

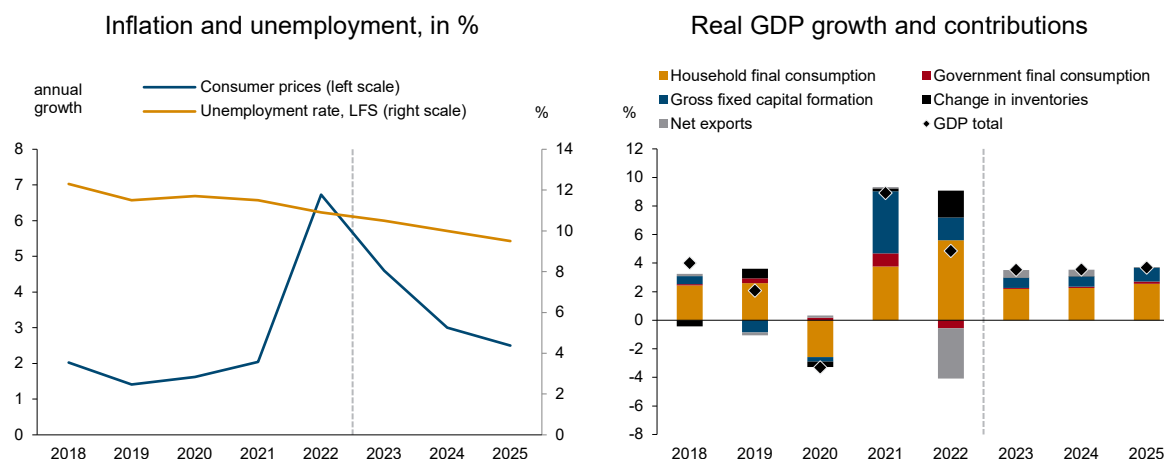


ALBANIA: Economic growth supported by external demand

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Economic growth will accelerate to 3.5% this year, and a similar pace is expected over the medium term, owing to favourable external and domestic demand. A bumper tourist season has greased the wheels of the economy. Strong services exports and buoyant remittance inflows have pushed the current account deficit to unprecedentedly low levels, while FDI inflows have also performed strongly. Consumer prices will surge by a relatively modest 5%, but an inflation rate in double digits for staple foodstuffs is eating into the income of the most vulnerable groups.

Figure 6.1 / Albania: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Economic growth in 2023 is expected to accelerate to 3.5% on the back of favourable external demand. By July 2023, the number of tourists had almost doubled compared to pre-pandemic levels (2017-2019). The economy is expected to perform better than expected in H2 2023 as well. High-frequency data suggest that production activity is being pushed up by the construction sector, the energy sector and retail trade and services. By contrast, manufacturing is not doing too well.

The current account deficit has fallen to a record low, thanks to expanding exports of services and robust remittance inflows. Exports of services kept rising rapidly in H1 – up by 31% – and this positive trend is expected to continue in H2 2023. The government's campaign drive over the last five years, the policy of open doors to tourism during the pandemic and more recently, and high prices in the EU and the surrounding countries have combined to turn Albania into a favourite tourist destination this year (to say nothing of 'ethnic tourism' and the return of migrants for the summer holidays). The number

of foreigners entering the country in January-July exceeded 5.2m – 31% up on the same time last year, while the number of hotel nights spent by residents and non-residents reached 2.9m (46% up).

We have entered good times for the inflow of foreign direct investment (FDI), and this is expected to last. In H1, FDI rose by 7% year on year, and will likely reach EUR 1.4bn for the full year (close to 6% of GDP). There have been several new announcements on solar and wind-power plants. There is also great enthusiasm surrounding the recent tests by Shell in the wake of the discovery of oil at Shpirag (close to Berat, in the central part of the country), which could prove a turning point. The prime minister has announced that Shell could invest EUR 7bn, if the company decides to develop the field. Other officials have announced that if it goes ahead, production could start in 2033. Furthermore, Statkraft – a Norwegian company that has already invested EUR 0.6bn in two hydropower projects in Albania – is considering investing further to expand the installed capacity of those two plants to a total of 1200 MW: this would correspond to 48% of the total hydropower capacity in Albania in 2022. The energy sector will benefit considerably from this investment – which could start in 2025 – since it will boost domestic electricity production and reduce the dependence on imports.

