

Bank of Albania

ANALYSIS OF DEVELOPMENTS IN
THE EXTERNAL SECTOR
OF THE ECONOMY

2011 Q4

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I. BALANCE OF PAYMENTS HIGHLIGHTS¹

The external position of the Albanian economy during 2011 was under the constant impact of the global macroeconomic developments, and particularly of those in the euro area. GDP growth deceleration, worsening employment situation and sluggish foreign demand led to significant moderation of merchandise exports' growth rate and decline in services' exports during 2011. The recovery of domestic demand and visa liberalisation for Albanian citizens travelling to the Schengen area contributed to the increase in the imports of goods and services mainly during the second half of 2011. On the other hand, the improvement in the income and current transfers account contributed positively to the current account, though not enough to offset the negative effect of the goods and services account. As a result of foreign currency flows in these accounts, the current account balance recorded a deficit of EUR 1145.4 million, about 12.5% higher than in 2010. The currency account deficit for 2011 was estimated at about 12.2% of nominal GDP² or about 0.9 percentage points higher than in 2010. Foreign inflows into the capital and financial account amounted to about EUR 921.2 million, up by about 5.6% y-o-y. The surplus in the capital and financial account during 2011 financed about 80.4% of the current account deficit of this period.

¹ The latest balance of payments data refer to the last quarter of 2011. Balance of payments' data on 2010 have also been revised.

² INSTAT's release of nominal GDP for 2003-10. Bank of Albania, Monetary Policy Department's projections for GDP in 2011.

Table 1 Balance of Payments Items

	2007	2008	2009	2010	2011
Current Account (EUR million)	-824.2	-1381.2	-1329.8	-1018.6	-1145.4
/ y-o-y	75.0%	67.6%	-3.7%	-23.4%	12.5%
/ GDP	-10.5%	-15.6%	-15.3%	-11.3%	-12.1%
Trade Balance	-2,104.0	-2,431.5	-2,303.7	-2,082.7	-2,241.6
Exports, f.o.b.	786.3	917.5	750.7	1,171.5	1,405.5
Imports, f.o.b.	-2,890.4	-3,348.9	-3,054.4	-3,254.2	-3,647.1
Services Balance	18.9	69.4	173.9	231.8	134.6
Credit	1421.3	1687.8	1771.4	1750.7	1747.4
Debit	-1402.3	-1618.3	-1597.5	-1518.8	-1612.7
Travel - net	79.0	112.1	167.5	194.9	47.9
Income Balance	218.0	44.0	-137.9	-90.1	24.2
Credit	281.7	321.1	269.4	286.3	231.5
Debit	-63.7	-277.1	-407.3	-376.4	-207.3
FDI Income - net	7.5	-174.1	-289.3	-273.2	-52.6
Current Transfers	1042.9	936.8	937.9	922.4	937.3
Credit	1219.8	1117.4	1096.2	1076.6	1050.3
Debit	-176.9	-180.5	-158.3	-154.2	-113.0
Workers' remittances - net	951.7	833.3	781.3	689.8	687.9
Capital and Financial Account (EUR million)	787.9	1621.0	1022.2	872.1	921.2
/ y-o-y	41.1%	105.7%	-36.9%	-14.7%	5.6%
/ GDP	10.1%	18.3%	11.7%	9.7%	9.8%
Capital Account	90.1	78.2	84.9	85.5	84.9
Financial Account	697.8	1542.8	937.3	786.6	836.3
A. Liabilities	756.9	1433.0	900.2	1061.9	1241.4
FDI	481.1	665.2	716.9	793.3	741.9
Portfolio Investment	42.3	38.9	-2.7	316.3	15.9
Other Investment	233.4	728.9	186.0	-47.8	483.6
B. Assets	-59.1	109.8	37.2	-275.3	-405.0
FDI	-17.5	-55.4	-28.2	-4.8	-30.1
Portfolio Investment	19.1	-63.5	15.4	-84.2	-98.4
Other Investment	-60.7	228.7	50.0	-186.3	-276.5
FDI (net)	463.7	609.8	688.7	788.5	711.8
Portfolio Investment (net)	61.4	-24.6	12.7	232.1	-82.5
Other Investment (net)	172.7	957.7	235.9	-234.1	207.1
Errors and Omissions	131.2	-18.7	272.0	325.4	195.5
Reserve Assets	-148.6	-191.9	32.0	-179.0	28.6

