

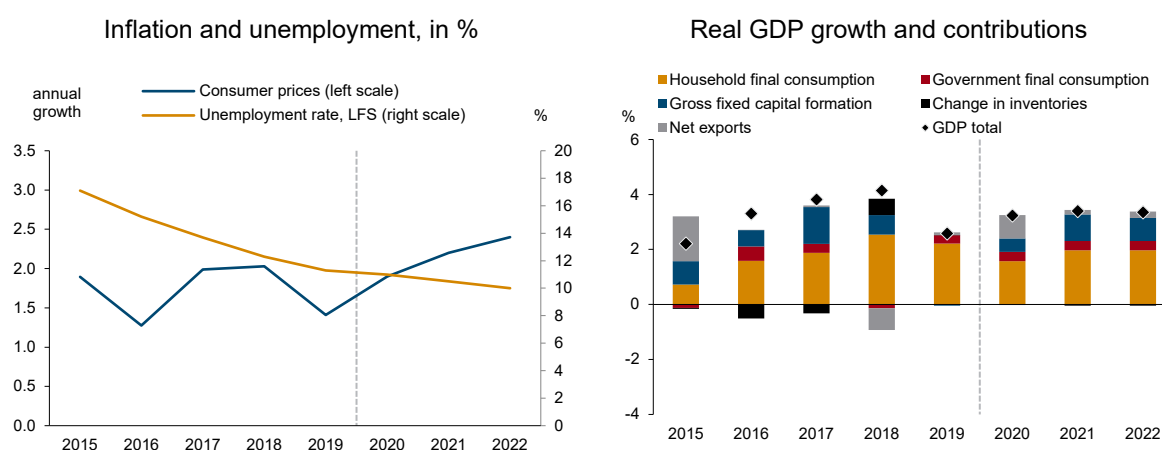


ALBANIA: Moderate growth and rising downside risks

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Growth is expected to remain moderate in the coming two years. Private consumption on the demand side and services on the production side will continue to support growth, but at a slower pace. A devastating earthquake hit Albania on 26 November 2019. The conference of donors initiated by France raised EUR 1.15 billion, which will likely spur growth in the short term. Since the EU enlargement process is being reformed, the accession process for Albania is likely to get stricter and more rigorous.

Figure 6.1 / Albania: Main macroeconomic indicators



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

A devastating earthquake hit Albania on 26 November 2019. In all, 51 people lost their lives and thousands were injured; thousands of buildings were damaged and the estimated cost of reconstruction is put at around EUR 1 billion. The areas worst hit by the earthquake were Durres and Tirana, where more than 50% of the Albanian economy is concentrated.³⁴ On the initiative of France, a conference of donors was organised in Brussels on 17 February 2020. The response of the international community has been very supportive, and EUR 1.15 billion were raised through donations, grants and soft loans. This fund will certainly help to mitigate the worst impacts of the earthquake, and through reconstruction works it will spur growth and employment, at least for the next two years.

Growth is expected to remain moderate in the coming two years. Tourism buttressed the economy for the third quarter of 2019, but overall growth in 2019 was weaker than in 2018. During the third quarter of 2019, real GDP growth recovered to 3.8%, following 2.56% and 2.48%, respectively, in the

³⁴ In 2017, the estimated GDP of Tirana and Durres at current prices corresponded to 52% of the country's total economic activity. Source: Regional Account Statistics, INSTAT, Albania. <http://www.instat.gov.al/en/themes/economy-and-finance/regional-accounts-in-albania/>

first and second quarters of 2019, year on year. Nevertheless, overall growth for 2019 is estimated at 2.6%, owing to the weakening of the economy in the last quarter of 2019. The growth drivers were private household consumption and services, bolstered by tourism, which is expected to continue to support growth in the coming years. Gross fixed capital formation receded into the negative zone, which is certainly linked to the completion of the Trans Adriatic Pipeline construction works on the Albanian side. In production terms, the first half of the year was particularly bad for industry – especially given the low electricity production. Consequently, high imports of electricity had an adverse impact on economic growth.

