected to be moderate.

Concluding the discussions, the Supervisory Council decided to hold the key interest rate unchanged at 4.25%. This decision aims at establishing appropriate monetary conditions to comply with the inflation target in the medium run. Against this backdrop, we deem that the monetary policy provides necessary support to stimulate the aggregate demand.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the Presentation of Bank of Albania Annual Report 2011 to the
Parliamentary Committee on Economy and Finance
30 April 2012

Honourable Chair,
Distinguished Members of the Committee, Ladies and Gentlemen,

Before starting my speech, I would appreciate your kind understanding about the fact that the period after the submission of the Report has enriched the 2011's economic data set with new information. It is understandable why this information is not incorporated into the submitted material. In the following, I will address overall economic developments based on the latest information, trying to also identify the distinctions between the latest data and the version available to you.

Our annual meeting on introducing Bank of Albania's Annual Report remains a special pleasure for me. More than a legal obligation, the Bank of Albania considers this Report as an important step to enhance institutional transparency, foster accountability and intensify the dialogue with all economic policy-makers and stakeholders.

Let me now start with an overview of main conclusions of the Report.

The economic activity recorded positive growth rates, while the macroeconomic balances remained stable or were further strengthened. It should be emphasized that this activity was conducted against the backdrop of deteriorating global economic and financial situation in 2011.

INSTAT's data reveal that Albania's economy grew 3.1% in 2011, supported mainly by the increased external demand for goods and services, whilst the domestic demand performed sluggishly.

The economic growth was materialised into a better performance of services sector and individual branches, while construction continues to suffer from sluggish demand and high inventory, especially of residential buildings.

These developments reflect the internal restructuring of the economy and Albanian business, in response to changed aggregate demand composition and the need for enhancing the economic competitiveness in the region and world wide.

Consumer price inflation appeared volatile in 2011, due to upward prices in

international markets and other supply-side shocks. However, the past year's average annual inflation was 3.5%, i.e., in line with Bank of Albania's target. The meeting of inflation target was driven by low inflationary pressures from the domestic economy, controlled monetary expansion and anchored inflationary expectations. Meeting inflation target amidst a challenging environment, full of unexpected developments, reflects the effectiveness and credibility of Bank of Albania's monetary policy. Our unwavering commitment to maintaining price stability has led to anchoring inflationary expectations.

Inflation anchoring has brought about direct benefits to the economy, in the form of mitigating economic fluctuations and reducing the intermediation cost of macroeconomic policies.

Year 2011 was featured by an increasing harmonisation of macroeconomic policies. These policies stimulated the Albanian economy, but were prudent in terms of maintaining macroeconomic and financial stability in the country.

In particular, the tightening fiscal policy made room for increasing monetary stimulus in the economy over the second half of the year. Along with continuous liquidity injection, key interest rate cuts were soon passed on to the short-term financial market segment, while the easing monetary policy conduct was followed by long-term interest rates.

Fiscal policy indicated an upward orientation towards consolidation over the past year. This commitment was reflected in maintaining the budget deficit at about 3.5% of the GDP and the public debt at about 58.1% of the GDP.

Although the prudent fiscal policy has a short-term cost in the form of absent fiscal stimulus, the Bank of Albania deems that the long-term benefits deriving from reduced risk premia make the pursuit of this policy necessary in the short and medium run.

Albania's trade and financial relations with foreign partner countries increased in 2011, mainly reflecting the satisfactory growth of Albanian exports and the increased import bill as a consequence of upward international prices. Current account deficit accounted for 12.1% of the GDP, continuing to illustrate a structural vulnerability in the economy.

The handling of this issue requires ongoing and speeded-up structural reforms, in order to promote competitiveness in the Albanian economy and establish appropriate balances among consumption, savings, and investments in the economy.

The banking system supported the economic development in 2011 with loans, liquidity, financial products and payment instruments. Unlike the experience of many other countries, loan portfolio of the economy increased over the past year; banking supervision framework was improved and financial stability was further strengthened. Although non-performing loans increased, the Albanian banking system, responding to strengthened prudential regulations of the

Bank of Albania and to our initiatives for enhancing the transparency of its balance sheet, remains solid, with adequate capital and liquidity to support the economic development.

I will proceed with a more detailed analysis of the foregoing issues, focusing on Bank of Albania's main directions.

1. Economic and financial highlights for 2011

GDP expanded by 3.1% in 2011. Likewise in 2010, external demand was the main driver of economic growth, though its impact pursued a moderate trend due to slowdown in our trading partner countries. On the other hand, domestic demand remained relatively sluggish.

Consumption and private investments remained under the impact of consumers and private businesses. These significant aggregate demand components did not reveal any strong signs of recovery over the past year, despite the improving financial conditions. The sluggish consumer spending reflected the continuation of consumers' high propensity to save and the heightened uncertainty about the future.

On the other hand, the presence of spare production capacities and tight lending conditions gave rise to a slow performance of private investments. Judging from the distribution of credit flows, these investments were mainly allocated to industrial and services sectors, which benefited the most from the external demand performance.

In 2011, fiscal policy was oriented towards further consolidation of fiscal indicators to maintain the public debt thresholds. This approach established a mild fiscal stimulus in the economy, concentrated mainly in the first and fourth quarters of the year. Budget deficit was 3.5% of the GDP, up by 0.5 percentage points, y-o-y. The budget deficit was determined by the slow increase in fiscal revenues and expenditures. Revenues increased by 1.8%, y-o-y due to decelerated economic activity. Their performance also determined the prudent approach in carrying out expenditures, which rose by 7% from the previous year.

The budget deficit was financed by domestic borrowing with a rising orientation towards longer maturities, thereby improving the public debt maturity structure and lowering the refinancing risk. The low public sector demand for financing was reflected in the decreased yields on government securities and also made more room for higher private sector financing.

Adverse developments in external economy were also reflected in the balance of payments. The curbed economic growth in Albania's trading partner countries

was reflected in decelerated exports, which reduced their annual growth rate to 20.0%. On the other hand, high global market prices materialized in 12.4% increase in import expenditures, in 2011. These developments reversed the adjustment trend of the current account deficit pursued over the past two years. Current account deficit reached 12.1% of the GDP, up by 12.5% from 2010. Net flows in capital and financial account increased by 5.6% and contributed to financing 80.4% of the current account.

Bank of Albania's international reserve remained almost unchanged at EUR 1.9 billion, sufficient to cover 4.4 months of imports of goods and services. In line with the economic activity performance, employment figures showed gradual signs of recovery in 2011. According to INSTAT's data, the average number of employed people increased by 1.7%, mainly as a result of higher employment in the private non-agricultural sector, while the number of people employed in the public sector maintained the downtrend that had started in the last quarter of 2010. The number of unemployed people remained almost unchanged from the previous year. Despite higher employment in the economy, unemployment rate fell slightly by only 0.2 percentage points, to 13.3% at end-2011. The presence of a negative output gap and the incomplete capacity utilisation kept the unemployment rate above 13% in 2011, thereby conditioning the dynamic of nominal wage increase in economy.

Monetary indicators in 2011 were in line with the real-economy developments, featured by a moderate monetary supply growth, low demand of the economy for funding and steadily high propensity of consumers to save. The broad money increased by 9.2%, y-o-y. Stimulating measures taken by the Bank of Albania, coupled with good liquidity condition and well capitalisation of the banking system, supported the increase of lending to the economy in 2011.

Private sector credit increased by 11.7% on average, improving from a year earlier. Nonetheless, the increase in bank lending remains contained due to supply and demand factors. The sluggish consumption and investments were reflected in a low demand for loans and mainly oriented towards shorter-term maturities. On the other hand, higher prudence by banks in lending was reflected in tighter credit supply terms.

Financial markets were generally stable and evidenced improved liquidity conditions and controlled risk premia. Money market interest rates pursued a downward trajectory due to Bank of Albania's easing policy and satisfactory liquidity levels.

While costs for the private sector credit were lower than a year earlier, the sluggish performance of the economy and uncertainties about its outlook moderated the trend of interest rates on lending to this sector.

Pressures on foreign exchange market were low and the exchange rate of the national currency against the major foreign currencies was stable, a supporting factor for controlling inflationary pressures at home and boosting confidence in foreign trade relations.

2. Inflation and monetary policy

In 2011, average annual consumer price inflation was 3.5%, remaining close to the previous year's average inflation rate. Inflation performance over the past year was characterised by a high volatility. In the first and second quarters, annual inflation rate approached the upper limit of the targeted band, mainly driven by rapid and sharp price rise for food and primary commodities in international markets. These pressures were short-term and soon moderated; in the second half of the year, inflation started to fall gradually reaching 1.7% in December. Besides the mitigation of imported inflation, the cancellation of the previous year's regulated price increases and the lack of any further increase in them are factors impacting on the downtrend of the annual inflation rate.

From the viewpoint of macroeconomic factors, the annual inflation volatility was induced by supply factors, while the demand inflationary pressures remained low.

Anchored inflation expectations prevented transmission of supply shocks to cost structure of the Albanian economy, dwarfing the effect of the supply shocks only on the first round effects. On the other hand, below-potential growth in the Albanian economy led to an incomplete utilisation of production capacities, generating moderate pressures on wages and production costs in the economy. Also, the sluggish aggregate demand reduced businesses' ability to dictate prices in the economy and hence their profit margins remained historically low.

These developments were also reflected in the performance of core inflation, which fluctuated around the lower half of Bank of Albania's target band. Finally, the Bank of Albania prudentially supplied the economy with liquidity and monetary expansion was in line with the economy's needs for monetary assets, thus preventing the generation of inflationary monetary impulses.

Bank of Albania's monetary policy maintained its expansionary nature in 2011, responding to the performance of inflationary pressures balance and taking into account the contained fiscal stimulus. The sharp price increase in international markets and its rapid pass-through to domestic consumer prices in early 2011 led to key interest rate rise by 0.25 percentage points in March. Such a move aimed at anchoring inflationary expectations and preventing second-round effects on inflation, against the setting of projections for further international price increases. Over the second half of the year, upon moderation of inflationary pressures and inflation's falling back within the target, as well as upon the shifting down of expected inflationary pressures balance, the monetary policy became strongly stimulating. The Bank of Albania carried out two consecutive key interest rate cuts, taking the key interest rate in the economy to the lowest historical level (to 4.75%).

The stimulating policy through the key interest rate was accompanied by continuous liquidity injections into the financial market. Overall, the monetary

policy pursued in 2011 and the sluggish demand for public sector financing helped in controlling the risk premia, leading to lower financing costs and increased financial intermediation in the national currency. The latter was also helped by a change in the required reserve instrument, by means of which the foreign required reserve remuneration was abrogated. It aimed to discourage foreign-currency intermediation and improve the monetary policy transmission mechanism.

The issue of financial euroization in Albania will continue to be on the focus of Bank of Albania's monetary policy in the future.

3. Banking system and supervision

The Albanian banking system has faced numerous challenges over the recent years and has succeeded in overcoming them, always maintaining sound parameters of liquidity and capitalisation. Even in 2011, banking system activity was conducted in an unfavourable context of international financial markets, and sluggish demand for loans and economic growth at home. Regardless of these factors, banks in Albania remained well capitalised and sound. The economic growth slowdown was reflected in moderate lending performance and increased non-performing loans, whereas bank liquidity condition improved. During 2011, prudence for monitoring the banking system was heightened to early identify any potential risks, and the regulatory framework was consolidated.

Stress-test results show that the banking system remained stable and resilient to large shocks on macroeconomic indicators and parameters.

Following, I would like to focus on several main indicators of the banking system in 2011, as this system remains the main stakeholder of financial intermediation in Albania.

Banking system highlights

At end-2011, the banking system assets accounted for about 85% of the GDP, from about 81% at end-2010. Financial profit of the banking system was downward, with a significant increase in provisioning expenses playing a determinant role. In the framework of absorbing any potential losses from credit risk, the banking sector increased the provisioning by about 52.4% from a year earlier. By contrast, net operating profit was up by about 7.7%, which shows that the banks have generally achieved a stable net profit and volume from their core activities.

The banking system profitability, which is estimated through return on assets and return on equity, is positive but lower than a year earlier, whereas the effectiveness indicator is higher.

As at end-2011, the capital adequacy ratio of the banking system was about 15.6%, being higher than in 2010 and significantly higher than the 12 % minimum regulatory requirement.

Supervision

During 2011, the supervision of banks and non-bank financial institutions was strengthened in accordance with international standards and dynamic requirements that the financial situation in the European market has brought about. On-site examinations aimed at a complete evaluation of institutions' risk profile, followed by examinations initiated from appearance of specific issues at licensed institutions. Overall, the system operated in accordance with the requirements of the legal and regulatory framework. Year 2011 recorded the finalisation of a number of new regulations and amendments to some other banking supervision regulations, aiming at alignment with Basel Committee standards, European Union directives and best practices on banking regulation and supervision.

I would highlight here, regulations on: credit risk, liquidity and operational risk management; enhancement of financial institutions' transparency to their clients; and, expansion, diversification and well functioning of business processes of financial institutions. In order to address the liquidity risk, at end-2011, some regulatory amendments were made, including re-definition of liquid assets, increase in the minimum regulatory threshold liquid assets to short-term liabilities ratio to 25%, and the start of implementation of two separate thresholds for the indicator in the national currency and in foreign currency at the minimum level of 20%. Banks responded swiftly to Bank of Albania's decision by increasing their liquidity level.

The supervision of the banking system and the assessment of the financial system stability show that credit risk exposure has increased due to increase in non-performing loans to outstanding loans in 2011.

As a result, loan portfolio quality indicator - non-performing loans to total outstanding loans of the banking system - increased by 4.8 percentage points, settling at 18.8%. Nonetheless, stress-tests have revealed that the banking system is resilient to shocks that may come from extreme deterioration of this indicator.

Concerning foreign-exchange risk, the indicator of open foreign-exchange position of the banking system shows a long position at 3.94% to the regulatory capital. Compared with the maximum regulatory threshold of 30%, this figure depicts a low level of exposure of the Albanian banking system to the foreign exchange risk.

As regards exposure to interest rate risk, the spread between assets and liabilities reprised up to three months, accounted for 5.1% of earning assets, which shows a low exposure to interest rate fluctuations at system level.

Moreover, during 2011, the banking system performed positively in terms of compliance with new standards and the regulations on operational risk management approved over the year.

Issues related to transparency and money laundering prevention were an important part of supervision in 2011. To monitor them, a number of examinations on banks and non-bank financial institutions, including foreign exchange bureaus, were conducted. They revealed that entities have generally taken preventive measures.

Transparency and publication of information were subject to reforms in 2011 and aimed at establishing a more appropriate business climate for banks and providing higher protection to the public. Banks, in turn, responded positively, by adapting their internal regulatory framework in line with these changes.

Further improvement is needed to enhance transparency with regard to credit agreements, which have been a source of customer complaint and on the focus of examinations on transparency and corrective measures taken by the Bank of Albania. The practices for deposit and account estimation, and disclosure and addressing of customer complaints are generally regarded as less problematic.

Supervision of non-bank financial institutions is also a functional part of the Bank of Albania. Their number has amounted to 19, from 17 a year earlier; their specific share has remained unchanged, accounting for 3.1% of the banking system assets. During 2011, their activity posted a moderate growth in total assets, loan portfolio and financial profit.

Overall, non-bank financial institutions have adhered to regulatory framework and supervision standards. However, on-site examinations have identified several problems, thereby making appropriate recommendations.

Among them, we would highlight the need to: improve lending process; revise internal regulatory framework; enhance transparency to clients, etc.

The expanded dynamic of the financial sector activity is reflected in the licensing process. During 2011, consent was granted to additional activities requested by banks and non-bank financial institutions, consisting in introducing new market products and diversifying the existing products by financial institutions. Moreover, a preliminary approval was granted to new bank branches and agencies (10), but at low paces, whereas the activity of some bank branches and agencies was closed (11). As at year-end, there were 528 bank branches and agencies operating in the country and 1 branch operating abroad.

Regarding supervision of the financial activity under the jurisdiction of the Bank of Albania, allow me to reiterate that it remains within the security parameters and is resilient to unexpected shocks.

The Bank of Albania remains committed to monitoring the Albanian financial system rigorously and vigilantly, aiming at identifying early any potential risks and taking corrective measures to prevent them.

Further to the foregoing directions of Bank of Albania's work, I would proceed with some other activities of our work, which contribute not only to fulfilment of our legal tasks, but also to development of the financial system and market economy in Albania.

4. Other Bank of Albania activities

Bank of Albania's role in the European integration

In line with the objective for Albania's integration in the European Union, the Bank of Albania has strived for aligning its activities and regulations with the European Union directives and standards.

Conform to institutional commitments, the Bank of Albania has regularly contributed to reporting by respective chapters of the *acquis communautaire*, reflecting the progress achieved on the approximation of the Albanian regulatory framework to EU legislation and attainment of European standards. With regard to Bank of Albania's activity, the EC in its Progress Report of October for Albania, *inter alia*, commented positively that the monetary policy has successfully helped in keeping inflation stable and that the banking sector remains well-capitalised and liquid.

Implementation of the EU-funded Twinning Project of the Bank of Albania with the Bank of Italy in partnership with the Bank of France started in 2011. This project, which covers the major part of Bank of Albania's activities, will help enhance institutional capacities, approximate the regulatory framework and work practices of the Bank of Albania to those of the EU and ECB, as well as promote the development of financial market and instruments at home.

Promoting payment system

Fulfilling its legal responsibility for smooth-functioning payment systems, in 2011, the Bank of Albania actively worked to strengthen the payment systems oversight, improve the technology infrastructure and develop new payment products in Albania. Both main payment systems, AIPS (for settling large-value payments) and AECH (for settling and clearing small-value payments) operated with full efficiency, reflecting the stability of the systems.

In March, the Bank of Albania made several amendments to regulations on the operation of both payment systems, aiming to promote the use of payment service and reduce the use of cash. Also, in fall 2011, the Bank of Albania submitted to the Ministry of Finance a draft-law "On Payment Systems", in pursuance of basic principles of EU directives. Also, the Bank of Albania is preparing draft-regulations for implementing the provisions under this draft-law.

Improving statistics

In 2011, the Bank of Albania worked intensively to identify new requirements on statistical production structure, in line with EU requirements for candidate and member countries. Construction of a reporting model, reviewing and improvement of reporting forms, and application of best practices for publication of statistics have been on the focus of our work.

Also, the Bank of Albania has started the project for “Regulatory Reporting Automation”, which aims to establish an electronic reporting system for institutions that report data to the Bank of Albania. This electronic reporting system would alleviate the reporting burden of institutions, shorten the reporting time, automate process control, generate statistical tables and significantly improve the quantity and quality of statistics produced by the Bank of Albania.

Improving research capacity

In recent years, the Bank of Albania has paid special attention to increasing the level of study and research in the institution by investing significantly in human and technical resources. During 2011, seminars and round-tables were organised, aiming at training and sharing scientific novelties among economists at local and international level, thus making the Bank of Albania a point of reference for researchers of economics and finance.

The main focus of Bank of Albania’s research papers was on issues pertaining to: financial stability, monetary policy, fiscal policy, regional integration and trade relations, study of uncertainties arising from estimation of econometric models, etc. Also, with the assistance of foreign experts, we worked for constructing and improving macroeconomic and statistical models, on whose basis the Bank of Albania builds its projections for macroeconomic and financial indicators.

Improving communication with the public

Enhancing transparent and establishing productive relations with the public is an integral part of Bank of Albania’s development strategy. Financial education activities for the public were a priority of the communication strategy in 2011.

In order to achieve Bank of Albania’s objectives in this area, we carried out a number of educational activities in 2011. Among them, we would highlight the project for integrating the financial education into high-school curricula in Albania.

A working group of Bank of Albania’s experts, assisted by experts of curricula from the Institute for Educational Development, worked for compiling the curricula and preparing the text in the form of a free-choice module, which was incorporated into the high-school curricula for the first time in the 2011/2012 academic year.

Also, Bank of Albania's Annual International Conference on "Building our Future through Financial Literacy" attended by senior representatives of public and private authorities at home and abroad, contributed to enhancing the awareness of financial education importance and drawing the attention of respective authorities and institutions.

Distinguished Members of the Committee,

Both current and previous year were filled with challenges posed from the external environment and the internal structure of the economy. I listed above only some of the major accomplishments of the Bank of Albania and issues the Bank was faced with in 2011, while the Annual Report contains more detailed information.

The Bank of Albania will continue working in order to fulfil its legal mandate and render maximum contribution to increasing the welfare in Albania. Concluding my introduction on the Report, I would like to share with you several reflections on Albania's economic outlook. Recent years, have brought to the fore certain fragilities of the Albanian economy. Against this backdrop, economic policies should intensify their efforts to ensure a stable economic growth.

In particular, increased productivity, ongoing restructuring and strong economic growth require the compilation and implementation of structural reforms to support domestic production and enhance its competitiveness in the national and international markets.

Also, economic policies should aim at further improving the free-market terms and conditions, in order to strengthen the structure of the market economy and enhance efficiency in our economy.

Lastly, the world experience, and ours as well, gained during these development decades, have shown that coordination of policies among various institutional actors and market operations is an indispensable requirement to ensure ongoing progress of the society and economy of a country.

In light of this, only the ongoing cooperation and coordination of efforts among all stakeholders would guarantee sustainable economic growth and welfare in Albania.

Concluding my speech, I would like to remind you that in addition to Bank of Albania's Annual Report 2011, the financial statements, as certified by auditors, are also submitted.

Thanking you for your attention, I remain available to your questions and comments.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision of the Bank of Albania's
Supervisory Council
29 May 2012

Today, on 29 May 2012, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the analysis of Albania's latest economic and monetary developments, and following discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to keep the key interest rate unchanged at 4.25%. This decision reflects the Supervisory Council's opinion that the actual monetary conditions are adequate to meet Bank of Albania's inflation target in the medium run. It holds the key interest rate at a record low, thereby maintaining the strong stimulating nature of monetary policy, in order to boost aggregate demand and economic growth. This decision also reflects the heightened uncertainty deriving from the external economic environment and, particularly, from the recent economic developments in Greece.

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

Annual inflation marked 1.6% in April, continuing to pursue an upward trajectory over the last two months and approaching the lower limit of the target band. After marking a minimum low in February, the rising trend of inflation was expected and communicated by the Bank of Albania. It reflects, to a large extent, the gradually subsiding supply-side shocks on inflation. The decelerated rise in primary commodity prices in the global markets, the low inflation in Albania's trading partners and the stable exchange rate, have generated reduced imported inflation rates.

However, though upward, inflation remains low due to the incomplete utilisation of capacities in the economy, which is reflected in weak pressures on the rise of wages and producer prices. At the same time, economic agents' inflation expectations remain low and money growth is in line with the economy's demand for money. In addition, the absent rise in regulated prices has contributed to low inflation rate over 2012.

While making an analysis of the economic developments, the Supervisory Council noted that the reappearance of stress in the global financial markets in the current month has significantly heightened the uncertainties in these markets, being translated into more strained financing conditions for the public and private sector. The fall in foreign demand and the higher perceived

risk for the entire area have started to affect the performance of economic activity in the countries of the region.

Statistical information available for the first quarter of 2012 provides evidence for a sluggish economic activity. This performance, inter alia, has been also affected by temporary factors arising from severe weather conditions. However, the analysis of available indicators draws the conclusion that both domestic and foreign demand remain sluggish.

Following the recovery in the last quarter of 2011, private consumption slowed down in the first quarter of 2012. The performance of consumer goods imports and the low annual growth in VAT revenues depict a sluggish consumer demand over the quarter under review. This assessment is also supported by qualitative data obtained from consumer, business and banking sector surveys. The dynamic of quantitative and qualitative indicators also suggests a sluggish performance of investments.

Against the background of low demand and spare production capacities, and in the presence of uncertainties about developments at home and abroad, businesses have postponed their new investment-related decisions. In addition, the contribution of public investment to aggregate demand growth was negative in the first quarter of 2012.

The Government pursued a prudent fiscal policy in the first four months of the present year, translated into annual reduction of the budget deficit by 28% during this period. Budget revenues continue to record moderate annual growth rates, reflecting the performance of economic activity and providing evidence for the mutual impact between the public and private sector dynamics. The Bank of Albania, however, points out that pursuing a fiscal policy oriented toward the long-term sustainability of budget and public debt figures will provide clear medium- and long-term benefits to the Albanian economy, in the form of lower risk premiums, greater room for private sector financing and, ultimately, lower financing costs. This policy is also in line with the developments in domestic and foreign financial markets.

Foreign demand continued to contribute to the expansion of the economy in the first quarter of 2012, albeit to a markedly lower extent. The sluggish increase in exports remains a concern as long as it affects the performance of the economy during 2012. It also provides evidence for Albania's strong reliance on certain geographical markets or products.

The analysis of monetary data suggests that the performance of monetary indicators was in line with the real-economy developments. Money supply maintained the growth rate of end-2011, recording an annualised growth of 8.8% in March. Our analyses suggest that its growth is in line with the demand of the economy for real money, signalling contained monetary inflationary pressures in the medium run. Lending to the private sector recorded an annual growth of 9.0% in March. Its performance, particularly in the recent months, was determined by the low private sector demand for credit and the cautious bank lending behaviour.

Financial markets were liquid and stable. Interbank market rates dropped significantly in April and trading volume in this market increased. The pass-through of easing monetary policy signals persisted in the lek deposit market as well, as reflected by lower interest rates.

Government security yields in the primary market remained at similar levels to the previous month. Their increase in the first quarter of 2012 reflects the developments in supply and demand structural factors, hence signalling no added inflation premiums. Interest rates on lek-denominated loans did not fully respond to the easing monetary policy signals due to higher credit risk premiums in certain branches of the economy.

New information supports our previous projection that GDP growth will remain below its potential in the quarters ahead, owing to moderate contribution of foreign demand, lack of fiscal stimulus and sluggish domestic demand. The two main components of the latter, consumption and private investment, remain slow. The incomplete utilisation of capacities, coupled with the slow rise in wages and unit labour costs, are expected to exert contained inflationary pressures in the period ahead.

Economic agents' inflation expectations are anchored close to the target. They may, however, be subject to the response to global developments in the short run. The gradually subsiding supply shocks in the period ahead, the termination of base effects' impact and the extended effect of Bank of Albania's stimulating policy are expected to be followed by a rising inflation trend, thereby approaching Bank of Albania's target in the medium run.

The Bank of Albania has continuously eased the monetary policy in the recent months, aiming at meeting the inflation target in the medium run, and keeping inflation expectations and risk premiums in the economy under control. This policy has aimed at responding to a situation where the main obstacle to the recovery of private sector demand and foreign direct investment relates to the uncertainty about the future and approach to risk, in the short and medium run. We consider that the provision of a cautious monetary stimulus, conditioned by the control of risk premiums and safeguard of financial stability, is major contribution the Bank of Albania can make to the stable and long-term economic growth in Albania.

Based on analysis of the above information, the Supervisory Council holds that risks around the expected inflation trajectory remain balanced. On the demand-side, below-potential economic growth will continue to generate low inflationary pressures, while supply shocks are also expected to remain contained. At the end of discussions, the Supervisory Council decided to hold the key interest rate unchanged at 4.25%. This decision aims to create adequate monetary conditions for meeting the inflation target in the medium run. It also provides proper support to boost aggregate demand.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the 3rd International Conference on FDIs in Albania
organised by AIDA and IDB
6 June 2012

Your Excellency Mr. Sali Berisha,
Dear Mr. Khalid Al Aboodi,
Dear Minister of Finance,
Dear ladies and gentlemen!

It is a special pleasure for me to address this joint conference with the Islamic Development Bank, dedicated to the promotion of investment in Albania. Allow me first to extend my thanks to Dr. Ahmed Mohamed Ali Al Madani, President of the Islamic Development Bank, for his utmost contribution to lobbying and supporting Albania's interests in the Arab world and beyond.

The Bank of Albania assesses that Albania's macroeconomic stability has been and remains a fundamental condition steering economic agents' investment, consumption or savings-related decision-making, not only for the present but also for the future. It is this very fundamental equilibrium in the economy that paves the way for Albania's long-term economic and financial development.

Let me recall to you that, in present days, macro-financial situation represents the "passport" the entire economic and financial credibility of a country is built on. In an integrated market that is increasingly being affected by the globalization process, macroeconomic stability exerts the same impact on foreign investors as well. Our monetary policy, our role as the supervisory authority for the banking sector in Albania, and our contribution to the communication between the public authorities at home, have been based on this reasoning and have reflected this fundamental principle.

The Bank of Albania has succeeded in guaranteeing a favourable macroeconomic environment in the recent years. I would like to remind you that the stability of the Albanian economy has been achieved under the constant pressure of the global crisis, which has severely hit our main trading partners.

Thanks to the efforts of the Bank of Albania, successful monetary and fiscal policy mix, stimulating policies in the tax area and ongoing improvement of the business environment, the Albanian economy has recorded satisfactory growth rates ranging 3-4% in real annual terms. This growth has been achieved amidst an environment characterized by stable prices and a balanced exchange rate. Albania's financial stability has, in no single moment, been put into question, and the banking system, which enjoys buoyant liquidity situation, continues to increase financial intermediation in the economy.

Allow me now to elaborate on these issues. The primary objective of the Bank of Albania is to maintain consumer price stability, which in quantitative terms is expressed as the annual increase in prices in the 2-4% range and targeting the midpoint of 3%. The Bank of Albania has successfully achieved this objective.

Different surveys show that economic agents report stable expectations for a low inflation. This consistent profile of our monetary policy has proved particularly useful in the last few years. We have had greater flexibility to implement a prudent easing monetary policy that promotes investment and consumption at home. Over a several-month period, the Bank of Albania has made a number of decisions for cutting the key interest rate in the economy, the one-week interest rate on repurchase agreements, to its record low of 4.25%. It is a pleasure to note that the degree of pass-through to the economy is satisfactory and in accordance with the time lags in the monetary transmission mechanism. During this easing cycle, the annual increase in the inflation rate has remained under control and lek's exchange rate has been stable.

As a result, foreign direct investment and other portfolio flows have been stable, financing the major part of economic agents' current demand for foreign currency. Macroeconomic stability is not an exclusive task of the central bank's activity, but it reflects broadly the sharing of the same principle and harmonisation of actions with fiscal policy.

Financial stability and banking stability in particular, is the second main pillar of our activity. I can state that, in the recent years, we have devoted most of our capacities to meeting this objective.

The challenges have been numerous considering that banking activity reflects not only the stability of the institution itself, but also the overall economic conditions. However, in close cooperation with the banking industry, we have succeeded in taking some measures that have enhanced the banking system's resilience.

As a result, despite the slower credit growth rate and lower credit quality, the banking sector continues to generate profit and remains well capitalized and liquid. In March, capital adequacy ratio stood at 15.9%, while liquid assets accounted for almost one-third of total sector's assets. The banking sector has expanded its activity driven mainly by the performance of public deposits, which continue to grow at buoyant rates.

We are, however, aware of the risks exposed during this period characterised by numerous unstable developments in global and regional economies. Therefore, our supervision has placed great emphasis on identifying the various risks to banking activity, improving the banking sector's ability to manage these risks and strengthening the legal and operational framework to address them in case of their materialisation.

In the wake of the global economic crisis, many countries are redesigning their economic development agendas and models. Throughout many years,

the Bank of Albania has initiated, encouraged and supported this discussion by engaging in an open communication with the public authorities, business community and academic circles.

Our opinion is that economic development policies should contribute to setting a better balance between the development priorities of the sectors of the economy, by supporting agriculture and production. One of our immediate objectives is enhancing the economic capacities that improve the competitiveness of our products and benefit more from foreign demand. To this purpose, the development and further perfection of financial infrastructure, as well as the qualitative improvement of technology, are, among others, a priority. We must ensure a well-educated labour force, able to adapt to the international labour market, in addition to the local one. Therefore, the education-related policies on the younger generation must, above all, ensure the quality of education and incorporate programmes that assign greater importance to its practical orientation.

The Bank of Albania is now very seriously committed to its public financial literacy programme. In this context, we have designed and implemented a series of projects and cooperation initiatives, covering different age groups and geographical areas across the country.

It is clear that these objectives cannot be accomplished by the simple wave of a magic wand. They are even hard to be accomplished in due time and with the capacities of a single economy. Albania is indeed a small economy but thanks to continuous reforms, it has turned into an attractive country to foreign investors. Our vision has been and remains open to any regional initiatives. We are able to become part of joint regional projects, thus providing evidence for the great absorptive capacity for big investments and serious investors.

Therefore, the formulation of policies for attracting foreign investment, coupled with the constant improvement of the business climate and relevant legal framework, should be continuous part of the country's economic development strategy.

Dear guests,

Although a small country, Albania represents a vibrant economy with vital people who are able to undertake wide-ranging business initiatives.

Moreover, our country shares a considerable part of its official borders with Albanian-inhabited areas, hence providing a different quantitative and geographical dimension to various potential business initiatives. I believe that Albania is one of the countries currently being listed among the distinguished European countries, enjoying stable macroeconomic and financial stability, and economic growth.

We have ample natural resources, fantastic diversity of climate, cultures, social, ethnographic and geographical features, qualified labour force, admirable

flexibility of private entrepreneurship and an improved legal framework. For these reasons, I avail myself of this opportunity to invite you to increase your interest in Albania and make it part of your investment or partnership projects. I am strongly confident that this will not only contribute to Albania's and the Albanian people prosperity in the future, but it will also represent a safe investment alternative.

Thank you for your attention and I wish you all great success!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the joint press conference with Mr. Gani Gërguri,
Governor of the Central Bank of the Republic of Kosovo, on
“Banking System and Economic Development”

12 June 2012

Dear Governor Gërguri,
Dear participants,

I am honoured to take part in the proceedings of this joint activity organised by the Central Bank of the Republic of Kosovo and the Bank of Albania. It is taking place during the jubilee year that coincides with the 100th Anniversary of Albania’s Declaration of Independence. After a long cavalcade of torments and existential discourses, finally both our countries have entered an irreversible process of transformation and convergence to democracy and market economy standards. The respective financial systems have been part of this process, in which thanks to the dedicated and hard work done by both our institutions, the achievements are numerous. The banking industry of both countries has grown rapidly in recent years, enjoying a stable financial health. It has made a significant contribution to the financing of our economies, leading to a stable economic growth over the years.

It is my pleasure to see that the Central Bank of the Republic of Kosovo is growing daily, assuming more and more the characteristics of a modern central bank, like its counterparts in the region.

Let me take this opportunity to express my appreciation for the commendable work done by the Central Bank of the Republic of Kosovo’s staff, led by my old friend, Mr. Gani Gërguri. I am fully convinced that we have, and will have even in the future, a responsible and committed institution that aims to successfully fulfil its challenging mission and confront with dignity all the challenges ahead.

Distinguished guests,

For a long time, our economies have been finding themselves under the global crisis pressure. Recently, almost all our trading partners, such as the countries in our region and the euro-area economies are displaying acute symptoms. This situation has induced elevated uncertainties regarding probable macroeconomic implications and contamination of the financial stability of our countries, mainly through the existence of several European banking groups.

Despite this international turmoil, our economies have succeeded in maintaining a stable performance. Consumption and private sector investments have continued to play a primary role in expanding the Kosovo’s economic activity, while in Albania, the external demand has played a primary role. The other

indicators have remained in check. However, their trends must be monitored scrupulously and constantly.

At present, the maintaining of basic balances, i.e., the macroeconomic balance and the financial one, is our major objective. These two pillars represent our legal mandate. Therefore, we must do the utmost to consolidate the inherited balances, by making cautious analyses and taking appropriate measures to best absorb all the risks posed to the country's macro-financial stability. Currently, the fulfilment of our legal mission has become a difficult and challenging task, full of surprises.

Our countries represent small economies, whose share and influence can not play an active or imposing role in the international arena. Moreover, I am increasingly convinced that our economies are net importers of both material goods and international crisis.

Personally, I think that the moments we are currently experiencing constitute a historic opportunity for all of us, to leave a good name as competent managers in times of the great crisis. As long as things go well, we fail to understand the need for ongoing adaptation, for constant correction. This is the reason that mostly leads to creation of "financial bubbles" in the economy. Apparently, decision-makers lack the ability or the willingness to stop blowing bubbles, and hence they burst. From this viewpoint, I assess that Bank of Albania's experience carries over elements of preliminary correction, i.e., preventive elements.

Let me be more specific. Since early 2005, we have addressed the interplay between macroeconomic stability and financial stability prudentially. While there was a historic stability in keeping inflation in check, there existed many unclear things in the banking system stability.

I would like to remind you, briefly, of the fact that we are talking about a period when the banking system was transformed into a 100% private capital and when credit expansion dominated the banking business.

Since 2005, the outstanding credit to the economy has expanded by 7-8 percentage points of the GDP. Moreover, 75% of credit was denominated in foreign currency and the hedging against exchange rate risk was frequently overlooked. It was the time when competition for market share increased tremendously among banks, even at the expense of credit quality.

Periodic examinations conducted by banking supervision identified several vulnerabilities that could threaten the financial stability of the system. I would mention: lack of an electronic credit register; risk management weaknesses, structural weaknesses in internal audit; lack of transparency in dealing with customers about the supplied products.

One of the most important issues worth mentioning is bank management in general, and their managers' role and integrity in particular.

Identification of weaknesses requires investigating, taking administrative measures, and making legal and regulatory changes to solve the problems. To this end, several initiatives were launched, including: establishing a credit register; creating the Financial Stability Department; conducting prudential supervision; creating a regulatory base for protecting Albanian consumers; and, undoubtedly, public education. The latter, in particular, is a very important issue constituting one of the cornerstones of the financial stability and of the central bank's monetary policy success.

A financially educated public makes fewer mistakes in financial decisions and reacts swiftly and predictably to economic developments and policies pursued by a central bank and other authorities. Therefore, financial education of the public has been and remains a priority of the Bank of Albania.

Individual decision-making of households and businesses should be assessed as much as the meeting of inflation target or the maintaining of financial stability. This assessment is supported by the fact that individual choice based on financial literacy and good interpretation of economic information provides benefits to the whole society.

Financial literacy is essential from the point of view of individuals and social welfare. It should be seen as a public good that contributes to strengthening of stability, efficiency of economic policies. Above all, it increases individual's financial welfare and, hence, the overall economic welfare. This is why the Bank of Albania has adopted the slogan: "Education costs, but it is priceless." Bank of Albania's approach to financial education has been focused on three directions. First, promoting deep knowledge and awareness of basic economic and financial concepts; secondly, knowledge of the Bank of Albania, its role and policies, and its decision-making; third, knowledge of economic information and its interpretation.

The Bank of Albania started financial public education by communicating openly and actively with various groups of interest.

Our experience shows us that financial education should be an integral part of our national strategy. Consequently, seeking the cooperation and understanding of the Albanian Government (the Ministry of Education and Science), the Bank of Albania has become an initiator for defining financial education strategies, policies and practices in the education system.

The Bank of Albania has played an active role in preparing the teaching programmes, implementing and coordinating the teaching process, so that students perceive financial education as part of the high-school education curriculum. This activity is a special and significant contribution that the Bank of Albania has made to financial education. It is crowned with the publication of the book "Personal finance in your hands", conceptualised for high schools, incorporated as an elective subject in high-school curriculum, and distributed at schools, training of economics teachers is also included.

This difficult process has consumed considerable human and financial resources, but the interests aroused, fully justify it. Education institutions, and students that will have long-term benefits from financial education, have positively received this initiative. Along with them, the whole economy will also benefit.

Financial education and financial stability are two important issues and two examples of the avant-garde policies pursued by the Bank of Albania. These policies have in common the fact that their effects on changing the behaviour of individuals, businesses and overall economy are gradual and life-long. In both cases, what matters is the side of movement, the direction in which these policies lead the economy.

Credibility of institutions, confidence in the financial system and financial literacy help people not only in managing their financial affairs and raising their standard of living, but also in proposing and supporting the right policies. They also contribute to sustainability and efficiency of the financial system for the whole economy.

Improved macro-financial management and financial education help each other for a successful journey. Today's activity, organised by both central banks of one nation, is also part of this journey.

Currently, we should keep our focus on and harmonise the central banks' positions to ensure macro-financial stability, as the only way that enhances the credibility of economies in our region and improves the foreign investment climate. Cooperation and coordination of policies of central banks and financial authorities for creating a regional market will increase the value of existing investments and of our economies in general. Harmonisation of economic agendas to maintain macroeconomic and financial stability, higher opportunities for regional cooperation and new joint projects, is the only way for promoting new private investments and attaining the real convergence of our economies.

