

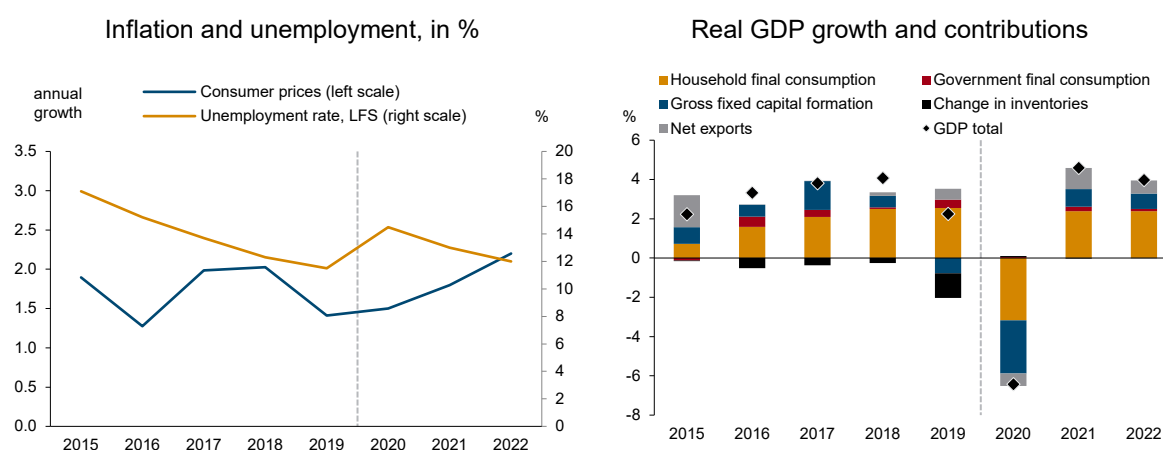


ALBANIA: Light at the end of the tunnel, but still far off

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The economy is expected to contract by 6.4% in 2020. Recovery is unlikely to be just around the corner, given the current pandemic. The public debt is in danger of becoming unsustainable and public finances have little room for manoeuvre. In the medium term, the prospects for FDI inflows look positive. Assuming that the pandemic does not trigger a second lockdown, we expect the economy to resume growing at over 4%, backed by an upsurge in external demand and a rebound of private consumption in 2021.

Figure 4.1 / Albania: Main macroeconomic indicators



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

The economic contraction has been greater than expected. The consequences for the economy of the double whammy of the November 2019 earthquake and the lockdown in March-June 2020 have been more severe than anticipated. For three quarters in a row – Q4 2019, Q1 and Q2 2020 – the economy contracted, by 0.1%, 2.5% and 10.3% y-o-y. In particular, in the second quarter of 2020, the stringent measures applied during the COVID-19 lockdown led to private consumption declining by 7%, investments by 11% and real net exports by 3% (exports of goods and services shrank by 49%, while imports of goods and services fell by 36%). In terms of production, activity fell in all sectors, except for agriculture and real estate activities, whose positive contributions to GDP growth were 0.7 and 0.3 percentage points (pp) in Q2 2020, year-on-year. The negative supply shock to the economy came mainly through trade, transport and accommodation services (4.1 pp) and manufacturing (1.5 pp) – a reflection of how acutely the restrictions on mobility hit tourism and export-oriented businesses.

The lockdown triggered from mid-March 2020 was able to contain the coronavirus pandemic for only a while. The effects of the pandemic witnessed in Italy in February and early March 2020 were a wake-up call for the Albanian government, which responded immediately with a lockdown. However, the gradual reopening of the economy towards the end of April, the start of the tourist season on 1 June and a further relaxation of the restrictions led to a rapid rise in infections over the summer months.

Accordingly, some measures (such as the wearing of masks in enclosed areas) were reinstated and a number of activities – especially recreation, arts and entertainment activities – were again shut down. In October, the daily number of new infections is double the figure for July. Still, infections have not risen exponentially and the death toll has remained flat throughout the pandemic, fluctuating at between two and four lives lost each day since June 2020. As of 15 October, masks are compulsory in all public areas, both indoor and outdoor.

