

BLACK SEA TRADE AND DEVELOPMENT BANK

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# Albania

## Country Strategy

2019-2022

## TABLE OF CONTENTS

- I. Recent Economic Developments and Outlook
  - a. *Economic Structure and Demographic trends*
  - b. *Performance 2015-2018*
    - i- *Real Sector*
    - ii- *Public Sector and Fiscal Policy*
    - iii- *Monetary and Financial Sector*
    - iv- *External Sector*
  - c. *Forecast for 2019–2022*
- II. Overview of BSTDB Portfolio
- III. Review of Country Strategy
- IV. Priorities

### TABLES:

- Table 1: Basic Macroeconomic Indicators at a Glance
- Table 2: Current BSTDB Portfolio - BoD Approved Operations
- Table 3: BSTDB Country Strategy Performance (2015-2018)

**Table 1: Basic Macroeconomic Indicators at a Glance**

Country Long Term Foreign Currency Sovereign Risk Rating: **S&P: B+** | **Moody's: B1** | **Fitch: N/A**

INDICATOR	2015	2016	2017	2018	2019	2020	2021	2022
Population (Million)	2.88	2.88	2.87	2.87	2.87	2.87	2.87	2.87
Avg Exch. Rate (LEK/ USD)	125.96	124.14	119.10	107.99	109.5	109.5	109.5	109.5
Inflation (CPI Avg.)	1.9%	1.3%	2.0%	2.0%	1.5%	2.1	2.4	2.8
Average monthly wages (US\$)	428.70	438.92	502.21	565.08	n.a.	n.a.	n.a.	n.a.
GDP (LEK billion) current prices	1,434.3	1,472.5	1,551.3	1,630.9	1,705.2	1,793.5	1,905.1	2,039.6
GDP US\$ billion	11.39	11.86	13.03	15.06	15.56	16.4	17.4	18.6
GDP per capita (current US\$)	3,952.8	4,124.0	4,532.9	5,255.7	5,416.8	5,696.8	6,051.2	6,477.8
Real GDP growth, %	2.2%	3.3%	3.8%	4.1%	3.4%	4.1%	4.5%	4.5%
Official Unemployment (ILO) %	17.5%	15.6%	14.1%	12.8%	n.a.	n.a.	n.a.	n.a.
Industrial Production Growth, %	8.5%	3.2%	6.8%	n.a.	n.a.	n.a.	n.a.	n.a.
Agricultural Production Growth %	-0.8%	2.0%	0.8%	0.9%	1.9%	1.5%	2.4%	2.5%
Domestic Credit Growth %	-2.4%	0.1%	0.6%	-3.2%	n.a.	n.a.	n.a.	n.a.
Lending rate (average for non-bank clients)	8.7%	9.7%	6.6%	5.9%	7.9%	8.3%	8.9%	9.0%
Consolidated Budget Balance/ GDP, %	-4.1%	-1.8%	-2.0%	-1.6%	-1.9%	-1.6%	-1.3%	-1.1%
Total External Debt/ GDP	74.4%	73.5%	68.7%	65.5%	55.1%	53.6%	50.5%	50.2%
Public External Debt/GDP	32.4%	32.7%	31.6%	30.5%	28.6%	28.0%	25.2%	25.4%
Private External Debt/ GDP	29.0%	29.8%	26.9%	24.0%	23.1%	21.9%	20.8%	19.8%
Exports- growth	-17.2%	-7.4%	11.7%	23.7%	8.4%	15.1%	13.2%	24.1%
Imports- growth	-2.5%	8.0%	9.2%	6.5%	6.9%	8.0%	5.5%	8.6%
Trade Balance / GDP	-22.4%	-24.3%	-24.4%	-22.5%	-23.1%	-22.3%	-21.1%	-19.8%
Current Account / GDP	-8.6%	-7.6%	-7.5%	-6.7%	--8.0%	-7.1%	-6.7%	-6.2%
Forex reserves (excluding gold) EUR mn	2,880	2,945	2,995	3,367.3	3,495.7	3,826.5	4,161.9	4,558.7