Ladies and Gentlemen,

Let me once more congratulate you for organising this event and for your good work done so far. It is wonderful to see so many individuals and organisations working for one goal, for economic education of Albanians, for boosting confidence in financial institutions, for good management of the economy nation-wide, for making the best choices to ensure future economic prosperity.

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

At the High-Level Seminar "South East Europe: Pre-Requisites for Reform",
hosted by the Bank of Albania in collaboration with the University of Oxford
14 June 2012

Dear Minister of Finance,
Dear Governors,
Dear Ladies and Gentlemen,

I would like to thank you all for your participation and interest in sharing opinions on an extremely important issue to all of us: economic reforms and policies the countries of the region need to undertake against a background of an unclear situation in Europe, our main trading partner.

Special thanks go to representatives of the University of Oxford and the European Bank for Reconstruction and Development, who have worked closely with the Bank of Albania in hosting this Conference. This activity today is a follow-up of our joint study work with the University of Oxford dedicated to the competitiveness of the Albanian economy in a regional and global context, attraction of foreign investment and macro-financial stability of our economy.

Dear guests,

The year 2011 and the first part of the current year evidenced that the euro area crisis has plunged into its most acute phase. Right at the centre of this crisis, the sovereign debt risk, the curtailed ability of the financial system to absorb this risk and the continuous economic activity slowdown are spinning in a vicious circle. Against a background of public and private sector deleveraging, there are heightened concerns about public debt financing, cost and sustainability. This phenomenon is a concern not only for the short but also for the long run, and moreover, it has spread across a number of euro area member states.

Recent developments in the global economy, and particularly in the euro area, are as significant to the countries of our region as to Europe itself. The direct effects of this situation on personal business budgets and on overall economy have been in the spotlight of daily discussions of politicians, policymakers, central banks, analysts and the public. The short-term and direct concentration is justifiable in light of the hard time facing our economies and taking into account that the euro area is our main trading partner. The short-term focus and problematic situation have shifted the attention away from long-term policies and reforms.

The fact that the global crisis was perceived and interpreted with an escalating

crescendo tone is indisputable. It was partly perceived from the moment it first hit and, little by little, it transformed from a mortgage crisis into the deepest global crisis since the Great Depression. The response to the crisis and the lessons drawn from it followed in a similar fashion. The approach and extent of response to the crisis was not uniform across the countries. The economies having fresh memories of the financial crises responded swiftly and more strongly. The same can be said for the public and business community in these economies. The economies enjoying a favourable fiscal position also faced the crisis without impairing their long-term fiscal sustainability. The situation seemed slightly more complex in some developed European economies. Seeking to find a balance between deleveraging and fiscal consolidation, euro area authorities demanded setting up a protective wall against the possible fire bursting into from the outside. But, as noted, this fire had already burst out and was spreading inside the euro area walls; therefore, setting up this "protective wall against fire" was pointless at this point. The European Union and its institutional structures, along with the international financial institutions and partners, are undertaking a number of reforms to put this "fire" out. However, it is still unclear how long this "agony" will last and, likewise, is its impact on the euro area and its trading partners.

The exhaustion of fiscal and monetary policy incentives failed to increase economic activity and, moreover, it further aggravated the sovereign debt situation and financial stability. Consequently, the sovereign debt sustainability and banking system credibility-related issues were added to the concerns about economic growth.

The question facing many countries today has the form of a trade-off between stability and sovereignty. Currently, the latter two are intertwined in an endogenous relationship (of mutual impact on one another), in which the multi-dimensional need for stability (implying the maintenance of price stability, macroeconomic stability, financial and fiscal stability) requires taking balancing measures. The latter have considerable social costs in the short run. Social discontent against them and the governments proposing them erodes the credibility of reforms and the authorities, increasing, in turn, the sovereign debt risk.

The euro area, particularly its southern member states are facing a concern, whose solution bears consequences with economic and political implications for the future of all member states and the common currency. The reforms and policies undertaken by euro area authorities, individually or in concert, have important and direct implications for our economies.

Experience to date has shown that our partners and their large banks have adopted an approach that maximises their benefits as "owners". Consequently, their decision-making is entirely conditioned by the fear of loss of stability and sovereignty that associates the current concerns of the economy and the parent bank. This has pushed these countries to take biased measures against our economies, risk rating investment in our countries at 100%. This decision-making, which is directly linked to the events taking place within the

euro area, has practically transferred the issue of stability versus sovereignty in our economies. These policies represent a negative phenomenon, which contradicts the positive and stabilizing role that our partners have been playing so far in South East European economies and societies.

The countries of our region have in the last 20 years undertaken numerous structural, political and economic reforms, in view of consolidating the democratic state, the rule of law based on principles of market economy and supported by a consolidated financial system.

These reforms have enhanced the credibility and independence of public institutions and, in particular, the central bank's role and independence. They were not guided by the wish and goal to join Europe, but rather to build a society similar to the European one. By achieving economic, political and social convergence in these countries, each of them hopes to become a worthy partner to the developed Europe, and adopt the euro as the final phase of this transformation process. From this viewpoint, the European integration process, European Commission and the euro became powerful external anchors for each SEE country.

Current developments have diminished the anchoring role of the EU and the euro. Consequently, the European Commission and all European decision-making authorities should, in the future, pay greater attention to the characteristics of countries and regions aspiring to EU membership, and engage in closer cooperation with the respective national authorities.

It is, however, important to emphasize an evident and indisputable fact to all of us: external factors cannot safeguard long-term stability if internal anchors are missing. The current situation in Europe shows that the integration process does not prove to be a sufficient anchor, be it both inside and outside the euro area, as long as the internal economic and political choices are not stable in the long run.

This conclusion underlines the role and importance of internal anchors as warrantors for macro-financial stability and continuation of structural reforms that have brought our economies to this point. These anchors are strong arguments in the hands of the public at large to exert pressure on public institutions, and to formulate and implement policies that guarantee long-term stability and sovereignty.

Unfortunately, as I stated earlier, these anchors are currently being jeopardized by internal factors. Driven by short-term perceived benefits vis-à-vis the real costs of the correction process, the public, the business community, syndicates and stakeholders ask for short-term concessions from the institutions, and particularly from the central bank. Judging on the benefits, they require shifting the focus from the objectives and traditional instruments our institutions have been mandated for. These short-term perceived benefits, seemingly, have the potential to offer a right and moral solution to sovereignty versus stability, but they bear the risk of causing the loss of both in the long run.

Political and institutional factors have not addressed yet some important concerns identified by the Bank of Albania to have caused financial stability-related concerns and decelerated economic growth in Albania. I refer here to collateral execution, lowering of perceived risk arising from the severe political situation and lack of consensus, deceleration of reforms required by the European Commission and receiving EU candidate country status, severity of political warfare, and use of the economy and the situation for political gain.

Lastly, the Bank of Albania notes that the Albanian economy remains under the pressure of market developments in our main trading partners and their economic and financial policies. The measures taken by our trading partners to enhance confidence in their financial systems and adjust the macro-financial imbalances hamper monetary policy transmission in the economy. They heighten public concern and undermine its confidence in the future. These are the very reasons preventing the banking system to finance the economy and the government at lower interest rates and, consequently, the central bank's monetary policy transmission to easing the monetary and financial conditions.

What is currently happening represents higher risk premium in the countries of the region for all the reasons referred to earlier, rather than an increase in real interest rates. Concluding, I would like to clarify that central banks should make their utmost to preserve the frail macro-financial balances and bolster public confidence in institutions and the financial system.

In this context, the Bank of Albania will continue to foster macroeconomic and financial stability in Albania. This is our major obligation arising from the Constitution and relevant laws. We are committed to meeting this obligation with dedication and meticulousness. We are fully focused on these two major objectives, just like a good captain focusing on the horizon, rather than on the hands laid on the ship's helm.

The Bank of Albania believes that, by guaranteeing these two vital pillars to the stability and prosperity of the economy, we have provided the best contribution to achieving higher economic growth.

On the other hand, this would create an attractive surrounding for absorbing and accommodating foreign investment, and allowing the entry of new capital into the economy, which is vital to support the country's economic activity and its credibility in the region and beyond.

The Bank of Albania is committed to guaranteeing a sound banking system and efficient in channelling public savings into the economy. We will continue to carry out our periodic examinations to guarantee the banking system's stability. Sufficient capitalisation and capital quality remain our primary objective. I would like to guarantee the system that the Bank of Albania will take all the measures to supply with liquidity, while increasing the pressure for higher credit volume and improved quality.

Dear guests,

I invite you to actively participate in today's debate and discussions on issues that have been and will remain the focus and our common interest in the future. I invite you all to contribute, through presentations and discussions, to setting objectives our region will face in the future and solving the current challenges.

Thank you for your attention!

SPEECH BY ARDIAN FULLANI, GOVERNOR OF THE BANK OF ALBANIA

On the Monetary Policy Decision of the Bank of Albania's
Supervisory Council
27 June 2012

Today, on 27 June 2012, the Supervisory Council of the Bank of Albania reviewed and approved the monthly Monetary Policy Report. Based on the analysis of Albania's latest economic and monetary developments, and following discussions on their performance outlook, the Supervisory Council of the Bank of Albania decided to hold the key interest rate unchanged at 4.25%.

The Supervisory Council deems that monetary conditions are adequate to meet the inflation target in the period ahead, while they provide the needed monetary incentive to support the domestic demand.

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

Annual inflation marked 1.9% in May, continuing to pursue a gradual upward trajectory. Inflation rate in May was largely driven by the rise in food prices, whose performance triggered inflation's behaviour over the last two years. The impact of other commodities basket on inflation remains stable and slightly volatile.

Within the macroeconomic context, the analysis of economic and financial developments reveals the lack of strong and sustainable inflationary pressures, which is reflected on the current low annual inflation rate. As aggregate demand increased below its potential, spare production capacities were created in the economy, generating weak pressures on the increase in wages. Imported inflation remains moderate, owing to the contained performance of primary commodity prices, moderate inflation in Albania's trading partner countries, and stable exchange rate. Also, economic agents' inflation expectations remain low, administered prices provide a minimum effect, and monetary developments and liquidity in the economy are in line with the mid-term price stability.

Data available on the economic performance for the first five months of 2012 show that economic expansion slowed down. Estimations based on indirect, qualitative and quantitative data reveal a sluggish production sector in the first quarter of 2012, whereas services improved compared to the fourth quarter of 2011. On the demand-side, economic developments in this period show a moderated foreign demand and a sluggish domestic demand. The latter

is determined by the weak performance of private sector's expenditures and investments, and the low fiscal stimulus.

January – May 2012 is characterised by a consolidating behaviour of fiscal policy.

The budget deficit decreased by 6.5% y-o-y, in this period, reflecting the increase in budgeted revenues and expenses, by 2% and 0.8%, respectively. Notwithstanding the short-term reduction of fiscal stimulus, the Bank of Albania deems it necessary for the public sector to focus on consolidating and reducing public debt indicators. The implementation of this policy will provide short and long-term benefits to the Albanian economy in the form of lower risk premiums in financial markets and more credit opportunities for the economy.

Foreign demand, the main source on the increased aggregate demand in the last two years, appeared moderated during the first four months of 2012. The relevant partial information, obtained from the external trade data, shows a contraction of 4% in Albanian exports during the first months of year.

This contraction is largely driven by the reduced exports of electric energy. Excluding the latter, Albanian exports grew by about 7% y-o-y, albeit insufficient to maintain the growth paces during 2012. At the same time, imports shrank during the first four months of 2012, by 1.8% in nominal terms. These developments are materialised in a narrowed trade deficit in goods and services, by about 2.3% for this period. The narrowed trade and current account deficit are welcomed, particularly given the high fluctuation of global financial markets.

Monetary developments were in line with the performance of the real economy. Monetary supply rose by 8.3% y-o-y in April, about 0.5 percentage points lower compared to March. This deceleration reflected the lower financing by banks to the government and the decelerated demand of the private sector for monetary assets.

Annual increase of credit to the private sector marked 8.1% in April. Given that uncertainties concerning the external and domestic macroeconomic developments augmented, private sector's demand for banking credit continues to fall. Households demand for consumer or mortgage loan shows weak, due to their increased propensity to save. Business demand for credit has been downward, due to the failure to utilise producing capacities in full and the uncertainties on the demand performance in future.

The banking system continues to be increasingly prudent regarding crediting, albeit its balance sheets remain completely sound and capable of promoting credit growth at home.

The decelerated lending is a known phenomenon within the context of global financial markets, and characterises the developments in all regional economies. Banking credit and foreign direct investments are the two main

contributors to private sector's long-term investments slowdown in Albania. In this light, the Bank of Albania deems that businesses and banking system have room for closer collaboration and better mutual understanding to support crediting.

Financial markets operated under liquidity terms and showed low interest rate fluctuation. Indicators related to soundness of the banking system are positive and stable, and adequate to enhance financial intermediation. Interest rates in the domestic currency trended downward in April and May, notably in inter-bank and deposits markets. This tendency was followed by increased inter-bank trading and lek deposits. On the other side, the relatively high yields rates of government Treasury bills, since the beginning of year, seem to considerably factorise structural changes in primary market and do not transmit added inflationary pressures.

In the light of Bank of Albania's analysis on the expected fiscal and monetary developments, this trend may return, in the second half of year, to improved demand and supply ratios for public sector securities.

Basic projections on the expected economic performance in the future continue to align with our previous estimations for an economic growth, but below its potential. Economic slowdown in Albania's trade partner countries is expected to impose a sluggish foreign demand during the rest of year. Given the lack of room for a substantial fiscal stimulus, the main drivers of domestic demand will be the consumption and private investment, which have shown few recovering signal so far. Overall, the expected economic developments at home and abroad are expected to condition a slow rise in consumption prices at home.

Real and monetary sectors convey low pressures on prices; also, inflation in global markets is expected to be low, while inflationary expectations remain anchored.

The gradual subsiding supply shocks and the termination of base effects impact are expected to be followed by a slight rising inflation trend in the second half of the year. At a high probability, consumer prices inflation is expected to remain below the target over the medium run. These circumstances, in the absence of unexpected shocks, encourage the further maintaining and strengthening of the monetary policy's stimulating nature. The reconfirmed commitment of the government to continue the fiscal consolidation process even in the next review of budget, as well as the calmer situation in global markets, will pave the way to review the monetary policy position.

Based on the analysis of the above information, the Supervisory Council holds that inflationary pressures on consumption prices at home remain low over the policy-relevant horizon. On the demand side, below-potential economic growth shall continue to generate low inflationary pressures. Also,

the supply-side pressures generated from both external environment and domestic macroeconomic environment are expected to remain moderated. At the end of discussions, the Supervisory Council decided to hold the key interest rate unchanged at 4.25%.

The Supervisory Council remains committed to maintaining price stability in the medium run, as the primary target of the Bank of Albania.

Without jeopardising this target, the Supervisory Council remains heedful and monitors prudentially the macroeconomic and financial developments at home and abroad to assess the monetary leverage for supporting the economic growth and maintaining the domestic and external equilibriums at home.

PERIODIC ANALYSES*

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

ANALYSIS OF FINANCIAL INTERMEDIATION, 2012 Q1

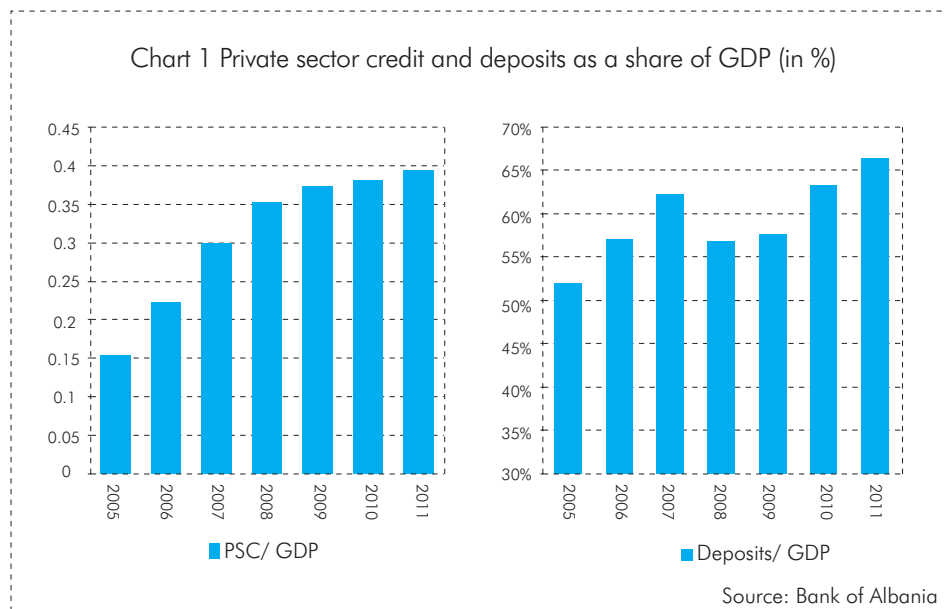
ERJONA SULJOTI, SOFIKA NOTE

MONETARY POLICY DEPARTMENT, APRIL 2012

I. BANKS AND FINANCIAL INTERMEDIATION

In the first quarter of 2012, financial intermediation remained at similar levels to 2011. It performed in line with the year-start seasonal behaviour and the below-potential economic activity in Albania. The banking system was characterised by satisfactory liquidity levels, supported by households' ongoing propensity to save. Moreover, it was well-capitalised, reflecting the capital injection in the second half of 2011, in accordance with the regulatory requirements. On the asset side, loan portfolio was conditioned by economic agents' moderate demand for credit, driven by a low capacity utilization rate and low consumption. Also, against the background of heightened uncertainties surrounding the external and domestic economic outlook, as well as influenced by cross-border parent banks' conservatory policies, the banks tightened their lending conditions and were cautious in choosing sound projects. Credit activity survey for this period indicated that the demand for credit by businesses and households was weak because of the macroeconomic situation in the country, heightened uncertainties and concerns around certain sectors of the economy, as well as real-estate market performance.

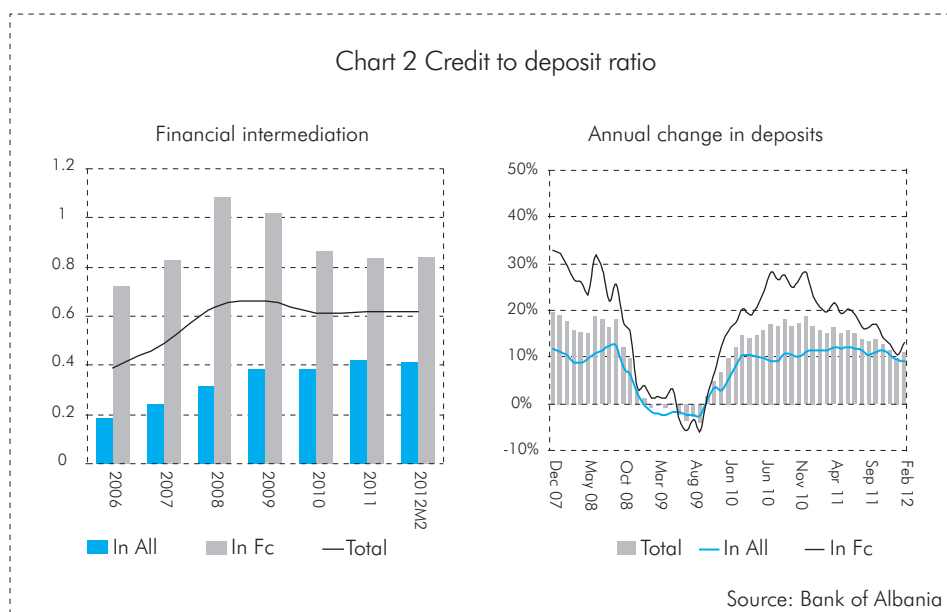
Chart 1 Private sector credit and deposits as a share of GDP (in %)



Credit portfolio developments signal economic agents' weak demand for credit and banks' reluctance to take risks. As a ratio of GDP, the private sector credit portfolio, as at end-2011, reached 39.5%, or 1.4 percentage points higher than a year earlier. At the same time, deposits accounted for

about 66.2% of the GDP, up by 3 percentage points from end-2010. The phenomenon of poor lending performance against the background of slowing economic activity is being experienced by many South Eastern and Central European countries (SECE) and has also been explored by several working papers. A comparative analysis on loan portfolio performance by countries in the region and Central Europe depicts that Albania is one of the countries with the highest loan portfolio growth, at a time when some countries are experiencing portfolio contraction. Moreover, empirical assessments highlight non-performing loans, loan price and economic growth as determinants to this performance. They are assessed as statistically important factors for credit performance in the SECE countries.¹ Albania's higher credit growth is attributed to positive economic growth and good performance of banking system deposits over the past two or three years.

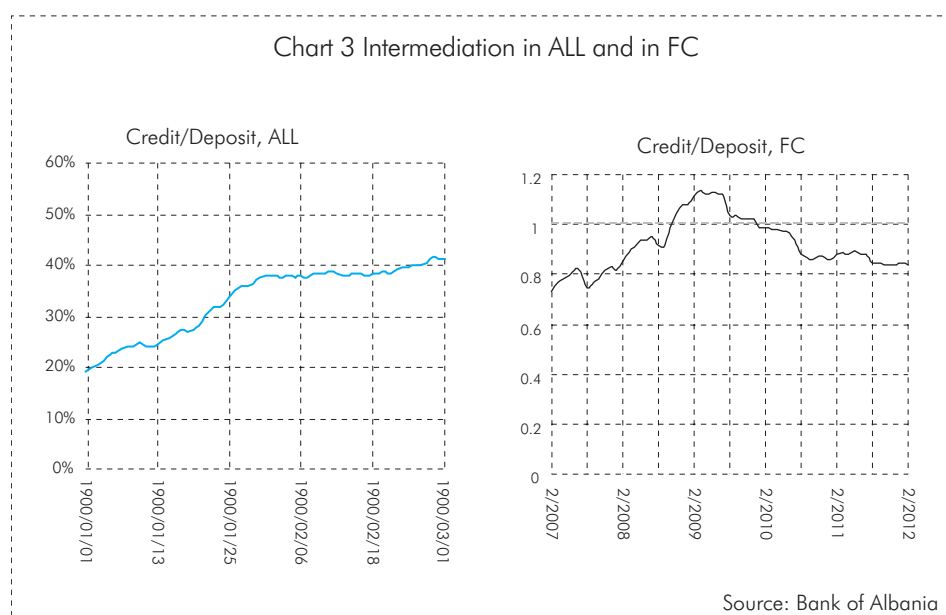
Monetary developments have been characterised by stable annual growth rates compared to end-2011. Notwithstanding the key interest rate cut, the transmission of easing monetary policy signals to the economy has remained slow and incomplete. The banks' loan portfolio quality impairment and their orientation by cross-border parent banks to restrict credit exposure have conditioned the increase in financial intermediation to the private sector. In 2011, the level of non-performing loans was 18.8%, or 4.8 percentage points higher than in 2010. The banking system intermediation has been stable over the past two years. In February, credit to deposit ratio remained similar to the previous year's level (61.7%). Unlike in the previous year, the increase in ALL intermediation has offset the decline in foreign-currency intermediation, compared to a year earlier.



¹ For more details, see the box on "Lending in the countries of the region", Annual Report 2011, Bank of Albania.

1.1 Intermediation by currency

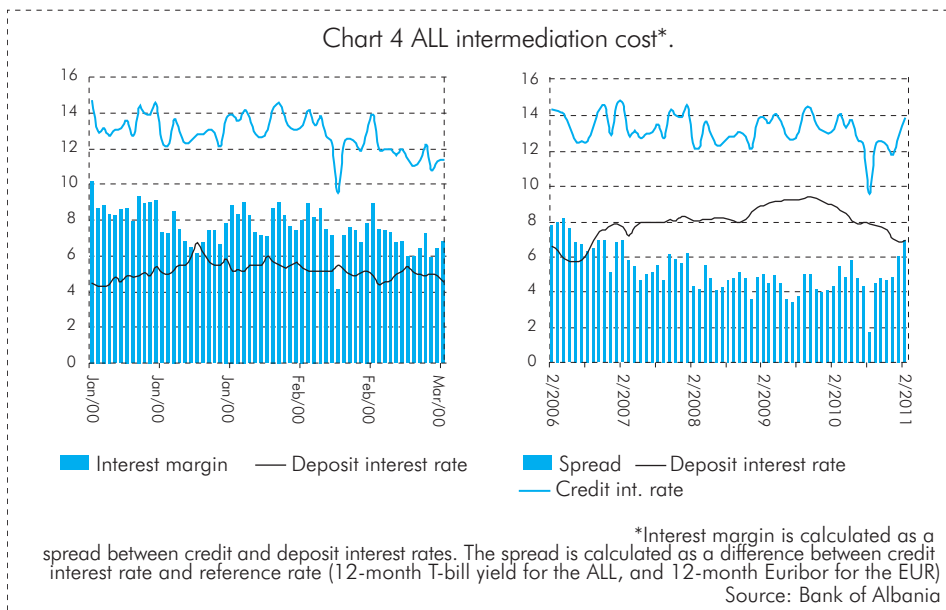
ALL intermediation in January-February was stable and slightly higher compared to the fourth quarter of 2011. Credit to deposit ratio settled at 41.2% over these two months, from 40.7% in the fourth quarter of 2011. Unlike in the previous year, when the increase in ALL intermediation was driven by high ALL-denominated credit growth rates and stable ALL-denominated deposit growth rates, in the first two months of the current year, the increase in intermediation was determined by their instantaneous slowdown.



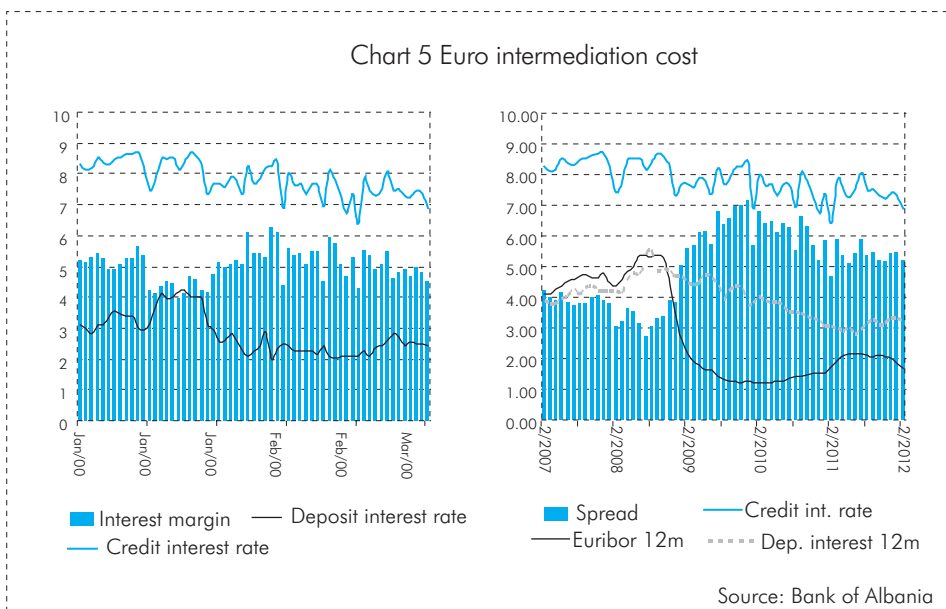
During January-February 2012, the performance of foreign-currency intermediation increased slightly, averaging 84.0%, from 83.6% in the fourth quarter of 2011. However, the size of foreign-currency intermediation remained lower than in the first half of 2011, with a spread of 4 percentage points. The decline in foreign-currency intermediation ratio since the second half of 2011 is attributed to decelerated deposit and credit growth rates; however, the impact of the latter has determined the downtrend of foreign-currency intermediation.

1.2 Intermediation costs

Following the growth recorded in the fourth quarter of 2011, the ALL intermediation cost increased slightly during January-February, averaging 6.6 percentage points for both months. While the average interest rate on ALL-denominated credit remained almost unchanged, deposit interest rate lowering, in response to easing monetary policy signals, has determined the performance of the ALL intermediation margin over the last months. Also, stable ALL-denominated credit interest rate and increased T-bill yields over the first months of the current year have been reflected in a narrowing spread between them.



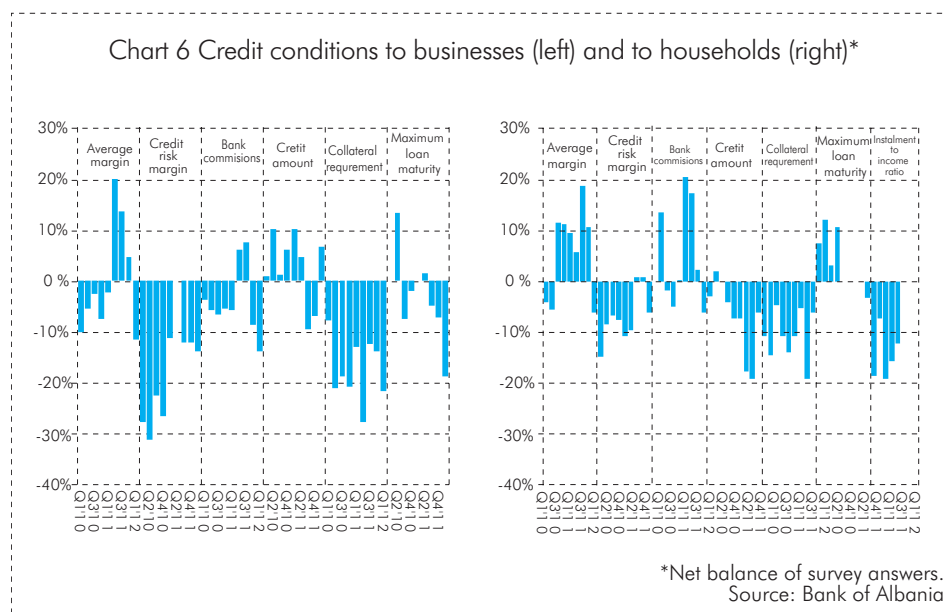
The euro intermediation cost² was 4.65 percentage points over the first two months of 2012, continuing the downtrend having started since the second half of 2011. Its performance over the last two quarters has reflected the instantaneous lowering of interest rates on both loans and deposits denominated in euro, though the effect of the latter has been stronger. Despite the lowering of deposit interest rates, they remain significantly higher than the euro-denominated deposit interest rates internationally, reflecting Albanian banks' tendency to ensure ample liquidity in foreign currency.



² The banks' activity in foreign currency is dominated by their transactions in euro, which account for more than 80% of foreign-currency activity.

1.3 Non-price elements

Analysis on bank lending activity for the first quarter of 2012 reveals tightening in credit conditions of the banking system, both to businesses and households. Likewise in the previous quarter, the major part of non-price



elements continued to impact on the tightening direction.

Business credit conditions tightened further in the first quarter of 2012, albeit less than in the fourth quarter of 2011. Excluding the credit size criterion that eased during this quarter, all other non-price elements tightened. This tightening was associated with further rise in commissions and average credit risk margin. Also, following the easing taking place over some quarters, normal credit margin also increased in the first quarter of 2012, thus contributing to tightening business credit conditions.

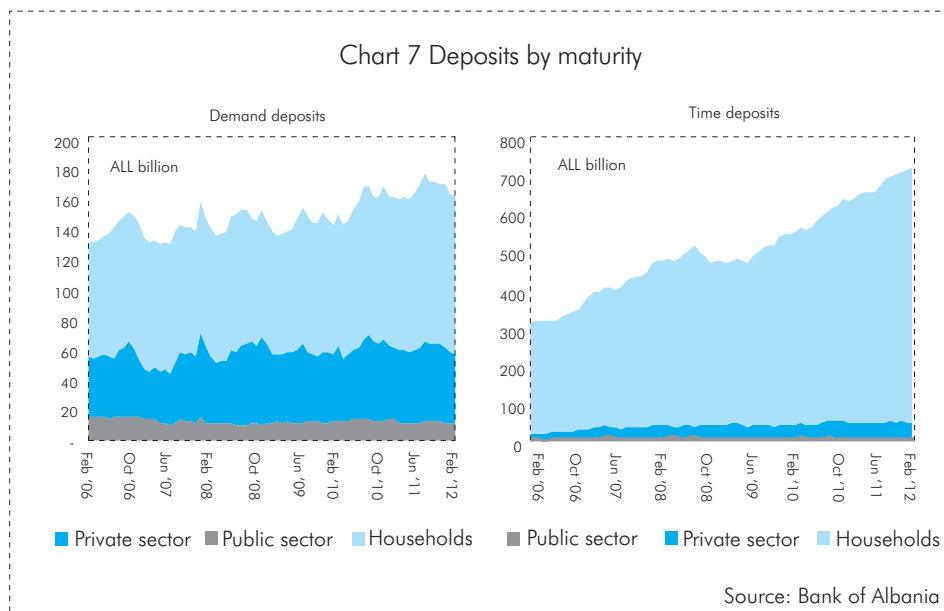
After remaining unchanged in the fourth quarter of 2011, credit conditions tightened at a larger extent for households than for businesses, in the first quarter of 2012. This tightening was mainly due to credit price elements (average credit risk margin, high credit risk margin, and commissions). Credit maturity criterion continued to provide a neutral effect on household credit conditions. Also, the tightening impact from other non-price criteria was smaller in this quarter than in the previous one

2. DEPOSIT ACTIVITY

Funds deposited at the banking system in February were 11.1% higher than a year earlier. The slowing pace of their growth in 2011 reached the lowest level in January, by 9.8%, to subsequently increase in February. Improvement in the annual growth rate of total deposits has reflected not only their monthly increase by ALL 6.8 billion, but also the base effect of comparison with the

previous year. During the first two months of 2012, deposits increased less than in the fourth quarter of 2011, in response to their seasonal behaviour. Also, their net flow during January-February was about 35% lower than in the same period of the previous year. This reduction has reflected the slower money creation in the first quarter of 2012 and the developments in business deposits, mainly in foreign currency.

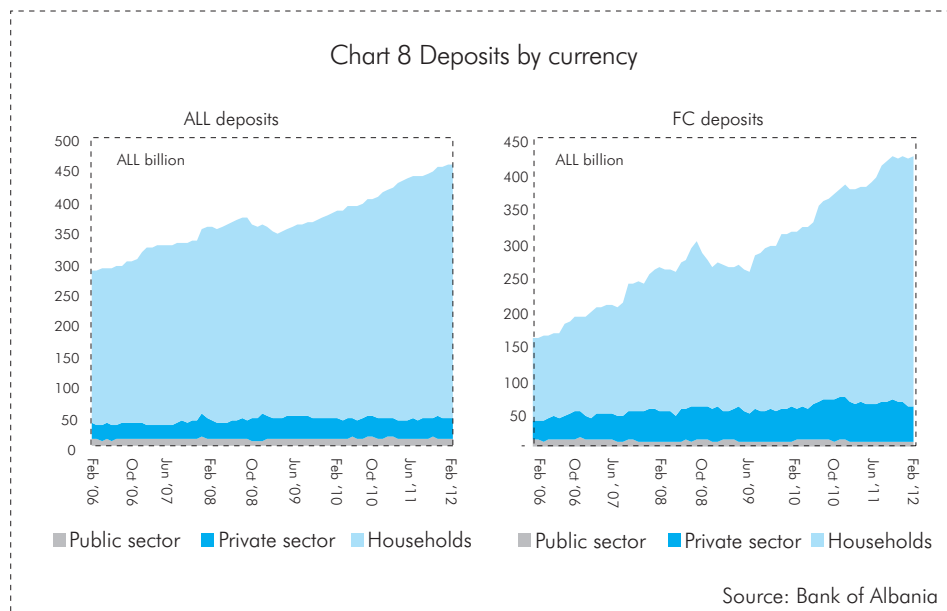
Changes in deposit time structure over the first two months of 2012, confirmed the shift of household savings from demand deposits to time ones. This shift was even more obvious in ALL-denominated deposits. At the same time, business deposits were in line with their trading activity in the first months of the year. Likewise a year earlier, business deposits, mainly time and foreign-currency ones, have been used for loan repayment. The level of business deposits as at end of February was close to the several-year average. Shifting deposits to over-two-year time deposits has made their ratio to total deposits reach historically high levels, to 81.7%.



Deposit structure by currency shows that it remained almost unchanged relative to end-2011. ALL-denominated deposits account for 52% of total deposits. On a year earlier, they have slightly increased. This performance has reflected households' low preference for holding cash, as well as the larger money creation due to banks' intermediation in the national currency. The time structure of ALL-denominated deposits is dominated by time deposits (82.7%). Household deposits account for about 90% of total ALL-denominated deposits, remaining unchanged over the past two years. Net deposit flows in the first two months of the year were lower than in the same period a year earlier, averaging ALL 2.4 billion per month, compared to ALL 4.6 billion a year earlier.

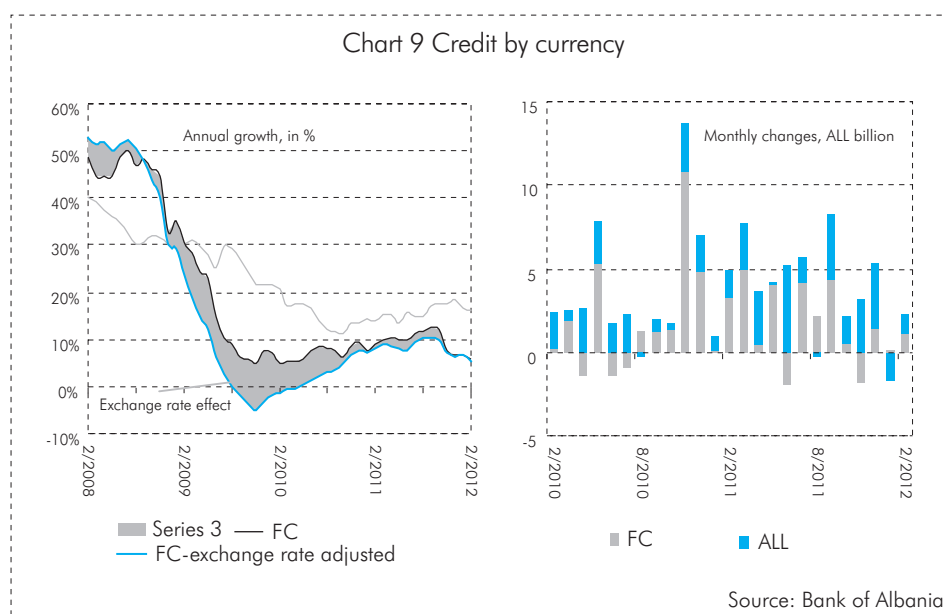
Foreign-currency deposits account for about 48% of total deposits. The time structure of foreign-currency deposits is dominated by time deposits (81%).

Household deposits account for about 86.4% of foreign-currency deposits and this ratio has been rising over the past two years. Foreign-currency deposits increased by 11.8% y-o-y, in the first two months of the year, continuing the decelerated growth rates relative to early 2011.



3. CREDIT ACTIVITY

Private sector credit³ performed slowly during the first two months of 2012, mainly due to private sector’s low demand for credit, reflecting its reluctance to spend and invest. On the other hand, the banks have displayed low tolerance to risk, by further tightening credit conditions over the first quarter of



³ Private sector credit accounts for about 97% of total credit.

the year. The poor performance of the private sector credit in early 2012 has been reflected in further decline in its annual growth. As at end-February, the annual private sector credit growth was 9.2%, from 10.4% as at end-2011.

In January and February, unlike in 2011, the ALL-denominated private sector credit performed sluggishly. Its annual growth fell to 16.6% and 16.0% in January and February, respectively, from 18.5% as at end-December 2011. The lower growth rate of ALL-denominated credit is apparent to business credit due to higher settlements of working capital loans over this period. ALL-denominated household credit maintained stable annual growth rates. Over the first two months of the year, its extension to households, albeit small, has taken the form of real-estate investment financing.

The annual growth of foreign-currency private sector credit, after remaining unchanged in January (at 6.6%), slowed down to 5.9% in February. Its performance was driven by overall low demand for credit in early 2012 and a lower preference for foreign-currency loans, in particular by households. The main source of its growth remains the business demand, which, during this year-start, albeit low, was mainly oriented towards investment loans. Households continued to reduce their foreign currency liabilities to banks, reflected in annual contraction of foreign-currency loans to households over the last four months of the year.

