

Bank of Albania

ANALYSIS OF DEVELOPMENTS  
IN THE EXTERNAL SECTOR  
OF THE ECONOMY

2014 Q2

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*The views expressed herein are solely of the authors and do not necessarily reflect those of the Bank of Albania.*



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## 1. BALANCE OF PAYMENTS HIGHLIGHTS<sup>1</sup>

Albania's net current account balance recorded a deficit of EUR 343.7 million in 2014 Q2. It maintained a widening tendency for the third consecutive quarter, deepening by around 20.6%, on an annual level, during the quarter under review. The current account deficit was estimated at 12.8% of nominal GDP.

By current account components, worsened net exports deficit and primary income contributed to widening this period's deficit. In the meantime, secondary income contributed to narrowing the annual current account deficit.

The stable external demand helped maintain the uptrend in exports of goods and services. However, the continuous uptrend in imports of goods and services for the third consecutive quarter, contributed to net exports deficit deepening for this quarter. The primary income account balance remained in negative territory for the second consecutive quarter. After five consecutive quarters of continuous decline, secondary income rose around 2.6% in 2014 Q2, driven largely by the annual increase in remittances by about 4%.

Net capital inflows increased to EUR 15.3 million, from EUR 4.8 million in 2013 Q2. Net financial flows recorded an annualised decrease of around 16.1%, financing 64% of the current account deficit. Net foreign direct investments dropped by around 47.7%, on an annual level. Foreign direct investment inflows, minus foreign capital participation in privatisations, which amounted to around EUR 111 million in 2013 Q2, recorded an annualised increase of 4.9%.

Dividing the current deficit financing as debt creating inflows and non-debt creating inflows, a more pronounced support to the second type of financing during the quarter under review is noted. However it is worthy to underline, that the financing by debt-creating inflows increased considerably, from a quarter earlier.

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<sup>1</sup> The latest data on the balance of payments are as of 2014 Q1. From 2014 Q1, Financial Stability and Statistics Department at the Bank of Albania prepares the Balance of Payments Statistics, in compliance with the International Standards laid down in sixth edition of the Balance of Payments and International Investment Manual, released by the International Monetary Fund (BPM6.) Earlier, they were published based on the Balance of Payments Manual, fifth edition - IMF. The main differences between two methodologies are synthesised in the guideline "Publication of Financial Statements of statistics of external sector, in accordance with BPM6-IMF", published by the Bank of Albania at [http://www.bankofalbania.org/web/pub/01\\_commentary\\_for\\_changes\\_in\\_the\\_publication\\_of\\_external\\_sector\\_statistics\\_according\\_to\\_bpm6\\_june\\_2014\\_6689\\_1.pdf](http://www.bankofalbania.org/web/pub/01_commentary_for_changes_in_the_publication_of_external_sector_statistics_according_to_bpm6_june_2014_6689_1.pdf) For the purposes of internal analysis, the Balance of Payments data from 2002 to 2013 are reclassified in line with the new methodology by the Monetary Policy Department.

The overall balance of payments shows that, in 2014 Q1, foreign exchange reserve assets increased by about EUR 22.5 million. At end-June 2014, the foreign exchange reserve stock was around EUR 2, 01 billion, sufficient to cover 4.5 months of imports of goods and services.

