

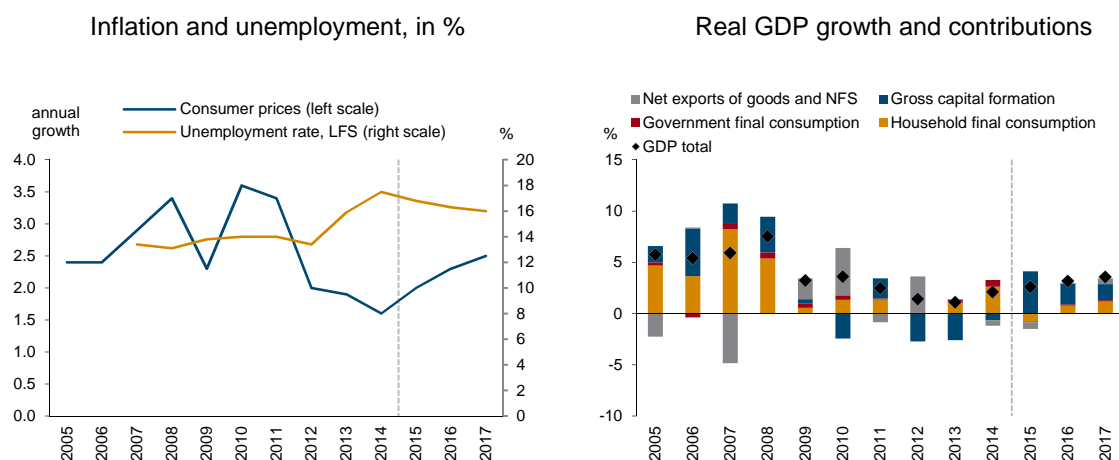


ALBANIA: The challenge of stepping out of the shadow

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A credit market lacking vigour, a contraction of exports and meagre fiscal performance are restraining economic growth. Differently, an outstanding performance in terms of gross fixed capital formation, foreign direct investments and remittances, which are flourishing again, is expected to boost the economy by 2.6% in 2015. Growth above 3% is expected in 2016-2017. The rigorous campaign against the shadow economy and consequently a more efficient tax collection can open up more space for public investments.

Figure 39 / Albania: Main macroeconomic indicators



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

The local elections in June induced a shift of power from the right- to the left-wing coalition, which guarantees to the latter exercising its power at the local and the central levels. Leaking of confidential information of a report produced for internal use from the OSCE (Organisation for Security and Co-operation in Europe) classifying a number of parliament members suspected of criminal activities in their past has heated the political debate. Nonetheless, putting the finger on the problem has pushed the government to take further steps towards a reform of the justice system and decriminalisation law. The new decriminalisation law will define the procedures and certain requirements (e.g. prohibition to become a civil servant if in the past the person has been condemned by a local or international court) to be adopted for regulating employment in the public sector.

The Albanian economy has been running below its potential. In the first half of 2015, growth accelerated by 2.53%, on a year-on-year basis. Household consumption contracted by 2.3% compared with the first half of 2014. In spite of the decline, the dynamics of household consumption indicate that in nominal terms its level stays above the average of the last two years by 1.6%. A strong increase of 16% was recorded for gross fixed capital formation. Accordingly, construction output expanded by 20%, but industrial production was cut by 4.3%. The stock of public debt increased by 3% but with respect to GDP stagnated at 70% of GDP. Until August 2015, public revenues increased by 5.1% nominally in lek terms. By contrast, expenditures went down by 1.1% year-on-year. Revenues collected from VAT represent the highest source, but still the performance was 1.7% lower on a year-on-year basis. Capital expenditures rose by 6.4% whereas expenditures on wages and social insurance contributions hardly changed, increasing only by 0.6% year-on-year. The weak performance of tax collection and the customs office has prompted the Albanian government to undertake an intensive campaign against the underground economy.

