Albanian Economic Performance – 2017 Annual Report

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PREFACE

The Economic Society of Albania and Epoka University are pleased to launch 2017 Annual Report on Albanian Economic Performance, which contains the latest national economic figures and statistics. The report reviews the Albania’s national economic milestones and most prominent achievements over the past period, while analyzing its present status and exploring its future prospects. We are confident that this report will serve as an important addition to the efforts of policy makers, businessmen, and other stakeholders to take the most informed and knowledge-driven decisions in order to contribute to the country’s overall prosperity and progress. Lastly, we want to thank all professors from Epoka University, Tirana University, University of Shkodra “Luigj Gurakuqi”, Aleksander Moisiu University of Durres, for their contribution to this report and for their valuable expertise.

Assoc. Prof. Dr. Eglantina Hysa
President of Economic Society of Albania
Head of Economics Department, Epoka University

1 INTRODUCTION

Dr. Timothy Hagen, Epoka University

This report seeks to assess the performance of the Albanian economy in 2017 and provide a record for future analysis. It is created by the Economic Society of Albania (ESA), which was established in 2014 and brings together an international community of economists to facilitate and promote research on global economics issues and those in the Albanian economy. This Albanian Economic Performance 2017 Annual Report furthers the latter goal. The report begins with a chapter by Prof. Dr. Güngör Turan providing a macroeconomic overview of the Albanian economy. Turan places these indicators in the context of the wider Western Balkans over the years 2007-2017 and finds that while the Albanian economy faces a number of challenges, it has sustained the second-highest average GDP real growth after Kosovo and the second-lowest average inflation rate after the Former Yugoslav Republic of Macedonia.

An overview and analysis of investments in Albania is presented by Dr. Erjola Sakti in chapter four. Sakti’s analysis finds that Albania’s fixed capital formation is two-thirds more heavily concentrated in construction than the European average. Sakti finds that energy, information technology, and financial and insurance activities constitute the largest foreign direct investment (FDI) sectors in Albania in 2017 and that the country of origin of the largest shard of FDI in Albania is Greece.

Albania’s foreign trade in 2017 is analyzed by Assoc. Prof. Dr. Soana Jaupllari in chapter five.
Jaupllari finds that trade is growing, particularly in travel services, likely reflecting the growth in tourism in Albania in 2017. Indeed, Jaupllari finds that despite a large, persistent real trade deficit, Albania’s sale of services has helped reduce that trade deficit in 2017.
An analysis of the financial and monetary sector of the Albanian economy in 2017 is provided by Dr. Juliana Imeraj in chapter six. Imeraj’s expansive overview of the sector includes observations that pension funds led the growth in the financial system in 2017, that the rate of non-performing loans has decreased, that the restructuring of banks announced in 2017 will reduce the number of commercial banks in Albania from 16 to 14, and that a new stock
market has been opened in Albania to specialize in the trading of government securities. In chapter seven, Dr. Arajan Tushaj provides an overview of public finance in Albania in 2017. Tushaj reports the increase in the national budget and budget deficit, the latter being financed largely by external debt. Tushaj further observes that local government funding experienced the highest rate of growth of budget categories in 2017. The concluding chapter highlights the key observations from this Albanian Economic Performance 2017 Annual Report.

2. MACROECONOMIC INDICATORS

Prof. Dr. Güngör Turan, Epoka University

Macroeconomics is the study of the economy as a whole, including growth in incomes, changes in prices, and the rate of unemployment. Macroeconomists attempt both to explain economic events and to devise policies to improve economic performance. Macroeconomic indicators characterize macroeconomic aspects of an economy and the performance of that country’s economy as a whole. The main macroeconomic indicators are real GDP growth, inflation, unemployment and interest rates.

(i) Real GDP measures changes in total output represents whether the economy is growing up or not, depending on efficiently using of resources. In the longer-term, it determines changes in living conditions, well-being of people in associate with quality of human development and capital. Private consumption and investment level, public spending and net export are dynamics behind economic growth.

(ii) Unemployment measures performance of the labor market. It explains that human resources are using efficiently or not? When the economy works efficiently, it means that output rises due to increases in private consumption and investment, government expenditures and net export, and therefore the economy is creating new employment and job opportunities, especially for unskilled and low skilled unemployed work force.

(iii) Inflation reflects cost of living in the country depending on changes in price levels. Achieving higher economic growth in associated with setting price stability are highly important in macroeconomics in the long-term.

(iv) And, another indicator, interest rate explains financial conditions and cost of borrowing, and determines total investment level in the economy depending on expected inflation and money supply.
During the last ten years, seen in Table 2.1, Albanian economy has been remained in stagnation and slowed-down due to falling in private consumption and investments, and factors behind global financial and economic crises. In the last ten years, average growth rate has been realized as 3.3 percentages which is not satisfactorily enough to stimulate private consumption and investments, and therefore not creating enough works and employment level in the labor market. Unemployment rose to its highest level in 2014 because of low investments, and therefore low demand in the labor market. Increases in price levels were lower due to slow-down and not adequate demand in the markets. Inflation remained under expected level which was average at 3 percentage targeted by BoA. Interest rates on loans were not satisfactorily low to motivate private consumption and investments, therefore to stimulate the economic recovery in the country.