Last updated on November 13, 2019

Sources: INSTAT, Macroeconomic and Fiscal Framework, Bank of Albania, IFS & IMF, Oct 2019

## I. Recent Developments and Outlook<sup>1</sup>

Albania has transformed from one of the poorest countries in Europe to an upper-middle-income country, as it is implementing structural reforms to promote growth, while also advancing its European Union accession objective. Albania's economic growth has trended upward in recent years benefitting from the economic expansion of its EU trade partners. Growth is estimated at slightly above 4% in 2018 and is projected to stay close to 3.5% p.a. over the medium term, supported by strong domestic demand, exports and investments. However, economic slowdown among Albania's main trading partners could hamper growth through reduced exports, remittance inflows and FDI.

The fiscal stance was broadly neutral in 2018, and the fiscal deficit is expected to stay below 2% of GDP over the medium term. In October 2018, the authorities successfully issued a €500 million Eurobond with a seven-year maturity, at a favorable rate of 3.50%. As large investments with import-intensive components are completed, the current account deficit is expected to narrow to around 6.7% of GDP over the medium term.

Although the banking system is well-capitalized and liquid, the provision of credit has remained weak. Non-performing loans (NPL) declined to about 11%, but a number of vulnerabilities remain.

### a. *Economic structure and Demographic trends*

With a population of almost 3 million, Albania had at end 2018 a GDP per capita of USD 5,256 (current prices), and is estimated to reach about USD 5,417 by end 2019. The estimated poverty rate decreased in 2018 to 31.3% compared to 32.8% in 2017 and 33.9% in 2016, and is anticipated to decline further to 29.5% in 2019 (WB definition, less than \$5/day in PPP).

Exports and regional integration are below potential. Albania faces significant infrastructure gaps, which are currently being addressed through the extensive use of PPPs. As of end 2018, more than 200 PPP projects (31% of GDP) have been contracted, with additional projects in the pipeline accounting for about 15% of GDP. The very high number and amount of infrastructure PPP projects is posing significant risk to public finances, as PPPs are not well integrated into the public investment management framework. Power generation projects, accounting for about 23% of GDP, are covered by power purchase agreements that determine the purchase price, and therefore carry limited fiscal risk. Structural reforms should aim at enhancing investment management and ringfencing risks from contingent liabilities.

Albania has made progress in terms of energy, transport and digital infrastructure development, but low education levels and technology transfers hinder Albania's competitiveness. Agriculture's significant share in GDP formation leads to volatility of growth and low overall productivity. The lack of diversification in the economy is a key constraint holding back medium-term growth prospects.

Population ageing and the outflow of migrants are key challenges that dampen the economy's long-term growth potential. The EU assessed that "With regard to migration, some progress was made in improving the institutional capacity on border management and asylum. Albania signed the European Border and Coast Guard Status Agreement with the EU in October 2018. Reception capacity to deal with mixed migration flows was further enhanced. The number of unfounded asylum applications lodged by Albanian nationals in the EU has decreased but remains high and requires continuous and sustained efforts, as well as to address the phenomenon of unaccompanied minors."

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<sup>1</sup> Data sources: Government of Albania, IMF, World Bank, EBRD, European Commission and BSTDB calculations.

**b. Performance 2015-2018**

**i- Real Sector**

Economic growth accelerated to 4.1% in 2018 from 3.8% in 2017. On the expenditure side, private consumption contributed most to growth, while net exports' contribution was negative. On the production side, the energy sector was the strongest contributor to growth while trade and service also performed well. Investment also made a positive contribution to growth, although the construction of the major energy projects, namely the Norwegian investment in hydropower plants on the river Devoll and the Trans Adriatic Gas Pipeline (TAP), continued to slow down following a peak in the first half of 2017.

