

B a n k o f A l b a n i a

ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY

2012 Q4

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The views expressed in this material are those of the authors and do not necessarily reflect those of the Bank of Albania.

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1. BALANCE OF PAYMENTS HIGHLIGHTS¹

Trade transactions of Albania with other countries continued to be under the pressure of the global macroeconomic setting in general and neighbouring countries, such as Italy and Greece, in particular. The continuing difficult economic situation in Greece and the precipitated economic and political situation in Italy persisted to impact the performance of external sector indicators in Albania. The decelerating economic growth in these countries and the weakening of external demand led to a significant moderation of the growth rate in exports of goods and services during 2012. The drop in imports of goods and services during 2012 shows a weak domestic demand. Thus, nominal export deficit narrowed at an annual rate 14.4% driven by the fall in imports. Net financial flows in the capital and financial account narrowed by about 11.3% during 2012 and financed about 84.9% of this period's current account deficit.

Table 1 Balance of Payments indicators

	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2011	2012
Current account (in EUR million)	-366.4	-290.4	-251.8	-242.8	-236.3	-1185.4	-1021.3
y-o-y / GDP	2.8%	26.7%	-23.9%	-6.2%	-35.5%		-13.8%
Trade balance	-658.6	-465.3	-475.5	-540.5	-517.8	-2,241.6	-1,999.2
Exports, f.o.b.	360.0	325.8	394.2	402.5	403.1	1,405.5	1,525.6
Imports f.o.b.	-1,018.6	-791.2	-869.7	-943.0	-920.9	-3,647.1	-3,524.8
Balance of services	41.3	8.5	26.2	132.6	27.9	134.9	195.1
Credit	428.5	293.8	381.1	578.1	402.1	1,747.4	1,655.1
Debit	-387.2	-285.4	-354.9	-445.4	-374.2	-1,612.4	-1,459.9
Travel - export	285.1	185.1	246.4	445.3	268.4	1,169.4	1,145.2
Travel - import	-256.8	-180.8	-240.1	-325.6	-256.1	-1,121.5	-1,002.7
Travel - net	28.4	4.3	6.2	119.7	12.3	47.9	142.6
Balance of income	10.3	-40.4	-27.7	-20.6	-0.2	22.7	-89.0
Credit	53.2	48.2	43.0	57.8	55.3	220.1	204.4
Debit	-43.0	-88.6	-70.7	-78.5	-55.5	-197.3	-293.3
Net FDI income	-7.0	-54.8	-29.8	-42.0	-26.2	-53.2	-152.8
Current transfers	240.7	206.8	225.3	185.8	253.9	898.5	871.7
Credit	266.6	243.5	265.2	224.1	285.8	1,003.8	1,018.6
Debit	-25.9	-36.7	-39.9	-38.4	-31.9	-105.3	-146.9
Net remittances	182.5	166.5	171.6	140.8	196.3	664.5	675.3
Capital and financial account (in EUR million)	284.9	258.3	185.5	174.4	249.1	978.1	867.3
y-o-y / GDP	-30.7%	15.1%	-21.3%	-25.2%	-12.5%		-11.3%
Capital account	27.8	12.9	43.0	9.8	15.6	84.9	81.4
Financial account	257.0	245.3	142.5	164.6	233.5	893.2	785.9
A. Liabilities	398.0	307.5	277.7	378.4	224.4	1,302.5	1,188.0
FDI	288.2	205.5	191.1	164.5	183.7	745.4	744.9
Portfolio investment	21.3	14.5	19.6	7.8	21.0	75.7	62.9
Other investments	88.6	87.5	67.0	206.0	19.7	481.3	380.2
Borrowing	39.3	41.6	30.4	28.5	10.5	221.6	111.0
Currency and deposits	53.1	69.1	34.8	164.8	3.7	261.4	272.5
B. Assets	-141.0	-62.2	-135.2	-213.8	9.2	-409.2	-402.1
FDI	-19.5	-2.7	-0.3	-7.7	-7.0	-29.9	-17.7
Portfolio investment	14.4	-6.0	9.9	-26.4	-10.0	-88.8	-87.5
Other investments	-135.8	1.5	-144.8	-179.7	26.2	-290.5	-296.9
Currency and deposits	-94.3	-11.0	-133.2	-178.2	67.0	-174.2	-255.4
Lending (for commercial financing)	-56.9	9.7	0.6	-1.8	-52.8	-119.5	-44.3
Errors and omissions	75.3	35.4	73.8	158.0	-36.0	178.6	231.2
Reserve assets	6.2	-3.2	-7.5	-89.7	23.1	28.7	-77.3

Source: Bank of Albania.

