

**Bank of Albania**

ANALYSIS OF DEVELOPMENTS IN  
THE EXTERNAL SECTOR OF THE  
ECONOMY  
2015 Q1

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



# C O N T E N T S

<i>I. BALANCE OF PAYMENTS HIGHLIGHTS</i>	<i>4</i>
<i>II. CURRENT ACCOUNT</i>	<i>5</i>
<i>III. CAPITAL ACCOUNT</i>	<i>8</i>
<i>IV. FINANCIAL ACCOUNT</i>	<i>9</i>
<i>V. ERRORS AND OMISSIONS</i>	<i>12</i>

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

- Albania's net current account balance recorded a deficit of EUR 230 million in 2015 Q1.
- Net capital inflows amounted EUR 26 million, whereas net financial assets decreased by EUR 179 million.
- The overall balance of payments resulted in increased foreign reserve assets by EUR 111.8 million.

Current deficit narrowed by around 15.3% on an annual level, after five quarters of deepening trend, and was estimated at 10.1% of the nominal GDP. By item of the current account, the improved balance of net exports and the higher secondary income compared to the same quarter a year earlier, contributed to the narrowing side. The stable external demand helped maintain the uptrend in exports of goods and services. On the other hand the imports of goods and services trended down. Secondary income increased by 27.3% on an annual level, by highlighting the increase in remittances by around 23.5%. Primary income deficit continued the deepening trend for the sixth successive quarter, by contributing to the narrowing of the annual current account deficit. In structural terms, measured by the national gap between savings and investments, the public sector played a major role in the formation of the current deficit.

Net capital inflows increased by 15.2% on an annual level, whereas net foreign currency flows in the financial account decreased by around 10.1%. Net foreign direct investments grew by around 53.4%, in annual terms, and completely financed the current deficit. On the other hand, other net investments recorded a positive net surplus by around EUR 61.2 million, mainly driven by the increase of domestic assets invested abroad. On contrary, net portfolio investments decreased by around EUR 94.1 million. The breakdown of the current deficit financing according to debt-creating and non-debt creating flows reveals a more pronounced support for the second type of financing.

At the end of March, the stock of foreign exchange reserve was around EUR 2.4 billion, sufficient to cover 5.3 months of imports of goods and services and 192% of the short-term external debt.

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<sup>1</sup> The latest data on the balance of payments are as of 2015 Q1. As of 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 sixth edition of the Balance of Payments and International Investment Manual (BPM6), released by the International Monetary Fund. 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) The data for 2013 are reclassified in accordance with BMP6-IMF by the Department of Financial Stability and Statistics. For the purposes of internal analysis, the Balance of Payments data from 2002 to 2012 are reclassified in line with the new methodology by the Monetary Policy Department.

Table 1 Balance of Payments indicators (in EUR million)