Public finances have come under strain. Revenue declined by 12% in January-August 2020, y-o-y, partly as a result of the various tax deferrals offered during the pandemic. The anti-COVID-19 financial packages are estimated to be worth close to 3% of GDP. A number of fiscal measures were introduced to help stimulate economic activity and support businesses. The submission of annual financial statements was postponed (until the end of July) and a moratorium was offered on loan repayments (until the end of May). Tax payment deferrals until 2021 were granted to a number of companies in the garment industry, call centres, tourism and small businesses – sectors that are vital for employment, but were hindered by the lockdown. Also, the government offered EUR 88 million as a ‘sovereign guarantee fund’ for large companies, so that they could get bank loans to pay their employees’ salaries, and another EUR 132 million as collateral to support companies to secure investment loans from banks. At the same time, many infrastructure projects have been facing delays due to budgetary shifts. All in all, the public deficit is estimated at 5% of GDP for the first eight months of 2020, and the public debt to GDP ratio is expected to exceed 80% by the end of 2020.

The lockdown threw the job creation successes of 2018 and 2019 into reverse. In Q2 2020, employment fell back to 2017 levels, dropping by 48,000 compared to Q4 2019 – a fall of 4.1% of total employment. Given the high level of informality, the actual number of jobs lost is probably much higher. The restrictions on mobility meant that inactivity rose even more than unemployment. Job destruction affected particularly the private sector: 61% of jobs lost were in that sector; a further 36% were in agriculture; and the rest involved the public sector. Also, the lockdown had repercussions for those Albanians who usually work seasonally in Greece or other EU countries.

The support measures to tackle job retention and earnings during the pandemic have helped, but they are not sufficient. The government approved two COVID-19 packages to assist employment. The first allotted EUR 52 million to pay the salaries (equivalent to the minimum wage of LEK 26,000 (EUR 210)) of workers in small businesses for three months. Further measures within this package included doubling unemployment and social assistance benefits for April-June 2020. The second COVID-19 financial package in support of job retention and earnings – EUR 57 million – offered a one-off payment of LEK 40,000 (EUR 322) to 176,000 employees, distributed among workers in big companies (37%), small businesses (57%) and tourism (6%). Another EUR 50 million was allocated from the European Union in support of business recovery. Given the structure of the Albanian economy and the high dependence of employment on export-oriented firms, job creation is much slower than job destruction. Therefore, the recovery in employment will depend on how quickly these businesses can crank up their activity.

Private consumption contracted sharply and will pick up again only in 2021. Remittances – a vital income source – dropped by 19% in the first half of 2020, y-o-y. No rapid rebound is to be expected: the economies of the main sending countries – e.g. Italy and Greece – have been badly hit by the pandemic. High-frequency indicators suggest that consumption will remain depressed throughout the second half of 2020. The prognosis is better for 2021, assuming that the pandemic does not trigger a second lockdown. Expectations are rising on account of certain moves by the government, which in September 2020 launched a number of new schemes to promote employment and assist with the reintegration into work of those who lost their jobs during the pandemic. The government will fund 100% of the minimum wage and the mandatory social security contributions for a period of 4-12 months. In support of earnings, the government has proposed to raise the minimum wage by 15% (to LEK 30,000, equivalent to EUR 242 a month) – a move that will affect 26% of employees from 1 January 2021. A pay rise of 40% for health professionals and 15% for education staff has been proposed from 1 January 2021. Given the big exodus of medical staff over the past decade, such a wage hike could help to halt the brain drain for this category of workers.

External sector demand contracted sharply, but in the medium term the signals are mixed. High-frequency data indicate a big drop in exports and in goods imports during the lockdown, although these picked up again rapidly with the relaxation of the restrictions: in March and April exports declined (from month to month) by 29% and 16%, respectively, and imports fell by 14% and 18%; but in May, exports rose by 47% month to month, and imports similarly increased by 23%. Overall, from January to August, merchandise exports contracted by 15.4% and imports by 12.3%. Exceptionally, food exports remained positive, rising by 8% to attain an export share of 15%. The pandemic changed the configuration of trading partners, with exports to Germany, Serbia and Turkey growing fastest. Looking ahead, goods exports (largely textile products and mainly in partnership with Italian businesses) are likely to remain depressed this year, but will very likely recover next year, given that the Italian economy is expected to contract by 14% in 2020, but then to see growth bounce back to 5% in 2021.