Starting from 2014, the Albanian economy has entered the upturn due to increases in consumption and investments both in private and public, resulting slightly increases in annual output and economic growth. In 2017, output increased by 3.5 percent which was the highest level in the last years. The results of this economic recovery have been seen in the labor market. Unemployment decreased to 13.6 percentage in 2017, but still not satisfactorily low because of structural, organizational and institutional problems of the Albanian labor market such as:

(i)  Sectorial composition of employment based on traditional and seasonal works in agriculture consisting of unpaid family workers, mining, textile, construction, tourism, hotel and restaurant which requires low skilled work force to be employed, and therefore labor productivity remains low.

(ii) Skill mismatch in the labor market due to inefficiency working of National Employment Office which is not successful in meeting the needs of labor demand and skills of labor force.

(iii) Low number of schooling years and educational attainment in employment, particularly in industry, manufacturing industry which needs collaboration with FDI to be promoted and developed for employment of HEIs’ graduates to increase labor productivity in the economy.

(iv) Informality in employment is high, around 40 percent due to sectorial composition of employment.

Table 2.1: Main macroeconomic indicators in Albania

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth*</th>
<th>Inflation**</th>
<th>Unemployment</th>
<th>Interest***</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>6</td>
<td>3.1</td>
<td>13.5</td>
<td>14</td>
</tr>
<tr>
<td>2008</td>
<td>7.5</td>
<td>2.2</td>
<td>13.2</td>
<td>11</td>
</tr>
<tr>
<td>2009</td>
<td>3.4</td>
<td>3.5</td>
<td>13.8</td>
<td>12</td>
</tr>
<tr>
<td>2010</td>
<td>3.7</td>
<td>3.6</td>
<td>14.2</td>
<td>12</td>
</tr>
<tr>
<td>2011</td>
<td>2.5</td>
<td>1.7</td>
<td>14.3</td>
<td>11</td>
</tr>
<tr>
<td>2012</td>
<td>1.4</td>
<td>2.4</td>
<td>13.8</td>
<td>10</td>
</tr>
<tr>
<td>2013</td>
<td>1</td>
<td>1.9</td>
<td>16.4</td>
<td>8</td>
</tr>
<tr>
<td>2014</td>
<td>1.8</td>
<td>0.7</td>
<td>17.9</td>
<td>8</td>
</tr>
<tr>
<td>2015</td>
<td>2.2</td>
<td>2</td>
<td>17.5</td>
<td>8</td>
</tr>
<tr>
<td>2016</td>
<td>3.3</td>
<td>2.2</td>
<td>15.6</td>
<td>7</td>
</tr>
<tr>
<td>2017****</td>
<td>3.5</td>
<td>1.8</td>
<td>13.6</td>
<td>8</td>
</tr>
</tbody>
</table>

2007-17***** 3.3 2.3 14.9 10

2014-17***** 2.7 1.67 16.1 7.8

*Real GDP growth rate, percent.
**Yearly changes in prices, at the end of year, percent.
*** Average interest rates of loans in ALL, at the end of year, percent.
**** As of third quarter of 2017, percent.
*****Average, calculated by author.

During the last ten years, the macroeconomic performance of the Albanian economy based on real GDP growth, seen in Table 2, was relatively successful in the region comparing to a group of competitor economies with similar characteristics in the region, in Western Balkans. Real GDP grow rate average was higher than Serbia, Montenegro and Macedonia, and slightly lower than Kosovo. In the last two years, Albania has been diverged positively from the others realized the highest level of increases in annual output in the region.

**Table 2.2: Real GDP growth rates in Western Balkans, 2007-2017.**

<table>
<thead>
<tr>
<th>Years</th>
<th>Albania</th>
<th>Kosovo</th>
<th>Macedonia, FYR</th>
<th>Montenegro</th>
<th>Serbia</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>6</td>
<td>8.3</td>
<td>6.5</td>
<td>10.7</td>
<td>5.9</td>
</tr>
<tr>
<td>2008</td>
<td>7.5</td>
<td>4.5</td>
<td>5.5</td>
<td>6.9</td>
<td>5.4</td>
</tr>
<tr>
<td>2009</td>
<td>3.4</td>
<td>3.6</td>
<td>-0.4</td>
<td>-5.7</td>
<td>-3.1</td>
</tr>
<tr>
<td>2010</td>
<td>3.7</td>
<td>3.3</td>
<td>3.4</td>
<td>2.5</td>
<td>0.6</td>
</tr>
<tr>
<td>2011</td>
<td>2.5</td>
<td>4.4</td>
<td>2.3</td>
<td>3.2</td>
<td>1.4</td>
</tr>
<tr>
<td>2012</td>
<td>1.4</td>
<td>2.8</td>
<td>-0.5</td>
<td>-2.7</td>
<td>-1</td>
</tr>
<tr>
<td>2013</td>
<td>1.3</td>
<td>3.4</td>
<td>2.9</td>
<td>3.5</td>
<td>2.6</td>
</tr>
<tr>
<td>2014</td>
<td>1.8</td>
<td>1.2</td>
<td>3.6</td>
<td>1.8</td>
<td>-1.8</td>
</tr>
<tr>
<td>2015</td>
<td>2.2</td>
<td>4.1</td>
<td>3.8</td>
<td>3.4</td>
<td>0.8</td>
</tr>
<tr>
<td>2016</td>
<td>3.4</td>
<td>3.4</td>
<td>2.4</td>
<td>2.5</td>
<td>2.8</td>
</tr>
<tr>
<td>2017</td>
<td>3.7</td>
<td>3.5</td>
<td>2.5</td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