During the last three years, a broader use of the national currency in bank lending has been also reflected in a significant increase of its share to private sector credit, particularly to businesses. As at end-February, the ALL portfolio accounted for about 30% of total business credit, up by 3 percentage points from end-2010 and up by 10 percentage points from end-2008. In relative terms, ALL-denominated credit to households was higher than ALL-denominated credit to businesses. The ALL-denominated credit accounted for about 46% of household credit as at end-February, up by 2 percentage points from 2010 and up by 3 percentage points from 2008.

INFORMATION ON SELECTED ECONOMIC AND MONETARY INDICATORS IN THE CENTRAL, EASTERN AND SOUTH EASTERN EUROPEAN COUNTRIES, 2012 Q1

DORIANA LAMA, MEDVIN SHEHU

MONETARY POLICY DEPARTMENT, APRIL 2012

1. SELECTED ECONOMIC FIGURES AND MONETARY POLICY ORIENTATION IN ADVANCED ECONOMIES

The global economy has experienced stability and improvement in many indicators, confirming the opinion for a more positive global economic outlook. The factors that slowed down economic growth, over the previous year, have been somewhat reduced in the first months of 2012, being affected by the mitigated tensions in the financial markets. The actions and the monetary policy of the ECB have slightly calmed down the economic agents. However, problems arising from high public debt crisis in many euro area advanced countries have conditioned the recovery of the economy providing a negative contribution to this recovery. Many euro area countries recorded modest growth rates, signalling the possible return of the economic downturn in the periods ahead. By contrast, Central and Eastern Europe (CEE) countries showed positive growth rates based on their exports towards world markets and on the performance of certain domestic demand elements. The effects of the debt crisis on euro area countries coupled with those persisting from the 2008-09 crisis have affected the overall risk perceived by the main market's actors about this region, making the absorption of capitals difficult and expensive, and creating a lot of problems to the economic strengthening of these countries. The inflationary dynamic was subdued in the euro area and in many advanced countries, whilst in CEE countries inflation increased slightly, mainly due to the rise in taxes and other temporarily factors. The exchange rate in many CEE countries is following a depreciating trend, while investors' perception concerning government debt securities in financial markets is becoming more critical. The fragile equilibrium characterising many of these economies increases the perceived risk from the spillover of euro area crisis' effects.

Euro Area

After recording negative rates in the last quarter, the euro area economy probably will continue to contract during this quarter. The preliminary direct and indirect indicators do not appear optimistic and reveal a mixed outlook, whose balance mostly speaks of deceleration. However, ECB's action through many operations and interventions to reduce tensions in debt securities market and increase confidence in market agents proved effective. These actions, along with the accord of investors to work out the disagreement concerning the Greek debt, avoided the re-appearance of another crisis of tightening lending conditions. Unemployment has edged upwards

since 2011 H1, standing at 10.8% in the last months. Inflation descended gradually, pointing to 2.7% in March. The sluggish economic growth and increased unemployment suggest that inflationary pressures be contained and driven by costs, wages and prices. Performance of the main euro area economy variables, such as exports, government activity, investments and domestic consumption has reflected weakness and uncertainty concerning their rapid recovering. The uncertain climate has decelerated consumer spending and the willingness for investments, making the economic growth frailer. Net exports performed positively during this period, notwithstanding an increased uncertainty concerning their future performance in the light of an unclear economic context worldwide, hence intensifying the more pessimistic expectations in experts' forecasts.

Table 1 Key interest rates and use of instruments in advanced economies

	Euro area (ECB)	USA (FED)	UK	Japan
Inflation target	< 2%	n.a.	2%	1% ^{1,2}
Key interest rate changes	09.02.12 (0.00)	13.12.11 (0.00)	09.02.12 (0,00)	14.02.12 (0.00)
	08.03.12 (0.00)	24.01.12 (0.00)	08.03.12 (0,00)	13.03.12 (0,00)
	04.04.12 (0.00)	13.03.12 (0,00)	05.04.12 (0,00)	10.04.12 (0,00)
Actual interest rate	1.00%	0-0.25 %	0.50%	0-0.1 %
Latest inflation rate ³	2.7%	2.6 %	3.5 %	0.50%
Schedule of MPC meetings	09 February	24-25 April	09-10	28 April
	08 March	19-20 June	May 06-07 June	19-20 May
	04 April	31 July	04-05 July	13-14 June
Future events	10 May 14 June Monthly Bulletin	06 June 18 July Beige book	16 May Inflation Report	21 May 19 June Monthly Report

Source: Respective central banks.

¹ Bank of Japan has not adopted the Inflation Targeting and the rate considered as price stability from this bank points to the band of 0-2% or precisely the midpoint 1.00%.

² Source: "Understanding of Medium- to Long-Term Price Stability", Bank of Japan.

³ March 2012 for the euro area, USA and UK and February 2012 for Japan.

ECB maintained the key interest rate unchanged during these three months and implemented an accommodative monetary policy by re-employing the non-traditional monetary policy instruments. Banks accessed about EUR 530 billion through the LTRO held at the end of February. Through this amount, in addition to the improved regulatory requirements of many liquidity indicators, banks took the advantage to increase their activity in capital markets by affecting the overall decrease in yields. At the end of March, it was agreed to raise the capital of the European Stability Mechanism¹ and crisis management, from EUR 500 to EUR 700 billion.

USA

The U.S. economy performed more positively than the euro area over this year, particularly being more evident in the second half of the year, recording positive growth rates in 2011 Q4. Direct and indirect indicators show that it

¹ In this case, the European Stability Mechanism (ESM) and the preceding European Financial Stability Facility (EFSF).

will continue to be positive in 2012 Q1 as well. The rise in business inventories and private consumption drove the economic growth. The latest publication of the Beige Book² shows that the U.S. economy has recovered and has recorded positive growth and rates. However, it identifies some risk factors which may affect both the speed and rate of growth. In this period, GDP relied on the positive expansion of business inventories, suggesting that ongoing upsurge in private consumption or exports need to follow GDP growth. At present both these variables, show uncertainty due to both the labour market in the USA and the performance of global economy. The Federal Reserve has not changed its key policy rate for the U.S. dollar during this period and has continued to sell short-term debt securities of the U.S Government to later shift the sales toward long-term securities. The latest statements by the FED Governor B. Bernanke appear to have decreased the market operators' confidence on a third operation on quantity easing at the near future.

2. SELECTED ECONOMIC INDICATORS, INFLATION AND MONETARY POLICY ORIENTATION IN SELECTED CEE COUNTRIES³

The overall economic growth in CEE countries appeared positive and improved from the previous year. Excluding the Czech Republic, whose economy slowed down, the other countries grew at higher rates than those in the previous year. The economic growth decelerated considerably in the Czech Republic, while it maintained almost the same rates in Hungary and Poland in 2011 Q4.

These countries are all export-oriented and their economic growth has been affected by the overall performance of the Western European countries' economy. In the absence of the domestic demand strengthening, the forecasts about economic growth in 2012 and 2013 are revised downward by reflecting a potential slowdown of the demand from the main partner countries and a lower contribution by the fiscal item. The increased investments were assessed positively during 2011 and are expected to be confirmed during this year as well, and contribute to the growth of the respective GDPs. Inflation rates have started to increase. In addition to the transmission of rise in VAT and in a number of excises, in many of these countries, the surge in energy products prices and the depreciated performance of the domestic currencies affected inflation. Overall, the central banks of this region consider inflationary pressures contained, albeit being surrounded by rising uncertainty rates.

2.1 Economic Activity

The Czech Republic's GDP declined to 0.6% in 2011 Q4, from 1.3% in 2011 Q3, due to the persistent fall in private and public consumption. The increase in net exports during this quarter eased somewhat the negative contribution of many items to the formation of GDP. Agriculture and manufacturing recorded upraised rates, thus providing a positive contribution.

² *Beige Book, April 2012.*

³ *The Czech Republic, Hungary and Poland*

Rating CZECH REPUBLIC		
A1 (stable) (Moody's)	A (positive) (S&P)	A+ (positive) (Fitch)

Data related to the first months of 2012 confirm the calm trend of the Czech economy, reflecting the tight fiscal conditions, the sluggish performance of domestic demand items and the fall of demand from the Czech Republic's trading partners. The labour market, investments' paces and indirect indicators signal a weak performance, albeit forecasted, of the Czech Republic's economy for 2012 Q1 and the rest of the year. The overall financing conditions and those of financial market appear good. In general, interest rates on credit and deposits are downward.

Hungary' GDP grew by 1.4% (y-o-y) in 2011 Q4, unchanged from 2011 Q3. Net exports and the lower industrial production continued to drive economic growth, while domestic consumption continued to fall.

Rating HUNGARY		
Ba1 (negative) (Moody's)	BB+ (negative) (S&P)	BB+ (negative) (Fitch)

Temporary developments, such as the positive performance on agriculture expectations and the realisation of some investments and structural projects from the Hungarian Government in the last months of year, affected the GDP dynamics. Preliminary indicators such as industrial output and trade balance reveal at a large extent a modest growth in 2012 Q1, as confirmed by the CHB experts' expectations, which show a weak growth in 2012. Most of Hungary's economy will depend on how stable the international markets perceive it. A rigorous fiscal policy by the government and a swift financial aid agreement with the EU and the IMF would play an important role.

Data on the Polish economy continued to be positive. Its GDP pointed to 4.3%, alike the previous quarter. Economic growth was close to 4% in 2011. Although Poland' economy is export-oriented, its economic growth was more balanced compared to the other countries in the region, relying on domestic demand and on investment growth rates

Rating POLAND		
A2 (negative) (Moody's)	A- (stable) (S&P)	A- (stable) (Fitch)

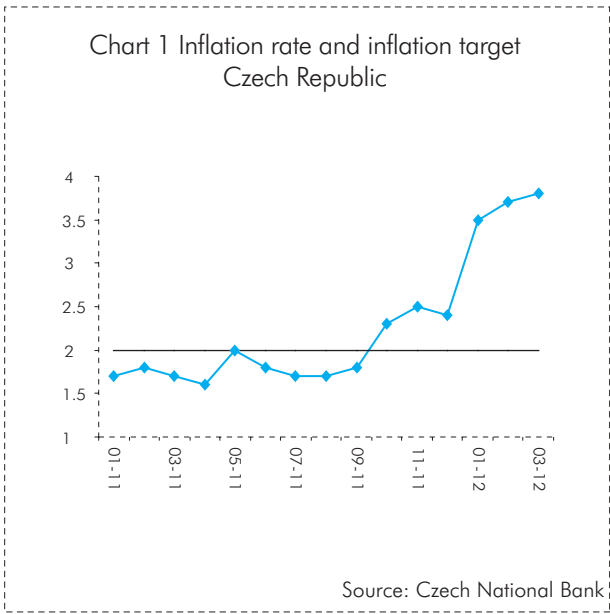
Preliminary indicators about the first months of 2012 and lending to businesses, and sales give evidence for a positive performance during 2012 Q1. The decelerated European economy growth and boosted private consumption are expected to affect Poland's economy. The Polish zloty has shown an appreciating trend in the last months.⁴

⁴ Poland's Central Bank projects that the GDP will grow by 3.0% in 2013.

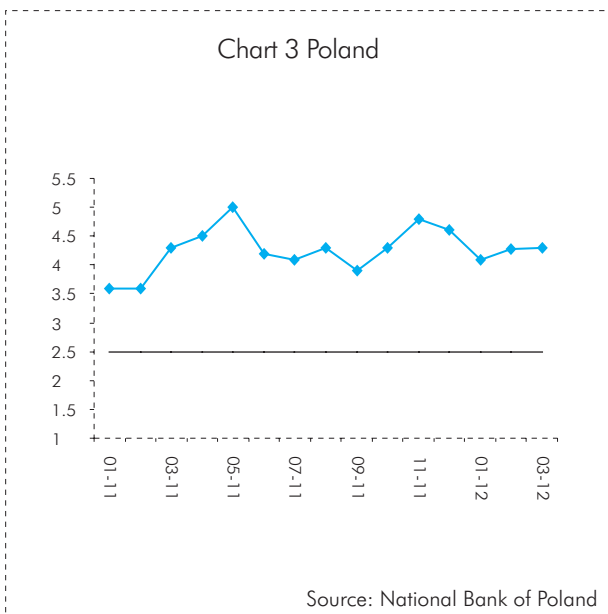
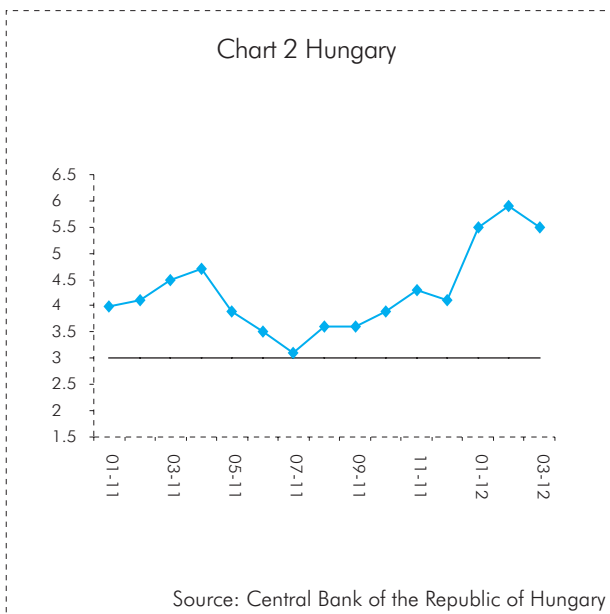
2.2 Inflation and Monetary Policy

Inflation in the Czech Republic has been increasing during 2012 Q1, above the tolerance band of the CNB's target. Since January, inflation has ranged 3.5-3.8%, higher than the expectations of the central bank's experts.

According to the central bank, temporary events coupled with higher-than-expected transmission of the increased VAT rates from January, which mainly affected food prices and administered prices, contributed to inflation performance. By contrast, inflation rate, excluding these effects and oil prices, showed negative values, confirming the non-inflationary pressures arising from the domestic economy. Consequently, the Czech National Bank decided to keep the monetary policy direction unchanged with the two-week repo rate at the minimum historical rate of 0.75%. Due to projected fiscal measures by the Government, a change in the inflationary expectations of economic agents may jeopardise the performance of inflation. Central bank's forecasts that inflation rate may reach somewhat above 3% during 2012, while it is expected to fall within the tolerance band in 2013, due to the fading-out effect of the VAT rise in the beginning of 2012

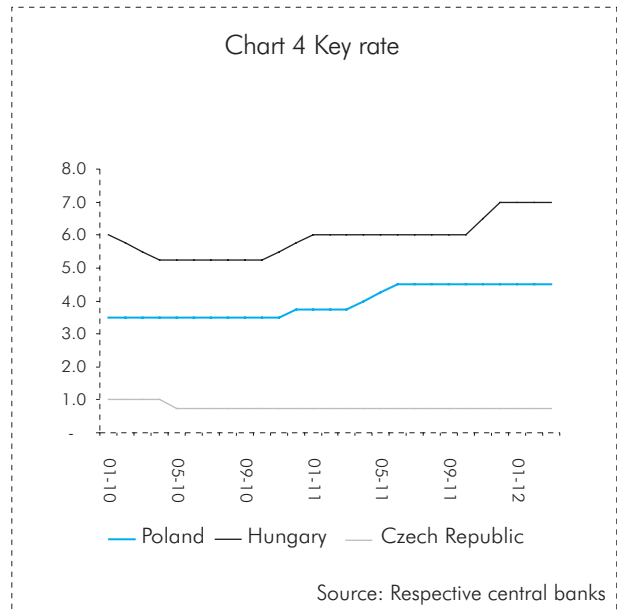


In Hungary, inflation fell at 5.5% in March, compared to 5.9% in February, in line with the central bank's forecasts. The Central Bank of the Republic of Hungary has kept the key interest rate unchanged during this period, at 7.0%. In a more detailed view, the latest developments in inflation show the VAT increase contribution in January, the continued oil price rise and the stronger-than-expected transmission of the domestic currency depreciation in 2011 H2. According to the Central Bank of the Republic of Hungary's



forecasts, the ongoing contraction in consumption and domestic demand and the high unemployment rate will exercise non-inflationary pressures on inflation reducing or offsetting the increasing pressures arising from oil price, exports and the exchange rate

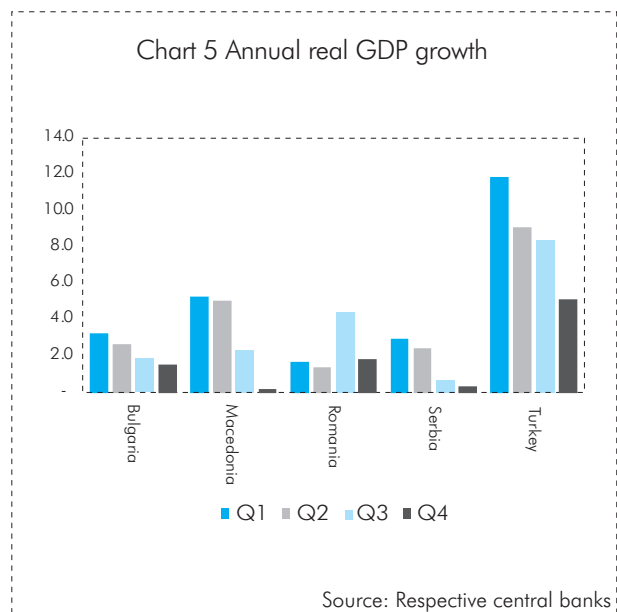
In Poland, the annual inflation rate has been increasing in 2012 Q1, 1.7% higher than in the previous quarter. In January and February, it marked 4.1 and 4.4 %, respectively, remaining below the rate of 4.8% of May. The National Bank of Poland has kept the key interest rate unchanged at 4.50% (since June 2011). The inflationary pressures will remain high due to the immediate price rise in the previous period (VAT rise by 1% and the low comparison base) and the depreciation of the Polish zloty in the recent months. According to the central bank, inflationary pressures will be temporary and are expected to decrease in the year ahead.



3. SELECTED ECONOMIC FIGURES, INFLATION AND MONETARY POLICY ORIENTATION IN SELECTED SEE COUNTRIES AND TURKEY⁵

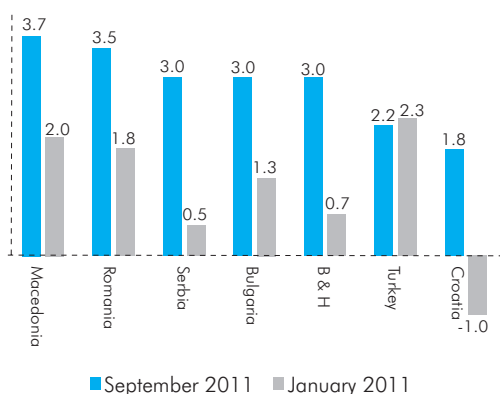
SEE countries recorded lower economic growth in 2011 Q4 compared to the previous quarter, albeit figures remain different across countries. The economy slowed down due to a weak domestic demand. Notwithstanding the positive developments in the real wage, consumers and enterprises are inclined to strengthen their own balances, trying to face the tight lending conditions, the increased unemployment rate and the tightening of fiscal stimulus. Net exports provided a positive contribution to the economic growth during 2011, but deteriorated in 2011 Q4, warning a decline of foreign demand in the year ahead.

As the economic activity fell in this quarter, forecasts about 2012 are positive, but revised downward. The high exposure of this region against the euro area makes it sensitive against the worsening of trading partner economies and the financial problems of this area. Also, fiscal tightening in some countries (Bulgaria, Romania) will affect the economic growth's figures. Indirect data for the first two months of 2012 reflect the decline in consumption and investments, and confidence



⁵ Bulgaria, Macedonia, Romania, Serbia, and Turkey.

Chart 6 IMF's GDP growth forecast of 2012, September 2011 and January 2012



Source: WEO-IMF, 2011

indicators suggest the persistence of these paces. Expect for Turkey, inflation rates, trended down in 2012 Q1, driven by the slowdown of the domestic demand. Foods prices fell considerably, whilst the rise in energy and oil price has partially offset this effect. The transmission of expectations for a further increase in oil and energy prices to other products' costs and inflationary expectations, as well as the behaviour of fiscal indicators in countries holding elections (Serbia, Romania) are identified as risks associated with inflation. Central banks have mainly implemented easing policies to support the economic activity, by reducing the key interest rate and easing collateral requirements. By contrast, given the high inflation rate and the depreciation of its currency, Turkey has employed mechanisms which led to the tightening of monetary conditions.

3.1 Economic activity

Rating BULGARIA

Baa2 (stable) (Moody's)	BBB (stable) (S&P)	BBB-(positive) (Fitch)
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Annual GDP growth in Bulgaria pointed to 1.6% in 2011 Q4, almost similar to that in 2011 Q3. Net exports arising from the quicker growth of exports compared to imports contributed positively to the GDP. The diversification of exports to non-EU member states helped maintain high paces of this indicator. The positive performance of private consumption supported the economic activity in 2011 Q4. In real terms, wages resulted high due to the fall of inflation, while employment indicators remain weak. Investments recorded a negative growth, partially affected by the decline in FDI flows.

Year 2011, recorded a growth of 1.7%, from 0.7% in 2010. Despite the positive figure in 2012, uncertainties concerning economy increased due to economic and financial problems in EU countries. Also, industrial production increased to -3.1% y-o-y, from -1.2% in December. Exports recorded a negative rise by -10.2% in January, for the first time since October 2009.

Rating MACEDONIA

- (Moody's)	BB (stable) (S&P)	BB+ (stable) (Fitch)
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Economic activity slowed down in Macedonia in 2011 Q4, faster than expected. The real GDP grew 0.2%, compared to the central bank's projection of 0.7% (and 2.3% in 2011 Q3). The decline in industry sector provided the main contribution to this slowdown. Real GDP growth dropped to 3%, throughout the year 2011 (from 1.8% in the previous year) backed by investments and private consumption. Net exports were negative upon the domestic demand

pressure, being reflected on high imports. Current account improved and accounted for -2.8% of the GDP in 2011 (from -12.8% in 2008). Depending considerably on energy imports, trade deficit was totally covered by unusual inflows of private transfers in 2011 Q4.

The beginning of 2012, suggests a slow economic growth, followed by uncertainties arising from the external environment. The worsening of European debt crisis is expected to be factorised on the lowering of the foreign demand. First indicators show falling industrial production, exports and imports, whose performance led to the narrowing of trade deficit in January-February

Rating ROMANIA		
Baa3 (stable) (Moody's)	BB+ (stable) (S&P)	BBB-(stable) (Fitch)

Romania's economy grew 1.9% in 2011 Q4, about 2.5 percentage points lower than in 2011 Q3, ranking sixth among EU member countries. The construction and agriculture sectors provided the main contribution to the GDP growth during this quarter. In terms of demand components, private consumption contributed positively, while public consumption and foreign demand contributed negatively. The country's economy grew 2.5% in 2011, mainly driven by the considerable increase in agriculture. Both foreign and domestic demand have been climbing compared to the year 2010, and affected the improvement of current account for the year. In the financial account FDIs fell considerably as their net share covered 33.8% of the current account in 2011, compared to 40.5% in 2010. They are offset by the investments in portfolio due to the public debt issuance in the international market.

Romania's economy is expected to slow down during the current year, due to lower exports and the high base of the increase in agricultural production in 2011. Industrial production recorded an annual growth of 1.2% in January, from 11.8% in the same period in the previous year.

Rating SERBIA		
Not-estimated (Moody's)	BB (stable) (S&P)	BB- (stable) (Fitch)

Economic activity in Serbia dropped across the quarters. In real annual terms, it rose 0.4% in 2011 Q4, compared to 0.7% in 2011 Q3. The domestic demand, in particular investments, provided the main contribution to quarterly growth. Net exports were negative due to the faster increase in imports. In 2011, economic activity grew 1.6%, almost the same as in the previous year. The central bank's (and IMF's) expectations regarding economic developments in 2012 suggest a reduction of economic activity. Indirect data for the first two months of 2012 show this fact. Industrial production fell by 12.8%. Partially, this fall is attributable to the unfavourable conditions of weather and the unsteady energy supply for the industrial producers.

Rating TURKEY		
Ba2 (Moody's)	BB (positive) (S&P)	BB+ (stable) (Fitch)

Data regarding the fourth quarter show that economic growth in Turkey maintained sound parameters. GDP growth in 2011 Q4 resulted 5.2%, from 8.4% in 2011 Q3. Services trended up, whilst construction slowed down its upsurge. The tight monetary policy that started in October and the negative sentiments arising from the external environment affected the decelerated economic growth. They reduced private consumption and investments, whereas public expenses declined in Q4. Net exports provided a positive contribution, as Turkey diversified the countries where it exports to, and the Turkish lira depreciated. Economic growth resulted 8.5% in 2011, compared to 9.2% in 2010, mainly triggered by the domestic demand.

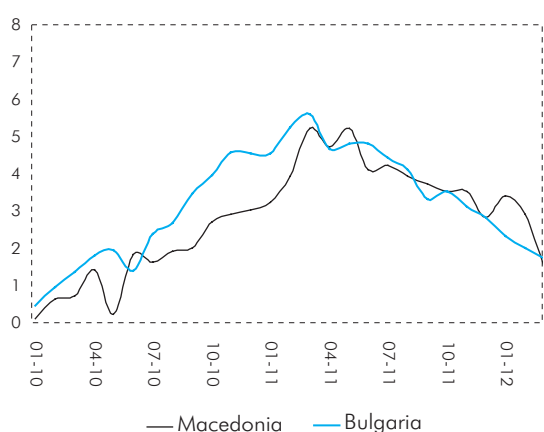
Meanwhile, domestic demand slowed down in the beginning of 2012. Sales in the first two months fell, whereas consumer credit increased at weak paces. Confidence indicators improved in February, and those of businesses do not reveal slowdown of investments, suggesting an expected improved aggregate demand in the second quarter. Exports increased at stable paces, although uncertainties concerning economic growth worldwide jeopardise their positive performance, notwithstanding the competitive level of Turkish products.

3.2 Inflation and monetary policy

According to available data, inflation in Macedonia trended down in the first months of 2012, in line with the central bank's projections. In March, annual inflation, dropped to 1.4%. The performance of macroeconomic indicators provided a favourable environment to implement the monetary policy. The central bank continued to purchase foreign currency in the market, thus increasing the foreign reserve above the forecasted rate and contributing to the improvement of the country' external position.

The economic slowdown in Bulgaria is reflected on low inflation rates in 2012. The average annual inflation rate was 2.0% in 2012 Q1, from 3.1% in 2011 Q3. In March, this indicator descended at 1.4%. The rise in oil price in international market being transmitted to the transportation costs has been faded - out by the seasonal drop in vegetable prices in March.

Chart 7 Annual inflation rate



Source: Respective central banks

Table 2 Key interest rate and use of instruments in the CEE and SEE economies

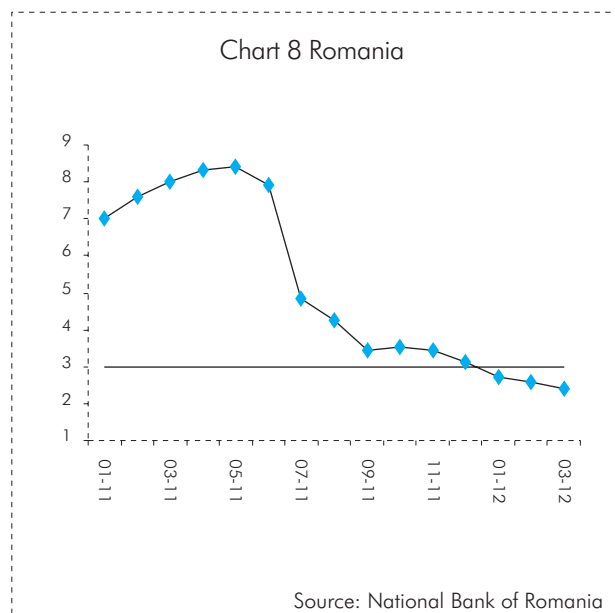
	Czech Republic	Poland	Hungary	Romania	Serbia	Turkey
Inflation target	2.0% (\pm 1%),	2.5% (\pm 1%)	3.0%	3.0% (\pm 1%)	4.4% (\pm 1.5%)	5.0% (\pm 2%)
Latest meetings and key interest rate changes	02.02.12 (0.00)	21.02.12 (0.00)	28.02.12 (0.00)	02.02.12 (-0.25)	19.01.12 (-0.25)	27.03.11 (0.00)
	29.03.12 (0.00)	20.03.12 (0.00)	27.03.12 (0.00)	30.03.12 (-0.25)	12.04.12 (0.00)	18.04.12 (0.00)
Actual interest rate	0.75%	4.50%	7.0%	5.25%	9.50%	5.75%
Latest inflation rate ¹	3.8%	4.4%	5.5%	2.40%	3.2%	10.4%
Scheduled MPC meetings	03.05.12	24.04.12	24.04.12	02.05.12	10.05.12	29.05.12
	28.06.12	22.05.12	29.05.12	27.06.12	07.06.12	21.06.12
Future releases	May (Inflation Report)	June (Inflation Report)	June (Inflation Report)	May (Inflation Report)	May (Inflation Report)	May (Inflation Report)

Source: Respective central banks.

¹ March 2012.

Inflation trended down to historical rates in Romania triggered by the implementation of the economic and financial programme under the EU and IMF Agreement. Maintaining monetary parameters, fading-out of VAT increase effect and favourable developments in foods prices drove the quick drop of inflation. Since January, annual inflation rate has been below the central bank's target band of 3.0% - declining to 2.4% in March.

The National Bank of Romania cut the key interest rate from 6.25% to 6.00% in November, for the first time after 18 months, signalling the start of an eased cycle. In January and February, the interest rate dropped again settling at 5.50%. Risks on inflation have been declining given that the output gap continues to be negative and lending to the economy is sluggish. The central bank projects a temporary increase of inflation in the second half of the year, due to the comparative base; but not at worrying levels to meet the target. In the light of these estimations, the key rate has been cut once again in March, by 0.25 percentage points. To boost lending, the central bank has relaxed the demands for collateral in its open market operations.

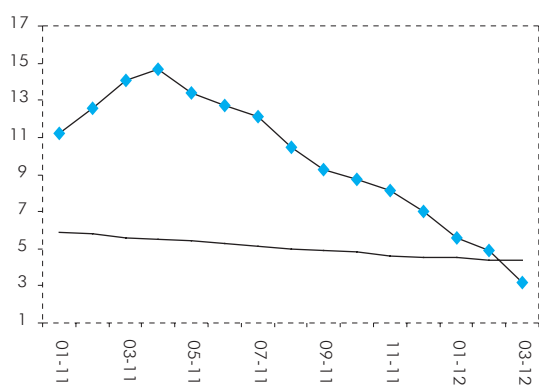


As at the end of 2011, inflation in Serbia resulted somewhat lower than expected by the central bank, due to some methodological changes in its calculation. Given the projections on low inflation rates during 2012, in part due to the base effect, the economy slowdown and the external financial uncertainties, the central bank cut the key interest rate by 0.25 percentage points in January. Inflation rate continued to decline in the first three months of the year, pointing to 3.2% in March (below the target). According to the central bank, inflation will result close the target in the second half of the year, suggesting that the key interest rate will not change. This decision is backed also by the depreciation of the Serbian dinar at the beginning of year. The central bank has not hesitated to intervene in

the market to defend the domestic currency. Inflation-associated risks mainly relate to the fiscal developments (Serbia is holding the parliamentary elections in May), and international markets developments. Due to the fiscal risks, the IMF has temporarily frozen the financial agreement with Serbia, which may have transmitted negative signals to the markets for the financing of the country. On the other side, the granting of the candidate status to join the EU, may impact positively the tendencies in capital movement.

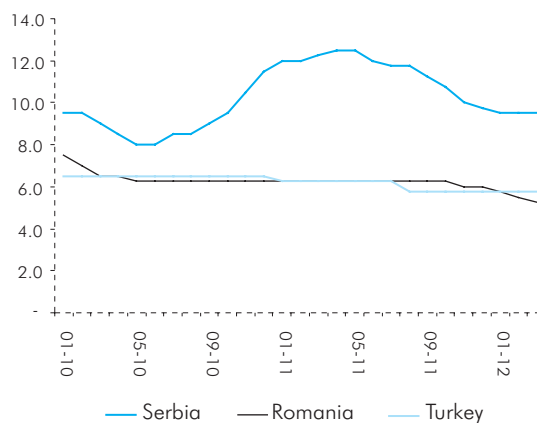
Inflation rates in Turkey remained high in 2012 Q1. Energy and oil prices are the main contributors to inflation formation. Their performance is balanced by the fall in food prices, which is expected to continue in the quarter ahead as well. Annual inflation rate pointed to 10.43%, colse to the quarter average, 10.49%.

Chart 9 Serbia



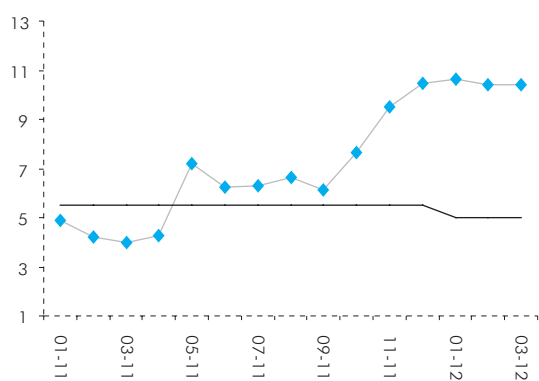
Source: National Bank of Serbia

Chart 10 Key rate



Source: Respective central banks

Chart 11 Turkey



Source: Central Bank of the Republic of Turkey

Domestic demand triggered economic growth, which coupled with the depreciation of the Turkish lira and led to price increase. In this view, the central bank stated a tightening of monetary conditions. According to the central bank, an increase in oil and energy prices, which may lift product costs and deviate inflationary expectations, is one of factors that will direct the further tightening of monetary conditions. The key interest rate remained unchanged (5.75%), whereas other instruments on liquidity tightening were used. In the meeting of March, the central bank narrowed the limits on repo auctions for injecting liquidity and implemented eased measures on the required reserve to partially reduce their effect⁶.

⁶ The upper limit of lira required reserve held in gold was raised from 10% to 20%.

ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY 2011 Q4

MERITA BOKA

MONETARY POLICY DEPARTMENT, APRIL 2012

1. BALANCE OF PAYMENTS HIGHLIGHTS¹

The external position of the Albanian economy during 2011 was under the constant impact of the global macroeconomic developments, and particularly of those in the euro area. GDP growth deceleration, worsening employment situation and sluggish foreign demand led to significant moderation of merchandise exports' growth rate and decline in services' exports during 2011. The recovery of domestic demand and visa liberalisation for Albanian citizens travelling to the Schengen area contributed to the increase in the imports of goods and services mainly during the second half of 2011. On the other hand, the improvement in the income and current transfers account contributed positively to the current account, though not enough to offset the negative effect of the goods and services account. As a result of foreign currency flows in these accounts, the current account balance recorded a deficit of EUR 1 145.4 million, about 12.5% higher than in 2010. The currency account deficit for 2011 was estimated at about 12.2% of nominal GDP² or about 0.9 percentage points higher than in 2010. Foreign inflows into the capital and financial account amounted to about EUR 921.2 million, up by about 5.6% y-o-y. The surplus in the capital and financial account during 2011 financed about 80.4% of the current account deficit of this period.

Table 1 Balance of Payments Items

	2007	2008	2009	2010	2011
Current Account (EUR million)	-824.2	-1381.2	-1329.8	-1018.6	-1145.4
/ y-o-y	75.0%	67.6%	-3.7%	-23.4%	12.5%
/ GDP	-10.5%	-15.6%	-15.3%	-11.3%	-12.1%
Trade Balance	-2,104.0	-2,431.5	-2,303.7	-2,082.7	-2,241.6
Exports, f.o.b.	786.3	917.5	750.7	1,171.5	1,405.5
Imports, f.o.b.	-2,890.4	-3,348.9	-3,054.4	-3,254.2	-3,647.1
Services Balance	18.9	69.4	173.9	231.8	134.6
Credit	1421.3	1687.8	1771.4	1750.7	1747.4
Debit	-1402.3	-1618.3	-1597.5	-1518.8	-1612.7
Travel - net	79.0	112.1	167.5	194.9	47.9
Income Balance	218.0	44.0	-137.9	-90.1	24.2
Credit	281.7	321.1	269.4	286.3	231.5
Debit	-63.7	-277.1	-407.3	-376.4	-207.3
FDI Income - net	7.5	-174.1	-289.3	-273.2	-52.6
Current Transfers	1042.9	936.8	937.9	922.4	937.3
Credit	1219.8	1117.4	1096.2	1076.6	1050.3

¹ The latest balance of payments data refer to the last quarter of 2011. Balance of payments' data on 2010 have also been revised.

² INSTAT's release of nominal GDP for 2003-10. Bank of Albania, Monetary Policy Department's projections for GDP in 2011.

Debit	-176.9	-180.5	-158.3	-154.2	-113.0
Workers' remittances - net	951.7	833.3	781.3	689.8	687.9
Capital and Financial Account (EUR million)	787.9	1621.0	1022.2	872.1	921.2
/ y-o-y	41.1%	105.7%	-36.9%	-14.7%	5.6%
/ GDP	10.1%	18.3%	11.7%	9.7%	9.8%
Capital Account	90.1	78.2	84.9	85.5	84.9
Financial Account	697.8	1542.8	937.3	786.6	836.3
A. Liabilities	756.9	1433.0	900.2	1061.9	1241.4
FDI	481.1	665.2	716.9	793.3	741.9
Portfolio Investment	42.3	38.9	-2.7	316.3	15.9
Other Investment	233.4	728.9	186.0	-47.8	483.6
B. Assets	-59.1	109.8	37.2	-275.3	-405.0
FDI	-17.5	-55.4	-28.2	-4.8	-30.1
Portfolio Investment	19.1	-63.5	15.4	-84.2	-98.4
Other Investment	-60.7	228.7	50.0	-186.3	-276.5
FDI (net)	463.7	609.8	688.7	788.5	711.8
Portfolio Investment (net)	61.4	-24.6	12.7	232.1	-82.5
Other Investment (net)	172.7	957.7	235.9	-234.1	207.1
Errors and Omissions	131.2	-18.7	272.0	325.4	195.5
Reserve Assets	-148.6	-191.9	32.0	-179.0	28.6

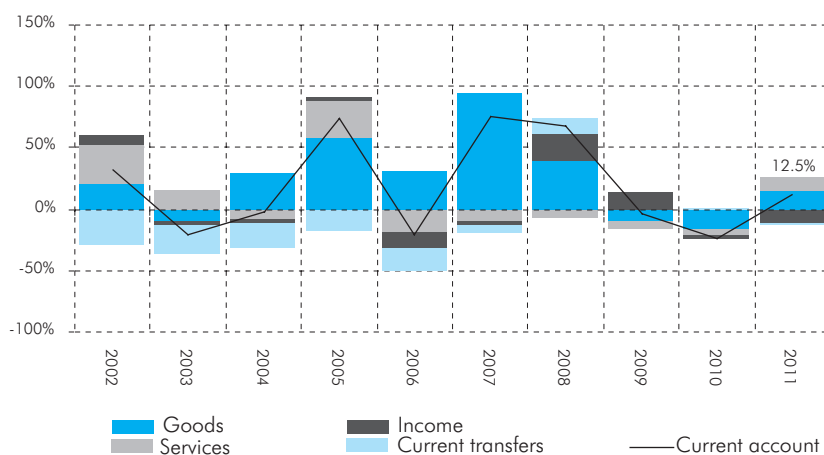
Source: Bank of Albania.

1.1 Current account

Albania's net current account balance recorded a deficit of EUR 1 145.4 million in 2011. After narrowing down in the previous two years, the current account deficit widened by nearly 12.5% y-o-y in 2011, hence slightly aggravating its sustainability. As a percentage of nominal GDP, it was estimated at 12.1% or about 0.8 percentage points higher than in 2010.

