2. INTERNATIONAL DEVELOPMENTS

(6) During the period, global economic developments were generally positive. The economy grew faster in the second quarter, mainly driven by the favourable financing conditions and the continuation of accommodative policies in advanced countries and in some emerging countries. At the end of the previous year, oil prices recovered somewhat, helping thus the exporting economies, but this performance was short lived, and prices returned to the previous levels. Conditions in financial markets, overall, were favourable, notwithstanding the deepening of divergences among the monetary policies of advanced countries. The European Central Bank (ECB) and the other larger banks continued to implement accommodative monetary policies, while the Federal Reserve further tightened its monetary policy. The global inflationary pressures remained subdued, owing to oil and primary commodity prices. Inflation rates in advanced economies returned at rates below central bank targets, while in emerging countries they were stable or downward. Based on these developments, the IMF's outlook for global growth is 3.5% in 2017 and 3.6% in 2018[5], positively affected by the performance in both advanced and emerging economies.

(7) Economic growth accelerated in advanced economies, and maintained the positive trend in emerging economies. Among *advanced economies*, the US economy revved up over 2017 Q2, after a weaker start to the year. The surge was mainly fuelled by the positive contribution of consumer spending and inventories. Conditions in the labour market continued to improve and the unemployment rate fell at 4.4%. In the United Kingdom, economic activity slowed down during this year, due to the fall in private consumption, as a result of the depreciation of the British pound and the increase of inflation. Economic performance, across *emerging markets*, overall, was positive. Nevertheless, differences across countries remain notable, owing to a set of internal and external factors. Hence, the stimulating fiscal policies continued to support the stable economic performance in China, while oil price recovery, at the end of the previous year, and the positive expectations about the global trade, have supported the exporting economies.

(8) Economic growth of the euro area is more balanced. Most countries in this region recorded positive growth, mainly driven by the domestic demand, and partially by the positive contribution of inventories. Labour market conditions continued to improve, underpinning the increase in households' income and consumption. Employment increased close to the level of the pre-crisis period, while unemployment fell at 9.1%.

[5] *IMF: World Economic Outlook, July 2017.*

(9) In the euro area banking sector, lending, overall, grew driven by lending to households. The continuous easing of lending standards and the low financing costs boosted the credit supply and demand in most euro area countries. On the other hand, notwithstanding the notable progress of some European banks in clearing and consolidating their balance sheets, the still high level of non-performing loans continues to decelerate the credit recovery.

(10) Global economic growth is expected to continue in the period 2017-2018. Emerging regions will have the main share in this growth. Their economies are expected to further improve in the two next years. Advanced economies, also, will continue to recover, but at a subdued pace during the next year. The normalisation of monetary policy in advanced countries, and the response of relevant markets are currently the main risks to the global economy perspective. On the other hand, risks related to low inflationary pressures, macroeconomic structural weaknesses in emerging economies or the yet-to-be completed balance sheet consolidation of financial institutions in advanced economies continue to be present in the global macroeconomic environment.

(11) In the euro area, monetary policy pass-through to the real economy will continue to underpin the increase of domestic demand and ease the consolidation of both private and public sectors' balance sheets. The favourable financing conditions and the increase of profitability in the private sector will promote the further growth of investments, while global economy recovery is expected to favour European exports. The improvement of labour market conditions will continue to contribute positively to the growth of private consumption, through the increase in household disposable income. Main risks to expectations for the euro area's economic performance are mainly related to external factors, such as the policies of the US administration, and the new relationship with the United Kingdom after "Brexit". Nevertheless, in some countries of the region, internal risks remain, such as the protraction of structural reforms and the slow progress in consolidating the balance sheets in certain sectors.

Table 2.1 Selected macroeconomic indicators for the U.S. and euro area

	GDP change (annual %)				Inflation (annual %)		Unemployment (annual %)		Gross government debt (as a % of GDP)	
	2017 Q1	2017 Q2	2017f	2018f	March 2017	June 2017	March 2017	June 2017	2016 Q4	2017 Q1
U.S.	1.2	2.6	2.1	2.1	2.4	1.6	4.5	4.4	105.7	104.1
Euro area	1.9	2.1	1.9	1.7	1.5	1.3	9.4	9.1	89.2	89.5
- Germany	1.7	:	1.8	1.6	1.5	1.5	3.9	3.8	68.3	66.9
-France	1.0	:	1.5	1.7	1.4	0.8	9.6	9.6	96.3	98.7
-Italy	1.2	:	1.3	1.0	1.4	1.2	11.5	11.1	132.6	134.7
-Greece	0.4	:	:	:	1.7	0.9	22.0	:	179.0	176.2

Source: European central Bank, Eurostat, BEA (Bureau of Economic Analysis), Bureau of Labour Statistics, IMF; f-IMF estimates, July 2017; no available data.