**Average** 3.35 3.86 2.91 2.65 1.51

Consequently, after five consecutive years of economic slow-down, the average annual growth rate in Albania, rose to 3.5 per cent in 2017. Furthermore, that rate remains over the average for a group of comparator economies with similar characteristics in the region in Western Balkans. This upward trend is forecast to continue due to increases in consumption and investment both in private and public, and therefore resulting decreases in unemployment, particularly rising from expected spillover effects of Trans Adriatic Pipeline both in output and employment. Therefore, growth in Albania is expected to strengthen further in 2018, 2019 and 2020.
3. INVESTMENTS

Dr. Erjola Barbullushi, University of Shkodra “Luigj Gurakuqi”

3.1 Local investments

Herein, is represented an overview of the most important sources of GDP in Albania according to economic activity during the first three quarters of 2017. The components that contribute more than others refer to products of agriculture, forestry and fishing, followed by wholesale, transportation and storage services, industry and public administration and defense services.

Figure 3.1. GDP current prices by Economic Activity (in million ALL).

Figure 3.2: Real Growth Rates comparison with corresponding quarter of previous year (chainlinked volume measures, reference 2010 year (2010=100).

Source: INSTAT

Although, from the first to the third quarter, some accounts are increased like manufactured products, wholesale, administrative services and public administration, other are decreased like products of agriculture etc., and industry, the net amount of GDP is slightly increased from GDP 335982 million ALL in the first quarter to 338988 million ALL in the third one. According to the last data reported, as of September 2017, Albania’s GDP real growth rate was 3.55% comparing to the third quarter 4.09% and 3.96% to the first one.
Gross fixed capital formation decreased to 90530 million ALL in the third quarter of 2017 from 97247 million ALL in the second quarter. Comparing the first quarter of 2016 to first quarter of 2017, there is reported a small increase, while the highest amount reached in the fourth quarter of 2016. Final consumption expenditures which consist on household consumption and government consumption reported the highest value at the end of second quarter of 2017, which was almost the same as of the second quarter of 2016.

Figure 3.3: Quarterly GDP by expenditure approach, chain-linked volume measures, reference 2010 year (2010=100).

3.2. Foreign Investments

Actually, Albania has attracted many foreign investors in different areas, industry, financial services, transportation, energy etc. The main areas that still play an important role even in 2017 are telecommunication and financial services, energy, mining etc. In the third quarter of 2017, an increase is reported in investments in energy and in mining industry.
4. FOREIGN TRADE

Assoc. Prof. Dr. Soana Jaupllari (Teka), University of Tirana

4.1. Trade and macroeconomic developments

Albanian economy continued to grow in the second half of 2017, even though at slower pace than in the first half of the year. According to INSTAT, gross domestic product grew by 3.5% in the third quarter, marking a slowdown compared to the average growth rate of 3.9% in the first quarter.

As underlined in the Bank of Albania Balance of Payment Report (Dec, 2017), from the aggregate demand perspective, economic growth was mainly fed by the expansion of private consumption and demand in tourism, while its slowdown reflected the deceleration in investment and the negative contribution of foreign trade, a trend which continued in the fourth quarter of 2017. From the sectorial perspective, economic growth continues to be supported by the expansion of the service sector activity, whereas accompanied by contraction in the construction sector and certain branches in that industry. According to IMF Country Report\(^1\), having grown by 3.7% in 2017, the expectation in medium terms of GDP growth is projected to accelerate to approximately 4 percent, a growth rate mainly driven by continued strong domestic demand and reforms that improve the business climate.

4.2 The main characteristics of trade in goods and services

According to the Bank of Albania\(^2\), referring to trade in goods and services, the real trade deficit increased by 6.5% in the third quarter of 2017 compared to one year before. The annual growth of real imports in goods and services was by 9.6%. In the case of exports, for the same period,

\(^1\)International Monetary Fund (IMF), 2017, Albania Staff Report for the 2017, Article IV, IMF Country Report Nr.17/373


despite the high growth of 11.4%, the performance was not enough to exceed the impact of imports. The increase in export of services by about 14.3% was the main contributor to export growth. The dynamics in real terms resulted entirely different compared to the deficit performance in nominal terms (in nominal terms, the deficit for the same period narrowed by 11.6%). The cause of these developments was due to the high level of export deflators (both of goods and services). On the other hand, import deflators have been negative by climbing real growth above the nominal level.

