

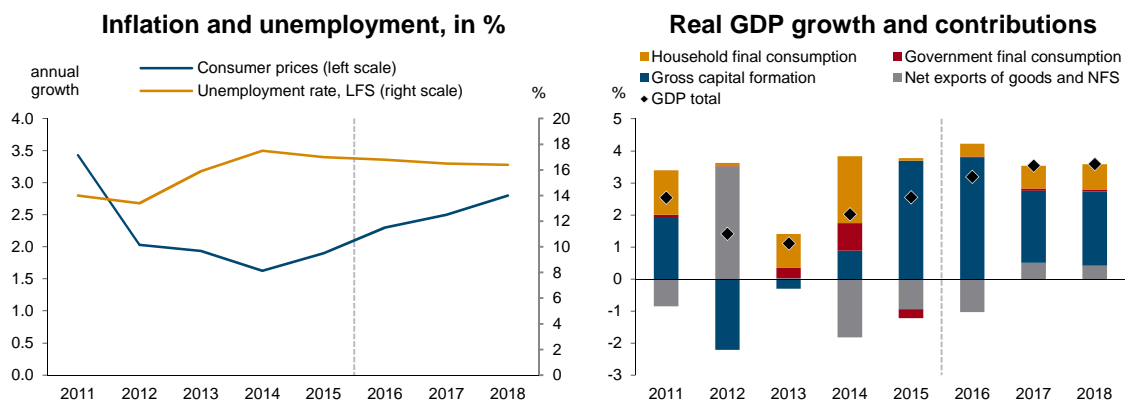


ALBANIA: Higher growth despite headwinds

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Investment will continue to be a major component of growth whereas household consumption will recover only slowly, in parallel with improvements in employment and consumer confidence. Exports will continue to be negatively affected by the fall in international oil prices. For the next three years, foreign direct investments and other capital inflows will support a growth rate of more than 3%.

Figure 36 / Albania: main macroeconomic indicators



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

Albanian economic dynamics improved despite fiscal under-performance and international headwinds. Real GDP growth for the third quarter of 2015 reached 2.98% year on year, indicating an upward trend following rates of 2.14% and 2.96%, respectively, in the preceding quarters. The main drivers of growth during 2015 were gross fixed capital formation (GFCF) and, to a certain extent, household consumption. Growth was restrained by falling government consumption and a sharp decline in exports of the extraction and energy-related industries (in both nominal and real terms). Furthermore, a negative impact arose from agriculture, which has been continuously suffering from floods and droughts. The international oil price turmoil and a strong cut in base metal prices of chrome and cooper reduced not only exports (by 25% in nominal terms and by 11% in real terms) but also imports of this sector (by 33% and 8.6%, respectively).

The judicial reform is dominating the political discourse. It is a precondition for the opening of negotiations for EU accession. The government has announced to finalise the reform in March 2016. By December 2015 a 'decriminalisation' law was passed. On paper, the law prohibits Albanian criminals – 'Malavitas' – to become part of politics and public administration. The litmus test will be next year's parliamentary elections and the list of candidates which will be presented beforehand. Another law approved by parliament (only with the votes of the left-wing government coalition) but not ratified by the president (the latter – elected during the former right-wing coalition government – has sent the issue to the Constitutional Court) is the Property Restitution Law. This law intends to compensate Albanians for their properties expropriated during communism, but according to the president the established compensation is symbolic, around ALL 50 billion for a total of 74,000 hectares of land within the next ten years. Nevertheless, the law has high potential to finally resolve the enormous disputes over ownership and may thus pave the way for further private and foreign investments.

The results of the reform in the energy sector (such as the liberalisation of the sector, the campaign against electricity theft, the completion of the South Ring interconnection line) are encouraging, but the 'campaign against informality' seemingly proceeds in a quite chaotic way, without much substance. From September 2015 small businesses were subject to tough inspections, but starting from January 2016 tax exemptions and simplifications apply. Small businesses with an annual turnover below ALL 5 million are exempted from income taxes; for businesses with an annual turnover between ALL 5 and 8 million an income tax of 5% applies. This manoeuvre may have certain side effects for fiscal revenues. While it might reduce tax evasion among small businesses, it might also increase tax avoidance among big companies, which could be tempted to fragment their activities in order to benefit from tax simplification. Last but not least, the Constitutional Court has frozen the new law on fines on informality on the grounds of those being excessively high and disproportionate.

