



ALBANIA

Highlights

- **Macroeconomic performance continues to strengthen.** GDP growth rates are on an upward trajectory and the IMF programme has been successfully concluded, contributing to enhanced fiscal stability and a falling (albeit still-high) level of public debt.
- **Construction of the Trans Adriatic gas Pipeline (TAP) section in Albania is well under way.** The TAP is a vital project for Albania as it contributes to energy diversity and regional integration.
- **Confidence is increasing in the banking sector.** The level of non-performing loans (NPLs) has started to decrease, measures to enhance governance in the sector are being introduced, and consolidation of the still-large number of banks is proceeding slowly.

Key priorities for 2018

- **EU-oriented reforms should be stepped up.** It is critical for Albania's long-term prosperity that the momentum in the EU approximation is preserved and accelerated and that everything is done in the areas of public administration reform and rule of law (among other areas) to meet EU requirements for the opening up of accession talks.
- **Further business environment reforms are needed.** The campaign against informality has yielded important results but extra efforts are needed to tackle deep-rooted problems such as getting electricity, registering property and enforcing contracts.
- **The reform momentum in the power sector should be sustained.** Steps already taken include: increased bill collections and the related lowering of distribution losses and repaid arrears to the private sector. Further improvements in governance and operational practices of the state-owned enterprises (SOEs) in the power sector are needed to make their improved financial position sustainable.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	1.0	1.8	2.2	3.4	3.7
Inflation (average)	1.9	1.6	1.9	1.3	2.1
Government balance/GDP	-5.2	-5.5	-4.1	-1.8	-1.2
Current account balance/GDP	-9.3	-10.8	-8.6	-7.6	-9.2
Net FDI/GDP [neg. sign = inflows]	-9.5	-8.1	-8.0	-8.7	-9.3
External debt/GDP	60.5	56.1	63.3	62.0	n.a.
Gross reserves/GDP	21.6	20.4	27.6	26.2	n.a.
Credit to private sector/GDP	39.8	39.4	37.3	33.5	n.a.

Macroeconomic performance

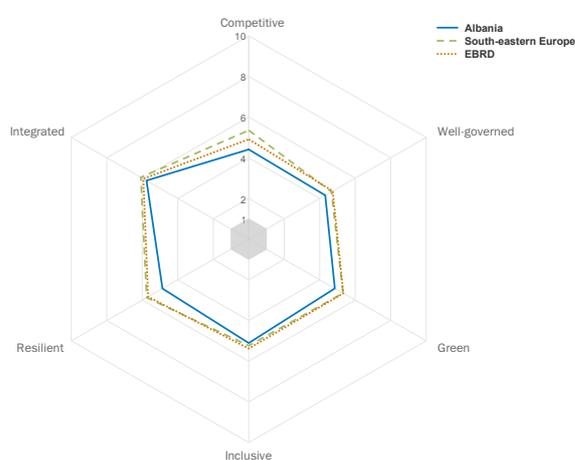
Robust economic growth is continuing. Overall GDP growth reached 3.4 per cent in 2016, compared with 2.2 per cent in 2015, on the back of strong growth in private consumption and investment. Government spending increased moderately after levelling off the year before. Net exports also had a positive contribution to growth (although small), mostly because of the good performance of services exports, such as tourism. Economic activity accelerated in the first quarter of 2017, with growth reaching 4.0 per cent year-on-year, driven mainly by the construction sector where several major infrastructure projects are advancing.

Monetary policy continues to be accommodative, but lending is still sluggish. In August 2017, the central bank announced that it would keep its key policy rate at 1.25 per cent, the same rate since November 2015. The central bank's low interest rate policy in recent years has led to the lowering of interest rates across several segments of the financial market (average lending rate as of mid-2017 was 6.6 per cent), thus stimulating private domestic demand to some extent. However, lending remains sluggish, especially for business loans. Average inflation in 2016 was 1.3 per cent, below the central bank's target of 3.0 per cent, and averaging 2.1 per cent in the first nine months of 2017.

Fiscal policy has been strengthened, putting public debt on a downward trajectory. For the past three years fiscal policy was anchored within a three-year Extended Fund Facility (EFF) programme with the International Monetary Fund (IMF). The programme successfully concluded in February 2017. Restoration of a significant degree of fiscal stability was among the major achievements of the programme, as fiscal policy has been prudent and public debt was put on a downward trajectory, peaking at about 73 per cent of GDP in 2015. At the end of 2016, public debt had fallen to 71 per cent of GDP. The Albanian parliament has endorsed the state budget for 2017 which envisions the budget deficit of 2 per cent of the projected GDP, which would be the lowest level in the last two decades. This is despite significant increases in public sector wages and the minimum wage announced in spring 2017.

