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EU CANDIDATE AND PRE-ACCESSION COUNTRIES ECONOMIC QUARTERLY *CCEQ*

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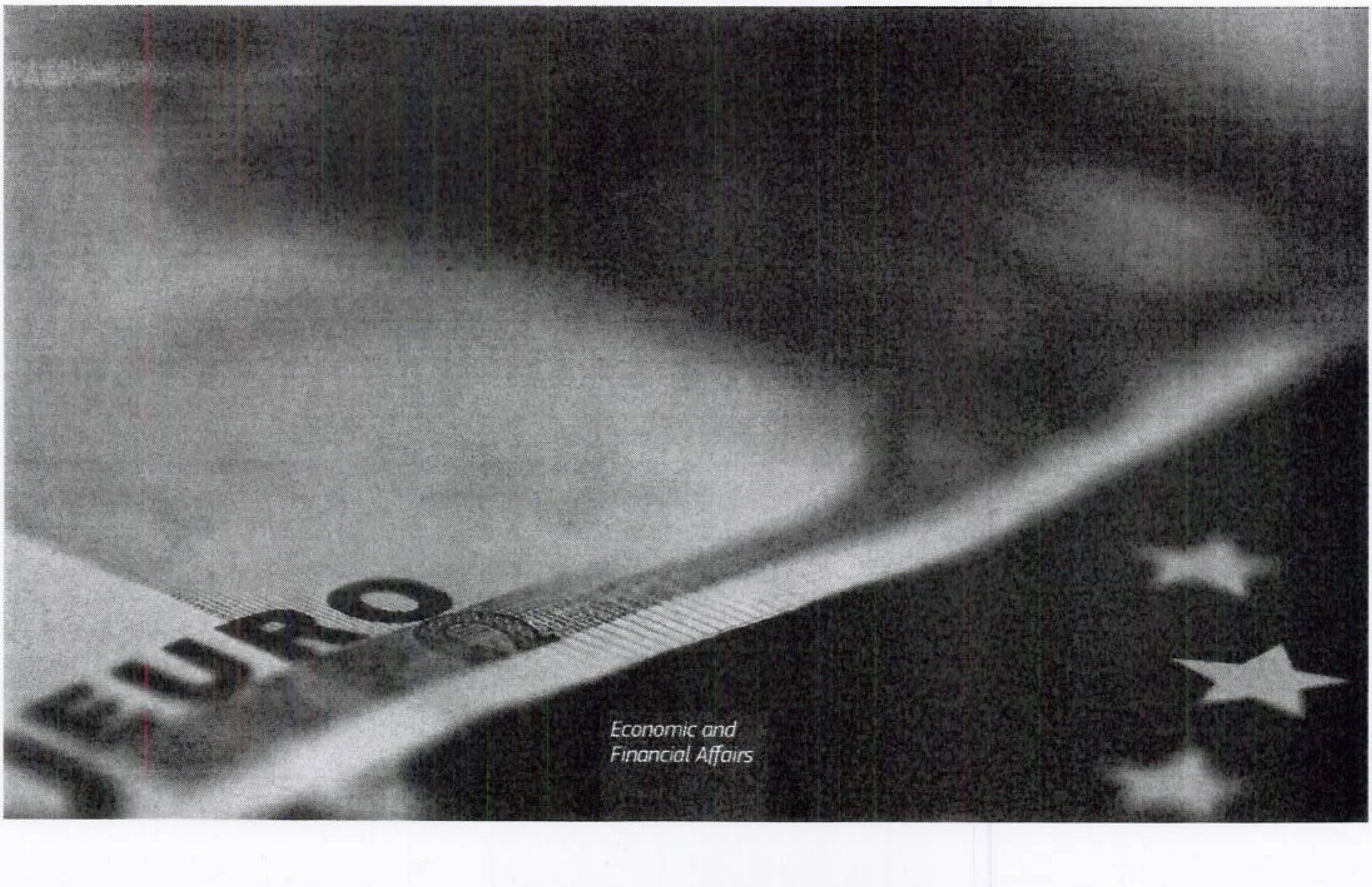

CANDIDATE AND PRE-ACCESSION COUNTRIES' ECONOMIC QUARTERLY

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ALBANIA

Key developments

The Council of the European Union welcomed in December the adoption by Albania of the relevant key judicial, public administration and parliamentary reform measures as well as the successful conduct of the parliamentary elections in June. The Council also commended the action taken by Albania in the fight against corruption and organised crime. The decision on granting Albania candidate status, recommended by the Commission in its 2013 Progress Report, was however postponed to June 2014, subject to further progress by Albania and endorsement by the European Council.