Starting from 1 September 2015, the key milestone of the governmental programme for the coming 300 days is to reduce the shadow economy, which according to an EBRD and World Bank survey in 2013 is estimated at around 36% of GDP during 1996-2012.⁴⁵ So far the strategy adopted by the government is focusing on the use of punitive measures, such as high lump sums of fines to be applied in case of non-conformity (e.g. in case of exercising an unregistered activity, lack of possession of fiscal devices, non-provision of fiscal statements, non-maintenance of inventories, etc.). By the end of 2014, the number of enterprises active in Albania was 112,537. 90% of them are small businesses with one to four employees (69% have only 1 employee). The EBRD and WB survey in 2013 revealed that 40% of the companies claim to compete with businesses that operate informally. According to the Ministry of Finance, some first tangible results of the campaign during August and September have been the registration of more than 19,000 new businesses (but no official figures are reported on the number of closed activities/businesses) and the inclusion of 60,000 new employees in the social security system. Especially for small businesses avoiding their bankruptcy (due to high penalties) and the shift into unemployment (particularly of those self-employed), the application of deterrence measures in complementary with diverse incentive tools – the so-called carrot and stick approach – would be required. Such an approach would not only motivate voluntary tax compliance but would further strengthen the fiscal consolidation in the medium and long run. Furthermore, more efficient tax collection can create more room for raising public expenditures and consequently contribute to public investments.

The signals from the credit market are mixed. Until August 2015, total loans shrank by 1.2% year-on-year. Loans to businesses dropped by 2.7% whereas loans to households rose by 2.9%. In the same period, total new loans went down by 1.1%. In particular, new loans to businesses fell by 12% while loans to households picked up by 15%. As a consequence, the contribution by households to the loan portfolio rose by 8 pp, from 11% to 19% year-on-year, whereas the share of loans to businesses contracted from 89% to 81%. According to the Bank Lending Survey of the Albanian Central Bank, expectations are pessimistic as concerns the demand for credit by businesses but optimistic as concerns households.

Non-performing loans (NPLs), in particular, continue to be a drag on credit growth; these are relatively high, at 20%, in spite of a 3.34 pp decline in the first half of 2015, year-on-year. The cut was achieved

⁴⁵ <http://ebrd-beeps.com/countries/albania/>

mainly through loan restructuring, abatement from the balance sheet and other new measures introduced by the Albanian Central Bank. The Annual Supervision Report 2014 of the Albanian Central Bank indicated that by the end of 2014, NPLs amounted to ALL 25 billion for households and ALL 110 billion for businesses, totalling approximately EUR 970 million or 10% of GDP. The Central Bank in collaboration with the government has been preparing a number of new measures, including bailouts (e.g. involvement of the government in buying part of the debt of a company facing difficulties in liquidity). The target is to reduce the share of NPLs to 16% by 2017. The key interest rate was slightly lowered to 1.75% recently, while inflation moved up from 1.3% in January to 2.2% in September 2015 (still below the target of 3%). The economic sentiment indicator for the second quarter of 2015 improved by 5.1 pp, standing above the long-term average by 4.8 pp. That increase is attributed to improvements in the industrial, services and consumer confidence indicators, as opposed to retail trade and construction, which lost confidence.

In the first eight months of 2015, the trade deficit expanded further, by 2.2%, on account of exports falling more strongly than imports, by 3.7% and 0.7% year-on-year, respectively. Disaggregating by commodity groups, not only exports of 'Minerals, fuels and electricity' – which used to have the largest share in exports – declined by 7 pp (from a share of 36% to 29%) but also imports of the same group fell by 6 pp (down from a 17% to a 11% share), a reflection of the oil price reductions in international markets and a higher demand for energy that is domestically satisfied. The expectations of the international oil price staying at the current level might contribute to a stable level of exports for this group. Particularly, owing to an increase in net domestic production of electricity by almost 60%, Albania turned from a net importer into a net exporter with gross exports six times higher and gross imports halved. The commodity group 'Machinery, equipment and spare parts' has a share in exports of only 5% but registered the highest increase in exports, by 42%. Similarly, imports of this category rose by 14% and reached a share of 20%, suggesting a further increase in private investments and gross fixed capital formation. The EU continues to remain the main trading partner; half of exports are directed to Italy, and two thirds of exports to this country are related to the garment industry. This is a sector constantly on the rise, already overtaking the role of 'Minerals, fuels and electricity' in foreign trade and showing the highest share in exports at 35.4%. The current account reflects a further expansion of export services, characterised by an increase in services exports by 7.4% and a decline in imports by 11.5%. Exports in services performed particularly well in tourism, which registering an increase of 9% in the first half of 2015, year-on-year. Foreign direct investment returned to moving upwards, recording an astonishing increase of 32% in the first half of 2015, year-on-year. This increasing trend is expected to be preserved for the rest of the year since the Trans Adriatic Pipeline project has been launched in June and the construction of hydropower plants at the Devoll river by the Norwegian company Statkraft is duly progressing. Other sources of secondary income such as remittances experienced an upswing, growing again by 18% in the first half of 2015, compared to a 1% increase in 2014, on a year-on-year basis. The reasons for that renewed increase may have been the uncertainties that characterised Greece in the first half of 2015 – the country that hosts the majority of Albanian migrants – and the related risk of the Greek drachma returning into circulation. The picking-up of remittances might not slow down considering that the two main destination countries of Albanian migrants, Italy and Greece, have returned to positive growth (according to the European Commission's Economic Forecasts, expectations are for growth rates of 0.6% and 0.5% in 2015 and 1.4% and 2.9% in 2016, respectively).

