Macroeconomic conditions

# Period 1998 – 2004

Economic developments during 2004 have followed a similar pattern to 2003 and have consolidated the progress made since 1998, with the following key features:

* Relatively high economic growth (at about 6% in real terms);
* Low annual inflation (at 2.9%);
* Decreasing deficit of the government budget (down to 4.6% of GDP);
* Improvements in the balance of payments, with an increase in reserves;
* Strong exchange rate.

If the current progress in Albania can be maintained over the next decade, the incidence of relative poverty should be halved, absolute poverty will be eliminated, average incomes will be nearly double their current levels and the gap between Albania and neighbouring countries will be substantially reduced. The main macroeconomic indicators for 1998-2004 are given in the table below:

Key macroeconomic indicators

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Unit | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| Population | Million | 3.35 | 3.37 | 3.23 | 3.08 | 3.10 | 3.10 | 3.12 |
| Inflation (average) | % | 20.9 | 0.4 | 0.0 | 3.1 | 5.2 | 2.4 | 2.9 |
| Exchange rate | Lek / $US | 150.6 | 137.7 | 143.7 | 143.5 | 140.2 | 121.9 | 102.8 |
|  | Lek / Euro |  | 147.0 | 132.6 | 128.5 | 132.4 | 137.5 | 127.7 |
| Output |  |  |  |  |  |  |  |  |
| Gross Domestic Product | Lek billion | 412.3 | 474.3 | 530.9 | 588.7 | 630.0 | 695.1 | 780.1 |
| Gross Domestic Product | $ billion | 2.7 | 3.4 | 3.7 | 4.1 | 4.5 | 5.7 | 7.6 |
| Real GDP growth | % | 12.7 | 10.1 | 7.3 | 7.2 | 3.4 | 6.0 | 6.0 |
| GDP per capita | Lek thousand | 122.9 | 140.6 | 164.3 | 191.4 | 203.4 | 223.9 | 249.9 |
| GDP per capita | $ | 816 | 1021 | 1143 | 1334 | 1450 | 1837 | 2431 |
| Public finance |  |  |  |  |  |  |  |  |
| Total revenue | Lek billion | 102.5 | 123.2 | 130.6 | 145.6 | 154.6 | 167.2 | 184.4 |
| Total expenditure | Lek billion | 141.6 | 165.7 | 170.6 | 186.1 | 192.5 | 201.2 | 222.4 |
| Overall deficit | Lek billion | -39.1 | -42.5 | -40.0 | -40.4 | -37.9 | -33.9 | -38.1 |
| Total revenue | % GDP | 24.9 | 26.0 | 24.6 | 24.7 | 24.5 | 22.4 | 23.6 |
| Total expenditure | % GDP | 34.3 | 34.9 | 32.1 | 31.6 | 30.6 | 27.0 | 28.5 |
| Overall deficit | % GDP | -9.5 | -9.0 | -7.5 | -6.9 | -6.0 | -4.6 | -4.9 |
| Internal debt | % GDP | 36.2 | 37.4 | 42.6 | 39.6 | 38.8 | 38.0 | 37.8 |
| External debt | % GDP | 36.9 | 32.3 | 31.6 | 28.2 | 24.4 | 23.3 | 18.3 |
| Balance of payments |  |  |  |  |  |  |  |  |
| Trade balance | $ million | -604 | -663 | -821 | -1027 | -1155 | -1336 | -1579 |
| Exports | $ million | 208 | 275 | 255 | 305 | 330 | 447 | 603 |
| Imports | $ million | 812 | 938 | 1076 | 1332 | 1485 | 1783 | 2182 |
| Transfers | $ million | 520 | 353 | 533 | 571 | 613 | 842 | 1043 |
| Reserves | $ million | 384 | 482 | 608 | 754 | 860 | 1026 | 1374 |
| Reserves – Import cover | Months | 3.7 | 3.8 | 4.2 | 4.3 | 4.3 | 4.7 | 5.2 |
| Trade balance | % GDP | -22.1 | -19.2 | -22.2 | -25.0 | -25.7 | -21.9 | -20.8 |
| Export growth rate | % | 31.1 | 32.3 | -7.2 | 19.3 | 8.4 | 35.4 | 35.0 |
| Import growth rate | % | 17.0 | 15.5 | 14.8 | 23.7 | 11.6 | 20.1 | 22.4 |