Tax revenues during 2015 have been below expectations. Customs offices in particular have been underperforming, mostly as concerns excise and VAT tax – also due to the decline in imports – despite assistance by Crown Agent, a British company hired by the government to support the customs administration in the past two years. Government expenditures continued to shrink in 2015, by at least 1% year on year. Capital expenditures stood at almost the same level as in 2014. In 2016 a further reduction is expected, hinting at a meagre contribution of public investments to growth for the coming period. However, a good step forward for government finances has been the settlement of 95% of arrears which opens up the possibility for new productive activities to be financed. Accordingly, the public deficit in 2015 was kept at a lower level compared with 2014, at -4.2%, and public debt expanded further by 1 pp to almost 73% of GDP. Last November, the government issued EUR 450 million five-year Eurobonds which will help to restructure old debt. On the one hand, public debt depending mainly on foreign liabilities makes the country vulnerable to international exposure and particularly to exchange rate risks. On the other hand, there is the advantage of the domestic credit market not being overburdened. The reviews of the IMF Mission in February 2016 were successfully closed with the disbursement of the next tranche according to the agreement. Standard & Poor's upgraded Albania's credit rating from B to B+ affirming a stable outlook, supported by the IMF programme.

In January 2016, the inflation rate stood at 1.5%. In spite of a record low interest rate of 1.75%, the credit market is hardly growing. In order to tackle the structural challenge of non-performing loans, a high-level working group with representatives from the Central Bank, the government but also private stakeholders and international partners has been established. An action plan which revisits the

bankruptcy law, debt restructuring, and the execution of collaterals has been implemented. Accordingly, compared to the end of 2014 the level of NPLs was reduced by 5.1 pp to about 17.7% in the last quarter of 2015. This decline occurred mainly due to the reduction of sub-standard loans by 2.3 pp (NPLs that do not exceed 12 months). Lost loans were reduced by only 2.4 pp, suggesting that the restructuring process of longer-term NPLs is moving slowly.

Public investments are going to be modest during 2016, but are expected to recover in 2017 and 2018. Private investments in the form of FDI will keep on sustaining the economy. This year, the Trans Adriatic Pipeline (TAP) and the Hydropower stations of Banja and Moglica in Devoll, EUR 1 billion each, enter their intensive implementation phase. They are expected to cover a large part of the current account deficit and to generate new jobs in the years to come. The government has also announced to build a number of hydropower stations along the Vjosa river, in the South of Albania, and another two in Skavica, along the Black Drin river, in the North of the country. These investments will further boost electricity production in Albania but there is much discussion going on about the economic, social and environmental impact of such investments. According to the World Bank, the climate change and related disasters (droughts, floods, but also earthquakes) are going to affect Albania in the future. Therefore, projects with a long-term impact should be implemented with this outlook in mind.

Household consumption recovered only in the third quarter of 2015 but with an overall effect on growth almost negligible. Real wage growth – at least in the public sector – had not been more than 0.1% in 2014. The minimum wage was raised, but government expenditure on wages increased only moderately, by 1.4%. In addition, overall employment increased by 1.7% while unemployment rose by 3.2% in the first three quarters of 2015, year on year. Remittances recovered by at least 4% in the same period, year on year, but are still far from the 2008 level; they contributed to revitalising household consumption. The increase in household credit demand occurred mainly for buying houses/properties and less for consumption funding. Credit demand of businesses rose as well, particularly among small and medium-sized enterprises. The easing of the credit criteria by the banks contributed to the rise in demand for credits. The expectations are that this trend will continue during 2016.

The increase in unemployment was mainly driven by the age group 30-64. In contrast, youth unemployment fell by 1.5 pp between the fourth quarter of 2014 and the third quarter of 2015 but is still relatively high, at 32.3%. At the same time the labour force shrank by 1.3% and inactivity by 0.6%, which might be due to high emigration in 2015. According to INSTAT, net migration in 2015 stood at -17,076 (42,922 emigrants vs 25,846 immigrants). The contingent of involuntary returnees among Albanian asylum seekers in the EU is expected to increase since Albania has been included in the list of safe countries.

