ALBANIA: Energy infrastructure construction boom

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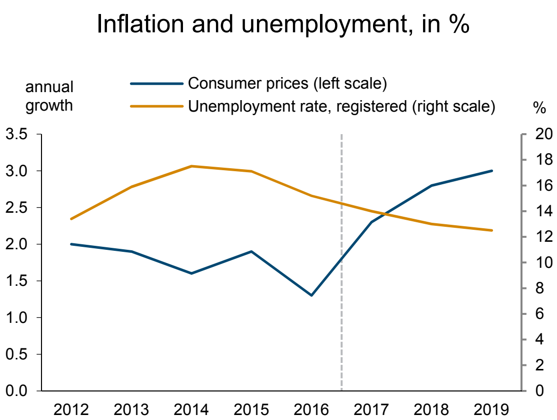
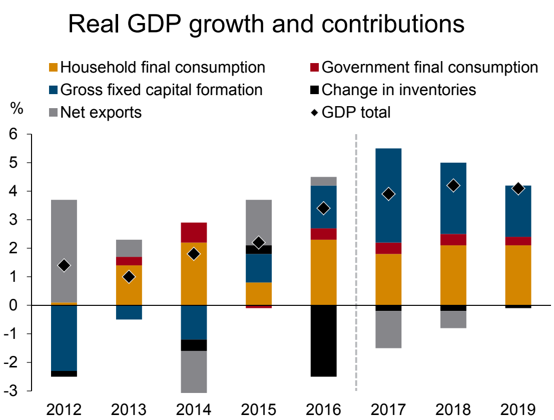
Strong investment in energy infrastructure will keep real GDP growth at around 4% in 2017 and during the remainder of the forecast period. These investments are mostly privately financed. The budget of the re-elected government of Prime Minister Rama is in surplus. In addition, the tourism sector is doing well, and promises to be an ever more important driver of growth in the coming years.

Figure 30 / Albania: Main macroeconomic indicators





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

The Socialist Party won the parliamentary elections in June 2017 and has a majority of seats in parliament. This is the first time in 16 years that the Socialist Party formed a government without the need for a coalition partner. The continuation of Edi Rama as prime minister might be reassuring for the progress of a number of reforms undertaken during the previous administration. This is particularly important in the context of the continuation and finalisation of the reform of the justice system, which is a crucial criterion for the opening of (lengthy) negotiations for joining the European Union.

Economic growth strengthened to around 4% during the first half of 2017. The first two quarters of the year recorded 3.9% and 4.1% real GDP growth, respectively, compared with the same period in 2016. Almost all sectors of the economy contributed positively. The shooting star was the construction industry, which contributed with 1.8 percentage points to real GDP growth in the second quarter of 2017. Gross fixed investments, as a mirror of the construction sector acceleration, experienced double-digit real growth of 13% in the first half of 2017 year on year – owing to both public and private investments. The construction of the TAP (Trans Adriatic Pipeline) was particularly important in this context; it poured more than EUR 400 million into the economy during the second half of 2016 and the first half of 2017. For 2017-2018 another EUR 800 million is expected to trickle in from the TAP project. Other sectors such as 'extractive industry, energy and water supply' contributed with 0.7 percentage points. The extractive industry benefited in particular from a positive export trend.

Household consumption grew less strongly, by 2.2%, during the first half of 2017. Labour market indicators have improved: overall unemployment dropped, gross earnings grew, and consumer confidence rose in the first half of 2017 as compared with the end of 2016. The fall in the unemployment rate for young people was particularly noteworthy – down from 28.1% to 26.2% – although joblessness rose slightly for those aged 30-64. The number of jobs created was not sufficiently high to generate a stronger recovery in consumption. Moreover, the labour market still suffers from a number of structural problems such as a skill/qualification mismatch. This might create a crowding-out effect of those less educated by those who are highly skilled, and furthermore a continuous outward migration flow. Remittances were slightly higher during the first half of 2017 as compared to the same period a year earlier, but are still – both in absolute terms and with respect to GDP – below the astonishing level reached in the pre-crisis period, at 9% of GDP (in 2016) versus 15% (in 2008).