The exchange rate has appreciated this year, owing to a bumper tourist season, remittances and FDI inflows. Between early January and mid-July, the lek appreciated by 15% against the euro. However, the overvaluation of the lek has hit export-oriented firms. Up to July 2023, goods exports contracted by 8% year on year, following the solid momentum built up over the past three years. In June, the government decided that next year such companies will only have to pay profit tax based on their balance; thus, in the event of a loss they will not have to pay.

Inflation is expected to decline to 4.6% in 2023, though the medium-term outlook is hazy. Annual consumer price inflation stood at 4% in August, and in January-August 2023 it averaged 5.2%. However, the rate of consumer inflation on food staples such as meat, cheese, milk, vegetables and other foodstuffs is still in double digits. Almost half of the consumption expenditure of households in Albania – and even more than half for vulnerable groups – goes on food. The government has announced a further rise of 8.6% for pensions as of October 2023, which implies an increase in the average old-age pension from EUR 164 to EUR 178. This will still be inadequate to cover inflation and ensure a decent living for the elderly, who account for a quarter of the population of Albania. It is no coincidence that remittances have surged, as emigration persists and the need to smooth consumption for family members left at home remains elevated. Up to June 2023, remittances grew by 18% year on year, and will reach EUR 1bn this year, or 5% of GDP.

Further fiscal consolidation will be achieved, as the public finances are improving. Up to July 2023, general government revenues (up 12% in nominal terms) grew faster than expenditure (up 4%). Public investments contracted by 4% and accounted for no more than 11% of total spending. The fiscal surplus achieved up to July 2023 will reduce the public debt, although it remains one of the highest in the region. A reform of public-sector wages was announced by the government this year: average wages in the public sector are set to increase from EUR 520 to EUR 900 by 2024, with the rise coming in two tranches – half in H2 2023 and the remainder by the end of June 2024. In H1 2023, nominal wages already grew by 20% year on year in the public sector and by 15% in the private sector – a consequence both of labour and skill shortages due to persistent emigration, and of labour market mismatches. In Q2 2023, the minimum wage rose by 25% year on year, reaching EUR 364. Despite that, average salaries in Albania remain among the lowest in the region. It cannot be ruled out that the

big rise in public wages could lead to a wage-price spiral, unless the move is accompanied by a further increase in labour productivity and more quality jobs in the private sector.

The hike in interest rates has already curbed the demand for credit. The acceleration of inflation to above the target level of 3% prompted the central bank to intervene by raising interest rates, from 0.5% in 2021 to 3% in 2023. That has curbed demand for credit, the volume of which has been stagnant over the past year. In 2023, up until July, demand for credit from the non-financial private sector had declined by almost 4%, while households had continued to expand their demand for credit – up 7%, mainly for the purchase of houses. Still, central bank interest rates are among the lowest in the region and are not expected to rise further. In July 2023, non-performing loans were at a low rate of 5.27% (the same as in July 2022), though that figure is 0.27 percentage points up on the beginning of the year. Though hardly a dramatic change, this still suggests the emergence of some strain, especially for the private sector.

Structural issues that cannot be resolved overnight mean that the labour market is sending mixed messages. Overall, the unemployment rate has declined further to 10.7% in Q2 2023, while the figure for employment has surged further to 57.1%, up 0.6 percentage points. The rise in employment has mainly been driven by the service sector; meanwhile on a yearly basis, in agriculture and industry employment has contracted. Women and people aged 30-64 have been the main beneficiaries of the new jobs. By contrast, youth unemployment has risen further. Moreover, inactivity and employment among those aged 15-29 contracted in Q2 2023, year on year, suggesting that the younger age cohorts are continuing to abandon the country, viewing emigration as a much better option. As a consequence, labour and skill shortages are looming. This is reflected particularly in tourism, but also in other sectors that need highly skilled professionals: curbing the emigration of such individuals is becoming something of an issue. The emigration of doctors, for example, has impelled the government to introduce a kind of 'brain drain' tax for this group: newly qualified graduates from medical school will be granted their diploma only once they have spent five years working in Albania following their graduation.

Overall, we expect GDP growth this year to accelerate to 3.5%, thanks to robust external demand. In the medium term, growth will be solid at above 3%, bolstered by rising domestic and external demand.

