

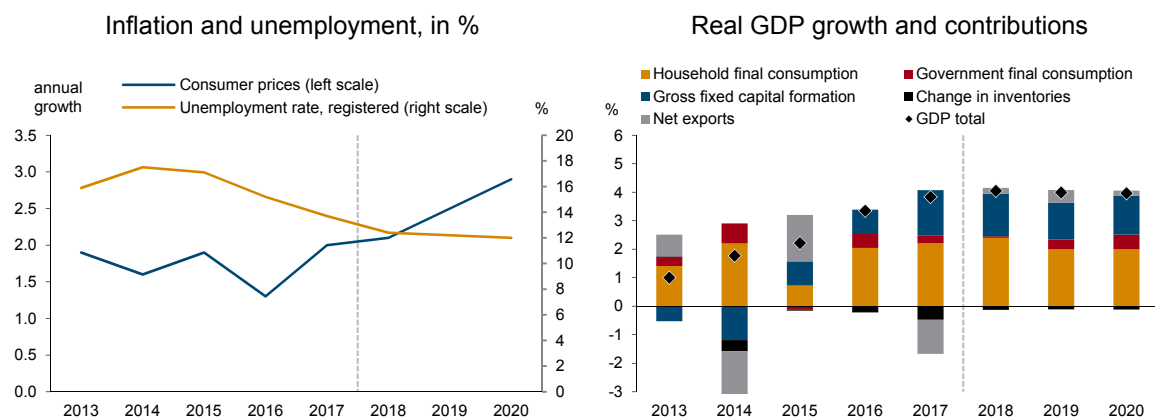


ALBANIA: Growth led by rebound in electricity production and exports

ISILDA MARA

Our forecasts are largely unchanged from the spring, and we continue to expect the economy to remain strong and grow above 4% in the medium term. Both domestic and external demand will support growth. Higher international oil prices should mean higher investments and exports in this sector. Public private partnership projects must be transparent and well monitored in order to avoid rises in public debt. Tangible progress of judicial system reform is critical for the start of EU membership talks.

Figure 36 / Albania: Main macroeconomic indicators



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

The start of EU membership talks has been postponed until June 2019. The fight against corruption and judicial system reform remain the key areas where Albania should demonstrate tangible progress according to the Commission. The implementation of a vetting law²⁶ in the judicial system has started. The opposition led by Lulzim Basha has asked for extending the vetting law also to politicians. A draft law has been amended and sent to the advisory body of the Council of Europe on constitutional matters known as the Venice Commission. Meanwhile, there are a number of success stories about criminal gangs being arrested and tonnes of cannabis being sequestered, especially in collaboration with international partners; a number of judges and prosecutors have been expelled from the judicial system. Nevertheless, these achievements, so far, do not suffice to ensure that the reform is properly geared towards a radical transformation of a highly corrupted judicial and political system.

²⁶ The vetting law is part of the judicial system reform. The law aims to rid the justice system of corrupt judges and prosecutors. This reform is one of the EU requirements for opening accession talks with Albania.

Growth is continuing on its upward path. In the first half of 2018 the economy grew by 4.4% year on year. The main growth driver was industrial production, especially electricity. Thanks to heavy rainfalls during the first half of 2018 electricity production doubled while its exports were five times higher than for the same period in 2017. Accordingly, the sector contributed to growth by 2.4pp. All main sectors of the economy contributed positively to growth except for construction and information and communications. The contraction of the construction sector contributed to the relatively meagre 3% year-on-year growth in gross fixed capital formation in the first half of 2018. The Trans Adriatic Pipeline (TAP) is approaching its completion and its impact on growth is therefore falling. The announcement by Deutsche Telekom that it will sell its unit in Albania is a symptom of telecommunication sector underperformance.

Household consumption has been buoyant growing at above 3% in the first half of 2018, year on year. Labour market indicators slightly improved in the same period. Still, in the second quarter of 2018, the unemployment rate among males rose by 0.3pp, to 12.9%. High unemployment among the youth persists, with a rate of 22.6% in Q2 2018 – despite having dropped by 4pp compared with Q2 2017. Wages rose by 2.3% in the same period, year on year. This rise can be considered more of an indexation taking into account that consumer price inflation hovered at 2.1% in January-August 2018. Actually, consumption might have been backed by rising remittances, at 11% in the first half of 2018, year on year, and this due to the revival of emigration.

For an emerging economy such as Albania, demographics matter. Starting with visa liberalisation in 2011, 126,000 Albanians have left the country. Net outward migration corresponds to 4.4% of the total population as of January 2018. Indirect statistics of Eurostat indicate that more than 172,000 Albanians submitted an asylum application in the EU-28 during the January 2011-August 2018 period – a rate close to 6% of the current total population.²⁷ According to the World Economic Forum²⁸, Albania has a low capacity – which is in a continuous decline – to retain, attract or efficiently use talents. Remittances are likely to grow because of this new wave of migration. Their amount was close to 70% of FDI or 6% of GDP in the first half of 2018. Therefore the government should think of introducing new policy instruments which might contribute to allocating remittances more into investments as such boosting job creation and entrepreneurship. Incentives to invest into those sectors that favour youth employment are central.