Economic activity momentum moderated in the first half of 2019, with GDP increasing 3.3% y/y. Household consumption (+4.5% y/y in 1H19) remained the major source of growth followed by government consumption (+6.0% y/y) while impact of the capital formation (+0.8% y/y), was limited and net exports had neutral contribution. On the production side domestic trade (+6.4% y/y) was the main drivers of growth while significant negative contribution came from non-manufacturing industry (-11.2% y/y).

**ii- Public Sector and Fiscal Policy**

Albania's public finances are characterized by relatively high government debt, a relatively low ratio of government revenues to GDP, and rising off-balance-sheet risks. Putting public debt on a firmly downward path requires further fiscal consolidation, based on higher tax revenues. The current fiscal strategy envisages a budget deficit target of 2% and a decline of the public debt-to-GDP ratio from 70% at the end of 2017 to 64.3% at the end of 2020.

As a result, in 2018 the fiscal deficit declined to 1.6% of GDP, from 2% in 2017. Public debt declined to 67.9% of GDP (including arrears) from 70.1% the year before. As of end-2018, domestic government arrears stood at 1.8% of GDP.

The better than expected performance was driven by lower than budgeted expenditures, mainly reflecting under-execution of the capital budget. Total revenue was slightly below the target due to lower than projected grants and tax revenue. In particular, lower than planned VAT revenue and customs duties (in part affected by the appreciation of the Lek versus the euro) and lower excise revenue drove the revenue underperformance. Local government revenue was instead higher than planned.

The 2019 budget foresees broadly stable revenue as a share of GDP and a slightly lower spending, driven by current expenditure while capital expenditure is expected to increase. On the revenue side, key measures include a decline in the personal income tax, a reduction in the dividend tax rate from 15% to 8%, VAT exemptions applied to the tourism sector, and an increase in excise duties on tobacco. Higher revenue will be supported by improved VAT collection due to efforts to reduce the size of the informal economy and better collection resulting from improved interaction between tax and custom administrations.

Consolidated government budget revenues in Albania were up 2.4% y/y to 28.3% of GDP, while expenditures were up 4.3% y/y to 27.4% of GDP, leading to 0.9% of GDP surplus in 1Q19. Boost in profit taxes (+20.4% y/y), local revenues (+37.7% y/y), and social insurance contributions (+5.3% y/y) were the main drivers of revenue growth. On the expenditure side, current spending was up 6.2% y/y, mainly due to social insurance outlays, while capital expenditures were down 12.3% y/y.

According to the budget execution figures for the first half of 2019, total revenue stood at 60.5% of the full-year budget target, reflecting the underperformance in VAT revenue that stood at 43% of the target. This was in part compensated by higher than planned revenue from profit and personal income

and local taxes. The lower revenue was offset to a large extent by lower than budgeted capital expenditures and interest costs (32% and 39% of targets, respectively).

### ***iii- Public Policy***

Priority reforms aim at restructuring the power sector, advancing governance and judicial reforms, reducing corruption, and closing infrastructure and labor skill gaps, so Albania can better benefit from regional integration.

Under the last IMF program (2014-2017), the government consolidated public finances and paid down arrears. However, contingent fiscal risks remain in the form of PPPs. The Government plans to strengthen the role of the Ministry of Finance and Economy in assessing risks arising from PPPs.

Public investment is planned to grow 5% annually, and the government is hoping to mobilize private investment into a number of infrastructure projects. Private investment is set to be driven by FDI into tourism, health and education facilities and into renewable energy.

The 2019 budget contains an explicit ceiling on the stock of PPPs for the year with a breakdown of pipeline projects. The ceiling is set at 46% of GDP compared to 43% in 2018. PPP related expenditures are estimated at 3% of previous year revenue, which is below the legally set limit of 5%.

