



ALBANIA

Highlights

- **The economy is facing a strong recession in 2020 due to the Covid-19 outbreak.** The main channels of influence are tourism, trade with Italy and remittances from Albania's workers abroad, which are all being hit severely.
- **The government has adopted two economic support packages, worth 2.8 per cent of GDP.** The packages consisted mainly of increased government expenditures, sovereign guarantees and one-off social transfers.
- **A contract for a large-scale solar park has been signed.** Besides helping the country in improving the energy mix by diversifying away from hydropower, the Karavasta solar park will also be the largest in the Western Balkans. In addition, Albania secured the lowest solar energy price in the region through a competitive capacity allocation process.

Key priorities for 2021

- **Fiscal adjustment will be needed to ensure public debt sustainability.** The government needs to strengthen public investment management and contain fiscal risks such as those relating to public-private partnership programmes. Simplifying the tax system and making it more transparent would help lead to higher budgetary revenues.
- **Measures should be stepped up to combat informality and level the playing field for private companies.** Key measures in this direction include a simplified tax system and procedures, strengthened capacities in public administration, further support and incentives for micro, small and medium-sized enterprises to formalise their activities, and a more decisive fight against corruption.
- **Further reforms are needed to support credit growth.** Resolution of issues with property rights and the bailiff system, implementation of the insolvency law and enhancement of property rights should all be high on the agenda.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.3	3.8	4.1	2.2	-9.0
Inflation (average)	1.3	2.0	2.0	1.4	1.6
Government balance/GDP	-1.8	-1.4	-1.3	-2.0	-8.5
Current account balance/GDP	-7.6	-7.5	-6.8	-7.6	-11.5
Net FDI/GDP [neg. sign = inflows]	-8.7	-8.6	-8.0	-7.6	-6.0
External debt/GDP	73.5	68.7	65.1	60.4	n.a.
Gross reserves/GDP	27.5	25.9	26.4	24.6	n.a.
Credit to private sector/GDP	36.6	34.8	33.0	34.4	n.a.

Covid-19: macroeconomic implications

The economy is contracting severely in 2020. After the November 2019 earthquake, which caused damage of around €1 billion, the economic outlook was further worsened by the outbreak of the Covid-19 pandemic. The negative effects are being seen mainly in tourism, which normally contributes to more than one-fifth of Albania's GDP, and through the decline in trade with Italy (close to 50 per cent of exports) and remittances from Albanians abroad. Available data show that GDP declined by 6.6 per cent year-on-year in the first half of 2020, on the back of falling exports, investment and consumption. Sectors related to tourism (trade, transport and accommodation services) recorded an overall fall in activity of 16.1 per cent year-on-year. Also, the construction sector was hit strongly as well as manufacturing. In the period of most severe lockdown (March to May 2020), goods exports to Italy fell by 42.7 per cent year-on-year. Overall, total exports of goods in the first seven months of 2020 were lower by 16.8 per cent year-on-year.

Monetary policy responded with policy rate cuts and foreign exchange market

interventions. At the end of March 2020 the Bank of Albania (BoA) lowered the key policy rate by 50 basis points, to a new record low of 0.5 per cent. The Covid-19 crisis also contributed to depreciation pressures on the domestic currency, mainly in the second half of March, when the Albanian lek lost around 7 per cent of its value against the euro. The pressures were eased by the BoA selling €20.4 million on the foreign exchange market at the end of March, and stability has returned since May. The weakening of the currency and a strong increase in food prices caused the inflation rate to pick up from 1.4 per cent in 2019 to 2.0 per cent year-on-year in June 2020, still below the central bank target of 3.0 per cent.

Public debt increased sharply in the first half of 2020, to 80 per cent of GDP. That is 14 percentage points higher than at the end of 2019. The biggest effect came from the seven-year €650 million Eurobond issuance in June 2020. In order to finance measures related to the pandemic and its economic consequences, Albania also borrowed from international lenders such as the European Union (€180 million, under the Macro-Financial Assistance) and the International Monetary Fund (€174 million, under the Rapid Financing Instrument).

A rebound is expected in 2021. GDP is forecast to drop by 9.0 per cent in 2020, and to rebound by 4.5 per cent in 2021. The resumption of normal economic activity and a boost from reconstruction after the November 2019 earthquake is expected in the second half of 2021. However, the forecast is subject to significant uncertainty over the possible return of the pandemic. The downside risks are associated with a potentially stronger impact of the pandemic on remittance inflows and the tourist season both in 2020 and next year.