4.2.1 Trade in services

Referring to the latest statistics from Bank of Albania, the service account recorded a positive balance of about 380 million Euros, about 111 million Euros higher compared to the same period of the previous year. The main contribution to this development resulted from the expansion of the respective surplus in “other business services” and “travel services” categories. Revenues and expenditures in this category increased respectively by 13% and 11%. “Travel services” account for the largest share of incoming and outgoing flows registered under the service account - with 63% of revenues and 75% of its expenditures. During the third quarter of 2017, the export of “travel services” has provided the domestic economy with 588 million Euros. Annual revenue growth was influenced by the increase in the number of foreign visitors (non-residents) in the country (about 3%), accompanied with the increase of the average expenditure of this group (by 16%).

4.2.2 The structure of trade in goods. Main characteristics.

As regards only to trade in goods, the trade deficit in 2017 was 353 billion lek, increasing by 5.1% compared to 2016, reflecting the higher weight of imports in trade flows, with an import coverage index of 43.6% in 2017 compared to 42% in 2016. The deepening of the trade deficit in goods is mainly a consequence of (i) high levels on imports of electricity and difficulties facing domestic production (ii) the decline in exports of minerals and fuels.

**Trade Indicators**

The relationship between trade in goods and gross domestic product is well integrated in the trade openness index, which is measured as a ratio of trade flows over the nominal GDP. Based on this definition, this indicator is considerably influenced by the fluctuations of trade flows. The index illustrated in Figure 5.2 demonstrates a positive trend starting from 2010 (51.6%) up to around 53.8% percent in 2016. Despite the upward trend, the openness index for Albania is still quite low.

The intensification of integration processes and the deepening of trade relationships trade within the region and beyond will positively impact the performance of this indicator.

The import coverage index (defined as a ratio of export to the import’s value) gives significant information about the structure of exports and their competitiveness. Despite the overall positive trend (from 25.1% in 2005, to 43.6% in 2017, this index is still quite low, reflecting a low competitiveness of Albanian’s exports and essential weaknesses of trade developments in Albania.
Trade Geography by Country of Origin or Destination

Trade with EU

The most important trade partner of Albania accounting for the highest share of exports to and imports from, remain the EU countries. Total trade flows between Albania and the EU were valued at ALL 596,210 million, experiencing an increase of 7.3% when compared to 2016. During 2017, exports to the EU countries account for 77.1% of total exports, showing a modest decline compared to 2016 (77.9%). Imports from EU countries in 2017 account for 61.6% compared to 63.2% in 2016. In aggregate terms, trade with EU countries in 2017 accounted for 66.3% of total trade, experiencing a decrease compared to one year before (67.6%). Italy, remain our main trading partner for both exports and imports (36.2%), followed by Germany (6.9%), Greece (6.8%), and China (6.4%). Countries with which Albania has experienced the highest increase rate of exports compared to one year before are: Italy with 9.9%, Kosovo with 26.0% and Spain with 87.5%. Meanwhile, countries in which Albania account for the highest increase of imports compared to 2016 are: Italy with 5.7%, Turkey with 11.2% and Greece with 9.2%. During 2017, “Footwear and textiles” and “Construction materials and metals” are the most exported categories to the EU countries, mainly representing by inward processing items that are re-exported to their partner’s country of origin. Imports distribution from the EU is more diversified between sectors than exports, mainly represented by “Mineral, fuels, electricity” and “Machinery, equipment, spare parts”. Also, the growth in food exports, mainly processed food items, contributed to the increase of shares to some other destinations, such as Sweden and Estonia.

Trade with the CEFTA region

The trade with the region represents an important part of trade flows for Albania. Due to the impact of the CEFTA agreement, trade with the region has improved systematically, even though slowly. The countries of the region with highest shares of Albanian exports in 2017 are Kosovo, with a share of 9.9% of total exports, and Macedonia accounting for 4%. Regarding the imports from regional countries, the main partners are considered Serbia, accounting for 6.4% of total imports and Macedonia at 2.3%. Exports to the region are mainly represented by the export of fuels, construction materials and food items. While in terms of imports to Albania from the CEFTA region, those from Serbia increased most, mainly due to the higher imports in fuels and grains.

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Albanian exports to the CEFTA region reflect a high level of concentration on low-value added or low-processed products such as textiles and footwear, minerals, fuel, etc. The oscillations in exports tendency are strongly related to their structure weakness and highly influenced by the world prices fluctuations of fuels and mineral prices, which occupy a significant share in the country’s total exports. Vertical, intra-industry trade is mainly focused in the inward processing industry, which is characterized by low added value, mostly based on low wages and foreign direct investment. Structural reforms in different sectors are expected to give positive results. In this context, sectoral policies in support of increasing the value added and export diversification are needed.

4.3 Developments under the Trade Integration Processes

Albania became a member of the WTO on September 2000, after making considerable progress towards liberalizing its trade policies. These policies were reviewed for the first time in 2010. Albania grants at least MFN treatment to all its trading partners. According to a WTO secretariat report, Albania’s trade regime is fully aligned with international trade rules. Albania has not been involved in any WTO dispute settlement proceedings as a complainant, defendant or third party.

Since its accession, Albania has submitted numerous notifications covering various WTO topics. Tariff quotas are applied to some imports from Turkey and the EU under preferential tariffs. Albania is a signatory to the Information Technology Agreement and has taken no anti-dumping, countervailing, or safeguard measures since its accession to the WTO in September 2000.