Table 1 Balance of Payments indicators

	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2
Current account (in EUR million)	-223,4	-285,0	-190,4	-336,2	-274,2	-343,7
y-o-y	-18.0%	13.2%	-23.2%	63.3%	22.7%	20.6%
/ GDP	-9.9%	-10.8%	-8.1%	-13.1%	-11.8%	-12.8%
Goods and services	-380,5	-442,5	-394,9	-518,1	-410,1	-488,4
Exports, f.o.b.	665,1	805,6	981,0	960,3	738,5	910,8
Imports, f.o.b.	1045,7	1248,1	1375,9	1478,4	1148,6	1399,3
Travel - net	-34,6	-31,5	26,1	34,0	-21,8	10,6
Primary income	9,9	-11,0	22,2	0,0	-7,1	-28,1
Credit	28,6	35,7	40,2	33,4	29,2	25,6
Debit	18,7	46,7	18,0	33,4	36,3	53,8
Net FDI income	-0,2	-20,1	6,2	6,9	-15,9	-31,3
Secondary income	147,2	168,4	182,3	181,9	143,0	172,9
Credit	179,9	200,5	216,5	213,5	170,2	201,7
Debit	32,6	32,0	34,2	31,6	27,3	28,8
Net remittances	121,6	129,6	152,5	140,1	115,9	134,8
Capital account	9,7	4,8	15,0	18,2	22,5	15,3
Net borrowing/net lending	-213,7	-280,2	-175,4	-318,0	-251,6	-328,4
Financial account	-126,7	-262,4	-70,9	-226,1	-230,6	-220,2
y-o-y	-44.5%	213.8%	78.4%	-16.2%	82.0%	-16.1%
/ GDP	-5.6%	-9.9%	-3.0%	-8.8%	-9.9%	-8.2%
Direct investments	-114,5	-270,5	-307,0	-231,2	-192,5	-141,4
Portfolio investments	22,9	104,4	6,2	-18,1	12,8	12,3
Financial derivatives	2,3	1,1	0,0	-2,4	0,0	0,0
Other investments	-13,8	-183,8	195,4	18,6	-10,5	-113,6
Reserve assets	-23,6	86,4	34,5	7,1	-40,3	22,5
Errors and omissions	87,0	17,8	104,5	91,9	21,0	108,2
Net borrowing/net lending	-213,7	-280,2	-175,4	-318,0	-251,6	-328,4

Source: Bank of Albania.

## 2. CURRENT ACCOUNT<sup>2</sup>

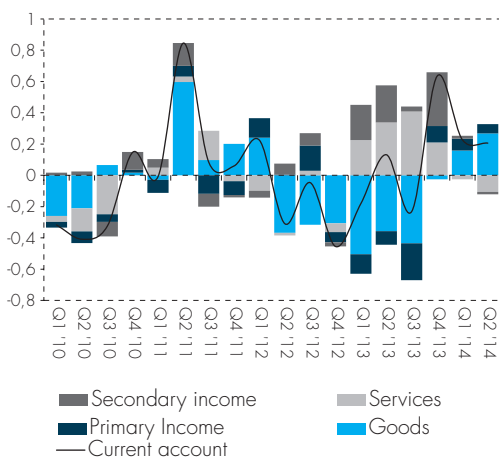
Albania's net current account balance recorded a deficit of EUR 343.7 million in 2014 Q2. Current deficit widened for the third consecutive quarter, increasing by 20.6% in annual terms, during the quarter under review. The current deficit accounted for about 12.8% of nominal GDP, or about 2.0 percentage points higher than in the same period a year earlier. Excluding income from official transfers, the current account deficit was estimated at about 12.9% of nominal GDP, from 11% in the same period a year earlier.

Current account dynamic, during 2014 Q2, continued to be broadly affected for the second consecutive quarter by the development of net exports balance in goods and services. Imports of goods and services grew by about 12.1% in annual terms. On the other side, the 13.1% y-o-y increase of goods and

services exports was not sufficient to offset the increase in imports. In 2014 Q2, nominal deficit in net exports increased by about 10.4% in annual terms, contributing to the deepening of the current deficit. The worsened net position of primary income account provided the same impact<sup>3</sup>. Secondary income<sup>4</sup> grew slightly by 2.6% in annual terms, providing contribution to the narrowing of current account deficit during this quarter.

While the resulted current deficit in 2014 Q2 is considered in the light of gap performance between public savings and national investments, a decreasing impact of private sector on the creation of current account deficit was noted<sup>5</sup>. The gap between savings and private investments was assessed at 7.4% of nominal GDP, about 3.9 percentage points

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



Source: Bank of Albania.

<sup>2</sup> Overall, the shift to the international standards laid down in Sixth Edition of the Balance of Payments Manual does not reveal any change in the general view of the current account, compared to the previous standards. The most significant changes consist in the goods and services account. Their composing sub-items are reclassified, renamed and further detailed.

<sup>3</sup> In accordance with the standards set forth in the Sixth Edition of the IMF's Balance of Payments and International Investment Position Manual, "primary income" corresponds to "income" in the Fifth IMF's Balance of Payments Manual.

<sup>4</sup> In accordance with the standards set forth in the Sixth Edition of the IMF's Balance of Payments and International Investment Position Manual, "secondary income" corresponds to "current transfers" in the Fifth IMF's Balance of Payments Manual.