In July 2019, parliament approved an amendment to the PPP law that addresses some of the shortcomings of the existing framework. First, the law abolishes unsolicited proposal for the construction, operation, maintenance and rehabilitation of national roads of particular importance. Second, it removes the bonus allocated for unsolicited proposals in all sector and replaces it with a monetary compensation system of up to 1% of the investment value. Third, it increases the oversight of the Ministry of Finance throughout the life of the PPP. Finally, it establishes a selection committee to provide technical assistance during the tendering process.

The government is also considering setting up a new institution, the Albanian Investment Corporation.

On property rights, progress has yet to be made towards improving the legal framework for registration, expropriation and compensation. In February 2019, the Parliament approved the Law on Cadastre. The decision on the registration and management of land located in the coastal area adopted by the government in November 2018 and contested by stakeholders has been amended. The total fund for compensating property owners amounts to approximately EUR 700 million. Further progress is dependent on future budget allocations for integrated land management and for follow-up legislation.

Efforts continued in several related areas, resulting in some progress in the efficiency and transparency of public services delivery, improving the regulatory framework on impact assessment of policies, more transparent recruitment procedures, and the overall strengthening of the administration's capacity to undertake merit-based civil service procedures.

#### *Labor market*

Employment was 2.1% higher in 2018 than one year earlier and solid job creation is set to continue, bringing down the unemployment rate (15-64 years) to below 11% by 2020. Some progress was made on increasing labor market participation and the quality and effectiveness of labor market institutions and services, but the employment rate and labor market participation remain low, and the informal economy is still a significant job provider.

#### **iv- Monetary and Financial Sector**

##### *Monetary Policy*

The Bank of Albania reduced its policy interest rate to the record low of 1% in June 2018, but the transmission of monetary policy to the real economy is hampered by structural bottlenecks.

Inflation has averaged 1.8% per year in Albania since 2012, and remained consistently below 2% in every month of 2019, ranging from 1.1% to 1.9%. In the first ten months prices were up 1.4% y/y.

Appreciation pressures, along with low imported inflation, continue to put downward pressure on inflation, which is expected to remain outside of the BoA's 3% target through 2022. The accommodative monetary policy is appropriate as long as inflation remains below the 3% target.

##### *Banking Sector*

Overall, the banking sector in Albania is very liquid, and average regulatory capital stands at 18%, well above the minimum regulatory requirements (12% for most banks). The NPL ratio in the banking sector has declined sharply between 2015 and mid-2018, mostly via write-offs, and at mid-2019 the NPL ratio stands around 11%. This is a steep decrease from the peak of 25% in 2014.

##### *Major governance reforms have advanced in the banking sector.*

The banking sector is finalizing a significant consolidation, from 16 banks in 2016 to 13 at present. The banking sector has also experienced a shift in ownership away from EU banks. Against this background, the BOA's recent measures for further regulatory alignment with international standards should be helpful, particularly to contain risks from large exposures and related-party lending.

Emerging risks to the financial sector require development and implementation of targeted enhancements of the supervisory framework. The BOA has adopted a more intensive inspection and supervision framework, both on-site and off-site, for banks with new shareholders.

##### *Credit growth, loans and deposits in the banking sector*

Credit growth has been subdued in Albania over the last seven years but has recently shown some signs of recovery in specific market segments (local currency, loans to households). The share of euro-denominated loans decreased, but deposits in foreign currencies remain above 50% of total deposits.

With growth in deposits outpacing growth in loans, loan to deposit ratio retreated from 57.4% in 2014 to 50.1% in 2018. Total loans accounted for 40.4% of total assets in 2018, down from 45.3% in 2014, with the share of loans to private non-financial sector declining from 27.5% of total loans to 21.9%. Around one-quarter of the banking sector assets is represented by holdings of public debt.

The ratio of bank assets to GDP went down from 91.0% in 1Q18 to 87.1% in 1Q19. Fall in assets was driven by a decline in gross loan portfolio to private sector by 3.5% y/y in 2Q19 and 4.7% y/y decline in transactions with banks and other financial institutions. Positive contribution came from increasing transactions with the Central Bank (+10.4% y/y) and decline in provisions (-24.4% y/y). Gross loans to private sector accounted for 37.4% of total assets, while share of FX assets in total assets was at 52.4%.