Although, 2017 was a parliamentary election year, the general government budget posted a surplus of 0.4% of GDP over the first eight months of the year. In January-August 2017, state budget revenues rose by 7% year on year and exceeded expenditures. In October 2016 the government relaunched a campaign against informality, mainly targeting large retailing companies. Nevertheless, tackling tax fraud with a tough approach may prove not to be the best option. A better way to increase tax revenue would be to ensure a better business climate, fair competition, and incentives to invest and expand; at present firms in Albania struggle with high corruption and an unfavourable business climate. The new government has announced changes in the tax system as of January 2018. The proposed changes concern the modification of the property tax (e.g. for houses, dwellings including the primary residence) from fixed to market value based; a cut in the tax on dividends to 6%; and a reduction of tax progressivity for high-income earners – changes which might induce less engagement in tax avoidance but which will have negative distributive effects.

Public debt is likely to fall, but the USD 1 billion public-private partnership programme announced by the new government could obstruct this trend. The new government is targeting up to 6% annual real GDP growth by the end of its current term in office. It aims to achieve this by supporting a number of investment projects in infrastructure, energy, natural resources and public services, funded by financial instruments such as public-private partnerships. Nevertheless, the IMF – which during the government's second term will act only as an advisor – has declared that such a programme might be subject to elevated fiscal risks, especially as concerns public debt. In private finance, signals from the banking sector have been encouraging regarding the drop in non-performing loans to 15.2% in August 2017, down from 21% in August 2016. Less comforting is the demand for credit: the overall stock has almost stagnated whereas the stock of loans of the non-financial private sector shrank by 2% in January-August 2017.

External demand has been strengthening in 2017, as exports of goods have recovered while tourism continued to expand further. However, while the recovery of merchandised goods exports is positive, 44% of these exports consist of garment industry products. This industry is an important source of employment, but the output is concentrated at the low end of the global value chain: more labour intensive and low technology oriented. Despite the long experience in this industry – more than 20 years – little progress has been made towards more capital-intensive chains of production. Consequently, the value added of this industry is still low. The tourism industry has expanded further, and the expectations are that such a trend will continue in the coming year. The new government has classified tourism as a top priority and is committed to invest further in the promotion, diversification and development of this sector.

Merchandise imports also increased, by almost 7% year on year in January-August 2017. In particular, imports of minerals, fuels, electricity grew by 17%, largely reflecting imports of electricity. Domestic production of electricity was sharply reduced because of the extreme drought during the summer. For January-October 2017 electricity imports are estimated to have totalled around EUR 100 million. Albania strongly depends on hydropower as the main source of energy production in the country, and consequently changes in precipitation throughout the year can make a huge difference in satisfying the demand. Given that rainfall is a mean-reverting process in the coming year, Albania is expected to be less dependent on imports of electricity in 2018, which will mean lower imports. The continuous droughts/floods which have been hitting the country in recent years put at risk not only the production of energy and the profitability of hydropower stations but also agricultural production. Investing in the gasification of the country and alternative energy production such as photovoltaic power stations are other options that the new government is aiming to develop further with the purpose of reducing the dependence on hydro resources.

Foreign direct investment in the first half of 2017 dropped by 7% compared with the same period in 2016. It is expected that the Trans Adriatic Pipeline will continue to add to FDI inflows in 2018 and 2019, as will Norvegian Statkraft by completing the Moglica hydropower project in 2018. Otherwise, the evolution of FDI inflows in the coming years is subject to significant uncertainty as long as the structure of FDI attracted by Albania does not change.

In conclusion, growth will continue to accelerate during the forecast period. Domestic demand will be the main driver. The construction boom is back. Tourism and the export industry will benefit from an improvement in external demand. The reforms initiated during the first Rama government have a good chance of being continued during Rama’s second tenure. The USD 1 billion programme of public-private investment would certainly be a strong push to the economy, but there is still a long way towards implementation. Thus, our GDP growth forecast remains unchanged for 2017, at 3.9%, has been slightly upgraded to 4.2% for 2018, and has remained at 4.1% for 2019.

