ALBANIA: New energy for the economy

ISILDA MARA

GDP growth is expected to increase progressively over the next three years, rising by 2% in 2015, 2.2% in 2016 and 2.4% in 2017. The economy might benefit from a resolute reform in the energy sector and growth in gross fixed capital formation stemming mainly from foreign direct investment in energy infrastructure. Nonetheless, with government and household consumption failing to thrive, the country's economy still begrudges the growth rates achieved in 2010 and earlier years.

The energy sector has been at a high risk of collapse for several years, recording a considerable increase in annual losses between 2010 and 2013, from 30% up to 45% of the total energy available for consumption. The last quarter of 2014 was characterised by a firm battle of the government against the abuses in the electricity system. The related campaign poured into the budget an additional EUR 49 million in revenues and a further EUR 37 million from reduced losses in the network. In this line, the government has drafted a new law that, if approved by the parliament, will give the state-owned distribution operator the authority to sequester assets of households and businesses with a debt above a ceiling of EUR 1,000 and 14,000 respectively. Another event which opens up the possibility for further and radical reforms in the energy system is the recent deal with the CEZ group to pay to the Czech energy giant, as the former owner of the Albanian electricity distribution company, an amount of EUR 95 million as compensation for the earlier revoked licence.

In 2014 general government budget revenues increased, in lek terms, by 9.2% nominally on an annual basis while expenditures, after declining severely in the first half of 2014, recovered during the second half of the year and recorded an increase of about 8.5%. Capital expenditure was cut by 7.5% compared to the previous year. In 2015, government capital expenditures in infrastructure are planned to account for 53% of the budget, mainly to be invested in new roads and the improvement of existing ones and their safety. The increase in the corporate income tax and the progressive taxation of income started in 2014 may heal the finances of the government but at the same time may reduce business activity and curb demand. Therefore, in 2015 revenues are expected to increase by 7% while expenditures are planned to rise only moderately, by 2%, suggesting that fiscal austerity measures will still prevail over expansionary ones. Most probably the floods that hit the country in early February 2015, apart from causing damage to the agricultural sector, will absorb some public funds for reconstruction, contributing to further investments in roads, bridges, and infrastructure in those particular areas which are in emergency need. Local elections in the early summer might contribute to a further increase in government expenditure. Hence the planned austerity measures might actually be softened.

The weak performance of exports in 2014, which shrank by 6.2% (from a volume of EUR 3.4 billion down to 3.2 billion year on year), compared to a less than 1% contraction of imports (from EUR 5.15 billion down to 5.10 billion year on year) widened the trade deficit by another 9% (rising from EUR 1.7 billion to 1.9 billion, year on year). According to customs statistics, exports of textiles, clothing and footwear grew the most, by 24%, followed by chemical and plastic products (up 17%), and wood and paper articles (up 15%). Conversely, exports of mineral fuels and electricity, which used to be the largest export group in 2013, suffered a sharp decline of 14%. The unexpected drop is a result of the drastic decline in oil prices on international markets which caused a reduction in Albanian crude oil revenues. Also in 2015, persistent low international oil prices will have a negative impact on exports of oil and on the investments in this sector. Bankers Petroleum, the country's main oil producer, has already drastically reduced production due to the oil price fall.

The signals concerning external demand are blurred. Some of the main trading and investment partners such as Italy and Greece are expected to achieve higher economic growth rates in the years to come. However, that recovery is still uncertain and may not necessarily exert an immediate positive impact on the Albanian economy via the export channel or a return of the level of remittance revenues to that prior to the international financial crisis (6% of GDP in 2013 vs. 16% in 2006).

From November 2013 to November 2014, the credit market almost stagnated, expanding by less than 1% on an annual basis, from 39.6% to 40.1% as a share of GDP. In the same period, new loans showed a better performance: they increased by 24% and their share in GDP rose from 14.3% to 16.8%. New loans to businesses increased by 29% whereas loans to households rose by a mere 1%. As opposed to previous years, new loans were taken predominantly in local currencies. The share of new business loans in lek rose by 4 percentage points, up from 44% in November 2013. By contrast, the share of new business loans in euro lost 15 percentage points, down from 52% in November 2013. A similar pattern was observed for household loans, experiencing an increase of 12% for loans in lek versus a decline of 16% for loans in euro. The shift in the preference towards loans in local currency may have been due to the closing gap of interest rates applied to local versus foreign currency.

