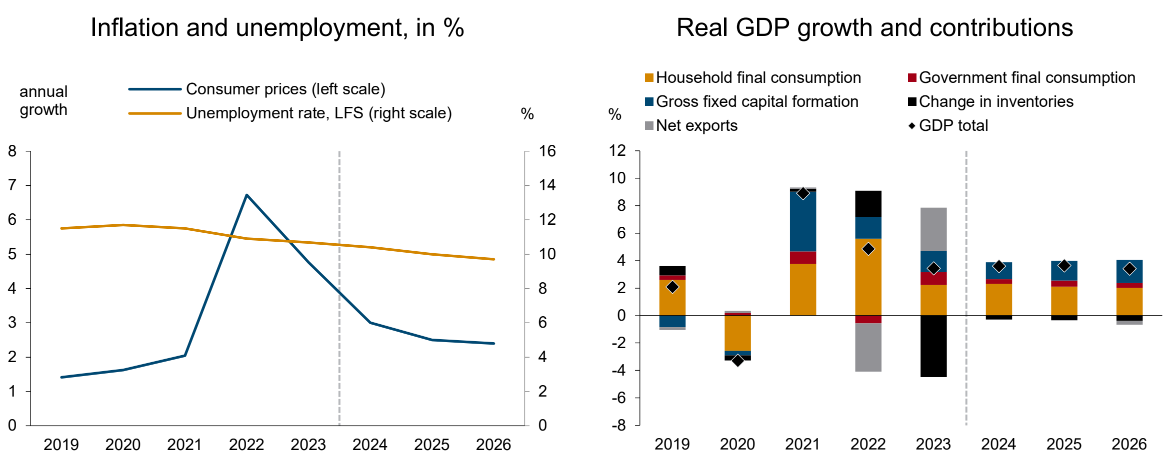
ALBANIA: Tourism to continue as the star of the economy

ISILDA MARA

The economy expanded by 3.4% in 2023, driven by increased domestic and external demand. Public finances remain robust, and efforts toward fiscal consolidation will continue. However, imbalances on the labour market are intensifying, posing a risk to growth as emigration rates surge and as labour and skills shortages loom. While inflation is expected to moderate, seasonal challenges persist. The current account deficit has nearly bottomed out and will likely remain low due to sustained external demand. Positive trends in tourism and foreign direct investment are set to continue to fuel the momentum, which is expected to result in growth of 3.5% in the medium term.

Figure 6.1 / Albania: Main macroeconomic indicators



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

In 2023, the economy expanded by 3.4%, driven by robust domestic and external demand. Key contributors to this were government and household consumption, which rose by 9% and 3%, respectively. Public investment remained high and gross fixed capital formation rose by 6.4%. Exports of services soared, and tourism in particular proved a bright star in the firmament: its growing role in the economy will remain vital in 2024. Despite a 5% contraction in goods exports, they still stood at double their pre-pandemic level. Imports continued to expand, albeit more slowly. Overall, the net effect of trade on growth was noteworthy. Real estate activity and construction continued to experience strong growth, increasing by 11% and 9%, respectively. Information and communication activities and public administration also enjoyed a positive year, growing by 8% and 6%, respectively. However, other sectors such as agriculture and manufacturing – so crucial to the economy and employment – receded by 1% apiece.

Both core and headline inflation have been falling, but a reversal is anticipated during 2024. In 2023, average consumer price inflation dropped to 4.8% – one of the lowest rates in the Western Balkans. Headline inflation was primarily influenced by food prices, which grew by around 9.5%. This year so far, disinflation seems to have continued, and the gap between core and headline inflation is now significantly narrower than in 2023. During January and February 2024, headline inflation stood at 2.6%, below the 3% target set by the central bank. However, we anticipate rising seasonal inflationary pressures as the year progresses, on account of the expected boom in tourism. In addition, wage hikes in both the public and the private sector may contribute to inflationary pressures, preventing inflation from dipping below 3% in 2024.

Public finances are improving, and further fiscal consolidation is expected. In 2023, public finances exhibited a significant improvement, and the trends during Q1 2024 appear promising. Last year, government revenue surged by 12% to reach 27.9% of GDP; this was partly a result of inflation but was mainly due to the increased collection of profit tax, personal income tax and social security contributions – a positive benefit of formalised working arrangements and rising wages. However, the sluggish growth in VAT collection (a rise of a mere 0.5%) suggests that informality and tax evasion continue to pose challenges. Government spending likewise increased: it accounted for 29.3% of GDP and resulted in a budget deficit of 1.4% at the close of 2023. Notably, the government allocated a larger share of the purse to public investments, which grew by an impressive 42% and absorbed 18% of total spending. This prudent fiscal stance helped rein in the public debt, which declined to nearly 60% of GDP. We forecast that the solid growth in revenue (thanks to robust GDP growth) will play a crucial role in furthering fiscal consolidation; public debt is expected to fall to 55% of GDP by 2026.