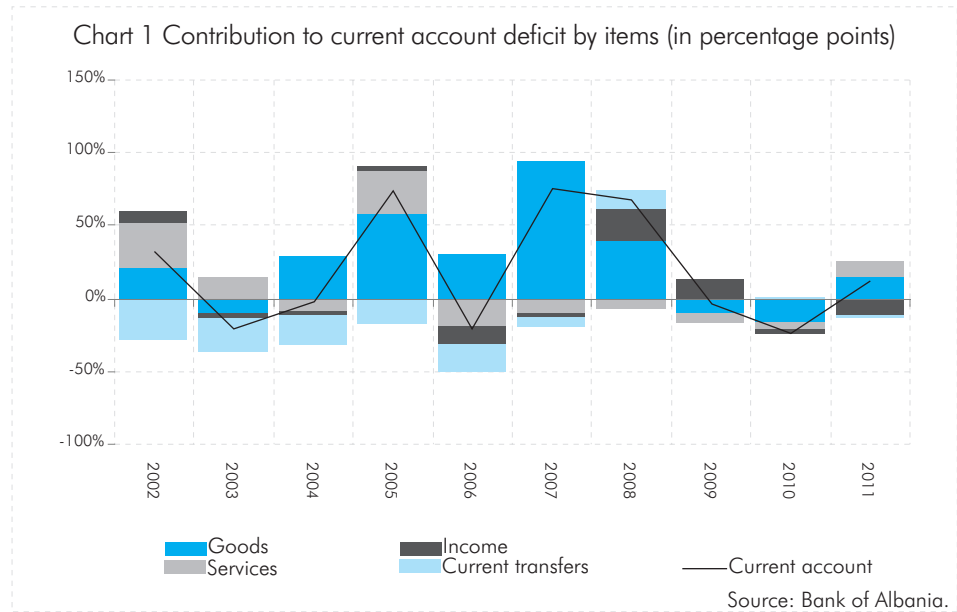
Source: Bank of Albania.

I.1 CURRENT ACCOUNT

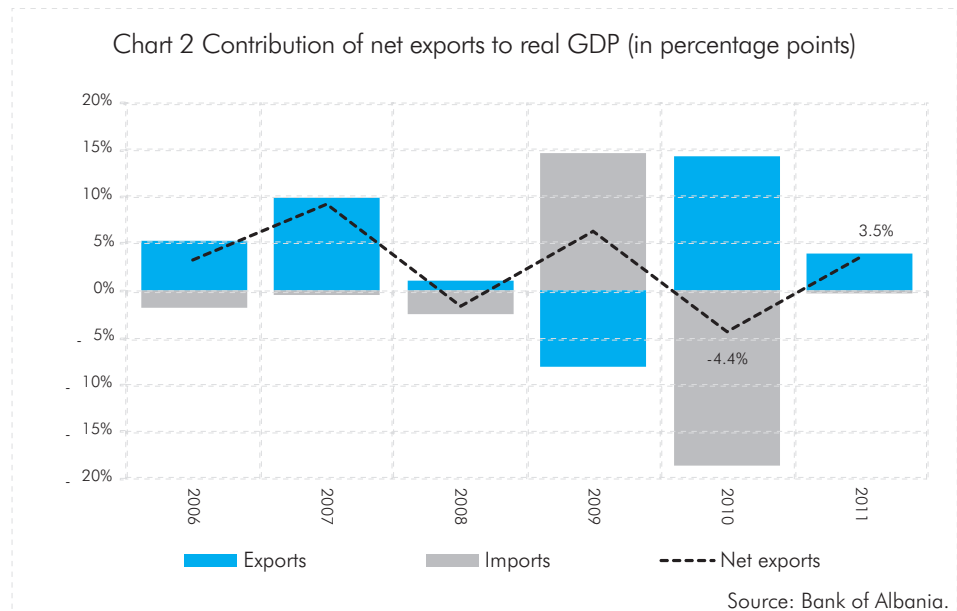
Albania's net current account balance recorded a deficit of EUR 1145.4 million in 2011. After narrowing down in the previous two years, the current account deficit widened by nearly 12.5% y-o-y in 2011, hence slightly aggravating its sustainability. As a percentage of nominal GDP, it was estimated at 12.1% or about 0.8 percentage points higher than in 2010.

The dynamics of the current account in 2011 were broadly determined by the performance of net exports and income account. The narrowing of the net exports deficit in 2010 by about 13.1% y-o-y contributed significantly to the adjustment of the Albanian current account deficit. Similarly, but conversely, the widening of the net exports deficit by about 13.8% y-o-y in 2011 was the main determinant of the current account deficit widening. On the other hand, the shift from deficit to net surplus in the income account provided substantial

positive contribution to the annual performance of the current account. The current transfers account registered a slightly higher figure than in the previous year. Workers' remittances, however, fell more slowly over 2011.



As a result of trade flows in goods and services, the degree of Albania's economic openness stood at 89.6% in 2011, 4.3 percentage points higher than in 2010.



