

ALBANIA

Recent developments

Table 1 **2018**

Population, million	2.9
GDP, current US\$ billion	15.3
GDP per capita, current US\$	5319
International poverty rate (\$ 19) ^a	11
Lower middle-income poverty rate (\$3.2) ^a	7.7
Upper middle-income poverty rate (\$5.5) ^a	39.1
Gini index ^a	29.0
School enrollment, primary (% gross) ^b	109.8
Life expectancy at birth, years ^b	78.3

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2012), 2011 PPPs.

(b) Most recent WDI value (2016).

Economic growth accelerated to 4.2 percent as favorable hydrological conditions supported energy production. Higher growth translated to job creation and a steady decline in unemployment. Contained spending and currency appreciation helped bring down the public debt, but off-balance risks including from PPPs are mounting. Growth is forecasted to moderate to 3.7 percent in 2019-2021. Growth will depend on the pace of reform implementation, including in the area of business environment, infrastructure and closing the labor force skills gap.

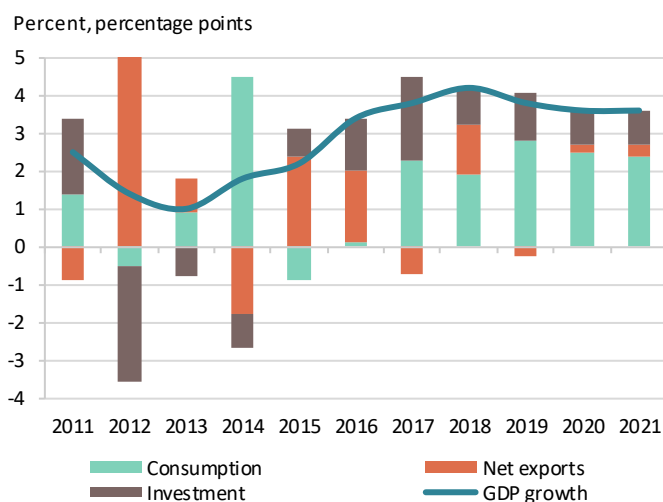
Growth sped up in 2018 and is estimated to have reached 4.2 percent. Favorable hydrological conditions more than doubled energy production in the first nine months of the year, making energy account for nearly half of GDP growth during the period. Meanwhile, a broad-based economic recovery supported job creation in all sectors. On the expenditure side, household consumption accounted for 1.9 percentage points of GDP growth, while strong exports of energy and services boosted the contribution of net exports to 1.3 percentage points of GDP growth. Public infrastructure investment increased, contributing 1 percentage point to GDP growth.

Economic growth was accompanied by job creation and increased labor force participation. Employment growth was stronger in industry (by 3.9 percent y-o-y) and services (2.5 percent). The average unemployment rate declined by 1.5 p.p. to 12.3 percent in 2018. Similarly, youth unemployment dropped by 2.8 percentage points in 2018 with respect to the same period in 2017. A stronger job market encouraged job search and labor force participation in the context of shrinking working-age population. Overall, labor force participation reached 59.4 percent, but a large gap between male and female participation remains. Despite the recovering labor market, poverty remains high, as about 35 percent of Albanians still live with under 5.5 dollars per day per capita (in 2011 PPP).

While fiscal consolidation alleviated debt-financing risks, risks from public off-balance and contingent liabilities still need attention. Fiscal consolidation continued in 2018 in the form of contained spending. Revenues declined to 27.2 percent of GDP from 27.7 in 2017, partially due to the clearance of VAT refund arrears and the currency-appreciation effect on the VAT of imported goods. Current spending declined from 25.3 percent of GDP in 2017 to 24.3 percent of GDP in 2018, as wage bill and social benefit growth were contained. Meanwhile, capital spending increased to 4.7 percent of GDP with new infrastructure projects implemented through rapid increase in PPPs. Though they alleviate short-term funding constraints, PPPs increase contingent liabilities and restrain the fiscal space for new policies. While the stock of public debt and arrears declined to 68.6 percent of GDP (mostly due to exchange rate appreciation), budgetary arrears totaled around 1.5 percent of GDP in 2018. The government successfully placed a 7-year, €500 million Eurobond at 3.50 percent in October 2018, which was used to buy back a portion of higher-priced debt due in 2020.

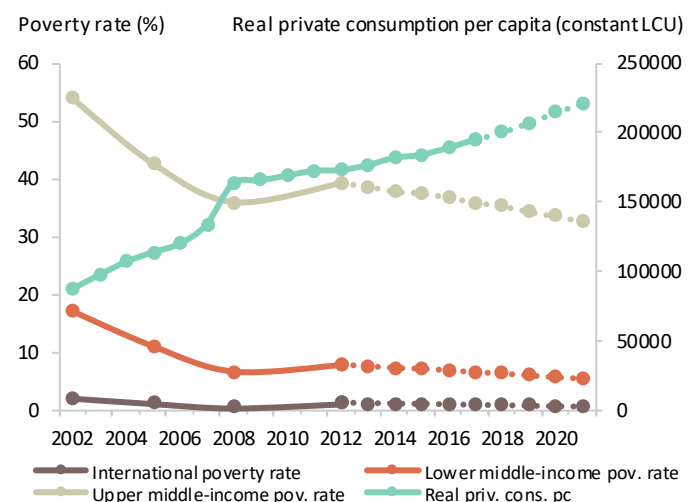
Weak inflationary pressure prompted an easing of the monetary policy stance, in line with the price stability framework. Headline inflation remains below the central bank's target of 3 percent and reached 2 percent at the end of 2018. Inflation dynamics during the year reflect the food price dynamics, with additional pass-through effects of the appreciation towards the second part of the year. The policy rate was lowered to a new low of

FIGURE 1 Albania / Real GDP growth and contributions to real GDP growth



Sources: Instat and World Bank.

