

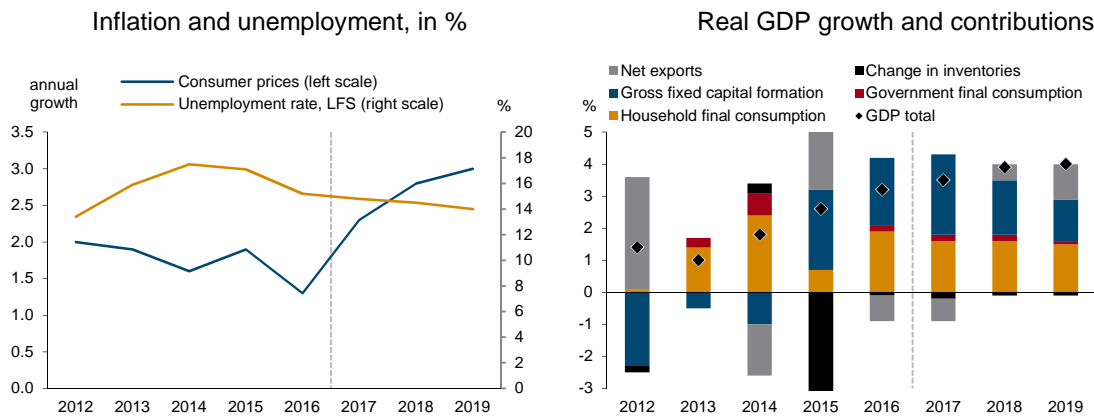


## ALBANIA: Trans Adriatic Pipeline investment will underpin stronger growth momentum

ISILDA MARA

The economy will continue to grow at above 3.6% in the medium term. Investment-driven economic growth will be supported by international capital inflows. A recovery in external demand is expected, in reaction to higher international oil prices and positive signs for the tourism industry. However, the parliamentary elections due in mid-June 2017 have been preceded by political tension, which has jeopardised their fairness, as well as the progress made in the judicial reform initiated last year.

Figure 33 / Albania: Main macroeconomic indicators



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

In February 2017, the EU Parliament officially approved the start of EU accession talks with Albania, on condition that the implementation of judicial reform is brought forward and that the parliamentary elections due in mid-June 2017 are free and fair. Ahead of the elections, the opposition Democratic Party is staging a protest (ongoing at the time of writing), calling for the government to step down. The party claims that a caretaker government is a prerequisite for free and democratic elections. The opposition is boycotting parliament and is threatening to do the same with the elections if its demands go unheeded. The protests are being led by Lulzim Basha, the new leader of the Democratic Party, although former leader Sali Berisha continues to exercise a strong influence. The current government has affirmed that it will not yield to the demands. The Socialist Movement for Integration, led by Ilir Meta – currently the speaker of parliament – has confirmed its alliance with the

Socialist Party, at least until the upcoming parliamentary elections. Such dynamics and the recent political tension risk impeding the vetting process<sup>30</sup> – the next step in judicial reform, scheduled for February. While the EU accession talks may be a blessing in terms of implementation of judicial reform, the opposition boycott of parliament may prove a curse.

**Driven by investment, real GDP growth accelerated to above 3% in 2016.** Gross fixed capital formation rose by 8.1% year on year in real terms during the first three quarters of 2016, boosted by international capital inflows. Over the same period, household and government consumption increased by 2.3%. Consumption is expected to continue growing in 2017, owing to better labour market conditions and wage rises. Remittances have recovered only slightly, but continue to smooth consumption. The main sectors of the economy that supported growth in 2016 – and that are expected to continue to do so in the medium term – are services, construction and financial activities. As far as investments are concerned, with 2017 an election year, potential investors – both domestic and foreign – are likely to adopt a wait-and-see attitude until the new government is formed.

**Fiscal consolidation was achieved during 2016, but uncertainties loom in 2017.** Meanwhile, public debt remains relatively high. In 2016, the general government budget deficit was cut by 2 percentage points (pp) to 2.1% of GDP, and public debt fell by 1.1 pp to 71.6% of GDP. Until November 2016, the general government budget was in surplus, thanks to a 7% year-on-year increase in revenue and a 2% decline in expenditure. Whether the fiscal consolidation achieved during 2016 continues is uncertain for a number of reasons. First, the government has announced an increase in the monthly minimum wage (from Albanian lek 22,000 to 23,000), a public wage rise (between 7% and 36%) and a retirement pension increase of 3% by March 2017. Second, with the parliamentary elections looming, an increase in public investment and capital expenditure is expected. Nevertheless, given the high level of public debt, the government does not have much room for manoeuvre. Third, the agreement with the IMF that began in September 2013 has ended, with no extension envisaged. Thus, a general government budget less committed to fiscal consolidation is likely to be on the cards. Overall, the fiscal stance will depend on the ability of the government to increase the performance of tax revenues at a time of favourable economic conditions and potential political change.