Financial sector reforms should help restore credit growth and accelerate intermediation. Continued strong supervision will be important to ensure that the expected increase in bank lending does not weaken financial stability.

## **v- External Sector**

In 2019 and 2020, export growth is forecast to decelerate partly on account of the lagged appreciation effect. Import growth, which has been driven by some large energy projects in recent years, is expected to slow down further in 2019 as these projects near completion. The current account deficit is set to continue narrowing over the forecast horizon to 6.5% of GDP.

### *Foreign Trade*

Exports from Albania in nominal EUR terms were up 1.4% y/y in the first nine months of 2019. Imports, on the other hand, were up 7.5% y/y in the same nine months of the year. As a result, trade deficit widened 13.5% y/y to EUR 2.1bn in 9M19. Negative contribution to exports in 9M19 came from decline in exports of mineral products (-25.0% y/y) and iron and steel (-14.7% y/y), while major positive contribution came from exports of machinery (+92.3% y/y), ores (+27.7% y/y) and vegetable products (+30.3% y/y).

### *Current Account and FDI*

Current account (CA) deficit widened 41.4% y/y in 1Q19 to EUR 243.3mn or from 6.1% of GDP in 1Q18 to 8.0% of GDP in 1Q19. Deterioration was due to worsening trade, primary, and secondary balances while improvement in services balance was limited.

Net FDI inflows were marginally down in 2018 (-4.4% y/y) but still more than enough to cover current account deficit. However, given further outflows from net errors and omissions, eventual gap was financed to a significant degree by reserves. FDI inflows were up 1.6% y/y in 1Q19 to EUR 285.6mn. 47.5% of total FDI inflow was in “Electricity, gas, and water supply” (-25.4% y/y), 17.1% in “mining and quarrying” (+67.6% y/y), and 9.6% in “Real estate activities” (+23.5% y/y).

With 23.4% of the total, Switzerland (+36.9% y/y) accounted for the highest share of foreign investments, followed by Netherlands (27.1% of total), Austria (8.8% of total), and Turkey (6.7% of total).

### *Exchange rate and reserves*

The Albanian lek remains a generally free-floating currency, with limited central bank intervention in the foreign exchange market. Large investment-related inflows, as well as the conversion of bank capital from euros into lek, have caused the lek to appreciate since 2017. The central bank halted the pace of the Lek appreciation against the Euro in mid-2018 with euro purchases.

Albania’s reserves including gold were up 18.3% y/y to EUR 3.4bn in 1Q19, enough to cover 6.8 months of imports of goods and services.

### *Foreign debt*

The authorities are actively pursuing efforts to increase debt sustainability, which is currently challenged by refinancing and foreign exchange risks. The average maturity of debt, while increasing over the past years, is still relatively short at 2.3 years. About one-half of Albanian government debt is denominated in foreign currency, bearing the risks of exchange rate fluctuations. This is particularly the case for domestically issued debt, about half of which needs to be refinanced annually.

In nominal Euro terms, in the first quarter of 2019 Albanian gross external debt was up 6.1% y/y to EUR 8.4bn, while as a proportion of GDP it was down to 64.4% from 65.7% in the first quarter of 2018. External debt in nominal terms was up due to public (+ 9.9% y/y to EUR 3.9bn), non-bank private (+5.3% y/y to EUR 1.3bn) and banking (+3.8% y/y to EUR 1.4bn) sectors’ borrowings, while debt obligations arising from FDI were up only 0.7% y/y to EUR 1.7bn.

*c. Forecast for 2019-2022*

Despite the recent growth moderation, Albania medium-term economic prospects remain favorable. Over the medium-term, GDP growth is projected to converge towards the 4% potential rate, as activity is expected to be driven by increasing labor market participation, strong domestic demand, gradual growth of exports, and pick-up in the investments needed to close the existing infrastructure gap.