Despite the budget surplus, the public debt-to-GDP ratio remains high. Between January and August 2018 revenues rose by 3% (1% below expectations) while expenditures grew by 1.7% (2% below expectations). A general government budget in surplus certainly brings down the public debt. Nevertheless we expect a public debt-to-GDP ratio of 68% by the end of 2018, a ratio which is relatively high for introducing fiscal stimulus. For 2019 the government has announced a further rise in wages and cuts in personal income taxes – lower income taxes for high-income earners – and cuts in corporate income taxes down to 8% or 10% compared with the current 15% tax rate. Also, starting in 2019, a new ‘baby bonus’ has been announced aiming at tackling the decline in population growth. In October 2018 the government issued a Eurobond of EUR 500 million in international financial markets. Part of the new debt will support government finances. Another part of EUR 200 million will serve to pay back the previous debt issued in 2015. The new debt has better conditions because it was issued at a lower interest rate – 3.55% vs 5.7% – and has a longer duration – seven vs five years – than the Eurobond

²⁷ Source: Eurostat – Asylum and first time asylum applicants by citizenship, age and sex Monthly data (rounded) [migr_asyappctzm]. Last update: 26-09-2018.

²⁸ <http://reports.weforum.org/global-competitiveness-index-2017-2018/countryeconomy-profiles/>

issued in 2015. Certainly the lower interest rates and the appreciation of the domestic currency are expected to push down the costs of external debt.

Despite the strong appreciation of the lek, exports picked up. The local currency appreciated by more than 7% between the start of the year and June 2018. However, exports of goods have been recovering and rose by more than 16% in January to August 2018. A strong expansion in exports was recorded for the group 'Minerals, fuels, electricity'. Imports of goods rose by 4% and imports of machinery increased by 8% in the same period year on year. Tourism performance has been on the rise continuously – almost 2.6 million tourists in January-August 2018, a 12% increase against the same period of 2017. FDI increased by 19% in the first half of 2018, year on year, but the reason behind was mainly high disbursements for TAP in this time span. Meanwhile, Bankers Petroleum, the largest oil producer in the country, run by the Chinese company Geo-Jade has announced that in 2019 – eased by high international oil prices – it is planning to increase production and to invest USD 158 million in new wells.

The government is progressing with the USD 1 billion programme for infrastructure in the form of public-private partnerships (PPP). In this frame, in June 2018 the construction of the Arbri highway was launched. This infrastructure project, worth EUR 240 million, is expected to be completed within three years. It is 75 km long and will connect the central and north-east parts of the country. The Trans Adriatic Pipeline is approaching its finalisation and gas delivery is expected to start by 2020. Accordingly, a number of project proposals, aiming at exploiting the natural gas supply through TAP, are developing. In spring 2018 the government received a project proposal by Ivicom Holding GmbH, based in Austria, to build a 500 MV power plant that will produce electricity with gas supplied via TAP. The project has gained the status of strategic investment; its estimated costs are EUR 350 million and will be privately funded.

Loose monetary policy is expected to continue in 2019. An unprecedented supply of euros in the domestic market – partly driven by a peak in the tourism season, FDI inflows and partly by illicit activities – resulted in a strong appreciation of the lek. During June-August 2018 the Central Bank had to intervene in order to prevent a further over-appreciation of the lek. The inflation hovered at around 2.1% – below the target level of 3% – in January-August 2018; as such it did not follow the rise in aggregate domestic demand. The loose monetary policy has not produced the desired effect on demand for credit. Against the expectations, demand for credit remained weak: among businesses it shrank by 3% in January-August 2018; among individuals it slightly recovered in July-August 2018. Nonperforming loans continued on their downward trajectory, dropping to 12.9% in August 2018, compared to 15% recorded in August 2017. The Central Bank has announced to continue with its easing monetary policy by keeping interest rates at 1% until the second quarter of 2019.

Overall, in the medium term we expect growth to increase further supported by stronger domestic and external demand. Consumption is expected to remain strong boosted by improvements in the labour market and the rise in remittances. Government efforts to promote infrastructure projects via PPP need to be transparent and well monitored in order to avoid rises in public debt. Higher oil prices are expected to revive investments in the extraction industry and will push up exports in this sector. Rising tourism and a more competitive services sector are expected to boost growth. We therefore expect growth to remain strong and at above 4% in the medium term, similar to our spring forecasts.

