



ALBANIA

Highlights

- **Economic stability has been preserved.** The past year has seen an improvement in growth, continued low inflation and further progress in the clearance of public sector arrears.
- **Power sector reforms have advanced.** The state-owned power producer, KESH and electricity distribution company, OSHEE, are currently undergoing a major restructure, including a commitment by both companies and the government to corporate governance reform and the introduction of climate resilience elements to KESH's operations.
- **An important judicial reform package has been adopted.** The new reforms are intended to enhance the independence and professionalism of the justice system. Successful implementation would be a key step in the country's EU approximation path.

Key priorities for 2017

- **Macroeconomic stability should be preserved once the current International Monetary Fund (IMF) programme ends.** The current IMF Extended Fund Facility, which ends in early 2017, has been an important anchor for the improved macroeconomic and fiscal performance of recent years. The gains made under this programme should be carefully preserved.
- **The campaign against informality should be stepped up.** The early steps in the campaign to register new companies yielded some good results, but further efforts are needed to enhance tax compliance and create a more level playing field for legitimate businesses.
- **A more commercial approach in the energy sector is needed for long-term sustainability.** Recent steps to reform the state-owned energy companies KESH and OSHEE are encouraging but the road ahead is challenging. Implementing improvements in corporate governance and operational efficiency will be essential for complying with the European Union's regulations in the energy sector.

Main macroeconomic indicators %

	2012	2013	2014	2015	2016 proj.
GDP growth	1.4	1.0	1.8	2.8	3.3
Inflation (average)	2.0	1.9	1.6	1.9	1.1
Government balance/GDP	-3.4	-5.2	-5.5	-4.1	-2.5
Current account balance/GDP	-10.2	-10.8	-12.9	-11.2	-13.3
Net FDI/GDP [neg. sign = inflows]	-6.8	-9.6	-8.1	-8.5	-8.2
External debt/GDP	36.2	35.8	34.3	41.1	n.a.
Gross reserves/GDP	21.0	21.6	20.4	27.5	n.a.
Credit to private sector/GDP	40.8	39.8	39.4	37.3	n.a.

Macroeconomic performance

Economic performance has gradually improved in the past year. In 2015, the economy recorded 2.8 per cent growth. Economic activity in 2015 was assisted by the clearing of most government arrears (providing a boost to suppliers) and supportive monetary policy (lower interest rates). The improvement mainly reflected the expansion of investment, supported by strong foreign direct investment (FDI) inflows, and net exports to some extent. Private consumption had a negative contribution to growth, as did government spending. Growth continued in the first half of 2016 at 3.1 per cent year-on-year.

The central bank has pursued expansionary monetary policy amid continued low inflation.

The still below-potential economic activity and low imported inflation, as well as a further decline in oil prices, have all helped to keep the 2015 average inflation rate at only 1.9 per cent, keeping it below 2.0 per cent for four years in a row. The central bank has continued its monetary easing with a series of cuts to the base interest rate. In November 2015, the central bank cut the key interest rate by 25 basis points to 1.75 per cent, and further similar cuts took place in April and May 2016, bringing the rate to an historic low of 1.25 per cent. The central bank's policy has led to the 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.

The IMF programme is on track. In June 2016, the IMF reached staff-level agreement for completion of the programme's eighth review. The IMF's Executive Board completed the review in August 2016, and approved the disbursement of a further €36 million, bringing total disbursements to €298 million, out of €370 million in total. The government has continued to pursue a relatively prudent fiscal policy in line with the aims of the IMF programme. The 2016 budget agreed with the IMF aims for a primary surplus of 0.3 per cent of GDP. It is expected that negative fiscal impacts from low oil prices (Albania being a significant oil producer) will be partially offset by higher GDP and revenues generated by the implementation of structural reforms in the energy sector, as well as the crackdown on informality launched in September 2015 and the resulting improved tax compliance.

Economic recovery is expected to continue. The short-term outlook remains positive but the downside risks, which could decelerate the pace of growth, are high. The Albanian economy continues to face structural weaknesses, while the financial sector remains exposed to both domestic and external shocks. Growth of 3.3 per cent is expected in 2016 and 3.5 per cent in 2017, on the back of private domestic demand and major construction work on large energy-related FDI, such as the Trans-Adriatic (gas) Pipeline (TAP). Monetary policy is expected to remain growth-supportive, while the pass-through from lower interest rates to an increased pace of credit lending should accelerate. Over the medium term, Albania could benefit considerably from a global recovery if it is able to make further progress on structural reforms and advance towards the start of EU accession talks.