In the second quarter of 2015, labour market indicators announced positive outcomes as concerns overall employment but negative ones with respect to the youth unemployment rate. The employment

rate went up to 45.8%, 1.4 pp higher than in the second quarter of 2014, while the unemployment rate fell to 17%, 0.2 pp lower than in the same period a year earlier. Nonetheless, youth unemployment remains a stumbling block for the Albanian labour market, signing a further increase to 34.2%, 0.7 pp more than a year earlier. The new migration wave of Albanians in the form of asylum seekers, at a record level of 44,600 during January-August 2015, may have contributed to bringing down the level of unemployment. But still it is a signal of malfunctioning of the labour market and a lack of working opportunities, especially among the youth. The inclusion of Albania in the list of safe countries has reduced the chances of recent asylum seekers to gain this status. Germany, which hosts more than 84% of the 44,600 new asylum seekers, has committed to returning them to Albania, thus there is the risk of the pool of unemployed rising again.

In view of shrinking exports, a weak credit market and meagre fiscal performance, economic growth is expected to be spurred by gross fixed capital formation, foreign direct investment and the restructuring of exports from energy-oriented towards services and other goods. The improvement in consumer sentiment, the increase in household credit for consumption and the recovering of remittances hint at a further expected boost to household consumption against the decline in the first half of 2015. Further fiscal consolidation can be achieved if deterrence measures are applied in complementary with incentives that motivate tax compliance. In the medium term, the economy is expected to move to growth rates of above 3%; for the coming years our forecasts have been adjusted upwards to 2.6% in 2015, 3.2% in 2016 and 3.6% in 2017.

