

33. ALBANIA

A gradual but steady recovery

Economic activity is accelerating mainly because of rising household spending and private investment. Private consumption and investment are projected to go on increasing on the back of solid gains in employment and strong growth in FDI-inflows. Public debt as a share of GDP is projected to fall, but the upcoming election period might test the authorities' commitment to the path of fiscal consolidation.

Growth strengthens in the first half of 2016

The Albanian economy advanced 3.1% (y-o-y) in the first six months of 2016. All components of domestic demand provided a positive contribution to output expansion. Household spending gained strength and became the main growth driver. After declining throughout 2015, public consumption also increased, even if only marginally. Investment growth decreased, but remained firmly in positive territory. The external sector subtracted from output growth because of surging imports, even as real exports also showed signs of a rebound following a weak performance in 2015.

Monetary policy to remain supportive

Domestic demand is expected to continue being supported by an expansionary monetary policy stance. Since May the Central Bank has kept its policy interest rate unchanged at a record low of 1.25%. With the gradual closure of the output gap, the Central Bank projects inflation to return to the 3% target only in the second half of 2018 and hinted that it would not raise the policy rate throughout 2016.

Interest rates have been on a downward trend across a wide range of financial instruments but private credit, especially business loans, remained sluggish. Bank lending continues to be impaired by the high level of non-performing loans (NPLs). Driven by some large bankruptcies, the proportion of NPLs has edged up since the beginning of the year, rising to 21.4% in August from 18.2% at end-2015.

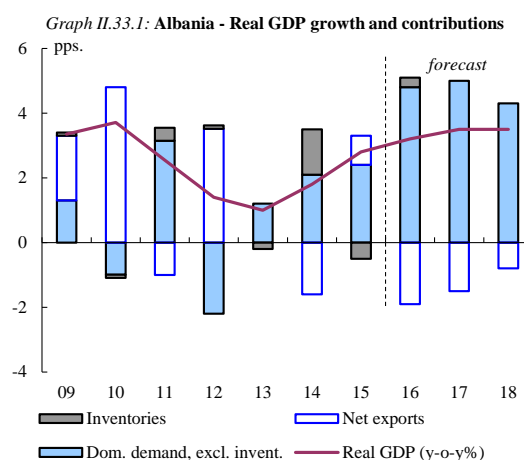
It is expected that the NPL ratio resume declining in the remainder of this year as the authorities' planned measures to tackle the problem get implemented and the economic recovery goes hand in hand with higher demand for new loans.

Positive outlook for private domestic demand

A marked improvement in the labour market conditions has underpinned the increase in

household spending and this is forecast to continue over the forecast horizon. Employment increased by 5.8% (y-o-y) in the second quarter of 2015 and triggered a drop in unemployment rate (15-64 years) to 15.9%, its lowest level in more than three years. Private consumption has also benefitted from a pick-up in household credit amid the continued easing of lending standards applied by banks for this loan category.

The upward trend in investment is also projected to continue as the significant boost from energy-sector FDI inflows related in particular to two large projects, should continue to offset the decline in gross capital formation in the extraction sector caused by low oil prices.



Net exports set to remain a drag on growth

Exports of goods in both nominal and real terms have suffered from the impact of low oil and other commodities prices. However, the extent of the decline since their peak in 2014 suggests that exports of goods might be close to bottoming out, especially as oil prices have started to recover somewhat. Exports of services, which make up the bulk of foreign sales, have recently gained momentum thanks to strong growth in tourism and manufacturing services. All in all, real export growth is expected to continue increasing in line

with the gradual recovery of Albania's main trading partners in the EU.

At the same time, rising domestic demand is projected to lift imports, leading to an overall negative contribution to growth from the external sector in the years to come.