The dynamics of the current account in 2011 were broadly determined by the performance of net exports and income account. The narrowing of the net exports deficit in 2010 by about 13.1% y-o-y contributed significantly to the adjustment of the Albanian current account deficit. Similarly, but conversely, the widening of the net exports deficit by about 13.8% y-o-y in 2011 was the main determinant of the current account deficit widening. On the other hand, the shift from deficit to net surplus in the income account provided substantial

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

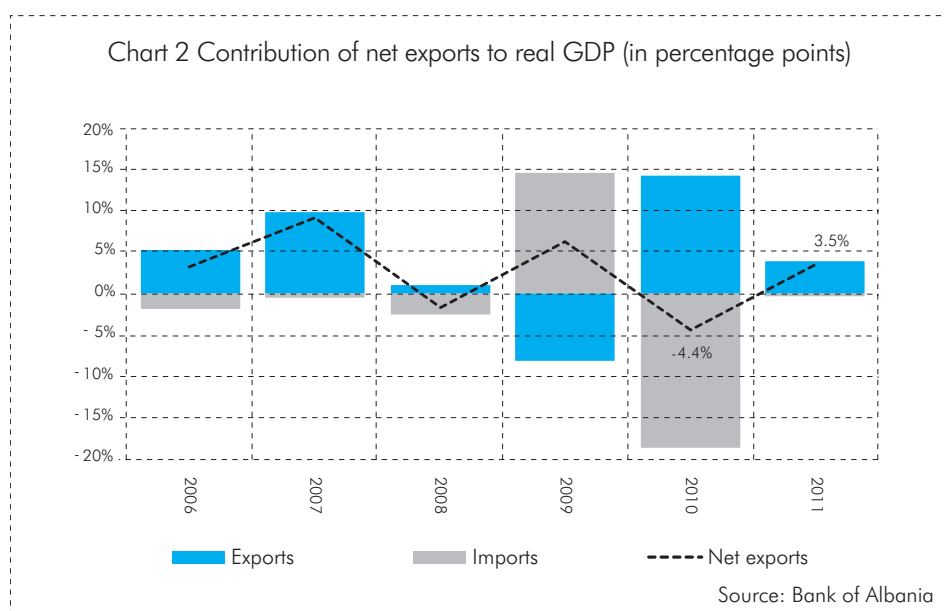


Source: Bank of Albania

positive contribution to the annual performance of the current account. The current transfers account registered a slightly higher figure than in the previous year. Workers' remittances, however, fell more slowly over 2011.

As a result of trade flows in goods and services, the degree of Albania's economic openness stood at 89.6% in 2011, 4.3 percentage points higher than in 2010.

The performance of external sector indicators in real terms provides evidence for the narrowing of the net exports deficit³ in 2011 compared to the previous year, as a result of the higher exports of goods and services in real terms by about 10.5% y-o-y. Developments in the import and export of goods and services in real terms materialised into a positive contribution of this component to aggregate demand growth over this period.

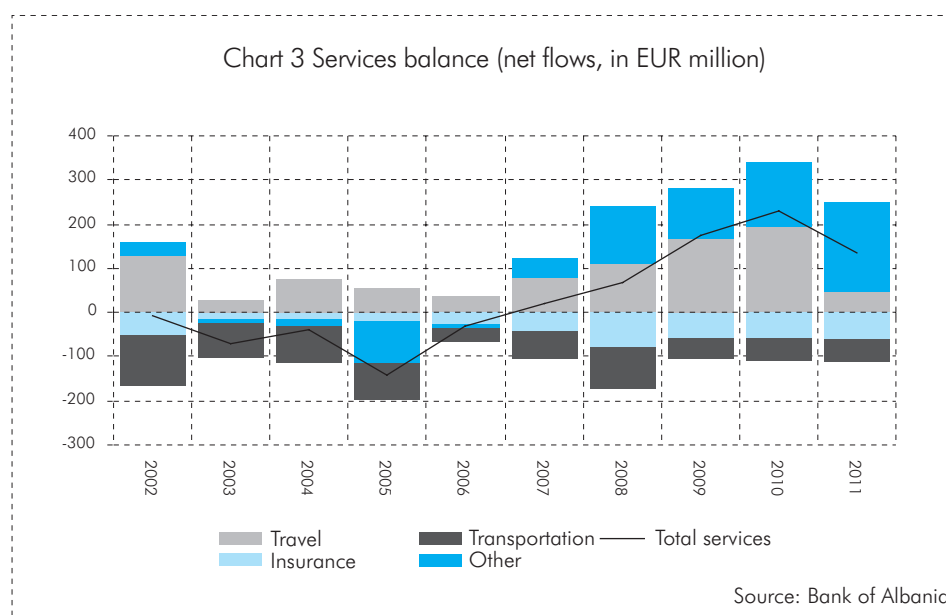


The increase in financial flows from the combined net position of the income, current transfers and services accounts moderated to about 3.0% in 2011 from 9.3% in 2010. Consequently, the net flows of these three accounts financed altogether about 48.9% of the trade deficit registered in 2011, which is about 2.2 percentage points lower than in 2010.

The net balance of the services account yielded a surplus of EUR 134.6 million in 2011, down by about 41.9% from 2010. The developments in this current account item seem to have been affected by the visa-free regime for Albanian citizens travelling to the Schengen area. The decline in foreign flows in the services account was more considerable in the second and third quarters of 2011, a period that corresponds to the summer tourism season. Consequently, the surplus of the net balance of the travel services (personal and business) account dropped in 2011 by about 75.4% y-o-y. The surplus

³ In order to derive the real terms of imports and exports of goods from the nominal terms, we use the Unit Value Index obtained from foreign trade volume data. For imports and exports of services, we use the Consumer Price Index of services as measured by the Bank of Albania.

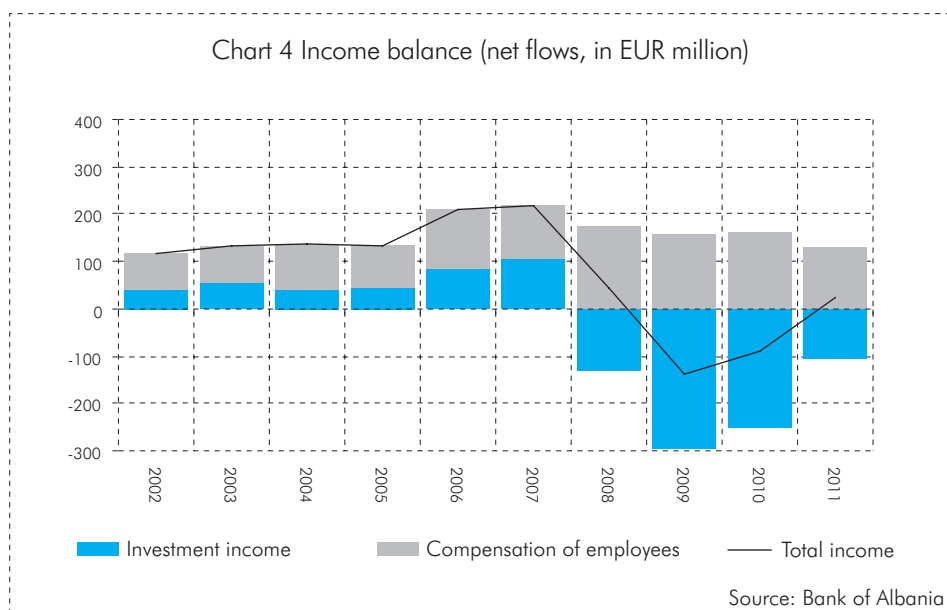
was mainly narrowed down due to higher travel services spending of Albanian residents abroad for tourism and business purposes by about 8.7% y-o-y. In the meantime, foreign inflows from personal travel services of non-residents fell by about -4.7% over the period under review. Other services (which include communication, construction, governmental, financial, computer and information services) registered a positive balance of EUR 200.1 million, up by about 37.4% y-o-y, hence contributing positively to the total services' account balance. On the other hand, the negative balance of transportation services and insurance services continued to contribute negatively to the total services' balance for 2011.



Against a background of high perceived risk, the income balance has since 2009 registered continuous deterioration, driven mostly by the accelerated increase in investment profit repatriation. In 2011, this account balance marked a shift in the tendency from a net deficit of about EUR 90.1 million to a surplus of about EUR 24.2 million, due to the lower outflows of total income by about 44.9% y-o-y.

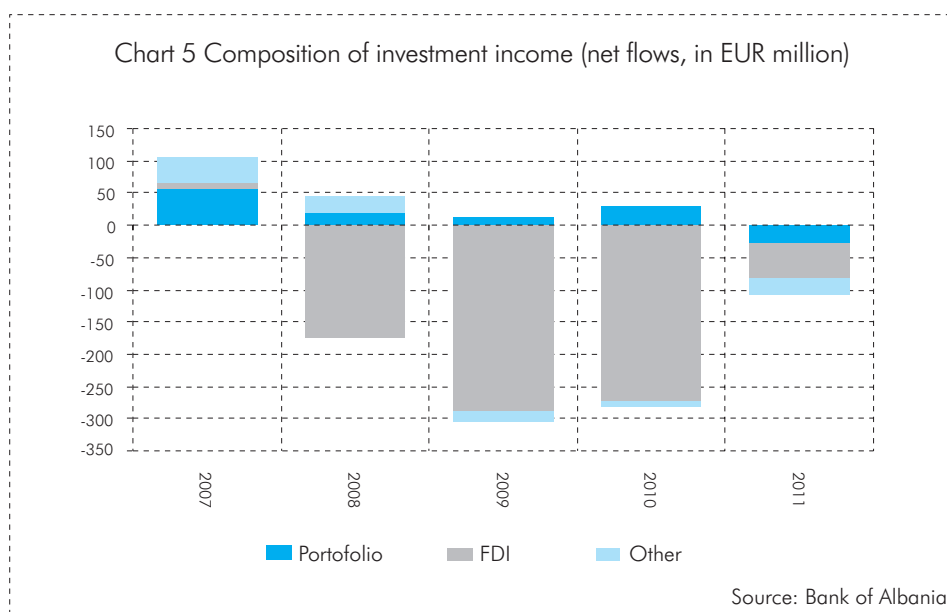
Income account balance improved significantly y-o-y as a result of lower outflows, mainly those of foreign direct investment-related income by about 71.8% y-o-y. Given the difficult situation facing the European countries, and particularly Italy and Greece⁴, the re-investment of earnings in the country may have been considered more attractive than its repatriation to the country of origin. Unlike in 2010, the balance of portfolio investment income registered a deficit of EUR 28.0 million in 2011. This is the first time, since 2007, that this sub-item of investment income registers a negative figure. Income from other net investment continued to record negative figures for the third consecutive year, mainly due to the higher net interest payments on public and private debt. This sub-item of the investment income account registered a deficit of about EUR 26.0 million in 2011 compared to EUR 9.3 million in 2010. Net

⁴ Based on 2010 data, EU countries account for about 67.3% of the foreign direct investment stock. Greece and Italy are ranked the top two countries in terms of total investment stock.



interest payments on public and private debt over the period under review have lowered Albania's liabilities by about EUR 86.6 million, while foreign inflows into this sub-item registered a slight decline by about 1.9% y-o-y.

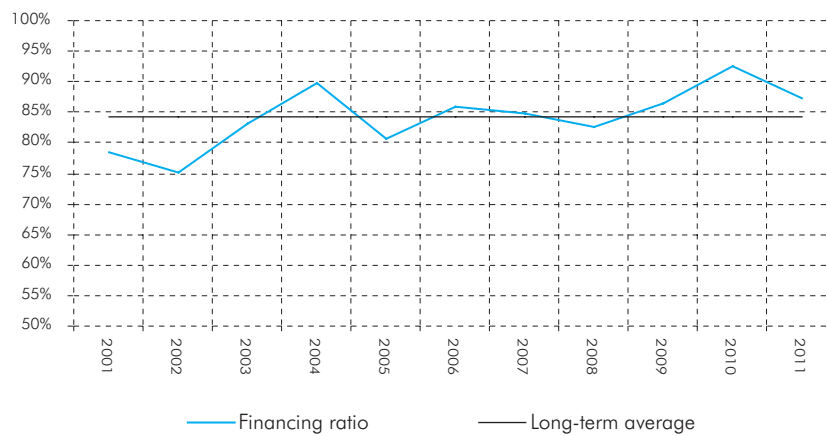
Foreign inflows of net labour income, albeit lower than in 2010, contributed to reducing the net negative position of the account under review.



After narrowing down by about 1.6% in 2010, current transfers account surplus increased by about 1.6% y-o-y in 2011, driven by the sharp decline in financial outflows.

Public sector's net transfers fell by about 53.9% in 2011, while other sectors' net transfers increased by about 4.5% y-o-y. Due to the labour market constraints in the countries with the highest concentration of emigrants and the cyclical

Chart 6 Financing ratio of imports of goods from the sum of exports, remittances and FDI



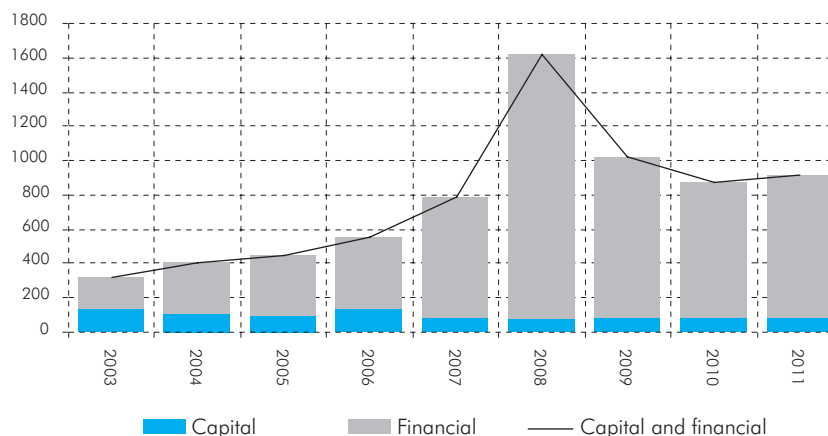
Source: Bank of Albania

factors, net workers' remittances maintained the annual downtrend that has begun since 2007, albeit at more moderate rates. Remittance inflows fell by about 0.5% y-o-y. The ratio of remittances to trade deficit was estimated at 30.9% in 2011, about 2.5 percentage points lower than in 2010.

1.2 Capital and financial account

Financial transactions amounted to about EUR 836.3 million in 2011. As a percentage of nominal GDP, they were estimated at about 8.9%. After registering a constant annual decline in the previous two years, financial flows increased by about 6.3% y-o-y in 2011. Residents' financial liabilities to non-residents increased by about EUR 1241.4 million in 2011 or 16.9% compared to 2010. In addition, our assets invested in non-resident economies

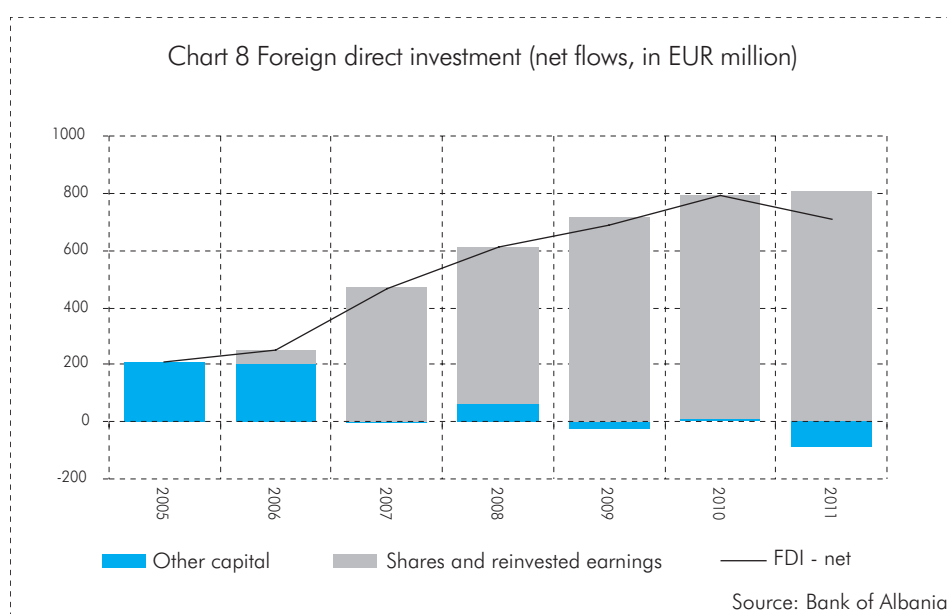
Chart 7 Capital and financial account (net flows, in EUR million)



Source: Bank of Albania

over the year under review amounted to about EUR 405.0 million, about 47.1% higher than in 2010. The largest part of financial inflows (liabilities) was in the form of foreign direct investment and other investments, with the public and private borrowing playing the main role. Concerning financial outflows (assets), other investments, currency and deposits of the Albanian banking system placed abroad played the major role. Due to financial flow movements in financial assets and liabilities, the degree of Albania's financial openness reached 17.5%, up by about 2.7 percentage points from 2010.

Net foreign direct investment (inflows – outflows) amounted to EUR 711.8 million in 2011, or about 9.7% lower than in 2010. As a percentage of nominal GDP, they were estimated at about 7.6%, down 1.2 percentage points from 2010. Based on the investment instrument, the annual analysis of (net) foreign direct investment dynamics in Albania provides evidence for an important role of financial outflows in the form of other direct investment capital.⁵ Net debt transactions between related enterprises increased in 2011 and amounted to about EUR 92.3 million, being mainly concentrated in the first and third quarters of 2011. Net foreign direct investment flows in the form of shares and reinvested earnings amounted to about EUR 804.1 million or 2.9% more than in 2010.

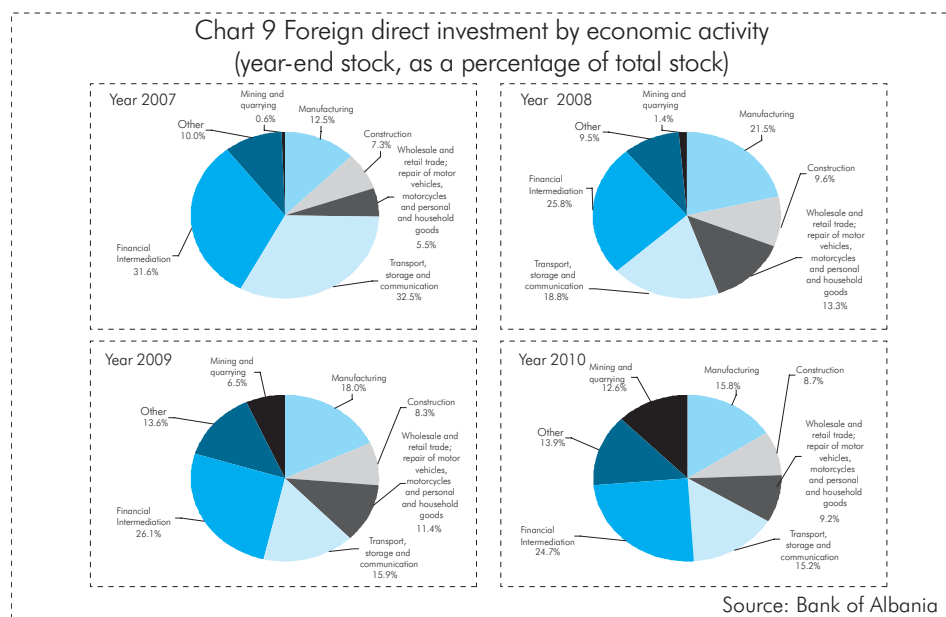


Excluding privatisation receipts, foreign direct investment inflows were about 6.5% lower than in 2010. Privatisation receipts have provided a modest contribution to FDI growth in Albania in the last two years.

⁵ Other direct investment capital covers the borrowing and lending of funds, including debt securities and trade credits between direct investors and direct investment enterprises and between two direct investment enterprises that share the same direct investor.

FDI STOCK BY ECONOMIC ACTIVITY AND COUNTRY⁶

Despite being under the pressure of the economic and financial crisis that swept across the international markets, foreign direct investment (FDI) stock in Albania has increased at progressive rates over the last three years (2008, 2009 and 2010). As at the end of 2010, the FDI stock amounted to about EUR 2,639.9 million or about 18.2% higher than in 2009. Developments in the FDI stock in Albania reflect foreign investors' preference to invest in Albania due to the lower producer prices and potentially higher profit margin.



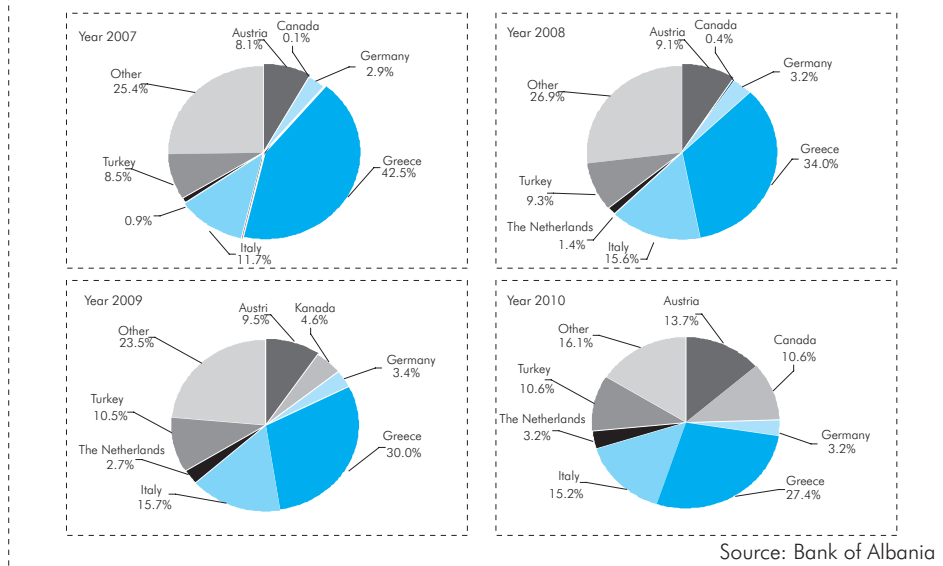
Broken down by economic activity, investments in the services sector show high concentration. This fact also seems to relate to the privatisations taking place in this sector over the course of years. The latest data show that "Monetary and financial intermediation"⁷ and "Transportation, storage and communication"⁸ have been the most attractive sectors and have absorbed the largest portion of FDI. In 2007, about 64.1% of total FDI was almost equally allocated to these two sectors. With the passing of years, their share in total FDI stock has lowered to the benefit of other sectors of the economy. In 2010, these two sectors accounted for about 39.9% of total FDI stock. The lower FDI concentration in these two sectors and the higher share of FDI in the other sectors of the economy over the course of years provides evidence for better investment portfolio diversification and multidimensional orientation. For instance, the share of "Extractive industry" increased considerably to about 12.6% in 2010, compared to 0.6% in 2007. Energy mineral extraction industry had the main share in this sector, particularly in 2010. Other sectors of the economy, such as processing industry; production and supply of electricity, gas, steam and hot water; health and other social activities have gained ground over the course of four years. By contrast, available data show that the share of hotels and restaurants in total FDI stock fell progressively over 2007-10

⁶ The latest data on foreign direct investment stock by country and economic activity refer to 2010.

⁷ "Monetary and financial intermediation other than insurance activities and pension funds" has the largest share of the FDI in this sector.

⁸ "Post and communication" has the largest share of the FDI in this sector.

Chart 10 Foreign direct investment by country (year-end stock, as a percentage of total stock)



The distribution of FDI stock by country of origin shows significant concentration of investments of Greek and Italian origin in Albania as a percentage of total FDI stock.

In 2007, investments of Greek origin accounted for about 42.5% of total FDI stock in Albania. Investments of Italian origin were ranked the second, sharing about 11.7% over the same stated period. Once the economic and financial crisis burst out and the Greek debt crisis intensified, the share of Greek investments in total FDI stock declined at progressive rates. From 2007 to 2010, the share of Greek investments fell by about 15.1 percentage points to about 27.4% of total FDI stock. On the other hand, after increasing their share by about 3.8 percentage points in 2008, investments of Italian origin maintained almost a similar share until 2010 (on average 15.5% during 2008-10). In 2007, the largest three investors in terms of the FDI stock⁹ accounted for about 62.3% of total stock. These three countries' concentration in FDI stock lowered during 2008-10 to the benefit of other countries. Hence, despite the lower share of FDI from Greece in total stock, the latter continued to increase in Albania. This increase may reflect the re-orientation of foreign investors towards the Albanian market. Consequently, the attraction of potential investors from other countries may minimize the Greek sovereign debt crisis effects on capital inflows to Albania.

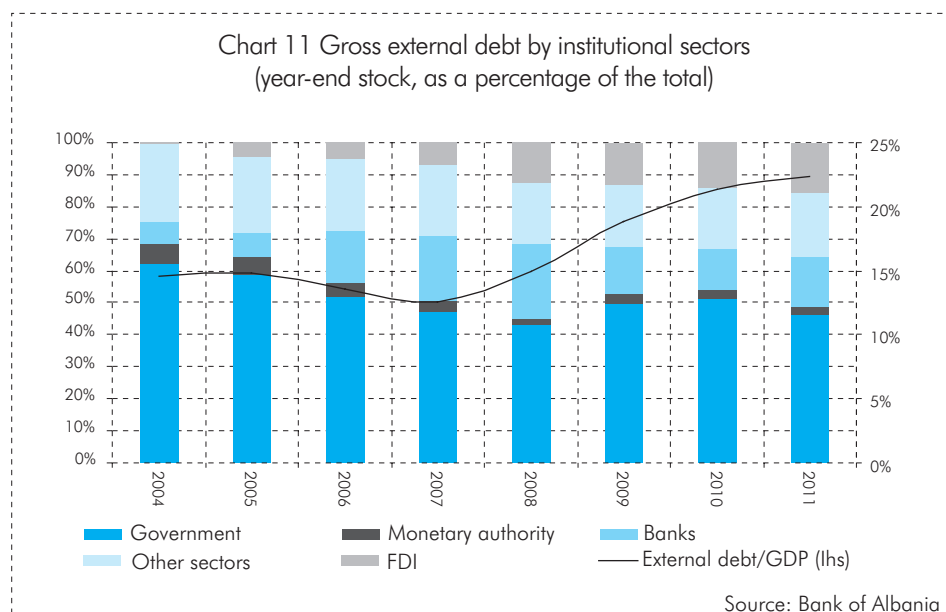
Net portfolio investment for 2011 increased domestic assets invested in foreign economies (residents' claims on non-residents) by about EUR 82.5 million. Due to the issue of the Eurobond in the international markets, in 2010, net portfolio investment increased Albania's liabilities by about EUR 232.1 million. Developments in this financial account item over 2011 were determined by the increase in portfolio investment outflows to foreign economies by about EUR 98.4 million. As in the previous years, residents have mainly chosen to invest in debt securities.

⁹ Greece, Italy and Austria.

Other investment account, net, registered a positive balance, contributing to the increase in residents' liabilities to non-residents by about EUR 207.1 million in 2011. This year marked a turn in position from creditor in 2010¹⁰ to debtor in 2011. The direction of financial flows in this account was determined by the increase in domestic liabilities by about EUR 483.6 million, mainly due to the higher public and private borrowing. The latter amounted to about EUR 238.9 million in 2011. Public and private withdrawals totalled EUR 370.0 million over the stated period, while debt (principal) payments lowered domestic liabilities by about EUR 131.1 million. Currency and deposits marked significant developments in 2011. Non-resident banking system investments in Albania recorded sharp growth compared to 2010. In addition, due to the improved liquidity situation in the Albanian banking system, non-resident investments in the form of currency and deposits increased by about 28.8% compared to 2010. On net basis, currency and deposits contributed to the increase in domestic liabilities to non-residents by about EUR 71.7 million.

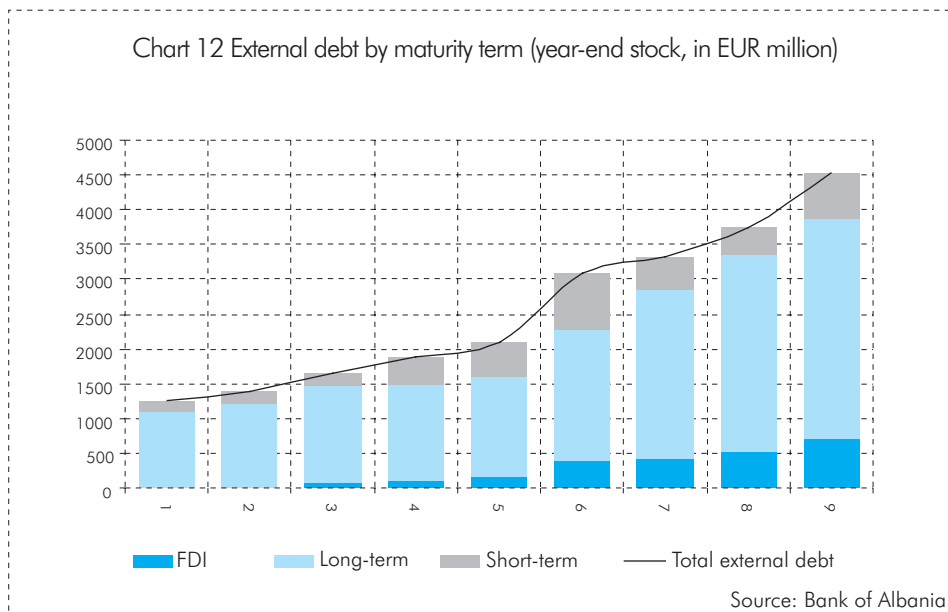
1.3 Gross External Debt

As at the end of the last quarter of 2011, Albania's gross external debt stock totalled EUR 4,533.9 million, up by about EUR 132.2 million from the third quarter of 2011 and EUR 783.4 million from the last quarter of 2010.

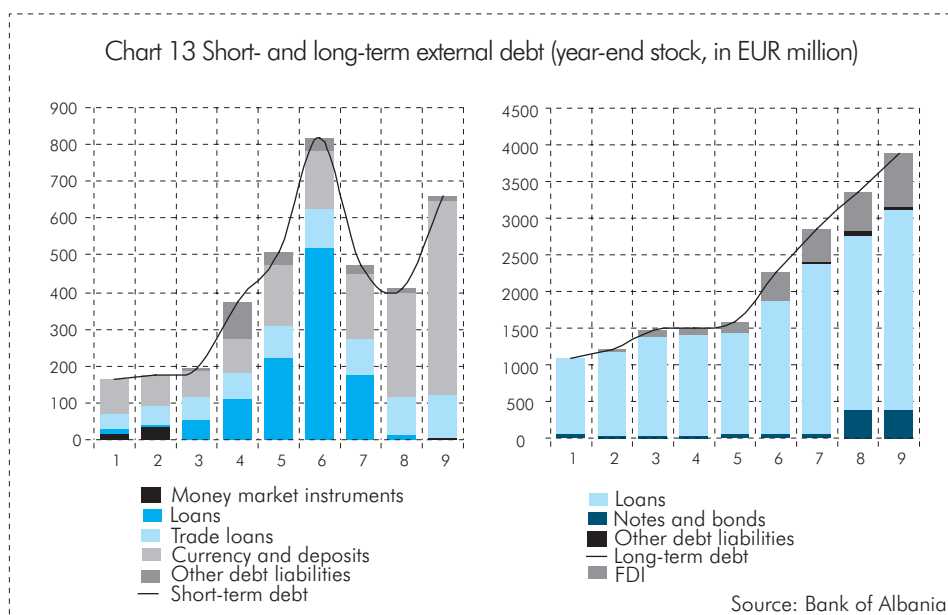


For the most part, the higher debt stock at end-2011 compared to end-2010 was mainly triggered by the increase in banking system borrowing and foreign direct investment – intercompany loans. Broken down by institutional sectors, as at end-2011, general government's share in total debt stock was about 46.3%. The remainder of debt has been allocated to other sectors (19.8%), banks (16.0%), foreign direct investment – intercompany loans (15.7%) and monetary authority (2.2%).

¹⁰ In 2010, other investment, net, amounted to EUR -234.1 million (EUR 234 million were domestic claims on non-residents). The negative sign implies a creditor position or a higher level of other investment outflows (resident investment in non-resident economies).



About 82.7% of the debt stock (excluding direct investment – intercompany loans) accounted for long-term debt, mainly in the form of loans. For the period under review, short-term debt accounted for about 17.3% and was mainly in the form of banking sector currency and deposits.



International reserves fell by about EUR 28.6 million in 2011. At the end of December 2011, the stock of international reserves totalled EUR 1,912.0, sufficient to cover 4.4 months of imports of goods and services.

RESEARCH PAPERS*

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

CONSTRUCTING A COMPOSITE LEADING INDICATOR FOR ALBANIA

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ABSTRACT

In the decision-making process of monetary policy, it is very important to assess the current economic situation and its developments. In the process of analysing economic developments, several indicators are taken in consideration, paying particular attention to the indicators with leading properties. Since the interpretation of the information provided by a large number of indicators is difficult, we have summarised the ones with leading properties and constructed a Composite Leading Indicator, based on OECD and the most developed European central banks methodologies.

I. INTRODUCTION

Cyclical performance of economies, particularly in turbulent times, has encouraged economists and researchers to search for the early signals of turning points in economies, between slowdown and acceleration phases of the economic activity. The application of proxy indicators to predict fluctuations of business cycles has always raised considerable interest in the economic literature. Among all indicators, composite leading indicators (CLI) are of particular interest, as they have improved the predictive power of business cycles. CLIs are also very useful in analysis and communication with public. Given these advantages, CLIs are developed almost worldwide.

CLI is an aggregate indicator, statistically important to analyse and predict macro-economic indicators of reference series.¹ It provides qualitative and/or quantitative information on the possible performance of reference series by one or two times in advance. The reference series should be a broadly accepted indicator that approximates the economic performance of a country.

The first attempt to explain the cyclical movements of economic activity based on a set of indicators dates back to 1919². In the 1930s³ the composite indicators took the form of today's indicators used by NBER. The CLIs system developed by OECD is receiving particular attention nowadays.

The methods employed to construct CLI in OECD countries were originally developed in the 1970's to give early signals of turning points in economic activity. They can also be useful to signal the direction in economic activity.

¹ "System of composite leading indicators" OECD (2008).

² The indicator was called "Harvard Barometer" and was based in a system composed of 13 series.

³ "Business Cycle Indicator", Handbook, The Conference Board (2001)

The information obtained through these indicators is important for economists, businesses, and policy makers to improve the current analysis and make short-term forecasts of economic activity. CLI's helps economic analysis because it is easier to study one indicator than the trend of a large number of series.

The main purpose of this research is to construct a CLI given the lack of such an indicator in Albania. The leading nature of the indicator provides preliminary information on the economic activity performance.

The structure of the paper is as follows: The second section deals briefly with the cyclical theory of business, its concepts and definitions. Then we describe the concrete steps followed to construct the CLI for Albania, based on the definition of business cycles measured as a "deviation-from-trend". In the third section we will describe the construction of the CLI based on the definition of "growth rates" business cycles. This is a quantitative indicator used to predict the economic activity. The main difficulty we experienced during the construction of a leading indicator for the Albanian economy was the length of series and the regular revision of some of them.

II. CONSTRUCTING THE COMPOSITE LEADING INDICATOR FOR ALBANIA

The concept and measurement of business cycles has changed since its first definition by Burns and Mitchell in 1946, reflecting all the changes occurred at global economy over the years.⁴ The earliest definition of business is that of the "classical cycle". "Classical cycles" are repeated phases of expansion and contraction observed simultaneously in many economic and financial series. The increase and decrease in the absolute value of economic series are observed, in order to identify the classical cycle. In this case, the time series are analysed in the original form without the need of transforming them, by reducing their long-term trend. By analysing the increase/decrease in the absolute value of economic activity, this method does not make distinction of the pace of growth; According to this approach, there is no difference if during the expansion/contraction phase the economy is growing and/or slowing down at either quicker or slower paces. Due to the fluctuations of economic activity and to the need of detecting if the economy was growing at either quicker or slower paces, the definitions of "growth cycle" of business and the "deviation-from-trend" emerged. According to this approach, business cycles are defined as subsequent phases of growth and fall of the growth's deviation from its long-term trend.⁵ The "deviation-from-trend" approach does not study the economic series in their absolute value. With this method the series are transformed by eliminating their long term trend. The elimination of long-term trends is the most frequent criticism to this method, as it needs strong assumptions and may drive to different conclusions, depending on the selected detrending method. Due to these restrictions, researchers have developed the "growth rates" cycle, defined as regular increase and decrease

⁴ Business cycles were firstly defined by Burns and Mitchell in 1946. Currently, this definition is used by NBER to set out the turning points of economic activity.

⁵ This approach was broadly known in 1970s and is employed by OECD to study the business cycle of its member countries.

in the growth rates⁶ of economic activity. Leading indicators constructed by this method usually precede the turning points of indicators constructed upon the second method.

The literature summarises the advantages of using leading indicators in studying the economic behaviour, as follows:

1. Easily summarise a considerable number of time series into a single indicator, with a view to supporting decision-makers;
2. Are easy to interpret;
3. Can assess progress of countries over time, while being easily comparable to the indicators of the other countries;
4. Synthesise the information by removing some components of a series, without dropping the underlying information base;
5. Facilitate communication with the public and promote accountability.

The use of CLI, has encountered different criticisms. The construction and interpretation of composite indicators require a special attention. OECD manual define the disadvantages of using CLI, as follows:

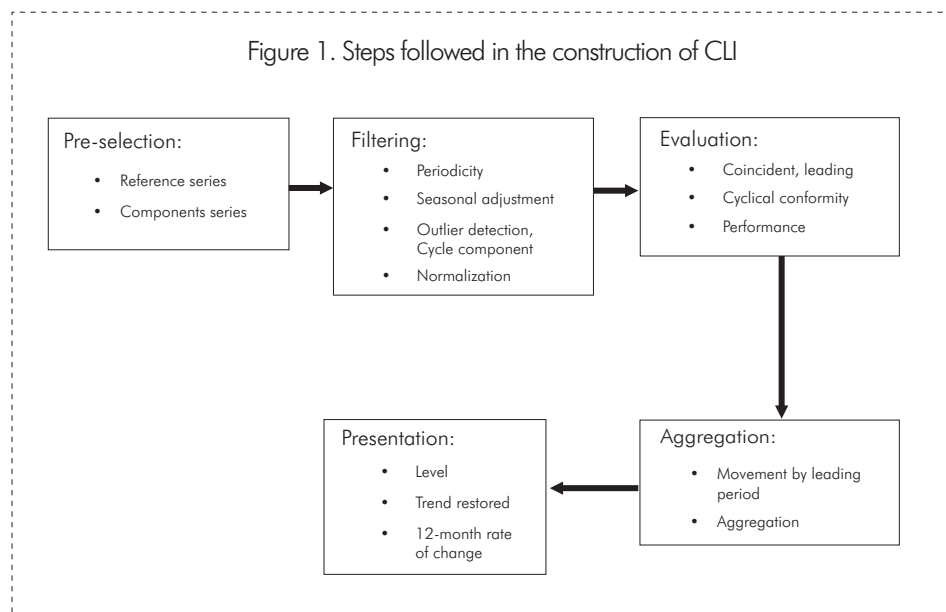
1. May drive to wrong decisions, if the indicator is wrongly calculated or the information provided is misinterpreted;
2. May lead to simplified conclusions on the economy performance;
3. May be misused, in particular if the construction is not transparent and lacks statistical and conceptual principles.

In order to be reliable, a leading indicator should have similar business cycle fluctuations to those of the reference series. Its relation to the reference series should be statistically important and sustainable, whereas the information provided may be used to forecast the upcoming movements in the reference series.

We have chosen to construct the leading indicators of the Albanian economy, based on the business cycle measured as "deviation-from-trend", as well as on the business cycle measured by "growth rates in economic activity". The first one shall provide qualitative forecasts (turning points), the second quantitative forecasts (growth rate). The methodological starting point for the construction of leading indicators is the CLI system of the OECD. The OECD mythology recommends the steps to be followed in the construction of CLI, as data transformation, selection of reference series, and selection of CLI component series. In addition, the OECD manual on the construction of composite leading indicators helps to interpret CLI performance.

The figure below shows the steps we followed to construct CLI:

⁶ This view of business cycle is currently used from ECRI (Economic Cycle Research Institute).



Reference series: Theory suggests that a reference series should be an indicator which represents the whole economy. We have chosen the quarterly real Gross Domestic Product (GDP) as a reference series. The GDP is considerably known and broadly accepted as the indicator which best represent the economic activity.

CLI component series: The study of a country' economic structure is the starting point in the selection process of possible series to be included in the CLI system. The economic analysis provides information on the main economic sectors and the factors to be considered when searching for the leading indicators of a country. We have considered time series with cyclical fluctuation similar to GDP cycles, which lead them or at least which are made available very soon after the period to which they refer. Broad indicators (which cover many fields) are preferred to specific indicators in the selection process. We have chosen the following criteria in the selection of the component series:

Frequency: we used quarterly series. Monthly series were converted to quarterly ones.