The prospects for FDI inflows look positive in the medium term. FDI inflows dropped by 17% in the first half of 2020 (y-o-y), mainly because large-scale investment projects such as the Trans Adriatic Pipeline and the Moglice hydropower plant on the river Devoll have already been completed. The latter project was the second hydropower station to be constructed in Albania by the Norwegian company Statkraft (following the plant at Banja). Moglice Hydropower started its operations in June 2020. It has an annual capacity of 450 GWh, and jointly with Banja will increase electricity production by 13%. In the short to medium term, two FDI projects are on the cards. The first is a solar power plant in Karavasta, in the western part of the country, close to the Adriatic. This will be an investment by the French company Voltalia and will be worth EUR 100 million. It will have a capacity of 140 MW and construction will begin by the end of 2020. The second infrastructure project is the Skavica hydropower station, to be built on the river Drin, in northeast Albania, following a deal signed with the American company Bechtel. The estimated investment will be between EUR 300 million and EUR 500 million. The Skavica hydropower plant will have a capacity of 210 MW. Certainly, such investments will provide a positive impetus to growth and will make the energy sector more resilient to droughts which have become more frequent in Albania given the global warming.

Demand for services – and especially tourism – has fallen sharply. Demand for services and tourism contracted by 35% and 52%, respectively, in the first half of 2020. The number of foreign and domestic tourists fell by 64% in January-August 2020, y-o-y. Tourists from the neighbouring countries –

especially Kosovo - but also Ukraine and Belarus provided some respite for the sector. However, the recovery has been fairly feeble, and now the summer season – which sees the highest number of tourists, and also Albanian migrants returning for their summer vacation – is over. With the ongoing pandemic, a ban on travel to Albania imposed by a number of EU countries and closed EU borders, the outlook for tourism remains bleak, particularly as the restrictions will continue to affect the sector throughout the second half of 2020, and most likely also at the start of 2021.

The banking sector remains stable and supportive to the economy. Non-performing loans dropped to 8% in Q1 2020, and remained at this level during the pandemic. The demand for credit recovered during the first quarter of the year in the wake of the earthquake; it then received a setback during the lockdown and only started to recover again later. The demand for loans was mainly driven by non-financial corporations – at 6% in January-July 2020. The central bank has kept the interest rate at 0.5%, and it will probably stay at that level until 2022. During the lockdown, the domestic currency depreciated by 7% against the euro, but since May 2020 it has been relatively stable. Inflation has fluctuated quite a lot, jumping from 1.2% to 2.1% between March and April, falling back to 1.3% over the summer, before rising slightly to 1.5% in September. It is mainly (imported) food products – especially fruit – that have driven the price instability, although the earthquake has also had an impact on rents.

The EU integration process is slowly moving in the right direction. In October 2020, the European Commission confirmed the commitment of the Albanian government to pursue the necessary reforms, despite the pandemic and the devastating earthquake of November 2019. The European Commission affirmed that the first inter-governmental meeting with the EU member states should take place by the end of 2020, under the German EU presidency.

Uncertainty looms and the economic recovery will be long in coming. The consequences for the economy of the double whammy (the earthquake and the lockdown) have been graver than expected, and we have revised downwards our forecast for 2020, from -5% to -6.4%. The lockdown wiped out the gains in the export of goods and services achieved over the past decade, and this year's figures are expected to be back at 2011 levels. The current account deficit will widen to 10% in 2020, mainly because of the major contraction of services exports and a fall in FDI and remittances inflows. In the medium term, we expect economic activity to grow at above 4%, assuming a second lockdown can be avoided. In 2021, depending on how rapidly economic activity and tourism grow, external demand could regain its momentum. Large infrastructure projects in the energy sector are expected to provide a positive impetus to growth in 2021-2022. Consumption is expected to resume its growth in 2021, assuming that the employment situation improves as a result of the job-promotion and retention programmes launched by the government.