Given Albania's low savings rate (about 17% of GDP), reforms directed toward improving the business environment and attracting FDI are critical to sustain a high rate of economic growth. Remittance inflows remain an important source of foreign currency, and FDI and remittances are expected to fuel domestic demand and finance current account deficits through 2022.

Despite the favorable environment and positive medium-term outlook, risks and vulnerabilities remain. External downside risks to growth arise from a slowing growth in key trading partners, specifically Italy and Greece, who are also the main sources for remittances.

On the domestic front, the vulnerabilities are arising primarily from high public debt, increasing contingent liabilities, and weaknesses in economic governance in general. Other sources of vulnerabilities include demographic prospects and heavy dependence of growth on weather conditions.

## II. Overview of BSTDB Portfolio

The Bank has made significant efforts to identify suitable operations for Bank financing. When necessary, BSTDB financing has been made available via the financial sector.

**Table 2: Current BSTDB Portfolio - BoD Approved Operations – September 30, 2019**

in EUR

#	Operation	Date of BoD approval	Amount	Outstanding
1	Balkan Accesion Fund	10.08.2006	217,002	23,537
2	Emerging Europe Accession Fund C.V.	25.09.2009	1,173,667	973,677
3	International Hospital	24.09.2010 23.08.2018(PREP)	10,000,000	7,747,771
4	Equity Participation in ADM CEECAT Recov	21.07.2011	94,987	36,070
5	Kurum International Corporate Loan III	25.07.2013	20,000,000	8,307,354
6	Kurum International Corporate Loan IV	20.02.2015	20,000,000	13,532,635
7	Fondi Besa MSME 2	23.09.2016	5,000,000	1,000,000
8	NOA	18.05.2018	2,000,000	1,600,000
9	Fondi Besa SME 3	08.02.2019	10,000,000	10,000,000
<b>Total</b>			<b>68,485,476</b>	<b>43,221,044</b>

### III. Review of Country Strategy

#### Independent Evaluation of 2015-2018 Country Strategy for Albania Evaluation Office, April 2019

The current evaluation was performed by the Bank's Evaluation Office as per the respective Evaluation Policy. It reveals the performance of the Bank's 2015-2018 Country Strategies, to provide accountability to the Board of Directors and Board of Governors as well as facilitate the eventual update of the country strategies.

The evaluation of the respective country strategy compares the stated targets with actual results and provides a country-oriented overview and conclusion. The 2015-2018 Country Strategy was approved by the Board of Directors, reflecting an independent evaluation of the implementation of the BSTDB's earlier strategies. It was aligned with the objectives of the Bank's Business Plan 2015-2018 and was therefore evaluated in that context.

Overall, the implementation of the Country Strategy did not fulfill either the targeted volumes or the intended sector coverage. As the respective targets were reached at just above 50%, despite the priority to increase investments in small shareholder countries, the evaluation assessed the performance as suboptimal. A more comprehensive overview is presented in the table below.

Post Evaluation of 2015-2018 Country Strategies				
2015- 2018 TARGETS		RESULTS		
Country Strategy	Sectors/ Priorities	Target: Signed number/ (EUR million)	Actual: Signed number/ (EUR million)	Evaluation Summary
Albania	<p><b>1. Energy and Infrastructure:</b> electricity, oil and gas transport infrastructure, municipal and telecom;</p> <p><b>2. Manufacturing:</b> transportation, textile, agribusiness, general industry, mining;</p> <p><b>3. Financial Sector SME/Trade/leasing /Equity/ Co-financing.</b></p>	6/63	5/35,8	<p><b>1. Volume:</b> 56,8%</p> <p><b>2. Sector coverage:</b> Kurum International (Manufacturing) Hightel Albania (Infrastructure) Fondi Besa (SME) NOA (SME) Fondi Besa (SME)</p> <p><b>3. Conclusion:</b> Quantitative targets insufficiently covered (56,8%). Weak sector diversity and growth. The Bank covered its priorities/sectors only partially</p>