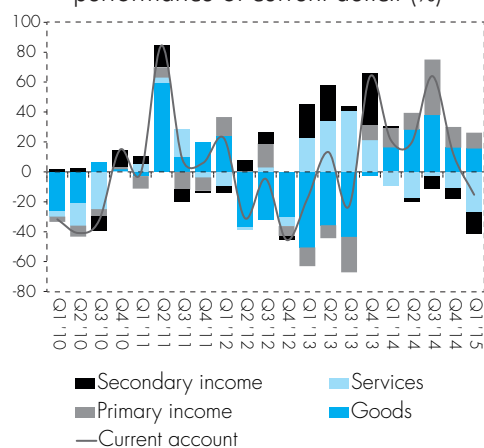
	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1
Current account (in EUR million)	-191.0	-337.0	-271.5	-341.0	-313.2	-377.5	-230.0
y-o-y (%)	-22.9	63.7	21.3	19.5	64.0	12.0	-15.3
/ GDP (%)	-8.2	-13.4	-11.7	-12.8	-12.6	-14.5	-10.1
Goods and services	-395.4	-518.9	-396.2	-473.3	-462.8	-536.0	-365.6
Exports, f.o.b.	861.3	808.7	608.8	752.0	838.8	757.1	624.4
Imports, f.o.b.	1256.8	1327.6	1005.0	1225.3	1301.6	1293.1	990.0
Travel - net	26.1	34.0	-21.8	10.6	32.0	66.0	43.6
Primary income	22.2	0.0	-20.6	-43.3	-48.7	-47.0	-49.3
Credit	40.2	33.4	28.7	25.7	28.3	27.8	22.9
Debit	18.0	33.4	49.3	69.1	77.0	74.8	72.3
Net FDI income	6.2	6.9	-30.4	-47.1	-56.2	-38.6	-52.0
Secondary income	182.3	181.9	145.3	175.6	198.3	205.4	184.9
Credit	216.5	213.5	172.6	204.4	230.6	244.1	216.1
Debit	34.2	31.6	27.3	28.8	32.3	38.8	31.2
Net remittances	152.5	140.1	118.2	137.5	165.1	171.0	146.0
Capital account	15.0	18.2	22.5	22.4	20.7	21.1	26.0
Net borrowing/net lending	-175.9	-318.8	-249.0	-318.7	-292.5	-356.4	-204.1
Financial account	-70.9	-226.1	-199.1	-214.5	-206.1	-285.9	-179.0
y-o-y (%)	78.4	-16.2	57.2	-18.3	190.7	26.5	-10.1
/ GDP (%)	-3.0	-9.0	-8.6	-8.0	-8.3	-10.9	-7.9
Direct investments	-307.0	-231.2	-168.0	-150.4	-253.4	-229.4	-257.9
Portfolio investments	6.2	-18.1	14.5	14.0	-12.4	104.7	-94.1
Financial derivatives	0.0	-2.4	0.0	0.0	0.0	0.0	0.0
Other investments	195.4	18.6	-5.2	-100.6	-94.2	-122.2	61.2
Reserve assets	34.5	7.1	-40.3	22.5	154.0	-38.9	111.8
Errors and omissions	105.1	92.7	49.9	104.2	86.4	70.5	25.1
Net borrowing/net lending	-175.9	-318.8	-249.0	-318.7	-292.5	-356.4	-204.1

Source: Bank of Albania

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

Albania's net current account balance recorded a deficit of EUR 230.0 million in 2015 Q1. In contrary to the previous year, current deficit narrowed by around 15.3%, in annual terms. Current deficit was estimated at around 10.1% of nominal GDP<sup>3</sup>, or about 2.1 percentage points lower, compared to the value recorded in the same period in the previous year. In terms of contributions, the improved balances of services account, broadly determined the narrowing of current deficit, during the period under review. The expanded foreign currency inflows in the secondary income account provided contribution in the same side. The expanded deficit of primary income account and of trade balance in goods provided negative contribution to the overall performance of current deficit.

Chart 1. Contribution by items (in percentage points) to the annual performance of current deficit (%)