Table 6 / Albania: Selected economic indicators

	2011	2012	2013	2014 ¹⁾	2014 January-June	2015	2015 Forecast	2016 Forecast	2017
Population, th pers., average ²⁾	2,905	2,900	2,897	2,894	.	.	2,896	2,898	2,900
Gross domestic product, ALL bn, nom. ³⁾	1,301	1,333	1,351	1,394	681	699	1,460	1,540	1,640
annual change in % (real)	2.5	1.4	1.1	2.2	0.4	2.6	2.6	3.2	3.6
GDP/capita (EUR at exchange rate) ³⁾	3,200	3,300	3,300	3,400	.	.	3,600	3,800	4,000
GDP/capita (EUR at PPP) ³⁾	7,300	7,300	7,400	7,800	.	.	.	.	.
Consumption of households, ALL bn, nom. ³⁾	1,012	1,032	1,052	1,104	566.9	558.5	.	.	.
annual change in % (real)	1.8	0.1	1.4	3.4	4.5	-2.3	-1.0	1.0	1.5
Gross fixed capital form., ALL bn, nom. ³⁾	382	353	350	347	142.9	168.9	.	.	.
annual change in % (real)	5.9	-7.9	-2.1	-2.2	-13.8	15.9	14.5	7.0	5.5
Gross industrial production									
annual change in % (real)	19.0	15.7	28.3	1.6	1.8	-4.3	-5.0	2.0	3.0
Gross agricultural production									
annual change in % (real)	4.8	5.7	-3.4	2.0	.	.	.	.	.
Construction output total									
annual change in % (real)	-1.1	-11.4	-13.0	5.0	-8.2	20.1	.	.	.
Employed persons, LFS, th ⁴⁾	1,160	1,140	1,024	1,037	1,004	1,075	1,078	1,090	1,100
annual change in %	.	-1.8	-10.2	1.3	-5.1	7.0	3.9	1.1	0.9
Unemployed persons, LFS, th ⁴⁾	189	176	194	220	216	219	218	212	208
Unemployment rate, LFS, in % ⁴⁾	14.0	13.4	15.9	17.5	17.7	17.0	16.8	16.3	16.0
Reg. unemployment rate, in %, end of period ²⁾	13.1	12.8	13.5	13.0	13.5	13.8	13.5	13.0	12.0
Average monthly gross wages, ALL	36,482	37,534	36,332	36,997	.	.	38,100	39,500	41,100
annual change in % (real, gross)	1.5	0.8	-5.0	0.2	.	.	1.0	1.3	1.5
Consumer prices, % p.a.	3.4	2.0	1.9	1.6	1.8	2.2	2.0	2.3	2.5
Producer prices in industry, % p.a.	2.6	1.1	-0.4	-0.5	-0.4	-1.5	-1.2	-0.4	-0.2
General government budget, nat.def., % of GDP									
Revenues	25.4	24.8	24.2	26.3	25.7	26.2	26.4	26.5	27.0
Expenditures	28.9	28.2	29.2	31.5	29.0	28.0	29.0	29.0	29.0
Deficit (-) / surplus (+)	-3.5	-3.4	-5.0	-5.2	-3.3	-1.8	-2.6	-2.5	-2.0
Public debt, nat.def., % of GDP	59.4	62.1	70.9	70.2	71.0	70.0	70.0	69.0	67.0
Central bank policy rate, % p.a., end of period ⁵⁾	4.75	4.00	3.00	2.25	2.50	2.00	1.8	1.8	1.8
Current account, EUR mn ⁶⁾	-1,225	-978	-1,049	-1,287	-609	-423	-1,000	-1,100	-1,000
Current account, % of GDP ⁶⁾	-13.2	-10.2	-10.9	-12.9	-12.5	-8.5	-10.0	-10.0	-9.0
Exports of goods, BOP, EUR mn ⁶⁾	1,406	1,526	1,051	932	481	422	900	920	950
annual change in %	20.0	8.5	.	-11.3	-2.8	-12.2	-3.4	2.2	3.3
Imports of goods, BOP, EUR mn ⁶⁾	3,647	3,525	3,030	3,147	1,456	1,399	3,100	3,150	3,200
annual change in %	12.1	-3.4	.	3.9	7.2	-3.9	-1.5	1.6	1.6
Exports of services, BOP, EUR mn ⁶⁾	1,747	1,673	1,715	1,881	809	869	1,900	1,930	2,000
annual change in %	-0.2	-4.2	.	9.7	21.9	7.4	1.0	1.6	3.6
Imports of services, BOP, EUR mn ⁶⁾	1,612	1,460	1,489	1,558	715	633	1,500	1,520	1,550
annual change in %	6.2	-9.5	.	4.6	11.8	-11.5	-3.7	1.3	2.0
FDI liabilities (inflow), EUR mn ⁶⁾	630	666	945	869	367	483	950	.	.
FDI assets (outflow), EUR mn ⁶⁾	21	18	22	58	21	15	90	.	.
Gross reserves of NB excl. gold, EUR mn	1,851	1,909	1,971	2,142	1,964	2,335	.	.	.
Gross external debt, EUR mn ⁶⁾	4,958	5,513	6,368	6,927	6,652	7,257	7,140	7,500	7,800
Gross external debt, % of GDP ⁶⁾	53.5	57.5	66.1	69.6	66.8	69.6	68.0	69.0	67.0
Average exchange rate ALL/EUR	140.33	139.04	140.26	139.97	140.21	140.43	140	141	141
Purchasing power parity ALL/EUR	61.56	62.65	62.85	61.86	.	.	.	.	.

1) Preliminary. - 2) According to census October 2011. - 3) According to ESA'10 (FISIM reallocated to industries etc). - 4) In 2011 survey done once a year, quarterly thereafter. 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.