



ALBANIA

Highlights

- **Macroeconomic stability remains but tax revenues have fallen below expectations.** Fiscal discipline has improved markedly in the past two years and has contributed to an overall improved macroeconomic environment, but weaknesses in tax collection point to the ongoing challenge of reducing informality in the economy.
- **Energy sector reforms have advanced.** A new electricity law, compliant with the Third EU Energy Package, was adopted in April 2015 and represents a decisive step forward on the long path of moving towards energy sustainability.
- **Non-performing loans (NPLs) are being tackled.** The level of NPLs remains high by regional standards but a comprehensive plan by the authorities to tackle the problem is being implemented, and should help to restore confidence and credit growth in the system.

Key priorities for 2016

- **Enhanced efforts by the authorities to reduce informality are welcome and should be implemented.** The problem of informality is long-standing in the economy and holds back the development of legitimate businesses as well as depressing tax revenues. The problem is particularly acute in the agriculture sector, where obtaining VAT receipts is very difficult.
- **Private sector involvement in infrastructure and energy should be encouraged.** Renewed efforts to involve private companies in the energy sector should be pursued, now that concrete reforms are being implemented, and a successful operations and maintenance public-private partnership (PPP) in the road sector could have important demonstration effects for future projects, provided the fiscal risks are managed carefully.
- **Successful implementation of the NPL plan is critical for restoring credit growth.** The authorities' measures so far have helped to stabilise the situation but more efforts are needed to bring NPLs down to acceptable levels.

Main macroeconomic indicators %

| | 2011 | 2012 | 2013 | 2014 | 2015 proj. |
|-----------------------------------|-------|-------|-------|-------|---------------|
| GDP growth | 2.5 | 1.6 | 1.4 | 2.2 | 2.3 |
| Inflation (average) | 3.4 | 2.0 | 1.9 | 1.6 | 2.0 |
| Government balance/GDP | -3.5 | -3.4 | -5.2 | -5.4 | -5.1 |
| Current account balance/GDP | -13.2 | -10.2 | -10.7 | -13.0 | -13.2 |
| Net FDI/GDP [neg. sign = inflows] | -6.6 | -6.7 | -9.5 | -8.0 | -8.1 |
| External debt/GDP | 34.8 | 35.6 | 34.4 | 36.9 | n.a. |
| Gross reserves/GDP | 20.7 | 20.6 | 20.7 | 22.0 | n.a. |
| Credit to private sector/GDP | 39.5 | 39.0 | 37.6 | 37.4 | n.a. |

Macroeconomic performance

Economic performance has improved, but growth remains sluggish. Economic growth in the last three years (2012-14) was limited. In 2014, growth of 2.2 per cent was driven mainly by the services sector (except for transport, post and communication). Oil extraction and agriculture made positive contributions to growth as well, while manufacturing and construction declined from the previous year. In the first half of 2015, the economy grew by 2.6 per cent, despite the damage caused by severe flooding in the south of the country in the spring. The unemployment rate had risen to 17.6 per cent at the end of 2014 from 16.8 per cent the year before, with youth unemployment (ages 15-29) at 33.8 per cent at the end of 2014.

Monetary easing has continued, while fiscal performance has weakened in 2015. Over the past year, weak aggregate demand and low imported inflation, as well as a decline in oil prices, have kept inflation below the central bank's target of 3 per cent. In line with the declining inflation rate, the central bank has continued with monetary easing with a series of cuts in the base interest rate, with the latest – in January 2015 – bringing it to an historic low of 2 per cent. Meanwhile tax revenues in the first quarter of 2015 were significantly below the government's expectations. The reasons for the shortfall include the recent weaknesses of the oil sector, due to lower oil prices, as well as more long-lasting problems of poor revenue-raising ability, a large informal economy and weaknesses in the tax collection system. The authorities have announced renewed efforts to crack down further on informality. In June 2015 the completion of the fifth review of the IMF programme was delayed pending further discussions on how to make up for the revenue shortfall. Nonetheless, the IMF praised the authorities for a broadly successful policy implementation during the first year of the programme, which is helping to strengthen public finance sustainability and reduce public sector arrears.