FIGURE 2 Albania / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

1 percent. While the currency appreciated by 6 percent against the euro over 2018, temporary forex interventions were used to prevent excessive fluctuations in the exchange market, caused by large one-off conversions. Despite monetary easing and a reduction in non-performing loans, private sector credit contracted by 2 percent (y-o-y) as of end-December 2018. Strong export performance and lower import growth improved external balances. The current account deficit narrowed to 6.3 percent of GDP in 2018, from 7.5 percent in 2017. Foreign Direct Investment (FDI) grew by 6.4 percent and now fully covers the current account deficit. Foreign reserves' coverage stood at 6½ months of imports at the end of 2018, mitigating risks posed by high foreign debt at 62.1 percent of GDP.

Outlook

Albanian economic growth is expected to fall to 3.8 percent in 2019, and to level off around 3.6 percent on average over the medium term, as energy production returns to normal levels. Growth will

continue to be led by domestic demand, with consumption expected to grow at around 3.4 percent annually, followed by fixed capital formation growth (3 percent per year). Net exports are also expected to support growth, albeit to a lesser extent, as imports expand in line with domestic consumption. As in the past, poverty is expected to react weakly to economic growth, falling steadily but slowly to reach about one-third of the population by 2020.

The fiscal deficit is likely to increase over 2019-2021 as the government speeds up the clearance of arrears and implements several fiscal incentives including VAT exemptions, a reduction in the income tax and an increase of the high-income tax bracket for the personal income tax. On the expenditure side, current expenditures including public sector wages, social transfers and operations and maintenance are expected to remain stable, while the government capital spending is projected to increase to 4.8-4.9 percent of GDP. Additional projects are expected to be financed by PPPs, some of them already signed in 2018 or in the pipeline; these will increase contingent liabilities.

The medium-term growth projections crucially depend on the pace of structural reforms and progress with EU accession. Albania needs to continue its path towards fiscal consolidation and mitigate risks from off-balance activities. Reform in the energy sector is needed to safeguard the economy and the budget from unexpected financing needs. Improving business climate addressing infrastructure gaps and labor force skill gaps is necessary to reap the early benefits of EU accession and make Albania attractive for FDI.

Risks and challenges

Over the medium-term, risks are significant. Albania is vulnerable to a slowdown in Europe, particularly among its main trading partners. A slowdown in these countries could spill over through lower exports, remittances, and FDI. In addition, the expected tightening of monetary policy in external markets will increase financing costs for Albania in the context of a high public debt, which is increasingly being refinanced through foreign sources.

TABLE 2 Albania / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	3.4	3.8	4.2	3.8	3.6	3.6
Private Consumption	2.6	3.1	2.6	3.6	3.6	3.2
Government Consumption	4.7	2.5	1.1	6.3	-0.7	4.1
Gross Fixed Capital Investment	3.2	6.8	3.3	4.1	3.0	3.1
Exports, Goods and Services	11.4	8.5	5.3	5.8	5.8	5.9
Imports, Goods and Services	6.9	8.2	2.5	5.3	4.8	4.7
Real GDP growth, at constant factor prices	3.2	3.8	4.3	3.8	3.6	3.6
Agriculture	1.7	0.6	1.4	2.1	2.2	2.2
Industry	2.1	6.8	8.3	4.2	4.4	4.4
Services	4.8	4.2	3.9	4.6	3.9	4.0
Inflation (Consumer Price Index)	1.3	2.0	2.1	2.5	2.9	3.0
Current Account Balance (% of GDP)	-7.6	-7.5	-6.3	-6.4	-6.1	-5.7
Net Foreign Direct Investment (% of GDP)	8.7	8.6	7.8	6.8	6.8	6.9
Fiscal Balance (% of GDP)	-2.3	-2.0	-1.8	-2.1	-2.0	-2.1
Debt (% of GDP)	73.2	71.8	68.6	65.8	64.7	62.4
Primary Balance (% of GDP)	0.2	0.0	0.4	0.0	0.1	0.0
International poverty rate (\$1.9 in 2011 PPP)^{a,b}	0.9	0.8	0.8	0.7	0.7	0.6
Lower middle-income poverty rate (\$3.2 in 2011 PPP)^{a,b}	6.8	6.5	6.2	5.9	5.6	5.4
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	36.7	35.9	35.2	34.4	33.5	32.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2002-LSMS, 2008-LSMS, and 2012-LSMS. Actual data: 2012. Nowcast: 2013-2018. Forecast are from 2019 to 2021.

(b) Projection using average elasticity (2002-2008) with pass-through = 1 based on private consumption per capita in constant LCU.