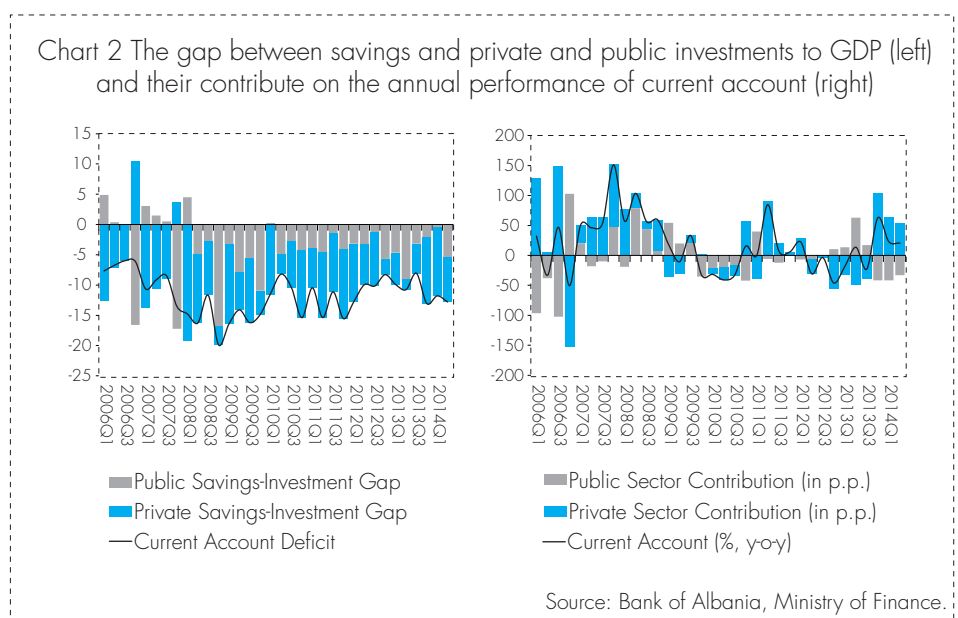
<sup>5</sup> An alternative but equivalent measuring of current account net position for a definite period is the method of gap between savings and national investments. Thus, the net realised position of current account is equal to the amount of gap realised between savings and public and private investments in period  $t$ .

$$CA_t = (S_{publike} - I_{publike})_t + (S_{private} - I_{private})_t$$

lower, from a quarter earlier. Although, private sector's impact on the creation of current account deficit was higher than public sector's impact, for the fourth consecutive quarter. Due to the need for a continuing accumulation of capital stock in Albania, and maintaining the stability of the external sector, the increase in the private sector share in creating the current deficit is welcomed<sup>6</sup>.

The gap between savings and public investments decreased at accelerated pace in annual terms during 2014 Q2. Nevertheless, the latter increased considerably, from a quarter earlier.

The gap between savings and public investments increased at accelerated paces in annual terms. Private sector' contribution to the creation of current account deficit was 57.6%, about 42 percentage points higher, compared to the same period a year earlier. More concretely, in the annual expansion of the current account deficit by about 20.6%, the public sector contributed negatively (-33.3 percentage points), whereas the private sector contributed positively (+53.9 percentage points).



Albania's Trade openness in 2014 Q2 stood at 86%, about 8.4 percentage points higher, from the same period a year earlier.

### Other current account items

In the framework of adopting the international standards of the Sixth Edition of the IMF's Balance of Payments and International Investment Position Manual,

<sup>6</sup> Various studies conclude that when the current deficit is created by the private sector, in an economy that is accumulating capital, the latter becomes more tolerant against persistently high current deficit rates. That was different from the cases when public sector provided the main contribution to the establishment of current deficit. See: Milesi-Ferretti & Razin (1996), 'Sustainability of Persistent Current Account Deficits', NBER, WP5467. Cusolito & Nedeljkovic (2013), 'Toolkit for the Analysis of Current Account Imbalances', WB, WP83248.