External sector imbalances have been a source of instability to the Albanian economy. In nominal terms both overall exports and imports were shrinking by 11.5% and 12.5%, respectively, during the past five years, 2011-2015. Compared to five years ago, exports of goods have almost halved. By contrast, exports of services are expanding, having reached a share of two thirds of total exports. Exports of goods are dominated by garment industry products and minerals – accounting for a share of almost two thirds. Along this trend, imports of minerals, electricity and fuels dropped by 33%, but also those of wood manufacturing and construction materials declined slightly. Imports of machinery and equipment continue to go up – having reached a 22% share in total imports – suggesting that private investments are flourishing. The main trading partners continue to be the EU countries and more specifically Italy,

Greece and Spain. In 2015, exports to Italy declined by 7% (industrial products exports halved) while imports decreased slightly (industrial products imports declined by 11%).

The international oil and basic metals price turmoil caused a reduction of exports and imports of the sector, both in nominal and real terms. In particular, the Canadian company Bankers Petroleum – accounting for 85% of Albanian oil production – has decided to suspend drilling activities until the international oil prices turn cost-effective. However, good news for the sector is that the Dutch company Shell has agreed to buy the shares of Petromanas, another Canadian company operating in Albania, confirming the high potential of oil extraction in Albania.

Overall, gross fixed capital formation will continue to be a major growth driver whereas household consumption will pick up slowly in parallel with a recovery in employment and consumer confidence. Improvements in the business environment and the easing of lending conditions of the banking sector will contribute positively to the development of domestic demand. External demand will continue to be negatively affected by the decline in international oil prices. Accordingly, our forecast for the next years assumes that external sources of financing such as foreign direct investments and other capital inflows will support further growth at above 3%.