Source: Bank of Albania

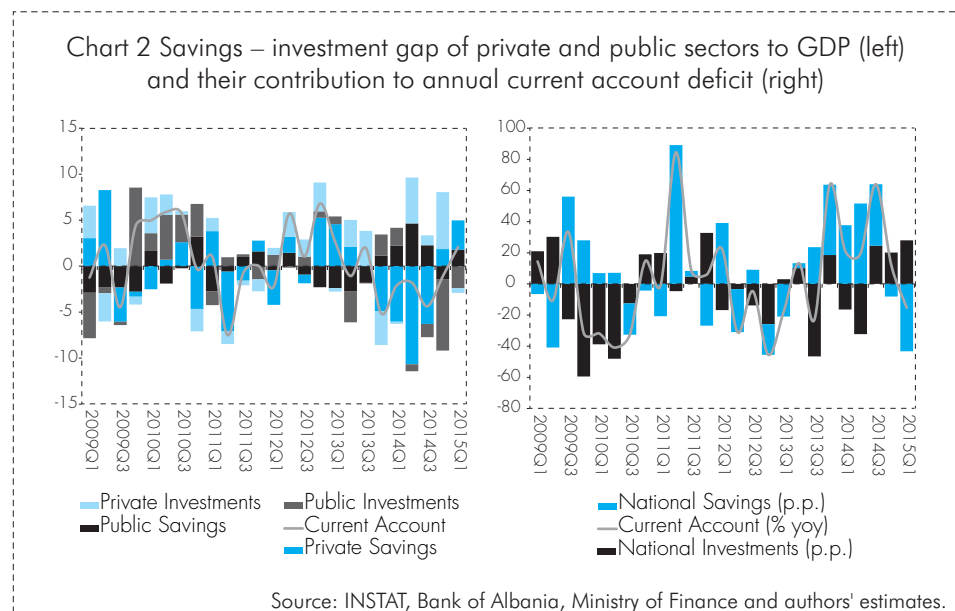
<sup>2</sup> Overall, the shift to the international standards laid down in Sixth Edition of the Balance of Payments Manual does not envisage changes in the overall presentation of the current account, compared to the previous standards. The most significant changes consist in the goods and services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

<sup>3</sup> Nominal GDP released by INSTAT.

In addition to the improved balance of secondary income account, the narrowed deficit of net exports contributed positively to the overall performance of current deficit. Imports of goods and services reduced by around 1.5%, in annual terms, while exports of goods and services expanded by around 2.6% in annual terms. Hence, net exports deficit narrowed by around 7.7% compared to the same period in the previous year.

According to the gap approach between savings and national investments, the gap between savings and private sector's investments<sup>4</sup> provided the main impact on the formation of the current account deficit. The gap between savings and private investments was estimated at 8.9% to GDP, being corrected by around 2.7 percentage points from 2014 Q1. The expanding in private savings by around 3.2 percentage points to GDP provided considerably impact within this item. The gap between savings and public investments was estimated at around 1.2% to GDP. Public investments and savings were higher compared to the same quarter in the previous year.

Since 2009, the continuing reduction of national savings has dictated the average expanding trend of the Albanian current deficit. Although national investments trended down, their impact on current account was lower. In contrary, the higher national savings were the main item contributing to the annual narrowing of current deficit, in the quarter under review. Notwithstanding national investments increased, they did not manage to cover the impact of savings. National investments were estimated at 24% of nominal GDP, expanding by around 2.9 percentage points on an annual level. National savings ratio to GDP was 13.9%, around 5 percentage points higher from a year earlier.



<sup>4</sup> An alternative, but equivalent measuring of the current account net position for a definite period, is the 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  $t$ .

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

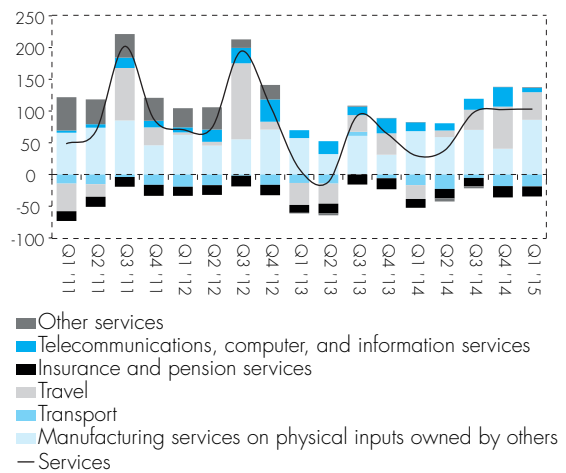
Net balance of services account improved considerably in 2015 Q1. Net income from services resulted around EUR 103.1 million, from around EUR 29.9 million in the same period in the previous year. In annual terms, income from services grew by around 14.7%, while expenses shrank by around 4.1%. Thus, net income in services was around 3.4 times higher in annual terms, being estimated at around 4.5% of nominal GDP. Income from “travel services (personal and business” and “manufacturing services on physical inputs owned by others” determined the direction of developments in the services account. Income from travel services grew by around 13.0% in annual terms, while expenses for travel services decreased almost at the same rate.