Table 11 / Albania: Selected economic indicators

	2014	2015	2016	2017 ¹⁾	2017 January-June	2018	2018 Forecast	2019 Forecast	2020
Population, th pers., average	2,889	2,881	2,876	2,873	.	.	2,870	2,868	2,867
Gross domestic product, ALL bn, nom.	1,395	1,434	1,475	1,553	763	806	1,600	1,700	1,800
annual change in % (real)	1.8	2.2	3.4	3.8	4.1	4.4	4.1	4.0	4.0
GDP/capita (EUR at PPP)	8,300	8,600	8,500	8,700	.	.	.	.	.
Consumption of households, ALL bn, nom.	1,120	1,147	1,187	1,242	628	660	.	.	.
annual change in % (real)	2.8	0.9	2.6	2.7	2.3	3.2	3.0	2.5	2.5
Gross fixed capital form., ALL bn, nom.	337	350	362	386	170	174	.	.	.
annual change in % (real)	-4.5	3.5	3.3	6.5	10.8	2.8	6.0	5.2	5.5
Gross industrial production									
annual change in % (real)	1.5	-2.1	-18.0	-0.6	4.2	25.2	12.0	4.0	3.0
Gross agricultural production ²⁾									
annual change in % (real)	1.4	2.6	3.3	4.0	.	.	.	.	.
Construction output total									
annual change in % (real)	5.0	19.4	5.1	19.6	29.1	0.8	.	.	.
Employed persons, LFS, th	1,037	1,087	1,157	1,195	1,179	1,227	1,230	1,260	1,300
annual change in %	1.3	4.8	6.5	3.3	3.5	4.1	2.9	2.4	3.2
Unemployed persons, LFS, th	220	224	208	190	192	174	170	180	180
Unemployment rate, LFS, in %	17.5	17.1	15.2	13.7	14.1	12.5	12.4	12.2	12.0
Reg. unemployment rate, in %, eop	13.0	12.9	8.8	7.2	7.8	6.9	.	.	.
Average monthly gross wages, ALL	45,539	46,829	45,845	49,840	48,147	49,769	53,400	56,700	60,100
annual change in % (real, gross)	-0.7	0.9	-3.4	6.6	0.5	1.3	5.0	3.5	3.0
Consumer prices, % p.a.	1.6	1.9	1.3	2.0	2.2	2.1	2.1	2.5	2.9
Producer prices in industry, % p.a.	-0.5	-2.1	-1.4	2.6	3.2	1.7	3.0	2.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	26.3	26.4	27.6	27.7	27.8	26.9	27.3	28.0	28.0
Expenditures	31.4	30.5	29.4	29.7	27.5	26.7	27.5	28.5	29.5
Deficit (-) / surplus (+)	-5.2	-4.1	-1.8	-2.0	0.4	0.2	-0.2	-0.5	-1.5
General gov.gross debt, nat.def., % of GDP	70.1	72.7	72.3	70.1	65.4	66.7	68.5	65.0	64.0
Stock of loans of non-fin.private sector, % p.a.	2.4	-2.6	0.2	0.7	-1.5	-2.4	.	.	.
Non-performing loans (NPL), in %, eop	22.8	18.2	18.3	13.2	15.6	13.3	.	.	.
Central bank policy rate, % p.a., eop ³⁾	2.25	1.75	1.25	1.25	1.3	1.0	1.0	1.0	1.3
Current account, EUR mn	-1,076	-884	-812	-866	-413	-338	-990	-960	-950
Current account, % of GDP	-10.8	-8.6	-7.6	-7.5	-7.3	-5.5	-8.0	-7.2	-6.7
Exports of goods, BOP, EUR mn	932	771	714	797	398	497	1,000	1,150	1,230
annual change in %	-12.7	-17.2	-7.4	11.7	24.4	24.8	25.0	15.0	7.0
Imports of goods, BOP, EUR mn	3,147	3,070	3,317	3,621	1,680	1,795	4,090	4,500	4,820
annual change in %	3.9	-2.5	8.0	9.2	6.6	6.8	13.0	10.0	7.0
Exports of services, BOP, EUR mn	1,881	2,028	2,396	2,856	1,270	1,366	3,260	3,750	4,200
annual change in %	9.7	7.8	18.1	19.2	26.2	7.5	14.0	15.0	12.0
Imports of services, BOP, EUR mn	1,558	1,503	1,599	1,774	786	846	2,060	2,260	2,420
annual change in %	4.6	-3.5	6.4	11.0	11.0	7.7	16.0	9.5	7.0
FDI liabilities, EUR mn	869	890	943	900	386	494	880	.	.
FDI assets, EUR mn	58	72	6	-94	-46.5	-21.4	50	.	.
Gross reserves of NB excl. gold, EUR mn	2,142	2,831	2,889	2,941	2,760	2,904	.	.	.
Gross external debt, EUR mn	6,927	7,634	7,882	7,928	7,859	8,111	8,500	9,000	9,500
Gross external debt, % of GDP	69.5	74.4	73.4	68.5	67.9	65.1	68.0	67.0	67.0
Average exchange rate ALL/EUR	139.97	139.74	137.36	134.15	135.13	129.96	128.5	127.0	126.5

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

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