

Bank of Albania

ANALYSIS OF DEVELOPMENTS  
IN THE EXTERNAL SECTOR  
OF THE ECONOMY

2014 Q3

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

Albania's net current account balance recorded a deficit of EUR 316.4 million in 2014 Q3, maintaining an upward trend for the fourth consecutive quarter. During the quarter under review, the current account deficit increased by around 66.2% in annual terms, and was estimated at 12.8% of nominal GDP.

Similarly to the first half of the year, the deterioration of deficits in both net exports and primary income contributed to the expansion side. Meanwhile, secondary income, which increased slightly compared to the previous year, contributed to the narrowing side.

In this quarter, external demand did not help maintain the uptrend in exports of goods and services. Imports of goods and services showed a downtrend, but at more moderate rates. The balance of the primary income account remained in negative territory for the third consecutive quarter, deepening further the registered deficit compared to the first half of the year. On the other hand, secondary income registered a 3.0% increase, due to the annual growth in remittances by around 1.9%.

Net inflows in the capital account were estimated at EUR 20.7 million, from EUR 15 million in the third quarter of the previous year. Net flows in the financial account doubled compared to the same quarter a year earlier, financing 44.5% of the current account deficit. Net foreign direct investments, in the quarter, fell by around 38.5% annually.<sup>2</sup> On the other hand, in other net investments, liabilities expanded by around EUR 91.6 million, due to the rise in liabilities in the form of central government debt.

<sup>1</sup> The latest BoP data are as of 2014 Q3. Since 2014 Q1, the 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 IMF's BPM6. Earlier, they were compiled based on IMF's BPM5. The main differences between the two methodologies are synthesised in the guideline "Publication of Financial Statements of external sector statistics, 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 BoP data from 2002 to 2013 are reclassified in line with the new methodology, by the Monetary Policy Department.

<sup>2</sup> Estimation of foreign direct investments of quarterly frequency during the year is based on the data that are obtained from banks and are not included in the information on borrowing/lending in relation to FDIs in Albania. For the year "x", this information is provided only by the annual survey of FDIs at the enterprises, which is published in September of year "x+1". Due to the data taken from this survey, FDIs values are reviewed for each quarter. Thus, FDIs value for each quarter of 2014 shall be reviewed after the FDIs survey in the publication of September 2015.

A breakdown of the current deficit financing, according to debt-creating and non-debt creating flows, reveals a more pronounced support to the second type of financing, during the third quarter. However, it must be noted that financing through debt-creating flows increased significantly over the last two quarters.

The overall balance of payments saw increased foreign reserve assets by about EUR 154 million in 2014 Q3. At the end of September, the stock of the foreign exchange reserve stood at around EUR 2.21 billion, sufficient to cover 5.3 months of imports of goods and services and 182% of the short-term foreign debt.

Table 1 Balance of Payments indicators

	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Current account (in EUR million)	-285.0	-190.4	-336.2	-260.8	-324.6	-316.4
yoy (%)	13.2	-23.2	63.3	16.7	13.9	66.2
/ GDP (%)	-10.9	-8.2	-13.4	-11.1	-12.2	-12.8
Goods and services	-442.5	-394.9	-518.1	-396.8	-468.8	-459.8
Exports, f.o.b.	805.6	981.0	960.3	609.7	753.0	842.1
Imports, f.o.b.	1248.1	1375.9	1478.4	1006.5	1221.8	1301.8
Travel - net	-31.5	26.1	34.0	-21.8	10.6	32.0
Primary income	-11.0	22.2	0.0	-7.1	-28.6	-44.5
Credit	35.7	40.2	33.4	29.2	25.8	28.3
Debit	46.7	18.0	33.4	36.3	54.3	72.8
Net FDI income	-20.1	6.2	6.9	-15.9	-31.4	-51.3
Secondary income	168.4	182.3	181.9	143.0	172.9	187.8
Credit	200.5	216.5	213.5	170.2	201.7	221.0
Debit	32.0	34.2	31.6	27.3	28.8	33.2
Net remittances	129.6	152.5	140.1	115.9	134.8	155.4
Capital account	4.8	15.0	18.2	22.5	15.3	20.7
Net borrowing/net lending	-280.2	-175.4	-318.0	-238.3	-309.3	-295.8
Financial account	-262.4	-70.9	-226.1	-231.3	-225.4	-140.7
yoy (%)	213.8	78.4	-16.2	82.5	-14.1	98.5
/ GDP (%)	-10.0	-3.0	-9.0	-9.8	-8.5	-5.7
Direct investments	-270.5	-307.0	-231.2	-192.6	-144.5	-188.9
Portfolio investments	104.4	6.2	-18.1	12.8	12.3	-14.2
Financial derivatives	1.1	0.0	-2.4	0.0	0.0	0.0
Other investments	-183.8	195.4	18.6	-11.1	-115.8	-91.6
Reserve assets	86.4	34.5	7.1	-40.3	22.5	154.0
Errors and omissions	17.8	104.5	91.9	7.0	83.9	155.1
Net borrowing/net lending	-280.2	-175.4	-318.0	-238.3	-309.3	-295.8

