

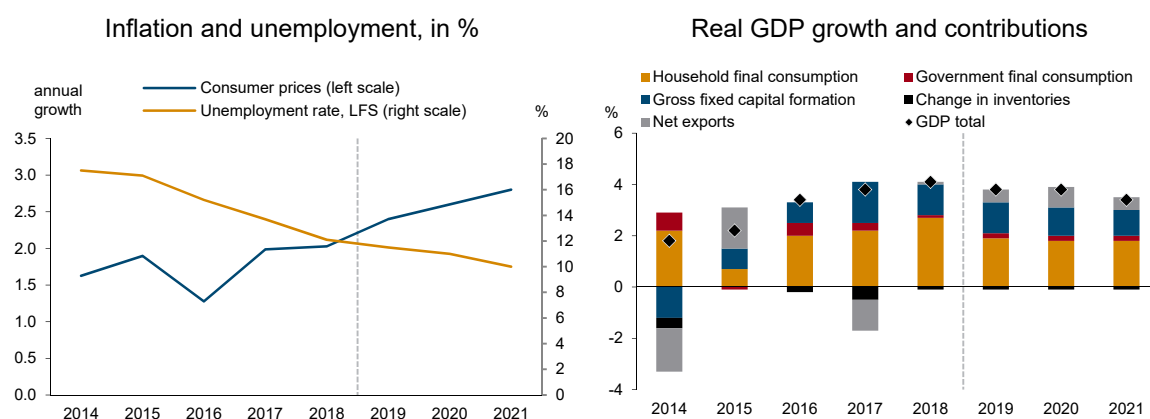


ALBANIA: Growth will lose vigour

ISILDA MARA

Economic growth, supported both by domestic and external demand, will continue, but at a slower pace. Remittances – close to 6% of GDP – will boost consumption, and will also contribute to a lower current account deficit. Fiscal consolidation is expected to continue, via a cut in expenditures. Intensification of investments in renewable energy is expected to boost alternate sources of energy production. Uncertainty about FDI inflows is expected. Political unrest and massive protests threaten macroeconomic stability and the process of EU integration.

Figure 6.1 / Albania: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Political unrest and massive protests threaten the stability of the country, the progress of the reforms and the opening of EU membership talks by June 2019. 2018 closed with massive protests all over the country, among others students' protests against the deterioration of the accessibility and quality of the education system. 2019 is continuing on a similar course. Protests have intensified because a number of corruption affairs in infrastructure projects and facts about manipulations of the electorate vote (during the 2017 central government elections) have emerged. Two thirds of the government were recomposed by January 2019 – 7 out of 13 ministers were replaced. Local elections are due in June 2019, but the opposition is pressing for the government to resign and have full parliamentary elections instead. The protests reached a peak on 16 February 2019.

Participation in this protest was massive – the largest in the three decades of democracy – and indicated the population's huge discontent with the current government. The protest was led by the opposition and its old political cast. Hence, it is doubtful whether the latter can be part of the solution

as long as they are part of the problem. Instead, a bottom-up approach led by a third pole in the Albanian politics is necessary for getting the country out of this baffled transition, but the chances for this to happen are scarce.

The reform of the judicial system, key to EU integration and the opening of EU membership talks, due in June 2019, is progressing slowly. Part of that reform is the establishment of a number of institutions – such as the Special Anti-Corruption and Organised Crime Structure (SPAK) – which has not been finalised yet. The progress of reforms, the economy and the EU integration perspective are expected to suffer the most from the political unrest.

Growth hovered above 4% in 2018, but will lose vigour in the medium term. During the first three quarters of 2018 the economy grew by 4.4% compared with the same period of the previous year. The main drivers were domestic demand – consumption rose by 3.4% and investments accelerated by 4% – and an upsurge in goods exports, which expanded by 16%. In production terms growth was driven by an 18% rise in industrial production, electricity in particular. The industrial sector – mainly electricity – contributed more than 2 percentage points to GDP growth in the first three quarters of 2018.

