



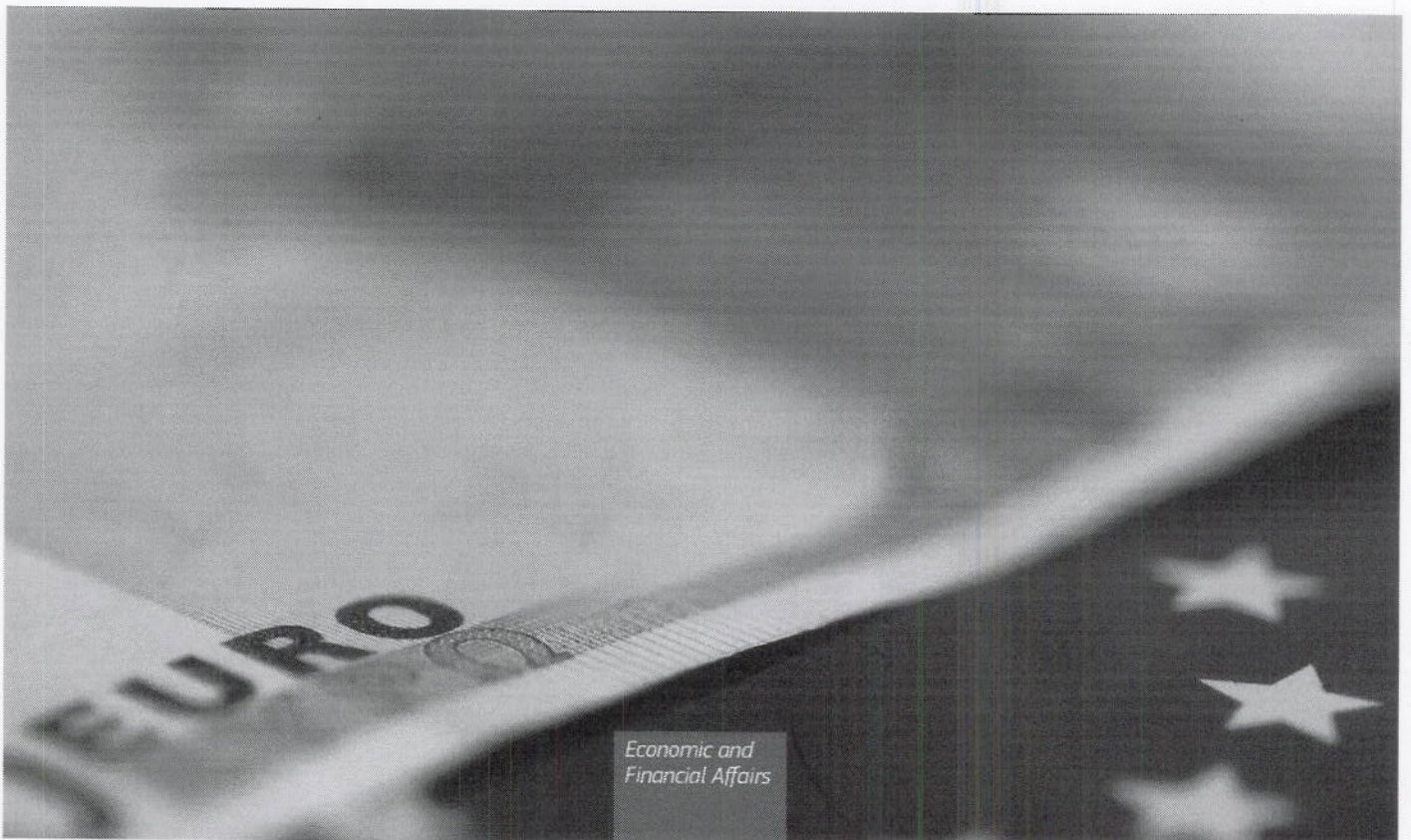
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Economic and  
Financial Affairs

## ALBANIA



### Key developments

The new Albanian government led by Prime Minister Edi Rama won the approval of parliament on 14 September, following the victory in the June election of the coalition formed by the Socialist Party and the Socialist Movement for Integration. The cabinet consists of 20 members, among them Shkëlqim Cani, the new minister of finance and a former central bank governor.