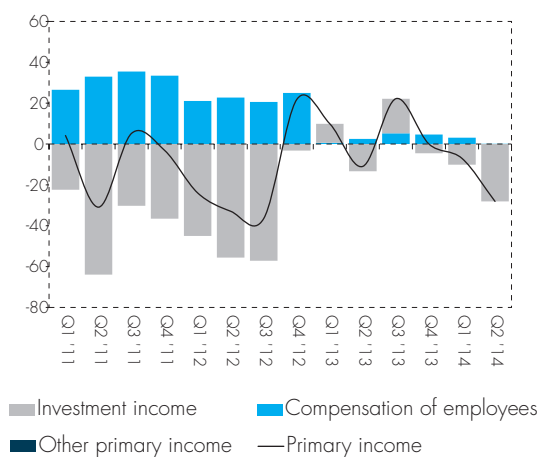
the constituent sub-items of services account were subject of a series of re-classifications and re-nominations in the light of an increasing importance of cross-border transactions in services. Thus, the most important changes relate to the sub-items of services account “processing services on physical inputs owned by others” (Manufacturing services on physical inputs owned by others BPM5) and “services for maintenance and repair” (“manufacturing goods” in BPM5), which are reclassified from “goods” to “services”. ““Merchanting” (net exports of goods under trading intermediation) and other services related to trade are re-classified from “services” to “goods”. Due to methodical changes, net balance of goods and services account reveals changes, particularly sensitive in the case of services account.

In 2014 Q2, services account improved slightly. Net income balance of this account recorded a net surplus of EUR 18.9 million, mainly due to the increase in foreign currency inflows from “travel services”. Net income balance from services continuous to be considerably affected by the development in the sub-items with the highest share in this account: “manufacturing services on physical inputs owned by others”, “travel services (personal and business)”. On the other hand, net income of “transport services” account narrowed during the considered period, providing contributing to the deepening of the net services account deficit.

Net income from “travel services” for tourism and personal purposes, recorded a positive balance. This sub-item recorded a surplus of EUR 10.6 million, from the deficit of EUR 31.5 million during the same period a year earlier. Foreign currency inflows from travel services of non-residents to Albania increased by 37.7%, in annual terms. Foreign currency outflows in the form of Albanian residents’ expenses for personal and business travel services abroad increased by about 16.9%, albeit they did not completely cancel out the positive effect of inflows.

Net balance of primary income account closed in negative territory in 2014 Q2. Net foreign-currency inflows in this account resulted in deficit by about EUR 28.1 million, from about Euro 11.0 million deficit in the same period a year earlier. The widening of deficit in “investment income” determined the direction of developments in this account during the considered period. Net “income from work” resulted lower, compared to a year earlier, providing a negative contribution to the total balance of this account

Chart 3 Income balance (net flows, in EUR million)

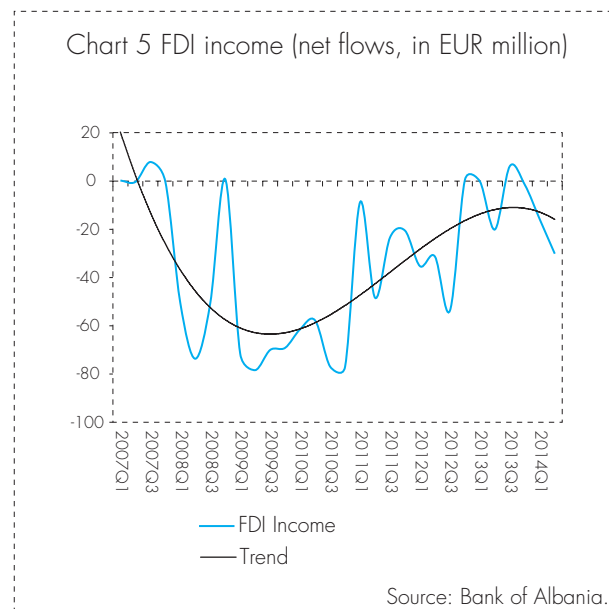
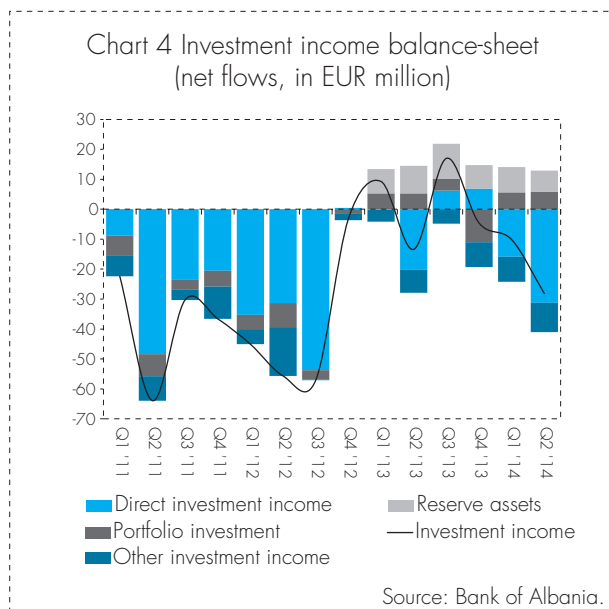


Source: Bank of Albania.

