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**Statement by Mr. Fanizza and Mr. Persico on Albania
Executive Board Meeting
November 23, 2020**

I. Introduction

On behalf of our Albanian authorities, we would like to thank very much both staff and management for the constructive policy dialogue following the request for a purchase under the RFI. Fund's support greatly facilitated their response to both the November 2019 earthquake, and the COVID-19 pandemic.

When impacted by these two shocks, the Albanian economy had set on a stable growth path, with growth projected at the time to continue at 3 percent in 2020. The devastating earthquake and the ongoing COVID-19 pandemic radically changed the outlook. The earthquake caused damage estimated close to 7 percent of GDP. The authorities had to pause their reconstruction efforts to contain the COVID-19 outbreak, and they quickly acted to support the affected households and businesses with good results that suggest a recovery will start to materialize in 2021.

The authorities have followed a flexible approach in response to emergency needs but have paid attention to keep a sound macroeconomic framework as a basis for an economic rebound once the emergency is over. Despite the challenging conditions, the authorities aim at lowering the fiscal deficit in 2021 and bringing the debt-to-GDP ratio soon on a downward path. The country's financing needs are fully met and the country's capacity to repay the Fund is adequate. The monetary policy accommodative stance remains appropriate and is complemented by targeted macro-prudential stimulus. Furthermore, Bank of Albania (BoA) expects a gradual increase towards its 3 percent target by end 2022. Financial markets are calm, and the banking sector is liquid and sound. BoA is looking forward for a gradual normalization and stand ready to respond, even considering unconventional measures, in case downside risks materialize.

II. The Outlook

The measures adopted to limit the spread of the COVID-19 pandemic have affected both aggregate production and demand starting from Q1-2020. From the production side, construction, manufacturing, mining and quarrying, as well as services, accounted for the largest negative contributions. From the demand side, the fall in GDP is mostly attributed to the decrease in private investment and private consumption. The Albanian authorities project growth to rebound in 2021 (5 percent) from the expected fall in 2020, broadly in line with the staff's projections, as a result in part of a run-up of reconstruction efforts.

There have been encouraging signs from in-land tourism inflows, which may partially offset the drop of in-flight in 2021 and help to bring the deficit of the external current accounts to 7 percent of GDP in 2021, down from 9 percent in 2020. The external reserve position is expected to remain comfortable, partially reflecting the successful placement of the Eurobond in June 2020. Inflation is likely to continue to stay low and below the BoA 3 percent target until the end of 2022.

III. Policy Responses and Reforms

Fiscal Policy

The 2020 Budget Law has been revised on three occasions to respond to evolving emergency needs. The reviews (approved in March, April and July) provided increased resources for the anti-COVID social and economic packages, in part, through re-prioritization of spending that reflected substantially lower than originally budgeted outlays for the reconstruction because of COVID slowdown. To date, out of the originally ALL 34 billion allocated for the reconstruction only ALL 2.6 billion have been spent by beneficiaries.

The Budget Law for 2021 envisages a deficit of 6.5 percent of GDP, down from 8.4 in 2020. However, the Ministry of Finance and Economy (MOFE) is confident that prudent budgetary implementation will keep the actual deficit well below the budgetary target, close to the staff's recommended level of 5.2 percent of GDP. Moreover, the authorities believe that, if needed, they will be able to identify policy actions to contain the deficit, following the 2021 parliamentary elections.

The authorities intend to resume their fiscal consolidation efforts, once the COVID emergency is over and the reconstruction needs are addressed. The main objective of fiscal policy will be to bring back the debt-to-GDP ratio to a downward path, all in compliance with the fiscal rules set by the Organic Budget Law enacted in July 2020. The main operational anchor will be the primary balance that should shift into a balance by 2023. The overall objective is to bring the debt to about 68.5 percent of GDP by 2025.

On financing needs, the recent RFI, coupled to the June 2020 Eurobond issuance, secured satisfactory levels of liquidity. Moreover, Albania is benefitting from Macro-Financial Assistance from the EU (Euro 180 million), a first tranche will be disbursed by end

2020. The 2020 budgetary deficit (8.4 percent of GDP) is fully financed. Despite a likely drop in revenue collections this year, the authorities are confident they will keep domestic financing comfortably below 3 percent of GDP over the next 5 years. Moreover, a new Eurobond issue is planned for 2022.

The authorities are keen to implement the Fund's TA recommendations on liquidity management and have already implemented the earlier recommendation on how to better manage the Treasury Single Account (TSA). In fact, TSA balances account were only slightly above the envisaged 1 percent of GDP upper bound of the recommended range ceiling (ALL 15-20 billion range); going forward the level should be comfortably within the foresaw range.

