A stronger-than-expected economic recovery driven by a quick rebound of tourism from neighbouring countries, as well as by high investment growth and a recovery of private consumption, boosted growth to 8.5% in 2021. For 2022 and 2023 growth is expected to be 2.7% and 3.1% respectively, mainly affected by the impact of Russia’s invasion of Ukraine, although only indirectly as Albania has little direct exposure to both countries. Increasing food and energy prices have prompted the government to provide additional support to households and SMEs, which is set to postpone to 2023 a more significant improvement in government finances.

A stronger-than-expected recovery in 2021

The Albanian economy grew by 8.5% last year, according to preliminary data, almost 2 pps. higher than the Autumn 2021 Forecast projection. Most expenditure categories exceeded their 2019 levels, driven by both public and private investment, private consumption and external demand. Public investment and a stable and liquid financial sector supported the exceptionally strong investment growth. Growing employment and increasing wages fuelled private consumption beyond pre-crisis levels. While goods exports, mainly electricity and construction material, more than recovered the ground lost in 2020, services exports, although benefitting from growing inbound tourism from neighbouring countries, still remained slightly below their pre-pandemic level. Investment and consumption growth drove the rise in goods imports, leading to a strongly negative growth contribution of net exports in 2021.

Normalisation of growth dampened by uncertainty about the external environment

Following the strong recovery of most demand components in 2021, expectations of a return to the over 3% historical average growth rate are damped by the impact of the war on the main EU trading partners, supply chains and commodity prices. Uncertainty about the economic effect of these disruptions, in addition to the likely tightening of financing conditions, is expected to subdue the growth of private consumption and investment. Public investment, in particular the completion of the post-earthquake reconstruction, will continue to support the economy, but less than planned as public expenditure of about 1.5% of GDP has been reoriented to subsidise electricity and fuel, as well as increased social support. Subdued domestic demand is expected to dampen import growth. On the other hand, tourism, which mainly depends on regional and EU tourists, is projected to continue supporting the growth of services exports, which is set to turn the contribution of net exports to growth slightly positive. Overall, economic growth is forecast at 2.7% in 2022 and 3.1% in 2023. This slowdown and increasing wages are likely to moderate employment growth in 2023. However, driven by recent labour shortages, the unemployment rate is expected to decline to below 11% by 2023.

This outlook is subject to downside risks, mainly related to the impact of a lasting energy price hike coupled with low domestic hydroelectric production due to insufficient rainfall, as already seen in 2022-Q1. In this case, Albania’s electricity import bill would increase substantially, and could, in addition to widening the trade deficit, overburden the public budget, which has so far covered the price gap between high external import prices and the regulated domestic prices for households and SMEs.

Rising commodity prices weigh on the current account deficit

A strongly increased services balance, in combination with rebounding remittances,
reduced the current account deficit by 1 pp. to 7.7% of GDP in 2021, despite an increasing deficit in goods trade. In 2022, rising commodity import prices are projected to widen even further the merchandise trade deficit, which is forecast to increase the current account deficit to 8.3% of GDP in 2022 before slightly improving in 2023, helped by a higher GDP denominator.

**Monetary policy is set for normalisation**

The central bank continued to support the economy with its record low policy rate of 0.5% until March 2022, when it raised the rate to 1% as a first step towards a gradual policy normalisation, in response to increasing price pressures. Inflation is projected to exceed the central bank’s 3% target by almost 2 pps. in 2022. For 2023, imported inflation is expected to subside but domestic upward pressure is forecast to keep the inflation rate above the target level at 3.5%.

**Government finances to remain under pressure**

Benefitting from the high GDP growth and lower public investment than planned, public deficit and debt ratios turned out 2 pps. lower than expected in 2021, despite a Eurobond issuance for pre-financing the 2022 budget balance. The high cost of subsidies and increased social support expected for 2022 will delay a substantial reduction of the deficit, to 2.7% of GDP, to 2023, when the debt ratio is projected to decrease to 70.9% of GDP.