The government programme for 2013-2017 recognises the limitations of the development model based on a remittances-fuelled construction boom and raw material exports, and aims to shift the focus to new sources of growth by identifying manufacturing, energy, tourism and agribusiness as priority areas. The programme also pledges fiscal discipline and the payment of accumulated public arrears. It also envisages a progressive personal income tax and the establishment of an agricultural development bank.

In September, an IMF staff visit to Albania concluded that a gradual but sustained fiscal consolidation, starting with the 2014 budget, was necessary to address growing vulnerabilities linked with high public debt. The clearance of unpaid bills, whose amount was estimated at 4% of GDP, would facilitate the resumption of credit growth by helping lower nonperforming loans (NPLs) and support domestic demand.

### Real sector

Contrary to some expectations, annual real GDP growth decelerated in the second quarter to 1.1% from 1.7% in the previous three months. The long-ailing construction sector, boosted by public investment spending, staged an impressive turnaround and expanded by 16% year-on-year, after contracting in the preceding five quarters. The annual growth of industrial output decelerated from 14.8% in the first quarter to 1.3% in the second, partly as a result of receding base effects. Agriculture maintained a positive growth of 3%, higher than the 2.1% achieved in the previous quarter but well below the growth rates of 6-9.5% recorded in all four quarters of 2012. On the other hand, all services branches experienced a fall in output led by

transport (-5.3%), post and communication (-4.6%) and trade, hotels and restaurants (-2.8%).

Unlike in previous quarters, the public sector was the main driver of aggregate demand growth in April to June. Private domestic demand remained sluggish on the whole. Business confidence deteriorated in the second quarter across all sectors and private investment spending remained weak, as reflected in decreasing imports of machinery and equipment. On the other hand, consumer confidence improved for the second quarter in a row and the retail trade index was trending up. The contribution of external demand fell compared with the previous quarter.

### Labour market

Labour market conditions continued to show signs of improvement in the second quarter, according to administrative data. Total employment increased by 1.5 % year-on-year, driven exclusively by more non-agricultural private sector jobs (+7.6%). The registered unemployment rate remained flat at 12.8%. However, the quarterly labour force survey paints a different picture, with unemployment at 14.5% in the first quarter of 2013, up 1.1 pp year-on-year.

### External sector

The five-quarter long trend toward a narrowing current account deficit was broken in the April to June period, when the deficit increased by 17% year-on-year to EUR 295 million. Still, in the four quarters to June, the current account deficit fell to 10.4% of GDP from 12.6% in the corresponding period a year earlier. The second quarter outcome is the result of a still shrinking merchandise trade deficit (down 16.4% year-on-year on the back of a 16.5% surge in exports and a 1.6% fall in imports), which was offset by a worsening services account (mainly due to the tourism balance that turned negative) as well as a 28% annual decrease in net current transfers. This latter was caused by a steep 39% fall in remittances from migrant workers.

On a positive note, net FDI inflows recorded a 23% year-on-year increase in the second quarter (9.1% in January to June) and financed some 80% of the current account deficit in the same

period. Official reserves increased slightly and covered in June 4.7 months of imports.

By end-June, gross external debt stood at EUR 5.4 billion or some 54% of projected GDP. It grew 6.8% in annual terms, driven by increases in liabilities of banks and the government sector. Around 43% of the gross external debt stock is composed of government long-term borrowing.

### Monetary developments

The monetary aggregate M2 grew by 5.4% in the second quarter after a 3.3% increase recorded in each of the previous two quarters.

The rate of annual consumer price inflation decelerated to 2.2 % in the second quarter from 2.5% in the first three months, inching closer to the lower limit of the central bank target range. Higher prices for unprocessed food accounted for the bulk of inflation, whereas processed food and non-food items made a low contribution to the headline rate. Housing's contribution continued to be negative. Due to the moderate rise in seasonal food prices, annual inflation decelerated further to 1.6% in July and 1.2% in August.

In the context of weak demand-side pressures, the absence of supply-side shocks and subdued inflation expectations, monetary policy continued to be accommodative with the Bank of Albania (BoA) lowering the base interest rate by 25 bps to a new historic low of 3.5% at the end of July.