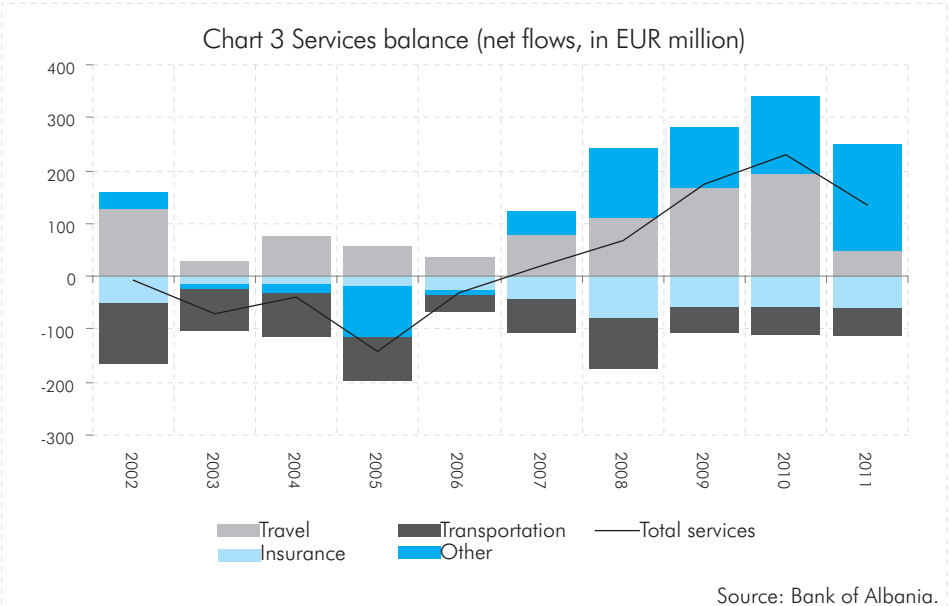
The performance of external sector indicators in real terms provides evidence for the narrowing of the net exports deficit³ in 2011 compared to the previous year, as a result of the higher exports of goods and services in real terms by about 10.5% y-o-y. Developments in the import and export of

³ In order to derive the real terms of imports and exports of goods from the nominal terms, we use the Unit Value Index obtained from foreign trade volume data. For imports and exports of services, we use the Consumer Price Index of services as measured by the Bank of Albania.

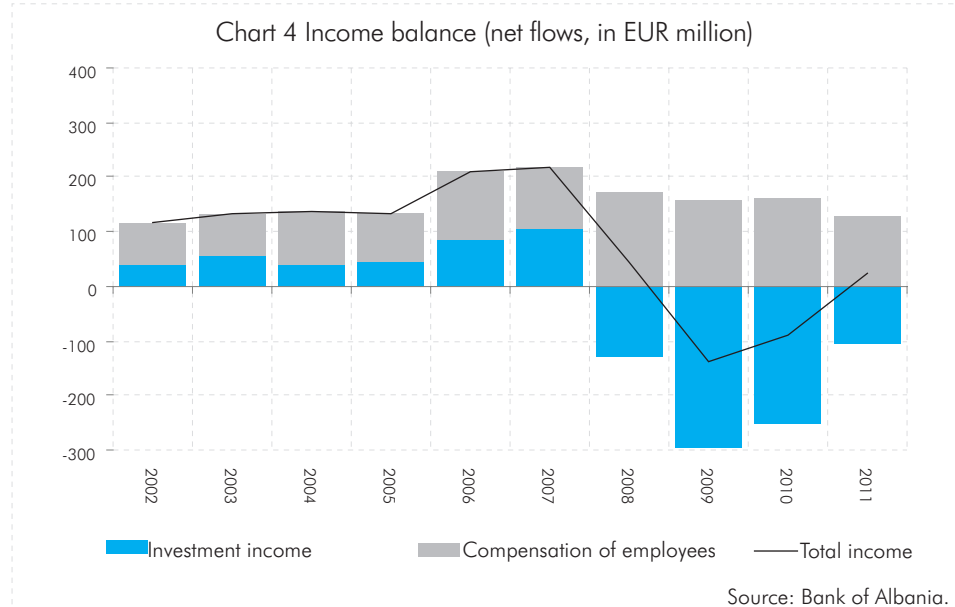
goods and services in real terms materialized into a positive contribution of this component to aggregate demand growth over this period.

The increase in financial flows from the combined net position of the income, current transfers and services accounts moderated to about 3.0% in 2011 from 9.3% in 2010. Consequently, the net flows of these three accounts financed altogether about 48.9% of the trade deficit registered in 2011, which is about 2.2 percentage points lower than in 2010.

The net balance of the services account yielded a surplus of EUR 134.6 million in 2011, down by about 41.9% from 2010. The developments in this current account item seem to have been affected by the visa-free regime for Albanian citizens travelling to the Schengen area. The decline in foreign flows in the services account was more considerable in the second and third quarters of 2011, a period that corresponds to the summer tourism season. Consequently, the surplus of the net balance of the travel services (personal and business) account dropped in 2011 by about 75.4% y-o-y. The surplus was mainly narrowed down due to higher travel services spending of Albanian residents abroad for tourism and business purposes by about 8.7% y-o-y. In the meantime, foreign inflows from personal travel services of non-residents fell by about -4.7% over the period under review. Other services (which include communication, construction, governmental, financial, computer and information services) registered a positive balance of EUR 200.1 million, up by about 37.4% y-o-y, hence contributing positively to the total services' account balance. On the other hand, the negative balance of transportation services and insurance services continued to contribute negatively to the total services' balance for 2011.



Against a background of high perceived risk, the income balance has since 2009 registered continuous deterioration, driven mostly by the accelerated increase in investment profit repatriation. In 2011, this account balance marked a shift in the tendency from a net deficit of about EUR 90.1 million to a surplus of about EUR 24.2 million, due to the lower outflows of total income by about 44.9% y-o-y.