Revision: series that are not subject to revisions were preferred.

Publication: series made available very soon after the period to which they refer were preferred.

Length: reference series are available from 2001 Q1. This period is selected as the starting point of all selected series.

In the construction of the CLI for Albania, we included a wide range of indicators from real economy, monetary indicators, fiscal indicators and qualitative indicators derived from confidence survey indicators. Taking in consideration the strong impact of trade relationships and the synchronization of the Albanian economy to the trade partners in Europe, we decided to consider indicators of the European economic activity. The data sources of the considered time series are available from INSTAT, Bank of Albania and Eurostat database. Table 1 in the attached Annex lists all the indicators analysed during the first step of the construction of the CLI.

Filtering. All the time series are statistically manipulated in order to remove factors, which may obscure their cycle pattern. Initially, all series, excluding surveys indicators, were turned into real while using CPI and other deflators,⁷ hence the real GDP is employed as reference series. All monthly series are converted to a quarterly frequency. Series showing seasonal behaviour are seasonally adjusted.⁸

In order to obtain the cyclical component, all the series, including the reference one (real quarterly GDP seasonally adjusted from INSAT) went through the filtering and smoothing process. Filtering eliminates the long trend of series, whereas smoothing eliminates the short-term fluctuations or the irregular component. Depending on the employed method, these two processes can be performed in a single step (referred to as band-pass filters), or separated into distinct steps for trend removal and then irregular component removal. After testing both methods, we chose to apply Hodrick-Prescott (HP) filter in two steps, by modifying λ parameter (this parameter sets out the smoothing degree of a series), based on the method used by the OECD to construct the CLI. First, HP filter was applied without changing λ parameter⁹ in order to obtain only its long-term trend.¹⁰ The removal of the long-term fluctuations, provides a series which contain only the medium-term fluctuations (cyclical component) and the very short-term fluctuations, less than 1 year and a half (irregular component).

Second, we decreased the λ parameter in order to remove the irregular component and to maintain the trend¹¹. Finally, we obtained only the cyclical component of series. The two-step application of the HP filter is very similar to the implementation of a band-pass¹² filter.

Series are normalised providing that their long-term average is 100¹³ to make them comparable and proceed with the CLI construction process.

Evaluation. The cross-correlation analysis was used in order to detect the

⁷ Different deflators, depending on specific series are employed to return series into real terms. Thus, for a great number of series Consumer Price Index is used. The series of fuels and energy import and the import of machineries and equipment are excluded. The weighted average of oil price index and electrical energy index were employed to deflate the first series. The selection of weights was based on import data detailed by foreign trade data. The second series was deflated by employing Industrial Material Index, IMF.

⁸ Census XII additive was employed for seasonal adjustment.

⁹ λ parameter suggested from Eviews to obtain the long-term trend of time series (series fluctuation higher than 8 years) of quarterly frequency is 1600.

¹⁰ Identification of real GDP long-term suggests for a more accelerated growth during 2003-2008 and a slowdown of increasing rates in 2008-2011. Average annual GDP rate growth for these two periods is 5.6% and 4.0%, respectively.

¹¹ OECD and European Central Bank set λ parameter at 100.

¹² Cyclical components obtained through the double application of HP filter have resulted rather similar to cyclical components acquired to Cristiano-Fitzerald (CF) filter. The main difference compared to the later is the somewhat higher smoothing degree that CF filter tried to identify more cycles than HP filter. The application theory of filters for the identification of cyclical components knows such results.

¹³ The normalisation process is achieved by subtracting from the filtered observations the mean of the series, and dividing this by the mean absolute deviation of the series, and finally, by adding 100.

relation between the variables and the reference series. The transformed series were tested for different leading times. The result of cross-correlation analysis helped us to select the leading series, those that moved contemporaneously with the reference series, and those lagging the reference series. The graphical view of the cyclical components for each series was used to detect the turning points. In selecting the series which will be further included in the construction process of CLI, the following three criteria helped:

1. The series should be economically important. To evaluate the economic importance we assessed the economic relation of each selected indicator with the reference series.
2. Series should be statistically important. The statistical importance was measured through the correlation coefficients, the number of leading quarters and the approximation of the turning points with the reference series. The minimum accepted correlation coefficient was 0.5.
3. Series qualities. The statistical quality was analysed in relation to the publication time and the possible revisions of each series.

Based on the above criteria we decided to aggregate the following series:

Table 1 CLI composite series

	Indicator	Maximum correlation coefficient	Leading period (in quarters)
1	Retail trading index	0.84	1
2	Credit to private sector	0.84	1
3	Imports of machinery and equipment	0.91	2
4	Fuels Imports	0.92	3
5	GDP EU27	0.73	3
6	Demand in construction, in balance	0.69	3
7	Value added tax income	0.91	1

Figure 1 in the attached Annex shows the business cycles of the series used as CLI components, along with the business cycles of reference series. As noted, the indicators cycles, shifted in the chart accordingly to the respective leading quarters, are very similar to the reference cycle series and suggest that the Albanian economy has experienced one and a half business cycle for the period 2003-2011.¹⁴ The balance indicator derived from confidence surveys shows the highest fluctuation, suggesting two completed business cycles for the analysed period.

The criteria set out priory hold for all the selected economic series:

Retail trading index is considered as a proxy of consumption in economy and as a stimulus to the economic activity, particularly in the trading sector. Its cyclical component covers better the cyclical component of reference series after 2006 Q3. Its leading period is 1 quarter and is published 3 months after the reference period from the INSTAT.

¹⁴ The selected method to eliminate long-term trend (in this case HP filter) affects easily the analysing of previous business cycles. When we use CF filter to remove long-term trend, business cycles analysis suggest that the Albanian economy has passed through two mini completed business cycles during 2003-2011.

Private sector credit is considered a strong stimulus to economic activity in all sectors. The PSC cyclical fluctuations lead with one 1 quarter the cyclical fluctuations of reference series. Data for PSC are available at the Bank of Albania 2 months after the reference period.

Imports of machinery and equipment is one of the main components of external trade statistics (in the division by 10 main categories) and is chosen to approximate investments in economy. Its cyclical component leads at two quarters the cyclical component of reference series and is considerably compatible to it. Data on imports by main categories are available one month after the referring month.

GDP in Europe – business cycles for European countries are considered to affect our business cycle through some channels: certain sectors in economy show a high synchronisation degree with European countries¹⁵; cross-border fluctuations in the economic activity affect remittances, which on the other hand, impact our business cycle; foreign direct investments are affected similarly.

Demand in construction, in balance, is a qualitative indicator originating from confidence survey in construction. This indicator is considered a stimulus to production in construction. It leads the reference series at three quarters and is rather quickly available at the Bank of Albania immediately after the reference period.

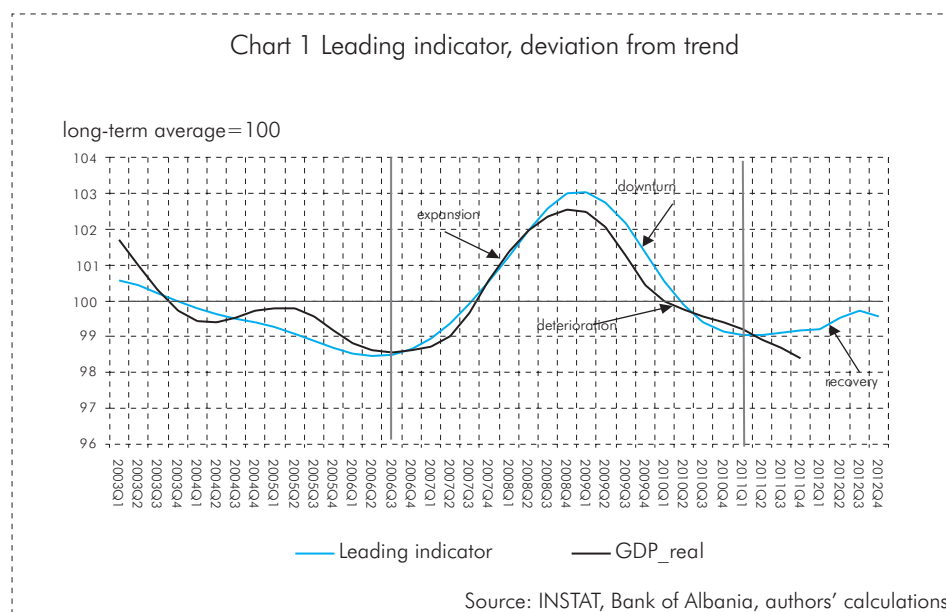
Value added tax revenues are considered as an indicator which approximates the trading activity at home at a given quarter and signals for the quarterly GDP at a quarter in advance. They are available two months after the reference period.

Aggregation. In theory there are known different aggregation methods for reducing the number of indicators with leading properties. We chose the aggregation approach of the principal component analysis.¹⁶ This approach provides new information from each individual series, which helps to explain movements in the reference series. The selection of principal components depends on total variance degree (the sum of variances of all series included in the analysis) which is explained by each component. The first principal component explains only 74.5% of the total variance. Before applying the principal component analysis, the data matrix was adjusted by shifting (by corresponding number of lead quarters) those series which lead. Thus, it was obtained an indicator which summarises in real time for each period the signals and the common information from all the components of the CLI.

¹⁵ Previous studies have concluded that developments in industry and construction have manifested the highest synchronisation degree to the developments in the respective sectors of Europe, and particularly with those of Italy (Kristo, 2010).

¹⁶ Principal component analysis (PCA) is a statistical method to reduce the number of indicators: through orthogonal transformations of variables, PCA selects a set of un-correlated indicators. PCA, in practice, provides to the covariance matrices of data Eigenvector and Eigenvalue which transform the multidimensional set of data into vectors at a double-dimensional space. The first resulted vector out of this transforming is called the first principal component and explains the major part of data set variance.

Presentation. The following chart shows that the leading indicator for Albania, aggregated from the selected series, has signalled in time the turning point in 2006 Q3 and in 2008 Q4. Overall, the indicator and reference series result above or below the long-term average of 100 for the same period. Nevertheless, in the second quarter of 2011, the indicator suggests a turning point which is not proved by the reference series. The up-coming publications of the quarterly GDP shall confirm the turning point quarter.



III. THE USE OF LEADING INDICATORS TO PROVIDE QUANTITATIVE FORECASTING

Leading indicator constructed according to the “deviation-from-trend” method may be used to forecast the turning points in business cycles, and to provide qualitative forecasts concerning the expected direction of the economic activity. It may not be used to provide quantitative forecasts, as the indicators employed prior to the aggregation process of data are de-trended. The purpose of this part of the material is to construct a leading indicator which may be used to forecast the changes in reference series in quantitative terms. This CLI is constructed based on the definition of “growth rates” of the business cycle. To construct the leading indicator, we implemented the methodology used by the Central Bank of Germany for the forecast of annual changes of the GDP and industrial production through the leading indicator.¹⁷

All the data series employed for the qualitative leading indicator were analysed once more to accurately select the best components of the quantitative leading indicator. The data were transformed in annual changes, excluding the indicators deriving from confidence surveys. Previous studies¹⁸ developed at the Bank of Albania have shown that the level of indicators deriving from

¹⁷ See K.A.Kholodilin and B.Silvestovs (2005) or Fritsche and Stephan (2000).

¹⁸ See E.Kristo (2010).

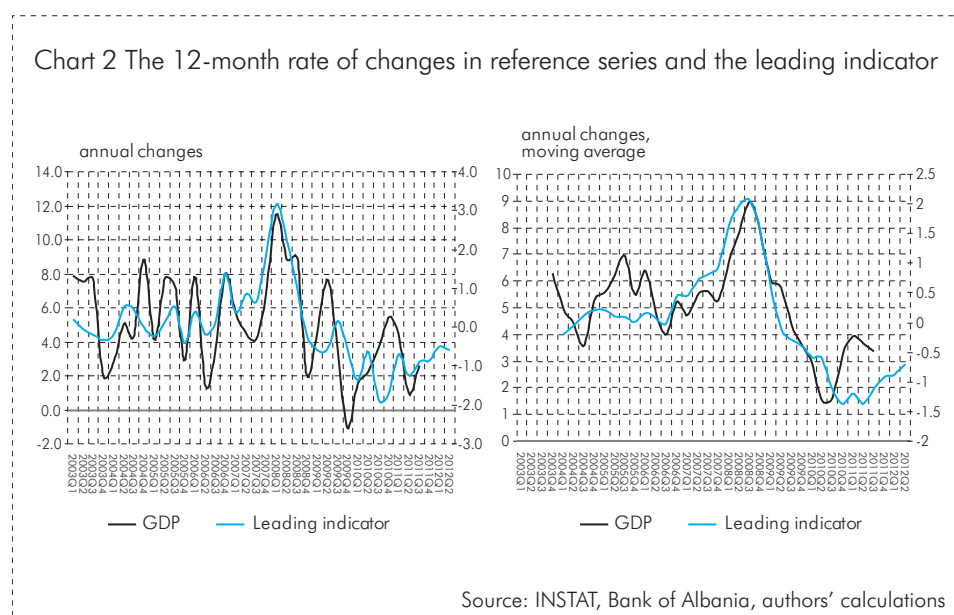
confidence surveys better relates to the GDP annual changes. These indicators are characterised by the lack of a long-term trend and are seasonality adjusted. The transforming of quantitative series into annual changes ensures the series stationarity¹⁹, the removal of long-term trend and their seasonal adjustment. The cross-correlation analyses, alike in the second part of the material, established the leading properties and the relation of indicators with the reference series. The results of this analysis are somewhat different from those carried out in part 2, due to the different transforming of indicators from their original value (cyclical component). The following table summarizes the selected series and the results of cross-correlation analysis.

Table 2. Summary of the cross-correlation analysis results

	Indicator	Maximum correlation coefficient	Leading period (in quarters)
1	Aggregate M3	0.44	3
2	Imports of machinery and equipment	0.54	2
3	GDP EU	0.57	3
4	Demand in construction, in balance	0.61	Coincident
5	Production in construction, in balance	0.59	Coincident
6	Value added tax revenues	0.50	Coincident
7	Fuels and energy import	0.49	3

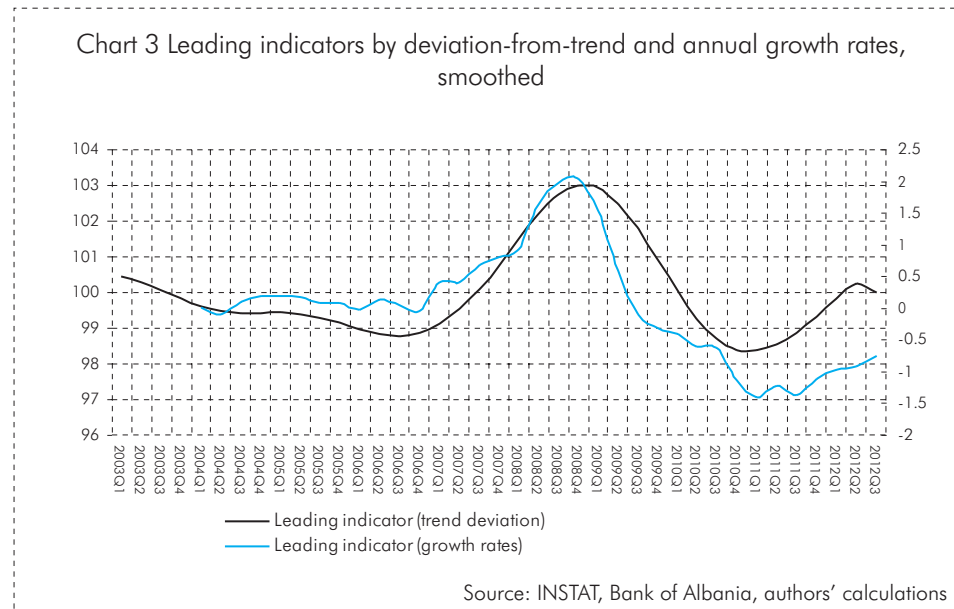
The seven series selected from the cross-correlation analysis, shifted in advance accordingly to their leading period, were aggregated to form a CLI using principal component analysis. Even in this case, only the first principal indicator was considered, which explains 66% of total variance of the sample.

Chart 2, left, shows the 12-month changes in composite leading indicator and in the reference series, and the right-side shows these changes have gone through a simple smoothing process.



¹⁹ Excluding credit series.

The 12-month changes, as shown by the chart, display high fluctuation compared to the smoother view in case of CLI measured as a “deviation-from-trend” (See chart 1). The following chart presents the CLI by “deviation-from-trend” and the moving average of four quarters of CLI constructed according to “the annual growth rates”. Both indicators show similar fluctuation.



The construction method, transforming the original form of composing series as less as possible (by not using the statistical method of filtering, smoothing and normalisation applied in leading indicator according to the “deviation from trend”), make possible the use of leading indicator “by the rates of growth” for quantitative forecasts, that is to forecast the numerical value (growing annual rate) of the reference series. The growth rates leading indicator was employed in a simple explanatory equation for the reference series. The equation explains the annual changes in real GDP through the changes in leading indicator. This differs from the approach applied so far at the Bank of Albania for the modelling and forecasting the quarterly GDP. Çeliku et. al. (2009) model the non-seasonally adjusted GDP quarterly changes (total and by sectors) through the quantitative indicators (hard data) and qualitative (surveys) ones, along with inertia terms and seasonal factors. The authors employ the aggregated results of different models to make a forecast: a system of equations by SUR assessment method; a group of indicator models serving as “bridge” equations for assessments by sectors; an indicator model for total GDP.

The explanatory quarterly GDP equation from leading indicator is shown below: (standard error and statistics t displayed in brackets):

$$Y_{vmv} = 4.8 + 1.9 * TPP$$

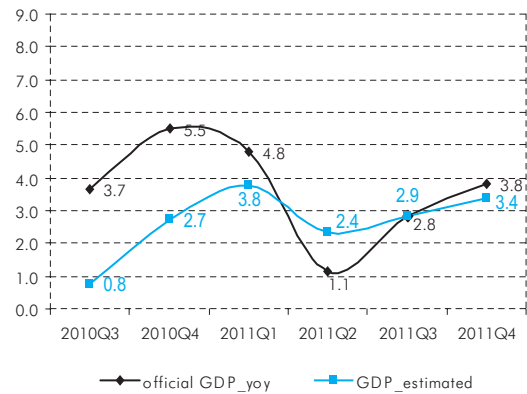
(0.34)	+	(0.32)
(13.9)		(5.95)

R^2 corrected = 0.50
 Normalization (Jarque-Bera) = 0.69 (0.71)
 Correlation series (LM(2)) = 1.99 (0.38)

The model was tested for the forecasting within the sample; the equation was estimated for the period 2003 Q1-2010 Q2. The results from this equation were employed to forecast the real quarterly GDP changes for the rest of six quarters of series, which is for the period 2010 Q3-2011 Q4. Chart 4 provides a comparison between the forecasted rates to the current official GDP rates.

The comparison between the growing rates of forecasted GDP and the official one published by INSTAT shows that their difference is considerable narrowed in the two last quarters. The forecasted values regarding annual GDP changes during 2012 are compared to those of three main models currently employed by the Bank of Albania to forecast the quarterly GDP. The values and the dynamics of forecasted GDP from the leading indicator model is closer to the one estimated by SUR model. The forecasting ability of the leading indicator constructed according to “growth rates” cycle, remains to be tested in the future, with the publication and extension of reference series. The equation may be used to forecast the changes in reference series for four leading quarters.

Chart 4 Annual changes in official GDP according to INSTAT and assessed from the model



Source: INSTAT, Bank of Albania, authors' calculations

IV. CONCLUSIONS

The purpose of this material is the construction of the Composite Leading Indicators (CLI) for Albania, which provide information on the performance of the economy for several quarters in advance. CLIs summarise in a single indicator different economic series with leading properties, containing information regarding developments in quarterly real GDP. These indicators shall be used to analyse the cyclical performance of the domestic economy, to give signals on the potential turning points and on the quantitative forecast of GDP series. The results obtained from the qualitative and quantitative forecast shall be verified in the future, along with the publication and extension of reference series.

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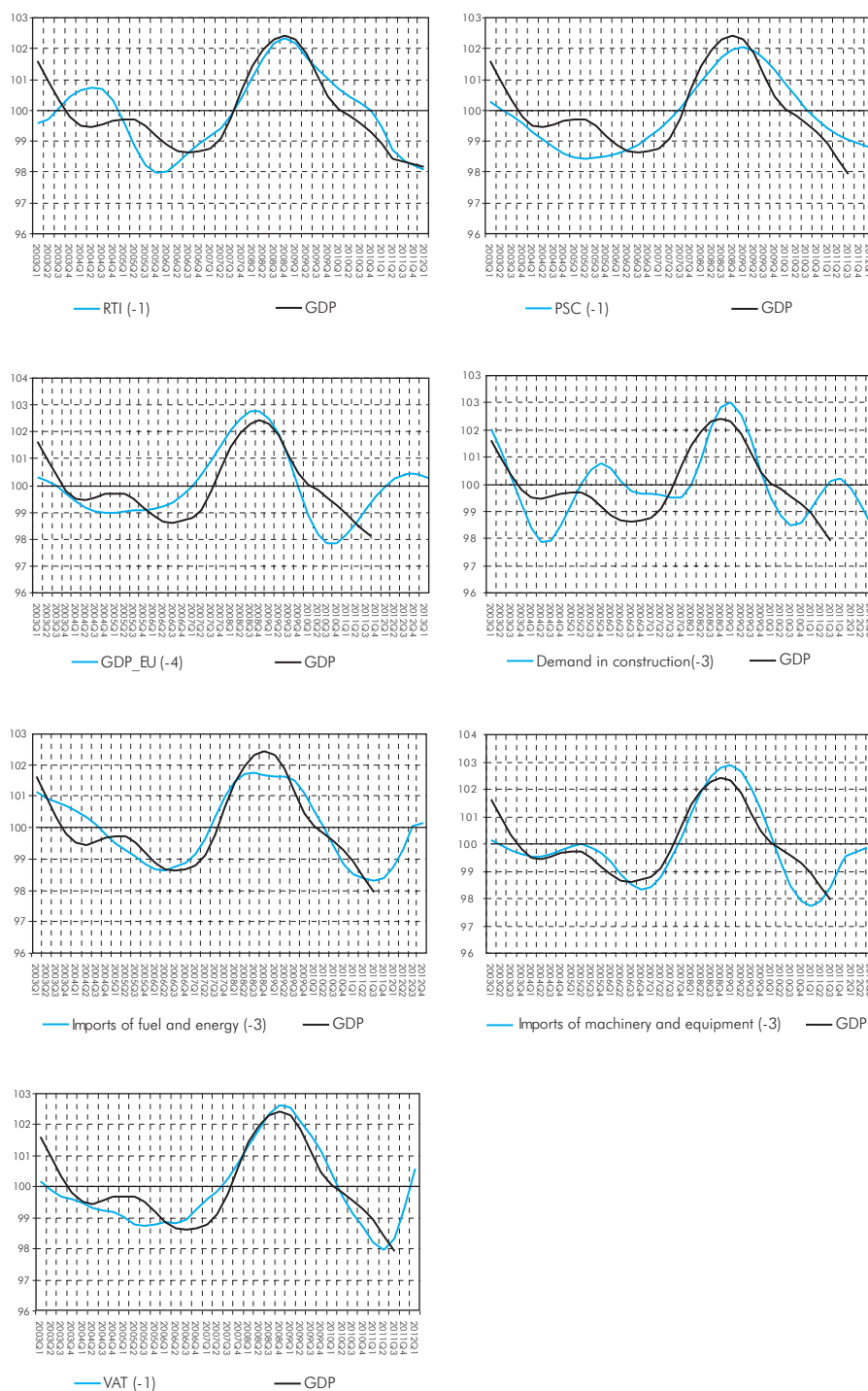
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ANNEX

Table 3. The analysed indicators during the first step for constructing Composite Leading Indicator:

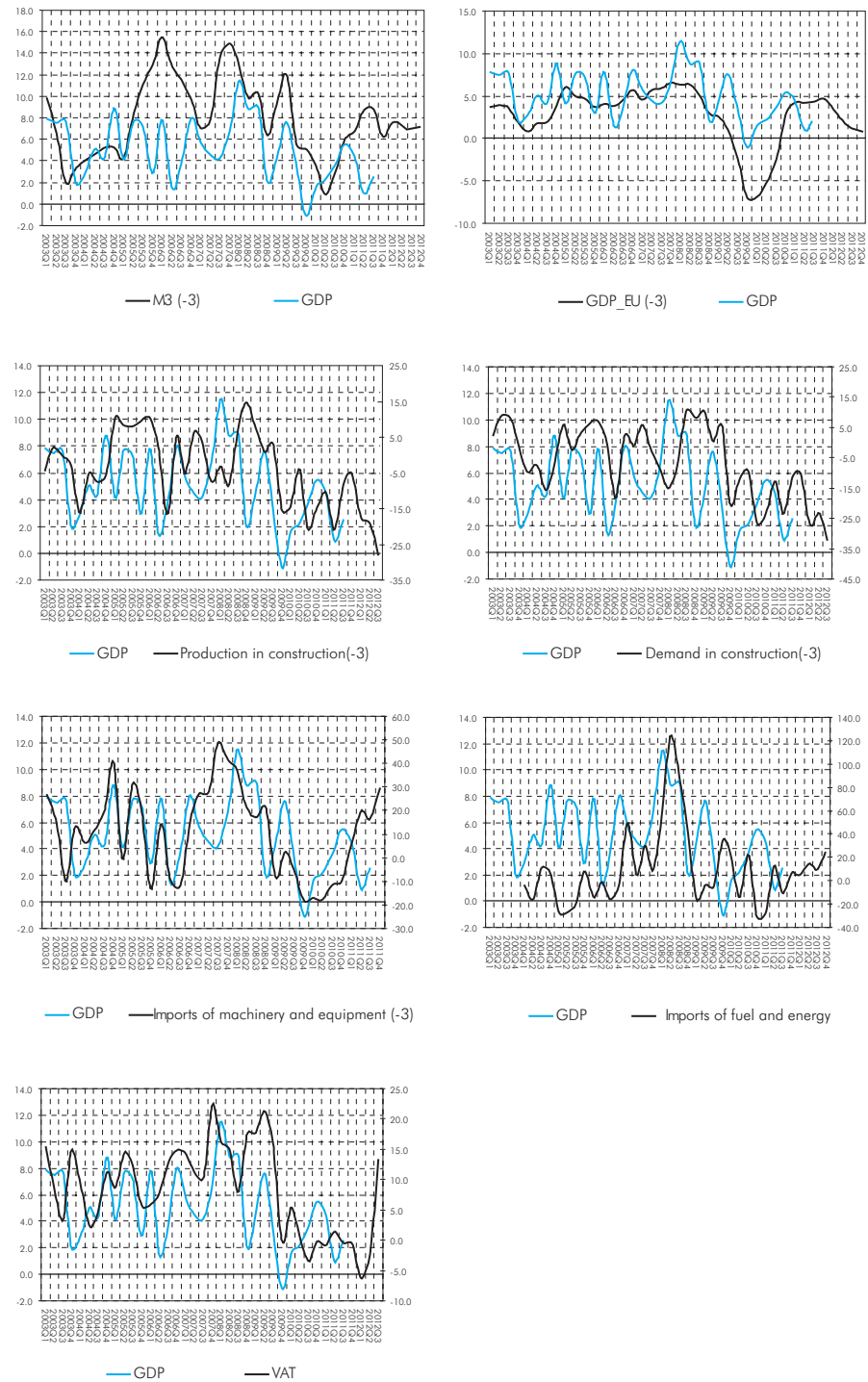
1	PPI
2	CPI
3	REER
4	NEER
5	12-month Treasury Bills interest rates
6	12- month T-bill interest rates - 12-month deposits
7	12-month deposits interest rate
8	Total credit
9	Credit to private sector
10	Credit to businesses
11	Credit to household
12	M3
13	M1
14	VAT
15	Government expenditure
16	Retail trade index
17	Turnover index in trade
18	Rate of construction permissions
19	Cement consumption
20	NX
21	Exports-Imports
22	Exports
23	Imports
24	Imports of machinery and equipment
25	Import of vehicles
26	Imports of raw materials and minerals
27	Import of fuels and energy
28	Exports in volume from customs
29	Imports in volume from customs

Chart 5 Business cycles of reference series and of qualitative CP composing indicators



Source: INSTAT, Eurostat, FMN, Bank of Albania, authors' calculations

Chart 6 One-year changes in reference series and in the quantitative CP composite indicators



Source: INSTAT, Eurostat, FMN, Bank of Albania, authors' calculations

HOUSE PRICE INDEX -METHODOLOGY AND USE-

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This paper introduces the calculation methodology for the House Price Index (HPI) and Rent Price Index (RPI) for Tirana. The methodology is based on the hedonic techniques for constructing indexes for goods, whose quality changes over time. We have employed this technique to construct the HPI and the RPI, starting from 1998 Q1. The obtained indexes are used to analyse the dynamics of the house price and rents in recent years.

I. INTRODUCTION

Investment in buildings account for about 15% of total investment in the Albanian economy, with investment in residential buildings¹ accounting for about 70%. On average, transactions in the construction sector share 15% of total sales in the economy, as of 2001. The purchase of a residential property is the main spending for a household and it is generally considered to be economic agents' largest investment (Glindro et al. 2008). House and rental price movements are important information items that impact consumers, businesses and policymakers decisions and behaviour. Time series of house prices can be used for various academic studies. Measuring and aggregating house and rental price data is complex as residential buildings are a lot more different from the other "goods". The differences arise not only because house purchasing or selling is the most important transaction for a consumer and, consequently, it is made more rarely than for other products, but also because each house is "a unique" good. That is, houses are very heterogeneous goods, whose quality differs a lot from one house to another. These characteristics of "house" as a good make it difficult to maintain the principle of comparability during the construction process of the classical price index.

This paper fulfils a part of the request for information on house price and rents by introducing the House Price Index (HPI) and the House Rent Index (HRI). The indexes have been built using the hedonic method of the price index. This method is used for "specific" goods, whose price changes over time, due to the change in their quality; such goods may be computers, household electrical appliances and houses. The House Price Index measured according to the hedonic method takes into account that part of the price change in two given periods is a result of transactions in goods with different qualities. For example, in a given quarter, bigger and better furnished houses have been sold compared to another quarter when houses of simpler qualities have been

¹ Structural survey of economic enterprises and Statistics Report, INSTAT. Investments for houses are proxied from approved construction permits, expressed in a value.

sold. The hedonic index allows that the quality change in houses selected in different periods (for example, average surface or the construction quality) will not affect "the real" house price. In order to prevent that a change in the set of characteristics in a quarter be transmitted to the index, the hedonic method ensures that they are kept constant over time. To achieve this, we need first to estimate and assess the relationship between the house price and the qualities it offers. The essence of all hedonic methods stands in the use of a regression equation to determine the relationship between the house price and the characteristics or qualities determining the price. Theoretically, the consumer pays a given price to purchase a house, because of its given surface in square meters, the location in a given area, orientation and proximity to different institutions, a certain level of furnishing, etc. That is, the consumer does not simply pay for the house, but for the set of qualities it provides. After establishing the relationship between the price and quality of the house, the regression equation coefficients are used to build the index.

Information on price movements in the residential housing market is important for a number of reasons: First, house price changes affect different aspects of businesses and consumers economic decisions. The purchase or sale of a house represents the largest single transaction that a consumer makes; therefore, changes in house prices affect consumer's spending and savings-related decisions. Changes in house and rental prices also affect the wealth of home owners. In several cases, individuals buy houses for investment purposes to create returns in the form of rental payments². In this case, changes in house prices may have an impact on rents. This is also the main channel through which house price inflation may have an impact on the rates of change of the Consumer Price Index (ECB 2006³). The share of spending on rent in the Albanian CPI basket is 10.2%. Developments in house prices may also have an impact on business investment-related decisions in the real estate market.

The indexes built according to the hedonic method have been used by the Bank of Albania in recent years to monitor house and rental prices movement. This has, in turn, facilitated the lack of official data on prices in the construction sector prices.

The following explains step by step the methodology for constructing the house and rental price indexes and explains their practical use. The second part describes in brief the methods used for constructing a House Price Index, excluding the impact of quality. Then it focuses on the concrete steps for constructing the HPI and CCI. Part three describes the usage of information obtained from the indexes in the house market analysis in Tirana.

² According to the Consumer Confidence Survey in 2010 Q3, 2.6 per cent of the respondents had chosen residences as a means of investment.

³ ECB (2006): "Residential property price statistics for the euro area and selected EU countries", Real Estate Price Indexes, OECD-IMF workshop.

II. METHODS USED TO CONSTRUCT A CONSTANT-QUALITY INDEX

The classical method for constructing an index, e.g. the consumer price index, maintains a fixed basket of goods and services and measures their price during consecutive periods. Constructing such a “traditional” index for house prices is difficult for the following reasons:

1. House purchase is usually the largest purchase of a household; therefore, transactions for a house *are very rare over time*.
2. Finding two *identical houses* in different periods is very difficult.
3. If a “basket” of houses were fixed over time, house improvements, construction of a public or private facility in the vicinity of the house or any other “qualitative” change would lead to *price volatility*.

A traditional index tries to measure the “real” change of price for a certain good over a period of time. Such indexes are applied on prices of products whose changes in quality over time are limited. Thus, the change of price over time stems only from the changes in the demand and supply for this good. The same principle would be followed for houses if their quality remained unchanged over time. For example, the house is not furnished with a parquet floor or central heating a few years after the original purchase. Hence, various statistical agencies aim to use a method, which keeps the house quality constant and measures only the true price change. Keeping the house quality constant over time imitates the basket of fixed goods used for calculating the Consumer Price Index.

Advanced methods for constructing a House Price Index keep the house quality unchanged over time. The methods for measuring constant-quality house prices try to standardise and make the information on houses comparable in terms of time. If the simple average method is used than problems may arise. The constant-quality methods are grouped in three main categories: repeat sales method, hedonic method and the hybrid method. The three methods, which aggregate price data in a single index, aim at measuring the “real” price changes as a result of demand and supply dynamics in the house market. They tend to exclude or minimise the house price change stemming from the quality change (improvement or deterioration). These changes in quality may owe to a better location of the house, improvement of construction feature improvements or vicinity to certain social facilities.

Repeat sales method. This method collects and records sale prices of a selected group of individual houses every time a transaction takes place. This is a direct method for constructing a House Price Index. The repeat sales method tends to maintain a grouping of constant qualities by observing the sale price of a fixed group of houses. In technical terms, constructing the index with the repeat sales method is simpler than for the other two methods, but it does not necessarily produce a constant-quality index (the quality of the fixed/selected house may vary over time). On the other hand, its practical application becomes difficult because of the low number of transactions over time for the fixed houses. Their follow-up over time is also a difficult process.

Hedonic method. The house price depends on a series of their features such as location or other physical qualities. Hedonic regression is a method used to measure the market price for each of these qualities. The hedonic method for constructing the House Price Index has various deviations, but they are all based on the hedonic regression (regression equations). The construction of hedonic indexes makes possible the division of the price rise in two components: first, rise due to house quality improvement; second, rise due to the demand and supply dynamics in the house market. The construction of the index using the information obtained by the hedonic function (definition below) manages to identify mathematically the price changes as a result of the quality change of house characteristics and exclude it from the final index. Thus, constant-quality indexes are obtained through the implementation of hedonic methods. On the other hand, the application of this method requires a broad base of data. The data collection phase requires a high number of surveys on sales transactions over each period (quarterly or monthly) with all the main details of the transaction. Similarly, the construction of the econometric model using these methods is somewhat complicated.

The hybrid method combines the hedonic and repeat sales methods. In the hybrid indexes, information from the hedonic function is used to impute only values that are absent in various periods and are not obtained from direct information according to the repeat sales method. The results of the hedonic function may be used directly or indirectly to construct the index. It is called direct because the information for constructing the index is obtained only through the constructed hedonic function. The indirect use employs information from the hedonic function to complement information from other sources, mainly to complement data that are absent for a certain period in the use of Repeat Sales Method, or adjust for the quality change in a normal index.

All these methods have their advantages and disadvantages. The repeat sales method and the hybrid method share the same disadvantage as the use of the simple average, if they leave important characteristics out of the modelling. Given that Hedonic methods use econometric techniques to adjust for the quality, they have the disadvantage that they require an abundant database. A critique for hedonic indexes is the multicollinearity. In general, house characteristics are correlated with each other; for example, the number of rooms is positively related to the available surface. This may cause multicollinearity problems in evaluating regress equations. To avoid negative effects in evaluating the equation, either the characteristics known to have a strong correlation are left out, or both correlated variables are merged into one. For example, in the case of the hedonic house index, the surface is represented either by square meters or the number of rooms in which the residential space is divided into.

Repeat sales method and the hybrid method would not be applicable in our case since, to use these models, we need data on the sale of the same house (or in general, of the same group of houses) over some periods of time. Under these circumstances, the most appropriate method to be applied is the

hedonic method which is based on the collection and processing of data on transactions carried out over determined time intervals.

III. HEDONIC METHOD

After a brief overview of various methods for constructing an index, which ensures a constant quality for “special” goods, in this section we will focus on indexes constructed with the hedonic method. The literature provides a number of hedonic methods for constructing price indexes for very heterogeneous goods, whose quality changes over time, such as computers, cars, and houses. All the methods have the construction and use of a “hedonic function” in common. Sometimes, the way the information obtained from the hedonic function is used differs from one hedonic method to another. The two main methods are the time-dummy method and constant-quality method.

1. COMMON CHARACTERISTICS OF HEDONIC INDEXES

The first hedonic price index was estimated by Andrew Court in 1939 and was used to estimate the price of automobiles. Hedonic indexes have a prominent place in price indexes for information and communication technology products and for measuring house prices. Hedonic indexes have been implemented for a number of products in many OECD countries.⁴

Overall, the construction of the index according to the hedonic method follows two main steps:

- First, the hedonic function is evaluated through an econometric equation, based on the hedonic hypothesis (explanation below).
- Second, the information obtained from the hedonic function is used to construct the House Price Index.

Hedonic Hypothesis (HH); each good is a combination of its characteristics. We may think of houses as a combination of its qualities. When a consumer wants to buy a house, he evaluates the house on the basis of some characteristics such as surface, number of rooms, location, and age. The quantity of characteristics is what the constructor “produces”.

Hedonic function (HF); it states the correlation between the price of a product and its characteristics (Triplet 2004). According to the HF, there is a functional relationship f between its price p and its characteristics vector x : $p = f(x)$. In our case, the HF states the house price (dependant variable) depending on the characteristics/qualities of the houses (explaining variable). The equation is evaluated through the ordinary least square method (OLS). The construction of an acceptable hedonic function is the main part of work for constructing hedonic price indexes.

⁴ OECD (2004): “Handbook on hedonic indexes and quality adjustments in price indexes: special applications to information technology products”, STI Working Paper 2004/9.

Coefficients of the hedonic function. They are the main source of information in hedonic methods. The coefficients are used in the second stage of constructing an index. They are often known as implicit prices or characteristics prices and denote the price paid when a unit is added to a certain quality. Like any other price, the implicit price depends on demand and supply.

House characteristics. Houses are heterogeneous goods and their price, therefore, is determined by a series of characteristics. In Hedonic House Price Indexes, house characteristics are grouped in three main categories:

- Structural characteristics, including size of the house (or land plot), number of rooms, type of construction material, age, etc.
- Location characteristics, which may be expressed also as a unit of distance, in km, such as proximity to the city centre, shopping area, hospitals, and schools.
- Characteristics of the area (neighbourhood), including social characteristics of the area where the house is situated.

The hedonic function relating the house price to its characteristics is as follows:

$$P = f(\text{structural, location, area}) \quad (1)$$

According to Rosen (1974), the partial derivative of the above hedonic function may be interpreted as the marginal characteristics price, when all other characteristics are kept unchanged. If we evaluate that equation (1) describes the relationship between the price and its characteristics and when all statistically-significant characteristics are incorporated in the evaluation, then we will be able to evaluate the price of an individual house based only on the information available for the characteristics of the house.

