

Bank of Albania

ANALYSIS OF DEVELOPMENTS
IN THE EXTERNAL SECTOR
OF THE ECONOMY

2012 Q3

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1. BALANCE OF PAYMENTS HIGHLIGHTS¹

As in the past two years, trade transactions with abroad during 2012 were under the pressure of the international macroeconomic setting, particularly of the euro area and the neighbouring countries. The decelerating economic growth in these countries and the weakening external demand led to a significant moderation of the growth rate of exports of goods and services in 2012 Q3. The moderate domestic demand and the subsiding effects of the visa liberalisation regime for Albanian citizens travelling to the Schengen area led to lower imports of goods and services over the period under review. Net export deficit narrowed at an annual rate of 14.4% in 2012 Q3. The strained employment situation, particularly for Albanian immigrants, in the countries with their highest concentration, led to a progressive decrease in remittances. Due to foreign flows in these accounts, Albania registered a current account deficit of EUR 198.1 million, decreasing at an annual rate of 18.8%. Foreign inflows into the capital and financial account amounted to about EUR 176.8 million, down at an annual rate of 22.3%. The surplus in this account financed about 89.2% of this period's current account deficit.

Table 1 Balance of Payments indicators

	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2011 9M	2012 9M
Current account (in EUR million)	-244.1	-352.1	-253.1	-219.9	-198.1	-769.9	-671.1
yoy	1.8%	-1.2%	19.4%	-29.9%	-18.8%	16.3%	-12.8%
/ GDP	-10.2%	-15.2%	-11.8%	-8.6%	-7.7%	11.1%	9.2%
Trade balance	-593.1	-658.6	-465.3	-475.5	-540.5	-1,583.0	-1,481.4
Exports, f.o.b.	344.1	360.0	325.8	394.2	402.5	1,045.5	1,122.5
Imports, f.o.b.	-937.2	-1,018.6	-791.2	-869.7	-943.0	-2,628.5	-2,603.9
Balance of service	116.7	41.2	8.5	26.2	132.6	93.4	167.3
Credit	629.8	428.5	293.8	381.1	578.1	1,318.9	1,253.0
Debit	-513.1	-387.3	-285.4	-354.9	-445.4	-1,225.4	-1,085.7
Travel - export	469.4	285.1	185.1	246.4	445.3	884.3	876.8
Travel - import	-386.5	-256.8	-180.8	-240.1	-325.6	-864.8	-746.5
Travel - net	82.9	28.4	4.3	6.2	119.7	19.5	130.2
Balance of income	14.1	14.5	-1.9	-10.2	20.8	33.1	8.7
Credit	77.5	67.5	59.7	60.9	74.9	202.0	195.5
Debit	-63.3	-53.0	-61.6	-71.1	-54.1	-169.0	-186.8
Net FDI income	-22.0	-7.9	-30.2	-30.1	-18.7	-48.2	-79.0
Current transfers	218.2	250.8	205.7	239.7	188.9	686.6	634.2
Credit	245.6	279.1	242.3	279.6	227.3	771.2	749.2
Debit	-27.5	-28.3	-36.7	-39.9	-38.4	-84.7	-115.0
Net remittances	153.8	188.7	159.5	178.6	138.9	499.2	477.0

¹ The latest balance of payments data are as at 2012 Q3.