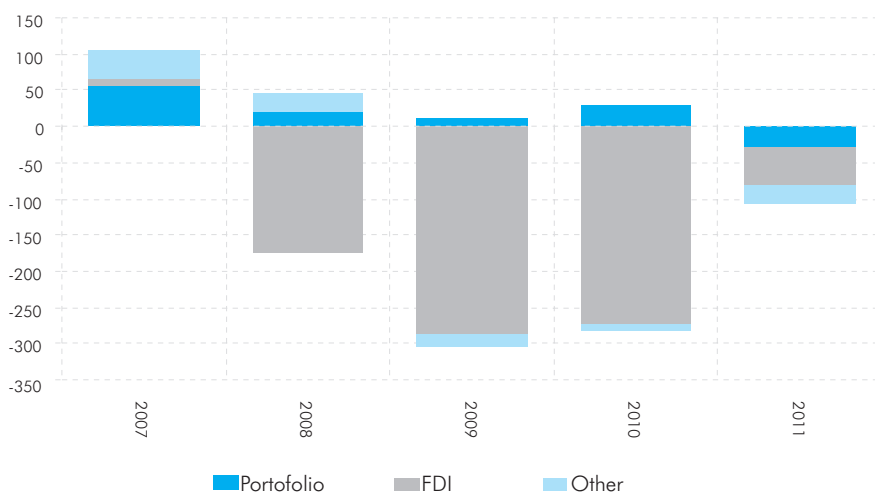


Income account balance improved significantly y-o-y as a result of the lower outflows, mainly those of foreign direct investment-related income by about 71.8% y-o-y. Given the difficult situation facing the European countries, and particularly Italy and Greece⁴, the re-investment of earnings in the country may have been considered more attractive than its repatriation to the country of origin. Unlike in 2010, the balance of portfolio investment income registered a deficit of EUR 28.0 million in 2011. This is the first time, since 2007, that this sub-item of investment income registers a negative figure. Income from other net investment continued to record negative figures for the third consecutive year, mainly due to the higher net interest payments on public and private debt. This sub-item of the investment income account registered a deficit of about EUR 26.0 million in 2011 compared to EUR 9.3 million in 2010. Net interest payments on public and private debt over the period under review have lowered Albania's liabilities by about EUR 86.6 million, while foreign inflows into this sub-item registered a slight decline by about 1.9% y-o-y.

Foreign inflows of net labour income, albeit lower than in 2010, contributed to reducing the net negative position of the account under review.

⁴ Based on 2010 data, EU countries account for about 67.3% of foreign direct investment stock. Greece and Italy are ranked the top two countries in terms of total investment stock.

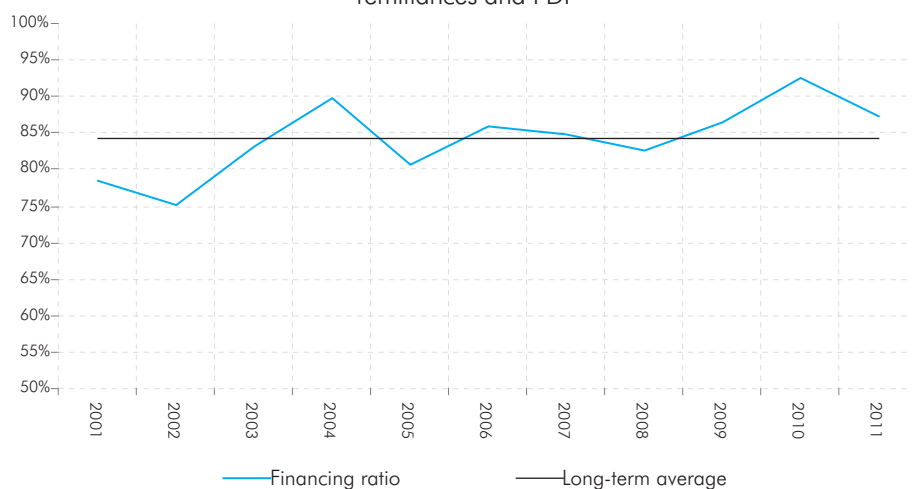
Chart 5 Composition of investment income (net flows, in EUR million)



Source: Bank of Albania.

After narrowing down by about 1.6% in 2010, current transfers account surplus increased by about 1.6% y-o-y in 2011, driven by the sharp decline in financial outflows.

Chart 6 Financing ratio of imports of goods from the sum of exports, remittances and FDI