In the case of Albania, to construct the House Price Index, we have used both the literature and the available data to select the characteristics of the house. Thus, we have determined location, age, furnishing and surface as important characteristics.⁵

The database used to construct the indexes is obtained from sale and rent announcements published in newspapers.⁶ The information pertains only to Tirana; it is valid only for apartments and does not take into account repeated announcements for apartment sales. Because of lack of information, the price announced by the seller is considered as the actual sale price for the apartment.

In order for the used data to be as homogenous as possible, the information has been collected only for apartments in multi-storey buildings. The sample

⁵ In literature, a number of other characteristics are used. We were limited only to this group of characteristics, as this is the basic information that we could collect. Enriching the database and adding to the variety of characteristics, would improve not only the index but also the quality of analysis based on this index.

⁶ The source is the sale announcements published in *Çelësi* newspaper, during March 1998–December 2010. Announcements are selected randomly aiming at collecting information on 90 apartments for each quarter (30 for each of the three zones).

size has been maintained unchanged across the periods and zones. We have tried to avoid the overlap in quarters by using different announcements for each period. However, it is supposed that the house price, whose sale announcement is present in two consecutive (even different) quarters, contains information on the level of prices during the two different periods. Thus, a lower price of this house in the second announcement reflects changes in the new house market conditions during that period.

The information collected and expressed in the form of indicators that will be used to construct the hedonic equation is as follows:

Dependent variable:

* Sale price: The transaction value is the value in the sale announcement.

Independent variables:

* Surface: The surface in square metres is the only constant variable, whereas the other three characteristics are stated through qualitative variables.

* Furnishings level: The houses are divided into three categories: furnished; partly furnished and not furnished.

* Age: The houses are divided into old and new according to the information in the sales announcement.

* Location: Tirana city is divided into three zones: Zone I includes the area very close to the city centre; Zone II includes houses within the ring road but not close to the centre, and Zone III includes houses outside the ring road.

The data are cleaned from extreme values, judging on the normal distribution of surveys in each value, excluding the extreme values. After the equation is run, all the observations, whose error term in absolute value are greater than 0.75 are removed.

2. CONSTRUCTING HEDONIC HOUSE PRICE INDEXES

Based on the information obtained through the hedonic function, following is a brief description of the two main constructions of the hedonic price indexes; indexes constructed according to the time-dummy method and indexes constructed according to the constant-quality method.

a. Time-dummy method

Time dummy is a hedonic method that uses the hedonic function to calculate the House Price Index. It is called the time-dummy method because it uses dummy indicators to construct the hedonic function for the periods according to the selected frequency (monthly, quarterly), an indicator less than the total number of periods for which the index is constructed. It may be also called

the most direct hedonic method, in the sense that index values over time are obtained without any further calculations; the coefficients before the time dummy variables are in themselves the values of the index for various periods.

The hedonic equation that is constructed in the case of the time-dummy method in our case is:

$$\ln P_t = a_0 + a_1(\text{surface}) + a_2(\text{furnishing}) + a_3(\text{location}) + a_4(\text{age}) + b_1(D_{t+1}) + b_2(D_{t+2}) + \dots + b_n(D_{t+n}) + \varepsilon_{it}$$

t is the time period from 1998 Q2 to 2006 Q3.

What is special about this method is the inclusion of dummy variables for each time period. The D_{t+1} variable is 1 for the period $t+1$ (1998 Q3) and zero for all the other periods, the D_{t+2} variable is 1 for the period $t+2$ (1998 Q4) and zero for all the other periods. The same principle applies to all quarters.

The same principle applies to all quarters.

Coefficients a_1, a_2, a_3, a_4 , are the coefficients before the characteristics. The coefficients are not used any more in a second step. According to this method, what is important is that the coefficients before characteristics be statistically significant.

The coefficients before the dummy variables indicate the percentage of the house price change between respective periods and the base period. Hence, the b_1 coefficient (rather its antilogarithm) indicates the house price change in per cent between D_{t+1} and D_t , keeping the house characteristics unchanged. In other words, these coefficients represent the price change (in literature it is also known as "pure" change of price) between

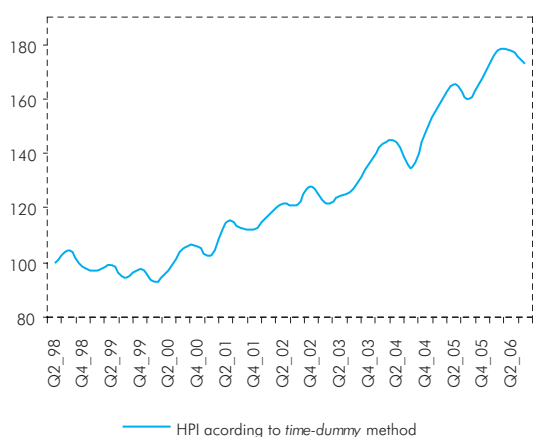
the periods, provided that house characteristics do not change.

Although the price index according to this method is obtained directly without further calculations (Chart 1 shows our calculations for 1998 Q2 - 2006 Q4), this method is not recommended by the literature for a number of disadvantages, which shall be discussed in section III-c.

b. Constant-quality method

The constant-quality method is another hedonic method for the calculation of indexes for goods with varying quality. This method consists in two main steps: construction of the hedonic function and use of information obtained from this function. In contrast to the time dummy, here, the coefficients before the characteristics are used in a second step, in a "traditional" formula to construct the index. In addition to using a traditional formula, e.g. Laspyers, and similar to traditional indexes, the constant-quality method enables us to

Chart 1 HPI according to the time-dummy method, 1998 Q2 – 2006 Q4



Source: Bank of Albania

select a base period for calculating the index. For these reasons the constant-quality method is most preferred and used by various statistical agencies in different countries.

The main characteristic of this method rests in the interpretation of the coefficients of the hedonic function as prices of respective characteristics. The House Price Index constructed in this way is similar to any other price index; in order to determine the weight instead of the quantity of a good (in this case the house), it uses the quantity of characteristics (considered as quantities of any other product). Therefore, the interpretation of the price index according to the characteristics requires only that the quantities of characteristics be the variables that the purchaser wants and uses, that the seller produces and trades and that the hedonic function evaluates.

Following the characteristics method, the hedonic equation is in the log-lin⁷ form:

$$\ln P_i = b_0 + b_1(\text{sip.}) + b_2(\text{mobilitimi}) + b_3(\text{zona}) + b_4(\text{vjetërsia}) + \varepsilon_{it} \quad (2)$$

The dependant variable, price, is presented in the form of a natural logarithm. The surface is taken in its absolute value, whereas other dependant variables are entered as qualitative dummy variables.⁸ This assignment of qualitative variables determines a "standard" hypothetical house, which may or may not exist in practice. In this case, a "standard" house is considered to be a house that has no furnishing and is located in Zone II.

According to the constant-quality method, an equation is evaluated for each quarter starting from 1998 Q1. The price series for each quarter is cleaned from values, which, in our view, were very high or very low. After equations for each quarter were evaluated, a second round of cleaning of extreme values took place, by removing those surveys, whose error term in absolute value was ≥ 0.75 . In this way, the excess influence of extreme values on the equation was avoided. After the cleaning, equations were applied again. Qualitative and quantitative characteristics explain 70-80 per cent of the movement of house prices offered for sale in Tirana.

The second step was the construction of the index. As mentioned earlier, coefficients before characteristics, which will be considered as the prices, will be used for the index calculation. The selection of a base period implies that the quantity of the characteristics of the community of houses selected during that period will be kept constant. Thus, we have selected the first quarter of 2005 as the base period, as we have assessed that during this period the

⁷ The hedonic equation may be set out in the linear form, double log (log-log) or semi log (log-lin). As a functional form, log-lin is the most preferred and used one. According to this form, coefficients interpretation is simpler and the form eliminates some statistical problems (Bourassa et. al, 2005).

⁸ The dummy variable of age is coded as 1 for old houses and 0 for new houses. The dummy variable of furnishing is coded as 1 for furnished houses and 0 for those not furnished. Two dummy variables are used for the zone. Zone II (the zone inside the ring road, excluding the centre) is assigned 0.

house market was stable.⁹ Equation coefficients, b_i , of each quarter will be used as characteristic prices. In concrete terms, b_1 is the price for surface, b_2 is the price for the furnishing and so on. The Laspeyres index for characteristics price may be written as follows:

$$index = \frac{\sum b_i * q_0}{\sum b_0 * q_0} \quad (3)$$

To construct an index of any type, we need the weight, which is denoted by q_0 in formula (3). The weights in the House Price Index are the quantity of characteristics. The index is constructed by keeping unchanged the quantity of characteristics of the base period. This is how fixed-weight index is constructed. That is, the denominator of the index represents the prices evaluated by the equation of the base period, whereas the numerator represents the prices evaluated by replacing in each quarterly equation, the respective characteristics with the characteristics of the base period. The numerator shows what the prices would have been for each period if the surface and characteristics of the house were the same in the base period. That is, it adjusts the change of characteristics over time. In the end, prices are turned from log forms in nominal values divided by the base period to obtain an index where 2005 Q1 = 100.

3. Comparison of the two hedonic methods

The constant-quality method has several advantages over the dummy variable method.¹⁰

1. Index formula. First, the index formula constructed with the constant-quality hedonic method is well known (Laspeyre). This formula is applied during the second step of index construction, after the hedonic function is explained. This separates construction of the index from the form of the selected equation used for evaluating the relation between the house prices and their characteristics. On the other hand, in the time-dummy method, there is no typical formula for calculating the index, since the index values are formed automatically from the coefficients before the time-dummy variables. In addition, the index constructed with the constant-quality hedonic method uses fixed weights in a period, getting even closer to a "traditional" index. The use of weights and of a widely-used formula makes the first index more comprehensible and acceptable among the users of these statistics.

2. Characteristics prices change over time. In the hedonic time-dummy method, the index values are taken directly from the final product of the hedonic function. According to this method, all you need is to evaluate only one equation for the entire period under review to obtain a House Price

⁹ 2005 Q1 is selected by the authors as the base period. Initially, we conducted some testing to determine the base period. As expected, we noticed that the first surveyed years (1998, 1999) were not appropriate as base periods taking into account that the *Çelësi* newspaper had just started to be published and the quality, quantity and heterogeneity of the announcements was not satisfactory, and the house market was not stable. Overall, during that period, there was a preference to rent the houses, most of the houses were built prior to the 1990s, and house prices varied significantly regardless of the characteristics and the location.

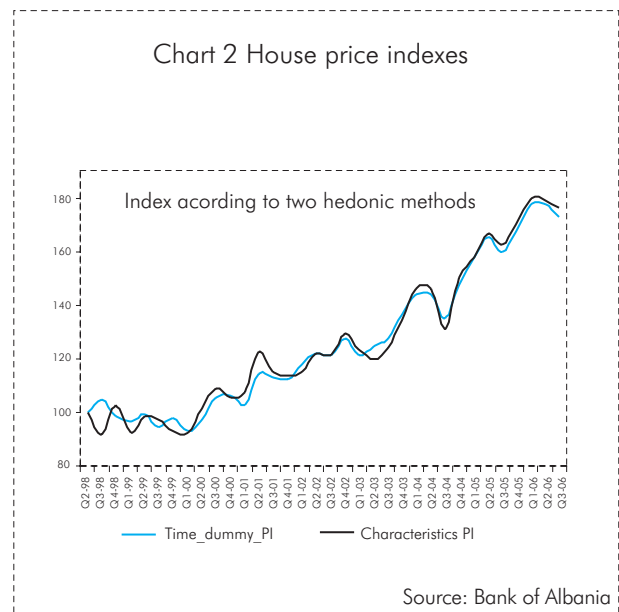
¹⁰ This part is based on the "Handbook on hedonic and quality adjustment in price indexes: special application to information technology products", Triplett, 2004, pp 60-65.

Index for this period. The problem with this method is the assumption that characteristics prices remain unchanged throughout the period under review. In the constant-quality method, the equation is evaluated every quarter and the respective characteristics prices are evaluated for each quarter. This is one of the reasons why the time-dummy method is recommended to be used only for short periods of time.

3. *Index is not revised.* The time-dummy method obtains a varying /non-constant index whenever a new period is added. This variation happens because the hedonic equation is evaluated for the entire period, and not only for the recently added period, by changing also the values of the preceding index. Keeping index values unchanged makes the index more usable in various analyses and studies.

4. *Easy calculation.* After the index is calculated for the available time series, the calculation for each consecutive added period is an easy task; for each additional quarter, only the hedonic equation with new surveys for that quarter is evaluated. After the new coefficients before characteristics are evaluated (new characteristics prices) they are entered in the index calculation formula to obtain the index value for the last quarter.

The following chart shows the indexes calculated with both methods; the time-dummy and the constant quality. In succeeding periods, the index has been constructed only according to the second method for the above-mentioned reasons.



4. House Rent Index

The House Rent Index (HRI) has been constructed by using the constant-quality method since 1998 Q2. In constructing the HRI we have followed the same steps as the ones used for constructing the House Price Index. The only difference is in the variable selected for this index.

The variables used for the HRI are:

Dependent variable:

* Monthly rent: In the absence of information, the monthly rent is considered to be the value in the house rent announcement. The value demanded by the owner has been assumed as the value that is paid for the rent.

Independent variables:

* Number of rooms: In the case of the rent, the number of rooms is more important than the surface¹¹ in square metres. The number of rooms is

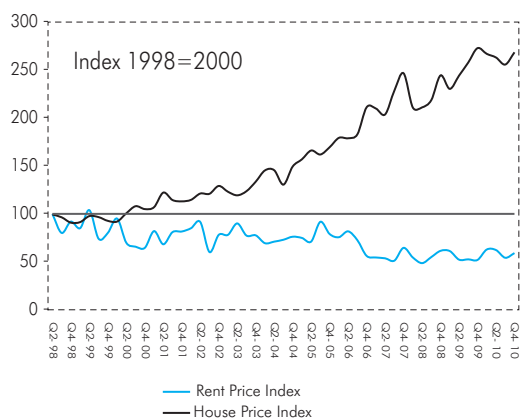
¹¹ In house rent announcements, the number of rooms is the main and most frequently used characteristic.

considered as a constant characteristic; the single room apartment is assigned the code 1, 1 bedroom apartment¹² is assigned 2, 2 bedroom apartment is assigned 3, 3 bedroom apartment is assigned 4 and apartments with more than 3 bedrooms are assigned 5.

* Furnishing: The houses are divided into three categories: fully furnished, partly furnished, and not furnished houses.

* Location: Definition and code assignment is identical to that used for the HPI.

Chart 3 House Price and Rent Price Indexes



Source: Bank of Albania

The hedonic equation used in the case of the house rent follows the characteristics method in the log-lin form:

$$\ln R_i = c_0 + c_1(\text{surface.}) + b_2(\text{furnishing}) + b_3(\text{location})^{13} + b_4(\text{age}) + \varepsilon_i \quad (2)$$

The successive steps are identical to those followed for the constant-quality index; an equation is evaluated for each quarter and an index is built using the formula of Laspeyres index. Here, the denominator is the base period and the numerator is the rent calculated from the coefficient of the current period with the characteristics of the base

period. The base period is 2005 Q1.

III. USING INDEX INFORMATION

Combined with other indexes, the House Price Index (HPI) and the Rent Price Index (RPI) contribute both to constructing a comprehensive picture in the house market and analysing the economic performance. The HPI in Tirana shows a clearly upward trend from the beginning of measurements in 1998 Q2, increasing +9 per cent on average per year. In Tirana, in nominal terms, the HPI has increased about 169% throughout these 13 years. On the other hand, the RPI has been more volatile, with a slight downward trend (Chart 3).

The annual changes of the HPI have undergone some minicycles. Its fluctuations do not seem to have always coincided with the minicycles of the GDP. As shown by Chart 4, house price fluctuations seem countercyclical vis-à-vis the GDP growth rates. The most outstanding deceleration of the HPI was recorded in 2007 and 2008, when house prices marked negative rates for the first time after a six-year period of upward rates. The price decline in this period was triggered by the significant increase of supply¹⁴ and the tightening of lending standards by banks, which may have contributed to a more

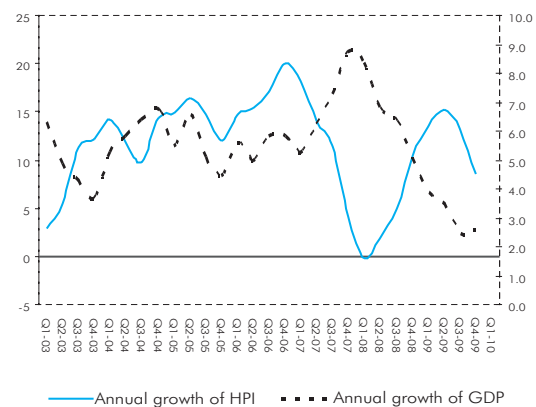
¹² 1 bedroom apartment shall mean 1 living room and 1 bedroom. The basis for code assignment is the number of bedrooms.

¹³ For the furnishing and location variables the coding procedure of the HPI is applied.

¹⁴ In 2008, construction permits increased pronouncedly after a one-year decline. The 2008 Q3 witnessed the record high of construction permits, +925%.

contained demand for houses. Following a period of upward rates recovery in 2009 and the first half of 2010, in the second half of 2010, house prices recorded negative growth rates. This development reflected mostly the effects of contracted consumer demand as a result of the global economic crisis. Consequently, the consumer confidence deteriorated and uncertainties for economic outlook increased, leading to lower private consumption in 2010. The slowdown of demand offset the price rise effect from the contraction of supply. The latter was reflected by less new transactions and longer period of holding the house in the market for sale. The decline in supply was preceded by a decline in construction permits since the end of 2009.

Chart 4 Annual growth of GDP and HPI

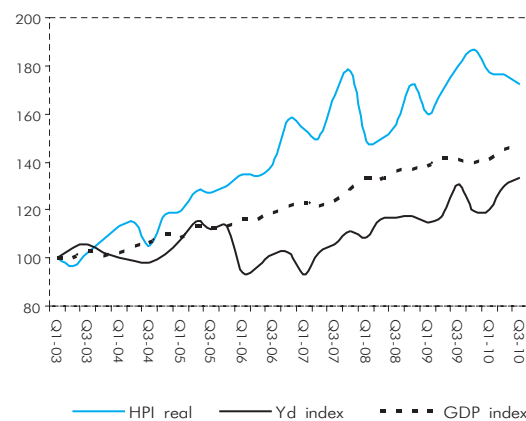


Source: INSTAT and Bank of Albania

In theory, the factors determining the house price fluctuation are numerous. They may be grouped in demand and supply-related factors. Like in any other market, house prices are determined by demand and supply. On the demand side, the main factors mentioned in literature are disposable income and interest rates.¹⁵ Key user cost elements include mortgage interest costs, maintenance costs, property taxes, and expected net capital gains, in the case of purchasing a house as an investment instrument. Another important factor in creating demand for houses is the population increase. House supply depends mainly on the available land for construction and building costs. A characteristic of the house market is the time lag between demand and supply. In contrast to other markets, in the house markets, the supply may lag demand due to delays in obtaining construction permits and designing and eventually building the house. These lags may cause house overpricing at certain times.

Despite determining macroeconomic factors, it appears that price volatility in Albania is triggered mostly by domestic factors, characteristic for Albania.¹⁶ Population growth, internal demographic movement and higher preference to own a house rather than rent it have created a stable and increasing demand for houses over the years. Chart 5 shows the HPI growing more rapidly than the GDP and the disposable income.

Chart 5 HPI, GDP and disposable income (converted in index, base period 2003 Q1 = 100)



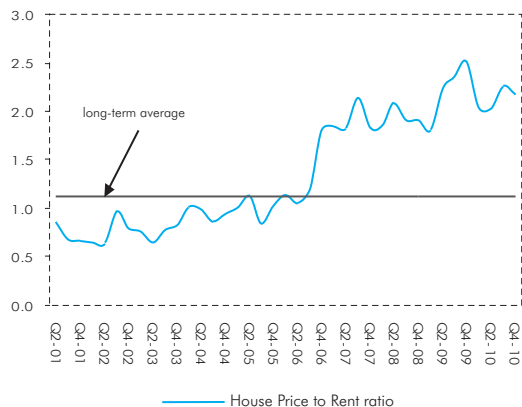
Source: INSTAT and Bank of Albania

¹⁵ Hilbers et.al. (2008): "House price developments in Europe: A Comparison", IMF Working Paper WP/08/211.

¹⁶ The analysis of price rise factors is limited only to specific factors that have affected price volatility in Tirana. The primary reason is that there are no available data for prices and rents in other cities. In addition, the price analysis nationwide would be very difficult as price volatility in various directions in various cities could leave unchanged the aggregated index nationwide. Finally, the house prices in Tirana are more dynamic.

To analyse the house price performance and contribute to economic analyses, a number of indicators and ratios have been constructed. One of the simplest ratios used for this purpose is the house price to rents ratio. The comparison of the actual with historical values may signal overpricing in the house market.

Chart 6 House Price Index to Rent Price Index ratio and its long-term trend

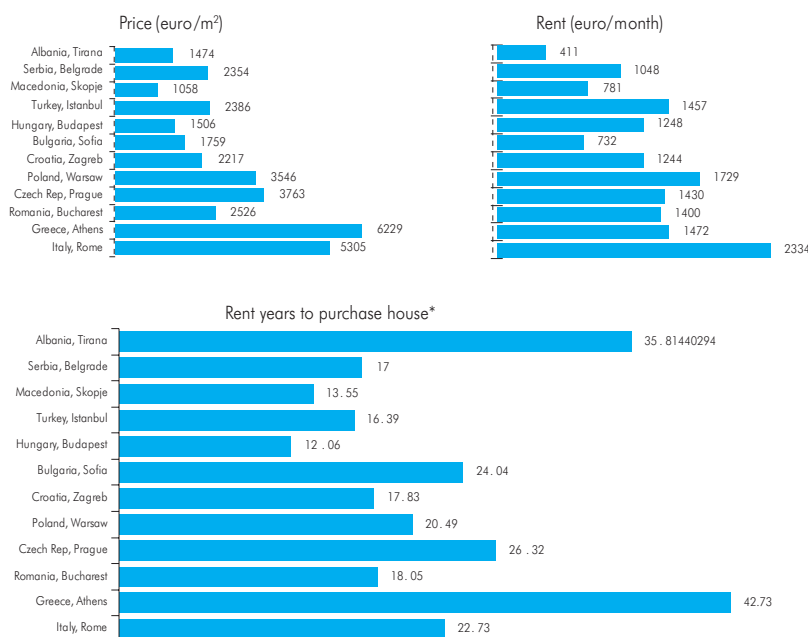


Source: Bank of Albania

Chart 6 represents the house price to rents ratio for Albania. Chart 7 calculates and compares the house price to rents ratio for Albania and other European countries according to the latest house market data. The price/rent ratio is equivalent to price/profit ratio for securities. In other words, it measures how much a buyer pays for a rental monetary unit earned. Rapid house price rise and unchanged rent prices signal overpricing in the house market. The house price to rents ratio has increased 4.5 times during 1998-2010. Although in 2008 this indicator showed a downward trend, in the last quarter of this year, its value stands at 1.9 times higher than the average of 1998-2008. While this index shows that the house prices are overestimated, its performance over time is driven both by price rise and rent decline. As shown in Chart 7, though price in Albania is relatively low compared to other countries, the renting cost is absolutely the lowest. According to the latest data, the average house price to annual rent cost ratio

low compared to other countries, the renting cost is absolutely the lowest. According to the latest data, the average house price to annual rent cost ratio

Chart 7 Average price and rent for an average house (a 102 m² house located in the city centre) and price/rent ratio compared to other countries

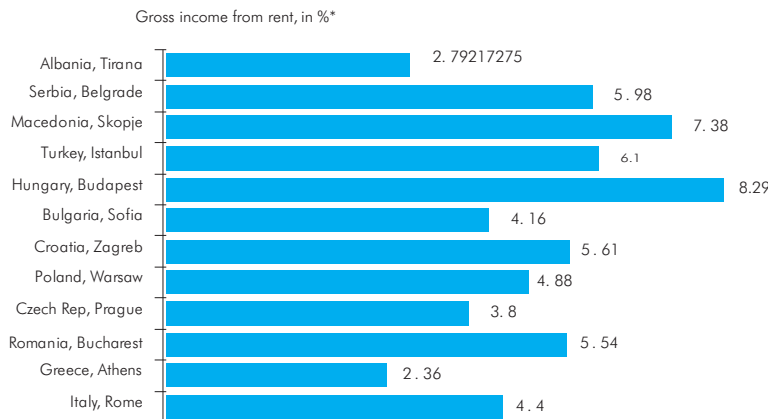


Source: Bank of Albania, Global Property Guide and BoA calculations.

*)This is calculated by dividing the average price of a 120 m² house in the city centre with the rent cost for the same house multiplied by 12 months: $\frac{\text{price}}{\text{rent} \cdot 12}$

for the same house is one of the highest among the countries in review. More than high prices, the comparison reveals that the high ratio is triggered by lower rents in all the countries under review. This conclusion is confirmed also by Chart 8, which shows that the gross net income from rent, as a percentage to the purchase price, is among the lowest ones. This shows that, in the case of Albania, purchasing a house for investment purposes is not very profitable.

Chart 8 Gross income from rent; comparison with other countries

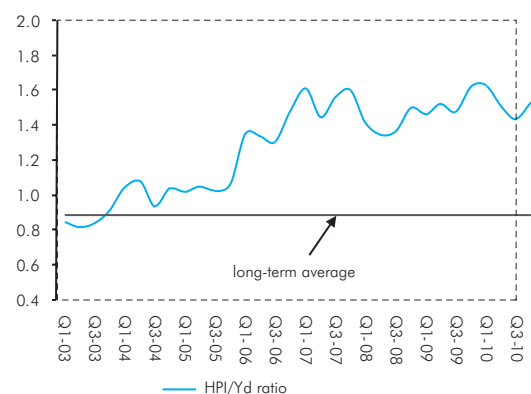


Source: Bank of Albania, Global Property Guide and BoA calculations
 *)The gross annual income from rent as a share of the house purchase price. This shows what an owner may expect to win if he buys a house for investment purposes, excluding taxes and other maintenance costs.

Another index that is often used to evaluate the price terms in the house market is the price to disposable income ratio, also known as the affordability index. This ratio is used as a simple and fast indicator to evaluate whether the house prices have risen more than the households' income and whether they are affordable. When this indicator is much higher than the historic average, it shows that the houses are overpriced. The house price to disposable income ratio has jumped above the historic average in two cases in 2003-2010; the first episode was during 2006 Q4 – 2007 Q4 and the second at the end of 2009. The recent decline (during 2010) of this ratio has driven its values close to the historic average.

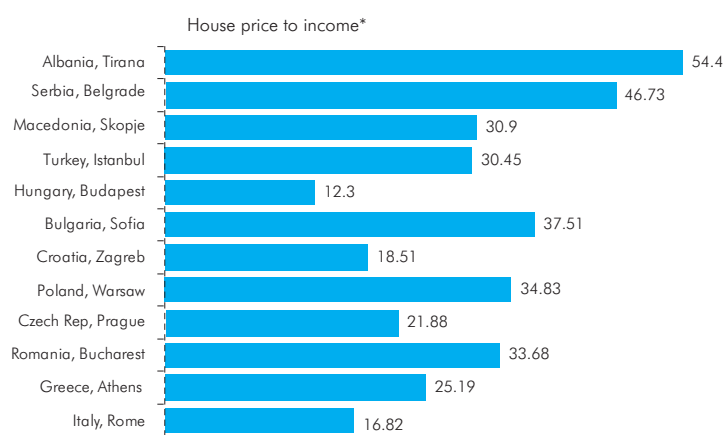
To complete the affordability index analysis, we have compared the house affordability in the capital of Albania with that in other European capital cities. For this purpose, we have constructed the house price to GDP per capita ratio, a similar ratio to the affordability one explained above. Chart 10 shows the house price to GDP per capita ratio for each country under review. The ratios are constructed based on the latest data of 2010. The price to GDP per capita ratio is higher for Albania, compared with other countries for the period under review.

Chart 9 House affordability index



Source: Bank of Albania

Chart 10 House price to GDP per capita index, comparison with other countries



Source: Bank of Albania, Global Property Guide and BoA calculations

CONCLUSION

In this paper, we present the methodology for constructing the house price index through the hedonic methods. The main motive for constructing this index is the need to analyse the house market in Albania, which would be impossible in the absence of an index that aggregates, in a single one, house price dynamics at home. The two hedonic methods employed here construct an index that is cleaned from the effects of the quality change. However, for further calculations, we choose the constant-quality method for a number of advantages that this method offers.

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HOUSE PRICES AND MORTGAGE LOAN EMPIRICAL EVIDENCE FOR TIRANA

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MONETARY POLICY DEPARTMENT, MARCH 2011

Key words: house prices, mortgage lending, DOLS method.

JEL Classification:

ABSTRACT

In the last 10 years the real estate market and the mortgage credit portfolio in Albania have experienced substantial changes. This paper aims to investigate the factors which have influenced the house prices dynamic, giving a special focus to the role of mortgage credit in this development. Based on the Dynamic Ordinary Least Square model (DOLS) a significant statistical relationship between these two variables has been estimated, also for Albania. Furthermore the paper shows that another significant factor influencing the housings' price is the cost of construction, both in the short and long run. However, taking into account some drawback that hinder the normal behavior of the real estate market and also that Albania is a developing economy, we believe that both variables (house pricing and mortgage credit) remain subject to dynamic changes in adaptation to new equilibrium levels in the future.

1. INTRODUCTION

In the recent years, the economists have paid special attention to the dynamics of real estate prices in the economy, due to their interference with many vital sectors, such as the construction sector and banking. In particular, close attention is paid to the impact that the performance of house prices has on the stability of the financial sector. Real estate prices significantly influence the financial intermediaries' ability for expanding their balance sheets in which major part of disbursed loans is backed up by real estate collateral. For this reason the behavior of house prices not only affects the business cycle dynamics through the direct effect that it gives to the aggregate demand, but also the performance of the financial system. Studies on the interdependence of mortgage credit and house prices are in the focus of many central banks since this relationship has a significant impact on the development of monetary and credit indicators and more over to the overall economy. Increasing the value of the collateral (in this case: the house) will allow obtaining a higher credit, and therefore will affect the demand for goods and services, which in turn would put inflationary pressures on the economy. Furthermore the financial accelerator mechanism, that is the main channel through which mortgage loans can influence house prices, is part of the transmission mechanism of monetary policy. As such it plays an important role in the implementation of

the monetary policy to meet the final objective, the inflation target. For these reasons the relationship of credit with house prices is of particular importance for the central bank's macroeconomic policies. Moreover, the volatility in asset prices, and in particular in house prices, sets out the challenge of selecting the appropriate response of monetary policy.

Along with macroeconomic policies, the relationship between mortgage loans and house prices has a significant impact on the financial stability. Theoretical and empirical approaches have shown that high growth of credit portfolio, associated with significant increase in house prices, is one of the most consistent and prognostic indicators of future financial crises (Borio and Lowe 2002). The financial crisis of years 2008-09 in many countries, once again confirmed the finding of these studies.

During the past 10 years, real estate markets and mortgage loan portfolios have experienced significant developments in Albania. Our study aims to investigate factors that influence the price dynamics, focusing on the effects of mortgage loan portfolios in the performance of house prices during this period. The interaction between these two indicators is of high interest to elaborate, not only because of the above mentioned reasons, but also because there are very few studies that investigate on the development of house prices in Albania. To fill this gap in the literature, this paper will seek to evaluate empirically the statistical significance of the relationship between credit and house prices in Albania.

This study is organized into four sections. The first section presents a literature review on the interdependence between credit and house prices. The paper continues with a detailed overview of the housing market and credit developments in Albania. The third section provides an empirical analysis of factors affecting the performance of house prices in Albania, highlighting the role played by the expansion of mortgage credit. The paper concludes with the main findings of the study, which confirm the statistical significance that the house prices play for the mortgage credit and vice versa in the long run. However the low statistically explanatory power of the influence of these two variables in the short term pinpoint for the importance of some drawbacks that hinder the natural development of house prices in Albania.

I. LITERATURE REVIEW

The empirical literature has extensively elaborated the factors which influence/determine the house prices. Numerous studies estimate the main factors which influence the demand for houses and their prices. On the demand side, it has been evaluated that the main factors which influence the dynamic of house prices in the long run are the development in households' disposable income; demographics changes; the tax system in the economy; bank credit; as well as the average interest rates. On the supply side, the main indicators to determine the long-term dynamic of house prices are: the availability and cost of land, construction's cost, investments in improving the quality of existing housing stock.

In the literature, it has been given a special attention to the interdependence of the mortgage credit and house prices. Investigation of this relationship is of high importance, especially for the implications in the two most important sectors of the economy (construction and banking sector), as well as direct or indirect implication of the development of this two sectors for the other sectors of the economy and overall financial stability.

Kindlerberger (1978) and Minsky (1982) in their studies have emphasized the important role of credit in house prices development. Facilitating the procedures for obtaining a loan, resulting in an easy financing to afford a house purchasing, along with other factors, will increase demand for housing. Given that in the short-term period, the housing supply is fixed (rigid), higher demand for houses would result in a price increase.

Through the financial accelerator mechanism, mortgage credit influences the house price and vice versa. According to Gelter and Bernanke (1989) the financial accelerator mechanism is self fulfilling (enforced) process of the mortgage credit and the house prices. Banks' mortgage credit supports the demand for houses purchases. In response to the higher demand, the house prices are going to increase and as the result the amount of the collateral will be enlarged, increasing the households' ability to take a loan for the added value of the collateral. And as such, higher demand for loan will increase lending influencing in higher demand for product and services in the future, also for houses, accelerating all the above processes.

Bernanke & Getler (1989), Kiotaki & Moore (1997) elaborate other transmission channels of the relationship of credit with house prices and with the entire economy. They emphasize that credit growth not only influences directly the house prices, but, through them, it also affects other macroeconomic variables, such as consumption and inflation. Initially high prices of houses would trigger the "wealth effect", whereby homeowners would feel richer, because of rising prices of their houses, and therefore will consume more, putting pressure on inflation. Moreover, some households would prefer to use the added value of their collateral to further increase the credit demand. As result these households have higher chances to obtain a new loan, which can be used to increase further consumption.¹ Increased consumption would support aggregate demand and would boost economic activity, and therefore would be accompanied by an overheating of the economy. As a consequence, what will be experienced are not only higher inflationary pressures on the economy, but also higher expectations for exalted return on assets, which would bring a further increase of house prices conditionally by the rigid house supply.

However, academics argue that the real cost of a booming period with housing pricing is not the inflation per se, as in fact the burst of the bubble in real estate market will slowdown the economic activity and induce a disinflation/deflation process. The burst of the house price bubble, which is associated with financial instability and a credit crunch influenced by collateral value, will be very costly to the economy in term of output.

¹ In literature this phenomena is recognized as wealth withdrawal.

However, time periods of a boom in lending and in house prices would end up, if an external factor² influences in the opposite direction the relation of these two factors. A lower value of collateral and an increased uncertainty would reduce bank's initiative to lend. Furthermore higher cost of mortgage credit service will bring some households to potential bankruptcy, especially to 'not that good quality' borrowers. Experiences from the past have shown that, in periods of boom, banks have a tendency to be more competitive and they incline to address more those segments of the households, which take high risk. Under high uncertainty, households will aim to reduce consumption and increase savings, and as a result they will shrink investments in real estate. Reduced demand for house purchases is reflected in their prices, and furthermore will reduce the value of the collateral that back up loans. Wealth effect would act in the opposite direction, resulting in a lower consumption. Finally, economic activity in general will decrease by the same instruments that were activated during economic boom and as result it would be experienced an increase of non-inflationary pressures. Many of these mechanisms were demonstrated by the developments during the latest financial crisis (in 2007/2008) in advanced and emerging economies.

Empirical studies which compare between countries with different economic and financial development, of various authors such as Ayousu et al (2003), Tsatsaronis and Zhu (2004), Anne (2005) and Egert and Mihaljek (2007) conclude that the elasticity coefficients of fundamental factors on changes in house prices vary significantly depending on the size of the country, the development of financial markets, as well as the size of the sample studied. However, all these studies have two main characteristics that seem to converge. First, the elasticity coefficients of key variables are higher for small countries³ and economies that are in converging phase⁴, compared with the major industrial countries. Secondly, in addition to income and real interest rates, statistically significant factors are the increase in private sector credit, demographic factors and other specific features of housing supply such as building permit, land disponibilities, and the initial housing stock quality. These factors are also considered to play an important role in the dynamics of house prices.

Egert and Mihaljek (2007) in their study make a comparative analysis between countries in East Central Europe and countries of the OECD. They emphasize that the house prices dynamic of Central and Eastern Europe countries, besides the already mentioned factors, is significantly influenced by country-specific factors, such as lack of institutionalization of the housing market, limited supply of new houses during the period of market liberalisation, improvement in quality of housing, as well as higher demand by non-residents. In these countries another factor of particular importance is the underestimated initial level of house prices in the transition period. Egert and Mihaljek have estimated that this factor has influenced the dynamics of house prices during the economic convergence of these countries.

² Such a factor may be: the confidence shaken on the banking system; tightening of the monetary policy etc.

³ Countries such as Denmark, Finland, the Netherlands, etc..

⁴ These are countries that are called "Catching up economy" such as Spain and Ireland.

The developments in the Albanian real estate market are analysed in a small number of studies. As far as we are aware, up to now there is no study, which estimates empirically the relation of house prices and mortgage lending. This paper attempts to fill this gap and bring thus some added value. The aim of this paper is to investigate empirically the relationship between credit and house prices in the case of Albania. The estimation process consists in two stages: first through the dynamic ordinary least square estimation (DOLS), used by Engle and Granger, and secondly through the error correction model. The selected methodology addresses properly the constraint of the short data series, and is also the best way to handle the endogeneity between variables. The empirical estimations aim to understand if there is a statically significant interrelation between these two variables, not only in the long run, but also in the short run. The error correction model addresses correctly the problem of endogeneity between variables and also allows for a more accurate estimation of correlation between these variables, as in short and long run times period. However, given the complex economic relationship between these two variables and the main features of the Albanian economy, adding also some database's constrains, in particular the lack of different/ detailed indicators of the housing market, the application of econometric methods remains a challenge.

II. HOUSE PRICES AND MORTGAGE LOANS IN ALBANIA

The housing market and credit portfolio in Albania have experienced significant changes. Developments in these two markets can be divided into two distinct periods. During the first period 2000-2007 there was a rapid expanding both of the housing market and of the mortgage loans. While during 2008-2010 period, both these markets have experienced a visible slowdown of their growth rate affected by the overall sluggish economic performance, reflecting also the influence of global financial crisis in the Albanian economy.

II.1. Developments in mortgage loans

During 2004-2007⁵, mortgage loans have increased substantially, expanding on annual terms by an average rate of 65%. The positive performance during this period was supported by the development of the banking system and the overall macroeconomic development. By this time, a stratum of middle-income population was created, which was capable to take over and pay regularly loans installment. In the meantime, it was accompanied by the privatisation of the largest bank in the system, savings bank by the well-known internationally Raffeissen Bank, which has released liquidity and has put banks under pressure to introduce and develop a new product, the "mortgage loan". On the supply side of housing loans, banks were eager to exploit this new market segment by providing credit on favorable terms under the pressure

⁵ During 2000-03 periods, the lending activity has been sluggish. In 2004, the privatization of the Savings' Bank, the largest bank in the system, from Raffeissen Bank, gave a new impulse to the credit development. During this period has been experienced higher competitiveness between banks, which aiming to increase their market share, have introduced new lending products, such as mortgage credit.

of high competition. For many banks, housing loan helps to diversify credit risk and for regulatory purpose can also be associated with lower cost for the bank's capital⁶.

Willingness of banks to develop this market segment was accompanied by the desire of their clients to get loans. During this period there was an increasing interest by households to get loans, driven by the rapid growth of the house prices during 2005-2007, which made it difficult for households to purchase a house with their own funds. The house prices during this period have increase in average 16% in a year or almost 50% higher than at the end of 2004. Meanwhile, banks introduced promotional mortgage lending products, where the credit standards were eased substantially, influencing as such the demand for mortgage loans. The annual growth of the mortgage credit signed almost 65% pro year, and at the end of the period the mortgage credit portfolio was almost twice as higher than in 2004. In addition, during this period the economic activity in the country experienced an (optimistic) increase, which helped to create positive expectations for the future and further growth of house prices, encouraging individuals to buy houses with loans.