The stock of VAT arrears to small taxpayers has been almost totally repaid (with the exception of ALL 79 million) and will not weight on the business climate. The remaining stock of ALL 12 billion is due to just three large taxpayers and are in the process to be cleared by mid-2021. Therefore, the authorities believe that the potential adverse effects of arrears, described by staff, on market perception and business climate will not materialize.

The authorities have started an in-depth reorganization of the tax system. In this regard, they will consider staff's advice on rationalization. Furthermore, the tax amnesty law is being reviewed by a parliamentary commission, and will take into account comments from Money Val, the European Commission, as well as stakeholders (involved in parliamentary audits). The authorities have stepped up their efforts to address the remaining deficiencies highlighted by the Money Val assessment. The MOFE is moving ahead with the related action plan; the main actions regard: land registry, beneficiary owner register, data sharing, licensing process supervision, sanctions enforcement, and the management of seizures/confiscated assets.

Monetary policy and financial sector.

In response to the adverse shocks, the BoA has further eased its monetary policy stance and applied judicious and targeted macro-prudential stimulus. The monetary stimulus was delivered by cutting the policy rate to a new historical low of 0.5% and by switching to fixed-price full-allotment liquidity injection operations. On the other hand, regulatory accommodation was delivered through a temporary relaxation of credit provisioning rules, aimed at encouraging credit restructuring and a time-limited deferral of loan installment payments. These measures were aimed at reducing debt-servicing costs, encouraging new lending, and improving the cash-flow of crisis-hit businesses.

Pursuant to these actions, both volatility and risk premia in domestic financial markets stabilized quickly. In addition, credit to the private sector continued to grow, greatly facilitating the liquidity situation of businesses and households.

BOA expects a subdued inflation profile in the coming year, followed by a gradual increase towards its 3 percent target by end 2022. This projection reflects its baseline scenario of a gradual improvement in the cyclical position of the economy, aided by several

factors: favorable domestic financial conditions, improving external demand, and growing confidence.

The banking sector remains sound, liquid and well-capitalized. While the crisis impact on the bank balance sheets' is yet to be fully materialized, the BoA stress-tests indicate the banking sector is robust enough to withstand its impact. The BoA will step up its on- and off-site supervision of the banking sector in compliance with its risk-based approach. Furthermore, the BoA will normalize its macroprudential policy stance within 2020: BoA aims to promote the transparency of the balance sheets of the banking sector in order to identify any potential sign of weakness and undertake timely remedial action.

While the baseline scenario remains positive, the accommodative monetary policy stance remains appropriate and any policy normalization will be only gradual and data driven. The prolonged monetary accommodation will account for the expected gradual withdrawal of fiscal stimulus over the next couple of years and will deliver an appropriate policy mix. The BoA will continue to give to the markets proper guidance on the expected likely path of the policy interest rate and the rationale behind its decision-making.

However, the balance of risks remains on the downside. While additional conventional monetary policy space remains, the BoA assesses it is both limited and likely to run into diminishing returns. Depending on the incidence and magnitude of the shocks, the BoA would consider using unconventional instruments as a last resort of policy accommodation. Being mindful of their potential pitfalls, their deployment will only be considered under extreme circumstances, pursuant a careful cost-benefit analysis of alternative policy instruments, and a diligent consultation with the IMF staff. Under current analysis, a potential quantitative easing program offers the best cost-benefit profile. Such a tool would help to raise liquidity, to lower risk premia in the domestic financial markets and to promote bank lending. The BoA concurs with staff that the QE adoption should not be seen and neither constitute an unlimited financing of deficit and that clear communication would be key. At the same time, the actual employment of any unconventional instruments will account for the nature of the shock and the relative effectiveness of any policy instrument.

The impact of the twin shocks on institutional investors has been very limited. Stress test to assess the COVID impact showed a good performance and stable prospects. Health-related insurances have not been subject to additional pressures, because COVID cases are treated only in public hospital, i.e. free of charge. On the earthquake impact, there are some administrative delays (on demolition's decisions by the local authorities), but there are no liquidity issues on the insurance market as only 2.5 percent of impacted building was insured – usually because of existing bank's loans. Although, investment funds were required to update their key risk assessment as they will not be protected by (COVID-related) public guarantee scheme.

Energy Sector

The authorities are pushing forward with the reform of the energy sector, also with the support from the World Bank-backed consolidation plan. In particular, the road map

toward liberalization and the instalment of the free market and power exchange (APEX) is progressing according with the timeline (should be in place in Q2 2021). The new framework would meet the requirement of the EU regulation on independent compliance, while would maintain a universal supplier – with de-regulated prices – to compensate eventual temporary lower supply. The envisaged division of the current public sectorial companies is progressing and should be completed at the end of the year.