¹ The latest data on the balance of payments are as at 2012 Q4. Along with the release of 2012 Q4 data, the data on the first three quarters of 2012 are revised. Also, data for 2011 are revised the balance of payments, external debt and FDIs data by economic activity and geographical allocation.

1.1 CURRENT ACCOUNT

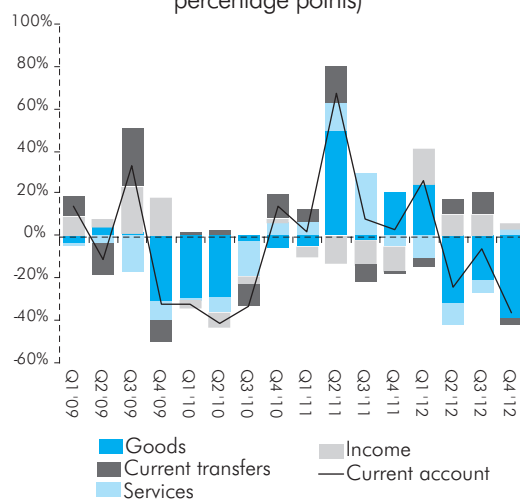
Albania's net current account balance recorded a deficit of EUR 236.3 million in 2012 Q4. Current account deficit shrank at an annual rate of about 35.5%, hence reinforcing the trend that had begun since 2012 Q2. The current account deficit was estimated at 9.8% of nominal GDP² or about 6.0 percentage points lower compared to 2011 Q4. Excluding official transfers' income the current account deficit, is estimated at about 10.2% of nominal GDP in 2012 Q4, compared to 16.2% in the same period a year earlier.

As in the three previous quarters, developments in the current account dynamic during 2012 Q4 were broadly determined by the performance of net export balance. Trade deficit narrowed at an annual rate of about 21.4% and services account by about 32.5%. The combined position of both accounts led to the decrease in net exports deficit in 2012 Q4 at an annual rate of about 20.6%. Due to the increase in income outflows, income net balance recorded a deficit, thus providing a negative contribution to current account performance. The surplus in the current transfers increased at an annual rate of about 5.5%. Remittances, the main sub-item in this account, grew at an annual rate of about 7.4% in 2012 Q4.

Albania's degree of economic openness stood at 87.0% in 2012 Q4, about 7.8 percentage points lower compared to the same period a year earlier.

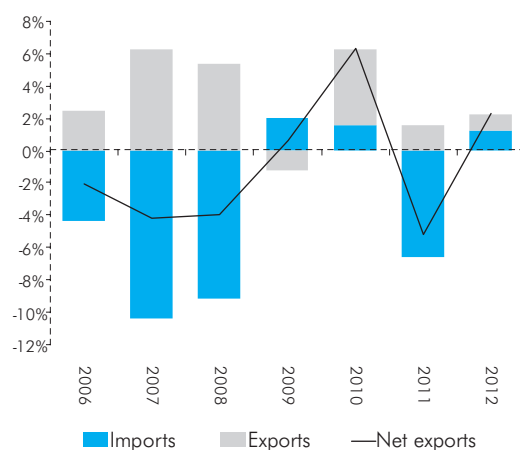
The performance of external sector indicators shows a positive contribution of this component to aggregate demand for 2012. Following the expansion by about 21.2%, y-o-y, in 2011, real net exports deficit³ narrowed at an annual rate of 7.4% during 2012, determined by the fall in imports of goods and services in real terms, by about 1.7%, and the increase in exports, by about 2.4%, y-o-y. The developments in real imports and exports of goods and services materialized into their positive contribution to aggregate demand growth over the period under review.

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



Source: Bank of Albania.