Meanwhile, following 2007, the annual growth rate of the loan portfolio has been significantly reduced marking also some negative values during 2010. In late 2008, on the supply side, the significantly slower growth of credit portfolio has been influenced by liquidity problems that the banking system encountered due to confidence crises. The lack of liquidity, especially in foreign currency, forced the banks to tighten significantly their lending standards, especially for foreign currency lending to households. Consequently, during this period the demand for mortgage loans experienced a contraction. Furthermore, the lower demand of mortgage loans reflected also the slowdown of disposable income growth, in response to weak economic performance over the last 2 years. Consumer confidence survey's data show more precautionous behavior of households, which in the last 2 years were oriented toward saving as a result of increased uncertainty about the future. Finally, the reduced demand for mortgage loans is thought to reflect a certain time delay in the decision for house purchasing, in response to households' expectations for a potential price correction in the real estate market⁷.

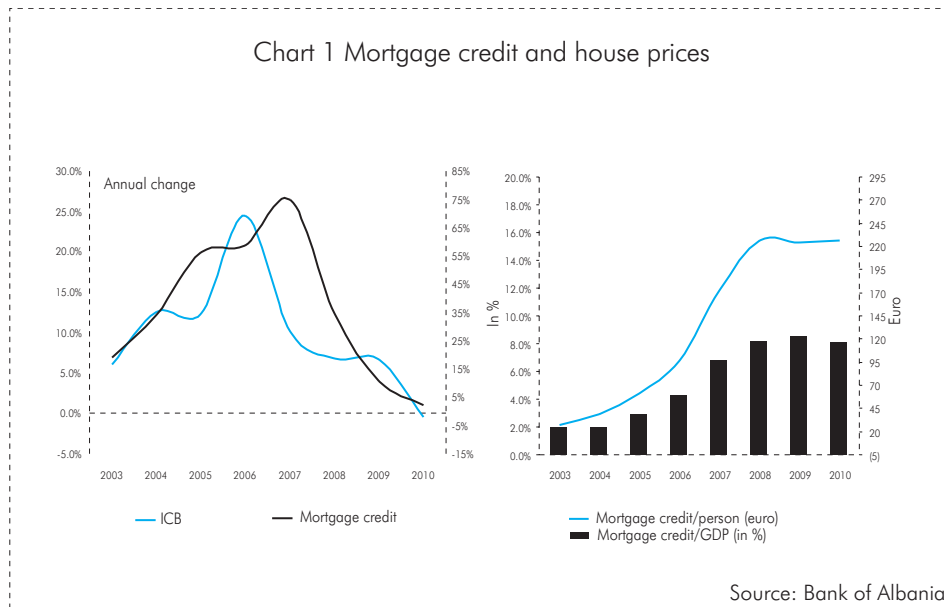
At the end of 2010, mortgage credit portfolio in Albania was less than 10 per cent of gross domestic product of the country, or almost Euro 226 worth of credits per capita. Mortgage loans to households makes up about 20 per cent of the banks' loan portfolio. Banks provide mortgage loans with fixed and floating interest rates⁸. This varies significantly by the lending currency. The data show that majority of banks provide mortgage loans in euro and floating interest

⁶ The Albanian regulatory framework required that the mortgage loan is weighted by 50% risk coefficient when it is calculated the adequacy ratio. In this regard, is estimated that the mortgage credit demand half of the capital unit in comparison to other credit product, to compile with the 12% minimum required capital.

⁷ Many countries have experienced such a correction during the latest global financial crises.

⁸ At the end of December 2010, 90% of the total credit portfolio was with floating interest rate and this ratio has been increasing compare to the previous period (before 2008). Data on this ratio only for the mortgage loan is not available

rate. However, some of the banks active in the market for mortgage loans have presented some hybrid products by applying fixed interest rate in the first 2-5 years and then a floating interest rate indexed to the reference rates. Banks lend to their clients in average 80 per cent of the pledged collateral. Meanwhile, the mortgage loans' maturity varies from 5 to 20 years. The large part of the



mortgage credit portfolio has a 10 years maturity term.

II.2. Developments in house prices

During 2000-07, house prices in Albania have increased significantly, particularly in the capital city. The database⁹ of housing market in Bank of Albania shows that during this period, house prices have increased on average by about 15 per cent per year. However, the level of house prices and their dynamics vary considerably from one area to another within the capital.¹⁰ Prices in popular (favorites; highly preferential) areas during this period have demonstrated an increase about 2 times higher than the average annual growth, while those on the suburb areas shows moderate growth, about 5-10 per cent.

In Tirana, one of the main factors, which has increased the demand for new constructions, since the early 1990s, has been the change in the demographic map, promoted by economic and social factors. An important role in this regard has been migration from other urban and suburban areas to Tirana, especially in the downtown. Another factor influencing the demand for houses has been also housing purchases by emigrants. Improved living conditions

⁹ The analysis of the house prices is based on the house price index calculated by Bank of Albania's database, which is based only in the prices of houses for Tirana district taken from announcements on the local newspaper. This index is calculated according to the hedonic estimation.

¹⁰ The house price index in Tirana is composed by dividing the city in three main areas: the first includes houses that are close to the downtown, the second includes houses that are within the so-called yellow line and the third includes houses that are beyond the yellow line.

and income of Albanian emigrants in host countries has influenced positively their financing ability creating an important source of demand for apartments in Tirana. Real estate agents estimate that purchases of apartments by emigrants have a considerable weight in the demand for housing, which has been growing by the end of 2007. Meanwhile, after the 2008 crisis, a significant shrinking of housing demand from this group has been noted due to high uncertainty for the labor market and overall sluggish economy in almost all the western countries where our emigrants live.

In many countries of Central and Eastern Europe, the demand for houses has been influenced also by non-resident purchasing.¹¹ Up to now the nonresident demand for housing in Albania has been low due to various handicaps that hinder the further development of the real estate market such as property rights, property registration, the underdeveloped infrastructure in the country.

In addition to demand factors, developments in house prices have been influenced also by restrictions in the supply side such as the reduction of building permits in the country's main cities. Housing price index for Tirana shows that there is significant increase in house prices during 2004-2006 period. INSTAT data show that during these years the building permits declined¹². Reduction of building permits in these areas is estimated to have shrunk the supply for new constructions, affecting the price rise. Also the price rise in construction costs of production, such as land price and the usage of higher quality materials, has increased prices for houses.

Consolidation and increased flexibility of the banking system to credit the households and construction firms operating in the market, is another important factor that has led to increased demand and supply in the housing market. Higher financial intermediation from the banking system has supported financially a large number of construction firms. Banking sector financing during this period constituted a major funding source for construction firms. Overall optimism in the real estate market influenced the construction firms to invest in building residential housing and requiring financing over their capacity. High prices of their building make available for the construction firms the necessary collateral to take new credit and expand their activity beyond their financial potential. The financial accelerator mechanism worked also for the household. With higher prices they were optimistic to take new credit and to finance their need for house purchasing not only to fulfill their basic need but also as an investment opportunity. The households during these periods could fulfill easily the required collateral from banks for granting a credit, without paying attention to long run obligation in serving the mortgage credit.

Developments over the period 2008-2010, show stagnation in the real estate market. Housing supply has not been expanded as it is shown by data of building permits and the output from the construction sector has been declining driven by the slowdown of the demand for new houses. The construction sector, since the end of 2008, has contracted the output, contributing negatively to the

¹¹ Balázs Égert and Dubravko Mihaljek, 2007 "Determinants of house prices in central and eastern Europe", BIS Working Papers Nr. 236.

¹² According to the statistic publish by the INSTAT.

overall real growth of the economy. Developments in the real estate market during this period are also affected by the contraction of housing demand, as it is observed in many other countries. This phenomenon reflected the expectations of households for downward correction of house prices and also higher uncertainty about the future. Likewise, demand from emigrants has declined, in response to deteriorating labor market conditions abroad. All these developments have led to a significant slowdown of rising prices of real estate. Downward correction in house prices has been observed, especially in suburb areas of Tirana. Real estate agents confirm that even if the house prices are declining, the number of transaction in the market has been low in the last two years. Recent dynamics in the housing market show that in the second half of 2010, purchases of apartments by emigrants are increasing, in line with this global economic recovery and somewhat reduced uncertainty for the future.

III. ECONOMIC AND ECONOMETRIC APPROACH

Empirical studies of house price dynamics and mortgage lending emphasize the significant interrelationship between the two variables. In this part of our study we will estimate how the data sustain statistically this theoretical conclusion in the case of Albania.

III.1. Data

Data included in the study are of monthly periodicity and the main data sources are the Bank of Albania, the INSTAT and the IMF. Data included in the study are: the house price index, mortgage lending from banks, disposable income approximated by the gross domestic income per capita, construction cost index and interest rate.

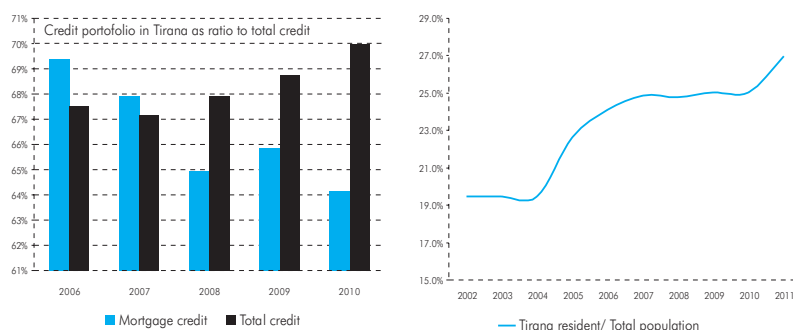
The dynamic of house prices in Albania is capture by the house price index compiled by the Bank of Albania. This indicator is the only available time series for the house prices and is an index calculated by the Bank of Albania based on the hedonic approach, which account for some specific feature of the houses. The house price index is calculated only for Tirana district. Even though it is very interesting to evaluate if the house price developments are in

Box 1. Some methodological issues

In our study we analyse the house price development only for Tirana. Not only because of the data availability, but also because Tirana district has experienced substantial demographic and urban changes after the communist period. According to some statistic from the INSTAT, one fourth of the total population lives in Tirana and its suburbs. However, by some estimation that consider also the unregistered or the persons that work in Tirana, but have not officially registered their residence, this figure is as high as one third of the population. Especially after the 2000, Tirana district has experienced considerable demographic changes. These changes have increased substantially the demand for houses. In response to high demand, during this period, Tirana accounts for almost 40% of the total surface built in the country according to official statistics.

The mortgage portfolio of the banking system shows high concentration of the loan portfolio in the capital. For the period 2006-2011, Tirana mortgage portfolio accounts for around 66% of the total loan on average. The higher concentration of the mortgage portfolio is closely related not only to higher population in Tirana, but also to higher relative demand from this population. There are several factors influencing this demand. One is related to the social profile, as the more financially educated could choose to finance a house purchasing with a bank's loans, while in the remoter parts, such an investment is usually financed with cash or borrowings from family and friends. Also, the employment rate and income per capita in Tirana is higher than in other cities, which could allow for easier access to bank loans.

Chart 2 Shares of mortgage credit and residents in Tirana as % to total



Source: INSTAT and Bank of Albania

However in our paper we include the total loans mortgage portfolio because from anecdotal evidence, it is estimated that, although many households may have taken a mortgage in their local bank, they have used it to buy a house in Tirana. Furthermore the data series according to district include only 4 years, which is not adequate for our study.

line with their fundamentals, this paper does not attend to address this issue. Another challenge has been to find an appropriate indicator for the disposable income. Due to data limitation, finding an indicator which includes not only the domestic income but also the income earned by emigrants abroad was quite difficult. Especially difficult it is finding a quarterly data series for the disposable income. However through data interpolation was tested the available data of national domestic product from INSTAT, an annual series. The results were not satisfactory, due to data limitation and compiling. As the result in the empirical part of this paper we have been based on the data series of the gross domestic product per capita, which performed and represent better the income earned.

III.2. Empirical findings

Econometric studies (Stoke & Watson, 1993) provide consistent estimates of

economic variables when the time span of the economic cointegrated series is not very long. Classical estimation models usually include the popular method of ordinary least square (OLS) or some recent models, as error correction model. However, the above methods, due to some constraints, fail to provide accurate estimates of the variables in case where time series are too short.

In this study we used the method known as the two-step estimation process, similar to that used for the first time by Engle and Granger (1987). The purpose is to find a long-run relationship between mortgage loan and house prices and, in a second step, to explore if the growth rates of the two variables are also related in a short term. Furthermore, we will try to respond to the question: is this interrelationship statistically significant, in both directions, in long and short run period?

From the Augmented Dickey-Fuller (ADF) test it has been noted that the series were stationary in first difference and as a result we chose to use the two-step estimation method of Engle-Granger. In the first step we estimate the relationship between cointegrated variables and then, in the second step, we used residuals from the first estimation to build a regression equation as an error correction term. This procedure is allowed because the variables in first difference are $I(0)$ ¹³. In the following section, we will estimate the long-term relationship through cointegrated relationship, as well as confirm that the residuals are stationary.

III.3. Long-term relationship

Long-term relationship between the mortgage credit and the house prices is estimated based on a system of simultaneous equations between credit and house price similar to the method used by Fitzpatrick and McQuinn (2007).

Equation 1

$$\text{Credit}_t = f(\text{HousePrices}_t, \text{Income}_t, \text{InterestRate}_t)$$

Equation 2

$$\text{HousePrices}_t = f(\text{Credit}_t, \text{Income}_t, \text{Constructions Costs}_t)$$

In the first equation mortgage loan is a function of income, interest rates and house prices while, in the second equation, house prices are a function of income, costs of construction and mortgage loans. This procedure allows us to capture the simultaneous relationship between mortgage and house prices, meanwhile incomes, interest rates and construction costs are assumed to be exogenous variables.

Nevertheless, the presented form of the two equations raises some problems that require solutions. First, the model highlights the problem of endogeneity between mortgage and house prices variables, which can lead to biased estimates of coefficients. Secondly, all variables in both equations are not stationary

¹³ See Appendix 1.

in level¹⁴, but are as such, in the first difference. Non-stationary economic variables can lead to violation of standard regression assumptions leading to incorrect and spurious estimates. Finally, the time span of data series is relatively short implying the same problems with the estimated coefficients as already mention.

In order to test a long-term relation between two variables in the study and eliminate the problems that classical methods of estimation evidence, we used Dynamic Ordinary Least Squares method (DOLS). This method, used for the first time by Stock and Watson (1993), is classified in the group of methods with one equation. We chose to use it in this study, because it allows for correlation between variables and residuals in the same equation with both long-term relationship variables differentiating time delay (lag) and time-driven (leads). This method improves the classical method of the least square, and is used in the case of small sample and multiple sources of error (which usually come from the frequently changes in the dynamics of time series, typical of emerging economies). Furthermore, in comparison to other methods (e.g. Johansen method), DOLS allows more accurate estimates of parameters in terms of only one equation and at the same time, correcting the problem of endogeneity and serial correlation between variables.

The table below presents the results of DOLS estimates for the following two equations:

Equation 3

$$\text{Credit}_t = \alpha + \beta_1(\text{Income})_t + \beta_2(\text{Interest Rate})_t + \beta_3(\text{House Prices})_t + \sum_{j=-16}^{16} \delta_{1,j} \Delta(\text{Income})_{t-j} + \sum_{j=-16}^{16} \delta_{2,j} \Delta(\text{Interest Rate})_{t-j} + \sum_{j=-16}^{16} \delta_{3,j} \Delta(\text{House Prices})_{t-j}$$

Equation 4

$$\text{House Prices}_t = A + \phi_1(\text{Income})_t + \phi_2(\text{Construction Costs})_t + \phi_3(\text{Credit})_t + \sum_{j=-16}^{16} \gamma_{1,j} \Delta(\text{Income})_{t-j} + \sum_{j=-16}^{16} \gamma_{2,j} \Delta(\text{Construction Costs})_{t-j} + \sum_{j=-16}^{16} \gamma_{3,j} \Delta(\text{Credit})_{t-j}$$

Table 1 Results of estimation.

Dependent variable	Constant	Credit	House Prices	Income	Yield bonds	Construction costs
Credit	-33.26		3.00	2.44	-0.008	
P-value			(0.006)	(0.0364)	(-0.70)	
House Prices	121.1	2.3		-12.74		3.06
P-value		(0.000)		(0.000)		(0.05)

¹⁴ Consequently, the inclusion of variables in level would affect the estimates of the coefficients of the model.

DOLS estimation of the credit equation shows house prices to have positive relation and statistical significant impact to the mortgage loans in the long-term. Also, an increase of income is expected to lead to growth of the mortgage loans. In the meantime, in the equation is observed that the interest rate coefficient has the expected negative sign, but it is not statistically significant¹⁵. The ADF test of the residuals of the equation 4 shows that mortgage credit, income, interest rates and house prices are cointegrated. Results of the housing price equation confirm that the long-term relationship between credit and house price, interacts on both sides. The credit coefficient is positive and statistically significant. The construction costs also show a positive coefficient, implying the statistically significant role of costs in the long run of the housing price. The negative sign before the income coefficient is not expected, but may be the result of high and positive correlation between income and mortgage loans (the estimated value of the correlation coefficient is about 0.94 in the period under review). To address this issue, we generate two separate model, one including the mortgage credit and the other one including the GDP. Results were similar to the results taken by Egert and Mihaljek. The incomes' coefficient resulted statistically significant and had the expected positive sign. ADF test of the residuals equation also confirms that the variables are cointegrated.

An estimation of the long-term relationship with DOLS method is valid if the group of variables has a single cointegrated relationship. Trace test shows that mortgage credit, income, interest rates and house prices have a single cointegration relationship. This test also concludes that a single cointegrated relationship exists for housing price, income, cost of construction and mortgage loans. If we consider the 5 variables together, the trace test shows that there are two cointegrated relationship. The confirmation that there is only one connection for each of the variables assures us that DOLS estimates are reliable.

Estimation of long-term relationship in the first equation indicates that a 1 per cent increase in the house prices will increase by nearly 3 per cent the mortgage loan. The long-term relationship equation of house prices, suggests that an increase of 1 per cent of the mortgage loan will be associated with a 2.3 per cent increase in house prices in the long run.

III.4. Short-term relationship

According to Granger-s Theorem, if the variables are cointegrated, then there is an error correction model type. We used the long-term relationship estimated by DOLS to generate components for the analysis of error correction term. The error correction model for the mortgage explains the growth rate of mortgage loans depending on the past changes of the mortgage credit,

¹⁵ As explained in the section of data in the Appendix, it may be related to the low elasticity of credit demand to its price. Meanwhile, parallel to yield bonds is also tested the interest rate of new credit in euro and the policy rate. In all cases, variables in the model result statistically significant, but with the opposite sign from that the economic literature suggested.

term error correction and at the same time the rate changes with time delay and other variables. The specific error correction model for the mortgage is:

Equation 5

$$\Delta Credit_t = \alpha + \sum_{i=1}^6 \gamma_i \Delta(Credit)_{t-i} + \sum_{i=1}^6 \delta_{1,i} \Delta(Income)_{t-i} + \sum_{i=1}^6 \delta_{2,i} \Delta(Interest Rate)_{t-i} + \sum_{j=1}^6 \delta_{3,i} \Delta(House Prices)_{t-i} + \lambda ECT_Credit_{t-1} + \varepsilon_t$$

where the term error correction is given by:

$$ECT_Credit_{t-1} = Credit_{t-1} + 33.26 - 2.44(Income)_{t-1} + 0.008(Interest Rate)_{t-1} - 3.0(House Prices)_{t-1}$$

The model is estimated by the method of ordinary least squares and is reparameterized step-by step. More specifically, it started with a general estimation of the model, then are removed from it variables that are not statistically significant (this is done by the statistical probability t) and the remaining model is reestimated. At the end of this process remained in the model only variables that were at least with 10 per cent confidence statistically significant, determining in that way the final form of the short-run model for the mortgage credit.

A negative value of the parameter λ indicates that house prices variable plays the role of error correction when there are deviations from long-term equilibrium. The same approach, from the general model to the particular one is applied also in the case of housing price short-term equation: initial short-term equation has the form:

Equation 6

$$\Delta House Prices_t = \alpha + \sum_{i=1}^4 \gamma_i \Delta(House Prices)_{t-i} + \sum_{i=1}^4 \delta_{1,i} \Delta(Income)_{t-i} + \sum_{i=1}^4 \delta_{2,i} \Delta(Construction Costs)_{t-i} + \sum_{j=1}^4 \delta_{3,i} \Delta(Credit)_{t-i} + \lambda ECT_House Prices_{t-1} + \varepsilon_t$$

Where the term error correction is given by:

$$ECT_House Prices_{t-1} = House Prices_{t-1} - 121.1 + 12.74(Income)_{t-1} - 3.06(Construction Costs)_{t-1} - 2.25Kredia_{t-1}$$

Table 2 Estimates of short-run equations, house prices

Variables	$\Delta(\text{House Prices})_t$
ECT_{t-1}	-0.0030(0.0055)*
$\Delta(\text{Credit})_{t-3}$	0.0528(0.0743)
$\Delta(\text{House Prices})_{t-1}$	0.5690(0.0000)
$\Delta(\text{House Prices})_{t-4}$	-0.3541(0.0000)
$\Delta(\text{House Prices})_{t-5}$	0.1440(0.0577)
$\Delta(\text{Income})_{t-1}$	-0.3283(0.0432)
$\Delta(\text{Income})_{t-4}$	0.5768(0.0085)
$\Delta(\text{Construction Costs})_t$	0.7163(0.0000)
R ² adjusted	0.4139

*In parenthesis is given the p-value (statistical significant) of the coefficient

From the results of the short-term equation, the negative signs and the low value of coefficients λ (statistically significant) in the housing price equation can be noted. This explains the fact that an increase of prices will be adjusted slowly toward the long run equilibrium in the coming periods. Equation 6 shows that an increase in income and in construction costs will influence higher house prices in the short run. Furthermore the positive coefficient of credit in the housing price equation, is statistically significant, indicating that positive relationship between two variables is confirmed also in the short run. The explanatory power of this equation of 41% indicates that other variable not included in the model, play an important role in explaining the return to equilibrium in the short-term relationship. One of these variables can be explained by the existence of frictional costs of the real estate market functioning, such as problem with property rights and rule of law. These costs suppose to inhibit the response of house prices to the availability of credit only in the short-term, while in the long run they lose their impact. According to the diagnostic test, the error term of the house prices' short run equation, shows to be stationary, assuring for the reliability of the Equation 6.

Table 3 Estimates of short-run equations, mortgage credit

Variables	ΔCredit_t
ECT_{t-1}	0.0360(0.0087)*
$\Delta(\text{Credit})_{t-4}$	0.1347(0.0967)
$\Delta(\text{Credit})_{t-5}$	0.1331(0.1070)
$\Delta(\text{House Prices})_{t-4}$	0.4011(0.0547)
$\Delta(\text{House Prices})_{t-5}$	-0.3151(0.1243)
$\Delta(\text{Income})_{t-2}$	2.4561(0.0007)
$(\text{Bond_Yield } 2)_{t-1}$	-0.0370(0.0484)
R ² adjusted	0.0958

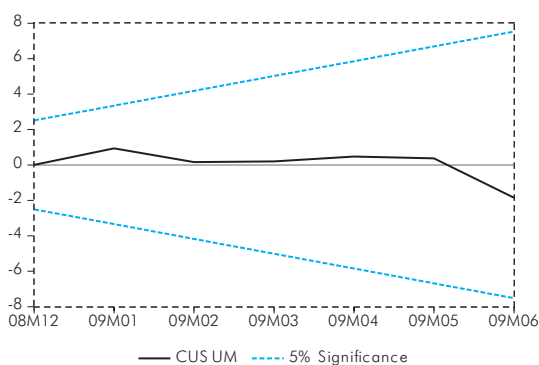
*In parenthesis is given the p-value (statistical significant) of the coefficient.

The short-term loan Equation 5 shows that the error correction term λ has the expected sign (negative) and is statistically significant. In comparison to the house prices short-run equation, the speed of adjustment to the equilibrium is higher. At the same time, the statistically significant coefficient of error correction term suggests that the amount of the mortgage loan is adjusted in the coming periods to maintain long-term relationship; furthermore, this action is performed by the other variables of long-term equation. However, the result of Equation 5 shows low values of regression coefficient, $R^2 = 10$ per cent, meaning that in the short run the selected variable can explain only a small part of the movement in the mortgage credit portfolio. The low explanatory power in short term mortgage equation may suggest that this set of data is too short. The low value of the coefficient can be explained also by the fact that the model also needs some other variable that has not been the subject of this study. This fact is supported by the periodical reports of the lending/financial intermediation activity, when the short run development of the credit portfolio are closely related to the willingness of banks to increase mortgage loan market in the context of the deepening of financial intermediation and also dependent on some drawback of banks to execute the collateral.

In equations 5 and 6, some of the variables appear two or more times and the signs of coefficients are not in the same direction. To test the zero hypotheses that the sum of these coefficients is different from zero, Wald's test is used. Results show that the reaction of house prices to a change in GDP and in construction costs is estimated to last about 6 months.

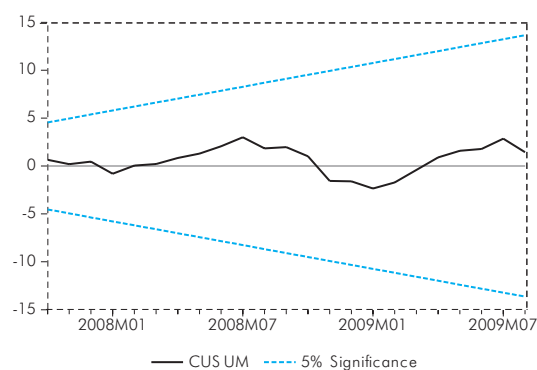
The presence of fast structural changes in the Albanian economy makes necessary the control of the stability of the above models. It consists in verifying the fact that if the model is unstable it will make the process of interpreting the regression results more difficult. Theoretically, an econometric model is fully described by its parameters, so that the stability of a model has to demand the stability of its parameters (Chan and Lee, 1997). To examine the stability of the models we used CUSM statistical test, whose results, in the case of long-term relationship equations are given in the following graphs:

Chart 3 Statistical test of stability coefficients for the equation of long-term relationship of housing prices



Source: Bank of Albania

Chart 4 Statistical test of stability coefficients for the equation of long-term relationship of credit



Source: Bank of Albania

IV. CONCLUSIONS

The motivation for this study is to elaborate the relationship of the mortgage credit and the house prices in Albania. The economic literature emphasizes the importance of this relationship for the economy as whole and also for the monetary and financial stability. The real estate market in Albania, and especially the relationship of credit and the house prices dynamic, are not so thoroughly investigated in literature. By elaborating this relationship in detail, we hope to contribute to the more complex examination of the interlinking between house prices and mortgage credit. We have presented a detailed picture of the most typical developments in the house market and in the mortgage credit.

Our empirical investigation aims to support statistically the importance that the mortgage credit has for the house prices and vice versa. Given the complex economic relationship between these two variables and the main features of the Albanian economy, adding also some database's constrains, the application of econometric methods remains a challenge. Since the length of data included in the sample (1998-2010) is relatively short to apply widely used models in literature, our empirical analysis is based on the dynamic ordinary least square estimation method (DOLS) and on the error correction model.

Based on a two-step estimation process, we find a statistically significant relationship between mortgage credit and house prices. In the first step we assessed the relationship between cointegrated variables and, in the second step, we used residuals from the long run estimation models to build a regression equation as an error correction terms for short run behavior. Our empirical estimation shows that important factors in the formation of house prices are the cost of construction, income and the mortgage credit. Further, the house prices have an effect on the size of mortgage loan in the long run. However, as the Albanian economy is a emerging economy, we believe that both variables (housing pricing and mortgage credit) remain subject to dynamic changes in adaptation to new equilibrium levels in the future.

Our finding of high statistical significance of the long run relationship between these two indicators stresses the importance that housing price developments have for the financial stability and the entire economy. However, the normal development of house prices remains conditional upon certain drawbacks. Legislative and institutional deficiencies such as in the property rights, in land and property registration, and legalization continue to be a serious handicap in the development and price formation of the real estate market. Addressing these problems will give a new impulse to the performance of the housing market.

ANNEX 1. DATA

This study is based on the data sources published by the INSTAT, the Bank of Albania and the IMF. Data series are monthly and with the time length from January 1998 to December 2010. Monthly periodicity is selected to adapt better to the methodological constraints of the model, in terms of a limited history of data. Also financial data with monthly periodicity are included in all the equations estimated. Based on what the econometric literature suggests, for the entire sample the lowest periodicity can be chosen. The cubic spine interpolation method has been used to transfer data from quarterly to monthly frequency. This interpolation method is used to create data series from low frequency to high frequency and consist on polynomial distribution of the added data creating a full cycle. Before running a model, data for each indicator has been tested in level for the existence of unit root, through the Augmented Dicky Fuller (ADF) test. Almost all variables, according to this test, confirmed the existence of unit root. To address the problem of the unit root, almost all of the data series included in the estimated model have been taken in first difference (I1), which was sufficient to transform the series in stationary time series. ADF test rejects the hypothesis that the variables in first difference have a unit root at 5 per cent level of significance, meaning that we can consider them as stationary at this level. Overall the data series included in the model are in real term, adjusted for price movements and seasonality. Each of the variables included in the empirical analyses is presented graphically below, in level (log) and in first difference:

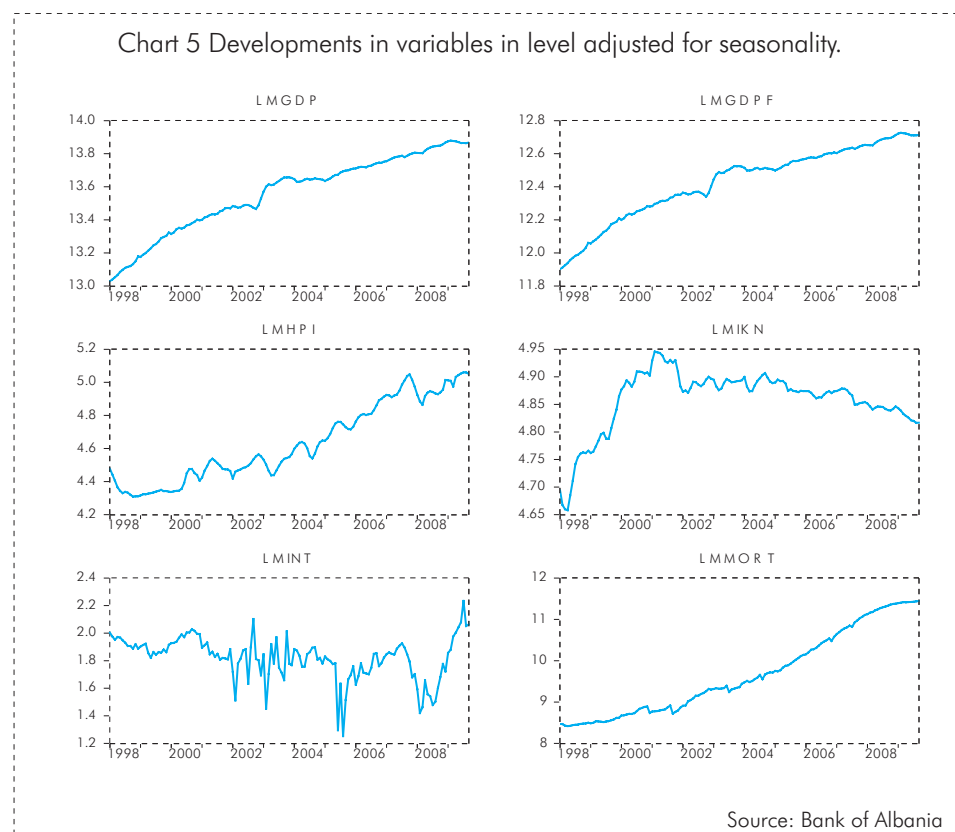
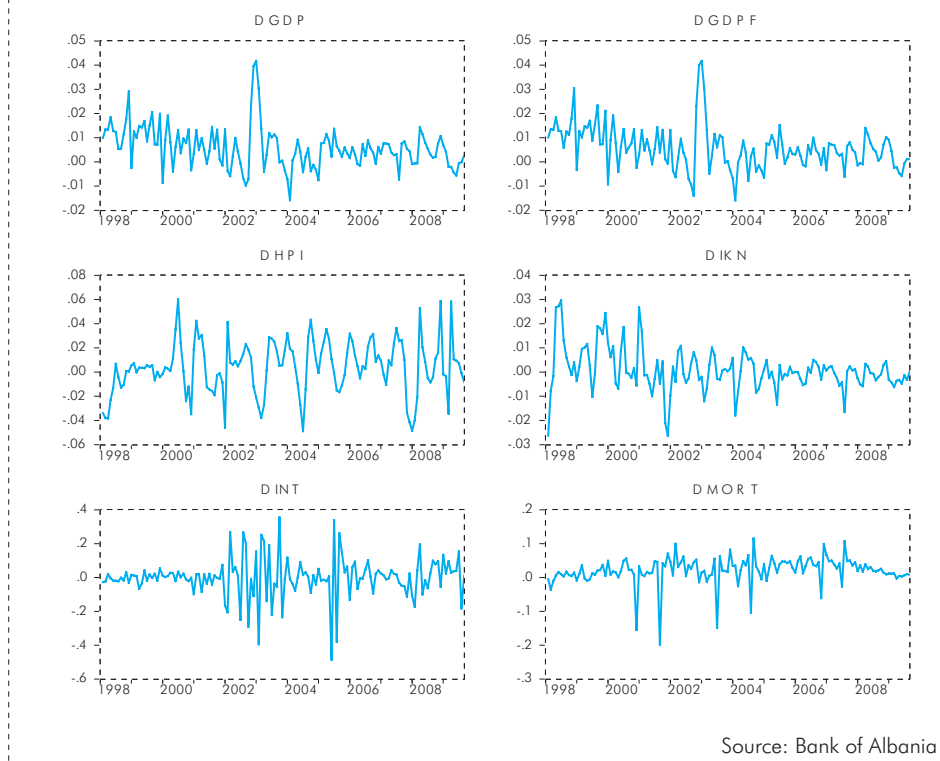


Chart 6 Development of variables in the first difference



Series included in the model for house prices is the index of house prices in Tirana compiled by the Bank of Albania, based on the hedonic method. This method calculates the index after quality control, meaning that it uses some housing characteristics as independent variables in a multiple regression. This method was deemed as most appropriate for the characterisation of the behavior of house prices even in the case of Albania. This index is available quarterly.¹⁶

The index of the gross domestic product per capita, included in the model, serves as a rough measure of household disposable income. Developments in GDP serve as a summary of information that can give other series directly related to income that will affect households' wealth (income) and their demand to invest in house purchasing. Likewise, the data series for the GDP is estimated to be statistically more appropriate than the other indicators which are assessed in connection with it. Series used in the model refers to real GDP per capita according to the IMF data, published annually, while quarterly distribution information is made by the INSTAT.

Mortgage loans included in the equation is a series of monthly data of mortgage credit to households, as reported by banks based on their monthly balances.

The cost in construction has been represented by the construction cost index, which reflects the cost of building new apartments. In economic terms, the increased cost of housing construction, and in particular the improvement

¹⁶ Bollano & Kristo 2006 "House price index-Methodology and application".

of their quality will be followed by increased house prices. Also, real estate agents estimate that the improved quality of housing constructed is the main factor for higher prices from the supply side. This indicator is published by the INSTAT quarterly.

In the model, the cost of obtaining a mortgage credit is also included. As a representative cost of money in the economy we have taken the 12-month Treasury bills yield. This indicator is thought to be more representative for market rates, because is closely related to the monetary authority decisions (reflecting monetary policy and the money cost) and simultaneously reflects a rational behavior of economic agents in the most competitive market. Also in the model were tested several other interest rates such as the key interest rate and weighted average interest rate on euro loans. But none of this cost of credit came out to be statistically significant. However, in theory the cost of taking a loan would be the total interest rate of loan fees or other fees associated with the allocation of credit. In the absence of data and because the interest rate represents the main cost for obtaining credit, in the model is included only the interest rate (yield), by abstracting from other costs associated with obtaining a mortgage loan. The data are taken from publications of the Bank of Albania and are based on monthly data reported by the banking system.

ANNEX 2. STATISTICAL TESTS

Table 3 Cointegration test for long term equation (mortgage credit, house prices, GDP per capita and construction cost index).

Sample (adjusted): 1998M06 2010M12				
Included observations: 151 after adjustments				
Trend assumption: Linear deterministic trend				
Series: LMGDPF LMHPI LMMORT LMIKN				
Lags interval (in first differences): 1 to 4				
Unrestricted Cointegration Rank Test (Trace)				
Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None*	0.203244	62.83339	47.85613	0.0011
At most 1	0.087314	28.52517	29.79707	0.0695
At most 2	0.080895	14.72924	15.49471	0.0650
At most 3	0.013104	1.991722	3.841466	0.1582

Trace test indicates 1 cointegrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

Table 4. Cointegration test for long term equation (mortgage credit, house prices, GDP per capita and interest rate).

Sample (adjusted): 1998M06 2009M12				
Included observations: 139 after adjustments				
Trend assumption: Linear deterministic trend				
Series: LMHPI LMMORT LMGDPF LMREPO				
Lags interval (in first differences): 1 to 4				
Unrestricted Cointegration Rank Test (Trace)				
Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None*	0.227291	64.37373	47.85613	0.0007
At most 1	0.108010	28.53211	29.79707	0.0694
At most 2	0.085039	12.64432	15.49471	0.1285
At most 3	0.002090	0.290879	3.841466	0.5897

Trace test indicates 1 cointegrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

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BANK OF ALBANIA NEWS JANUARY-JUNE 2012

Regional meeting of the Governor of the Bank of Albania, Mr. Ardian Fullani, with representatives of local authorities, banking system and business community of Fier District

The Governor of the Bank of Albania, Mr. Ardian Fullani held on 31 January 2012, a meeting with representatives of local authorities, banking system and business community of Fier District.

Governor Fullani discussed and shared opinions with participants on the recent developments in the global economy and their importance to the Albanian economy.

In the framework of public economic and financial education, Mr. Fullani held a meeting with students and teachers of "18 Tetori" secondary school in Lushnja, and representatives of the city's Education Department.

During this meeting, Governor Fullani highlighted that the establishment of a genuine financial literacy at home is indispensable.

Event on the 86th anniversary of the national banknote and coin

On the occasion of the 86th anniversary of the first issued national coin and banknote, Bank of Albania held educational activities dedicated to children and young people of different age groups, on 31 March 2012.

The educational programmes developed by the Bank of Albania are focused on the educational system, particularly on students of secondary education; this event called on pupils of elementary education to become part of this focus as well.

In the framework of this year of jubilee, elements of the 100th anniversary of Albania's Declaration of Independence were intertwined with some of the materials provided to visitors.

The purpose of the activities was to make young people aware of the history and values of the national currency. Our national currency has been playing an important role over these 86 years. It reflects the key moments in our history and personalities who have strongly contributed to the establishment and development of our country. Also, both the coin and banknote of a country are an integral part of the country's culture as they represent works of art.

Only through becoming aware of the importance of the national currency, the young people shall learn to prudently deal with the banknotes and coins they use everyday, and be responsible with the money and appreciate it.

Students and pupils from middle and primary schools of the country participated in the various educational activities.

Presentation of the Bank of Albania Annual Report 2011

On 30 April 2012, the Governor of the Bank of Albania, Mr. Ardian Fullani, presented the Bank of Albania Annual Report 2011 to the Parliamentary Committee on Economy and Finance. This report contains a comprehensive and transparent analysis of economic and financial developments at home,

and reflects the activity of the Bank of Albania aiming to fulfil its legal obligations and institutional commitments.

Governor Fullani underscored that both the current and the previous year were filled with challenges posed from the external environment and the internal structure of the economy. Governor Fullani guaranteed that the Bank of Albania will continue to work rigorously to fulfil its legal mandate and render maximum contribution to the growth of welfare in Albania.

The Albanian Parliament adopted on 7 June 2012 the Bank of Albania Annual Report 2011.

On 11 June 2012, the Governor of the Bank of Albania, Mr. Ardian Fullani, and the Governor of the Central Bank of the Republic of Kosovo, Mr. Gani Gërguri, signed a Cooperation Agreement between the two central banks.