“Investment income” sub-item recorded a considerable widening of deficit in 2014 Q2, by about EUR 28.2 million, from EUR 13.4 million in the same period a year earlier. The increase in FDI income outflows determined the direction of developments in this account during the period under review.



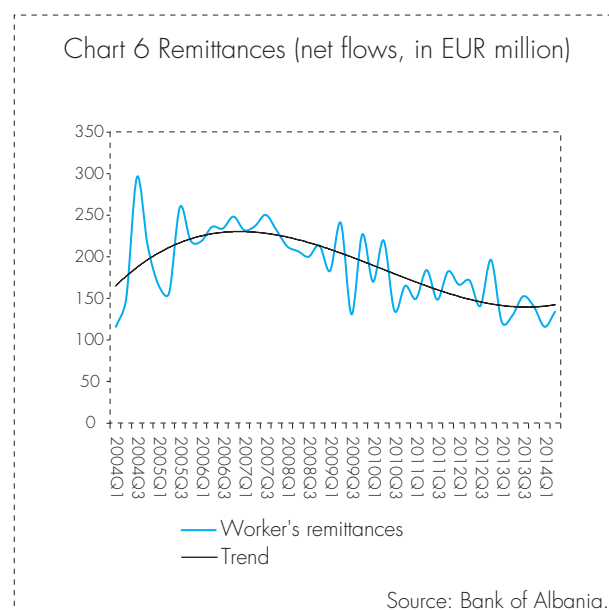
In 2014 Q2 net income deficit from “foreign direct investment” income widened by about 55.5%, standing at EUR 31.3 million. Income repatriation from investments in capital and equities in investments funds played an important role. Interest income recorded a net negative balance of EUR 0.3 million, from the surplus of EUR 1.3 million in the same period a year earlier.



The balance of “Portfolio investment” income continued to record positive values for the second consecutive quarter, at about EUR 5.9 million during the considered period. In this sub-item of income account, income represents mainly interests arising from debt instruments. In contrast, net income balance from “other investment” recorded a deficit of about EUR 9.8 million, from the deficit of about EUR 7.8 million in the same period a year earlier. Income from the investment in foreign exchange reserve assets<sup>7</sup> stood at EUR 7.0 million in 2014 Q2.

Net balance of secondary income account, unlike the performance during the previous year, recorded a slight improvement in financial flows in 2014 Q2. Total net balance of this account during the period under review recorded a surplus of about EUR 172.9 million, up by about 2.6% in annual terms. Foreign currency flows in the secondary income accounted for about 6.4% of nominal GDP. This ratio is similar to the ratio of the same period in the previous year.

The main sub-item of this account, net secondary income from “financial and non-financial corporates, households, and non-profit institutions serving households”, recorded a surplus of about EUR 142.7 million, up by about 12.1% in annual terms.



<sup>7</sup> In accordance with standards laid down in Sixth IMF’s Balance of Payments Manual in the primary income account, the item “investment income” includes the income from “foreign currency reserve” investment”.

The sub-item with the largest share in secondary flow income from “financial and non-financial corporates, households and NPISH<sup>8</sup>”, “remittances<sup>9</sup>”, trended up during 2014 Q2. In this period, remittances stood at EUR 134.8 million, up by about 4.0% in annual terms. They were estimated at about 5.0% of nominal GDP.

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<sup>8</sup> *Non-profit institutions serving households.*

<sup>9</sup> *From 2014 Q1, remittances are calculated based on the survey on remittances carried out by the Bank of Albania, and data on remittances transmitted through formal channels (money transfer operators and banking system).*

### 3. CAPITAL ACCOUNT

Capital account debits and credits all the transactions on the acquisition and disposal of non-produced, non-financial assets/goods<sup>10</sup> and the capital transfers<sup>11</sup> between residents and non-residents (on which there is no economic value in the exchange). In 2014 Q2, capital account recorded a surplus of about EUR 15.3 million, up from about EUR 4.8 in the same period a year earlier. This account's net capital flows accounted for about 0.6% of nominal GDP during the period under review. Incoming capital transfers were EUR 43.6 million, from EUR 28.3 million in the same period a year earlier, whereas capital outflow transfers amounted about EUR 28.3 million in 2014 Q2. Net capital transfer for the account of "central government" were EUR 15.2 million, while those in "financial and non-financial corporates", "households and non-profit institutions serving households" were about EUR 0.1 million.