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

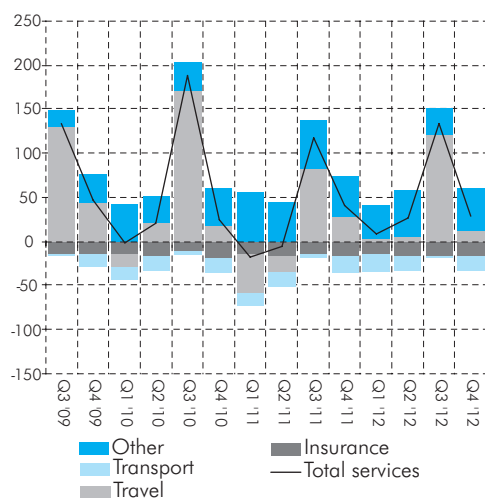


Source: Bank of Albania.

² Nominal GDP for 2003-2010 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.

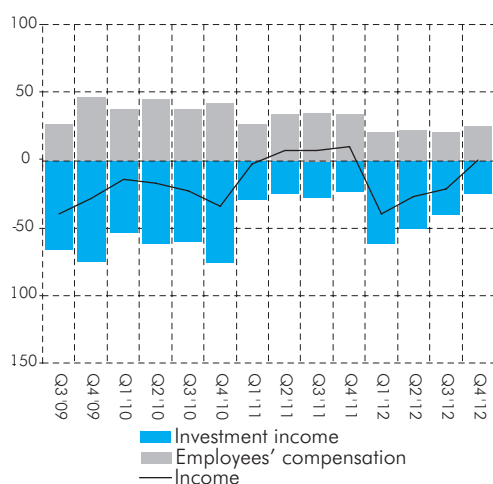
³ In order to switch from nominal to real terms of imports and exports of goods, we use the Unit Value Index calculated and published by the INSTAT. The Consumer Price Index of services, as measured by the Bank of Albania, is used for the imports and exports of services.

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



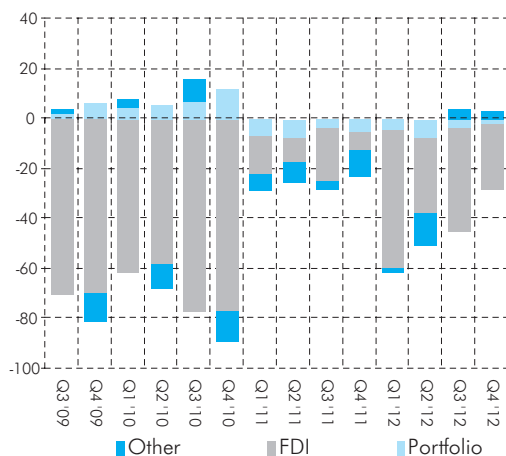
Source: Bank of Albania.

Chart 4 Income balance (net flows, in EUR million)



Source: Bank of Albania.

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



Source: Bank of Albania.

Net financial flows from the combined position of income account, current transfers and services fell at an annual rate of 3.7% in 2012 Q4. Consequently, the net flows of these three accounts altogether financed about 54.4% of the trade deficit, higher by about 10.0 percentage points, compared to a year earlier.

The net balance of services account performed positively during 2012, particularly in Q3. After the pronounced narrowing of this account surplus in 2011 due to the visa-free regime for Albanian citizens travelling to the Schengen area (which brought about an increase in foreign currency outflows for travel service), year 2012 recorded a positive balance of EUR 195.1 million, up at the annual rate of about 44.6%.

The quarterly analysis of services shows that the increase in foreign flows in the services account was more considerable in 2012 Q3, which corresponds to the summer tourist season. The 2012 Q4 yielded a surplus of EUR 27.9 million, down by 32.5% compared to a year earlier, mainly due to the fall in foreign currency inflows from travel services. The net balance of travel services (personal and business) sub-item shrank at an annual rate of about 56.6%, mainly due to the fall in foreign currency inflows for services for tourism and business purposes of non-residents in Albania. Foreign currency outflows in the form of expenses by residents for personal travel services dropped by about 0.2% during the period under review. Other services (which include communication, construction, government, financial, computer, information services) sub-item recorded a positive balance of EUR 48.1 million, up at an annual rate of about 3.3%. On the other hand, the deficit in "transportation" and "insurance services" sub-items continue to provide a negative contribution to the total services balance for 2012 Q4.