**The high level of non-performing loans (around 18% at the end of 2016) continues to impede the demand for credit.** Big companies are usually the motors of demand for credit, but in Albania they are responsible for the sluggish overall credit growth (0.6% up until November 2016, year on year). In all, 36 large enterprises are responsible for around two-thirds of non-performing loans. Accordingly, commercial banks have tightened their credit standards for loans to such companies. By contrast, the banks have eased their credit conditions for households and for small and medium-sized enterprises. In particular, the banking sector seems willing to support businesses in the service sector, construction and manufacturing (all expanding sectors). At the same time, consumer and business confidence for the first quarter of 2017 has improved with respect to the last quarter of 2016 and currently stands at above the long-term average. The demand for loans from consumers and small businesses is also increasing. In 2017, credit growth is expected to recover, fuelled mainly by higher demand, as well as by favourable credit conditions for both households and small companies.

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<sup>30</sup> The vetting law aims to rid the justice system of corrupt judges and prosecutors, bent politicians and organised crime. The law allows for the screening and subsequent appointment of judges and prosecutors based on their professional qualifications, moral integrity and detachment from organised crime, 'dodgy dealings' and corrupt politicians.

**The central bank will continue with an easy monetary policy during the first half of 2017, but an upward revision of key interest rates is expected in late 2017, as a result of an increase in domestic and imported inflation.** In December 2016, the central bank kept the key interest rate unchanged, at 1.25%. Last year ended with an inflation rate of 1.3%, far below the central bank's target of 3%. January 2017 saw an inflation rate of 2.8% year on year – almost double the rate of 1.5% recorded in January 2016. Domestic inflationary pressure is expected to rise, due to higher capital expenditure and liquidity in the domestic market. The higher international oil prices and rising import prices (e.g. from the EU, the main trading partner of Albania) expected in 2017 are additional sources of inflationary pressure. Therefore, domestic and imported inflation might prompt the central bank to revise the key interest rate upwards in late 2017, and to tighten policy further in the medium term.

**The recovery in international oil prices is expected to provide fresh impetus to the export of goods.** During 2016, performance of the external sector was quite poor as regards the export of goods, but quite promising as regards the export of services. Almost two-thirds of goods exported during 2016 fell into the category of either the garment or the extraction industry (respectively 43% and 19%). Such an undiversified structure of exports makes them heavily exposed to several external risks. In particular, the extraction industry's exports witnessed a sharp downturn in 2016 (by 10% and 28% in real and nominal terms, respectively, year on year) because of the low international oil prices over the past two years. With the rise in international oil prices, the industry's expectations for the coming years are optimistic. By contrast, labour-intensive products (such as those manufactured by the garment industry) saw significant progress in the course of 2016. The low level of unit labour costs in Albania renders the country still attractive. The performance of services exports has also been positive. Tourism has benefited from the heightened security risks in many competitor markets, notably Turkey. Despite its good performance, the sector has faced the challenge of meeting excess demand. The positive expectations for the coming period will require a long-term tourism strategy to make the sector sustainable over time. On the import side, the increase in both goods and services hints at an increase in consumption, but also an increase in investment.

**Exchange rates have been less stable, especially in the last quarter of 2016 and at the beginning of 2017.** The dollar has appreciated against the Albanian lek, while the euro has depreciated quite strongly. Usually, the seasonality of the euro depreciation is closely connected to remittances and the return of migrants. The high inflow of capital from big international projects such as the Trans Adriatic Pipeline (TAP) might have been another factor. Last year, the large amount of cannabis produced and traded (and also sequestered) may have generated an excess of euros on the domestic market. Appreciation of the domestic currency makes exports more expensive, but it is expected that further stabilisation of the euro and international oil prices will prevent any dampening effect on exports.

**The year 2017 is expected to be a favourable one, as TAP enters its second year of implementation; intensive construction works are planned in this phase.** According to estimates by Oxford Economics, the direct and indirect effects of TAP on Albanian GDP will amount to over EUR 500 million in 2016-2017. The neighbouring countries of Italy and Greece – Albania's main trading and foreign direct investment (FDI) partners – will also benefit from the EUR 6.9 billion TAP project. For a small economy such as Albania's, the footprint of a huge international FDI project is large. Late 2016 already saw FDI rising sharply compared to the first half of 2016. The indirect impact is also expected to be great, since many local enterprises will get involved. So far, 1,800 new jobs have been created, and that figure will more than double in 2017. The Albanian government recently renegotiated the terms of

the contract, seeking an increase in the positive externalities from the construction of the TAP in Albania. While the positive aspects of the project (such as infrastructure) are regularly emphasised, the negative impact – especially on the environment – is less often addressed.

**In a nutshell, we forecast that the economy will grow steadily in the next three years, by 3.6%, 3.9% and 4% in 2017, 2018 and 2019, respectively.** Several factors are conducive to rising economic growth. Growth will continue to be driven largely by investments. International capital inflows will play an important role. Growth will further be fuelled by rising external demand – in terms of both the export of goods (extraction industry exports thanks to higher international oil prices) and the export of services (tourism). The favourable economic conditions are expected to boost employment, consumption, savings and demand for credit. It is likely that the higher political risk (on account of the parliamentary elections due in mid-June 2017) will constrain private investment but boost public investment in the early part of the forecast period.