In December, Standard & Poor's lowered Albania's long-term sovereign credit rating to 'B' from 'B+' following a significant increase in public debt. The outlook is negative due to heightened roll-over risks.

Deteriorating public finances led the authorities to request an economic assistance programme from the IMF. In December, staff level agreement was reached on a 36-month Extended Fund Facility (EFF) with a proposed total assistance of EUR 300 million. The programme, due to be approved by IMF Management and the Executive Board in early spring, aims to support economic recovery and macroeconomic stability over the medium term, in particular by reversing the upward trend in public debt and clearing the government's arrears. The World Bank is expected to provide further financial assistance.

Real sector

The continuing sluggishness of private demand, exacerbated by tight lending conditions and falling remittances, weighed heavily on third quarter growth, offsetting the fading fiscal stimulus. Real GDP contracted by 2.3% in annual terms, as only agriculture registered growth (+2.9%) while construction (-10%), and all services branches experienced a slump (transport -4.2%; trade, hotels and restaurants -3.4%; post and communication -1.2%; other services -0.6%). Industry was also down 4.6% year-on-year, as the extracting industry's sharply decelerating but still positive growth (6.3% compared with rates of 20-30% in previous quarters) was outweighed by a decline in manufacturing (-7.1%).

The statistical office also revised previous quarterly estimates: first quarter annual growth was raised to 1.9% from 1.7%, and the second quarter outcome was improved to 1.7% from 1.1%.

Labour market

Despite the economic slump, total employment continued its uptick in the third quarter (+0.5% year-on-year), according to administrative data. This was exclusively due to more non-agricultural private sector jobs (+5.8%), whereas employment in agriculture (by far the largest sector in terms of employment) and the public sector contracted slightly on an annual basis. As the labour force also expanded, the registered unemployment rate remained flat at 12.8%. However, continuing weaknesses in labour market statistics call for some caution in interpreting these figures.

External sector

In the third quarter, the current account deficit shrunk by over 20% year-on-year, thus continuing the trend toward a narrowing shortfall that was interrupted in the previous three months. In the four quarters to September, the current account deficit fell to 9.8% of GDP from 12.3% in the corresponding period a year earlier. The third quarter outcome is the result of a 19% annual improvement in the merchandise trade deficit on the back of an enduring export boom (+13.2% year-on-year) as well as falling imports of goods (-5.4%). This was partly offset by the services balance that, although positive following two consecutive quarters in the red, was some 60% below its performance in the same period of the previous year, mainly due to weaker tourism. Net current transfers continued to shrink on an annual basis (-11.8%) thanks to a 15.6% drop in remittances, although the pace of contraction eased somewhat from the second quarter.

Net FDI inflows continued to be strong at EUR 259 million in the third quarter, increasing by some 65% year-on-year. The overall balance of payments was positive; as a result, official reserves increased by EUR 34 million and covered 7.1 months of merchandise imports.

Following a 4.4% annual increase, the stock of gross external debt stood at EUR 5.47 billion in the third quarter, or some 56% of projected full-year GDP. Around 43% of it consists of government long-term borrowing.

Monetary developments

The rate of annual consumer price inflation decelerated further to 1.5% in the third quarter from 2.2% in the previous three months, undershooting the lower limit of the central bank target range of 2-4%. Unprocessed food continued to account for the bulk of inflation in the third quarter, but its contribution was lower than in the previous three months thanks to increased domestic production. A stable exchange rate and global prices dampened processed food inflation. Housing and non-food consumer goods made negative contribution to the headline rate. Inflation continued to hover below 2% in October to December.

In the context of low inflation and a weak economy, the Bank of Albania (BoA) pursued its accommodative stance and cut the base interest rate in November and December by a total of 50 bps to a new historic low of 3%.