Private consumption will continue to support growth, but at a slower pace. Labour market indicators suggest that there have been further improvements. Employment has been rising: more than 41,000 new jobs were recorded between Q3 2018 and Q3 2019. The overall unemployment rate receded to 11.4% in Q3 2019, and youth unemployment (age 15-29) dropped to 21.4%. Gross monthly wages had risen by 4% as of Q3 2019, year on year. But this is not enough. A glance at the demographic trends indicates that emigration is continuing unabated, while the number of births and the fertility rate are declining rapidly. Another indicator – consumer confidence – has also been moving downward, declining further during Q4 2019 to stand at below its long-term average level; this trend is driven by less-optimistic expectations about the economy and the financial situation of households.

There is growing sentiment in favour of emigration across all age groups and across the skills spectrum. The 2019 Balkan Barometer Public Opinion Survey pointed out a strong sentiment in favour of outward mobility: 50% of Albanians would like to move abroad – more than any other country of the Western Balkans, where an average 39% would be willing to emigrate. Furthermore, among those willing to leave 10% already had concrete plans for emigration; another 22% were actively seeking to leave the country; and a further 66% were still thinking of doing so.³⁵ This last group of passive aspirant emigrants hints at a rising sense of discontent among Albanians. This sentiment is certainly driven by less advantageous economic prospects, but it also stems from a mistrust of public institutions. According to the 2019 Balkan Barometer Public Opinion Survey, this mistrust is shared by more than 70% of Albanians.

Fiscal consolidation has been meagre and slower than expected. Public debt to GDP is estimated to have contracted by only 0.5 percentage points in 2019 from the level of 67.9% recorded in 2018. Last year closed with a poor performance in terms of tax collection, which had risen by only 3% by November 2019, year on year. In contrast, overall expenditure rose by more than 5% over the same period. Capital expenditure declined further and absorbed only 15% of overall expenditure, hinting at weak investments through 2019. The effect of the earthquake will be felt through 2020 and in the next two years of general government budget planning. There will be a budget shift of EUR 200 million, to be allocated to post-earthquake reconstruction works. Half of this will fall within the 2020 general government budget, and the rest will be disbursed from the 2021 and 2022 budgets. Such shifts will certainly affect fiscal consolidation, and an annual budget deficit of 2% of GDP is estimated for 2020-2022.

The banking sector continued to turn in a satisfactory performance. In 2019, the level of non-performing loans dropped further to 8.4%, compared to the 18% recorded five years ago. The banking system is well capitalised and profitable. The demand for credit recovered in 2019, in contrast to the

³⁵ Source: 2019 Balkan Barometer Public Opinion Survey, page 67. <https://www.rcc.int/pubs/89/balkan-barometer-2019-public-opinion-survey>

anaemic growth of the previous five years. The stock of loans to households had risen by 7% by November 2019, year on year, whereas credit to the non-financial private sector had risen by almost 5% over the same period. Nevertheless, the impact that the earthquake might have on demand for loans will depend on the response of the banking sector to ongoing credits and facilities that might be offered to those affected by the earthquake. In 2019, the inflation rate remained low – at 1.4% – and a long way from its target of 3%. Monetary policy continues to stay loose and the central bank has kept the interest rate unchanged in 2020, at 1%.