Source: Ministry of Finance, Macroeconomic Department

# Economic growth

Economic growth is the main factor in reducing poverty and stabilising Albania’s macro-economy. Figure 2.1 below presents real growth over the past 7 years, showing that Albania has consistently managed to achieve high economic growth since 1998. During 2004 real GDP growth was estimated to be 6%.

Economic growth in Albania and selected countries, 1998-2004



Source: IMF Country reports; the figures for 2004 are projections

The combination of high growth and a decline in the resident population of Albania (by about 3.4% since the year 2000), has led to a doubling of per capita incomes, in Lek, over the last 7 years. Nevertheless, GDP per capita still remains very low compared with other countries and its increase constitutes one of the strongest challenges for the future. Real increase in the GDP for the period 1998-2004 in Albania and neighbouring countries is given in Table 2.2.

The sectoral composition of growth in 2004 has followed a similar pattern to the previous year, as shown in Table 2.2. Construction and transport have continued to grow strongly, while industry and agriculture are growing at a lower rate than the national average.

Sectoral structure and growth

|  |  |  |
| --- | --- | --- |
|  | Structure of GDP (%) | Real growth rate (%) |
|  | 2003 | 2004 | 2003 | 2004 |
| Total | 100 | 100 | 6.0 | 6.0 |
| Industry | 10.2 | 9.9 | 2.7 | 3.1 |
| Agriculture | 24.7 | 24.0 | 3.0 | 3.0 |
| Construction | 9.1 | 9.5 | 11.3 | 10.6 |
| Transport | 10.0 | 10.4 | 10.8 | 10.1 |
| Services | 46.1 | 46.3 | 6.4 | 6.4 |

Source: INSTAT

**Agriculture** continues to be one the most important sectors of our economy, contributing 24% of GDP and 58% of employment in 2004. Real growth in agriculture is estimated to be 3%, as a result of adequate climate conditions, investment in new production and technologies, especially in agro-industry, and improved power supplies. Good levels of production have led to low prices. Despite the strong Lek, there has been an increase in agricultural exports and domestic agricultural products have competed successfully against imports.

However, agricultural growth is below the national average growth rate, and is constrained by a number of issues, including emigration from rural areas and the legal framework on property. Agricultural growth is of particular importance to Albania, in view of the very low productivity of the agricultural and agro-industrial system inherited from the past. Further measures are needed to promote the commercialisation of agriculture, both for exports and domestic markets, and to encourage new technologies.

Growth in **industry** is also about 3% and has been dominated by the energy sector, which grew by around 48.9 %, because of investment, reform and favourable weather conditions. Growth of the energy sector remains one of the key elements of national strategy, both for economic and social development. In contrast, the metallurgical industry declined by 68.3 % in total, despite an increase in steel production. The manufacture of leather-shoes and chemicals grew by 25.3 % and 19.2 % respectively, while wood processing declined by about 4.3 %. The petroleum sub-sector grew at 7.6 %, despite a decline in volumes. The textile and confectionary industry both grew at about 3.4 %.

**Transport** grew by 10.1 % in 2004 and this has been dominated by road transport. Port activity has grown by 5.9%. Railway traffic has declined by 24.2% in volume, with a 15% decline in the value of passenger traffic and a 19.3% decline in goods traffic. The government is committed to improving the situation of the railway system and carrying out an efficient privatisation.