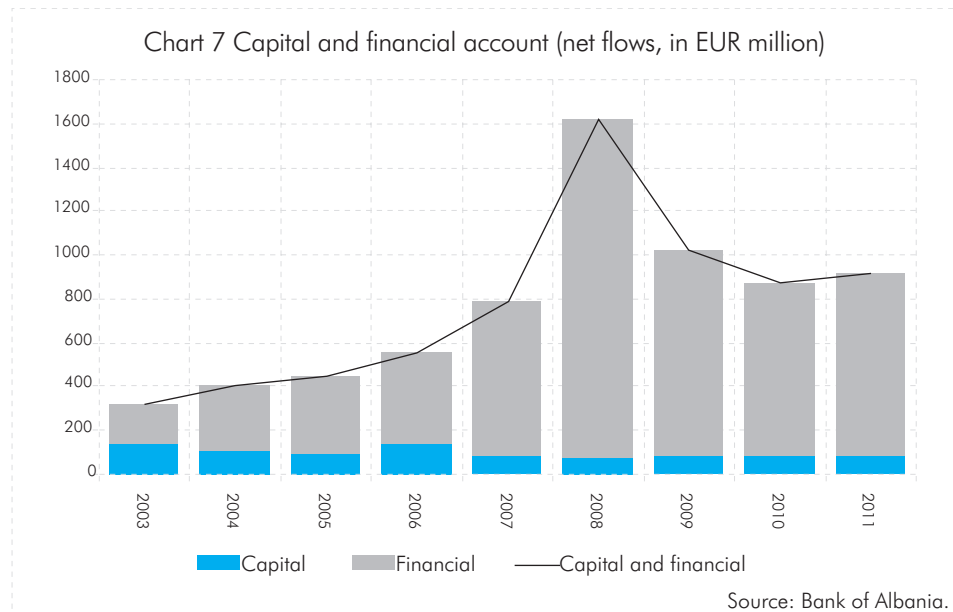


Source: Bank of Albania.

Public sector's net transfers fell by about 53.9% in 2011, while other sectors' net transfers increased by about 4.5% y-o-y. Due to the labour market constraints in the countries with the highest concentration of emigrants and the cyclical factors, net workers' remittances maintained the annual downtrend that has began since 2007, albeit at more moderate rates. Remittance inflows fell by about 0.5% y-o-y. The ratio of remittances to trade deficit was estimated at 30.9% in 2011, about 2.5 percentage points lower than in 2010.

I.2 CAPITAL AND FINANCIAL ACCOUNT

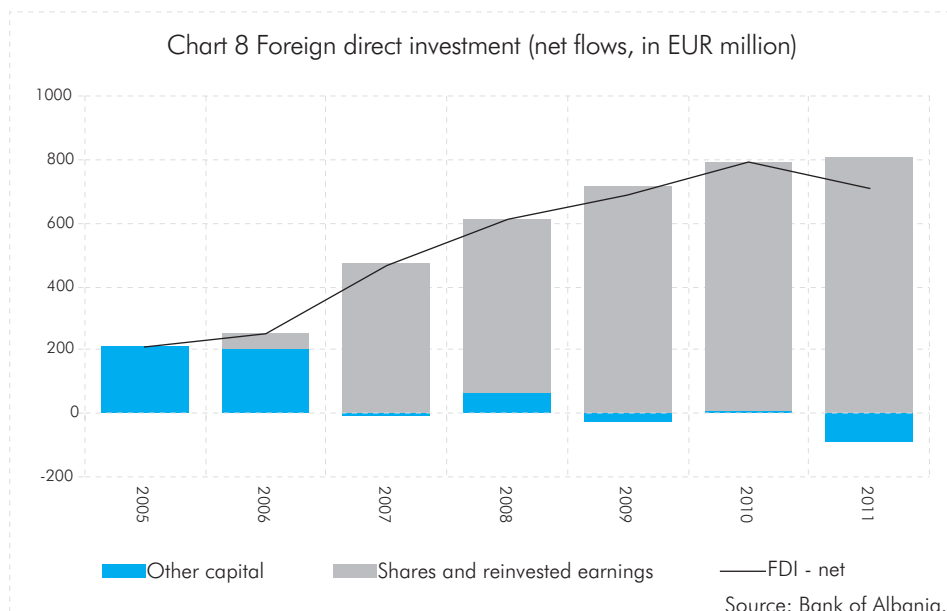
Net flows in the capital and financial account registered a positive balance of EUR 921.2 million in 2011, about 5.6% higher than in 2010. As a percentage of nominal GDP, net capital and financial flows were estimated at about 9.8% or about 0.1 percentage point higher than in 2010. Out of total flows, about EUR 84.9 million entered Albania in the form of capital investment grants and about EUR 836.3 million in the form of financial flows.



Financial transactions amounted to about EUR 836.3 million in 2011. As a percentage of nominal GDP, they were estimated at about 8.9%. After registering a constant annual decline in the previous two years, financial flows increased by about 6.3% y-o-y in 2011. Residents' financial liabilities to non-residents increased by about EUR 1241.4 million in 2011 or 16.9% compared to 2010. In addition, our assets invested in non-resident economies over the year under review amounted to about EUR 405.0 million, about 47.1% higher than in 2010. The largest part of financial inflows (liabilities) was in the form of foreign direct investment and other investments, with the public and private borrowing playing the main role. Concerning financial outflows (assets), other investments, currency and deposits of the Albanian banking system placed abroad played the major role. Due to financial flow movements in financial assets and liabilities, the degree of Albania's financial openness reached 17.5%, up by about 2.7 percentage points from 2010.

Net foreign direct investment (inflows – outflows) amounted to EUR 711.8 million in 2011, or about 9.7% lower than in 2010. As a percentage of nominal GDP, they were estimated at about 7.6%, down 1.2 percentage points from 2010. Based on the investment instrument, the annual analysis of (net) foreign direct investment dynamics in Albania provides evidence for an important role of financial outflows in the form of other direct investment

capital⁵. Net debt transactions between related enterprises increased in 2011 and amounted to about EUR 92.3 million, being mainly concentrated in the first and third quarters of 2011. Net foreign direct investment flows in the form of shares and reinvested earnings amounted to about EUR 804.1 million or 2.9% more than in 2010.