Source: Bank of Albania.

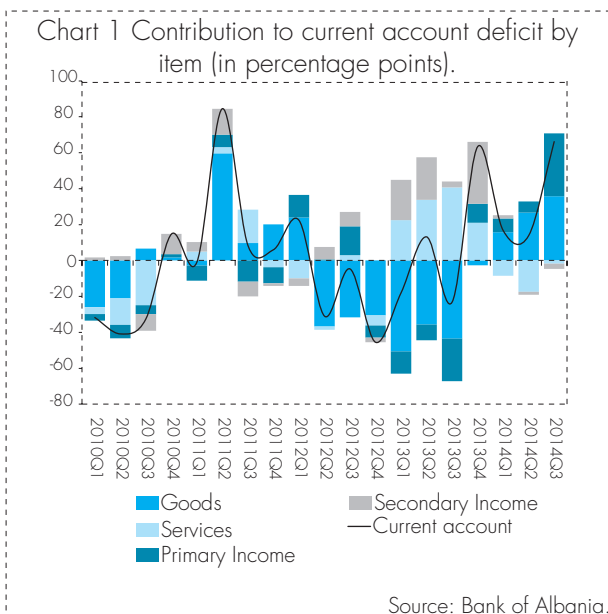
## II. CURRENT ACCOUNT<sup>3</sup>

Albania's net current account balance recorded a deficit of EUR 316.4 million in 2014 Q3. The trend in the current deficit was expansive for the fourth consecutive quarter. In this quarter, it widened by around 66.2% in annual terms. The registered deficit was estimated at around 12.8% of nominal GDP, or about 4.7 percentage points higher than in the same period of a year earlier. Excluding income from official transfers, the current account deficit stood at about 12.9% of nominal GDP. For the same period a year earlier, the current account deficit, excluding official transfers, stood at around 8.3%.

The current account deficit continued to expand for the fourth consecutive quarter, owing to the annual performance of net exports in goods and services. Imports of goods and services fell by about 5.4%, in annual terms. In the meantime, the same trend was observed in the performance of exports of goods and services, but the size of the annual drop was more pronounced.

Therefore, the net exports deficit expanded by around 16.4% in annual terms, providing the main contribution to the deterioration of the current deficit. The worsened net position of the primary income account contributed to the same side.<sup>4</sup> Secondary income<sup>5</sup> grew slightly by 3% in annual terms, contributing to the narrowing side in the annual performance of the current account deficit.

Viewed from the perspective of the national savings and investment gap, the private sector impacted the formation of the current account deficit at a greater magnitude compared to the first half of the year.<sup>6</sup> The private savings and investments gap was estimated at 10.4% to nominal GDP, about 3.7 percentage points higher from a quarter earlier. For the fourth consecutive quarter, the private sector



3 Overall, the shift to the international standards laid down in IMF's BPM6 does not envisage changes in the overall presentation of the current account, compared to the previous standards. The most significant changes consist in the goods and services accounts. Their composing sub-items are reclassified, re-nominated and further detailed.