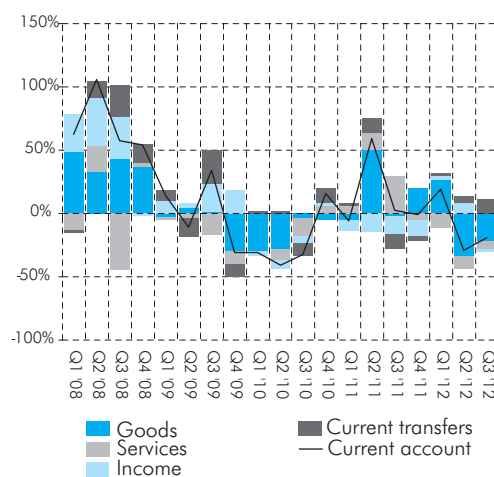
Capital and financial account (in EUR million)	227.6	277.1	258.3	172.2	176.8	649.9	607.4
yoy	29.1%	-32.6%	12.2%	-10.3%	-22.3%	40.9%	-6.5%
/ GDP	9.5%	11.8%	12.1%	6.7%	7.0%	7.0%	8.4%
Capital account	6.5	27.8	12.9	43.0	9.8	57.1	65.8
Financial account	221.1	249.3	245.4	129.2	167.0	592.8	541.6
A. Liabilities	413.3	390.7	307.5	268.6	375.9	860.9	951.9
FDI	160.1	289.7	201.8	178.3	171.2	457.2	551.4
Portfolio investment	11.1	11.4	14.3	13.2	14.9	28.4	42.4
Other investments	242.1	89.6	91.3	77.1	189.8	375.3	358.2
Borrowing	110.2	39.2	41.5	30.8	27.2	181.4	99.5
Currency and deposits	137.2	54.1	73.0	44.6	149.9	191.7	267.5
B. Assets	-192.3	-141.3	-62.0	-139.4	-208.9	-268.1	-410.3
FDI	-3.9	-19.8	-2.6	0.0	-7.3	-10.4	-9.9
Portfolio investment	-57.1	14.4	-61.0	9.9	-26.4	-103.1	-77.5
Other investments	-131.2	-135.9	1.5	-149.3	-175.2	-154.6	-322.9
Currency and deposits	-114.8	-94.3	-11.0	-137.6	-173.8	-79.9	-322.4
Credit (for commercial financing)	-34.5	-57.0	9.7	0.6	-1.7	-62.6	8.6
FDI (net)	156.2	270.0	199.3	178.3	163.9	446.9	541.5
Portfolio investment (net)	-46.0	25.7	-46.6	23.1	-11.5	-74.7	-35.1
Other investments (net)	110.9	-46.4	92.8	-72.2	14.6	220.7	35.2
Errors and omissions	72.9	68.8	-2.0	55.2	111.0	97.6	164.1
Reserve assets	-56.4	6.2	-3.2	-7.5	-89.7	22.4	-100.4

Source: Bank of Albania.

1.1 CURRENT ACCOUNT

Albania's net current account balance recorded a deficit of EUR 198.1 million in 2012 Q3. The current account deficit shrank at an annual rate of about 18.8%, hence reinforcing the trend begun since 2012 Q1. It was estimated at 7.7% of nominal GDP² or about 0.8 percentage points lower y-o-y. As in the previous two quarters, the current account dynamics during 2012 Q3 was broadly determined by the performance of net export balance. The narrowing of the trade deficit at an annual rate of 8.9% and the improving services account balance by about 13.7% shrank the net export deficit by about 14.4%. The net balance of the income account registered a surplus of EUR 20.8 million, mainly due to the lower outflows of foreign direct investment income and improved portfolio investment income balance. The surplus in the current transfers account narrowed at an annual rate of 13.4%. Remittances, the main sub-item in this account, continue to maintain a downward annual trend. On a nine-month cumulative basis, the current account deficit shrank by about 12.8% y-o-y, hence alleviating its sustainability issue.

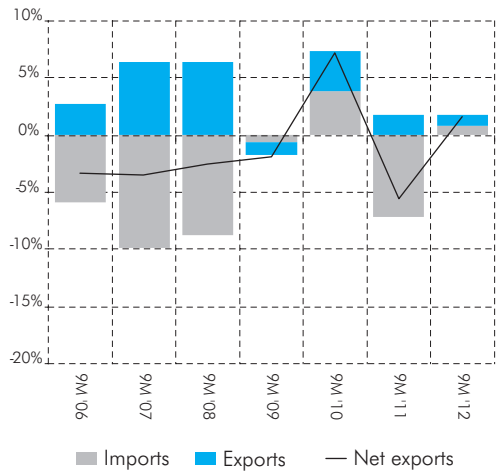
Chart 1 Contribution to current account deficit by item (in percentage points)



Source: Bank of Albania.