After a slight increase in 2011, net income balance, recorded a deficit of about EUR 89.0 million in 2012. The accelerated increase in investment profit repatriation and the decline in income from employees' compensation at annual rate determined the developments in this account during the period under review.

By quarters, the income account recorded the highest deficit during the first nine months of 2012. During 2012 Q4, net income account recorded a deficit of EUR 0.2 million, considerably lower compared to the rest of year. The fall by 25.2% in net income from employees' compensation and the investment profit repatriation determined the developments in net total income in 2012 Q4.

The balance of income account from foreign direct investment resulted with a deficit of about EUR 26.2 million, from EUR 7.0 million a year earlier. The increase in income deficit from FDI was due to the rise in their outflow. In 2012 Q4, income deficit from portfolio investments impacted negatively the income account. The balance of income from other net investment recorded positive figures for the second quarter in a row, mainly due to the lower net interest payments on public and private debt. The surplus of this income account sub-item was about EUR 2.8 million in 2012 Q4, against the deficit of EUR 10.9 million in 2011. Net interest payments on public and private debt lowered Albania's liabilities by about EUR 12.6 million during the period under review.

During 2012, net balance of current transfers account pursued the progressive fall in surplus started since 2009. Current transfers account surplus shrank at an annual rate of about 3.0%, during this period, due to their increased outflow.

Net current transfers surplus expanded by about 5.5% in 2012 Q4. Public and other sectors' transfers increased at an annual rate of 39.6% and 4.5%, respectively. Remittances grew at an annual rate of about 7.4%. Remittances-to-trade deficit ratio is estimated at 38.0%, about 10.2 percentage points higher than the financing ratio recorded in the same period a year earlier.

1.2 CAPITAL AND FINANCIAL ACCOUNT

Net flows in the capital and financial account recorded a positive balance of EUR 249.1 million in 2012 Q4, financing in full the current account deficit recorded during this period. Capital and financial flows fell by about 12.5% accounting for about 10.3% of nominal GDP. The annual fall in foreign flows in this account was mainly driven by the lower financial flows at an annual rate of about 9.1%. As a percentage to nominal GDP, the financial account was estimated at about 9.7%, about 1.4 percentage points lower compared 2011 Q4. Net flows in the capital account recorded a surplus of EUR 15.6 million in 2012 Q4. Residents' financial liabilities to non-residents declined considerably at an annual rate of 43.6%, due to the fall in FDI investment and other investment inflows.

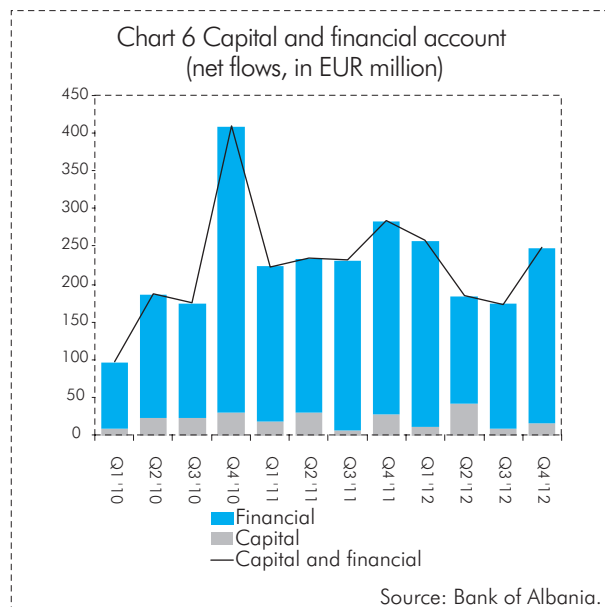
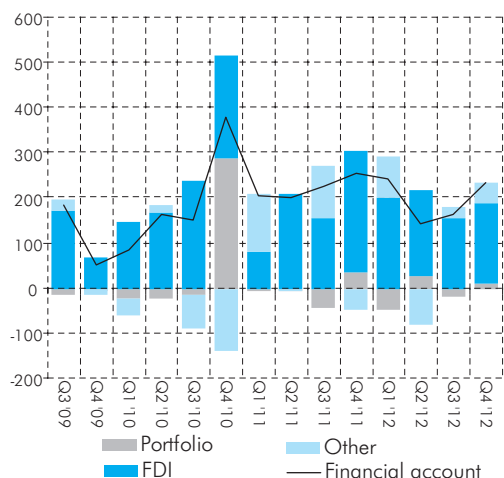


Chart 7 Capital and financial account
(net flows, in EUR million)



Source: Bank of Albania.