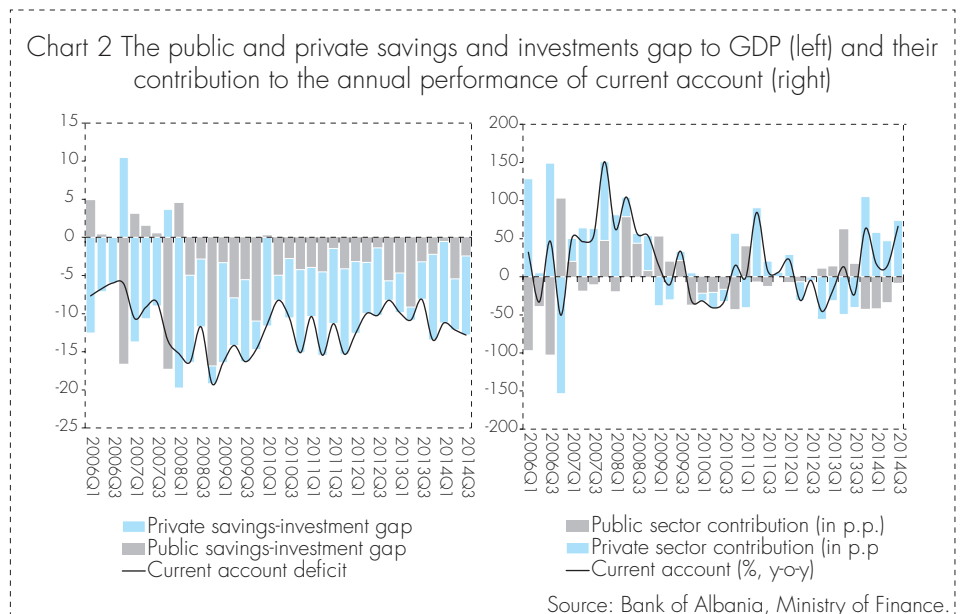
4 In accordance with the standards laid down in IMF's BPM6, "primary income" corresponds to "income" in IMF's BPM5.

5 In accordance with the standards laid down in IMF's BPM6, "secondary income" corresponds to "current transfers" in IMF's BPM5.

6 An alternative but equivalent measurement of the current account net position for a given 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  $t$ .  $CA_t = (S_{public} - I_{public})_t + (S_{private} - I_{private})_t$

contributed to the expansion side, whereas the public sector contributed to the narrowing side on the formation the of current account deficit. The public savings and investments gap narrowed, both annually and quarterly. At the same time, the share of the public sector in the formation of the current account deficit is significantly below its historic average. The reduction of the share of the gap between savings and public sector investments in the formation of the current account deficit is a welcomed development.<sup>7</sup>

The private savings and investments gap increased faster in annual terms. Private sector' contribution to the formation of the current account deficit was 77.1%, about 34.1 percentage points higher compared to the same period a year earlier. More concretely, in the total annual expansion of the current account deficit by about 66.2%, the public sector contributed negatively (-8 percentage points), whereas the private sector contributed positively (+74.2 percentage points).

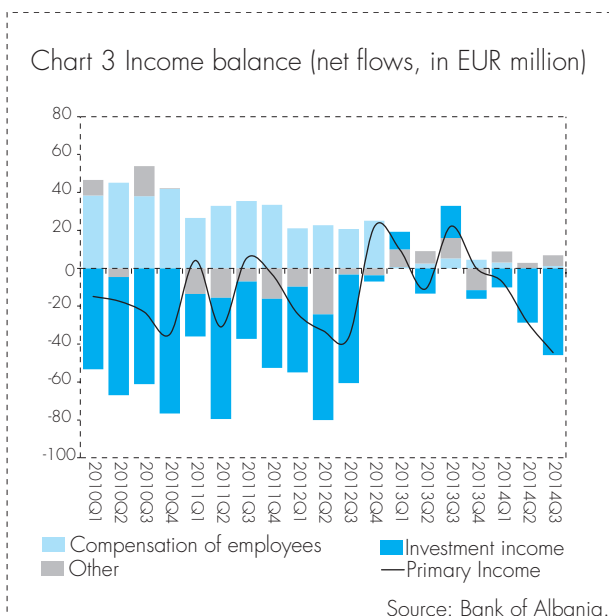


<sup>7</sup> Various studies conclude that when the current deficit is created by the private sector, in an economy that is accumulating capital, the latter becomes more tolerant against persistently high current deficit rates. That is different from the cases when the public sector provides the main 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.

## OTHER CURRENT ACCOUNT ITEMS<sup>8</sup>

The situation in the services account was slightly improved. The net balance of inflows from this account registered a net surplus of EUR 96.8 million, mainly due to the higher flow in foreign-currency income from “processing services for physical inputs owned by others”. In the meantime, the surplus in the sub-item “travel services (personal and business)”, which are closely related to the tourism season in Albania, expanded at moderate rates in annual terms. On the other hand, net income in the “transport services” account was in negative territory, for the fourth consecutive quarter.