(12) Economic growth in Western Balkans was satisfactory at the end of 2016, in particular in Serbia and Albania, albeit the pace was somewhat moderate in 2017 Q1. Economic activity in the region and Turkey expanded

by 2.8% (annual growth) in 2016 Q4, but it slowed down at 1.8% in 2017 Q1. All regional countries, excluding Macedonia, recorded a positive growth during 2017 Q1, mainly driven by private consumption and investments. Nevertheless, except Kosovo, where growth exceeded expectations, economic activity in other regional countries slowed down. Turkey also recorded accelerated growth, mainly driven by trade and the growth of public expenditure, due to the efforts of the government to support the economy of the country. Notwithstanding the specific problems, labour market conditions continued to improve, reflected in the increase of employment and decrease of unemployment. Low inflationary pressures continue to characterise Western Balkans, by reflecting the low prices in primary commodities and the stability of the exchange rate. In the banking sector, lending continued to support economic growth in the region. In all regional countries, credit growth to households was higher than that to enterprises. During 2017 Q1, the major part of the regional countries reduced the non-performing loans portfolio, and improved the framework to address them. Nevertheless, this indicator remains high, thus decelerating credit recovery in the region.

Table 2.2 Selected macroeconomic and financial indicators for Western Balkans

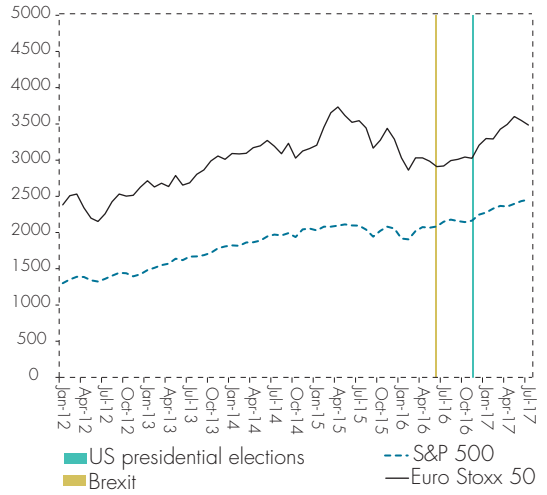
	GDP (real, annual %)			Unemployment (Annual %)		Sovereign debt (% of GDP)		Credit growth (Annual %)		Non-performing loans ratio	
	2016 Q4	2017 Q1	2017f	2016 Q4	2017 Q1	2016 Q4	2017 Q1	2016 Q4	2017 Q1	2016 Q4	2017 Q1
B&H	2.6	:	:	25.4	:	41.4	:	1.8	3.0	11.8	11.5
Macedonia	2.4	0.0	2.9	23.1	22.9	40.9	37.8	1.4	0.1	6.3	6.1
Montenegro	3.4	3.2	3.3	17.9	17.7	62.4	61.6	1.3	5.5	10.3	9.9
Kosovo	3.0	3.8	:	27.5	:	14.5	:	9.9	10.6	4.9	:
Serbia	2.5	1.2	3.2	13.0	14.6	72.8	71.5	9.0	7.6	17.0	16.8

Source: European Commission, ECFIN's forecast, 2017.

2.1 HIGHLIGHTS IN FINANCIAL AND PRIMARY COMMODITY MARKETS

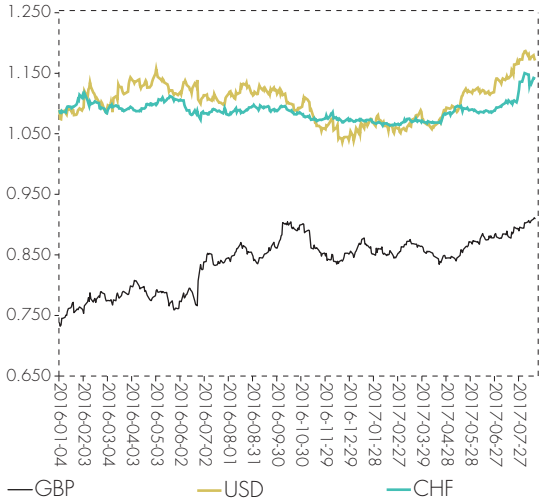
(13) During the period, developments in global financial markets, overall, were favourable and stable. The recent shocks related with the presidential elections in the US and France were rapidly absorbed by markets. The rise in the policy rate by the Federal Reserve in 2017 caused markets to fluctuate, affected by the expectations for gradual monetary tightening, while the other main central banks (ECB, Bank of England and Bank of Japan) are expected to continue the accommodative monetary policy stance. The performance of values and rates in advanced markets were also affected positively by the good economic performance in these countries and the optimistic outlook. Hence, the yields in European and American markets of government debt securities fell and spreads narrowed, particularly in the second quarter, reflecting the fall of investors' perception about this risk. This performance promoted also the increase of prices in equity markets for both financial and non-financial sectors. Money markets continued to be characterised by negative rates and ample liquidity levels, reflecting the monetary policy stance in many advanced economies.