Excluding privatisation receipts, foreign direct investment inflows were about 6.5% lower than in 2010. Privatisation receipts have provided a modest contribution to FDI growth in Albania in the last two years.

DISTRIBUTION OF FDI STOCK BY ECONOMIC ACTIVITY AND COUNTRY⁶

Despite being under the pressure of the economic and financial crisis that swept across the international markets, foreign direct investment (FDI) stock in Albania has increased at progressive rates over the last three years (2008, 2009 and 2010). As at the end of 2010, the FDI stock amounted to about EUR 2,639.9 million or about 18.2% higher than in 2009. Developments in the FDI stock in Albania reflect foreign investors' preference to invest in Albania due to the lower producer prices and potentially higher profit margin.

Broken down by economic activity, investments in the services sector show high concentration. This fact also seems to relate to the privatisations taking place in this sector over the course of years. The latest data show that "Monetary and financial intermediation⁷" and "Transportation, storage and communication⁸" have been the most attractive sectors and have absorbed

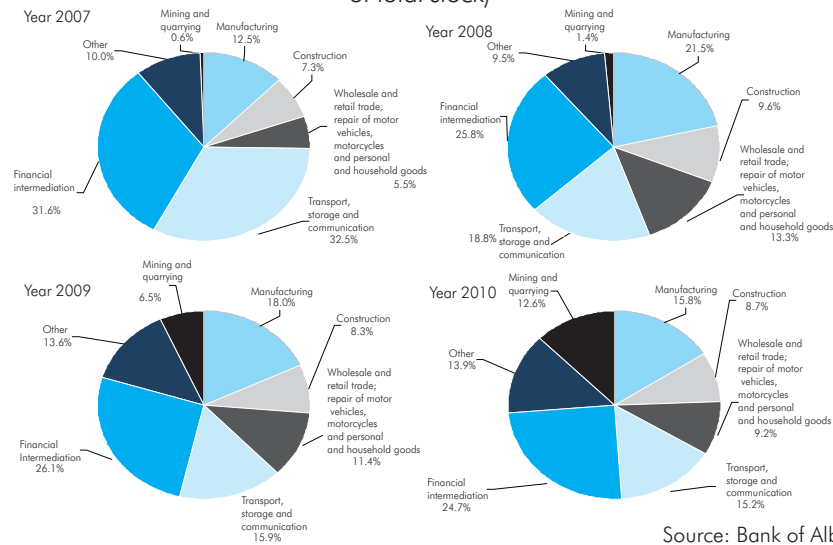
⁵ Other direct investment capital covers the borrowing and lending of funds, including debt securities and trade credits between direct investors and direct investment enterprises and between two direct investment enterprises that share the same direct investor.

⁶ The latest data on foreign direct investment stock by country and economic activity refer to 2010.

⁷ "Monetary and financial intermediation other than insurance activities and pension funds" has the largest share of the FDI in this sector.

⁸ "Post and communication" has the largest share of the FDI in this sector.

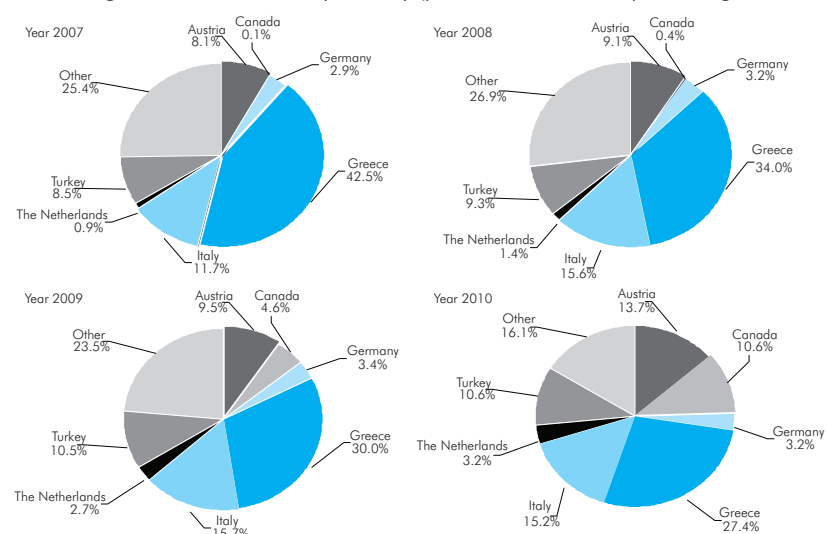
Chart 9 Foreign direct investment by economic activity (year-end stock, as a percentage of total stock)



Source: Bank of Albania.

the largest portion of FDI. In 2007, about 64.1% of total FDI was almost equally allocated to these two sectors. With the passing of years, their share in total FDI stock has lowered to the benefit of other sectors of the economy. In 2010, these two sectors accounted for about 39.9% of total FDI stock. The lower FDI concentration in these two sectors and the higher share of FDI in the other sectors of the economy over the course of years provides evidence for better investment portfolio diversification and multidimensional orientation. For instance, the share of “Extractive industry” increased considerably to about 12.6% in 2010, compared to 0.6% in 2007. Energy mineral extraction industry had the main share in this sector, particularly in 2010. Other sectors of the economy, such as processing industry; production and supply of electricity, gas, steam and hot water; health and other social activities have gained ground over the course of four years. By contrast, available data show that the share of hotels and restaurants in total FDI stock fell progressively over 2007-10.