Net income from “travel services” for tourism and personal purposes, recorded a positive balance. This item’s surplus was EUR 32 million, around EUR 5.9 higher than in the same period in the previous year. Foreign currency inflows and outflows for personal travel point to an expansion in these two constituent sub-items. This performance is also enhanced by the increase in the number of incoming travellers in Albania and increase in the number of Albanian travellers abroad.



Net balance of primary income account closed in negative territory in 2014 Q3. This was a characteristic trend throughout 2014. Net foreign-currency flows resulted in a deficit of around EUR 44.5 million. The latter was higher than in the previous quarter, while, a year earlier, the primary income account ended in surplus. The widening deficit in the sub-item “investment income” determined the direction of developments in this account, during the considered period. Net “worker compensation” resulted EUR 1.3 million, being lower compared to the previous year.

In 2014 Q3, the deficit of the “Investment income” sub-item widened considerably, by around EUR 45.8 million, from EUR 17 million surplus in the same period a year earlier. The increase in FDI income outflows determined the direction of developments in this account. In 2014 Q3, net income deficit from “foreign direct investment” income widened further compared to the first half of the year, reaching

<sup>8</sup> In the process of alignment with the international standards of IMF’s BPM6, the constituent sub-items of the services account were subject to a series of reclassifications and renomination. 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 in BPM5) and “services for maintenance and repair” (“manufacturing goods in BPM5), which are reclassified from “goods” to “services”. “Merchandising” (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.



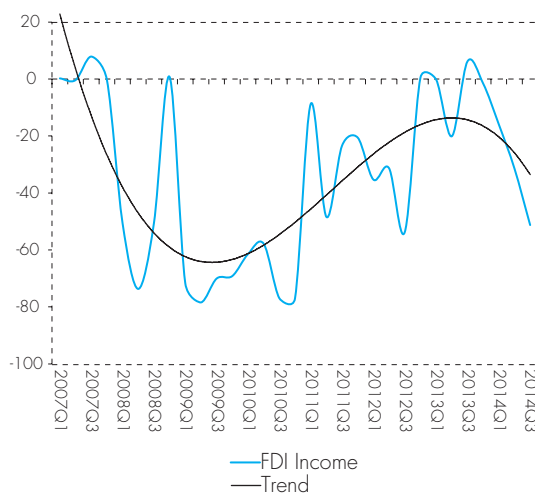
around EUR 51.3 million. Among them, income repatriation from investments in capital and shares in investments funds played the main role.

The balance of the "Portfolio investment" income continued to record positive values for the third consecutive quarter, at about EUR 4.7 million, during the period under review. In this sub-item of the income account, inflows represent mainly interests arising from debt instruments. Conversely, net income balance from "other investment" recorded a deficit of about EUR 9 million, from the deficit of about EUR 4.8 million recorded in the same period a year earlier. Income from investment in reserve assets<sup>9</sup> stood at EUR 9.8 million in 2014 Q3.

The net balance of the secondary income account continued the upward trend of financial flows that had started a quarter earlier. During the third quarter, this account recorded a surplus of EUR 187.8 million, up by around 3% in annual terms. Foreign currency flows in the secondary income account were estimated at around 7.6% to the nominal GDP.

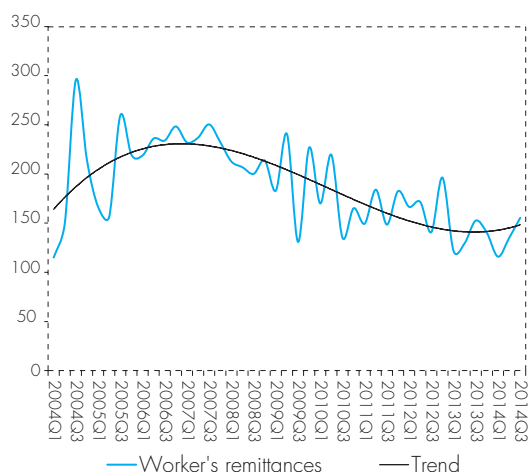
The main sub-item of this account, net secondary income from "financial and non-financial corporates, households, and non-profit institutions serving households", increased by about 4.5% in annual terms. In this period, remittances stood at EUR 155.4 million, up by about 1.9% in annual terms. They were estimated at about 6.3% of nominal GDP.