The current account deficit deteriorated further and will stall at a similar level as in 2019. For the first three quarters of 2019, year on year, the goods trade deficit widened, as exports shrank by 7%, while imports rose by 5%. Goods exports were especially badly hit by the negative trade balance on electricity, in huge contrast to the trade surplus of the previous year. The export of services and a very good tourist season, especially during the summer, provided a strong impetus to economic activity and generated a service trade balance in surplus. Despite the Trans Adriatic Pipeline on the Albanian side being almost completed in 2019, FDI inflows into the country stayed close to the 2018 level, and are estimated to have been EUR 1 billion in 2019. Italy more than doubled its FDI inflows into Albania: it contributed 12% of all FDI inflows for the first three quarters of 2019. FDI inflows through the Netherlands also intensified. Such investments might be attributed to Shell Upstream operating in Albania and the Norwegian company Statkraft, with headquarters in the Netherlands. The latter has constructed two hydropower plants on the Devoll River – an investment worth EUR 500 billion – which by the end of 2020 are expected to boost energy production in Albania by 18%. This company is also planning to build a floating solar power plant on the Banja hydropower reservoir. Austria is another country whose FDI inflows into Albania are rising. Chinese FDI is insignificant, despite a Chinese presence in strategic sectors such as transport and the oil extraction industry. The sectors that attracted most of the FDI inflows in 2019 were mining and quarrying, construction, and information and communication.

Important investment infrastructure projects have been announced, but the timetable and financing sources are still uncertain. After the failure of negotiations with a Turkish consortium, the government opened the Vlora Airport investment project up to new bids in December 2019. The rather optimistic scenario envisages the start of construction work by mid-2020, assuming that negotiations with the winning company are successful. Another important infrastructure project that is supposed to be launched in the first half of 2020 is the Llogara tunnel in southern Albania – an investment that would further boost tourism in the south of the country.

Under the proposed new EU enlargement rules, the EU accession process for Albania will get stricter and more rigorous. In February 2020 the European Commission presented a proposal for revising the EU enlargement methodology. The actual EU accession criteria will not change, but the process will. The EU Commission proposal envisages a more important role for fundamental reforms and their rigorous monitoring, in particular reforms aimed at the rule of law and anti-corruption. It is proposed that the 35 chapters of the acquis should be clustered into six thematic groups; interim benchmarks will be set and each cluster should be closed once the benchmarks have been met. In combination with the revised accession rules, the EU Commission also proposes an economic and investment development plan, to be authorised by the European Council. The revision of the EU enlargement process was initially proposed by France. The outlook for EU accession talks with Albania is expected to become clearer at the next European Council meeting, in March 2020, and at the summit

meeting of European Union and Western Balkan countries, to be held in Zagreb in May 2020 under the patronage of the Croatian EU presidency. Because the process is getting stricter, EU support should be stronger and more concrete, taking account of the frailty of institutions in the country. In this respect, there has been some progress: reforms of the judicial system and of election law have been advancing, albeit slowly. Part of the new electoral reform under discussion includes electronic voting and votes for emigrants. Still, the political context and discourse remain dire. The head of state, Ilir Meta, has accused the current government of engaging in a putsch, arguing that the Albanian constitution has been violated by the control of the judicial system exercised by Prime Minister Edi Rama.

In a nutshell, the devastating earthquake has had a marked and adverse effect on the economy and the psyche of Albanians. The financial aid from international partners and a credible reconstruction plan will provide positive impetus to growth in the short run. Over the forecast period, growth is expected to be moderate, driven mainly by private consumption on the demand side and by services on the production side. Because of rising downside risks, we have revised our forecast downwards: we expect the economy to grow at slightly above 3.4% in the period 2020-2022.