² Nominal GDP for 2003-10 as published by INSTAT. The quarterly distribution is based on quarterly real GDP weights. The authors use Bank of Albania Monetary Policy Department's projections for 2011 and 2012.

Chart 2 Contribution of net exports to real GDP (in percentage points)



Source: Bank of Albania.

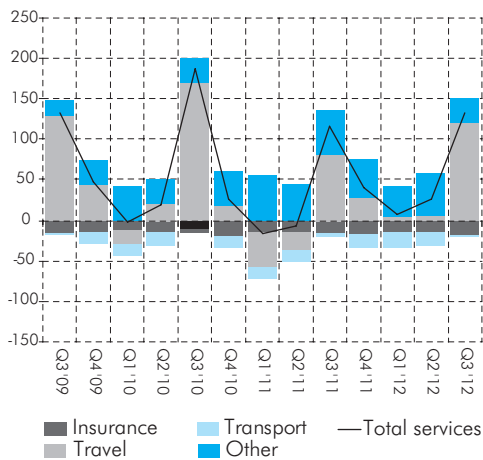
Albania's degree of economic openness stood at 92.4% in 2012 Q3, 8.9 percentage points lower y-o-y.

The performance of external sector indicators shows the annual narrowing of the real net exports deficit³ during the first nine months of 2012 due to the lower imports of goods and services in real terms by about 1.1% and the higher exports by about 2.0%. The developments in real imports and exports of goods and services materialized into a positive contribution of this component to aggregate demand growth over the period under review.

Financial flows from the combined net position of income account, current transfers and services fell at an annual rate of 1.9% in 2012 Q3.

Consequently, the net flows of these three accounts altogether financed about 63.3% of the trade deficit, up about 4.5 percentage points y-o-y.

Chart 3 Balance of services (net flows, in EUR million)



Source: Bank of Albania.

The net balance of the services account yielded a surplus of EUR 132.6 million in 2012 Q3, up about 3.7% y-o-y. After the sharp narrowing of its surplus in 2011 due to the visa-free regime for Albanian citizens travelling to the Schengen area, the first nine months of 2012 saw a very positive performance. The increase in foreign flows in the services account was more considerable in 2012 Q3, which corresponds to the summer tourist season. The net balance of travel services (personal and business) therefore played the most important role in this account for the period under review. It improved at an annual rate of about 44.4%, mainly due to the lower spending on residents' travel services for tourism or business purposes abroad at an annual rate of 15.8%. Foreign inflows from non-residents' personal travel services in Albania fell about 5.1% over the period under review.

Other services (which include communication, construction, government, financial, computer, information services, etc.) recorded a positive balance of EUR 31.5 million, down at an annual rate of 40.5%. On the other hand, the negative balance of transportation and insurance services continue to make a negative contribution to the total services balance for 2012 Q3.

³ In order to switch from nominal to real terms of imports and exports of goods, we use the Unit Value Index obtained from international trade volume statistics. While for imports and exports of services, we use the Consumer Price Index of services, as measured by the Bank of Albania.

Against a background of high perceived risk, the income balance has continuously deteriorated since 2009, owing mainly to the accelerated increase in investment profit repatriation. In 2011, the income balance improved due to the lower outflows of total income at an annual rate of about 44.9%. The net balance of the income account recorded a surplus of EUR 8.7 million during the first nine months of 2012, down at an annual rate of about 73.6%. This account's performance over the period under review was primarily driven by the decline in employees' compensation at an annual rate of 21.6%. The net deficit on investment income provided further impact, widening by about 5.2% y-o-y.

After deteriorating in two quarters in a row, the net income balance saw a positive figure of EUR 20.8 million in 2012 Q3, up at an annual rate of 47.6%. Foreign inflows of net labour income, albeit lower y-o-y, contributed to improving the total income account. The higher inflows from investment income and their lower outflows led to the narrowing of the net investment income deficit by about 83.9% y-o-y. The deficit of net foreign direct investment income shrank at an annual rate of 14.9%. In contrast to 2011, the net balance of portfolio investment income yielded a surplus of EUR 17.6 million in 2012 Q3, compared to EUR 6.0 million in 2011 Q3.