The banking sector remains solid and well capitalised. In March 2024, the central bank announced that the policy interest rate would remain unchanged at 3.25%, signalling a less restrictive monetary policy for the coming months. Meanwhile, the increased demand for credit continues. Notably, non-performing loans declined further – to 4.9% in 2023, down from 5.1% in 2022. Confidence – both consumer and business – has improved since the beginning of the year, with the exception of one sector: construction. The signals coming from tourism are especially encouraging, and optimism is high for this year.

Despite good growth momentum, labour market weaknesses persist. In 2023, the unemployment rate closed at 10.7%, just 0.1 percentage points (pp) lower than in 2022; meanwhile, the employment rate rose by 0.8 pp to reach 57.1%. Unfortunately, the fall in unemployment and the rise in employment do not translate into better job opportunities, especially for young people. The growth drivers stem primarily from sectors that are susceptible to high seasonal fluctuation, such as services (e.g. tourism), construction and agriculture. As such, any impact on employment is temporary. The labour market prospects facing young people remain bleak: in 2023, the employment rate in the age group 15-29 declined by 1.5 pp, falling from 44.6% in Q4 2022 to 43.1% in Q4 2023. At the same time, this age group also registered a fall in inactivity, in unemployment – and indeed in overall presence within the labour force. All this goes to show that the country is continuing to lose its most vital segment of the population because of emigration.

The spectre of soaring emigration, coupled with the labour and skills shortages, casts a pall over the economy. In response, the government has embarked on reforms related to public-sector wages: in 2023, these increased by 14% in nominal and 8.8% in real terms. This year, the average nominal wage in the public sector is set to surge to EUR 900 (a 14% nominal jump) from June 2024, which is expected to bolster consumption significantly. After all, the public sector serves as a vital source of employment for approximately a quarter of the workforce (excluding the agricultural sector). Meanwhile, the private sector has also responded to the challenges outlined above by raising nominal wages by 13% in 2024. The pressure is such that nominal wages will continue to rise, especially in the tourist industry.

However, there is a flip side to the emigration phenomenon: remittances. In 2023, remittances reached a staggering EUR 1bn (5% of GDP), marking an 11% increase. These inflows are likely to remain elevated, as emigration waves persist. Yet, despite the remittances, consumption may yet suffer as a consequence of the ongoing decline in the population.

The current account deficit came close to 'ground zero', thanks to robust external demand. In 2023, the current account deficit fell to an unprecedented 1% of GDP. This positive outcome was driven by a significant improvement in the trade balance, a surge in service exports and strong inflows of secondary income, particularly remittances. Notably, service exports enjoyed an exceptional year: their volume doubled compared to pre-pandemic levels and they were 38% up on the previous year. Specifically, tourism-related services experienced a remarkable growth of 50%, fuelled by over 10m tourists visiting in 2023. Looking ahead to 2024, the expectation is that service exports will continue to surge, and the number of tourists is projected to top 14m. However, in contrast, goods exports are contracting: there was a 16% decline for January-February 2024, compared to the same period last year. The reasons for this are twofold: (i) the strong appreciation of the domestic currency against the euro (by almost 9% in 2023), and (ii) the global economic slowdown, which has had an impact on merchandise trade not only within the EU, but also among its main trading partners.

Robust foreign direct investment (FDI) inflows are expected to persist. In 2023, FDI grew by 5% year on year, surpassing EUR 1.4bn, which corresponds to 7% of GDP. Several project announcements and ongoing construction projects (including Vlora airport), as well as investments in renewable energy, oil extraction and railways, all indicate that FDI will continue to thrive. Notably, NATO's investments in Albania have also expanded. Just last month, in March, an airbase in the central part of Albania was reopened following modernisation that involved NATO investment totalling EUR 50m. Furthermore, Standard & Poor's has upgraded the country's rating from B+ to BB- with a stable outlook. This positive signal is likely to attract foreign investors.

Solid economic growth will likely continue this year and beyond. While consumption will remain a key driver, it is expected to grow at a more moderate pace. Government spending will remain generous, providing support to the economy. Strong external demand is expected to sustain and accelerate economic growth in the medium term. Both public and private investments are expected to expand, further contributing to growth. Overall, we project that the economy will maintain a growth rate of 3.6% in 2024 and 3.5% in the medium term.