The foreign exchange market did not exert pressure on the domestic currency. In the second quarter the Albanian lek (ALL) depreciated slightly by 0.7% against the euro in quarterly terms.

### Financial sector

The transmission of the monetary policy stance to deposit rates and government security yields continued, but lending rates moved more slowly, partly as a result of high risk premia. The average rate on 12-month ALL deposits decreased to 3.83% in August from by 5.11% in May, while the downtrend in government yields intensified. The average interest rate on new ALL loans fluctuated without a clear direction until July, but the pronounced fall in August (to 9.44% from 10.93% the month before) might signal that a more tangible pass-through of monetary policy decisions to lending rates is within reach.

According to BoA's bank lending survey results, credit standards applied to businesses continued to tighten during the second quarter. However, lending standards for household loans eased further, and demand for both consumption and mortgage loans increased for the first time in two years.

Dragged down by weak lending to businesses, bank lending continued to slow down, registering an annual growth of only 0.7% in the second quarter (against 9.2% in the same period last year) and even turning negative in July (-0.9%) and August (-1.3%). Due to a larger fall in foreign currency lending, loans denominated in ALL made up 39% of the total loan stock in August, up from 36% a year earlier.

NPLs remained very high but their rate of increase eased: their share climbed to 24.4% in April to June from 24.0% in the previous quarter. The capital adequacy ratio rose to 17.0% in the second quarter from 16.8% in the previous three months, staying comfortably above the BoA's minimum requirement of 12%.

### Fiscal developments

Continuing weaknesses on the revenue side and pre-election spending increases left their mark on the budget. In the period January to August, total revenues were 7.2% below the initial plan and were even 3.8% lower than in the same period last year, on account of significantly underperforming revenues from direct taxes. Receipts from VAT, the single largest item on the revenue side, fell short of budget estimates by 12.3% (-8.2% compared with the same period last year), while excise tax revenues underperformed by 16.7% (-4.6% compared with last year), which points to still fragile domestic demand as well as inefficient tax collection.

By freezing public procurements and investments, the outgoing government took steps in July and August to rein in expenditure overruns following the pre-election spending spree that still weighs on cumulative figures. Total expenditure in January-August increased by 9.2% on the year, but was 3.3% lower than budgeted. Overall, the budget deficit in the first eight months surpassed last year's comparable figure by 129% and was 16% higher than planned. It already exceeded the full year target laid down in the initial budget by some 11%. Public debt climbed further and in the second quarter reached 64% of the projected full-year GDP.