Chart 4 FDI income (net flows, in EUR million)



Source: Bank of Albania.

Chart 5. Remittances (net flows, in EUR million)



Source: Bank of Albania.

<sup>9</sup> In accordance with standards laid down in IMF's BPM6 in the primary income account, the item "investment income" includes income from "foreign exchange reserve" investment.

### III. 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 Q3, the capital account recorded a surplus of about EUR 20.7 million, up from around EUR 15 million during the same period a year earlier. This account's net capital flows accounted for about 0.8% of nominal GDP. Incoming capital transfers expanded by 12.1% compared to the same period a year earlier. Capital transfer outflows decreased by 2.7%, in annual terms. Net capital transfers in the "central government" account amounted to EUR 10.8 million, while those in "financial and non-financial corporates", "households and non-profit institutions serving households" amounted to around EUR 9.9 million.

The combination of net non-financial transactions of the 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 the way 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 295.8 million, which is financed by the inflows 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 (intangible goods); 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.

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

Net position in the financial account resulted in lower assets of around EUR 140.7 million during 2014 Q3. Net inflows in this account financed around 44.5% of the current deficit registered during the period. Financial flows rose by about 98.5%, accounting for about 5.7% of nominal GDP, relative to the same period a year ago. The increase in foreign currency flows in the financial account was mainly attributable to the increase in net inflows in the form of other investments.

Residents' financial liabilities to non-residents fell by 5.6% in annual terms, due to lower FDI inflows. Albanian assets invested in non-resident economies fell by about 31.4% during the period under review.<sup>13</sup> The decrease in assets in the form of other investments was the main determinant of developments in Albanian assets invested abroad.

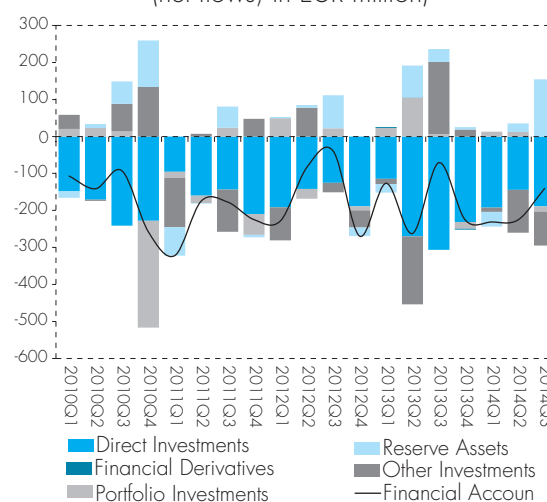
Net foreign direct investments dropped by about 38.5%<sup>14</sup>, from 2013 Q3. FDI inflows, excluding foreign capital privatisation receipts, recorded a more moderate decline, as a result of higher privatisations a year earlier. Domestic assets invested in the form of FDIs increased by EUR 18.4 million, compared to the decrease by EUR 8.5 million in 2013 Q3. Net FDIs were estimated at about 7.6% of nominal GDP, or about 5.5 percentage points lower, compared to the same period a year earlier.

Chart 6 Financial account, errors and omissions (net flows, in EUR million).



Source: Bank of Albania.

Chart 7 Financial account components (net flows, in EUR million)



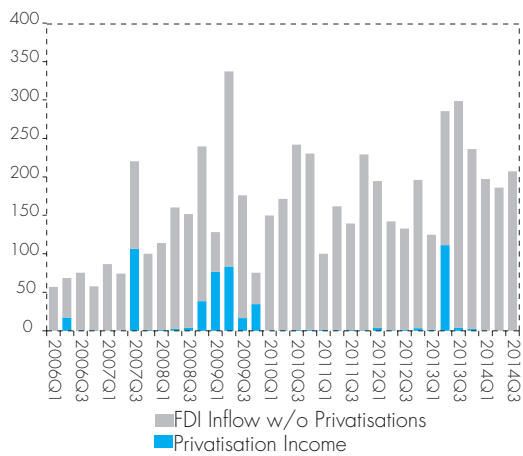
Source: Bank of Albania.

<sup>12</sup> In accordance with standards laid down in IMF's BPM6, 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 non-resident economies include foreign (reserve) assets.

