

## 33. ALBANIA

### Output is accelerating on the back of stronger domestic demand

*Economic activity continues to accelerate as household spending picks up while investment remains at a relatively high level. Foreign trade has revived and is set to expand at a decent pace. Inflation is projected to rise slowly towards the official target. An accommodative monetary policy supports household borrowing, but lending to the corporate sector remains constrained by the high level of non-performing loans. The fiscal policy stance is expected to slowly reduce public debt as a share of GDP.*

#### Growth has picked up

The Albanian economy advanced 3.5% in 2016, which was the third consecutive year with strengthening GDP growth. All components of domestic demand provided a positive contribution to output expansion, but gross fixed capital formation remained the main driver, benefitting from large foreign direct investments in the energy sector. Both private and public consumption recovered following weak performances in the preceding year. Exports of services accelerated to a growth rate of almost 20% which to a large part was the result of a strong tourism season. Some of this was offset by a continuing decline in goods exports related to weak raw material prices. Imports of goods and services expanded at a rate commensurate to final demand.

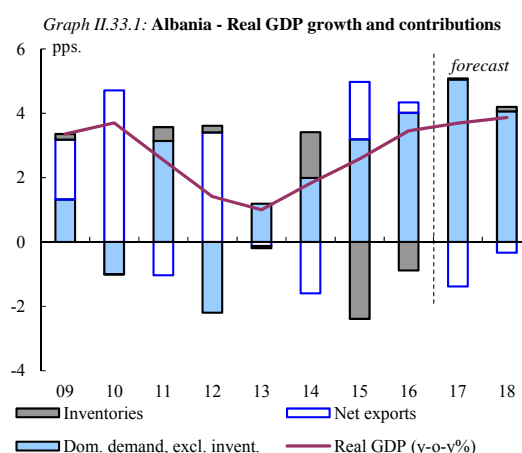
#### Monetary policy continues to provide support

Domestic demand is expected to continue receiving support from an accommodative monetary policy. The Bank of Albania has kept its policy interest rate unchanged at the record low level of 1.25% since May 2016 and has stated that the intensity of the monetary stimulus is unlikely to be reduced before the fourth quarter of 2017. It projects headline inflation to return to the 3% target in the course of 2018 from 2.1% in March 2017. The uptick in inflation since mid-2016 is mainly the result of higher food and energy prices. Underlying price pressures have remained subdued.

With low financing costs and an easing of credit standards for the household sector, lending growth to households has picked up. However, bank lending to the non-financial business sector has remained sluggish as it is still constrained by a sizeable overhang of non-performing loans (NPLs) on bank balance sheets. The ratio of NPLs to total gross loans has trended down over the four months to February 2017 when it stood at 18.0%, suggesting that corporate lending may ease up gradually.

#### Private domestic demand is set to remain solid

Household spending is not only benefitting from favourable financial conditions, but also from a marked improvement of labour market conditions. Employment was up by a strong 6.1% in 2016, reducing the unemployment rate (15-64 years) to 15.6% which is the lowest annual rate since 2012. A 10% wage hike was implemented in large parts of the public sector in March 2017. Rising employment and higher wages are expected to continue supporting household spending over the forecast horizon.



Investment activity is projected to remain strong, on the back of two large on-going projects in the energy sector which require additional foreign direct investments, particularly in 2017. Investments in the extraction sector are expected to stabilise over the forecasting horizon in view of higher commodity prices compared to 2016.

#### Net exports expected to weaken

The strong performance of services exports in 2016 resulted in a positive contribution to GDP growth from net exports. Over the forecasting period, overall export growth is expected to remain somewhat above the growth rate in Albania's export markets, but clearly below the extraordinary

performance in 2016. Higher commodity prices are expected to support goods exports, but on the other hand the recent real appreciation of the Albanian currency has reduced price competitiveness. Import growth is projected to remain relatively high, reflecting domestic demand. Overall, these projections result in a negative contribution to growth from the external sector, particularly in 2017. The current account deficit fell to just below 10% of GDP last year, but is projected to be running slightly higher over the next two years.