Chart 10 Foreign direct investment by country (year-end stock, as a percentage of total stock)



Source: Bank of Albania.

The distribution of FDI stock by country of origin shows significant concentration of investments of Greek and Italian origin in Albania as a percentage of total FDI stock.

In 2007, investments of Greek origin accounted for about 42.5% of total FDI stock in Albania. Investments of Italian origin were ranked the second, sharing about 11.7% over the same stated period. Once the economic and financial crisis burst out and the Greek debt crisis intensified, the share of Greek investments in total FDI stock declined at progressive rates. From 2007 to 2010, the share of Greek investments fell by about 15.1 percentage points to about 27.4% of total FDI stock. On the other hand, after increasing their share by about 3.8 percentage points in 2008, investments of Italian origin maintained almost a similar share until 2010 (on average 15.5% during 2008-10). In 2007, the largest three investors in terms of the FDI stock⁹ accounted for about 62.3% of total stock. These three countries' concentration in FDI stock lowered during 2008-10 to the benefit of other countries. Hence, despite the lower share of FDI from Greece in total stock, the latter continued to increase in Albania. This increase may reflect the re-orientation of foreign investors towards the Albanian market. Consequently, the attraction of potential investors from other countries may minimize the Greek sovereign debt crisis effects on capital inflows to Albania.

Net portfolio investment for 2011 increased domestic assets invested in foreign economies (residents' claims on non-residents) by about EUR 82.5 million. Due to the issue of the Eurobond in the international markets, in 2010, net portfolio investment increased Albania's liabilities by about EUR 232.1 million. Developments in this financial account item over 2011 were determined by the increase in portfolio investment outflows to foreign economies by about EUR 98.4 million. As in the previous years, residents have mainly chosen to invest in debt securities.

Other investment account, net, registered a positive balance, contributing to the increase in residents' liabilities to non-residents by about EUR 207.1 million in 2011. This year marked a turn in position from creditor in 2010¹⁰ to debtor in 2011. The direction of financial flows in this account was determined by the increase in domestic liabilities by about EUR 483.6 million, mainly due to the higher public and private borrowing. The latter amounted to about EUR 238.9 million in 2011. Public and private withdrawals totalled EUR 370.0 million over the stated period, while debt (principal) payments lowered domestic liabilities by about EUR 131.1 million. Currency and deposits marked significant developments in 2011. Non-resident banking system investments in Albania recorded sharp growth compared to 2010. In addition, due to the improved liquidity situation in the Albanian banking system, non-resident investments in the form of currency and deposits increased by about 28.8%

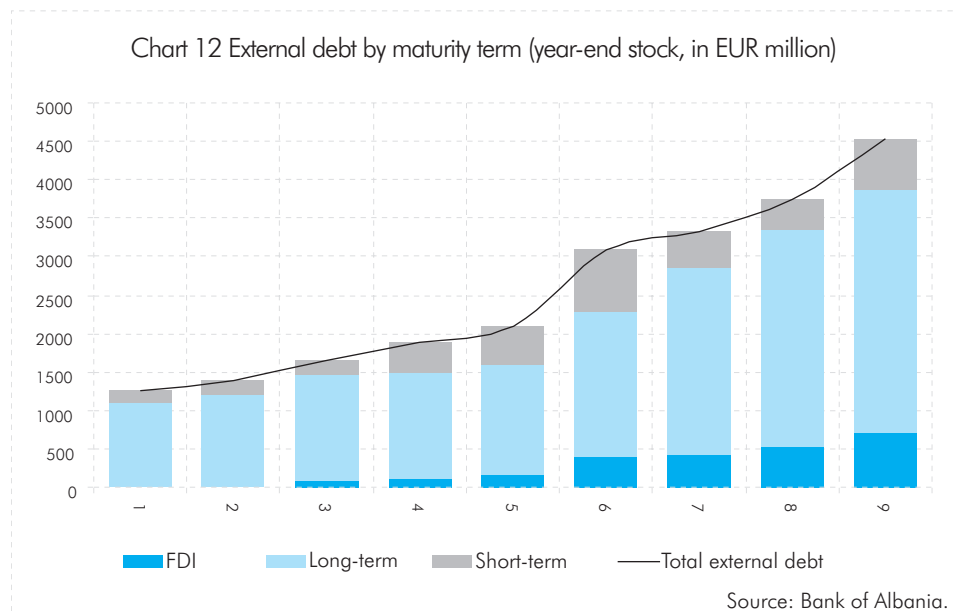
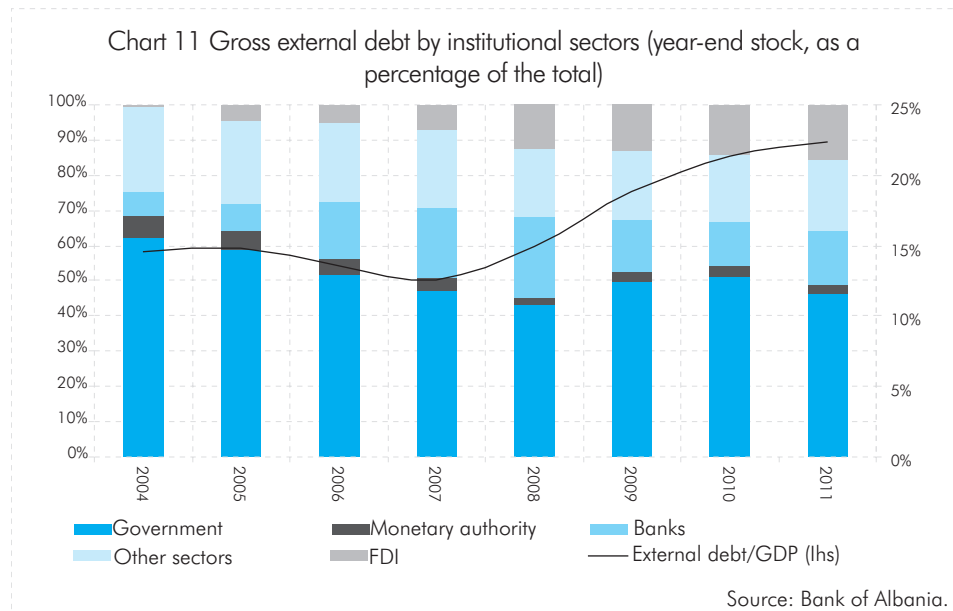
⁹ Greece, Italy and Austria.