Table 6.1 / Albania: Selected economic indicators

	2015	2016	2017	2018	2019 ¹⁾	2020	2021	2022
						Forecast		
Population, th pers., average	2,881	2,876	2,873	2,866	2,870	2,865	2,865	2,860
Gross domestic product, ALL bn, nom.	1,434	1,472	1,551	1,631	1,700	1,800	1,900	2,000
annual change in % (real)	2.2	3.3	3.8	4.1	2.6	3.2	3.4	3.4
GDP/capita (EUR at PPP)	8,800	8,600	9,100	9,600	10,000	.	.	.
Consumption of households, ALL bn, nom.	1,147	1,180	1,226	1,287	1,340	.	.	.
annual change in % (real)	0.9	2.0	2.3	3.2	2.8	2.0	2.5	2.5
Gross fixed capital form., ALL bn, nom.	350	359	381	394	390	.	.	.
annual change in % (real)	3.5	2.4	5.5	2.9	-0.2	2.0	4.0	3.5
Gross industrial production								
annual change in % (real)	-2.1	-18.0	-0.6	18.5	-2.0	3.0	4.0	1.0
Gross agricultural production ²⁾								
annual change in % (real)	2.6	3.3	4.0	5.0	5.0	.	.	.
Construction output total								
annual change in % (real)	19.4	5.1	19.6	5.6	6.0	.	.	.
Employed persons, LFS, th	1,087	1,157	1,195	1,231	1,275	1,285	1,290	1,295
annual change in %	4.8	6.5	3.3	3.0	3.6	0.8	0.4	0.4
Unemployed persons, LFS, th	224	208	190	173	160	160	150	140
Unemployment rate, LFS, in %	17.1	15.2	13.7	12.3	11.3	11.0	10.5	10.0
Reg. unemployment rate, in %, eop	12.9	8.8	7.2	5.4	5.6	.	.	.
Average monthly gross wages, ALL	47,900	47,522	48,967	50,589	53,600	56,000	58,400	61,600
annual change in % (real, gross)	3.2	-2.0	1.0	1.3	4.5	3.0	2.0	3.0
Consumer prices, % p.a.	1.9	1.3	2.0	2.0	1.4	1.9	2.2	2.4
Producer prices in industry, % p.a.	-2.1	-1.4	2.6	1.7	-1.0	-0.5	1.0	0.4
General governm.budget, nat.def., % of GDP								
Revenues	26.4	27.6	27.7	27.6	27.1	28.0	28.0	28.0
Expenditures	30.5	29.5	29.7	29.2	28.9	30.0	30.0	29.0
Deficit (-) / surplus (+)	-4.1	-1.8	-2.0	-1.6	-1.9	-2.0	-2.0	-1.0
General gov.gross debt, nat.def., % of GDP	72.7	72.4	70.1	67.9	67.5	67.0	66.0	65.0
Stock of loans of non-fin.private sector, % p.a.	-2.6	0.2	0.7	-3.6	6.6	.	.	.
Non-performing loans (NPL), in %, eop	18.2	18.3	13.2	11.1	8.4	.	.	.
Central bank policy rate, % p.a., eop ³⁾	1.75	1.25	1.25	1.00	1.00	1.0	1.0	1.0
Current account, EUR mn	-884	-812	-866	-866	-1,050	-1,020	-1,070	-1,060
Current account, % of GDP	-8.6	-7.6	-7.5	-6.8	-7.6	-6.9	-6.8	-6.4
Exports of goods, BOP, EUR mn	771	714	797	986	917	980	1,030	1,080
annual change in %	-17.2	-7.4	11.7	23.7	-7.0	6.0	5.0	5.0
Imports of goods, BOP, EUR mn	3,070	3,317	3,621	3,857	4,050	4,170	4,320	4,410
annual change in %	-2.5	8.0	9.2	6.5	5.0	3.0	3.5	2.0
Exports of services, BOP, EUR mn	2,028	2,396	2,856	3,073	3,320	3,550	3,690	3,810
annual change in %	7.8	18.1	19.2	7.6	8.0	7.0	4.0	3.2
Imports of services, BOP, EUR mn	1,503	1,599	1,774	1,962	2,100	2,180	2,270	2,340
annual change in %	-3.5	6.4	11.0	10.6	7.0	4.0	4.0	3.0
FDI liabilities, EUR mn	890	943	900	1,020	1,050	850	.	.
FDI assets, EUR mn	72	6	-94	-3	-50	-30	.	.
Gross reserves of NB excl. gold, EUR mn	2,831	2,889	2,941	3,342	3,240	.	.	.
Gross external debt, EUR mn	7,634	7,882	7,949	8,353	8,300	8,300	8,800	8,600
Gross external debt, % of GDP	74.4	73.5	68.7	65.3	60.0	56.0	56.0	52.0
Average exchange rate ALL/EUR	139.74	137.36	134.15	127.59	123.01	122.0	121.5	121.5

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

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