## TABLE

European Commission, ECFIN-D-1

## ALBANIA

		2008	2009	2010	2011	2012	Q1 13	Q2 13	Q3 13	Jul 13	Aug 13	Sep 13
<b>1 Real sector</b>												
Industrial confidence <sup>1.1</sup>	Percent	0.4	-13.4	-5.8	-3.8	-10.2	-6.3	-11.7	:	N.A.	N.A.	N.A.
Industrial production <sup>1.2</sup>	Ann. % ch	8.7	10.6	18.6	-3.0	:	:	:	:	:	:	:
Gross domestic product <sup>1.3</sup>	Ann. % ch	7.5	3.3	3.8	3.1	1.6e	1.7	1.1	:	N.A.	N.A.	N.A.
Private consumption <sup>1.4</sup>	Ann. % ch	9.8	6.2	5.7	7.2	8.0	:	:	:	N.A.	N.A.	N.A.
Gross fixed capital formation <sup>1.5</sup>	Ann. % ch	12.9	-2.3	-1.3	4.2	-4.7	:	:	:	N.A.	N.A.	N.A.
Construction index <sup>1.6</sup>	Ann. % ch	1.2	0.0	0.3	0.5	0.6	1.2	1.0	:	N.A.	N.A.	N.A.
Retail sales <sup>1.7</sup>	Ann. % ch	23.7	-1.7	5.4	-3.7	-0.7	13.7	11.3	:	N.A.	N.A.	N.A.
<b>2 Labour market</b>												
Unemployment <sup>2.1</sup>	%	12.8	13.6	13.7	13.4	12.9	12.8	12.8	:	:	:	:
Employment <sup>2.2</sup>	Ann. % ch	2.9	-5.9	-0.1	2.3	3.6	1.3	1.5	:	:	:	:
Wages <sup>2.3</sup>	Ann. % ch	8.3	11.9	6.7	7.0	7.3	5.9	5.9	:	:	:	:
<b>3 External sector</b>												
Exports of goods <sup>3.1</sup>	Ann. % ch	15.7	-11.8	62.5	22.2	7.6	17.4	:	:	:	:	:
Imports of goods <sup>3.2</sup>	Ann. % ch	16.4	-1.9	11.3	14.6	-4.0	-10.8	:	:	:	:	:
Trade balance* <sup>3.3</sup>	% of GDP	-27.3	-26.4	-23.4	-24.4	-21.1	-19.5	-18.6	:	N.A.	N.A.	N.A.
Exports goods and services <sup>3.4</sup>	% of GDP	29.2	28.9	32.8	34.4	33.5	33.7	33.8	:	N.A.	N.A.	N.A.
Imports goods and services <sup>3.5</sup>	% of GDP	55.7	53.4	53.6	57.4	52.5	51.7	51.6	:	N.A.	N.A.	N.A.
Current account balance* <sup>3.6</sup>	% of GDP	-15.5	-15.3	-11.5	-13.0	-10.8	-10.0	-10.4	:	N.A.	N.A.	N.A.
Direct investment (FDI, net)* <sup>3.7</sup>	% of GDP	7.5	8.2	8.9	8.1	7.9	7.7	8.3	:	N.A.	N.A.	N.A.
International reserves <sup>3.8</sup>	mio EUR	1638.9	1567.4	1825.3	1852.4	1910.7	1900.3	1946.7	:	1943.3	1980.8	:
Int. reserves / months imp <sup>3.9</sup>	Ratio	5.5	5.8	6.3	5.7	6.1	6.3	:	:	:	:	:
<b>4 Monetary developments</b>												
CPI <sup>4.1</sup>	Ann. % ch	3.4	2.3	3.6	3.5	2.0	2.5	2.2	:	1.6	1.2	:
Producer prices <sup>4.2</sup>	Ann. % ch	6.5	-1.7	0.3	2.6	1.1	-1.2	-0.5	:	:	:	:
Food prices <sup>4.3</sup>	Ann. % ch	5.2	4.9	4.8	4.8	2.4	5.0	5.3	:	4.0	2.8	:
M2 <sup>4.4</sup>	Ann. % ch	7.4	8.7	4.5	6.6	4.9	3.3	5.4	:	6.3	6.6	:
Exchange rate LEK/EUR <sup>4.5</sup>	Value	122.39	131.82	137.48	140.07	138.83	139.50	140.53	140.11	140.11	139.84	140.39
Nominal eff. exchange rate <sup>4.6</sup>	Index	:	:	:	:	:	:	:	:	:	:	:
<b>5 Financial indicators</b>												
Interest rate (3 months) <sup>5.1</sup>	% p.a.	6.24	:	:	:	5.16	5.06	4.75	:	4.00	3.69	:
Bond yield <sup>5.2</sup>	% p.a.	8.43	9.24	8.55	8.04	8.23	7.43	6.87	5.77	6.50	5.90	4.90
Stock markets <sup>5.3</sup>	Index	:	:	:	:	:	:	:	:	:	:	:
Credit growth <sup>5.4</sup>	Ann. % ch	43.8	20.5	8.6	11.7	7.4	1.6	0.7	:	-0.9	-1.3	:
Deposit growth <sup>5.5</sup>	Ann. % ch	14.8	-0.1	15.5	14.5	9.4	6.0	4.8	:	2.4	1.9	:
Non performing loans <sup>5.6</sup>	% total	4.7	9.1	12.6	17.0	21.7	24.0	24.4	:	N.A.	N.A.	N.A.
<b>6 Fiscal developments</b>												
General government balance* <sup>6.1</sup>	% of GDP	-5.5	-7.0	-3.1	-3.6	-3.5	-1.1	-2.8	:	:	:	:
General government debt* <sup>6.2</sup>	% of GDP	54.8	59.5	58.5	60.3	62.9	63.2	64.1	:	N.A.	N.A.	N.A.

\* Q figures refer to a 4 quarters moving average.

# CHARTS



European Commission, ECFIN-D-1

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