**Table 4 / Albania: Selected economic indicators**

	2012	2013	2014	2015	2016 <sup>1)</sup>	2017	2018	2019
						Forecast		
Population, th pers., average	2,900	2,897	2,894	2,889	2,886	2,887	2,887	2,886
Gross domestic product, ALL bn, nom.	1,333	1,350	1,394	1,435	1,500	1,600	1,700	1,800
annual change in % (real)	1.4	1.0	1.8	2.6	3.2	3.5	3.9	4.0
GDP/capita (EUR at PPP)	8,000	7,800	8,300	8,600	8,900	.	.	.
Consumption of households, ALL bn, nom.	1,032	1,074	1,130	1,161	1,200	.	.	.
annual change in % (real)	0.1	1.8	3.0	0.9	2.3	2.0	2.0	1.8
Gross fixed capital form., ALL bn, nom.	353	352	343	378	400	.	.	.
annual change in % (real)	-7.9	-2.0	-4.0	10.3	8.0	9.5	6.5	5.0
Gross industrial production								
annual change in % (real)	15.7	28.3	1.6	-5.0	-7.0	1.0	2.0	4.0
Gross agricultural production <sup>2)</sup>								
annual change in % (real)	5.7	-3.4	2.0	2.9	0.5	.	.	.
Construction output total								
annual change in % (real)	-11.4	-13.0	5.0	19.3	10.0	.	.	.
Employed persons, LFS, th	1,140	1,024	1,037	1,087	1,160	1,180	1,190	1,195
annual change in %	-1.8	-10.2	1.3	4.8	6.8	1.7	0.8	0.4
Unemployed persons, LFS, th	176	194	220	224	210	200	200	190
Unemployment rate, LFS, in %	13.4	15.9	17.5	17.1	15.2	14.8	14.5	14.0
Reg. unemployment rate, in %, end of period	12.8	13.5	13.0	12.9	12.0	.	.	.
Average monthly gross wages, ALL <sup>3)</sup>	37,534	36,332	45,539	46,829	48,800	51,700	54,800	58,400
annual change in % (real, gross)	0.9	-5.0	-0.7	0.9	2.8	3.5	3.2	3.5
Consumer prices, % p.a.	2.0	1.9	1.6	1.9	1.3	2.3	2.8	3.0
Producer prices in industry, % p.a.	1.1	-0.4	-0.5	-2.1	-2.4	-1.0	1.0	0.0
General governm.budget, nat.def., % of GDP								
Revenues	24.8	24.2	26.3	26.4	27.4	28.0	28.5	29.0
Expenditures	28.2	29.2	31.5	30.5	29.5	30.0	31.0	31.0
Deficit (-) / surplus (+)	-3.4	-5.0	-5.2	-4.1	-2.1	-2.0	-2.5	-2.0
Public debt, nat.def., % of GDP	62.1	65.6	70.1	72.7	71.6	69.0	67.0	65.0
Stock of loans of non-fin.private sector, % p.a	2.3	-1.2	2.4	-2.6	-2.5	.	.	.
Non-performing loans (NPL), in %, Dec	22.8	23.2	22.8	18.2	18.2	.	.	.
Central bank policy rate, % p.a., end of period <sup>4)</sup>	4.00	3.00	2.25	1.75	1.25	1.5	2.0	2.5
Current account, EUR mn	-978	-1,049	-1,287	-1,105	-1,254	-1,400	-1,400	-1,400
Current account, % of GDP	-10.2	-10.9	-12.9	-10.8	-11.5	-11.9	-11.3	-10.7
Exports of goods, BOP, EUR mn	876	1,051	932	771	609	620	640	670
annual change in %	26.3	19.9	-11.3	-17.2	-21.0	2.0	2.5	4.0
Imports of goods, BOP, EUR mn	3,102	3,030	3,147	3,070	3,438	3,700	3,800	3,900
annual change in %	-3.2	-2.3	3.9	-2.5	12.0	7.0	3.0	3.5
Exports of services, BOP, EUR mn	1,900	1,715	1,881	2,028	2,434	2,500	2,600	2,700
annual change in %	-5.8	-9.7	9.7	7.8	20.0	3.6	4.2	4.5
Imports of services, BOP, EUR mn	1,460	1,489	1,558	1,503	1,639	1,700	1,800	1,900
annual change in %	-9.5	2.0	4.6	-3.5	9.0	6.0	3.0	3.5
FDI liabilities, EUR mn	713	945	869	890	860	.	.	.
FDI assets, EUR mn	65	22	58	72	60	.	.	.
Gross reserves of NB excl. gold, EUR mn	1,909	1,971	2,142	2,831	2,889	.	.	.
Gross external debt, EUR mn	5,513	6,368	6,927	7,686	7,860	8,300	8,600	8,900
Gross external debt, % of GDP	57.5	66.2	69.5	74.9	72.0	71	70	68
Average exchange rate ALL/EUR	139.04	140.26	139.97	139.74	137.36	137	138	138

1) Preliminary and wiiw estimates. - 2) Based on UN-FAO data, from 2014 wiiw estimate. - 3) From 2014 based on data of General Directorate of Taxation, business statistics used before. - 4) One-week repo rate.

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