## IV. Priorities for 2019 – 2022

### Strategic Development Directions

The government's development program has the following priorities:

- ***Industry and Agribusiness:*** focus on expansion, restructuring and modernization of
  - Processing and storage facilities for meat, fish, olive oil, medicinal herbs;
  - Production for export of capital intensive garment and footwear industries
  - Logistics and industrial parks
- ***Infrastructure:*** rehabilitation and modernization of infrastructure, including municipal services (such as water, sewerage, waste treatment), as well as transport infrastructure (road concessions; secondary and local roads connections; railway network)
- ***Energy:*** focus on energy efficiency, rehabilitation of existing assets, and further investments for transportation and interconnectivity networks
- ***Financial Sector:*** priorities include support for SMEs development and promotion of trade by providing debt through reliable financial institutions.

### Areas for BSTDB Financing:

BSTDB will focus in the next four years on providing support for the implementation of the Government development program and priorities, while responding to market demand. The financial support will be in the form of medium to long term corporate loans, short to medium term pre-export financing facilities, SME credit lines, or other investment and working capital facilities.

The Bank shall also seek co-financing opportunities with IFIs, public sector institutions and private partners, in particular with observers and complementary international financial institutions (IFIs), Multilateral Development Banks (MDBs), other bilateral donors, and development institutions and agencies, such as EBRD, IFC, EIB, IDB, NIB, DBA, DEG and KFW, to seek ways to coordinate activities and share experiences, given the opportunities which exist for joint involvement.

Based on the 2019-2022 BSTDB Business Plan, the Bank would expect to sign over the four year period new operations from about € 100 million and up to € 140 million, which would translate into an indicative target of about € 30 million per year.

### Manufacturing Sectoral Opportunities and Priorities

Despite some developments in recent years, Albania still needs substantial amount of investment. The Bank will focus on identifying projects that help the development of general industries and will focus efforts on providing financial support to large and medium sized companies engaged in particular in export generating activities with high economic and employment impact.

Mining, agribusiness and textile are the major industries where Albania has competitive advantage.

***The Mining Industry:*** Albania's mineral deposits include chromite, copper, iron-nickel, and limestone. The share of this sector in the GDP is growing. The sector was previously dominated by state-owned enterprises, but it is now open to competition from private enterprises and the government is seeking to promote privatization and foreign direct investment.

*The textile industry* It is the largest job creator among the light industries. The main activities in the sector are focused on production of clothes and footwear uppers, which comprise the majority of the country's exports to the Italian, Balkan and European markets.

*The agribusiness sector* is in need of adequate medium term financing to expand operations and to increase exports. Agribusiness is one of the fastest growing economic activities with high contribution to export and significant potential for further growth.

*Construction* of shopping malls, office space and logistics centers appear attractive areas for financiers over the next four year period.

*Tourism* Albania has large potential for tourism, which is yet to be developed. Infrastructure is the main hurdle in front of tourism sector to develop. The Bank will explore the possibilities to finance projects that would contribute to the development of infrastructure.

### **Priorities in the Infrastructure sector**

Albania's needs for transportation and manufacturing investments are significant. In addition to the road construction and modernization projects, ports, airports, infrastructure projects for the development of health and tourism sectors and municipal projects will be given priority. Such projects may be financed under the PPP scheme, where possible.

Promoting the development of the public energy sector via the support of the public utilities and developing new sources of energy generation is a key priority for Albania. This is in addition to further integrating Albania regional linkages (both infrastructure and energy, as well as other economic linkages) while maintaining fiscal and financial sustainability. Therefore, attracting investments in the energy and infrastructure sectors (ENI) is one of the country's key priorities.