The combination of net non-financial transactions of current account and capital account provides the net position of the domestic economy, as net lender (surplus) and net borrower (deficit) versus the non-resident economies. Conceptually, this result is equal to the net balance of the financial account, which reflects how the net lending or net borrowing by non-residents is being financed. In quantitative terms, our economy reveals a net borrowing position, about EUR 328.4 million, which is financed by the income in the financial account (minus errors and omissions).

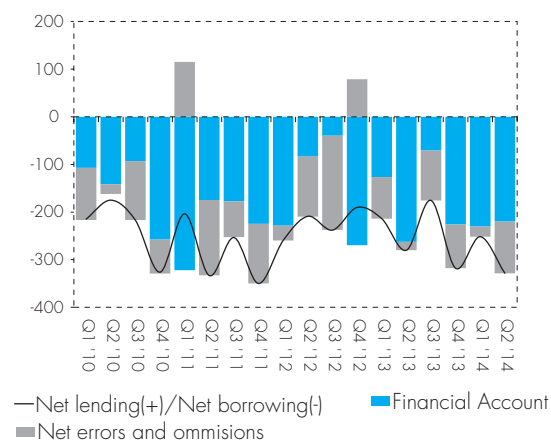
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<sup>10</sup> Acquisition and disposal of non-produced, non-financial asset include: 1. Acquisition and disposal of non-produced, non-financial asset include: 1. Natural resources (land, mineral rights, forestry rights, water, fishing rights, air space, and electromagnetic spectrum); 2. Contracts, leases, and licenses covers those contracts, leases, and licenses that are recognized as economic assets; 3. Marketing assets (brand names, mastheads, trademarks, logos, and domain names)

<sup>11</sup> Capital transfers consist in: 1. debt forgiveness; 2. Non-life insurance claims; 3. grants; 4. guarantees; 5. taxes (inheritance taxes, gifts, etc.); 6. Other capital transfers.

## 4. FINANCIAL ACCOUNT<sup>12</sup>

Chart 7 Financial account, errors and omissions (net flows, in EUR million)

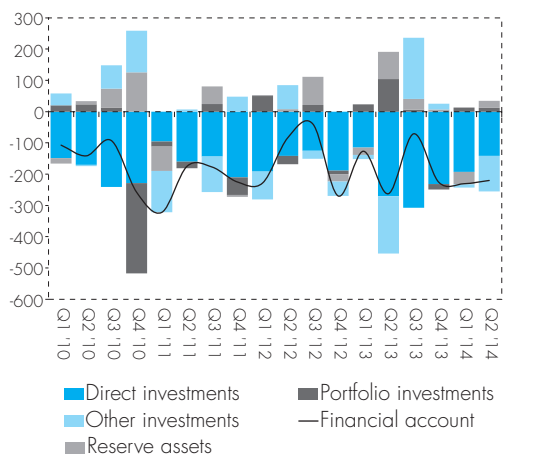


Source: Bank of Albania.

Net flows in the financial account recorded a positive balance of EUR 220.2 million during 2014 Q2, financing about 64.1% of the current account deficit recorded in this period. Financial flows decreased about 16.1%, accounting for about 8.2% of nominal GDP, relative to the same period a year earlier. The increase in annual terms in foreign currency flows in this account was mainly attributable to the decrease in net flows by about 47.7% in annual terms, in the form of direct investments. Net borrowing in domestic economy fell by 23.1% in annual terms in 2014 Q2.

Residents' financial liabilities to non-residents decreased by 15.2% in annual terms, due to lower FDI inflows. Albanian assets invested in non-resident economies decreased by about 12.3% during the period under review<sup>13</sup>. The decrease in assets in the form of other investment was the main determinant of developments in Albanian assets invested abroad.

Chart 8 Financial account components (net flows, in EUR million)



Source: Bank of Albania.

Net FDI decreased by about 47.7%, from 2013 Q2. Foreign direct investment inflows, minus foreign capital participation in privatisations, which amounted to around EUR 111 million in 2013 Q2, recorded an annualised increase of 4.9%. Domestic assets as foreign direct investment increased by EUR 41.6 million, from EUR 15.0 million in 2013 Q2. Net FDI was estimated at about 5.3% of nominal GDP, or about 5.0 percentage points lower, compared to the value recorded in the same period a year earlier.