<sup>14</sup> Estimation of foreign direct investments of quarterly frequency during the year is based on the data that are obtained from banks and are not included in the information on borrowing/lending in relation to FDIs in Albania. For the year "x", this information is provided only by the annual survey of FDIs at the enterprises, which is published in September of year "x+1". Due to the data taken from this survey, FDIs values are reviewed for each quarter. Thus, FDIs value for each quarter of 2014 shall be reviewed after the FDIs survey in the publication of September 2015.

Chart 8 Composition of foreign direct investment (flows, in EUR million)



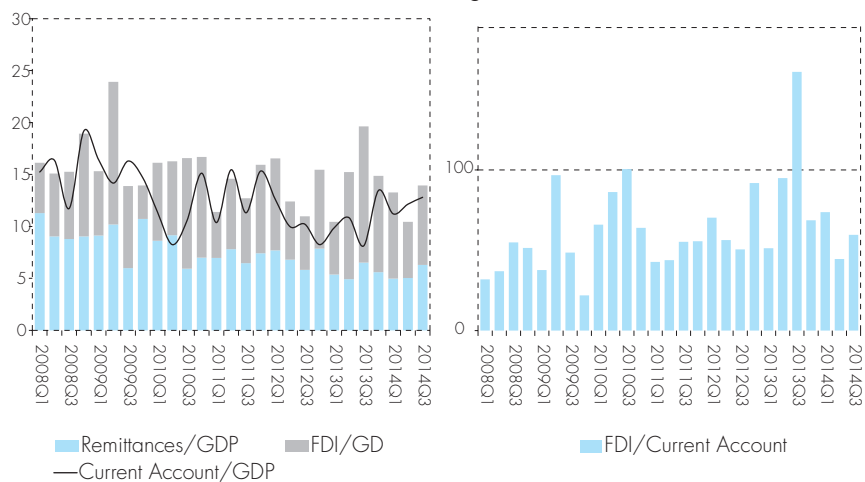
Source: Bank of Albania.

In accordance with the instruments used for investments<sup>15</sup>, net direct investments as “capital and shares in investments fund” decreased by about 32.8% in annual terms. Net FDIs in the form of “reinvestment of earnings” stood higher. Direct investments in the form of “debt instruments” were used less during this year. While in 2013, the “capital and shares in investment funds” and “debt instruments” were the most broadly used forms of FDIs, in 2014 investments in debt instruments were replaced by reinvestment of earnings.

In the long run, FDIs are an important foreign-currency inflow in financing the trade and the current account deficits in Albania. This trend was dominant especially at the beginning of 2009, when the importance of other foreign-currency flows, such as the ones in the form of remittances, begun to

progressively contract. Since 2013, FDIs have been the main financing source of external sector deficit in Albania. In 2014 Q3, the ratio of net FDI flows against the recorded current deficit was estimated at 59.7%.

Chart 9 Financing sources of current deficit (left) and covering of current deficit from net FDI (right)



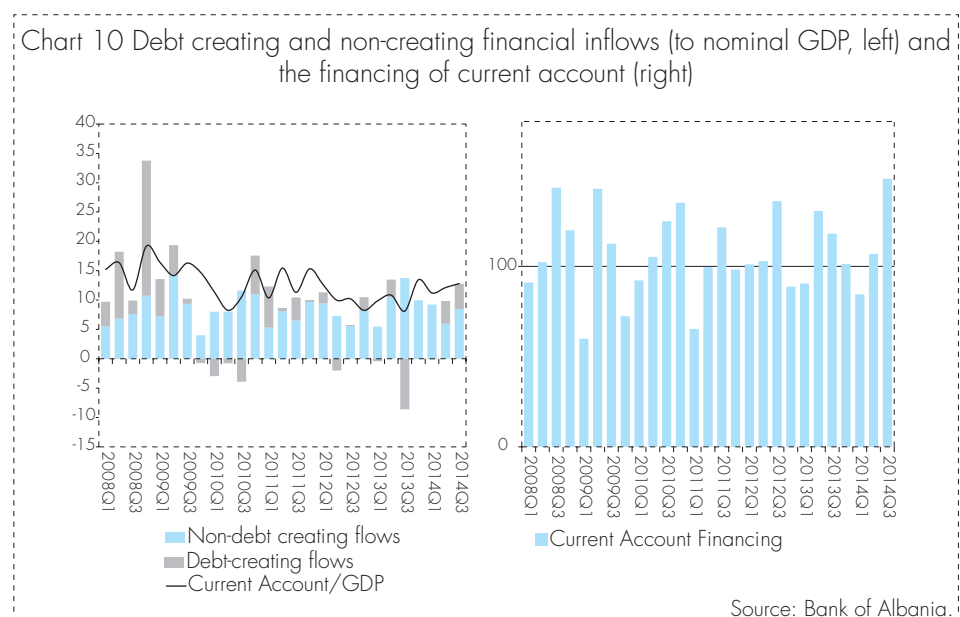
Source: Bank of Albania.