Growth of above 4% is not generating many jobs. Labour market indicators for the third quarter of 2018 suggest a drop in unemployment to 12.2% compared to 13.6% reported in Q3 2017. However, while more than 57,000 jobs were absorbed by the age group 15-29, employment of the age group 30-65 shrank by 35,000. These dynamics therefore rather hint at an exchange of jobs between young and older age cohorts. For the latter group not only employment, but also labour force, unemployment and inactivity dropped – dynamics which partly might be explained by the intensification of emigration. Informal employment dropped from 50% in 2014 to 35% in 2018. Still its level persists being one of the highest in the Western Balkan region – as long as 1 out of 3 of those employed is working informally. Taking into account real wage growth of 2.4% in 2018, against an inflation rate of 2% in 2018, working and remaining poor is persisting and driving further emigration. According to the World Bank Macro Poverty Outlook, the poverty headcount for 2018 is estimated at 28.3% – measured as USD 5.5 per person per day, at 2011 PPP.

Emigration has intensified further and its effect on human capital and demography might turn problematic in the medium and long run. The Albanian Institute of Statistics has projected that the active workforce is expected to decline by 2021 (Instat Albania, 2019). The rise in remittances – by 8% in the first three quarters of 2018, year on year, accounting for 6% of GDP – is certainly an indicator that emigration is in the growth stage of its cycle. In 2019 a new baby bonus has been introduced, aimed at curbing the rapid demographic decline, but its desired effects – likely to be visible in the long run – are still questionable as long as emigration, especially of the youth, is not ceasing. According to Eurostat, starting with visa liberalisation in 2011, more than 187,000 Albanians have knocked on EU doors seeking asylum. Between 2011 and 2016 more than 254,000 thousand Albanians acquired the citizenship of any of the EU28 and EFTA countries where they reside (Eurostat data). UNESCO²⁹ (2019) reports almost 130,000 *internationally mobile tertiary students* from Albania between 2011 and 2017 – a number close to the level of students enrolled in Albanian universities in 2017-2018. Around 90% of *internationally mobile tertiary students* have moved to the USA or EU and the likelihood of

²⁹ Source: Data extracted on 29 Jan 2019, 16:32 UTC (GMT) from UIS.Stat, <http://data.uis.unesco.org/>

returning home is low. Emigration at these levels, especially of those highly skilled, will generate losses in human capital and consequently affect the sustainability of growth in the medium to long run.

Fiscal consolidation is expected to continue by keeping expenditures low, rather than by rising revenues. General government budget performance has been below expectations. Revenues grew by 4% in 2018, hovering at 26.4% of GDP compared to 27.7% in 2017. Government spending rose by roughly 3%. Capital expenditures absorbed only 17% of total expenditures, despite an increase of 14.5%. The announced budget for 2019-2021 foresees that its level, both in terms of revenues and expenditures, will remain low hinting at parsimonious public spending on investment.

Demand for credit has not recovered as expected and its stock will continue to stay flat. Non-performing loans dropped by 2 percentage points to 11% of the total in 2018, but the stock of credit remains stuck at the 2011 level. Besides, the stock of loans to the non-financial private sector dropped by 5% until November 2018, year on year. The Albanian lek appreciated remarkably against the euro in 2018, by 7% year on year, and was floating at around 124.5 in January-February 2019. The Central Bank's monetary policy will remain loose: interest rates will be kept at 1% and no further rise is expected until the second half of 2019. Also, the Central Bank has announced that it will not intervene by buying euro in the market – as it did during 2018 – to prevent a further over-appreciation of the lek. This is in line with the economy's de-euroisation, which is strongly recommended by the IMF.

Investments in solar power plants are expected to boost alternate sources of renewable energy production. Early this year the Norwegian state-owned company Statkraft will complete the second hydropower plant (HPP) on the Devoll river. The start of energy production is expected by the second half of 2019. The two HPPs Banja and Moglica, completed in 2016 and 2019, respectively, will raise energy production by 17%. Taking into account the abundance of sunny days and the risks of droughts, Statkraft submitted to the Albanian government a request for building a floating solar power plant (SPP) in the lake of the Banja HPP. More than 95% of electricity production depends on HPPs – therefore, further investments in SPPs are supported by the government. Another priority of the government is the gasification of the country. Apart from being a transit country for the Trans Adriatic Pipeline (TAP) the government is aiming at getting access to the gas that TAP will deliver. Starting from 2020, TAP will deliver gas from Azerbaijan to the EU – transiting through Albania.