The Bank's choice of specific new ENI investments during the country strategy period will depend, to certain extent, on the on-going governmental priorities. In compliance with the Bank's Medium-Term Strategy and Business Plan for 2019-2022 the Bank will seek expanding its portfolio through public-sector lending and increased direct funding to sovereign-sponsored energy and infrastructure projects. Wherever applicable, and in cases of implementation of projects that are high priority for the national infrastructure and state security, the Bank will explore the possibility of seeking the certain recourse of sovereign guarantee instruments from the Government of Albania. Notwithstanding the imperative to expand its public sector activities, the Bank's principal ENI clientele will remain private companies active in Albania.

In terms of financing instruments, BSTDB will focus on medium/long-term corporate/project finance lending although it will retain the possibility of providing equity finance where conditions and strategic considerations warrant doing so. The Bank will also work in cooperation with other international financial institutions, commercial banks and export credit agencies in joint energy and infrastructure sector projects as an important source of institutional knowledge transfer and the operation co-financing.

Potential new ENI lending and operations of the Bank will focus on:

*Energy generation and transmission* The Bank will seek to support the ongoing unbundling process of the power distribution operator, OSHEE. This may involve support of the three new subordinate companies: the Distribution System Operator, which will manage and operate the power distribution network; the Free Market Supplier, which will manage the unregulated supply and trading of electricity; and the Universal Service Supplier, which will manage the final stage of the power delivery to customers in the regulated market. To further support energy security, the Bank will also support power and gas interconnections with neighboring countries.

Also the Bank will seek to support the ongoing development of renewable energy capacity by supporting independent power producers in their development plans of renewable energy plants, primarily from hydro, solar and wind resources.

*Petrochemicals distribution infrastructure* The Bank will continue its ongoing dialogue with the various petrochemical ports and infrastructure providers to support their continued development, providing further linkages to the wider European networks.

*Telecommunications and information technology* The Bank will consider providing funding for projects involving upgrade, development and modernization of telecommunications and information technology infrastructure to ensure competitive market standards in the country.

*Transportation and distribution* The Bank will continue its support the further development of transportation and distribution infrastructure in Albania, supporting the nascent PPP initiatives, to help promote regional transport linkages that will also improve cross-border links and lower transportation costs.

### **Trade Finance, SMEs and Financial Institutions**

The financial intermediation is still low in the banking sector, thus the Bank will continue to focus on non-bank financial intermediaries in order to add new names to its list that consists also of one micro-finance institution. The Bank started working with Fondi Besa back in 2014, signed 3 operations (latest one in 2019) in the amount of €20 million, cumulatively. The Bank also added the second name to the FI portfolio in 2018, NOA. Going forward, the likely scenario is to have for the time being repeat operations with these 2 names, and on best effort basis, promote trade finance and leasing products.

As such, most of the BSTDB's financing programs will be executed through financial intermediaries. By working through financial intermediaries, the Bank will also support the development of Albania's financial sector. The Bank will seek opportunities to locate financial intermediaries through which it will be able to promote its financial products, such as trade finance and SME finance or leasing.

*Trade finance* – it is necessary to provide financing for increasing exports and expanding regional trade. Financing to exporting companies may help improve competitiveness and content of value added in diversification of exports. Financing trade particularly for promoting imports of capital goods and manufacturing equipment from other BSEC countries is important for the Bank's mandate.

*SME and Micro enterprise sector* – the sector is in need of working capital as well as medium term finance, which would promote modernization of equipment and diversification of products and services. Most of the BSTDB's financing programs for promoting SME development and micro-enterprise activities will be executed through financial intermediaries. By working through financial intermediaries, the Bank will also support the development of Albania's financial sector.

*Leasing* – The Bank hopes to find suitable partners to support the development of leasing, as well. The Bank will use the leasing product for financing capital expenditure of SMEs and as a financing tool for the promotion of regional trade. Medium-term credit lines opened to leasing companies for trade related purpose will enable them to offer their customers finance for capital expenditures on imports from other countries in the region.