Cooperation agreement between the Bank of Albania and the Central Bank of the Republic of Kosovo

This Agreement aims at fostering the mutual relationship between the two institutions and enhancing the professional capacities of their employees; the exchange of work experiences and of the know-how would eventually lead to capacity building and institutional development.

Study visits, workshops, round tables and discussions on research papers are practical examples for the implementation of the Agreement.

On 14 June 2012, Bank of Albania in collaboration with University of Oxford organized the High-Level Seminar on "South East Europe: Pre-Requisites for Reform".

High-Level Seminar "South East Europe: Pre-Requisites for Reform" organized by the Bank of Albania in collaboration with University of Oxford

The seminar was attended by Mr. Ridvan Bode, Minister of Finance, Mr. Radoje Žugić, Governor of the Central Bank of Montenegro, Mr. Gani Gërguri Governor of the Central Bank of Kosovo, Ms. Anita Angelovska-Bežoska, Deputy Governor of the National Bank of the Republic of Macedonia, Mr. Turalay Kenç, Deputy Governor of the Central Bank of the Republic of Turkey, representatives of the banking system, public institutions and international organisations in Albania, and representatives from the Bank of Albania. This seminar was held in the framework of the cooperation agreement between the Bank of Albania and the University of Oxford, signed in September 2010.

The main issues discussed in the seminar concerned the current developments in the economies of the SEE region, the challenges they are encountering and reforms that need to be undertaken. The discussions were focused on the current developments that characterise these countries, especially in light of the recent developments in euro area. The discussants in this seminar paid considerable importance to the continuation of reforms in economy, in responding to the economic slowdown throughout the region.

In the framework of public educational activities, on 21 June 2012, the Bank of Albania organised an awareness-raising event under the slogan "Green Economy: Does it include you?" in the premises of "Rinia" park in Tirana.

Educational activity "Green Economy: Does it include you?"

The activity was co-organised with SOS Children Villages and the National Association for Education for Life (SHKEJ).

This event aimed at raising the awareness of the younger generation to help them grasp that nature lies at the foundation of life and environment protection and that it is a pre-requisite for long-term economic growth.

Various games and educational and artistic activities were organised to raise the awareness and educate the participating children and their parents and teachers on the environment and its protection, according to the 'learning is fun' principle.

Several works of art created with recycled material by the students of the High School of Arts and of the University of Arts in Tirana were also displayed for the public.

MONETARY POLICY DECISIONS

25 January 2012

Supervisory Council of the Bank of Albania decides to cut the key interest rate by 0.25 percentage points, bringing it to down to 4.50%.

29 February 2012

Supervisory Council of the Bank of Albania decides to keep the key interest rate unchanged at 4.50%.

28 March 2012

Supervisory Council of the Bank of Albania decides to cut the key interest rate by 0.25 percentage points, bringing it to down to 4.25%.

25 April, 29 May, 27 June 2012

Supervisory Council of the Bank of Albania decides to keep the key interest rate unchanged at 4.25%.

LEGAL NEWS, JANUARY-JULY 2012

MONETARY OPERATIONS

On 16 January 2012, the Supervisory Council of the Bank of Albania approved by Decision No 2 the Regulation "Procedures for the Intervention of the Bank of Albania in the Domestic Foreign Exchange Market". The purpose of this Regulation is to lay out the rules and procedures for the intervention of the Bank of Albania in the foreign exchange market. These interventions aim to avoid market disorders, align the exchange rate with the level determined by the underlying macroeconomic factors and to change the international reserve.

BANKING SUPERVISION

On 16 January 2012, the Supervisory Council of the Bank of Albania approved Decision No 03 "On Granting Preliminary Approval for the Increase of (Indirect) Qualifying Holding of Çalik Holding A.S., Turkey, in the Shareholders' Equity of National Commercial Bank sh.a.". Upon the approval of this Decision, the qualifying holding of Çalik Holding a.s. increases to 99.99% of the shareholders' equity of the National Commercial Bank.

On 29 February 2012, the Supervisory Council of the Bank of Albania approved Decision No 14 "On Granting the Approval for the Transformation of Alpha Bank – Albania Branch into a Subsidiary/Domestic Bank". Upon the approval of this Decision, Alpha Bank – Albania Branch is transformed into a domestic bank, held by Alpha Bank A.E. Greece at 100%. After the transformation, it will be named Alpha Bank Albania sh.a.

On 29 February 2012, the Supervisory Council of the Bank of Albania approved Decision No 15 "On Granting the Approval for the Transformation of the National Bank of Greece – Tirana Branch into a Subsidiary/Domestic Bank". Upon the approval of this Decision, the National Bank of Greece – Tirana Branch, is transformed into a domestic bank, held by the National Bank of Greece S.A. Greece at 100%. After the transformation, it will be named NBG Bank Albania sh.a.

On 13 March 2012, the Supervisory Council of the Bank of Albania approved by Decision No 16 the Regulation "On Liquidity Supporting Loan". The purpose of this Regulation is to determine the conditions for the provision of liquidity supporting loan to temporarily illiquid, but financially stable banks.

This Regulation, among others, establishes the form of loan, the instruments for its collateralization, as well as the amount, maturity and interest rate.

On 25 April 2012, the Supervisory Council of the Bank of Albania approved Decision No 24 "On Granting Preliminary Approval for the 100% Transfer of the Qualifying Holding in the Shareholders' Equity of Raiffeisen Bank sh.a., from Raiffeisen Bank International AG Austria to Raiffeisen SEE Region Holding GmbH, Austria". The purpose of this Decision is to grant preliminary approval for the transfer of ownership of 100% of voting rights of the shareholders' equity of Raiffeisen Bank sh.a. to the new shareholder, Raiffeisen SEE Region Holding GmbH, Austria.

On 16 May 2012, the Supervisory Council of the Bank of Albania approved by Decision No 27 the Regulation "On the Establishment, Licensing and Functioning of the Bridge Bank". This Regulation defines the bridge bank as a joint-stock company, which is established to temporarily manage the assets and liabilities transferred from a poorly performing bank. The proposal for the establishment of a bridge bank is drafted by the Supervisory Group, which assists the administrators or the management of the bridge bank, throughout its duration. The bridge bank shall be established upon the decision of Bank of Albania's Supervisory Council,

On 16 May 2012, the Supervisory Council of the Bank of Albania approved Decision No 28 "On an Amendment to the Regulation "On granting the license and the exercise of activity of banks and branches of foreign banks in the Republic of Albania"". Upon this amendment, banks and branches of foreign banks have the right to engage in insurance and re-insurance intermediation after having obtained preliminary approval from the Bank of Albania and met the required legal criteria. This Decision provides the requirements to be met and the procedures to be followed for obtaining approval.

On 29 May 2012, the Supervisory Council of the Bank of Albania approved Decision No 37 "On Granting Raiffeisen Bank sh.a. Preliminary Approval to Conduct Additional Activity". Upon this Decision, Raiffeisen Bank shall be entitled to conduct factoring and commercial transaction financing services.

On 13 June 2012, the Supervisory Council of the Bank of Albania approved by Decision No 38 "Supervision Annual Report for 2011". This Report provides a comprehensive overview of the supervision activity and developments in the banking system during 2011, according to the areas of activity and relevant risks. According to this Report, supervision consolidated its risk-based approach further in 2011, pursuant to the medium-term development strategy of banking supervision. It paid particular attention to addressing systemic issues - developments that transversally affect the whole banking system - and making micro-prudential supervision focus on specific concerns of individual financial institutions.

MONETARY POLICY

On 25 January 2012, the Supervisory Council of the Bank of Albania approved by Decision No 05 "Bank of Albania's Monetary Policy Statement on the Second Half of 2011". According to this Statement, the negative developments in the global arena reflected in heightened uncertainty in the Albanian economy and negative impact on domestic consumption and investments. The Albanian economy, however, continued to grow in 2011, albeit at lower rates. Annual inflation averaged 2.9% in the second half of 2011, down by 1.1 percentage points from the first half of 2011. The lower inflationary pressures in 2011 and the expectations for low inflation rates during 2012 motivated further easing of monetary policy. The Bank of Albania cut the key interest rate twice, in September and November, down to the record low of 4.75%. According to Bank of Albania's projections, the Albanian economy will continue to grow during 2012, albeit below its potential.

On 25 January 2012, the Supervisory Council of the Bank of Albania approved Decision No 06 "On Cutting the Interest Rate on Repo and Reverse Repos". According to this Decision, the Supervisory Council cut the interest rate on repo and reverse repos by 0.25 percentage points to 4.50%.

On 29 February 2012, the Supervisory Council of the Bank of Albania approved by Decision No 11 "Annual Report of the Bank of Albania for 2011". According to this Report, the economy grew by about 2.7% during the first nine months of 2011, while data suggest an acceleration of the economy during the fourth quarter of 2011. Economic growth was driven by foreign demand and a slight fiscal stimulus. Private investments and consumption remained weak, mainly due to the uncertainty and hesitation of Albanian households and businesses in their decision-making process. Despite the fluctuations, annual inflation averaged 3.5% in 2011, hence within Bank of Albania's target band. Monetary policy has aimed at stimulating the economy, being reflected in the cut of the key interest rate in the last quarter of the year and the supply of the economy with liquidity.

On 28 March 2012, the Supervisory Council of the Bank of Albania approved Decision No 17 "On Cutting the Interest Rate on Repo and Reverse Repos". According to this Decision, the Supervisory Council cut the interest rate on repo and reverse repos by 0.25 percentage points to 4.25%.

On 25 April 2012, the Supervisory Council of the Bank of Albania approved by Decision No 22 "Monetary Policy Report for the First Quarter of 2012". According to this Report, the Albanian economy continued to preserve the parameters of macroeconomic stability during the first quarter of 2012, even in the context of the ongoing global economic crisis. Annual CPI inflation slowed down significantly during this period. It averaged 1.1%, down by 1.4 percentage points from the previous quarter. In order to provide adequate monetary conditions to boost domestic private demand, the Bank of Albania cut the key interest rate twice to the record low of 4.25%.

ISSUE

On 15 February 2012, the Supervisory Council of the Bank of Albania approved Decision No 08 "On Re-minting the Albanian Legal Tender Coin with a Face Value of 20 Lek". The purpose of this Decision is to provide for the re-minting of the Albanian coin with a face value of 20 Lek, first minted in 1996 and re-minted in 2000. The year of issue, minted on the body of the coin, shall be 2012.

On 15 February 2012, the Supervisory Council of the Bank of Albania approved Decision No 09 "On Approving the Configuration of Drawings of Commemorative Coins to be Minted for Numismatic Purposes in 2012". The purpose of this Decision is to provide for the minting of coins for numismatic purposes. The coins shall have a face value of 200, 100 and 50 Lek, themed "100th Anniversary of the Declaration of Independence". This Decision also provides for the minting of non-circulating legal tender coins with a face value of 200 Lek, dedicated to Mother Theresa.

On 13 June 2012, the Supervisory Council of the Bank of Albania approved by Decision No 40 the Regulation "On the Exposure of Numismatic Values and Their Management and Preservation by the Bank of Albania". The purpose of this Regulation is to set out the rules and procedures for organizing the exposure of numismatic values, and their management and preservation by the Bank of Albania. The Regulation provides for a number of criteria to be met for the exposure of numismatic values, as well as the security elements of the facilities where they will be exposed.

FINANCIAL STABILITY

On 10 April 2012, the Supervisory Council of the Bank of Albania approved by Decision No. 19 "Financial Stability Report for the Second Half of 2011". According to this Report, the financial system and banking sector situation and performance remained stable during the second half of 2011. Capitalisation and liquidity figures of the banking sector activity were at satisfactory levels; however, its capacity to generate sufficient income remained concentrated in individual banks. During the period under review, the financial system expanded its activity further. Banking sector assets grew by 13.7% y-o-y. Loans increased by 15.5% y-o-y, while deposits increased by 13.2%.

SUPERVISORY COUNCIL

On 16 May 2012, the Supervisory Council of the Bank of Albania approved by Decision No 29 the Regulation "On the Minimum Required Reserve held by Banks with the Bank of Albania". The purpose of this Regulation is to set out the rules for the calculation, reporting, holding, use and remuneration of required reserve with the Bank of Albania. Required reserve is a monetary

policy instrument of the Bank of Albania, which aims at adjusting the level of liquidity in the banking system and stabilizing interest rates in the money market.

FOREIGN RELATIONS, EUROPEAN INTEGRATION AND COMMUNICATION DEPARTMENT

On 27 June 2012, the Supervisory Council of the Bank of Albania approved by Decision No. 42 the Regulation "On Transparency and Confidentiality at the Bank of Albania". The purpose of this Regulation is to set out the basic rules and procedures for guaranteeing the disclosure of information on Bank of Albania's activity to the public, and the protection of confidential information. This Regulation is guided by the principles of transparency, non-discrimination, accountability and preservation of confidentiality.

ECONOMIC POLICY

On 11 January 2012, the Council of Ministers approved Decision No. 27 "On the Employment Promotion Programme Aiming at Employing Women Belonging to Special Groups". This Decision provides for a number of facilitating measures and conditions aiming at encouraging employers to hire on a one-year contract women job-seekers belonging to special groups, such as trafficked women, women belonging to Roma community, single mothers or women suffering social issues.

On 18 January 2012, the Council of Ministers approved by Decision No 60 "Macroeconomic and Fiscal Framework for 2013-15". According to this Decision, average inflation rate is expected to be stable at 3% during the period under review. Real GDP is expected to grow by 4.3% in 2012, close to the 5% growth in the next three years. Unemployment rate is expected to fall to 9.4% in 2015, from 12.9% in 2011.

On 26 January 2012, the Assembly of the Republic of Albania ratified by Law No 1/2012 on the "Regional Convention on Pan-Euro-Mediterranean Preferential Rules of Origin". This Convention contains provisions on the origin of goods traded based on individual protocols applicable between the partner countries. It also defines the concept of "product of origin" and the method of administrative cooperation related to the relevant products. The contracting parties to the Convention are the European Union countries, the EFTA states, the Faroe Islands, the participants in the Barcelona Process, and the participants in the EU's Stabilization and Association Process.

On 1 February 2012, the Council of Ministers approved by Decision No 107 "Rules for the Submission, Opening and Evaluation of Bids for the Privatization of "Albpetrol" sh.a., Patos". The Decision establishes that the form for selecting the candidates interested in purchasing the shares of "Albpetrol" shall be an open tender with one phase. The candidates must meet a number

of criteria. The companies should be specialized in the fields of exploration, development, production and trading of oil and gas, and should have worked in these fields, on an international level, for no less than 5 years. They should have a fully paid in capital in the amount of EUR 80,000,000 (eighty million), net assets, and depending on the case, the consolidated net assets must equal at least EUR 100,000,000 (one hundred million).

On 1 February 2012, the Council of Ministers approved Decision No 105 "Albania's 2012-14 Economic and Fiscal Programme". This document provides a comprehensive overview of Albania's economic policies and medium-term priorities in the framework of structural reforms projected to be carried out during 2012-14. These reforms aim at ensuring macroeconomic stability and economic growth, as well as establishing a regulatory framework of sectoral policies in compliance with the European standards.

On 6 February 2012, the Minister of Finance adopted Guideline No 2 "Standard Procedures for Budget Implementation". The purpose of this Guideline is to set out the rules, procedures and deadlines to be followed during the budget implementation process by the general government units, in the framework of improving the financial management and control system, and enhancing the transparency in the use of public funds.

On 9 February 2012, the Assembly of the Republic of Albania adopted Law No. 7/2012 "Ratification of the Administrative Council and Governing Board of the Council of Europe Development Bank's Decisions (CEB), resolution No. 1532 "Proposal of the Administrative Council to an Increase in Bank's Capital" (Appendix a), Resolution No 386 "Decision on the Increase in Bank's Capital" (Appendix b), and document "Bank's Governor Letter, dated 8 April 2011, on the Capital Increase Phases". Upon the ratification of these documents, the Assembly agrees on CEB's 6th capital increase, along with the relevant conditions arising from its implementation. If all CEB's Member States subscribe to the capital increase, the subscribed capital will rise from EUR 3.3 to 5.5 billion. This increase will be accompanied by the incorporation of EUR 246 million from the reserves in the form of paid-in capital and without any disbursement on the part of the Member States.

On 10 February 2012, the Minister of Finance approved Order No 83 "Rules and Procedures for the Sale of Hydrocarbon Products". According to this Order, "Albpetrol" sh.a. Patos shall be responsible for the open auction sale of hydrocarbon products to the domestic market, for the purposes of their refinement and/or export. The procedure for the sale of hydrocarbon products shall begin once the company has deposited 20,000 (twenty thousand) to 30,000 (thirty thousand) tonnes of hydrocarbon products, despite the fact that this quantity has been created as a result of the production of the company or the resulting benefits of the company from agreements.

On 22 February 2012, the Council of Ministers approved by Decision No. 123 "Agreement between the Council of Ministers of the Republic of Albania and the Government of the State of Qatar on the Promotion and Reciprocal

Protection of Investments". By signing this Agreement, the governments of the two countries aim at creating and maintaining favourable conditions for investments, recognising that the promotion and protection of investments will stimulate economic prosperity. Each contracting party shall accord, in its territory, to investments and returns of investors of the other contracting party fair and equitable treatment and which is not less favourable than that accorded to its own investments and returns.

On 28 February 2012, the Minister of Finance adopted Guideline No 6 "On Some Amendments to Guideline No. 26, dated 4 September 2008 'On National Taxes', as amended". The amendments to this Guideline regulate the procedures for the payment of minerals resource rent tax and the payment on the export statement data by the exporters and permit holders. They also set out the form of the distribution of income derived from the minerals resource rent tax to the municipalities, which are included in the territory of companies operating in oil production and paying the rent tax.

On 29 February 2012, the Minister of Finance adopted Guideline No 7/1 "On Drafting the Local Budget". The purpose of this Guideline is to set out the preparatory ceilings on expenditures of the 2013-15 medium-term budget programme, the unconditional transfer to local government units, procedures and deadlines for drafting the 2013-15 medium-term budget, and the calculation form of conditional and unconditional transfers to local government units.

On 1 March 2012, the Assembly of the Republic of Albania adopted Law No. 20/2012 "On Some Amendments to Law No 8438, dated 28 December 1998 'On Income Tax', as amended". The amendments mainly affect the articles that regulate the annual personal income statement and the deductible expenditure for the purposes of calculating taxable income. This Law, inter alia, establishes that the individual taxpayers, resident in the Republic of Albania, who generate taxable income in and outside the territory of the Republic of Albania, shall submit the annual income statement to the central tax administration. All individuals generating, from all sources, annual gross income of less than ALL 2,000,000 (two million) are exempt from this obligation.

On 21 March 2012, the Assembly of the Republic of Albania ratified by Law No 29/2012 on the "Agreement between the Council of Ministers of the Republic of Albania and the Government of Montenegro for the Settlement of Albania's debt to Montenegro". By signing this Agreement, the parties agree that the debt, including the interest rate, which amounts to USD 532,823.61 shall be settled through two equal semi-annual payments of the principal amount, plus the interest rate, on every 31 January and 31 July.

On 21 March 2012, the Assembly of the Republic of Albania adopted Law No. 33/2012 "On the Registration of Immovable Property". The purpose of this Law is to set out the rules for the organization and functioning of the Office for the Registration of Immovable Property, the conditions and procedures for the

registration of immovable property, as well as the management of the public register of immovable property. The provisions of this Law are implemented for the registration of all immovable properties located in the territory of the Republic of Albania, based on acts for obtaining the ownership or creating real rights on property, according to the applications submitted by juridical/natural, national or foreign persons.

On 4 April 2012, the Council of Ministers approved Decision No 233 "Agreement between the Council of Ministers of the Republic of Albania and the Government of the Republic of Azerbaijan on the Promotion and Reciprocal Protection of Investments". By signing this Agreement, the governments of the two countries aim at creating and maintaining favourable conditions for investments, recognising that the promotion and protection of investments will stimulate economic prosperity. Each contracting party shall accord, in its territory, to investments and returns of investors of the other contracting party fair and equitable treatment and which is not less favourable than that accorded to its own investments and returns.

On 5 April 2012, the Assembly of the Republic of Albania adopted Law No 37/2012 on the "Adherence of the Republic of Albania to the International Convention on the Simplification and Harmonization of Customs Procedures, done at Kyoto on 18 May 1973 (as amended)". By adhering to this Convention, the contracting parties undertake to promote the simplification and harmonization of customs procedures and, to that end, to conform, in accordance with the provisions of this Convention, to the transitional standards and the recommended practices in the Convention.

On 5 April 2012, the Assembly of the Republic of Albania adopted Law No 38/2012 on the "Agricultural Cooperation Companies". The purpose of this Law is to set out the rules, criteria and conditions for the establishment and management of agricultural cooperation companies, rights and obligations of their founders and members, their reorganisation and dissolution, as well as the regulation and establishment of criteria on certain aspects of their activity. According to this Law, an agricultural cooperation company is a voluntary organization between natural or juridical persons for the purposes of meeting their needs or interests in the fields of production, processing and trading of agricultural products and livestock.

On 12 April 2012, the Assembly of the Republic of Albania adopted Law No 39/2012 on the "Ratification of the Loan Agreement between the Republic of Albania and OPEC Fund for International Development for Financing Tirana-Elbasan Road Project". By signing this Agreement, the lender agrees to provide the borrower with a loan of USD 20,400,000. The project financed through this loan aims at promoting Albania's regional and international trade integration by building a road that connects the capital and the city of Elbasan. To this end, the project provides for the construction of 27 km of two-lane paved road in each direction. The road shall have four traffic lanes and two emergency lanes.

On 12 April 2012, the Assembly of the Republic of Albania adopted Law No 40/2012 on the "Ratification of the Loan Agreement between the Republic of Albania and the International Bank for Reconstruction and Development (IBRD) on Additional Financing for the Dam Safety Project". By signing this Agreement, IBRD agrees to lend EUR 15,500,000 to help finance the Dam Safety Project. This project aims to contribute to safeguarding the major hydroelectric plants on the Drin and Mat rivers' cascades in Albania, and improve their operational efficiency and enhance the stability of power supply for the regional electricity market.

On 19 April 2012, the Assembly of the Republic of Albania ratified by Law No. 42/2012 "Agreement between the Council of Ministers of the Republic of Albania and the Government of the State of Qatar for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income". This Agreement shall apply to persons who are residents of one or both of the contracting states. It shall apply to taxes on income imposed on behalf of a contracting state or of its political sub-divisions or local authorities, irrespective of the manner in which they are levied.

On 26 April 2012, the Assembly of the Republic of Albania adopted Law No 46/2012 on the "Ratification of Loan Agreement A between the Republic of Albania, represented by the Ministry of Finance, and KfW Frankfurt am Main, for the Financing of "Municipal Infrastructure II, Water Supply and Sanitation for the Cities of Berat, Fier, Kamza, Kuçova, Lushnja and Saranda"". By signing this Agreement, KfW agrees to extend to the Republic of Albania a loan A of EUR 12,000,000, another loan (loan B) of EUR 2,000,000 and a financial contribution from the European Union of EUR 20,482,000. The purpose of this project is to provide stable and hygienic water supply to the people living in the abovementioned cities.

On 30 April 2012, the Minister of Economy, Trade and Energy adopted Guideline No 1 "Rules and Procedures for the Examination of Applications for Building Permits for Energy-Related Buildings and Buildings of High Risk in this Area, as well as for Setting up a Commission for the Examination of Applications for these Permits". This Guideline, among others, provides for the setting up of a commission for the examination of applications for building/use permits. It also determines the application tariff, which amounts to ALL 150,000 regardless of the type of energy-related building or building of high risk in this area, the applicants have applied for.

On 10 May 2012, the Assembly of the Republic of Albania adopted Law No 55/2012 on the "On some Amendments to Law No 9235, dated 29 July 2004 'On Restitution and Compensation of Property', as amended". The amendments to this Law affect the articles regulating the property valuation process and methodology and the coordination of the restitution and compensation of property process. The amendments also establish that the value of the property being compensated is determined based on the market price, type of property and purpose of use, in compliance with the international standards on the immovable property valuation.

On 16 May 2012, the Council of Ministers approved Decision No 329

“Criteria and Procedures for Granting State Financial Aid to Cover Damages Caused by Natural Disasters and other Disasters Caused by Human Activity”. The purpose of this Decision is to set out the procedures for the provision of financial aid. This aid shall be granted in cases when, as a result of natural disasters or other disasters caused by human activity, there has been damage to people and property damage, in order to cope with the situation when a state of civil emergency has been declared or not.

On 31 May 2012, the Assembly of the Republic of Albania adopted Law No 64/2012 “On Fishery”. This Law regulates fishing activity in general, its management, protection of marine life and inland waters, by promoting the stable development of the activity in maritime and inland waters in the Republic of Albania. It aims to ensure a rational and responsible use of biological resources of maritime and inland waters, and establish the necessary measures and rules for the control, inspection and implementation of fishery policies, in full compliance with the European policies in this regard.

On 6 June 2012, the Council of Ministers approved Decision No. 375 “Creation, Registration, Functioning, Management, Interaction and Security of the Immovable Property Registration System”. The purpose of this Decision is to establish the state database “Immovable Property Registration System”. This system will contain data on immovable property and facts related to their legal status, based on all the information of the technical and legal documentation, and cards and indicative registration maps/cadastral maps on immovable properties subject to first registration.

On 14 June 2012, the Assembly of the Republic of Albania ratified by Law No. 67/2012 “Agreement between the Council of Ministers of the Republic of Albania and the Government of the Republic of Croatia for the Settlement of Albania’s Debt to the Republic of Croatia”. By signing this Agreement, the parties agree that Albania’s final debt, including the interest rate, amounts to USD 5,484,668.38. This debt shall be settled in four equal semi-annual instalments, plus the interest rate, on every 31 March and 30 September.

On 27 June 2012, the Council of Ministers approved Decision No 387 “On Raising Pensions”. The purpose of this Decision is to determine the different categories of pensions benefitting the increase by 4% and 5%, as well as the criteria to be met and amount of compensation of expenses arising from the change in energy and fuel price. The financial effects arising from the implementation of this Decision amount to ALL 1,602,000,000 and they will be borne by the Social Insurance Institute funds and the Contingency Fund projected in the 2012 state budget.

On 27 June 2012, the Council of Ministers approved Decision No 414 “On some Amendments to Decision No 1114, dated 30 July 2008 of the Council of Ministers 'On some Issues Pursuant to Law No 7703, dated 11 May 1993 'On Social Insurance in the Republic of Albania', as amended', Law No 9136, dated 11 September 2003 'On the Collection of Compulsory Social and Health Insurance Contributions in the Republic of Albania', as

amended, and Law No 7870, dated 13 October 1994 'On Health Insurance in the Republic of Albania', as amended". The purpose of these amendments, among others, is to determine the minimum monthly salary for the purposes of the calculation of social and health insurance contributions. As from 1 July 2012, the minimum monthly salary shall be no less than ALL 18,295, while the maximum monthly salary shall be ALL 91,475. In addition, as from 1 July 2012, the minimum monthly contribution for all the insurance branches shall be ALL 5,104.

BANK OF ALBANIA MANAGEMENT, AS AT 30 JUNE 2012

SUPERVISORY COUNCIL

ARDIAN FULLANI	Chair
ELISABETA GJONI	Deputy Chair
ADRIAN CIVICI	Member
ARJAN KADAREJA	Member
DHORI KULE	Member
ELA GOLEMI	Member
ERMELINDA MEKSI	Member
HALIT XHAFA	Member
PETRAQ MILO	Member

GOVERNOR

ARDIAN FULLANI

DEPUTY GOVERNORS

ELISABETA GJONI First Deputy Governor

GENERAL INSPECTOR

ELIVAR GOLEMI

GOVERNOR'S OFFICE

GENC MAMANI

HEAD OF COORDINATION

GRAMOZ KOLASI

DEPARTMENTS AND OTHER UNITS

HUMAN RESOURCES DEPARTMENT	Roden Pajaj
MONETARY POLICY DEPARTMENT	Erald Themeli
RESEARCH DEPARTMENT	Altin Tanku
MONETARY OPERATIONS DEPARTMENT	Marjan Gjermeni
SUPERVISION DEPARTMENT	Indrit Banka
FINANCIAL STABILITY DEPARTMENT	Klodion Shehu
INFORMATION TECHNOLOGY DEPARTMENT	Xhilda Deliana
STATISTICS DEPARTMENT	Diana Shtylla
ISSUE DEPARTMENT	Dorian Çollaku
ACCOUNTING AND FINANCE DEPARTMENT	Fatos Ibrahim
PAYMENTS SYSTEM DEPARTMENT	Dashmir Halilaj
LEGAL DEPARTMENT	Toni Gogu
AUDIT DEPARTMENT	Elivar Golemi
FOREIGN RELATIONS, EUROPEAN INTEGRATION AND COMMUNICATION DEPARTMENT	Oneda Andoni
ADMINISTRATION DEPARTMENT	Agron Skënderaga
SECURITY AND PROTECTION DEPARTMENT	Eduard Sinani

BRANCHES

SHKODRA	Ermira Istrefi
ELBASANI	Valentina Dedja
GJIROKASTRA	Anila Thomaj
KORÇA	Liljana Zjarri
LUSHNJA	Shpresa Meço

BANKS AND BRANCHES OF FOREIGN BANKS LICENSED BY THE BANK OF ALBANIA, AS AT 30 JUNE 2012

1. RAIFFEISEN BANK SH.A.

Licence No. 2/1998, dated 11.01.1999

Approved by the Bank of Albania Supervisory Council Decision No. 163, dated 11.12.1998

Certificate No. 2 "On Deposit Insurance"

Director: Christian CANACARIS

Address: Bulevardi "Bajram Curri", European Trade Center, Tirana, Albania

Tel: +355 4 2274 910

Fax: +355 4 2275 599

E-mail: info@raiffeisen.al

Website: www.raiffeisen.al

2. UNITED BANK OF ALBANIA SH.A.

Licence No. 3/1998, dated 11.01.1999

Approved by the Bank of Albania Supervisory Council Decision No. 165, dated 11.12.1998

Certificate No. 3 "On Deposit Insurance"

Director: Hikmet GÜLER

Address: Rruga e Durrësit, sheshi "Rilindja" (Zogu i Zi), Godina Teknoprojekt, P.O. BOX 128, Tirana, Albania

Tel: +355 4 240 45 75 / 76 / 77

Fax: +355 4 240 45 58

E mail: info@ubaal.com

Website: www.uba.com.al

3. VENETO BANKA SH.A.

Licence No. 5/1998, dated 11.01.1999

Approved by the Bank of Albania Supervisory Council Decision No. 164, dated 11.12.1998

Certificate No. 4 "On Deposit Insurance".

Director: Lucio Luigi GAITA

Address: Bulevardi "Dëshmorët e Kombit", Ndërtesa Kullat Binjake, Tirana, Albania

Tel: +355 4 2280 555

Fax: +355 4 2280 356

E-mail: info@venetobanka.al

Website: www.venetobanka.al

4. NATIONAL COMMERCIAL BANK SH.A.

Licence No. 6/1998, dated 11.01.1999

Approved by the Bank of Albania Supervisory Council Decision No. 162, dated 11.01.1999

Certificate No. 5 "On Deposit Insurance"

Director: Seyhan PENCAPLIGIL

Address: Bulevardi "Zhan D'Ark", Tirana, Albania

Tel: +355 4 2250 955

Fax: +355 4 2250 956

E – mail: info@bkt.com.al

Website: www.bkt.com.al

5. TIRANA BANK SH.A.

Licence No. 7, dated 12.09.1996

Approved by the Bank of Albania Supervisory Council Decision No. 9, dated 12.09.1996

Certificate No. 6 "On Deposit Insurance"

Director: Georgios CHARALAMPAKIS

Address: Rruga "Ibrahim Rugova", Tirana, Albania.

Tel: +355 4 2269 616 / 7 / 8, 2233 441 / 42 / 43 / 44 / 45 / 46 / 47

Fax: +355 4 2233 417 / 2369 707

E – mail: info@tiranabank.al

Website: www.tiranabank.al

6. NATIONAL BANK OF GREECE – ALBANIA SH.A.

Licence No. 8, dated 25.11.1996

Approved by the Bank of Albania Supervisory Council Decision No. 4, dated 14.03.1996.

Certificate No. 7 "On Deposit Insurance"

Director: Ioannis KOUGIONAS

Address: Rruga e Durrësit, Godina "Comfort", Tirana, Albania

Tel: +355 4 2274 802 / 2274 822

Fax: +355 4 2233 613

E – mail: nbgalbania@icc-al.org

7. INTERNATIONAL COMMERCIAL BANK SH.A.

Licence No. 09, dated 20.02.1997

Approved by the Bank of Albania Supervisory Council Decision No. 9, dated 30.04.1996

Certificate No. 8 "On Deposit Insurance"

Director: Gideon van den BROEK

Address: Qendra e Biznesit, Rruga "Murat Toptani", Tirana, Albania

Tel: +355 4 2254 372 / 2256 254

Tel/Fax: +355 4 2254 368

E – mail: info@icbank-albania.com

8. ALPHA BANK - ALBANIA SH.A.

Licence No. 10, dated 07.01.1998

Approved by the Bank of Albania Supervisory Council Decision, No.01/03/96, dated 27.12.1997

Certificate No. 9 "On Deposit Insurance"

Director: Periklis Drougkas

Address: Rruga e Kavajës, G – KAM Business Center, kati II, Tiranë.

Tel: +355 4 2278 500

Tel/fax: +355 4 2232 102

E – mail: tiranabranh@alpha.gr

9. INTESA SANPAOLO BANK ALBANIA SH.A.

Licence No. 11, dated 10.08.1998

Approved by the Bank of Albania Supervisory Council Decision, No. 105, dated 10.08.1998

Certificate No. 10 "On Deposit Insurance"

Director: Stefano FARABBI

Address: Rruga "Ismail Qemali" Nr. 27, P.O. Box 8319, Tirana, Albania

Tel: +355 4 2248 753 / 4 / 5 / 6, 2276 000.

Fax: +355 4 2248 762

E – mail: info@intesasanpaolobank.al

Website: www.intesasanpaolobank.al

10. PROCREDIT BANK SH.A.

Licence No. 12, dated 15.03.1999

Approved by the Bank of Albania Supervisory Council Decision No. 22, dated 03.03.1999

Certificate No. 11 "On Deposit Insurance"

Director: Flutura VEIPI

Address: Rruga e Durrësit, Laprakë, Tirana, Albania

Tel: +355 4 2389 300

Fax: +355 4 2233 918

E-mail: info@procreditbank.com.al

Website: www.procreditbank.com.al

11. EMPORIKI BANK - ALBANIA SH.A.

Licence No. 14, dated 28.10.1999

Approved by the Bank of Albania Supervisory Council Decision, No.105, dated 19.10.1999

Certificate No. 13 "On Deposit Insurance"

Director: Luc BEISO

Address: Rruga e Kavajës, Nr. 59, "Tirana Tower", Tirana, Albania

Tel: +355 4 2258 755 / 56 / 57 / 58 / 59 / 60

Fax: +355 4 2258 752

E-mail: headoffice@emporiki.com.al

Website: www.emporiki.com.al

12. CREDIT BANK OF ALBANIA SH.A.

Licence No. 15, dated 28.08.2002

Approved by the Bank of Albania Supervisory Council Decision No. 66, dated 28.08.2002

Certificate No. 14 "On Deposit Insurance"

Director: Sherine KAMEL

Address: Rruga "Perlat Rexhepi", Al-Kharafi Group Administration Building, Kati 1&2, Tirana, Albania

Tel: +355 4 2272 168, +355 4 2272 162

Fax: +355 4 2272 162

E-mail: creditbkalb@icc-al.org

13. CREDINS BANK SH.A.

Licence No. 16, dated 31.03.2003

Approved by the Bank of Albania Supervisory Council Decision No. 22, dated 26.03.2003

Certificate No. 15 "On Deposit Insurance"

Director: Artan SANTO

Address: Rruga "Ismail Qemali", Nr. 21, Tirana, Albania

Tel: +355 4 2234 096

Fax: +355 4 2222 916

E-mail: info@bankacredins.com

Website: www.bankacredins.com

14. SOCIETE GENERALE ALBANIA BANK SH.A.

Licence No. 17, dated 16.02.2004

Approved by the Bank of Albania Supervisory Council Decision No. 06, dated 11.02.2004

Certificate No. 16 "On Deposit Insurance"

Director: Hubert de SAINT JEAN

Address: Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Kulla 1, Kati 9, Tirana, Albania

Tel: +355 4 2280 442 / 3

Faks: +355 4 2280 441

Mobile: 068 (69) 20 60 974

E-mail: sgalb.info@socgen.com

Website: www.societegenerale.al

15. UNION BANK SH.A.

Licence No. 18, dated 09.01.2006

Approved by the Bank of Albania Supervisory Council Decision No. 101, dated 28.12.2005.

Certificate No. 17 "On Deposit Insurance"

Director: Gazmend KADRIU

Address: Bulevardi "Zogu I", pallati 13-katësh, përballë stacionit të trenit, Tirana, Albania

Tel: +355 4 2250 653 / 2258 081

Fax: +355 4 2272 880

E-mail: info@unionbank.com.al

Website: www.unionbank.com.al

16. FIRST INVESTMENT BANK ALBANIA SH.A.

Licence No. 19, dated 06.07.2007.

Approved by the Bank of Albania Supervisory Council Decision No. 35, dated 27.06.2007

Certificate No. 12 "On Deposit Insurance"

Director: Bozhidar TODOROV

Address: Bulevardi "Dëshmorët e Kombit", Kullat Binjake, Kulla 2, Kati 14, Tirana, Albania

Tel: +355 4 2276 702 / 3

Fax: +355 4 2280 210

Website: www.fibank.al

In addition to banks and branches of foreign banks, the Bank of Albania has as at 30 June 2012 licensed the following entities:

Nr.	ENTITIES
21	NON-BANK INSTITUTIONS
310	FOREIGN EXCHANGE BUREAUS
2	UNIONS OF SAVINGS AND CREDIT ASSOCIATIONS
126	SAVINGS AND CREDIT ASSOCIATIONS
1	REPRESENTATIVE OFFICE OF FOREIGN BANKS

PUBLICATIONS ISSUED BY THE BANK OF ALBANIA OVER 2012

This list is designed to inform readers about publications issued by the Bank of Albania over the first half of 2012. By visiting our website (www.bankofalbania.org) you can subscribe to our mailing list either by e-mail at public@bankofalbania.org or sending a fax to + 355 4 2419408 and enroll in the mailing list for the publications of the Bank of Albania.

You can also subscribe to updates by signing up to receive free e-mail notices when new items are posted on the Bank of Albania website. You will receive e-mail notices each time we post new items of the series you selected. Listed below you can find all the publications issued by the Bank of Albania over 2012. This list does not include surveys carried out by the Bank of Albania as they are available only online (http://www.bankofalbania.org/web/vrojtime_3405_1.php).

ANNUAL REPORT:

Annual Report 2011

FINANCIAL STABILITY REPORT:

Financial Stability Report 2011 H2

MONETARY POLICY PERIODICAL REPORTS:

Monetary Policy Report 2011 Q4

Monetary Policy Report 2012 Q1

PUBLICATIONS ON STATISTICS:

Statistical Report (Published monthly)

OFFICIAL BULLETIN

Official Bulletin – Volume 13, no. 12 Year 2011

Official Bulletin – Volume 14, no. 1 Year 2012

Official Bulletin – Volume 14, no. 2 Year 2012

Official Bulletin – Volume 14, no. 3 Year 2012

Official Bulletin – Volume 14, no. 4 Year 2012

Official Bulletin – Volume 14, no. 5 Year 2012

Official Bulletin – Volume 14, no. 6 Year 2012

BULLETIN OF THE BANK OF ALBANIA:
Bulletin of the Bank of Albania - 2012 H1

RESEARCH PAPERS:

Empirical investigation of forecast uncertainty with Monte Carlo simulation-
Altin Tanku, Elona Dushku, Kliti Ceca

Performance evaluation: Uncertainties in forecasting inflation-
Evelina Çeliku, Gent Hashorva

Optimal level of reserve holdings: An empirical investigation in the case of
Albania
Gerti Shijaku

SCIENTIFIC NOVELTIES AT THE BANK OF ALBANIA:

Scientific Novelties at the Bank of Albania No. 7

Scientific Novelties at the Bank of Albania No. 8

OTHER PUBLICATIONS

9-th International Conference of the Bank of Albania on "Building our Future
through Financial Literacy", Conference proceedings.