The government's attempt to reduce non-performing loans and foster weak credit growth by paying arrears to private companies does not seem to be very successful. The payment of arrears has assisted a number of firms in being removed from the blacklist of the banks but meanwhile some others have moved in. The level of non-performing loans has remained high, which is a symptom of a credit portfolio not that well-structured, of weak economic performance, consumer demand, investments from corporate, small and medium-sized enterprises as well as weak liquidity of the market. It is expected that credit growth will continue to remain low not only because of low demand. Banks persist in their reluctance to lend to private businesses, hesitating to soften credit conditions as long as the level of non-performing loans remains as high as 24.9% of total loans (third quarter of 2014).

A high level of non-performing loans puts into question the role that the banking sector and the central bank can play in incentivising other sectors of the economy. Apart from this, the newly elected central bank governor Gent Sejko has to cope with a low inflation rate of 1.3% in January 2015, far below the target of 3%, as well as to introduce new monetary tools dealing with deflationary risks. A further cut in the key interest rate to an unprecedentedly low rate of less than 2% is not unlikely.

The last quarter of 2014 economic sentiment indicator, a combination of businesses’ and consumers’ confidence in the economy, sends favourable signals as concerns the construction, services and trade sectors but rather discomforting ones with regard to the industry sector and consumer confidence. In particular, the construction sector, which had been languishing for four consecutive years, demonstrated the first signs of recovery in 2014 and will experience further progress in the first quarter of 2015. By contrast, consumer confidence worsened because of unbalanced spending, income and purchases. Besides, the confidence of consumers has been eroded by pessimistic expectations as concerns unemployment, the financial situation and the increased cost of living.

As of 2015 we expect a number of public, private and joint public-private investments to start or make progress in the next four years. This February the new manager of the Trans Adriatic Pipeline (TAP) consortium, Ian Bradshaw, confirmed the start of the TAP construction by early June 2015 if the expropriation of land owners runs smoothly. This project will give a boost to the inflow of FDI to Albania. The initiation of the construction of the TAP pipeline is going to be one of the biggest foreign direct investments in Albania so far, EUR 1.2 billion out of a total investment volume of EUR 32 billion. For 2015 an investment of EUR 64 millions in infrastructure and 3,000 new jobs are expected. Thus, the boosting effect on the economy is expected to materialise only in the medium term. Further investments which are expected to boost especially the energy sector and also the export of electricity is the construction of a hydropower plant at the Devoll river by the Norwegian company Statkraft. This investment is to increase electricity production by about 17% from 2018 onwards. In addition, for 2015 the Norwegian company agreed to invest EUR 70 million in infrastructure, mainly roads in the area of Devoll. Another vital investment to be launched in 2015 is the road bypass of the city of Vlora, funded by the European Union (EUR 17 million), the European Bank for Reconstruction and Development and the European Investment Bank (EUR 18 million each).

Overall, the credit market will continue to record sluggish growth. Exports of crude oil are expected to suffer due to low international oil prices, and further investments in this sector will be postponed. Under austerity measures more substantial growth will be delayed. Nevertheless, the improvement in business expectations and investment growth are important steps towards economic recovery. On these grounds we have revised our earlier forecasts upwards, to 2% in 2015, 2.2% in 2016 and 2.4% in 2017.