Albanian assets invested in non-resident economies were down by about EUR 9.2 million, compared to the increase of EUR 141.2 million in the same period a year earlier. The considerable fall in assets as other investments was the main determinant of developments in Albanian assets invested abroad.

Net foreign direct investment (inflows – outflows) dropped considerably by 34.2%, compared to 2011 Q4. This change owes, to a large extent, to the decrease in liabilities in the form of FDI (FDI inflows) by about 36.2%. By type of investment instrument, FDI inflows in the form of shares and reinvested earnings fell at an annual rate of about 31.3%. Capital inflows in the form of other capital inflows were down by EUR 1.7 million, against the increase of EUR 23.1 million in 2011 Q4.

Privatisation receipts continue to have a modest role on total foreign direct investments. Excluding privatisations, FDI declined at an annual rate of about 36.8% during the period under review.

In cumulative annual terms, 2012 recorded a slight increase in foreign direct investments by about 1.6%, after their fall by 9.3% during the previous year.

FDI STOCK DISTRIBUTION BY ECONOMIC ACTIVITY AND COUNTRY⁴

FDI stock in Albania has increased progressively during the last three years (2009, 2010 and 2011), albeit being under the pressure of the global economic and financial crisis that captured the international markets. FDI stock was estimated at about EUR 3,036.6 million as at end-2011, about 13.9% higher compared to the rate recorded in 2010. Positive performance of FDI in Albania reflects foreign investor's preference to invest in our country due to the lower production cost and the potentially high profit margins.⁵ Privatisations have played a modest role on FDI growth in the last two years, showing the interest of foreign investors in Albania.

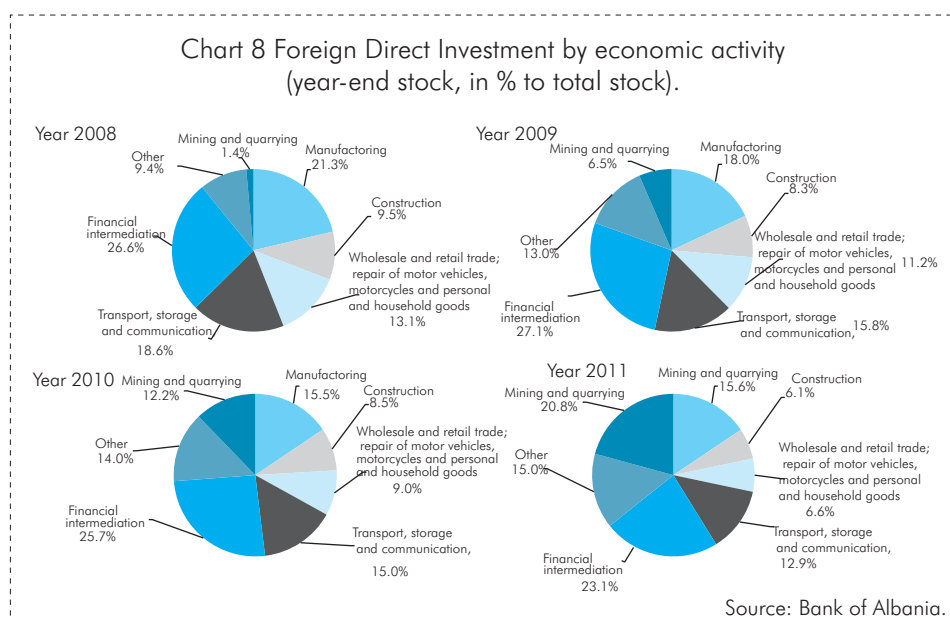
FDI distribution by economic activity suggests a high concentration of investments in services. This fact is related to privatisations characterising this sector during these years. Latest data for 2011 show that "Monetary and financial intermediation⁶" and "Extractive industry" are the main sectors

⁴ The latest data on foreign direct investment stock by country and economic activity refer to 2011.