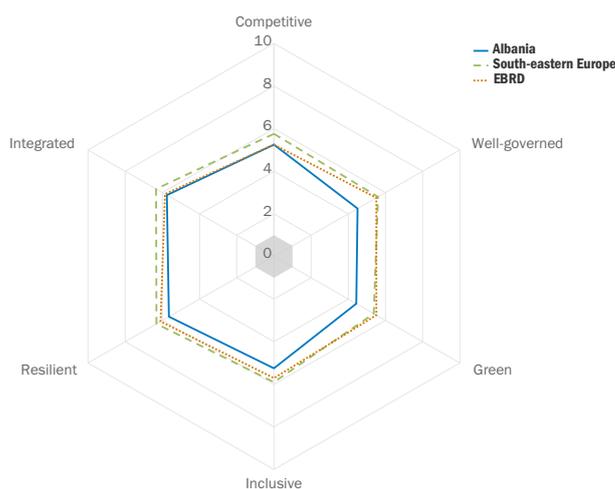
Policy response to Covid-19

The government adopted two support packages to support businesses, healthcare and vulnerable people. The packages included: state aid to companies experiencing difficulties in paying workers' wages; emergency payments for employees in tourism and those dismissed from large companies; income support for micro businesses and the self-employed; cancellation or write-off of penalties on late payments of energy bills for more than 200,000 people; and additional funding for medical personnel. Additional measures adopted in July 2020 were the abolition of value-added tax for small companies with an annual turnover below Lk 8 million (€64,000) from 2021, and a 0 per cent profit tax for small companies with an annual turnover of up to Lk 14 million (€115,000).

Financial measures range from state guarantees to a loan payment moratorium. A sovereign guarantee fund has been established for companies to access overdrafts in the banking system to pay wages for their employees, for up to three months. In addition, a sovereign guarantee was provided for working capital loans for all private companies that were tax-compliant and solvent before the pandemic. Payment holidays for loans, for those applying, were extended until the end of August 2020. In addition, banks have been allowed to restructure loans in 2020 without additional provisioning or downgrades for borrowers. The BoA has temporarily suspended the distribution of dividends for banks until the end of the year, in order to support their capitalisation and lending

potential. The BoA also stated its readiness to provide unlimited liquidity to the banks. In July 2020 the BoA announced that it was setting up a €400 million repurchase agreement line with the European Central Bank, which will be in place until at least June 2021. The line would serve to provide euro liquidity to Albanian banks in case of need.

Assessment of transition qualities (1-10)



Structural reform developments

The banking sector remains well capitalised and liquid, but non-performing loans (NPLs) are still relatively high. At the end of June 2020 the capital adequacy ratio stood at 18.1 per cent, and one-third of banks' assets were liquid. The NPL ratio has continued to decline further in the past year, indicating improved asset quality, but at 8.1 per cent at the end of May 2020 it remains the highest in the Western Balkans and is at risk of increasing again once the moratorium on bank loan payments is lifted.

Albania is moving forward in diversifying away from hydro energy. The country has been making efforts to diversify its energy mix, which is dominated by hydropower, and decrease its dependence on weather conditions (rainfall). In August 2020 a contract was signed for the first large-scale solar park in Albania. The Karavasta park would be the largest in the Western Balkans and, through a competitive capacity allocation process, Albania secured the lowest solar energy price in the region. Further solar tenders are expected in the future through the same approach, and wind power will be developed under the same competitive principles. The completion of the offshore Trans Adriatic Pipeline connection between Albania and Italy in June 2020 could also open opportunities for the introduction of gas in the country's energy mix.

The country has narrowed the compliance gap in the electricity sector by reforming the regulatory framework. In May 2020 Albania amended the Power Sector Law with a view to improving compliance with the EU energy legislation and allowing for effective unbundling of the distribution system operator.

The European Council decided to open EU accession negotiations with Albania. In March 2020, the European Council, having assessed that the country fulfilled the conditions identified by the previous councils, decided to open accession negotiations with Albania. It invited the European Commission to prepare the framework for the negotiations, reflecting on the revised methodology (enhanced approach) of the accession process adopted by the council on the same day. Once the

council adopts the negotiating framework, this should be followed “as soon as possible” by the first intergovernmental conference (the formal start of the negotiations). However, the council decided that before the first intergovernmental conference Albania ought to implement a number of specific conditions, including the adoption of electoral reform, continued implementation of judicial reform, and strengthening the fight against corruption and organised crime. Respective key priorities for Albania have been integrated into the draft negotiating framework, which the European Commission presented to member states on 1 July 2020.

