

*Mario Holzner*

## **Albania: SAA signed**

Besides Croatia and Macedonia, Albania has become the third West Balkan country that has signed a Stabilization and Association Agreement (SAA) with the European Union. This ties Albania closer to the EU and opens a concrete accession perspective for a country that has in recent years progressed a lot in terms of economic development as well as in the sphere of democracy and civil rights. Governments have changed peacefully. The economy has been growing strongly at an average annual rate of 6%, driven by a vibrant construction sector which is fuelled by high remittances from Albania's diaspora. This is notwithstanding a kick-off from very low levels, which is probably one explanation why foreign direct investment has not yet surged in heavily. However, this might change now too.

The SAA foresees free trade between Albania and the EU within the next ten years. In fact the EU has liberalized unilaterally already back in 2000, when it granted Autonomous Trade Concessions to five Western Balkan countries. These concessions allow for tariff-free exports to the EU for almost all product groups. Thus in the years to come Albania is obliged to abolish its remaining trade barriers vis-à-vis the EU. Tariffs on 83% of finished products imported from the EU will be zeroed immediately. Tariffs for the remaining products will be lowered stepwise until 2011. Under the SAA Albania is also committed to align its legislation to the common European standards. Closer cooperation in justice and security issues is envisaged as well.

However, apart from the recent success in EU integration, there are still many stumbling blocks on Albania's path to prosperity. Missing and malfunctioning infrastructure appears to be one of the most crucial. Poor power grids, missing connection to international power networks, mismanagement in the state electricity company KESH, extreme dependence on national hydro-power generation, together with a drought at the end of 2005 caused heavy electricity shortages and dampened 2005 real GDP growth below the mid-term average rate of 6% to some 5.3%. This will also have its effects in 2006, where economic growth is expected at 5.2%. Moreover, first-quarter sales data indicates a drop in construction sector sales. This is allegedly due to a lack of construction permits.

It seems though that it is finally understood that the improvement of the electricity sector is of utmost importance to further dynamic growth of the economy. Various short- and long-term actions have been initiated, on both the demand and supply side. Starting this summer, the energy regulatory entity will increase electricity prices for households by 11%; still, the government has promised to subsidize families in need. At the same time businesses will have to pay 22% lower rates than before. This should help to reduce energy demand without hurting productive economic units. Another important issue will be

to reduce technical network losses (i.e. mostly electricity theft). Also, the government plans to privatize the power utility KESH at the beginning of 2007, starting with the sale of the company's distribution arm. On the supply side, a Swiss-based international consortium including US General Electrics plans to build a USD 1.9 billion thermal power plant and re-gasification terminal. This would make the country less dependent on hydro power. The completion of the project is scheduled for 2009. By then the country should not only be able to satisfy domestic demand but also export energy. The deal is expected to be passed by parliament this summer.

Currently Albania is heavily importing energy products. According to recent customs statistics, first-quarter 2006 imports of the category 'minerals, fuels, electricity' doubled as compared to the first quarter of the previous year. This category now accounts for one sixth of total imports. In euro terms, total imports of goods increased by 30% in the first quarter. Exports were growing too, but only by 20%. Thus, for the whole year 2006 we may again expect a widening trade deficit, though probably less pronounced than what the first-quarter results would suggest – unless domestic hydro power generation is again struck by a drought.

With improvements in the electricity sector and more FDI starting to trickle in, economic growth prospects for 2007 appear favourable. A rebound close to the 6% GDP trend growth rate can be expected. Unlike other countries in the Balkans, Albania is not being threatened by unsustainably high external debt. Debt is well below 20% of GDP. Fiscal and monetary policy being harmonized, the inflation pressure is low. In the first quarter of 2006 consumer prices rose by only 1.4%, which is 0.8 percentage points less than in the first quarter of last year. However, given the expected increase in energy costs, an inflation rate above 2% is likely for the whole of the year 2006. The government was able to improve tax collection and reduce expenditures, which resulted in a budget surplus of lek 10.3 billion in the first quarter of 2006. The main improvements occurred in excise, profit and income tax collection. The general government budget deficit by the end of 2006 can be expected at or below 3% of GDP. This will also be due to a significant wage increase in the public sector planned for the second half of 2006. The Albanian Central Bank continues to pursue a de facto peg of the Albanian lek to the euro. In fact the currency is even appreciating slightly in nominal terms. The increase in the money supply is mainly due to further credit expansion to the economy.

Overall, the economic outlook for Albania is favourable. The persistently high growth rates could even be accelerated: On the one hand, the government could use additional funds from improved tax collection to finance public investment in ailing energy and transport infrastructure; the planned supplementary budget for high-priority capital spending for the second half of 2006 is a move in the right direction. On the other hand, a more flexible exchange rate policy of the Albanian Central Bank could improve the competitiveness of the Albanian export industry.