Major structural reform developments

An important judicial reform package has been adopted, assisting Albania's path towards EU accession. Albania has been a candidate country for EU membership since June 2014, but no date for the opening of accession negotiations has been set. An important step forward was the adoption by parliament in July 2016 of a set of constitutional amendments, paving the way for the implementation of justice reform through further approval of primary and secondary legislation. The reform is intended to enhance the independence and professionalism of the judicial system. Albania's accession path was also aided by an allocation of up to €649.4 million under the European Union's new Instrument for Pre-accession Assistance (IPA II) in 2014-2020. The assistance will support reforms in preparation for EU membership, socio-economic development, social policies, agriculture and rural development.

The campaign against informality has advanced. In September 2015, the government launched a comprehensive campaign against informality in the economy, with the aim to combat tax evasion and to punish businesses that work outside the law. After some initial successes, the second phase of the operation was introduced in April 2016. This phase will be based on the risk assessment and

onsite inspection control of businesses, focused mainly on the regular issuance of fiscal coupons and invoices, as well as the declaration of employees. In addition, the Ministry of Finance has launched a wide consultation campaign with the business community with a view to identifying and introducing measures aimed at simplifying tax procedures.

Online applications for building permits have become mandatory. This measure, effective from September 2016, is aimed at preventing illegal construction. Under the new measure, no constructor will be able to submit projects for obtaining a building permit without an electronic signature. Applicants will be informed electronically of their application's progress for a building permit. The measure is a first step towards more comprehensive digitalisation, which will also include other institutions, such as the Registry of Property. This is part of the government's efforts to improve the business climate in the country and it has already had a positive impact on Albania's ranking in the World Bank's *Doing Business* report. The 2017 report upgraded Albania by 32 places to 58th position (out of 190) mainly because of the major improvement in dealing with construction permits. A further positive development was the launch in April 2016 of the National Business Centre (NBC), which was created as a single body by merging the National Registration Centre and the National Licensing Centre for companies. The NBC will offer services from these institutions in a one-stop shop and is intended to reduce the time of proceedings and provide better services to companies.

Progress on privatisation in the past year has been mixed. A positive step was the sale of the state-owned insurance company, Insig, in March 2016. The Albanian insurer Eurosig won the tender for the privatisation, following several failed privatisation attempts over the years. However, plans to privatise the oil company Albpetrol have been put on hold, as low oil prices have reduced the potential interest of foreign investors, and the company would require significant restructuring before any potential sale. Meanwhile, a new Law on Strategic Investments entered into force in January 2016, with the aim of facilitating large investments.

Power sector reforms have advanced. The state-owned power producer, KESH, is currently undergoing a major restructure, with support from the EBRD which signed a loan of €218 million to the company in July 2016. The KESH reform is complementary to the Financial Recovery Plan developed by the government and KESH in cooperation with the World Bank. The restructuring programme includes a commitment by KESH and the government to corporate governance reform, compliance with the EU's Third Energy Package and the introduction of climate resilience elements to its operations. Albania is also working with neighbouring Kosovo on creating a joint electricity market; in June 2016 the two countries inaugurated a 400kW power transmission line.

The first toll road in the country is being launched. In September 2016, following an extended tendering process, the Albanian government awarded a 30-year concession to a UAE-based consortium for the maintenance and upgrade of the Milot-Morine motorway section. This decision reversed a previous decision in July 2016 to award the concession to a Turkish private consortium. This will be the first toll road in Albania, with a fee of €5 for vehicles (higher for trucks). Milot-Morine is part of the trans-Albanian motorway, connecting the port of Durres with the Morine border crossing with Kosovo.

Non-performing loans are being tackled. NPLs remain a major problem in Albania, representing 21.4 per cent of all loans in the banking sector as of August 2016. Although this rate has increased recently because of two large borrowers' defaults, it is expected to decline again in the coming months, reflecting important policy initiatives by the authorities to tackle the problem. Measures already undertaken by the central bank include the obligatory write-off of bad loans of more than three years old, while additional measures will include further clarification of the tax definition of bad debt, improved collateral execution, and assistance to corporates for the preparation of recovery resolution plans. The NPL action plan is being carried out in close coordination with private economic actors and the ministries of finance, economy and justice, as well as international organisations and banks through the Vienna Initiative. Overall, the banking sector remains highly liquid, prudently capitalised (16 per cent is the ratio of regulatory capital and risk-weighted assets) and has weathered potential spillovers from the Greek crisis well (Greek banks own around 17 per cent of total assets in the Albanian banking sector).