Exports of goods and services have performed well, but are unlikely to continue at a similar pace. The external sector has been characterised by a strong push, in export of both goods and services. The upsurge in goods exports was helped by electricity exports. Thanks to heavy rains during the first three quarters of 2018 energy production doubled while electricity exports were six times higher than for the same period in 2017. The main external trading partners continue to be the EU countries. More than two thirds of exported goods go to Italy, Spain, Germany, Greece and Kosovo. Italy – with a 50% market share – is the main trading partner and two thirds of goods exported to Italy are accounted for by the garment industry. However, in 2018 exports to Italy rose only by 2%. Taking into account the strong appreciation of the lek, which is expected to continue, and the fact that the Italian economy is going through a recession period, we expect that goods export – in particular the sector of the garment industry – might be negatively hit. Besides, as long as the export goods basket continues to be undiversified and concentrated on few partners, the external sector demand will continue to bear certain risks.

There is a high uncertainty about the pace of FDI inflows in the medium term. Foreign direct investment inflows rose by 11% in the first three quarters of 2018. Nevertheless, in terms of structure and rise in FDI inflows, the main driver continued to be TAP and the Devoll HPPs – both to be completed this year. Good news in the manufacturing sector is the entry of Yura Corporation, a South Korean company which produces electric and electronic components for the automobile industry. Yura Corporation plans to invest EUR 6.5 million already in 2019 and will provide 600 new jobs. Less good news is the announcement of Shell about the suspension of its seismic survey for oil reserves in Zagorie (in the South-East of the country) because a number of designated sites fall into protected areas under Albanian legislation. In spring 2018, Ivicom Holding GmbH, based in Austria, proposed to build a 500 MW power plant worth EUR 350 million for producing electricity via the gas that will be supplied by TAP. Even though the project has gained the status of strategic investment, the negotiations are moving slowly. Also last spring, the government announced the construction of a new airport near the city of Vlora in the south of Albania, worth EUR 100 million, to be launched in the course of 2019. Nevertheless, there seem to be delays also in this case. Bankers Petroleum, run by the Chinese company Geo-Jade, announced an invest plan of USD 158 million in 2019. However, the drop in international oil prices raises concerns that this investments might be postponed as well. Overall, taking into account the lag in time between the announcement and commencement of a project, we expect the trend in FDI inflows to move downwards.

Overall, growth is expected to stay close to or below 4% in the medium term. Both domestic and external demand will continue to provide a positive impetus to growth – nevertheless, at a lower intensity. The political tensions in the country might not only threaten macroeconomic stability and the business climate, but also the process of EU integration and the opening of EU membership talks due in June 2019. We have therefore slightly revised downwards the medium-term projections, to below 4%.