Albania’s relationship with the EU remains governed by the 2009 Stabilization and Association Agreement (SAA). Albania obtained the status of EU candidate country in June 2014. In 2000, the EU granted autonomous trade preferences to all the Western Balkans which allow almost all exports to enter the EU markets without customs duties or quantity limits. This preferential regime has contributed to an increase in the Western Balkans’ exports to the EU.

On December 19, 2006, Albania, Bosnia and Herzegovina, Macedonia, Croatia, Montenegro, Serbia, Moldova, and Kosovo became part of the Agreement that consisted to amend and enlarge the Central European Free Trade Area (CEFTA). These main objectives of the agreement consisted on expanding trade in goods and services eliminating barriers to trade, fostering investment,
ensuring stable and predictable rules, providing protection of intellectual property rights in accordance with international standards and rules, etc. The Agreement fully conforms to the WTO rules and procedures and EU regulations. Albania has been intensively involved in European and regional integration processes. The attention in recent years has focused on facilitating customs procedures, facilitating trade in services, recognizing and unifying standards with special attention to sanitary and phytosanitary ones, but also empowering connectivity, enhancing competitiveness, strengthening in this way the links of regional and European integration processes. The implementation of full accumulation, the Additional Protocol 5 on trade facilitation, also the adoption as soon as possible of the Additional Protocol 6 on trade in services liberalization are among the main short term priorities for CEFTA. Additional efforts should be dedicated though to approximate CEFTA MFN (most favored nation) duty rates with the EU Common External Tariff, as part of Western Balkans countries commitment under SEE 2020⁸, and the establishment of a functional dispute settlement system. The regional trade, investment agenda and connectivity agenda are considered as complementary components to each other, as a whole part of single market agenda.

### 5. FINANCIAL AND MONETARY SECTOR

**Dr. Juliana Imeraj, Aleksander Moisiu University of Durrës**

#### 5.1. Financial system in Albania

The financial system in Albania consists of financial institutions licensed and supervised by the Bank of Albania, namely commercial banks, non-banking financial institutions (NBFI), savings and loan associations and unions (SLA and Unions), and other financial institutions licensed and supervised by the Financial Supervision Authority, namely insurance companies, pension funds and investment funds. As at the end of first half of 2017, in Albania operated 16 commercial banks, 28 non-banking financial institutions (NBFI), 13 savings and loan associations (SLA), 12 insurance companies, 3 supplementary private pension funds and 3 Investment funds (Bank of Albania).

The share of the financial system’s activity in the Gross Domestic Product (GDP) has slightly decreased during first half of 2017. This was mainly due to decline in the share of banking activity from 94.9% at the end of 2016 to 91.9%. Meanwhile the non-banking sector, insurance companies and pension funds maintained their share to GDP. Only investment funds made positive contributions to this performance indicator, as shown in Table 6.1.

#### Table 5.1: The share of activity of financial system in Gross Domestic Product (GDP), figures are on %

<table>
<thead>
<tr>
<th>Financial System</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017 H1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking sector</td>
<td>89.6</td>
<td>90.5</td>
<td>91.7</td>
<td>91.3</td>
<td>94.9</td>
<td>91.9</td>
</tr>
</tbody>
</table>

The activity of investment funds expanded, as a result of the increase of investments in government debt securities. The return rates by the participation of investors in investment funds is usually higher than that of deposits in banks, reflecting the higher risk profile of investment funds. These funds’ assets are mainly invested in T-bills and bonds issued by the Government of the Republic of Albania in lek and euros.

As a result of the dominance of the banking sector in the financial system, the ratio of the financial system assets against GDP declined at 101.9%. Meanwhile in the terms of annual growth of financial system components, the situation as at the end of first half of 2017, is presented in Figure 5.1.

### 5.1.2 Financial markets

During 2017 H1, average interest rates for government debt securities increased in both half yearly and annual terms. As at end 2017 H1, the average interest rate of the government debt was 2.9% or 0.5 percentage points higher than at the end of the previous period. T-bills continue to dominate the structure of domestic debt in lek, at a round 70%. Domestic debt in lek issued during 2017 H1 was around ALL 190 billion, 36% higher than the debt issued during the second half of the previous year, but comparable with the value of a year ago.

Issues and average interest rates of short-term government debt increased compared with the previous six months. Issues of government debt securities in the form of T-bills were around ALL 130 billion, or around 30% higher than 2016 H2, but 12% lower than the value of a year earlier.

Within short-term debt, 12-month maturity bills account for around 83% of the total. Average interest rates on T-bills for the 3 maturities, increased by 0.5 percentage points from the previous period, reaching 2.4%. In some T-bills auctions, and mainly those of 6-months maturity, the supply for investment was lower than the demand for borrowing or the amount announced by the government, due to the decline of the yield for this maturity. Due to higher preference by the investors, the yield on 12-month bills decreased from 3.3% in the auctions at the beginning of the year to 2.2% at the end of June.