Downside risks dominate

The balance of risks remains tilted to the downside. Increased political uncertainty related to next year's parliamentary election might dampen consumption and investment. Credit recovery might take longer than expected in the context of persistently high NPLs. Electricity production remains subject to weather-induced volatility. On the other hand, implementing structural reforms, such as the recently started comprehensive overhaul of the justice system, could improve the business environment and the economy's growth potential.

Fiscal consolidation faces mounting risks

In the first eight months of this year, tax revenues increased broadly in line with the authorities'

plans, although this has been partly due to the one-off payment of a large disputed tax obligation which might have to be reimbursed. Expenditures in the same period were lower than one year earlier as a result of the completion of the arrears clearance exercise. Overall, budget execution in January-August resulted in a surplus amounting to 0.9% of estimated full-year GDP. The government took measures to speed up sluggish infrastructure spending and now expects a deficit of 2.3% of GDP for the year as a whole. This is 0.2 pps. of GDP higher than the initial target, but the difference is fully financed by new privatisation receipts.

Under the no-policy change assumption, the reduction of the budget deficit is expected to continue in line with the government's current fiscal strategy, and the public debt to GDP ratio is projected to gradually decrease. However, in the run-up to next year's election there is a risk that the government relaxes its fiscal consolidation plans, which will lose an important anchor following the end of the country's IMF-supported programme in February 2017.

Table II.33.1:

Main features of country forecast - ALBANIA

	2015		97-12	Annual percentage change						
	bn ALL	Curr. prices		% GDP	2013	2014	2015	2016	2017	2018
GDP	1435.8		100.0	4.7	1.0	1.8	2.8	3.2	3.5	3.5
Private Consumption	1148.9		80.0	3.0	1.8	3.0	-0.4	2.8	2.2	3.1
Public Consumption	155.9		10.9	-0.2	2.9	6.4	-3.2	1.1	1.9	2.9
Gross fixed capital formation	390.7		27.2	7.3	-2.0	-4.0	12.5	8.9	10.7	4.9
of which: equipment	-		-	6.4	-	-	-	-	-	-
Exports (goods and services)	391.1		27.2	15.8	-12.4	1.8	-0.3	6.6	5.4	5.8
Imports (goods and services)	638.7		44.5	9.8	-7.9	4.6	-2.1	8.4	6.4	5.1
GNI (GDP deflator)	1421.9		99.0	4.5	2.0	0.4	3.0	3.5	3.5	3.5
Contribution to GDP growth:										
Domestic demand				4.2	1.2	2.1	2.4	4.8	5.0	4.3
Inventories				0.1	-0.2	1.4	-0.5	0.3	0.0	0.0
Net exports				-1.2	0.0	-1.6	0.9	-1.9	-1.5	-0.8
Employment				-0.5	-9.7	1.6	2.0	3.4	2.6	2.7
Unemployment rate (a)				-	16.4	17.9	17.5	16.0	15.2	14.2
Compensation of employees / head				-	-	-	-	-	-	-
Unit labour costs whole economy				-	-	-	-	-	-	-
Real unit labour cost				-	-	-	-	-	-	-
Saving rate of households (b)				-	-	-	-	-	-	-
GDP deflator				4.1	0.3	1.4	0.2	0.6	1.7	2.3
Harmonised index of consumer prices				-	1.9	1.6	1.9	1.4	2.3	2.6
Terms of trade goods				-1.8	1.6	1.5	0.8	-3.8	-0.1	-0.1
Trade balance (goods) (c)				-24.0	-20.6	-22.2	-22.4	-24.8	-25.8	-26.2
Current-account balance (c)				-	-10.9	-12.9	-10.7	-12.2	-13.1	-13.2
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-	-	-	-	-	-	-
General government balance (c)				-	-5.0	-5.2	-4.0	-2.3	-1.7	-1.3
Cyclically-adjusted budget balance (d)				-	-	-	-	-	-	-
Structural budget balance (d)				-	-	-	-	-	-	-
General government gross debt (c)				-	70.4	72.1	72.7	72.2	70.5	68.1

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.