⁵ Approximated by income outflows from foreign direct investment. Starting since 2008, foreign direct investment income has grown considerably, y-o-y. During 2008 – 2011, foreign direct investment income (outflows) were EUR 1,483.8 million.

⁶ "Monetary and financial intermediation in addition to insurance activities and pension funds" sub-item has the highest share in FDI.

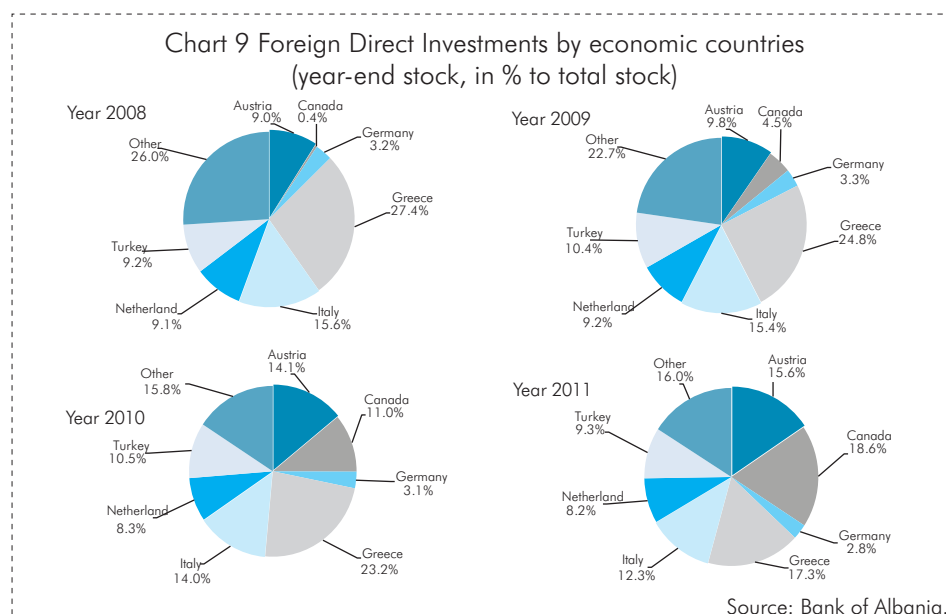
attracting most of FDIs, by 23.1% and 20.8%, respectively against the total stock. During 2011, FDIs by sectors of economy were re-allocated, the FDI portfolio was further diversified and their orientation was multi-dimensional. So far, “Monetary and financial intermediation” has represented the sector with the highest share in FDI stock till 2011. However, this sector’s share vis-à-vis other sectors of the economy has decreased progressively, from 32.1% in 2007 to 23.1% in 2011. The most significant change is noted in the increase of “Extractive Industry” share from 12.2% in 2010 to 20.8% in 2011. The extractive industry of energy and non-energy minerals, by 88.6% and 11.4%, respectively had the main share in this sector. Orientation of foreign direct investments to natural resources supported the increase in Albanian exports for these products, providing positive contribution to the improvement of Albania’s economy external position. The processing industry did not attract foreign investments in 2011. Its share in FDI stock remained unchanged compared to a year earlier (15.6%). “Electricity, gas, steam, and warm water production and delivery” and “Real estate, renting, informatics, research and scientific work, other professional activities” also increased their share in FDI total stock during 2011. Meanwhile, tourism potentials of our country are not explored by the foreign investors yet. “Hotels and tourism”, along with the share in investment stock, pursued a downward trajectory in the last three years.



FDI stock structure by countries of origin during 2007 – 2011 shows considerable changes from year to year. The main partners in investments during these years have been Greece and Italy. In 2007, foreign direct investment from Greece represented about 28.5% of total FDI stock in Albania. Investment from Italy accounted for about 12.0% in the same period. With the beginning of the economic and financial crisis and the intensified debt crisis in Greece, its share in the total FDI stock fell progressively. From 2007 to 2011, FDI share from Greece has dropped by about 11.2 percentage points, representing in 2011 about 17.3% to FDI stock. On the other hand, Italian investments, after increasing their share by about 3.6 percentage points

during 2008, maintained almost the same share till 2009 (averaging 15.5% in 2008 -2009). During 2010 and 2011, Italian investment fell back to the pre-crisis levels. In 2011, investments of Italian origin shared only 12.3% of FDI total stock.