The balance of income from other net investment has been recording negative figures since 2010 Q4, owing mainly to the higher net interest payments on public and private debt. The deficit of this income account sub-item was EUR 2.4 million in 2012 Q3, compared to EUR 6.0 million in 2011 Q3. Net interest payments on public and private debt lowered Albania's liabilities by about EUR 26.7 million over the period under review.

Current transfers account surplus, an important source of current account deficit financing, recorded progressive decline during the first three quarters of 2012. The narrowing of current transfers surplus in the first nine months of 2012 at an annual rate of 7.6% was largely driven by the decline in other current transfers items.

Net current transfers surplus shrank by about 13.4% in 2012 Q3. Public and other sectors' transfers fell at an annual rate of 38.2% and 12.7%, respectively. Due to labour market constraints in the countries with the highest concentration of Albanian immigrants, net

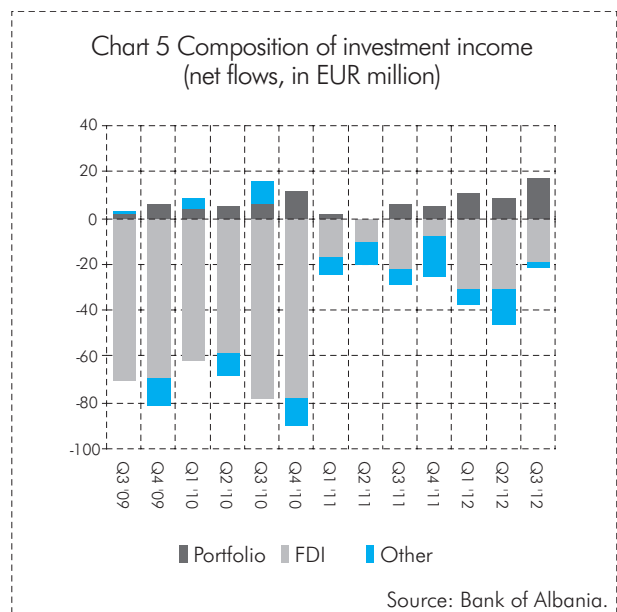
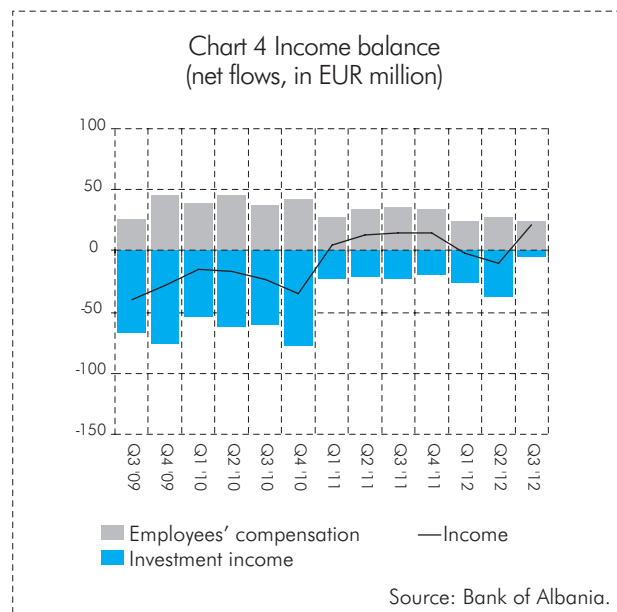
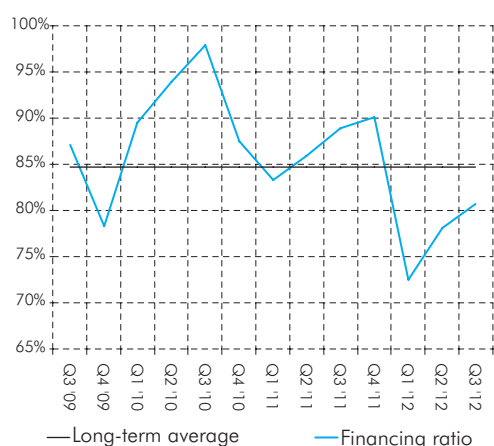