Chart 2.1 Main indices stock market



Source: European Central Bank.

Chart 2.2 Exchange rate - euro versus main currencies



Source: European Central Bank.

(14) Expectations about the future course of monetary policies and differences in the stages of economic cycles across countries imposed the fluctuations of the exchange rate. Hence, overall, during 2017 Q2, the euro appreciated against the currencies of advanced economies, US dollar and Swiss franc, as well as against the currencies of a considerable part of emerging regions.

(15) The recovery of oil prices at the end of the previous year and at the beginning of 2017 appears to have been limited, mainly imposed by supply-side factors. The effects of the agreement between the main oil producers[6] to cut oil production quota, seems to have resulted as temporary, affected by the growth of US inventories. As a result, gross oil prices during March June 2017 ranged from USD 46/barrel to USD 54/ barrel. The extension of the agreement on the cut of oil production quota by nine months seems to have been anticipated by the markets, thus it did not provide the desired effect in the increase of oil price. The prices of other commodities, particularly of metals, have been also falling since March 2017, mainly affected by the fall in the demand from China.

[6] *The agreement (signed in June 2016, and ratified on 30 November 2016) among OPEC and non-OPEC countries sets out the cut of oil production quota by 1.27 and 0.6 million bpd, respectively. On 25 May 2017, this agreement was extended by nine months.*

BOX 2.1 DEVELOPMENTS IN FOREIGN BANKING GROUPS OPERATING IN ALBANIA

At the end of the period, foreign banking groups operating in Albania show stable capitalisation levels, although the financial result in some of them was negative. The following table shows some main indicators of the financial statements of the parent banking groups operating in Albania, in relative terms, compared to the same period in the previous year. Related to the share of the Albanian subsidiaries in the activity of the banking group, the operations performed during the period reflect the specifics of their individual activity.

Table 2.3 Highlights of foreign banking groups operating in Albania

Change (%)	Raiffesen Bank International[1]	Intesa San Paolo[2]	Alpha Bank[3]	Piraeus Bank[4]	National Bank of Greece[5]	Societe Generale[6]
Assets	2.8%	2.3%	-6.0%	-11.0%	-10.5%	-2.3%
Loans	1.7%	1.2%	-3.6%	-3.0%	-3.5%	-1.9%
Deposits	1.6%	-2.7%	6.9%	7.0%	0.8%	-3.5%
Provisions	-81.1%	-75.0%	-3.6%	-6.0%	-67.9%	-6.7%
Net profit	...	...	...	(...)	-59.4%	-24.3%
Operational income	5.0%	-1.0%	0.6%	3.0%	7.6%	-26.1%
Net income from interests	1.3%	-1.8%	1.4%	-2.0%	0.3%	-12.1%
Net income from commissions	8.9%	5.8%	-1.8%	10.0%	...	-
Operational expenditures	2.0%	0%	-7.2%	-4.0%	5.9%	4.4%
Net result	9.4%	-1.9%	-	4.0%	-53.0%	19.9%
Ratios						
NPLs	7.3%	3.8%	38.1%	37.8%	-	4.6%
Net interest margin	2.46%	-	3.0%	2.7%	3.04%	-
Capital adequacy	12.9%	13.0%	17.2%	16.3%	16.0%	14.4%
Bank assets in Albania against total group	1.38%	0.15%	0.81%	0.72%	0.38%	0.05%

Note: (...) shows pronounced change (over 100%), whether in positive or negative terms.
(-) shows data are unavailable in the publications of the respective bank.
Source: Official pages of the banking groups.

During 2017 H1, the activity of the banking group "Veneto Banca" was completely restructured, after a decision of the Bank of Italy and the Italian Government. The major part of this group activity, including its subsidiaries in Albania and in some other countries, was transferred to Intesa Sanpaolo Bank, which is the largest banking group in Italy. This change is confirmed also in the press release by Intesa Sanpaolo banking group of 26 June 2017. For the Albanian banking sector it means that "Banka Veneto" sh.a, previously under complete ownership of "Veneto Banca", now is in ownership of "Intesa Sanpaolo" banking group, and its activity shall be part of this banking group.

Some European banking groups operating in Albania are still undergoing a restructuring process to improve the financial situation. This process includes: network restructuring, change of shareholders or merger with other institutions. Developments in the European legislation in terms of recovery and resolution are insensitive to banks' clients. At the same time, these legal stipulations and the operational actions show the importance of coordinating the actions among the responsible authorities at the countries where the banking group under reconstruction performs its activity. In this regard, the Bank of Albania remains committed to monitor the developments and coordinate the potential necessary actions, with the relevant domestic and international authorities, with the purpose the fulfilment of the final objective to maintain the financial system stability.