In 2010, three investors countries with the highest share in FDI stock⁷ represented about 53.1% of total stock. In 2011, these three countries' concentration on FDI stock decreased. Nonetheless, foreign direct investment stock continued to grow, despite the downward FDI share from Greece and



Italy. This growth may reflect the reorientation of foreign investors to the Albanian market, mainly those from Austria and Canada.⁸ Thus, the attraction of potential investors from other countries might minimise the effects of public debt crisis in Greece and the difficulties in Italy in the inflows of capital at home.

Net portfolio investments contributed to the increase in Albania's liabilities to non-residents by about EUR 11.0 million in 2012 Q4, about 69.2% lower compared to the same period a year earlier. Residents invested about EUR 10.0 million in debt securities in the period under review. Portfolio investment inflows stood almost at the same level with the previous year.

In annual cumulative terms, net portfolio investment contributed to the increase of Albanian's assets invested abroad by about EUR 24.6 million, almost doubled from a year earlier.

Other net investments closed with a positive balance contributing by about EUR 45.9 million to the increase in residents' liabilities to non-residents.

⁷ Greece, Italy and Austria.

⁸ In 2011, FDI from Canada represented about 18.6% of FDI total stock at home turning into the partner with the highest share of investments in Albania. FDI from Austria represented about 15.6% of stock.

Compared to the same period a year earlier, the net creditor position changed to net debtor one. During this quarter, the liabilities inflows fell considerably in annual terms and assets invested abroad declined. In other-investment accounts, Albania's liabilities to non-residents fell by EUR 19.7 million from EUR 88.6 million in the same period a year earlier, mainly due to the decline in borrowing and currencies and deposits flow. Private and public borrowing was about EUR 10.5 million during the quarter under review, compared to EUR 39.3 million in 2011 Q4. The payment of principal by private sector triggered the fall in total borrowing. Private and public debt payments lowered Albania's liabilities by about EUR 69.3 million in 2012 Q4. Domestic assets invested in foreign economies as other investments, fell in 2012 Q4 by about EUR 26.2 million from the increase by about EUR 135.8 million in the same period a year earlier. Our assets invested abroad dropped mainly due to the pronounced fall of assets invested as currencies and deposits by our banking system abroad. Albania's banking system deposits fell by about EUR 67.0 million from the EUR 94.3 million increase in 2011 Q4.

GROSS EXTERNAL DEBT

As at end-2012 Q4, Albania's gross external debt stock totalled EUR 5,294.4 million, up about EUR 51.8 million compared to the previous quarter and about EUR 498.7 million compared to its stock as at end-2011 Q4. For the most part, the higher debt stock as at end-2012 Q4 was determined by the increase in banking system and central government borrowing. By institutional sectors, as at end-2012 Q4, general government's share in total debt stock was about 42.0%. The remainder of debt has been allocated to: other sectors (19.3%), banks (20.8%), and foreign direct investment – intercompany loans (16.1%) and monetary authority (1.7%).

Central government continues to have the highest share in total debt stock. As at end-2012 Q4, its debt stock totalled about EUR 2.2 billion. Throughout the four quarters of 2012, the share of central government debt has been in the range of 42.0 - 43.2%, with the lowest share in the fourth quarter. Relative to end-2011, the share of central government debt has declined from 43.1 to 42.0% as at end- 2012 Q4.

