



ALBANIA

Highlights

- **Robust economic growth is continuing.** GDP grew by 3.8 per cent in 2017, driven equally by private consumption and investment. Monetary policy remains accommodative, while fiscal deficits have been reduced.
- **EU approximation is advancing.** The European Council at its meeting in June 2018 set out the path towards opening EU accession negotiations with Albania in June 2019, subject to further progress in reforms.
- **Consolidation in the banking system is taking place.** The banking sector now comprises 14 banks, two fewer than in mid-2017. In addition, two other banks are in the process of changing owners.

Key priorities for 2019

- **Power sector reforms should be pursued vigorously.** In the short term the priorities are to further liberalise the market, enforce payment discipline in state-owned companies, and improve the regulatory framework to ensure cost-reflective tariff-setting.
- **Infrastructure projects should be carried out transparently.** Albania's requirements in areas such as roads, railways and ports remain numerous, but it is vital that investment projects are tendered according to best practice competitive rules and standards.
- **Factors holding back credit growth should be tackled.** Non-performing loans have declined but remain high by regional standards and are holding back credit growth; efforts to reduce them further should be intensified.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	1.8	2.2	3.4	3.8	4.0
Inflation (average)	1.6	1.9	1.3	2.0	2.3
Government balance/GDP	-5.5	-4.1	-1.8	-1.4	-2.2
Current account balance/GDP	-10.8	-8.6	-7.6	-6.9	-7.1
Net FDI/GDP [neg. sign = inflows]	-8.1	-8.0	-8.7	-8.4	-6.9
External debt/GDP	56.1	63.0	61.9	63.2	n.a.
Gross reserves/GDP	20.4	27.5	26.1	27.1	n.a.
Credit to private sector/GDP	39.4	37.5	34.4	32.2	n.a.

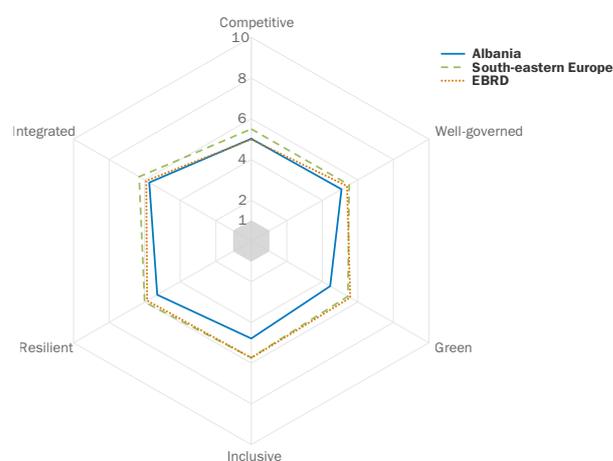
Macroeconomic performance

The economy continues to grow strongly. GDP grew by 3.8 per cent in 2017, following 3.4 per cent in 2016. Growth in 2017 was driven equally by private consumption and investment. The construction of two major energy projects, namely the Norwegian investment in hydropower plants on the river Devoll and the Trans Adriatic Gas Pipeline (TAP), was the main contributor to overall investment, although the direct economic impact on GDP is expected to decelerate in the short term (construction continued to slow down in the first quarter of 2018, following its peak in the first half of 2017). Economic activity accelerated in the first half of 2018, with growth reaching 4.4 per cent year-on-year, driven mainly by industry (including electricity production, fuelled by heavy rainfall particularly during the second quarter following a prolonged drought in the second half of 2017), which contributed more than half of value added.

Further monetary easing has occurred amid a strengthening currency. Average inflation in 2017 was just 2 per cent, once again below the central bank's target of 3 per cent, and has continued to be below the target in the first half of 2018. In response, the Bank of Albania made another cut to its key policy rate by 0.25 percentage points in June 2018 to 1 per cent, a new historical low. The central bank's low interest rate policy in recent years has supported the overall lowering of interest rates across several segments of the financial market, thus stimulating private domestic demand to some extent. However, lending remains sluggish, especially for business loans. Meanwhile the lek has been appreciating against the euro in recent years, and particularly during 2018, providing a further justification for the policy rate cut. This reflects the ongoing de-euroisation policy initiative of the central bank in the financial sector, as well as the capital conversion of some banks (see below) and a good tourism season. Some unrecorded cross-border activities may also be contributing to the appreciation pressures. In early June 2018 the Bank of Albania intervened in the market to dampen these pressures.

Fiscal policy continues to be prudent. Restoration of a significant degree of fiscal stability was among the major achievements of the authorities in the past few years, assisted by an IMF programme which ended in early 2017. The 2017 budget deficit was 1.4 per cent of GDP, the lowest level in the last two decades, while the government's 2018 budget targets a deficit of 2 per cent of GDP. The government is taking steps to reduce public arrears further, especially those related to VAT reimbursements and local government arrears, particularly of the capital Tirana. Public debt had fallen to approximately 70 per cent of GDP as of the end of 2017, and is equally divided between external and domestic creditors, but recently signed infrastructure projects under a public-private partnership (PPP) framework are adding to potential public debt liabilities in the future.