Net portfolio investments for 2014 Q3 recorded a negative balance of EUR 14.2 million. For the period under review, residents’ assets (depositing corporations, excluding the Bank of Albania) invested abroad fell by around EUR 21.1 million. Liabilities in the form of portfolio investments also recorded a negative position of EUR 6.9 million.

<sup>15</sup> In accordance with BPM6 standards, direct investments are realised through three main instruments: 1. Capital and shares in investment funds; 2. Reinvestment of earnings; 3. Debt instruments.

Other investments account closed with a negative balance by around EUR 91.6 million. In this account, Albanian assets invested abroad surged by around EUR 44.2 million. The figure is downward in annual terms, as Albanian assets invested abroad in the third quarter of the previous year amounted to around EUR 248.5 million. On the liabilities side, non-residents increased their investments in Albania by about EUR 80 million, from 10.8 million a year earlier. The increased borrowing by the central government during 2014 was the key factor contributing to the expansion of liabilities in the form of loans.

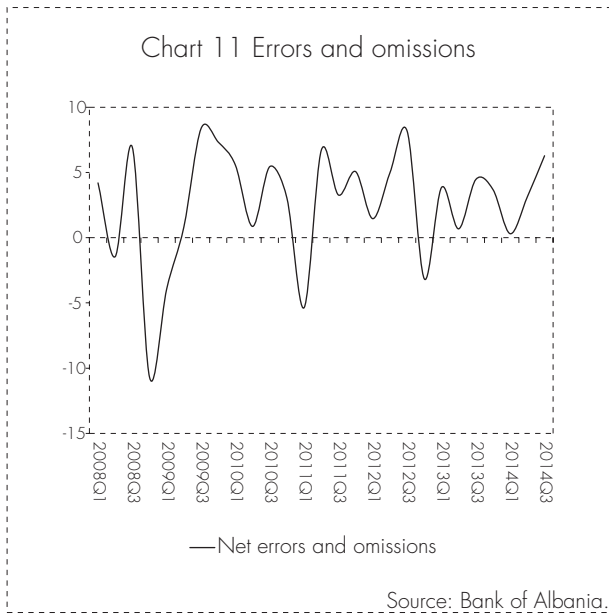
As regards the profile of external financing of the current deficit, it is important to monitor the reliance on debt-creating flows vis-à-vis the more desirable non debt-creating flows.<sup>16</sup> Thus, in 2014 Q3, non-debt-creating inflows from net FDI and from the capital account were estimated at 8.5% of nominal GDP, about 5.3 percentage points lower than in the same period a year earlier. On the other hand, the upward trend in debt-creating flows was present in two consecutive quarters. In this quarter, they were estimated at 4.3% of the nominal GDP. 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 quarter under review, the ratio of current account financing stood at 148.7%, implying a rapid expansion in the foreign exchange reserve stock.



Foreign exchange reserve assets expanded by about EUR 154 million, at the end of 2014 Q3. This performance was determined mainly by the increase in assets placed as Special Drawing Rights (SDRs) and the decrease in assets in the form of "other reserve assets". At the end of September, the stock of the foreign exchange reserve stood at around EUR 2.21 billion, sufficient to cover 5.3 months of imports of goods and services and 182% of the short-term foreign debt.

<sup>16</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 classified in debt-creating flows.

## V. ERRORS AND OMISSIONS



Due to the problems that may be faced in sources of information and during the compilation of external sector statistics, the balance of payments may have discrepancies. Thus, in the balance of payment statistics, they are aggregated under the errors and omissions 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). In 2014 Q3, “errors and omissions” recorded a positive value of EUR 155.1 million, estimated at around 6.3% of nominal GDP.