#### Stronger GDP growth, but downside risks

GDP growth is projected to strengthen slightly in the forecasting period, but the balance of risks is tilted to the downside. In particular, the political crisis surrounding the parliamentary election, scheduled for June 2017, may eventually dampen consumption and investment. In addition, credit recovery may take longer than expected and the still elevated level of sovereign debt provides little room for countercyclical policies in case of need. On the upside, the implementation of structural reforms, such as the recently started comprehensive overhaul of the justice system, could improve the business environment and, eventually, the economy's growth potential.

#### Moderate fiscal deficits projected to lower the public debt ratio

The general government deficit in 2016 amounted to 1.8% of GDP which was significantly smaller than planned due to a broad-based under-execution of expenditures. The forecast projects that the fiscal deficit will be close to 2% of GDP over the forecast period based on the 2017 budget and the government's current fiscal strategy. A deficit of this magnitude implies a declining trajectory for the public debt ratio on the basis of the forecast's projection for nominal GDP. In 2016, the debt ratio already declined by 0.7 pps. to 72.0% after having risen for six consecutive years.

The fiscal projection is associated with a number of risks, which include: (1) the current fiscal policy stance may be relaxed in the context of the upcoming elections; (2) the IMF's Extended Fund Facility Arrangement for Albania was concluded in February 2017, removing an important anchor of the government's fiscal consolidation strategy; (3) remaining weaknesses in public finance management pose a challenge for the execution of public budgets according to plan.

Table II.33.1:

#### Main features of country forecast - ALBANIA

	2015			Annual percentage change						
	bn ALL	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP	1434.7	100.0	4.7	1.0	1.8	2.6	3.5	3.7	3.9	
Private Consumption	1161.2	80.9	3.0	1.8	3.0	0.9	2.5	2.8	3.2	
Public Consumption	160.7	11.2	-0.2	2.9	6.4	-0.3	2.1	4.3	2.5	
Gross fixed capital formation	377.5	26.3	7.3	-2.0	-4.0	10.3	7.1	9.0	4.7	
of which: equipment	-	-	6.4	-	-	-	-	-	-	
Exports (goods and services)	391.1	27.3	15.8	-12.3	1.8	1.1	12.8	5.6	6.4	
Imports (goods and services)	638.7	44.5	9.8	-7.8	4.6	-3.1	7.4	6.7	4.9	
GNI (GDP deflator)	1420.9	99.0	4.5	2.0	0.4	2.8	4.0	3.7	3.9	
Contribution to GDP growth:										
Domestic demand			4.9	1.2	2.0	3.3	4.2	5.3	4.2	
Inventories			1.0	-0.2	1.4	-2.5	-0.9	-0.1	0.1	
Net exports			-1.2	0.0	-1.6	1.8	0.2	-1.4	-0.4	
Employment			-0.5	-9.7	1.6	4.9	6.1	4.5	4.5	
Unemployment rate (a)			-	16.4	17.9	17.5	15.6	14.7	13.8	
Compensation of employees / head			-	12.2	1.6	-2.0	1.8	5.3	3.3	
Unit labour costs whole economy			-	0.3	1.4	0.3	4.4	6.1	4.0	
Real unit labour cost			-	0.0	0.0	0.0	4.7	3.1	1.3	
Saving rate of households (b)			-	-	-	-	-	-	-	
GDP deflator			4.1	0.3	1.4	0.3	-0.3	2.9	2.7	
Harmonised index of consumer prices			-	1.9	1.6	1.9	1.3	2.2	2.6	
Terms of trade goods			-1.8	1.6	1.5	0.1	-1.6	-0.1	0.5	
Trade balance (goods) (c)			-24.0	-20.6	-22.2	-22.4	-24.1	-25.2	-25.1	
Current-account balance (c)			-	-10.9	-12.9	-10.7	-9.6	-10.9	-10.5	
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-	-11.4	-13.8	-12.0	-9.0	-10.2	-9.7	
General government balance (c)			-	-5.0	-5.2	-4.1	-1.8	-2.0	-1.9	
Cyclically-adjusted budget balance (d)			-	-	-	-	-	-	-	
Structural budget balance (d)			-	-	-	-	-	-	-	
General government gross debt (c)			-	70.4	72.1	72.7	72.0	69.5	67.0	

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