Assessment of transition qualities (1-10)



The short-term outlook remains positive but risks remain. Growth of 4.0 per cent is expected in 2018, with a similar rate (3.9 per cent) projected for 2019. 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 non-performing loans (NPLs) in the banking sector. Private consumption and investment are expected to remain the main drivers of growth, both having a boost from increased confidence. The economy will likely benefit from enhanced foreign investor interest, especially if there is further progress in the EU approximation process. However, downside risks remain, associated with the embedded structural weaknesses in public administration and infrastructure, the potential slow-down of the reforms due to internal political tensions, as well as vulnerability to external shocks in Albania's main economic partner, the eurozone.

Major structural reform developments

The European Commission has recommended the launch of EU accession talks with Albania.

In April 2018 the European Commission (EC) issued the recommendation to open EU accession negotiations with Albania. The European Council at its meeting in June 2018 set out the path towards opening EU accession negotiations in June 2019, subject to further progress in reforms. Meanwhile, the EC has launched the screening process to evaluate the readiness of the country to start accession talks, with a focus on the crucial rule of law chapters 23 and 24 of the EU's *acquis communautaire*. Albania applied for EU membership in 2009 and has been an EU candidate since June 2014. The speed of EU approximation remains conditional on (among other things) tangible progress in implementing judicial reform, in particular with regard to the law on re-evaluation of judges and prosecutors, known as the vetting law, and progress in the fight against corruption and organised crime. The EC has also urged the government to pursue civil service reform, including a change of their recruitment model, basing it fully on candidates' professional achievements (rather than on their political orientation, as is currently sometimes the case).

Progress in business environment reforms has been mixed. The country was ranked 63rd overall (out of 190 countries) in the World Bank *Doing Business 2019* report, two places up from a year ago, and more than 20 places higher than a few years ago. The most notable reform over the past year registered in the report was in enforcing contracts, as Albania made this area easier for doing business by amending the code of civil procedure, thus establishing a simplified procedure for small claims and introducing time standards for certain court events. However, the most problematic areas, according to the report, are still in the areas of enforcing contracts, dealing with construction permits and getting electricity.

Plans to develop renewable energy sources are advancing. In August 2018 the government invited bids for a 50 MW photovoltaic solar power plant near the southern coastal city of Vlora. Albania relies entirely on hydropower production, but the government is moving forward with its plans to diversify renewable sources by targeting the implementation of 120 MW of solar and 70 MW of wind power capacity by 2020.

The power distribution operator, OSHEE, has started the process of unbundling. The company registered three new companies in April 2018, thus beginning the unbundling process in response to pressure from the Energy Community. OSHEE will operate as the key company managing the three new subordinated companies: the Distribution System Operator, which will manage and operate the power distribution network; the Free Market Supplier, which will manage the unregulated supply and trading of electricity; and the Universal Service Supplier, which will manage the final stage of the power delivery to customers in the regulated market. The government is considering plans to float OSHEE on the stock exchange at some point.

Major road projects are advancing amid concerns about openness of procurement.

In February 2018 the government signed a €240 million contract with local company Gjoka Construction for the construction, operation and maintenance of a section of the Arber road, connecting Tirana with the Macedonian border. Similarly, in July 2018 the government awarded a €225.8 million contract to local company Gener 2 for the construction, operation and maintenance of the Kashar-Thumane motorway, connecting Tirana with the northern part of the country. Both projects are within the framework of the government's €1 billion PPP programme announced in 2017. The scheme, which envisages financing of the construction by contractors and repayment of long-term debt by the government, has been criticised by some observers, including the IMF, because of the potential for hidden liabilities for public finances and the fact that projects are based on unsolicited bids. Meanwhile, an attempt to introduce the first toll road in the country – the Durrës-Kukës motorway – initially encountered significant resistance from local communities because of the perceived high cost of the tolls, but came into force in September 2018.

Consolidation and change of ownership in the banking system are ongoing. In the fourth quarter of 2017 the Albanian branches of Intesa Sanpaolo (the fourth largest bank in the country) and Veneto Bank (among the smallest banks in the country) began to merge, a process expected to be completed by the end of 2018. In February 2018 the local American Bank of Investments (ABI) signed an agreement with the National Bank of Greece (NBG) to buy the Greek bank's Albanian branch. In August 2018, FYR Macedonia's Komercijalna Banka signed a binding agreement with Albanian investment group Balfin to acquire together Tirana Bank from Greece's Piraeus Bank. And in August 2018 the Hungarian OTP Bank acquired an 89 per cent stake in Banka Societe Generale Albania, the country's fifth-largest bank with a market share of 6 per cent. OTP Bank expects to close the transaction in the fourth quarter of 2018, pending regulatory approval.