Table 5 / Albania: selected economic indicators

| | 2011 | 2012 | 2013 | 2014 | 2015 ¹⁾ | 2016 | 2017 Forecast | 2018 |
|---|--------|--------|--------|--------|--------------------|--------|------------------|--------|
| Population, th pers., average | 2,905 | 2,900 | 2,897 | 2,894 | 2,889 | 2,886 | 2,880 | 2,870 |
| Gross domestic product, ALL bn, nom. | 1,301 | 1,333 | 1,351 | 1,401 | 1,460 | 1,540 | 1,630 | 1,740 |
| annual change in % (real) | 2.5 | 1.4 | 1.1 | 2.0 | 2.6 | 3.2 | 3.5 | 3.6 |
| GDP/capita (EUR at exchange rate) | 3,200 | 3,300 | 3,300 | 3,500 | 3,600 | 3,800 | 4,100 | 4,300 |
| GDP/capita (EUR at PPP) | 7,300 | 7,800 | 7,700 | 8,300 | 8,800 | . | . | . |
| Consumption of households, ALL bn, nom. | 1,012 | 1,032 | 1,052 | 1,105 | 1,130 | . | . | . |
| annual change in % (real) | 1.8 | 0.1 | 1.4 | 2.7 | 0.1 | 0.5 | 0.9 | 1.0 |
| Gross fixed capital form., ALL bn, nom. | 382 | 353 | 350 | 343 | 395 | . | . | . |
| annual change in % (real) | 5.9 | -7.9 | -2.1 | -3.9 | 13.0 | 12.0 | 7.0 | 7.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | 19.0 | 15.7 | 28.3 | 1.6 | -5.0 | 2.0 | 3.0 | 2.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | 4.8 | 5.7 | -3.4 | 2.0 | 2.9 | . | . | . |
| Construction output total | | | | | | | | |
| annual change in % (real) | -1.1 | -11.4 | -13.0 | 5.0 | 18.0 | . | . | . |
| Employed persons, LFS, th ²⁾ | 1,160 | 1,140 | 1,024 | 1,037 | 1,080 | 1,090 | 1,100 | 1,100 |
| annual change in % | . | -1.8 | -10.2 | 1.3 | 4.1 | 0.9 | 0.9 | 0.2 |
| Unemployed persons, LFS, th ²⁾ | 189 | 176 | 194 | 220 | 224 | 212 | 208 | 204 |
| Unemployment rate, LFS, in % ²⁾ | 14.0 | 13.4 | 15.9 | 17.5 | 17.0 | 16.8 | 16.5 | 16.4 |
| Reg. unemployment rate, in %, end of period | 13.1 | 12.8 | 13.5 | 13.0 | 13.2 | . | . | . |
| Average monthly gross wages, ALL | 36,482 | 37,534 | 36,332 | 36,997 | 38,100 | 39,500 | 41,100 | 42,000 |
| annual change in % (real, gross) | 1.5 | 0.8 | -5.0 | 0.2 | 1.0 | 1.3 | 1.5 | 1.0 |
| Consumer prices, % p.a. | 3.4 | 2.0 | 1.9 | 1.6 | 1.9 | 2.3 | 2.5 | 2.8 |
| Producer prices in industry, % p.a. | 2.6 | 1.1 | -0.4 | -0.5 | -2.0 | -0.4 | -0.2 | -0.2 |
| General government budget, nat. def., % of GDP | | | | | | | | |
| Revenues | 25.4 | 24.8 | 24.2 | 26.2 | 26.2 | 26.5 | 27.0 | 27.0 |
| Expenditures | 28.9 | 28.2 | 29.2 | 31.3 | 30.3 | 29.6 | 29.0 | 29.0 |
| Deficit (-) / surplus (+) | -3.5 | -3.4 | -5.0 | -5.1 | -4.2 | -3.1 | -2.0 | -2.0 |
| Public debt, nat. def., % of GDP | 59.4 | 62.1 | 69.5 | 71.2 | 73.0 | 72.0 | 70.0 | 68.0 |
| Central bank policy rate, % p.a., end of period ³⁾ | 4.75 | 4.00 | 3.00 | 2.25 | 1.75 | 1.75 | 1.75 | 1.75 |
| Current account, EUR mn ⁴⁾ | -1,225 | -978 | -1,049 | -1,287 | -1,050 | -1,100 | -1,150 | -1,150 |
| Current account, % of GDP ⁴⁾ | -13.2 | -10.2 | -10.9 | -12.9 | -10.0 | -9.9 | -9.8 | -9.3 |
| Exports of goods, BOP, EUR mn ⁴⁾ | 1,406 | 1,526 | 1,051 | 932 | 783 | 740 | 770 | 800 |
| annual change in % | 20.0 | 8.5 | -31.1 | -11.3 | -16.0 | -5.0 | 4.0 | 4.0 |
| Imports of goods, BOP, EUR mn ⁴⁾ | 3,647 | 3,525 | 3,030 | 3,147 | 3,052 | 3,080 | 3,110 | 3,170 |
| annual change in % | 12.1 | -3.4 | -14.0 | 3.9 | -3.0 | 1.0 | 1.0 | 2.0 |
| Exports of services, BOP, EUR mn ⁴⁾ | 1,747 | 1,673 | 1,715 | 1,881 | 2,005 | 2,050 | 2,110 | 2,190 |
| annual change in % | -0.2 | -4.2 | 2.5 | 9.7 | 6.6 | 2.0 | 3.0 | 4.0 |
| Imports of services, BOP, EUR mn ⁴⁾ | 1,612 | 1,460 | 1,489 | 1,558 | 1,550 | 1,570 | 1,590 | 1,610 |
| annual change in % | 6.2 | -9.5 | 2.0 | 4.6 | -0.5 | 1.0 | 1.0 | 1.0 |
| FDI liabilities (inflow), EUR mn ⁴⁾ | 630 | 666 | 945 | 869 | 1,000 | . | . | . |
| FDI assets (outflow), EUR mn ⁴⁾ | 21 | 18 | 22 | 58 | 30 | . | . | . |
| Gross reserves of NB excl. gold, EUR mn | 1,851 | 1,909 | 1,971 | 2,142 | 2,831 | . | . | . |
| Gross external debt, EUR mn ⁴⁾ | 4,958 | 5,513 | 6,368 | 6,927 | 7,630 | 7,860 | 8,250 | 8,580 |
| Gross external debt, % of GDP ⁴⁾ | 53.5 | 57.5 | 66.1 | 69.2 | 73.0 | 71.0 | 70.0 | 69.0 |
| Average exchange rate ALL/EUR | 140.33 | 139.04 | 140.26 | 139.97 | 139.74 | 139 | 139 | 140 |
| Purchasing power parity ALL/EUR | 61.57 | 58.64 | 60.67 | 58.25 | 57.74 | . | . | . |

1) Preliminary and wiiw estimates. - 2) In 2011 survey done once a year, quarterly thereafter. - 3) One-week repo rate. -

4) From 2013 based on BOP 6th edition, 5th edition before.

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