¹⁰ In 2010, other investment, net, amounted to EUR -234.1 million (EUR 234 million were domestic claims on non-residents). The negative sign implies a creditor position or a higher level of other investment outflows (resident investment in non-resident economies).

compared to 2010. On net basis, currency and deposits contributed to the increase in domestic liabilities to non-residents by about EUR 71.7 million.

I.3 GROSS EXTERNAL DEBT

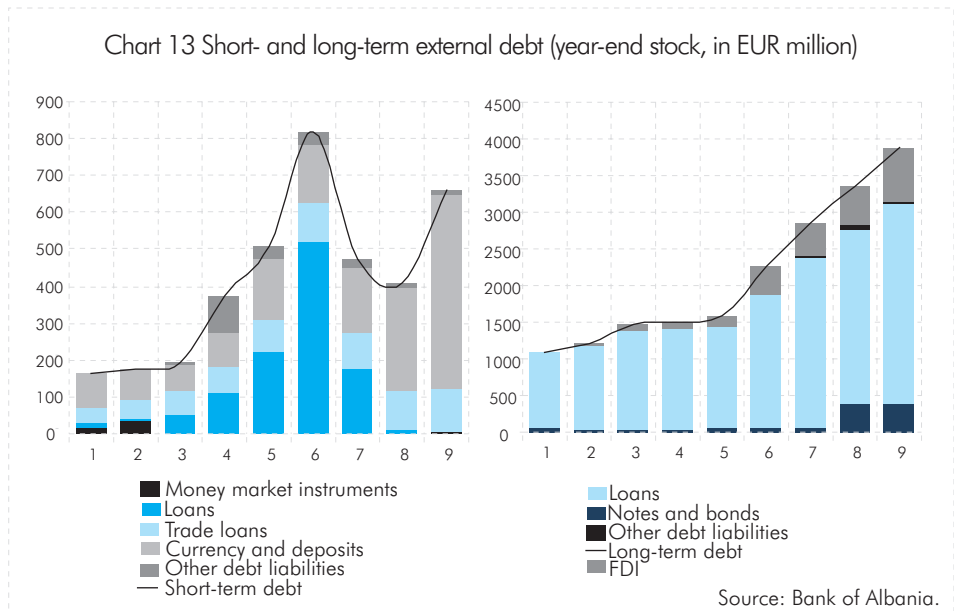
As at the end of the last quarter of 2011, Albania's gross external debt stock totalled EUR 4,533.9 million, up by about EUR 132.2 million from the third quarter of 2011 and EUR 783.4 million from the last quarter of 2010.



For the most part, the higher debt stock at end-2011 compared to end-2010 was mainly triggered by the increase in banking system borrowing and foreign direct investment – intercompany loans. Broken down by institutional sectors, as at end-2011, general government's share in total debt stock was about 46.3%. The remainder of debt has been allocated to other sectors

(19.8%), banks (16.0%), foreign direct investment – intercompany loans (15.7%) and monetary authority (2.2%).

About 82.7% of the debt stock (excluding direct investment – intercompany loans) accounted for long-term debt, mainly in the form of loans. For the period under review, short-term debt accounted for about 17.3% and was mainly in the form of banking sector currency and deposits.



International reserves fell by about EUR 28.6 million in 2011. At the end of December 2011, the stock of international reserves totalled EUR 1,912.0, sufficient to cover 4.4 months of imports of goods and services.