Table 6.1 / Albania: Selected economic indicators

	2020	2021	2022	2023 1)	2024	2025 Forecast	2026
Population, th pers., average	2,838	2,812	2,778	2,745	2,730	2,715	2,700
Gross domestic product, ALL bn, nom.	1,647	1,856	2,138	2,313	2,500	2,700	2,900
annual change in % (real)	-3.3	8.9	4.9	3.4	3.6	3.7	3.4
GDP/capita (EUR at PPP)	9,220	10,260	12,100	12,880	.	.	.
Consumption of households, ALL bn, nom.	1,318	1,411	1,610	1,733	.	.	.
annual change in % (real)	-3.3	4.7	7.4	3.0	3.1	2.8	2.7
Gross fixed capital form., ALL bn, nom.	373	452	511	563	.	.	.
annual change in % (real)	-1.4	19.2	6.5	6.4	5.0	6.0	7.0
Gross industrial production							
annual change in % (real)	-6.3	26.2	2.8	-7.6	3.0	4.5	3.0
Gross agricultural production 2)							
annual change in % (real)	1.6	-0.8	0.4	-1.0	.	.	.
Construction output total							
annual change in % (real)	9.6	17.9	12.5	-1.5	.	.	.
Employed persons, LFS, th, average	1,243	1,249	1,298	1,327	1,345	1,365	1,370
annual change in %	-1.8	0.4	4.0	2.2	1.4	1.5	0.4
Unemployed persons, LFS, th, average	165	163	160	159	160	150	150
Unemployment rate, LFS, in %, average	11.7	11.5	10.9	10.7	10.4	10.0	9.7
Reg. unemployment rate, in %, eop 3)	7.4	7.3	7.0	6.9	.	.	.
Average monthly gross wages, ALL	53,662	57,191	61,898	70,531	81,400	87,600	92,400
annual change in % (real, gross)	0.8	4.4	1.4	8.8	12.0	5.0	3.0
Consumer prices, % p.a.	1.6	2.0	6.7	4.8	3.0	2.5	2.4
Producer prices in industry, % p.a.	-3.3	2.7	20.0	6.1	1.0	0.5	0.5
General governm. budget, nat. def., % of GDP							
Revenues	25.9	27.5	26.8	27.8	28.5	29.0	29.0
Expenditures	32.6	32.1	30.4	29.2	30.0	30.5	30.0
Deficit (-) / surplus (+)	-6.7	-4.6	-3.7	-1.4	-1.5	-1.5	-1.0
General gov. gross debt, nat. def., % of GDP	74.3	74.5	64.5	59.2	59.0	56.0	55.0
Stock of loans of non-fin. private sector, % p.a.	6.9	9.6	7.0	3.8	.	.	.
Non-performing loans (NPL), in %, eop	8.1	5.7	5.0	4.7	.	.	.
Central bank policy rate, % p.a., eop 4)	0.50	0.50	2.75	3.25	3.25	3.00	3.00
Current account, EUR m	-1,153	-1,166	-1,063	-191	-330	-350	-390
Current account, % of GDP	-8.7	-7.7	-5.9	-0.9	-1.4	-1.3	-1.4
Exports of goods, BOP, EUR m	794	1,265	1,933	1,836	1,890	1,980	2,070
annual change in %	-12.5	59.4	52.8	-5.0	3.0	5.0	4.5
Imports of goods, BOP, EUR m	3,776	5,094	6,201	6,376	6,580	6,740	6,870
annual change in %	-6.8	34.9	21.7	2.8	3.2	2.5	2.0
Exports of services, BOP, EUR m	2,226	3,486	4,801	6,645	6,910	7,120	7,260
annual change in %	-34.6	56.6	37.7	38.4	4.0	3.0	2.0
Imports of services, BOP, EUR m	1,174	1,690	2,400	3,214	3,350	3,470	3,550
annual change in %	-45.1	43.9	42.0	33.9	4.3	3.5	2.2
FDI liabilities, EUR m	937	1,032	1,372	1,492	.	.	.
FDI assets, EUR m	43	42	182	245	.	.	.
Gross reserves of CB excl. gold, EUR m	3,806	4,831	4,786	5,644	.	.	.
Gross external debt, EUR m	8,549	9,755	9,766	10,147	11,300	12,100	12,700
Gross external debt, % of GDP	64.2	64.4	54.3	47.7	47.0	46.0	45.0
Average exchange rate ALL/EUR	123.77	122.46	118.98	108.80	104.0	103.0	103.0

Note: Introduction of new index 2021=100 (new weights) for construction.

1) Preliminary and wiiw estimates. - 2) Based on UN-FAO data, wiiw estimate in 2023. - 3) wiiw estimate from 2021. - 4) One-week repo rate.

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