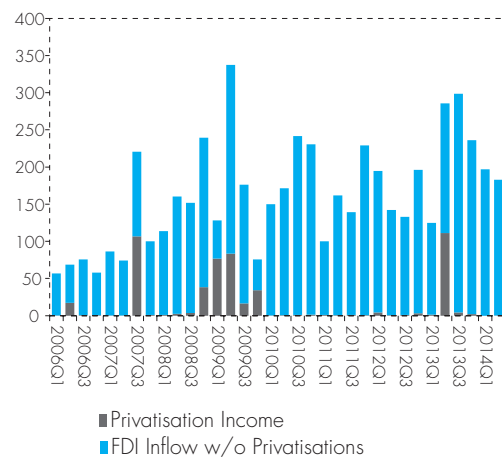
<sup>12</sup> In accordance with standards laid down in the Sixth Edition of the IMF's Balance of Payments and International Investment Position Manual, increase in assets and liabilities is shown with a positive sign; decrease in assets and liabilities with a negative sign. Net financial account balance is calculated as a difference between assets and liabilities. Also, main items in financial account are: 1. Direct investment; 2. Portfolio investment; 3. Other investment; 4. Financial derivatives and employee stock options; 5. Reserve assets.

<sup>13</sup> In addition to methodical amendments stipulated in BPM6, total domestic financial assets invested in foreign economies include also the foreign assets (reserve assets).

In accordance with the instruments used for investments<sup>14</sup>, net direct investments as “capital and stocks as investments fund” decreased by about 29.9% in annual terms. Net FDI as “re-invested profits” in Albania also decreased in annual terms. At the same time, foreign investors increased their investments as “debt instruments” in undertaking direct investments, about EUR 7.0 million. Assets invested as “debt instruments” at direct investment undertakings increased considerably by about EUR 25.0 million.

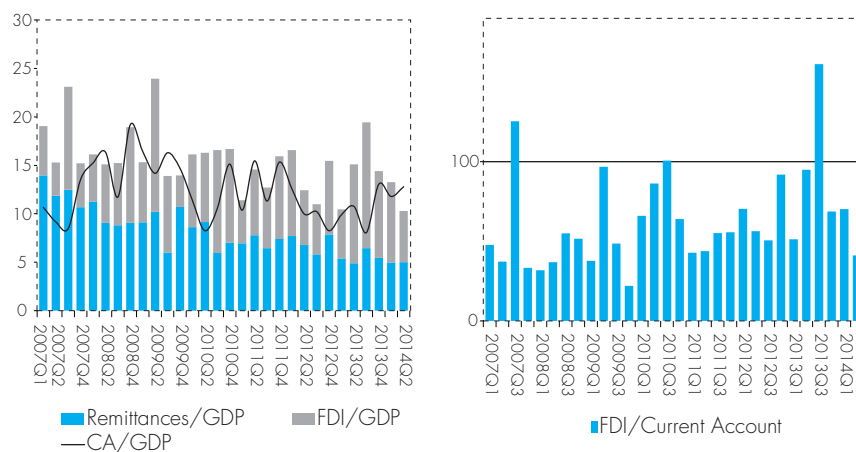
In the long run, FDIs are an important foreign-currency inflow in financing trade and current deficit in Albania. This trend was dominant especially at beginning of 2009, when the importance of other foreign-currency flows in the form of remittances, began to progressively contract. Since 2013, FDIs have been the main financing source of external sector deficit in Albania. In 2014 Q2, the ratio of net FDI flows to recorded current deficit was estimated at 41.1%. This financing rate was about 53.8 percentage points lower compared to the same period a year earlier.

Chart 9 Composition of foreign direct investment (flows, in EUR million)



Source: Bank of Albania.