Issued government long-term debt during the period was higher than in the previous period, while the average yield did not mark significant changes. Government debt securities issued in the form of bonds amounted to around ALL 55 billion, or around 60% higher than in 2016 H2. Around 77% of the issued bonds volume consists of 2 and 5-years fixed interest rate bonds. The bonds’ weighted average rate in lek for the first half of the year was 4.1%. The increase of the weighted interest rate of bonds in lek during the 2016 H2 was reflected in the increase of the demand for investment in these securities in 2017 H1. Overall, the amount offered for investment in bond auctions was higher than the amount required by the government; however, in some auctions, in which the yields had a downward trend, the supply for investment was lower than the demand for borrowing.

The government also re-issued in the domestic market medium-term debt in euros in the form of 2-year bonds. This was the only issue in euro in 2017 H1 and represents around 3% of the domestic around EUR 39 million, 13% higher than the amount issued during the previous period. The higher demand of the government for domestic borrowing in euro was accompanied with the increase of the security yield to 0.80% from 0.75% registered in the previous six months (Bank of Albania).

| Source: Bank of Albania, Albanian Financial Supervision Authority |
However, the upward trend of yields on government securities was not transmitted to other segments of the financial market. The interest rates on loans and deposits denominated in lek remained at minimum historical levels.

5.2 Banking sector

5.2.1 Classification of Banks

As at end-June 2017 (latest figures reported by BOA), banks operating in Albania are divided into the following peer groups according to their share of assets:

- **Peer Group 1** (each bank sharing 0-2% of total banking sector assets): United Bank of Albania (UBA) sh.a., Veneto Bank (VB) sh.a., International Commerci Bank (ICB) sh.a., First Investment Bank, Albania (FIB) sh.a., Credit Bank of Albania (CBA) sh.a. They account for around 4.7% of the sector’s total assets.

- **Peer Group 2** (each bank sharing 2-7% of total banking sector assets): Procredit Bank (PCB) sh.a., National Bank of Greece-Albania (NBG) sh.a., Societe Generale – Albania (SGA) sh.a., Alfa Bank – Albania (ABA) sh.a., Union Bank (UB) sh.a., Tirana Bank (TB) sh.a., American Bank of Investments (ABI) sh.a. They account for around 27.2% of the sector’s total assets.

- **Peer Group 3** (each bank sharing over 7% of total banking assets): National Commercial Bank (NCB) sh.a., Raiffeisen Bank (RB) sh.a., Credins Bank (CB) sh.a., Intesa Sanpaolo Bank – Albania (ISBA) sh.a. They account for around 68.4% of the sector’s total assets.

As at end-June 2017, by capital origin, the banks operating in Albania were divided as follows:

- **Banks with foreign capital** 13. They account for around 82.6% of the sector’s total assets.

- **Banks with Albanian capital** 3: Credins Bank sh.a., Union Bank sh.a., American Bank of Investments sh.a. They account for around 17.4% of the sector’s total assets.

As at end-March 2018, two changes were made public, which will reduce the number of banks operating in Albania from 16 to 14. Firstly, as the activity of the banking group “Veneto Banca” was completely restructured, after a decision of the Bank of Italy and the Italian Government, the major part of this group activity, including its subsidiaries in Albania, was transferred to Intesa Sanpaolo Bank, which is the largest banking group in Italy. For the Albanian banking sector it means that “Banka Veneto” sh.a, previously under complete ownership of “Veneto Banca”, now is in ownership of “Intesa Sanpaolo” banking group, and its activity shall be part of this banking group. Secondly, NBG bank has been sold to American Bank of Investments (finalized in 2018). Some other European banking groups operating in Albania are still undergoing a restructuring process to improve the financial situation. This process includes: network restructuring, change of shareholders or merger with other institutions.

5.2.2 Banking sector developments

During 2017, developments in the banking sector have been positive, despite the overall contraction in the banking activity. The assets of the banking sector decreased by 0.9%, compared to end of year 2016, reaching ALL 1.394 billion. The highest decline was registered in “Securities transactions”, followed by “Transactions with the treasury”. Also, lending continued to show moderate growth rates, although interest rates on credits remain at low levels. This performance is driven by the low credit demand and the still tight lending standards applied by banks.

On the liabilities side, the main items continue to be “Costumer transactions”, which represent the depositing activity and “Permanent resources”, which represents the capital of banks or their own funds. The banking activity was mainly financed by deposits, which accounted for about 81.4% of total assets. In June 2017, the deposit/credit ratio stood at 52.5%. Banks have maintained the capital adequacy ratio to finance their operations, in compliance with the relevant regulatory capital requirements. The Albanian banking system was also characterized by high concentration for some of its activities, such as: credit to enterprises.

5.2.3 Banking sector’s exposure to activity risks

Commercial banks operating in Albania are faced with several types of risks. The most important ones that even Bank of Albania assesses are as follows:

- **Credit risk**

  Credit risk fell significantly during the period, in which Non-performing loans (NPL’s) fell by 15.2%. As a result, the ratio of non-performing loans fell to 15.6%.

  Several actions contributed to the reduction of NPL’s such as: banks actions to collect, restructure, and write them off from the balance sheet.