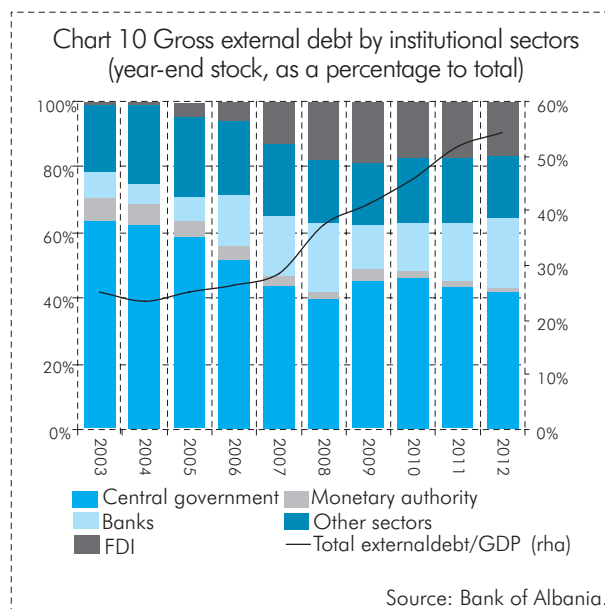
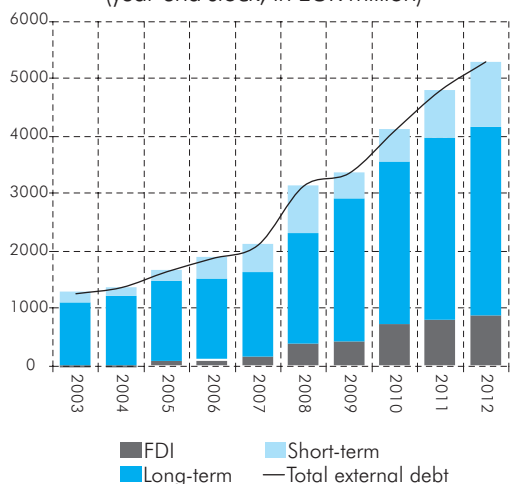


Chart 11 External debt by maturity
(year-end stock, in EUR million)



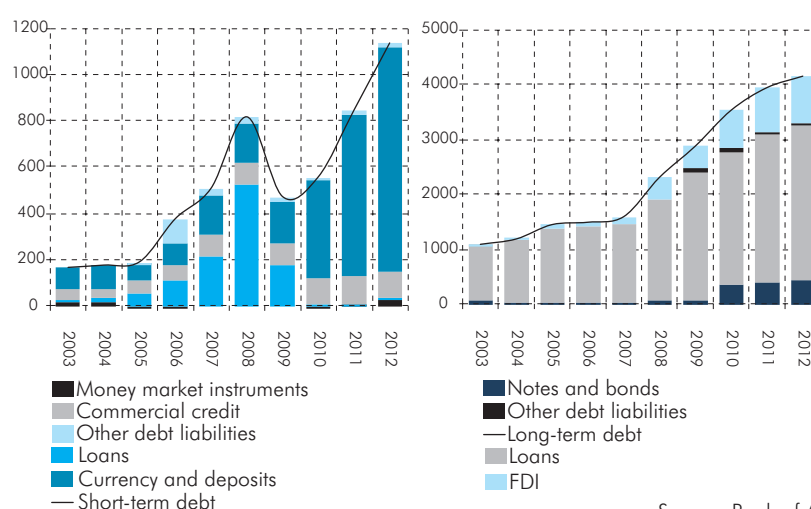
Source: Bank of Albania.

The banking system's gross external debt amounted to about EUR 1.1 billion in 2012 Q4, up about EUR 232.6 million from end-2011. Other sectors' external debt amounted to about EUR 1 billion, up by EUR 69.2 million from 2011. Its share in total external debt stock for the period under review stood at about 19.3%, down by about 0.6 percentage points from end-2011. During the period under review, foreign investment stock totalled EUR 853.4 million, up about EUR 51.6 million or about 6.4% compared to end-2011.

In 2012 Q4, about 62.4% 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 21.4% to total debt stock and was mainly in the form of banking sector currency and deposits. FDIs account for 16.1% 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. By instruments and maturity, loans represent the main long-term investment instrument, accounting for about 84.8% of total long-term debt (excluding FDIs). About 13.5% of long-term debt is held in the form of notes and bonds. Short-term debt is mainly represented by currency and deposits, accounting for about 84.9% as at end-2012 Q4. Commercial credit accounted for about 10.2% of short-term debt stock.

Chart 12 Short and long-term external debt (year-end stock, in EUR million)



Source: Bank of Albania.

International reserves decreased by about EUR 23.1 million in 2012 Q4. As of December 2012, international reserves totalled EUR 1.972,5 million, sufficient to cover 4.5 months of imports of goods and services.