The short-term growth outlook remains subdued. Growth is likely to pick up modestly in 2015 to 2.3 per cent, assisted by the clearing of most government arrears in the past year, lower interest rates and a gradual pick-up in bank lending. However, the downside risks are high as macroeconomic imbalances persist and the financial sector remains exposed to both domestic and external shocks. An additional difficulty lies in the fact that macroeconomic policy buffers have been largely exhausted – with tight fiscal space and historically low interest rates. Faster growth is expected in 2016 on the back of an improved external environment (especially in the eurozone) and the start of major construction work on the Trans-Adriatic pipeline (TAP). 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

No date has been set yet for the opening of EU accession negotiations. Albania was granted EU candidate status in June 2014. In March 2015, at the fifth "High Level Dialogue meeting", the European Commission (EC) and Albania discussed the country's plans to implement the key priorities necessary for the next stage, namely, the opening of accession negotiations. The government intends to submit a detailed progress report on the implementation of the five key reforms to the EC in autumn 2015. Albania has been allocated up to €649.4 million under the European Union's new Instrument for Pre-Accession Assistance (IPA II) in 2014-20. The assistance will support reforms in preparation for EU membership, socio-economic and regional development, social policies and rural development.

An Investment Council has been established. The new council was set up in April 2015, and is supported by a permanent secretariat. The council is supported by the EBRD within the context of the Investment Climate and Governance Initiative signed by the EBRD and Albania in February 2014. The first meeting of the council was held in July 2015. Tax inspections and informality were identified as two areas on which the council would focus its future work. In September 2015 the government launched a comprehensive operation to fight informality in the economy. Albania's efforts to improve the business climate were reflected in a major jump in the World Bank *Doing Business 2015* rankings (up by 40 places), while the 2016 report downgraded Albania to 97th position mainly because the country made dealing with construction permits more difficult by suspending the issuance of building permits.

State involvement remains significant in key sectors. There are a number of companies in Albania with major state ownership, many of them in the energy sector, including natural resources and power. Albania plans to launch a new attempt to sell off 100 per cent state-owned oil and gas company Albpetrol this year. Documentation for the sale of the company is already being drawn up, with help from international financial institutions. Albania's previous government attempted to sell off Albpetrol, but the process was cancelled in February 2013, as the winning bidder failed to make a downpayment. The government remains a major owner in the power sector, with the power distribution company, OSHEE, back in state ownership after the government's €95 million settlement agreement with its previous owner, the Czech power company CEZ, in June 2014.

Energy sector reforms are advancing. Since the start of transition, Albania's energy sector has faced chronic and persistent problems of technical and commercial losses. Problems with electricity were identified by participants in the fifth round of the EBRD/World Bank Business Environment and Enterprise Performance Survey as a major constraint to doing business. Sustained efforts are under way to improve the situation. In September 2014 the World Bank approved a US\$ 150 million loan agreement with Albania for power sector recovery. The project consists of four components, including provision of short-term complementary power import support, upgrade of distribution infrastructure, upgrade of the transmission meter/data centre and support to power sector reforms. Meanwhile, a new electricity law, compliant with the EU's Third Energy Package, was adopted in April 2015. The law consolidates the reforms taken so far and represents significant progress in energy reforms.

The government has launched a natural gas master plan. The new plan, which is scheduled for completion in November 2016, will examine all aspects (technical, legal, regulatory, economic, market and social) related to the introduction of a gas market. In addition, in May 2015 Albania also launched a procedure to start negotiations with hydrocarbon companies for the exploration of oil and gas at seven onshore and offshore blocks. Three international companies placed bids for two onshore oil blocks in Albania. Shell Upstream Albania and Interland Investment have placed bids for oil exploration in Block 4. Shell and Interland also filed offers for exploration of the Block of Durme. A third company, Navitas Petroleum, has also submitted a bid for the latter.

Private sector involvement in road transport is being solicited. The Albanian Ministry of Transport and Infrastructure (MTI) has relaunched the qualification process for the Milot-Morine Highway PPP, the first road PPP in the country for operation and maintenance. The MTI originally launched the project in late 2011 and prequalified five teams. However, the bids were never submitted due to concerns with the original project structure. The new transaction structure has a minimum traffic guarantee as the main bidding criterion instead of the toll rate as was the case previously.

The central bank has drafted a comprehensive national platform to tackle bad loans. NPLs remain a major problem in Albania, amounting to 21 per cent of all loans in the banking sector as of July 2015. Measures already undertaken by the central bank include the obligatory write-off of bad loans of more than three years old. Additional measures will include further clarification of the tax definition on bad debt, improved collateral execution, and assistance to corporates for the preparation of recovery resolution plans. The central bank's programme 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.