  Among the existing non-performing loans, the lowest quality is noted in the foreign currency loans, loans to enterprises and loans with longer maturity term.
The reduction of nonperforming loans is accompanied by the improvement of their coverage with reserve funds (provisions) and capital, as well as the coverage with collateral.

The reduction of non-performing loans during the period will contribute positively, by releasing resources of banks engaged in the management of non-performing loans, gradually improving the perception of the banking sector on the credit risk, and eventually give a stronger boost to credit growth in the period ahead.

Regardless of the significant improvement, the level of non-performing loans in the banking sector is estimated as still high. This situation requires the banks to be fully and constantly engaged in this process.

b) Liquidity risk

Liquidity risk in the banking activity is considered as low. The liquidity ratios, both in lek and foreign currency, have stood above the minimum regulatory requirements.

Deposits are the main source of financing, covering almost double the volume of the sector’s credit. Yet, the negative gap between assets and liabilities by segment of residual maturity is considered as high and has increased against previous periods.

The change in the structure of liabilities, in which the share of time deposits continues to lessen against other non-term alternatives, contributes to maintaining this gap.

Such structure of liabilities imposes the need for the banking sector to maintain high level of liquid assets, and seek higher return through longer-term investments.

This feature is related to the actual stage of the financial cycle and should gradually change at a time when macroeconomic developments require an increase in interest rates, which leads to higher opportunity costs to the public for maintaining their savings in more liquid forms.

5.2.4 Banking sector’s financial indicators

At the end of the period, the banking sector’s capital adequacy ratio was 16.3%, considerably higher than the 12% level of the minimum requirement.

The banking sector also experienced improved profitability ratios. Return on Assets (ROA) and Return on Equity (ROE), resulted at 1.6% and 16.7%. However, the positive contribution to the financial sector’s performance has come from the decline in credit risk provisions. Meanwhile, the financial result from the core activity of financial intermediation, as reflected in net interest income continued to decrease. The net interest income decreased due to return on investments falling faster than the relevant expenses, by having operated in an environment of low interest rates for a relatively long period of time. On the other hand, banks have enjoyed improved capital adequacy ratio due to reduction in risk-weighted assets, even higher than the minimum ratio imposed by Bank of Albania (12%). These indicators are satisfactory and even pass the stress tests carried out by Bank of Albania.

5.3 Money supply

The expansion of monetary supply remains low, while the trend of savings shifting to longer term maturities or to alternative instruments of financial market, such as government securities, continues. The broad money aggregate, M3, recorded an average annual growth rate 1.1% in Q4, from 2.1% in Q3 of 2017. The performance of this indicator demonstrates the slow creation of money in the economy, structural changes in holding the money, and the currency appreciation effect. In 2017 Q4, deposits continued to shift toward maturity terms over two years, which are not included in the calculation of monetary aggregates. The money aggregate in lek, M2, recorded an annual growth by 1%, during this period, unchanged from 2017 Q3, mainly supported by the credit in the domestic currency. The liquid money indicator, M1, showed an average annual growth rate of 7.5% in 2017 Q4. The ratio of currency outside banks to M2 increased at 35.9%, by reflecting the end-of-year seasonal behaviour and the structural changes in M2.

Deposits in the banking system recorded 2.3% average annual growth in Q4, compared with 3.5% in Q3 of 2016.

The deposits expanded by ALL 10.2 billion from the end of September, when the growth of deposits in lek offsets the slight contraction of deposits in foreign currency. Nevertheless, deposits in foreign currency broadly supported the deposits growth from the previous year.

5.4 Developments in the stock market

Starting from 3rd July 2017, Albania has a new private stock exchange: Albanian Securities Exchange – ALSE. This stock exchange is founded by two commercial banks “Credinsh.a” and “American Bank of Investments sh.a” each owning 42.5% of the capital, and a non-bank financial institution “AK Invest sh.a” with 15% of the capital. This is the third time a stock exchange has been founded. The first stock exchange, Tirana Stock Exchange was created as a department of Bank of Albania in 1996.

The second time was founded as a state company in 2002. In both cases the exchanges did not realize even a single transaction in bonds or shares. However, this time the stock exchange is only licensed to trade government securities, continues. The broad money aggregate, M3, recorded an average annual growth rate 1.1% in Q4, from 2.1% in Q3 of 2017. The performance of this indicator demonstrates the slow creation of money in the economy, structural changes in holding the money, and the currency appreciation effect. In 2017 Q4, deposits continued to shift toward maturity terms over two years, which are not included in the calculation of monetary aggregates. The money aggregate in lek, M2, recorded an annual growth by 1%, during this period, unchanged from 2017 Q3, mainly supported by the credit in the domestic currency. The liquid money indicator, M1, showed an average annual growth rate of 7.5% in 2017 Q4. The ratio of currency outside banks to M2 increased at 35.9%, by reflecting the end-of-year seasonal behaviour and the structural changes in M2.