In the third and fourth quarter, the Albanian lek (ALL) depreciated against the euro in annual terms by 1.7% and 0.5%, respectively. The nominal effective exchange rate remained unchanged due to a weaker USD and increase in trade with China and Turkey.

Financial sector

The transmission of the monetary policy easing to the economy continued to be constrained by high risk premia applied by banks and low levels of crediting.

The average interest rate on new ALL loans came down to 9.36% in November from 10.21% a year earlier, lagging behind the much more pronounced downtrend in 12-month ALL deposit rates (from 5.23% to 2.65%).

The level of non-performing loans (NPLs) remained very high at 24.3% in the third quarter, constituting one of the main factors behind continuing tight lending standards. On a positive note, for the first time since their steep increase started in 2008, NPLs decreased slightly from the previous quarter, which might signal a turning point.

Reflecting both supply and demand factors, outstanding credit to the economy shrank by 1.3% year-on-year in the third quarter, and the rate of decrease accelerated in October (-2.2%) and November (-2.4%).

The capital adequacy ratio of the banking sector as a whole rose to 17.8% in the third quarter from 17.0% in the previous three months, staying comfortably above the BoA's minimum requirement of 12%. On the other hand, the sector's net income turned negative, mainly on account of high loan loss provisioning.

Fiscal developments

Large budgetary slippages, caused mainly by disappointing revenue from direct taxes, necessitated the adoption of a substantially revised 2013 budget in October. The amendment lowers total revenues by some 10.7% compared with the initial budget, leaving them more than 3% below even their 2012 level. Apart from personal income tax, revenues are lowered across the board, but the bulk of the shortfall comes from underperforming VAT (-13.7% compared with the initial budget) and excise taxes (-17.5%). Expenditures are cut by 1%, helped by lower than anticipated debt service costs. The full year deficit is expected to be 71% higher than planned; this, along with a downward revision of nominal GDP, would result in a budget shortfall of 6.2% of GDP, compared with initial plans of 3.5%. Based on the January-November figures, the actual fiscal outturn for the year might be slightly more favourable.

Receipts from the earlier privatisation of four hydro power plants are used to plug some 15% of the deficit, but the need for additional borrowing means that public debt (not including government arrears) climbed to 64.4% of GDP in the third quarter.

The 2014 budget, adopted by the Parliament on 28 December, expects total revenues to increase by 13.1% year-on-year, raising the revenue-to-GDP ratio to 26.3% from 23.8% in 2013. Increases in excise duties, the lifting of some VAT and excise exemptions in the hydrocarbon sector, and the hike in the corporate income tax rate from 10% to 15% (with a lower rate of 7.5% for small businesses) are expected to boost revenues, while a progressive personal income tax is forecast to yield less than the previous flat rate. Expenditures are projected to increase by 13.4% year-on-year as the clearance of a substantial part of arrears, amounting to 2.8% of GDP, is budgeted. The deficit is projected to widen to 6.6% while public debt is to climb to 73.6% of GDP in 2014.