Chart 6 Financing ratio of imports of goods from the sum of exports, remittances and FDI



Source: Bank of Albania.

remittances maintained their annual downward trend begun since 2007, albeit at more moderate rates. Remittances fell at an annual rate of 9.7% in 2012 Q3. Remittances-to-trade deficit ratio is estimated at 26.0%, or about 0.6 percentage points lower y-o-y.

1.2 CAPITAL AND FINANCIAL ACCOUNT

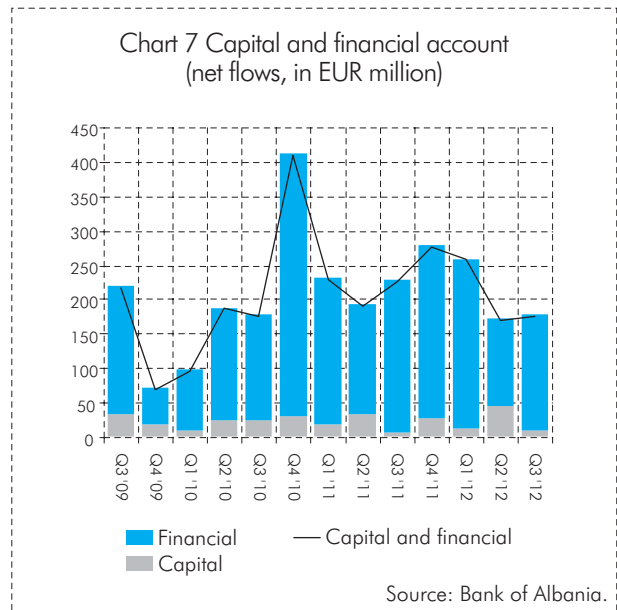
Net flows in the capital and financial account recorded a positive balance of EUR 176.8 million in 2012 Q3, financing 89.2% of the current account deficit. Capital and financial flows fell by about 22.3% y-o-y and were estimated at 6.9% of nominal GDP. The annual fall in foreign flows in this account was largely driven by the lower financial flows at an annual rate of 24.5%. As a percentage of nominal

GDP, the financial account was estimated at about 6.5%, 2.7 percentage points lower y-o-y. Net flows in the capital account recorded a surplus of EUR 9.8 million in 2012 Q3. Residents' financial liabilities to non-residents fell at an annual rate of 9.1%, partly as a reflection of the lower liabilities in the form of other investments, while those in the form of portfolio investment and FDI increased. Albanian assets invested in non-resident economies increased at an annual rate of 8.6%, driven mainly by the higher assets in the form of other investments and FDI. Assets in the form of portfolio investments fell in 2012 Q3.

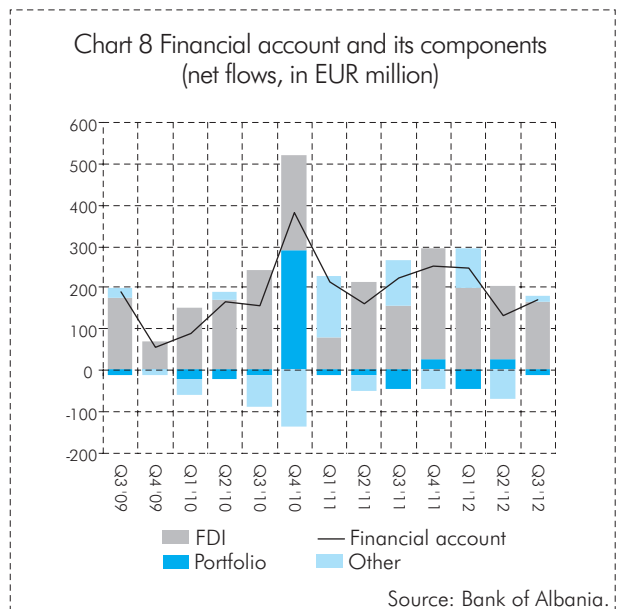
Net foreign direct investment (inflows – outflows) increased by about 4.9% y-o-y. This change owes, to a large extent, to the increase in liabilities in the form of FDI (FDI inflows) by about 6.9%. By type of investment instrument, FDI inflows in the form of shares and reinvested earnings fell at an annual rate of 12.9%. Capital inflows in the form of other capital increased slightly in 2012 Q3, while in the same quarter in 2011, this item recorded capital outflows. Net foreign direct investment increased at an annual rate of 21.2%, owing mainly to the higher residents' liabilities to non-residents. FDI sectoral distribution in 2012 Q3 suggests their concentration in the hydrocarbon extractive sector (about 64%) and telecommunication (about 11%).