Chart 10 Financing sources of trade deficit (left) and FDI income to net FDI (right)



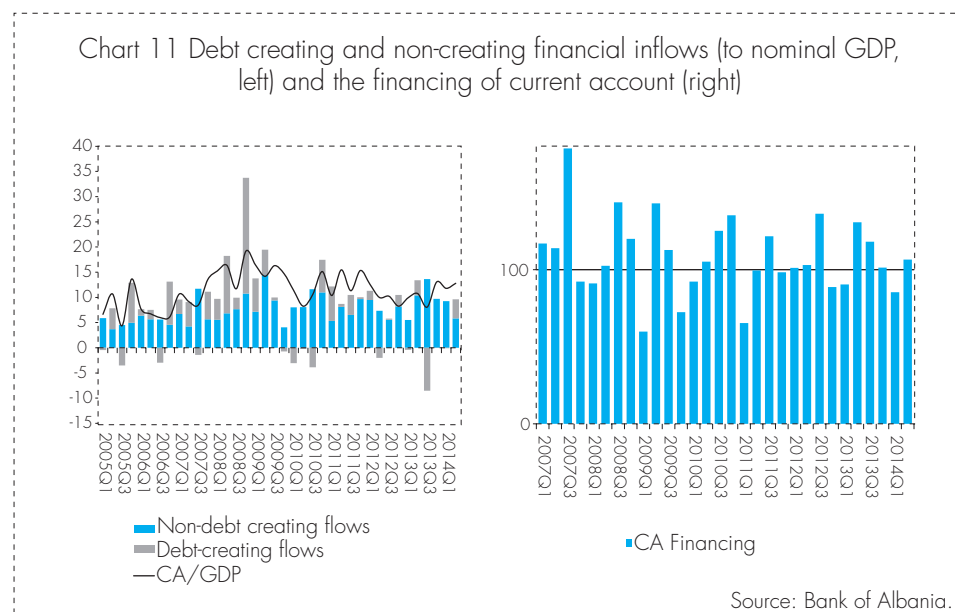
Source: Bank of Albania.

Net portfolio investments in 2014 Q2 recorded a positive balance of EUR 12.3 million. Residents’ assets (depositing corporates, excluding the Bank of Albania) invested abroad increased by about EUR 24.6 million, mainly in the form of debt securities. Liabilities as portfolio investments stood at EUR 12.3 million, during the period under review, from EUR 2.1 million in the same period a year earlier.

<sup>14</sup> In accordance with standards laid down in BPM6, direct investments are realised through three main instruments: 1. Capital and shares in investment fund; 2. New invested profit; 3. Debt instruments.

In 2014 Q2, other investment account closed with a negative balance of about EUR 113.6 million. In other investment account, Albanian assets invested abroad decreased by about EUR 20.0 million, from the decrease by EUR 130.7 million in the same period a year earlier. On the side of liabilities, non-residents invested in our country about EUR 93.6 million, from 53.2 million a year earlier. "Currency and deposits" were the main contributors to the performance of net other investments. In net terms, our banking system investments abroad fell by about EUR 27.4 million, from the fall of EUR 92.4 million in 2013 Q2.

As regards the profile of external debt financing, it is important to monitor the reliance on debt-creating inflows versus more desirable non debt-creating inflows<sup>15</sup>. Thus, in 2014 Q2, non-debt-creating inflows from net Foreign Direct Investment and from capital account were estimated at 5.8% of nominal GDP, about 4.6 percentage points lower than in the same period a year earlier. On the other hand, net debt-creating inflows widened at annual level during this quarter. They were estimated at 3.8% of nominal GDP. This ratio was about 0.8 percentage points higher from the second quarter a year earlier. The overall financing of the current account deficit is estimated by adding net errors and omissions to net debt-creating and non-debt creating foreign-currency flows. During the previous quarter, inflows were insufficient to completely cover the current account deficit and resulted with a reduction in foreign currency reserve. In contrary, during the quarter under review, the ratio of current account financing stood at 107%, implying an increase in foreign exchange reserve stock.



Foreign exchange reserve assets recorded a positive balance of about EUR 22.5 million at the end of 2014 Q2. The increase of assets, placed as SDR (Special Drawing Rights) and the decrease of "Other reserve assets", drove to this performance. At end-June 2014, the foreign exchange reserve stock was about EUR 2, 01 billion, sufficient to cover 4.5 months of imports of goods and services.

<sup>15</sup> This breakdown serves to monitor the impact of financial and capital flows on Albanian's external debt. FDI and capital inflows are classified as non-debt-creating flows. Portfolio investment and other net investment are included in debt-creating flows

## 5. ERRORS AND OMISSIONS

Due to the problems that may be faced in information sources and during the preparation of statistics in external sector, the balance of payments may have discrepancies. Thus, in the balance of payment statistics, they are summarised in the omissions and errors item, that is calculated as "the rest" (difference between the balance in financial account and the balance in current account plus the balance in capital account). Thus, In 2014 Q2 "omissions and errors" was EUR 108.2 million, about 4.0% of nominal GDP.