TABLE

European Commission, ECFIN-D-1

ALBANIA

		2009	2010	2011	2012	2013	Q2 13	Q3 13	Q4 13	Oct 13	Nov 13	Dec 13
1 Real sector												
Industrial confidence [1.1]	Percent	-13.4	-5.8	-3.8	-10.2	:	-11.8	-10.2	:	N.A.	N.A.	N.A.
Industrial production [1.2]	Ann. % ch	-1.2	19.9	-10.2	16.6	:	58.2	:	:	N.A.	N.A.	N.A.
Gross domestic product [1.3]	Ann. % ch	3.3	3.8	3.1	1.6e	:	1.7	-2.3	:	N.A.	N.A.	N.A.
Private consumption [1.4]	Ann. % ch	6.2	5.7	7.2	8.0	:	:	:	:	N.A.	N.A.	N.A.
Gross fixed capital formation [1.5]	Ann. % ch	-2.3	-1.3	4.2	-4.7	:	:	:	:	N.A.	N.A.	N.A.
Construction index [1.6]	Ann. % ch	0.0	0.3	0.5	0.6	:	1.0	0.5	:	N.A.	N.A.	N.A.
Retail sales [1.7]	Ann. % ch	1.4	-1.2	-4.0	-0.7	:	6.4	2.9	:	:	:	:
2 Labour market												
Unemployment [2.1]	%	13.6	13.7	13.4	12.9	:	12.8	12.8	:	N.A.	N.A.	N.A.
Employment [2.2]	Ann. % ch	-5.9	-0.1	2.3	3.6	:	1.5	0.5	:	N.A.	N.A.	N.A.
Wages [2.3]	Ann. % ch	11.9	6.7	7.0	7.3	:	5.9	2.6	:	N.A.	N.A.	N.A.
3 External sector												
Exports of goods [3.1]	Ann. % ch	-11.8	62.5	22.3	7.5	:	17.6	15.0	:	:	:	:
Imports of goods [3.2]	Ann. % ch	-1.7	10.9	14.2	-4.3	:	-0.5	-3.7	:	:	:	:
Trade balance* [3.3]	% of GDP	-26.5	-23.5	-24.5	-20.6	:	-18.5	-17.5	:	N.A.	N.A.	N.A.
Exports goods and services [3.4]	% of GDP	29.1	32.9	34.5	32.8	:	33.6	33.7	:	N.A.	N.A.	N.A.
Imports goods and services [3.5]	% of GDP	53.6	53.7	57.6	51.5	:	51.3	51.3	:	N.A.	N.A.	N.A.
Current account balance* [3.6]	% of GDP	-15.3	-11.5	-13.0	-10.5	:	-10.3	-9.8	:	N.A.	N.A.	N.A.
Direct investment (FDI, net)* [3.7]	% of GDP	7.7	9.4	7.8	7.5	:	7.9	9.0	:	N.A.	N.A.	N.A.
International reserves [3.8]	mio EUR	1562.7	1823.1	1847.5	1907.6	:	1946.7	1985.5	:	1951.0	1947.8	:
Int. reserves / months Imp [3.9]	Ratio	6.1	6.7	6.1	6.5	:	6.8	7.1	:	:	:	:
4 Monetary developments												
CPI [4.1]	Ann. % ch	2.3	3.6	3.5	2.0	:	2.2	1.5	:	1.7	1.0	:
Producer prices [4.2]	Ann. % ch	-1.7	0.3	2.6	1.1	:	-0.5	0.0	:	:	:	:
Food prices [4.3]	Ann. % ch	4.9	4.8	4.8	2.4	:	5.3	3.6	:	3.5	2.1	:
M2 [4.4]	Ann. % ch	8.0	5.5	6.7	4.7	:	5.7	7.2	:	7.2	6.8	:
Exchange rate LEK/EUR [4.5]	Value	132.06	137.79	140.33	139.04	140.26	140.71	140.28	140.39	140.85	140.11	140.21
Nominal eff. exchange rate [4.6]	Index	:	:	:	:	:	:	:	:	:	:	:
5 Financial indicators												
Interest rate (3 months) [5.1]	% p.a.	6.23	5.76	5.46	5.16	:	4.75	3.71	:	3.43	3.41	:
Bond yield [5.2]	% p.a.	7.82	7.25	6.53	6.77	:	6.57	5.90	:	4.94	4.75	:
Stock markets [5.3]	Index	:	:	:	:	:	:	:	:	:	:	:
Credit growth [5.4]	Ann. % ch	20.5	8.6	11.7	7.4	:	0.7	-1.3	:	-2.2	-2.4	:
Deposit growth [5.5]	Ann. % ch	-0.1	15.5	14.5	9.4	:	4.7	2.4	:	1.7	2.3	:
Non performing loans [5.6]	% total	9.1	12.6	17.0	21.7	:	24.4	24.3	:	N.A.	N.A.	N.A.
6 Fiscal developments												
General government balance* [6.1]	% of GDP	-7.0	-3.1	-3.6	-3.4	:	-3.5	-4.3	:	-3.9	:	:
General government debt* [6.2]	% of GDP	59.5	58.5	60.3	61.5	:	64.3	64.4	:	N.A.	N.A.	N.A.

* Q figures refer to a 4 quarters moving average.

CHARTS

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