Portfolio investment inflows contributed to the increase in Albania's assets invested in foreign economies by about EUR 26.4 million in 2012 Q3, or EUR 30.7 million lower y-o-y. Residents invested about EUR 27.4 million in debt securities over the period under review. Portfolio investment inflows increased at an annual rate of about 33.7%, being primarily concentrated in debt securities. The net portfolio investment position stood at EUR -11.5 million in 2012 Q3, reflecting the higher Albanian assets invested in this type of instrument in the foreign economies. On a nine-month cumulative basis, net portfolio investments were about EUR -35.1 million compared to EUR -74.1 million in 2011 Q3. The direction of this type of investment was determined by Albanian assets invested in foreign economies.

Other net investments recorded a positive figure in 2012 Q3, contributing by about EUR 14.6 million to the increase in residents' liabilities to non-residents. This figure is markedly lower than in the same period in 2011 when other net investments amounted to about EUR 110.9 million. The direction of financial flows in this account was determined by the increase in Albanian assets invested in foreign economies by about EUR 175.2 million in 2012 Q3. Albania's liabilities to non-residents in other investments fell at an annual rate of 21.6%, owing mainly to the lower public and private borrowing. The latter amounted to about EUR 27.2 million during the quarter under review compared to EUR 110.9 million in 2011 Q3. Debt (principal) payments lowered Albania's liabilities by about EUR 34.8 million in 2012 Q3.



Our assets invested in non-resident economies have been increasing since 2012 Q2, primarily due to the higher assets of the Albanian banking system invested abroad in the form of currency and deposits. Albania's banking system deposits grew EUR 173.8 million from EUR 114.8 million in 2011 Q3.



GROSS EXTERNAL DEBT

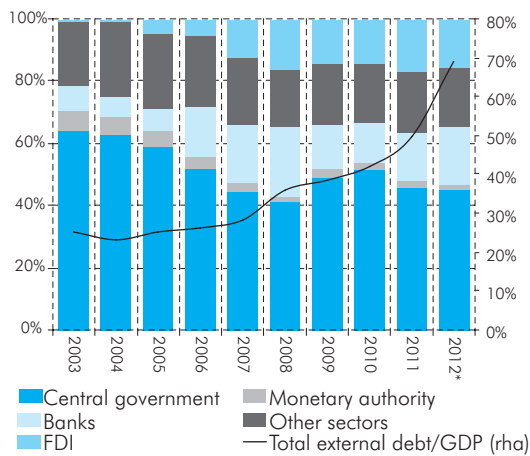
As at end-2012 Q3, Albania's gross external debt stock totalled EUR 5,044.6 million, up about EUR 184.8 million q-o-q and about EUR 633.1 million y-o-y. For the most part, the higher debt stock as at end-2012 Q3 was triggered by the increase in banking system and central government borrowing. Broken down into institutional sectors, as at end-period, general government's share in total debt stock was about 44.9%. The remainder of debt has been allocated to other sectors (19.1%), banks (18.8%), foreign direct investment – intercompany loans (15.4%) and monetary authority (1.8%).