The short-term outlook is positive but downside risks remain. Growth of 3.7 per cent is expected in 2017, staying at the same level in 2018, on the back of private domestic demand and major construction work on large energy-related foreign direct investment (FDI), such as the Trans-Adriatic gas Pipeline (TAP). Monetary policy is expected to remain growth-supportive, and the pass-through from lower interest rates to an increased pace of credit lending is expected to rise gradually, in line with the ongoing efforts to tackle NPLs in the banking sector. The economy would also benefit from further progress in the EU approximation process. However, significant downside risks remain, associated with the embedded structural weaknesses in public administration and infrastructure, as well as vulnerability to external shocks in Albania's main market, the eurozone.

Assessment of transition qualities (1-10)



Major structural reform developments

Progress is being made in the EU approximation process. In November 2016 the European Commission (EC) recommended the conditional opening of EU accession negotiations with Albania. This came after the country adopted an important judicial reform package in July 2016. However, the recommendation remains conditional on (among other things) tangible progress in implementation of judicial reform, in particular with regard to the law on re-evaluation of judges and prosecutors, known as the vetting law. The EC has also urged the government to pursue civil service reform, including the creation of a civil servants register and a change of their recruitment model, basing it fully on candidates' professional achievements (rather than on their political orientation as is often the case). At the same time, the EC has recognised the country's steady progress towards fulfilling its key priorities within the EU accession process, namely: public administration reform, strengthening the rule of law, as well as reforms aimed at developing a functioning market economy.

Customs procedures have been improved. In June 2017 the new customs code that eases the procedures for businesses and reduces the time and costs related to customs charges entered into force. The introduction of streamlined procedures of exports and imports aims to bolster trade, and the code has been drafted in line with the EU *acquis communautaire*. This is an example of the business environment improvements in Albania in recent years, contributing to the country reaching 65th place in overall ease of doing business in the World Bank's *Doing Business 2018* report, compared with 85th five years ago.

Trans Adriatic gas Pipeline (TAP) construction is progressing. TAP is currently the most important infrastructure project in the country, aiming to reduce EU dependence on Russian gas and potentially diversify the energy mix and strengthen energy resilience in Albania. The TAP route through Albania is approximately 215 km onshore and 37 km offshore, out of the entire length of 878 km, starting at the Greek-Turkish border. The investment in Albania's section is expected to amount to about €1.5 billion over six years, and up to €450 million in 2017 alone. In January, the government established a new transmission system operator, Albgaz, with the task of developing and managing gas infrastructure. Meanwhile, the government has also been studying the feasibility of secondary gas infrastructure in the country and identifying priority gasification projects as part of the Gas Master Plan for Albania, for possible implementation in the period 2018-20.

Progress on energy efficiency and renewables is advancing. In November 2016 Albania transposed EU law on the energy performance of buildings, as set out in the EU's 2010 Energy Performance of Buildings Directive. According to the Energy Community Secretariat, this rectifies breaches and ensures the country's compliance with Energy Community ministerial council decisions from October 2016. The government has also issued licences for the development of wind and solar power plants, in line with plans to reduce the reliance on hydropower and increase the production of energy from renewable resources.

Transport integration with neighbouring countries is moving ahead. In August 2017 the government launched a tender procedure for the Arber motorway, connecting Tirana with the Macedonian border. Once completed, the highway will reduce transport times from Tirana to FYR Macedonia, thereby boosting trade between the two countries. This is planned to be the first project under the government's recently proposed "€1 billion for reconstruction" programme, which, if it proceeds, may use public-private partnerships (PPPs). Feasibility studies are also under way for the proposed Ionian Adriatic highway corridor as well as a detailed design for the rehabilitation of the railway line connecting Albania and Montenegro.

Governance in the banking sector is being strengthened. The central bank is currently preparing new regulations to strengthen the governance of banks and the independence of their controlling structures. According to the new regulations, the chairman of the bank's audit committee will also be a member of the Steering Council. This official should not have a private interest relationship with the bank's shareholders or executives in order to prevent conflicts of interest. Further proposed measures refer to strengthening the importance and independence of risk management units in the banks. These measures should help prevent a return of large amounts of NPLs. The NPL level remains high by regional standards but has come down to 15.6 per cent of total loans as of the end of June 2017.

Albania's first private stock exchange is expected to be launched by the end of 2017. The stock exchange is expected to be operational after it was licensed by the financial supervisory authority in July 2017. Albania's Credins Bank and American Bank of Investments will own 42.5 per cent of the exchange's capital each, while the remaining shares will be held by AK Invest. The stock exchange will use the same electronic system used by the bourses in Ljubljana, Skopje, Sarajevo, Banja Luka and Podgorica, meaning that in the future it could potentially be incorporated into the regional SEE link.