Table 6.1 / Albania: Selected economic indicators

	2014	2015	2016	2017	2018 ¹⁾	2019	2020	2021
						Forecast		
Population, th pers., average	2,889	2,881	2,876	2,873	2,866	2,870	2,865	2,865
Gross domestic product, ALL bn, nom.	1,395	1,434	1,475	1,553	1,600	1,700	1,800	1,900
annual change in % (real)	1.8	2.2	3.4	3.8	4.1	3.8	3.8	3.4
GDP/capita (EUR at PPP)	8,300	8,800	8,700	9,100	9,700	.	.	.
Consumption of households, ALL bn, nom.	1,120	1,147	1,187	1,242	1,310	.	.	.
annual change in % (real)	2.8	0.9	2.6	2.7	3.4	2.4	2.2	2.2
Gross fixed capital form., ALL bn, nom.	337	350	362	386	410	.	.	.
annual change in % (real)	-4.5	3.5	3.3	6.5	5.0	5.0	4.5	4.0
Gross industrial production								
annual change in % (real)	1.5	-2.1	-18.0	-0.6	12.0	4.0	3.0	6.0
Gross agricultural production ²⁾								
annual change in % (real)	1.4	2.6	3.3	4.0	5.0	.	.	.
Construction output total								
annual change in % (real)	5.0	19.4	5.1	19.6	6.0	.	.	.
Employed persons, LFS, th	1,037	1,087	1,157	1,195	1,234	1,260	1,300	1,320
annual change in %	1.3	4.8	6.5	3.3	3.3	2.1	3.2	1.5
Unemployed persons, LFS, th	220	224	208	190	170	160	160	150
Unemployment rate, LFS, in %	17.5	17.1	15.2	13.7	12.1	11.5	11.0	10.0
Reg. unemployment rate, in %, eop	13.0	12.9	8.8	7.2	6.0	.	.	.
Average monthly gross wages, ALL	45,539	46,829	45,845	49,840	54,400	57,700	61,000	64,000
annual change in % (real, gross)	-0.7	0.9	-3.3	6.6	7.0	3.5	3.0	2.0
Consumer prices, % p.a.	1.6	1.9	1.3	2.0	2.0	2.4	2.6	2.8
Producer prices in industry, % p.a.	-0.5	-2.1	-1.4	2.6	1.8	1.6	2.0	1.8
General governm.budget, nat.def., % of GDP								
Revenues	26.3	26.4	27.6	27.7	28.1	26.5	27.0	27.0
Expenditures	31.4	30.5	29.4	29.7	29.7	28.0	28.5	28.0
Deficit (-) / surplus (+)	-5.2	-4.1	-1.8	-2.0	-1.7	-1.5	-1.5	-1.0
General gov.gross debt, nat.def., % of GDP	70.1	72.7	72.3	70.1	72.8	67.5	67.0	66.0
Stock of loans of non-fin.private sector, % p.a.	2.4	-2.6	0.2	0.7	-3.6	.	.	.
Non-performing loans (NPL), in %, eop	22.8	18.2	18.3	13.2	11.1	.	.	.
Central bank policy rate, % p.a., eop ³⁾	2.25	1.75	1.25	1.25	1.00	1.0	1.3	1.3
Current account, EUR mn	-1,076	-884	-812	-866	-800	-880	-850	-890
Current account, % of GDP	-10.8	-8.6	-7.6	-7.5	-6.4	-6.4	-5.9	-5.8
Exports of goods, BOP, EUR mn	932	771	714	797	930	1,040	1,140	1,200
annual change in %	-12.7	-17.2	-7.4	11.7	16.7	12.0	9.5	5.7
Imports of goods, BOP, EUR mn	3,147	3,070	3,317	3,621	3,950	4,250	4,480	4,700
annual change in %	3.9	-2.5	8.0	9.2	9.1	7.5	5.5	5.0
Exports of services, BOP, EUR mn	1,881	2,028	2,396	2,856	3,230	3,550	3,890	4,240
annual change in %	9.7	7.8	18.1	19.2	13.1	10.0	9.5	9.0
Imports of services, BOP, EUR mn	1,558	1,503	1,599	1,774	1,930	2,060	2,170	2,300
annual change in %	4.6	-3.5	6.4	11.0	8.8	6.5	5.5	6.0
FDI liabilities, EUR mn	869	890	943	900	900	.	.	.
FDI assets, EUR mn	58	72	6	-94	-50	.	.	.
Gross reserves of NB excl. gold, EUR mn	2,142	2,831	2,889	2,941	3,342	.	.	.
Gross external debt, EUR mn	6,927	7,634	7,882	7,949	8,400	8,500	8,900	9,200
Gross external debt, % of GDP	69.5	74.4	73.4	68.7	63.0	62.0	61.0	60.0
Average exchange rate ALL/EUR	139.97	139.74	137.36	134.15	127.59	124.5	124.0	123.5

1) Preliminary and wiiw estimates. - 2) Based on UN-FAO data, wiiw estimate from 2017. - 3) One-week repo rate.

Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.