Table 6.1 / Albania: Selected economic indicators

	2020	2021	2022 ¹⁾	2022 January-June	2023	2023 Forecast	2024 Forecast	2025
Population, th pers., average	2,838	2,812	2,778	.	.	2,745	2,730	2,715
Gross domestic product, ALL bn, nom.	1,647	1,856	2,138	.	.	2,300	2,500	2,700
annual change in % (real)	-3.3	8.9	4.9	.	.	3.5	3.6	3.7
GDP/capita (EUR at PPP)	9,210	10,300	12,080	.	.	.	.	.
Consumption of households, ALL bn, nom.	1,318	1,411	1,610	.	.	.	.	.
annual change in % (real)	-3.3	4.7	7.4	.	.	2.9	3.0	3.4
Gross fixed capital form., ALL bn, nom.	373	452	512	.	.	.	.	.
annual change in % (real)	-1.4	19.2	6.5	.	.	3.0	3.0	4.0
Gross industrial production								
annual change in % (real)	-6.3	26.2	2.8	0.2	-7.2	3.5	4.0	4.5
Gross agricultural production ²⁾								
annual change in % (real)	1.5	-2.2	2.0	.	.	.	.	.
Construction output total								
annual change in % (real)	9.5	18.0	12.5	7.2	-6.2	.	.	.
Employed persons, LFS, th, average	1,243	1,249	1,298	1,278	1,323	1,325	1,345	1,365
annual change in %	-1.8	0.4	4.0	3.7	3.5	2.1	1.5	1.5
Unemployed persons, LFS, th, average	165	163	160	161	160	160	150	140
Unemployment rate, LFS, in %, average	11.7	11.5	10.9	11.2	10.8	10.5	10.0	9.5
Reg. unemployment rate, in %, eop ³⁾	7.4	7.3	7.0	.	.	.	.	.
Average monthly gross wages, ALL	53,662	57,191	61,898	59,954	67,805	75,100	85,100	91,600
annual change in % (real, gross)	0.8	4.4	1.4	0.7	7.1	16.0	10.0	5.0
Consumer prices, % p.a.	1.6	2.0	6.7	5.6	5.5	4.6	3.0	2.5
Producer prices in industry, % p.a.	-3.3	2.7	19.9	18.8	8.2	4.0	3.5	2.0
General governm. budget, nat. def., % of GDP								
Revenues	25.9	27.5	26.8	.	.	29.0	29.0	29.5
Expenditures	32.6	32.1	30.4	.	.	31.2	30.5	30.5
Deficit (-) / surplus (+)	-6.7	-4.6	-3.7	.	.	-2.2	-1.5	-1.0
General gov. gross debt, nat. def., % of GDP	74.3	74.5	64.5	65.0	58.7	62.0	59.0	56.0
Stock of loans of non-fin. private sector, % p.a.	6.9	9.6	7.0	12.5	1.4	.	.	.
Non-performing loans (NPL), in %, eop	8.1	5.7	5.0	5.3	5.2	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	0.50	0.50	2.75	1.00	3.00	3.00	3.00	3.00
Current account, EUR m	-1,153	-1,166	-1,063	-445	-323	-750	-810	-830
Current account, % of GDP	-8.7	-7.7	-5.9	-5.2	-3.2	-3.6	-3.5	-3.4
Exports of goods, BOP, EUR m	794	1,265	1,933	992	912	1,860	1,990	2,070
annual change in %	-12.5	59.4	52.8	64.9	-8.0	-4.0	7.0	4.0
Imports of goods, BOP, EUR m	3,776	5,094	6,201	2,806	3,023	6,880	7,350	7,810
annual change in %	-6.8	34.9	21.7	27.0	7.8	11.0	6.9	6.2
Exports of services, BOP, EUR m	2,226	3,486	4,801	2,081	2,721	6,100	6,530	6,860
annual change in %	-34.6	56.6	37.7	45.1	30.7	27.0	7.0	5.0
Imports of services, BOP, EUR m	1,174	1,690	2,400	1,074	1,362	2,830	2,960	3,030
annual change in %	-45.1	43.9	42.0	51.1	26.9	18.0	4.5	2.5
FDI liabilities, EUR m	937	1,032	1,372	640	686	1,400	.	.
FDI assets, EUR m	43	42	182	90	126	100	.	.
Gross reserves of CB excl. gold, EUR m	3,806	4,831	4,786	4,740	5,357	.	.	.
Gross external debt, EUR m	8,549	9,755	9,766	9,863	10,183	10,500	11,000	11,400
Gross external debt, % of GDP	64.2	64.4	54.3	54.9	50.0	50.0	48.0	46.0
Average exchange rate ALL/EUR	123.77	122.46	118.98	121.17	112.87	110.0	109.0	109.0

1) Preliminary. - 2) Based on UN-FAO data, wiiw estimate in 2022. - 3) wiiw estimate from 2021. - 4) One-week repo rate.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.