Table 5 / Albania: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., average	2,895	2,889	2,881	2,876	.	.	2,890	2,890	2,890
Gross domestic product, ALL bn, nom.	1,350	1,395	1,428	1,473	718	767	1,600	1,700	1,800
annual change in % (real)	1.0	1.8	2.2	3.4	3.3	4.0	3.9	4.2	4.1
GDP/capita (EUR at PPP)	7,800	8,300	8,500	8,600	.	.	.	.	.
Consumption of households, ALL bn, nom.	1,074	1,120	1,150	1,201	609	634	.	.	.
annual change in % (real)	1.8	2.8	1.0	2.9	3.7	2.2	2.2	2.6	2.6
Gross fixed capital form., ALL bn, nom.	352	337	352	373	158	179	.	.	.
annual change in % (real)	-2.0	-4.5	4.0	6.0	5.1	12.9	13.0	10.0	7.0
Gross industrial production									
annual change in % (real)	28.2	1.5	-2.1	-16.6	-23.4	4.6	4.0	2.0	2.0
Gross agricultural production 2)									
annual change in % (real)	0.5	0.7	2.9	0.5	.	.	.	.	.
Construction output total									
annual change in % (real)	-13.0	5.0	19.3	5.1	1.6	29.1	.	.	.
Employed persons, LFS, th	1,024	1,037	1,087	1,157	1,139	1,179	1,190	1,230	1,250
annual change in %	-10.2	1.3	4.8	6.5	6.0	3.5	2.8	3.4	1.6
Unemployed persons, LFS, th	194	220	224	208	217	192	190	180	180
Unemployment rate, LFS, in %	15.9	17.5	17.1	15.2	16.0	14.1	14.0	13.0	12.5
Reg. unemployment rate, in %, eop	13.5	13.0	12.9	8.8	10.7	7.8	.	.	.
Average monthly gross wages, ALL 3)	36,332	45,539	46,829	45,845	54,400	58,500	49,200	52,600	56,300
annual change in % (real, gross)	-5.0	-0.7	0.9	-3.4	0.3	5.2	5.0	4.0	4.0
Consumer prices, % p.a.	1.9	1.6	1.9	1.3	0.7	2.2	2.3	2.8	3.0
Producer prices in industry, % p.a.	-0.4	-0.5	-2.1	-1.5	-3.0	3.4	3.0	2.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	24.2	26.3	26.6	27.6	27.6	27.7	28.0	29.0	29.5
Expenditures	29.2	31.4	30.6	29.4	25.2	27.3	27.8	30.0	31.0
Deficit (-) / surplus (+)	-5.0	-5.2	-4.1	-1.8	2.4	0.4	0.2	-1.0	-1.5
Public debt, nat.def., % of GDP	65.6	70.1	73.1	72.4	69.0	66.7	72.0	69.0	67.0
Stock of loans of non-fin.private sector, % p.a	-1.2	2.4	-2.6	0.2	-3.0	-4.0	.	.	.
Non-performing loans (NPL), in %, eop	23.2	22.8	18.2	18.3	20.0	15.6	.	.	.
Central bank policy rate, % p.a., eop 4)	3.00	2.25	1.75	1.25	1.3	1.3	1.3	1.8	2.5
Current account, EUR mn	-891	-1,076	-884	-812	-485	-383	-1,030	-1,170	-1,250
Current account, % of GDP	-9.3	-10.8	-8.6	-7.6	-9.4	-6.7	-8.6	-9.3	-9.4
Exports of goods, BOP, EUR mn	1,067	932	771	714	320	398	750	790	830
annual change in %	21.9	-12.7	-17.2	-7.4	-24.3	24.3	5.5	5.0	5.0
Imports of goods, BOP, EUR mn	3,030	3,147	3,070	3,317	1,576	1,678	3,700	4,000	4,200
annual change in %	-2.3	3.9	-2.5	8.0	12.6	6.5	11.0	7.5	5.5
Exports of services, BOP, EUR mn	1,715	1,881	2,028	2,396	1,006	1,271	2,700	2,900	3,100
annual change in %	-9.7	9.7	7.8	18.1	14.7	26.3	14.0	8.5	7.0
Imports of services, BOP, EUR mn	1,489	1,558	1,503	1,599	708	785	1,800	1,900	2,000
annual change in %	2.0	4.6	-3.5	6.4	11.9	10.9	13.0	8.0	7.0
FDI liabilities, EUR mn	945	869	890	943	409	380	950.0	.	.
FDI assets, EUR mn	22	58	72	6	31.2	-37.6	50.0	.	.
Gross reserves of NB excl. gold, EUR mn	1,971	2,142	2,831	2,889	2,767	2,760	.	.	.
Gross external debt, EUR mn	6,368	6,927	7,634	7,882	7,828	7,851	8,200	8,600	8,900
Gross external debt, % of GDP	66.2	69.5	74.7	73.5	73.0	66.0	69.0	68.0	67.0
Average exchange rate ALL/EUR	140.26	139.97	139.74	137.36	138.28	135.13	134.5	135.0	135.5

1) Preliminary. - 2) Based on UN-FAO data, from 2015 wiiw estimate. - 3) From 2014 based on data of General Directorate of Taxation, Structural Business Statistics (market producers) used before. - 4) One-week repo rate.

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