Table AL

## Albania: Selected economic indicators

	2001	2002	2003	2004	2005 <sup>1)</sup>	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., end of period	3084.1	3102.8	3119.5	3135.0	3150.0	.	.	.	.
Gross domestic product, ALL mn, nom.	590282	631338	714049	775864	835000	.	.	910000	980000
annual change in % (real)	7.1	4.3	5.7	6.7	5.3	.	.	5.2	5.8
GDP/capita (EUR at exchange rate)	1495	1542	1669	1945	2140	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	3850	4010	4250	4640	4860	.	.	.	.
Gross agricultural production									
annual change in % (real) <sup>2)</sup>	2.2	2.1	3.0	3.1	3	.	.	3.5	3.5
Construction output total									
annual change in % (real) <sup>2)</sup>	49.3	8.7	11.3	10.6	9.0	.	.	10	11
Consumption of households, ALL mn, nom.	422651	455952	508108	.	.	.	.	.	.
in % of GDP	71.6	72.2	71.2	.	.	.	.	.	.
Gross fixed capital form., ALL mn, nom.	151156	143914	160210	.	.	.	.	.	.
in % of GDP	25.6	22.8	22.4	.	.	.	.	.	.
Reg. employment total, th pers., end of period <sup>4)</sup>	920.6	920.1	926.2	931.0	932.0	931	.	.	.
annual change in %	.	0.0	0.7	0.5	0.1	1.3	.	.	.
Reg. unemployed, th pers., end of period	180.5	172.4	163.0	157.0	155.0	156	.	.	.
Reg. unemployment rate in %, end of period	16.4	15.8	15.0	14.4	14.2	14.3	.	14	14
Average gross monthly wages, ALL <sup>3)</sup>	17218	19659	21325	24393	26808	26091	.	.	.
annual change in % (real, gross) <sup>3)</sup>	11.6	8.1	6.1	11.2	11.0	.	.	.	.
Consumer prices, % p.a.	3.1	5.2	2.2	3.0	2.4	2.2	1.4	2.5	2
Producer prices in manufacturing ind., % p.a.	-7.2	5.1	1.8	12.2	.	.	0.7	.	.
General governm.budget, nat.def., % GDP									
Revenues	24.7	24.5	23.4	23.8	24.5	.	.	.	.
Expenditures	31.5	30.5	28.2	28.7	27.8	.	.	.	.
Deficit (-) / surplus (+), % GDP	-6.9	-6.0	-4.8	-4.9	-3.4	.	.	-3	-3
Public debt in % of GDP	41.0	41.4	40.3	38.5	38.1	.	.	.	.
Refinancing base rate, % p.a., end of period	7.0	8.5	6.5	5.3	5.0	4.0	5.0	.	.
Current account, EUR mn <sup>4)</sup>	-243.5	-433.1	-360.7	-286.2	-453.7	-52.3	.	-500	-520
Current account in % of GDP	-5.3	-9.1	-6.9	-4.7	-6.7	.	.	-6.8	-6.5
Gross reserves of BoA incl. gold, EUR mn <sup>5)</sup>	863.5	813.0	812.7	1005.2	1201.6	1045.5	1221.5	.	.
Gross external debt, EUR mn	1355.0	1135.0	1118.0	1165.0	1200.0	.	.	.	.
FDI inflow, EUR mn <sup>4)</sup>	231.5	151.4	157.8	269.4	209.3	43.3	.	.	.
Exports of goods, BOP, EUR mn <sup>4)</sup>	340.2	350.5	397.9	485.6	530.2	121.5	144.4 <sup>6)</sup>	600	700
annual growth rate in %	22.6	3.0	13.5	22.0	9.2	11.3	19.2 <sup>6)</sup>	13	17
Imports of goods, BOP, EUR mn <sup>4)</sup>	1486.5	1574.5	1578.3	1762.3	2006.9	398.1	540.4 <sup>6)</sup>	2400	2500
annual growth rate in %	27.4	5.9	0.2	11.7	13.9	9.5	29.6 <sup>6)</sup>	20	4
Exports of services, BOP, EUR mn <sup>4)</sup>	595.3	618.4	638.1	807.5	930.4	196.5	.	1050	1150
annual growth rate in %	22.6	3.9	3.2	26.6	15.2	11.3	.	13	10
Imports of services, BOP, EUR mn <sup>4)</sup>	494.8	623.7	709.8	848.0	1099.5	225.9	.	1200	1300
annual growth rate in %	5.9	26.1	13.8	19.5	29.7	35.5	.	9	8
Average exchange rate ALL/USD	143.5	140.2	121.9	102.8	99.9	96.7	102.2	.	.
Average exchange rate ALL/EUR (ECU)	128.5	132.4	137.5	127.7	124.2	126.7	123.0	123	122
Purchasing power parity ALL/USD, wiiw <sup>7)</sup>	43.6	43.9	46.1	45.7	45.5	.	.	.	.
Purchasing power parity ALL/EUR, wiiw <sup>7)</sup>	49.9	50.9	54.0	53.5	54.7	.	.	.	.

Note: ALL: ISO code for the Albanian lek.

1) Preliminary. - 2) According to gross value added. - 3) Public sector only. - 4) Until 2003 calculated from USD. - 5) Refer to total foreign assets of Bank of Albania. - 6) Based of customs statistics. - 7) wiiw estimates incorporating data of World Penn Tables.

Source: wiiw Database incorporating national statistics; wiiw forecasts.