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6. PUBLIC FINANCE

Dr. Arajan Tushaj, University of Tirana

6.1 Total Revenues

Continued changes related to the fiscal regimes have affected continuity the structure of budget revenues and expenditures by significantly increasing the volatility of public finances. Over the years, the macroeconomic indicators have demonstrated sustainability due to the monetary interventions of Bank of Albania and strict fiscal rules. During 2017 the government budget has accumulated an increase of 5.74% of total revenues compared to 2016. Referring to sources of budget revenues, local government revenue has demonstrated the largest increase by 23.39%, meanwhile the smallest increase related to tax revenues respectively to 7.77% compare to 2016. Of course, the increase in local government revenue reflects the positive effect of the territorial-administrative reform on municipality performance. But the negative impact on revenue growth has demonstrated by the non-tax revenue source, which it shrank to 8.07% compared to 2016. However, the largest contribution to budget revenues related to the tax revenues resulting at 92.62%, while the lowest contribution linked to the local government respectively 4.29%. The following figure showed the comparative analysis of the contribution of each source related to budget revenues during 2016 - 2017.

Figure 6.1: Contribution of revenue sources to budget revenues during 2016 – 2017

Source: Ministry of Finance and Economy (2017)

6.2 Total expenditures

While the fiscal expenditure has resulted in an increase of 6.38% during 2017 compared with 2016, where the capital expenditures have marked the high increase compared to current expenditures, respectively 15.09% and 4.13%. This situation explained that the revenue growth has contributed to the growth of public investment meaning the stimulation economic development of the country. Taking into consideration the components of fiscal expenditures, the largest increase demonstrated by the subsidy expenditures at 33.94% compared to 2016, while the lowest increase by other social expenditure at 2.91%. Meanwhile the adverse effect on the increase in fiscal expenditures has denoted by the interest expenditures and operative maintenance expenditure showing the decrease at 12.01% and 2.0% respectively. The reduction of their expenditure explained the decrease of debt’s costs according to the government has written and on the other side demonstrated the decreasing of value related to the budget holding in operating costs. During 2017, the largest contribution to total fiscal expenditures was recorded for special funds, 35.15%, while the lowest contribution to subsidies was 0.50%. The following figure showed the growth rate of components of fiscal expenditure during 2017 and the comparative static of contribution according to each of them during 2016 - 2017.
Fiscal policy projections are in the convergence of fiscal consolidation and in function of sustainable medium and long-term economic growth. Results of fiscal targets demonstrated the reduction of public debt during 2017 (69.9% of GDP (Ministry of Finance, (2017)) as well as the budget deficit to 2.0% of GDP. Already, the consolidated budget indicators have included to the new stage of administration under the control of fiscal rules and targeting economic parameters.

Finally, observation from the perspective of sector financing, budgets over the years have undergone continuous struggle making difficulties to identify the national priorities supported by budget priorities.
7. CONCLUSIONS

Assoc. Prof. Dr. Eglantina Hysa, Epoka University

This Albanian Economic Performance 2017 Annual Report provides a promising snapshot of Albania in the last year as a number of indicators point in encouraging directions, yet it also sheds light on areas of concern.

Albania is showing positive steps comparing the macroeconomic indicators to the other countries of the Western Balkans. After a period of 5-years economic slow-down, the average annual growth rate in Albania increased to 3.5 per cent in 2017. Unemployment rate decreased from 15.6 percentage in 2016 to 13.6 percentage in 2017. The inflation rate in Albania has shown a slight decrease, whereas the interest rate has increased comparing to 2016.

In investment, gross fixed capital formation, which in Albania is largely located in the construction sector, follows a cyclical pattern, which in 2016 and 2017 appears to peak in the second quarter of each year. As in consumer spending, this cyclical pattern shows slight increases from the quarters of 2016 to the corresponding ones in 2017. FDI has increased in 2016 and 2017, perhaps in part because of investments such as the Trans Adriatic Pipeline.

While trade with the EU increased in 2017, trade with non-EU countries expanded as a share of Albania’s total trade in 2017. Trade with CEFTA has increased in 2017, and this is promising as a means of bringing greater prosperity and stability to the Western Balkans and building towards Albania’s eventual membership in the EU.

The financial sector saw an announced decrease in the number of commercial banks, the opening of an exchange for trading government securities, and a decrease in non-performing loans. Nevertheless, the banking sector saw a decline in its relative contribution to GDP as pension funds saw a relative increase.

Despite numerous positive developments in the economy of Albania in 2017, this report also observes areas of concern. Interest rates and inflation, while low, have not been high enough to stimulate much improvement in savings in the case of the former or spending in the case of the latter. Furthermore, despite growth in travel services, likely representing tourism, and double-digit growth in exports, large increases in imports caused Albania to suffer from an increase in the trade deficit in real terms in 2017. Additionally, public finance saw a decrease in subsidies and an increase in funding for local government, both promising developments. However, deficits and external debts both increased.

In conclusion, this Albanian Economic Performance 2017 Annual Report is designed to contribute to a better understanding of the Albanian economy and further collaboration between stakeholders in improving the Albanian economy and the well-being of all in Albania and the region.
8. REFERENCES


9. ACKNOWLEDGEMENTS

We want to thank all professors contributed to this report for their continued support by sharing with all the readers their perspective and analysis of the Economic Development Performance of 2017. The underneath Bio-s include some important information on their academic profile and their expertise.

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Albanian Economic Performance

2017 Annual Report

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1. Ekonomia 2. Politika ekonomike

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