**Construction** is one of the most dynamic sectors of the Albanian economy, with a real growth of 10.6% in 2004. Construction activity is concentrated in the major urban centres. Private sector construction is mainly focused on flats and buildings for families, which comprise about 81.6% of the total financing of private construction. State participation in the construction sector is mainly focused on infrastructure and engineering constructions. State financing for engineering constructions constitute 84.8 % of total state financed construction, but is 69 % above the level achieved in 2003.

An analysis of future prospects for construction, based on construction permits issued during 2004, does not look optimistic. Problems appear to be associated with the limited number of construction permits issued, along with constraints on state investment, rather than with private investment capacity and demand.

**Services** contribute 46.3% of GDP and grew at a rate of 6.4% in 2004, slightly above the national average. Post and telecommunications have increased rapidly, as a result of improvements in service quality, although reforms and price changes in the telecommunications market have led to some major changes. Reforms and restructuring at Albtelekom remain a priority, in preparation for privatisation. Tourism is a major part of the service sector: during 2004 it is estimated to have generated $673m in revenues, marking an increase of over 29% compared to 2003, with increases in visitor numbers and expenditure per person.

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| Public debate on economic growth and povertyThe NSSED Department organised a public debate in March 2005 to discuss the sources of economic growth in Albania and the impact of growth on poverty. The debate was attended by about 50 people, from a variety of public, private and voluntary organisations. It was launched by a statement from the Minister of Finance, which stressed the need for growth to incorporate social dimensions, as well as economic dimensions, in order to be sustainable. This will involve increased emphasis on human development, civil society and government transparency.Discussion was stimulated by presentations covering: regional experience with economic growth; the national macroeconomic situation; the sources of economic growth; and the linkages between growth and poverty.Participants were invited to fill in a questionnaire indicating the importance of different sectors and constraints for economic growth and for poverty alleviation. They were also divided into groups, and asked to define the key actions which would: a) promote economic growth; and b) promote poverty alleviation.There was broad agreement about the actions required to promote economic growth, as already defined in the NSSED. However, there are a wide variety of views about the relative importance of these different actions. **Infrastructure** and **private investment** were widely stated as high priorities, but there were differences on the following issues:* One group argued that the **financial sector** should have a high priority, whilst others argued that this would have little impact until financial institutions started offering services to a wider variety of activities.
* It was argued by 2 groups that modernising and commercialising the **agricultural sector** should be given the highest priority, in view of current employment patterns and the potential for reducing poverty in rural areas. However, the view was also expressed that economic growth in recent years had come largely by shifting from agriculture to more productive sectors and that this should continue.
* Contrast views were also expressed on the relative importance of **barriers to investment**, including the definition and enforcement of administrative, regulatory and legislative controls. One group placed this as the top priority, whilst another argued that growth had already been occurring without strong enforcement, and could continue to do so.
* One group placed **free trade** and **exports** as a high priority, whilst the others did not. There was some discussion about the complex nature of free trade impact on the economy.
* **Property status** and its use for collateral was considered as important by a number of individuals, but did not emerge as a key priority during group discussions.
* A number of people mentioned the importance of **tourism**, as a key source of economic growth and there was a debate about the importance of supporting a type of tourism which would have the widest possible benefits for the local economy. **Environmental** issues were not raised in the debate, except as a constraint for tourism development.

The discussion on poverty reduction supported the assertion that economic growth was the main priority and would lead to poverty reduction. One group argued that **education** needed particular attention, whilst another group reminded the debate that there were disagreements on what type of skills and attitudes were required for poverty reduction. |

# Macroeconomic projections

The government’s macroeconomic projections are defined in the Medium Term Budget Programme (MTBP) for the period 2005-2007. These are based on continued stability:

* Sustaining economic growth at a level of 6 %,
* Maintaining an annual inflation rate at the interval 2-4%,
* Preserving foreign currency reserves at the level 4 to 4.5 months import cover, and
* Reducing the deficit of the balance of payments current account, with exports growing faster than imports.

Economic growth in 2005 is expected to be based first on the growth of the services and construction sectors, accompanied by an increase in transport, agriculture and industry.