Table 4.1 / Albania: Selected economic indicators

	2017	2018	2019 ¹⁾	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022
Population, th pers., average	2,873	2,866	2,854	.	.	.	2,846	2,844	2,840
Gross domestic product, ALL bn, nom.	1,551	1,636	1,678	373	387	761	1,600	1,700	1,800
annual change in % (real)	3.8	4.1	2.2	-2.3	-10.2	-6.6	-6.4	4.6	4.0
GDP/capita (EUR at PPP)	8,940	9,440	9,710	.	.	.	.	.	.
Consumption of households, ALL bn, nom.	1,224	1,277	1,333	323	342	665	.	.	.
annual change in % (real)	2.6	3.2	3.3	1.4	-7.6	-3.5	-4.0	3.0	3.0
Gross fixed capital form., ALL bn, nom.	381	391	378	66	87	152	.	.	.
annual change in % (real)	6.0	2.4	-3.3	-15.7	-11.1	-13.2	-12.0	4.0	3.5
Gross industrial production									
annual change in % (real)	-0.6	18.5	-1.1	-0.1	-22.0	-11.8	-12.0	4.0	1.0
Gross agricultural production ²⁾									
annual change in % (real)	0.9	1.9	5.0	.	.	.	.	.	.
Construction output total									
annual change in % (real)	19.6	5.6	-2.5	-9.7	2.0	-3.4	.	.	.
Employed persons, LFS, th	1,195	1,231	1,266	1,258	1,225	1,241	1,225	1,250	1,280
annual change in %	3.3	3.0	2.8	1.1	-3.6	-1.2	-3.2	2.0	2.4
Unemployed persons, LFS, th	190	173	165	162	166	164	210	190	170
Unemployment rate, LFS, in %	13.7	12.3	11.5	11.4	11.9	11.7	14.5	13.0	12.0
Reg. unemployment rate, in %, eop	7.2	5.4	5.8	5.6	7.1	7.1	.	.	.
Average monthly gross wages, ALL	48,967	50,589	52,380	53,232	54,149	53,691	54,200	56,800	59,500
annual change in % (real, gross)	1.0	1.3	2.1	1.7	0.9	1.3	2.0	3.0	2.5
Consumer prices, % p.a.	2.0	2.0	1.4	1.6	1.9	1.8	1.5	1.8	2.2
Producer prices in industry, % p.a.	2.6	1.7	-0.8	-2.1	-4.1	-3.1	-3.0	1.0	0.4
General governm.budget, nat.def., % of GDP									
Revenues	27.8	27.5	27.4	27.9	23.5	25.7	25.0	28.0	28.0
Expenditures	29.8	29.1	29.3	28.6	32.7	30.7	32.0	30.0	29.0
Deficit (-) / surplus (+)	-2.0	-1.6	-1.9	-0.8	-9.3	-5.1	-7.0	-2.0	-1.0
General gov.gross debt, nat.def., % of GDP	70.2	67.7	66.3	72.6	79.1	79.1	80.0	72.0	69.0
Stock of loans of non-fin.private sector, % p.a.	0.7	-3.6	6.6	8.9	6.6	6.6	.	.	.
Non-performing loans (NPL), in %, eop	13.2	11.1	8.4	8.2	8.1	8.1	.	.	.
Central bank policy rate, % p.a., eop ³⁾	1.25	1.00	1.00	0.5	0.5	0.5	0.5	0.5	0.5
Current account, EUR mn	-866	-866	-1,089	-234	-378	-612	-1,240	-1,140	-1,100
Current account, % of GDP	-7.5	-6.8	-8.0	-7.7	-12.2	-10.0	-9.6	-8.2	-7.5
Exports of goods, BOP, EUR mn	797	986	907	200	171	370	760	800	840
annual change in %	11.7	23.7	-8.1	-4.7	-29.5	-18.0	-16.0	5.0	5.0
Imports of goods, BOP, EUR mn	3,621	3,857	4,050	853	827	1,680	3,600	3,690	3,760
annual change in %	9.2	6.5	5.0	-5.7	-19.2	-12.9	-11.0	2.5	2.0
Exports of services, BOP, EUR mn	2,856	3,073	3,405	648	317	965	2,350	2,560	2,690
annual change in %	19.2	7.6	10.8	-4.4	-61.2	-35.4	-31.0	9.0	5.0
Imports of services, BOP, EUR mn	1,774	1,962	2,141	379	178	557	1,500	1,610	1,670
annual change in %	11.0	10.6	9.1	-2.9	-68.1	-41.3	-30.0	7.0	4.0
FDI liabilities, EUR mn	900	1,020	1,072	233	221	454	800	.	.
FDI assets, EUR mn	-94	-3	36	12	-1	11	-50	.	.
Gross reserves of NB excl. gold, EUR mn	2,941	3,342	3,240	3,195	4,026	4,026	.	.	.
Gross external debt, EUR mn	7,949	8,353	8,246	8,198	8,908	8,908	9,000	9,400	9,100
Gross external debt, % of GDP	68.8	65.2	60.4	63.5	69.1	69.2	70.0	68.0	62.0
Average exchange rate ALL/EUR	134.15	127.59	123.01	122.84	124.51	123.68	124.2	123.0	123.0

1) Preliminary. - 2) Based on UN-FAO data, wiiw estimate in 2019. - 3) One-week repo rate.

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