Central government continues to have the highest share in total debt stock. As at end-2012 Q3, its debt stock totalled about EUR 2.3 billion. During the first three quarters of 2012, the share of central government debt has been in the range of 44.9%-51.5%, with the lowest share in Q3. Relative to end-2011, the share of central government debt has fallen from 46.0% to 44.9% as at end-2012 Q3. The banking system's gross external debt amounted to EUR 946.6 million, up about EUR

235.3 million from end-2011. Other sectors' external debt amounted to EUR 964.6 million, slightly higher by EUR 43.8 million from end-2011. Its share in total external debt stock for the period under review stood at about 19.1%, down from end-2011 and 2010. Foreign investment stock totalled EUR 778.0 million, up about 9.2% y-o-y.

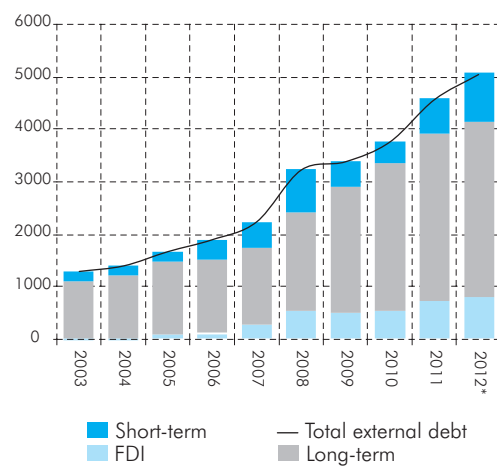
As at end-2012 Q3, about 66.2% of the debt stock (excluding direct investment – intercompany loans) accounted for long-term debt mainly in the form of loans. For the same period, short-term debt accounted for about 18.4% and was mainly in the form of banking sector currency and deposits. FDIs account for 15.4% of total public debt stock. General government and the monetary authority hold only long-term debt, while the banking sector and other sectors hold a composite portfolio of long and short-term debt.

Chart 9 Gross external debt by institutional sectors (year-end stock, as a percentage to total)



*Note: This chart refers to end-2012 Q3 debt stock.
Source: Bank of Albania.

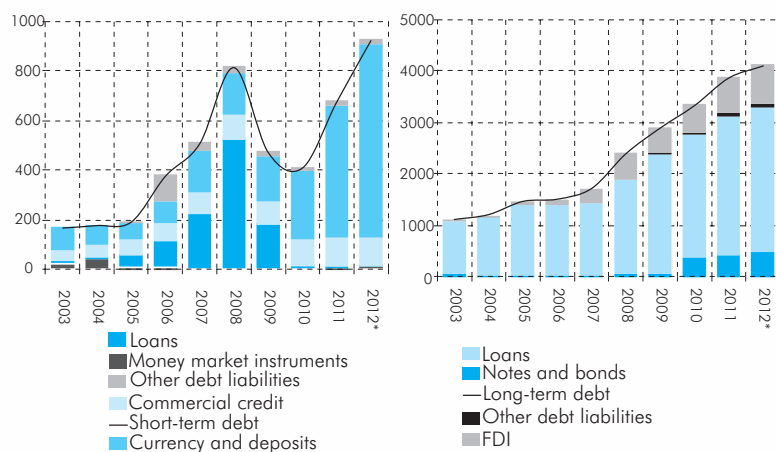
Chart 10 External debt by maturity (year-end stock, in EUR million)



Source: Bank of Albania.

Broken down into instruments and maturity, loans represent the main long-term investment instrument, accounting for about 84.2% of total long-term debt. About 14.2% of long-term debt is held in the form of notes and bonds.

Chart 11 Short and long-term external debt (year-end stock, in EUR million)



*Note: This figure refers to end-2012 Q3 debt stock.
Source: Bank of Albania.

Short-term debt is mainly represented by currency and deposits, accounting for about 84.7% as at end-2012 Q3. Commercial credit accounted for about 12.2% of short-term debt stock.

International reserves increased by about EUR 89.7 million in 2012 Q3. As at end-September 2012, international reserves totalled EUR 2.024,3 million, sufficient to cover 4.5 months of imports of goods and services.