Table 1 / Albania: Selected Economic Indicators

	2010	2011	2012	2013	2014 1)	2015	2016	2017
							Forecast	
Population, th pers., average 2)	2,913	2,905	2,900	2,897	2,894	2,890	2,885	2,880
Gross domestic product, ALL bn, nom. 3)	1,240	1,301	1,335	1,365	1,400	1,450	1,510	1,570
annual change in % (real) 3)	3.7	2.5	1.6	1.4	1.5	2.0	2.2	2.4
GDP/capita (EUR at exchange rate)	3,100	3,200	3,300	3,400	3,500	3600	3700	3800
GDP/capita (EUR at PPP)	7,100	7,300	7,400	7,500	7,700	.	.	.
Consumption of households, ALL bn, nom. 3)	962	1,012	1,035	1,069	1,110	.	.	.
annual change in % (real) 3)	1.7	1.8	0.7	1.8	1.9	1.5	1.6	1.9
Gross fixed capital form., ALL bn, nom. 3)	352	382	345	354	360	.	.	.
annual change in % (real) 3)	-8.5	5.9	-11.3	1.2	2.0	3.6	4.0	4.4
Gross industrial production								
annual change in % (real)	36.2	19.0	15.7	28.4	7.6	9.0	10.0	13.0
Gross agricultural production								
annual change in % (real)	6.2	4.8	5.8	1.0	2.0	.	.	.
Construction output total								
annual change in % (real)	-13.3	-1.1	-11.4	-13.0	0.2	.	.	.
Employed persons, LFS, th 4)	1,167	1,160	1,117	992	1,022	1,070	1,090	1,100
annual change in %	0.6	.	-3.7	-11.2	3.0	4.7	1.9	0.9
Unemployed persons, LFS, th 4)	191	189	173	184	206	194	190	190
Unemployment rate, LFS, in % 4)	14.0	14.0	13.4	15.6	18.0	17.5	17.5	17.5
Reg. unemployment rate, in %, end of period 2)	13.8	13.1	12.8	13.4	13.5	13.5	13.0	13.0
Average monthly gross wages, ALL	34,767	36,482	37,305	40,860	41,600	42,800	44,100	45,400
annual change in % (real, gross)	-7.0	1.5	0.2	7.4	0.2	1.3	1.3	1.3
Consumer prices, % p.a.	3.6	3.4	2.0	1.9	1.6	1.5	1.7	1.7
Producer prices in industry, % p.a.	0.3	2.6	1.1	-0.5	0.3	1.0	1.0	1.0
General governm.budget, nat.def., % of GDP								
Revenues	26.2	25.4	24.7	24.0	26.2	28	28	29
Expenditures	29.3	28.9	28.2	28.9	31.3	32	31	31
Deficit (-) / surplus (+)	-3.1	-3.5	-3.4	-4.9	-5.2	-4.0	-3.0	-2.0
Public debt, nat.def., % of GDP	57.7	59.4	62.0	70.2	70.6	72.0	72.0	71.0
Central bank policy rate, % p.a., end of period 5)	5.00	4.75	4.00	3.00	2.25	2.25	2.00	2.00
Current account, EUR mn 6)	-1,019	-1,225	-978	-1,035	-1,350	-1,400	-1,450	-1,500
Current account, % of GDP	-11.3	-13.2	-10.2	-10.6	-13.5	-13.6	-13.7	-13.7
Exports of goods, BOP, EUR mn 6)	1,172	1,406	1,526	1,063	1,100	1,200	1,300	1,400
annual change in %	56.1	20.0	8.5	.	3.5	9.1	8.3	7.7
Imports of goods, BOP, EUR mn 6)	3,254	3,647	3,525	2,956	3,200	3,400	3,600	3,800
annual change in %	6.5	12.1	-3.4	.	8.3	6.3	5.9	5.6
Exports of services, BOP, EUR mn 6)	1,751	1,747	1,673	2,349	2,100	2,250	2,350	2,500
annual change in %	-1.2	-0.2	-4.2	.	-10.6	7.1	4.4	6.4
Imports of services, BOP, EUR mn 6)	1,519	1,612	1,460	2,192	1,900	2,050	2,200	2,300
annual change in %	-4.9	6.2	-9.5	.	-13.3	7.9	7.3	4.5
FDI inflow (liabilities), EUR mn 6)	793	630	666	945	800	900	950	1,000
FDI outflow (assets), EUR mn 6)	5	21	18	22	80	90	80	100
Gross reserves of NB excl. gold, EUR mn	1,851	1,851	1,909	1,971	2,142	.	.	.
Gross external debt, EUR mn 6)	4,100	4,958	5,513	6,177	6,750	.	.	.
Gross external debt, % of GDP	45.6	53.5	57.4	63.5	67.5	.	.	.
Average exchange rate ALL/EUR	137.79	140.33	139.04	140.26	139.97	141	143	143
Purchasing power parity ALL/EUR	59.88	61.45	62.53	62.74	63.03	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census October 2011. - 3) According to ESA'10 (FISIM reallocated to industries etc). -
4) Until 2011 survey once a year, quarterly thereafter. From 2011 according to census October 2011. - 5) One-week repo rate. - 6) From 2013 based on BOP 6th edition, 5th edition before.
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.