Some of the main macroeconomic indicators for 2005 are given in Table 2.3:

Main macroeconomic indicators for 2005

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Unit | 2004 | 2005 | Growth rate (%) |
| GDP at current prices | Lek million | 780100 | 857300 | 9.9 |
| Real GDP growth rate | % | 6.0 | 6.0 |  |
| GDP per capita | $ | 2431 | 2575 | 5.9 |
| Inflation (average) | % | 2.9 | 2.4 | -17.2 |
| Exchange rate | Lek/$ | 102.8 | 106.0 | 3.1 |
| Trade balance | $ million | -1579 | -1981 | 25.5 |
| Exports | $ million | 603 | 766 | 27.0 |
| Imports | $ million | 2182 | 2747 | 25.9 |

Reforms in the tax and customs administration, combined with efforts to reduce the informal economy, will increase the total budget revenues from 23.6% to 24.1% of GDP. This is equivalent to an 11.9% increase in revenue in nominal terms. All forms of revenue will increase, with tax revenues (notably personal income tax) and social contributions increasing slightly faster than the rest. Expenditure will remain constant as a proportion of GDP, allowing for a 6% real increase in public spending.

Main fiscal indicators for 2005, as a proportion of GDP (%)

|  |  |  |
| --- | --- | --- |
|  | 2004 | 2005 |
| Total revenues | 23.6 | 24.1 |
| Total expenditure | 28.5 | 29.0 |
| Deficit | -4.9 | -4.9 |

The main objective of monetary policy during 2005 will continue to be the preservation of the annual inflation rate at 2-4 %. This objective will be achieved by maintaining the increase in money supply at a level in line with the increase of nominal GDP, and assuming some progress in the rate of money circulation. Macroeconomic stability will lead to a continued decline in interest rates and expansion of credit in the economy.

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| Methodology of macroeconomic projectionsThe macroeconomic projections are generated by a model which uses independent projections of underlying (or final) demand in the economy and then calculates the level of domestic economic activity needed to meet this demand, using input-output analysis. The final demand of the economy is defined as: government spending (current and capital); exports (of goods and services, including tourism); and private spending (both on investment and consumption). A part of private income is also projected independently (spending of government transfers and income from abroad), whilst spending of income earned domestically is calculated from the input-output analysis. Projections are made as follows:* Government spending is projected by the Budget Department at the Ministry of Finance, based on the Medium-Term Budget Programme process.
* Exports of goods are projected by the Ministry of Finance in discussion with IMF.
* Exports of services (mainly tourism) are projected by the Macroeconomic Department at the Ministry of Finance to grow at 10% per year.
* Government transfers to households are projected from budget and Medium-Term Budget Programme data.
* Private income from overseas (mainly remittances) is projected from Ministry of Finance and IMF figures.
* Independent projections are made of private investment and food consumption, leaving a residual of private income for other consumption goods.

The sectoral composition of each element of final demand is assumed to be constant. The model then uses input-output analysis to calculate the level of output which is necessary to produce the demand from these underlying forces. The input-output analysis also produces estimates of private income from domestic activity and of imports of goods and services, both to economic activities and for household consumption. The model then calculates government revenue, based on the tax incidence on economic activities. This provides a projected government deficit. Expenditure can then be re-specified and the model is run again, to achieve the desired deficit. |

The government is currently working on medium term projections to 2008 and extending to some additional years. This work has initially been done using the Ministry of Finance macroeconomic model described above. However, extending the macro model to include a fuller picture of the macroeconomy has raised a number of issues, which are being debated within government bodies. In particular, the Ministry of Finance aims to compare the conclusions from the macroeconomic model with the conclusions from more typical macroeconomic consistency frameworks, such as those used by the IMF and the World Bank.

The government is also working on the definition of a number of scenarios, which will help to illustrate the range of possible macroeconomic outcomes. This will help in setting revenue projections within a range, so that government expenditure can be planned to take place at different rates of progress.