Net balance of primary income account was negative. This trend characterised this account throughout 2014. Net foreign-currency inflows in this account resulted in deficit by about EUR 49.3 million, from about EUR 20.6 million deficit in the same period in the previous year. The deficit of this account was estimated at around 2.2% of nominal GDP. The deepening of deficit in “investment income”, similarly to the previous year, determined the direction of developments in this account, during the considered period. Net “income from work” sub-item was EUR 4.7 million, around EUR 1.6 million higher from the same period a year earlier.

“Income from investments” sub-item recorded a considerable widening of deficit, by around EUR 54.1 million, from around EUR 23.7 million in the same period in the previous year. The increase in FDI income outflows determined the direction of developments in this account. Net income deficit from “foreign direct investment” widened further standing at EUR 52.0 million. Among them, repatriation of earnings from capital investments and shares in investment funds played the major role. At the same time, the balance of income from “portfolio investment” recorded a positive value of EUR 7.4 million, mainly due to the payment of interests on loans. Income from “other investments” recorded a negative balance of around EUR 9.5 million.

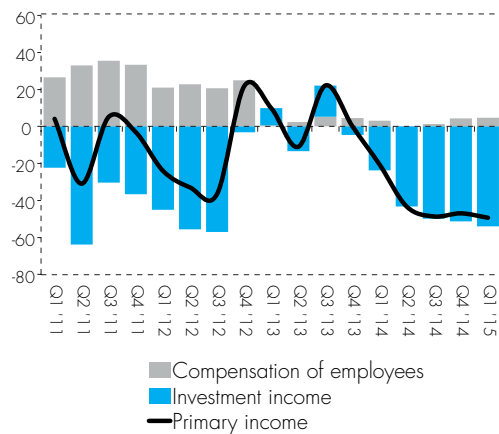
The net balance of the secondary income account continued the upward trend of the surplus started in the previous year. In 2015 Q1, this account

Chart 3 Main items in services account (net flows in EUR million)



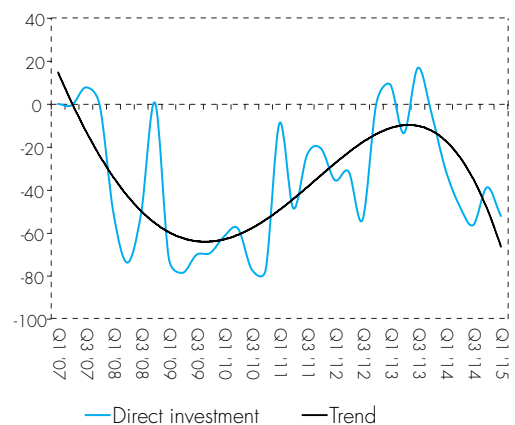
Source: Bank of Albania

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



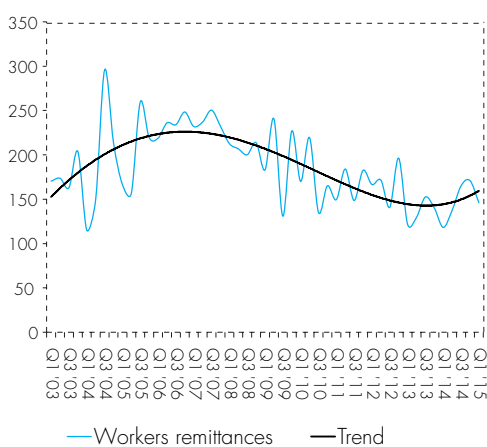
Source: Bank of Albania

Chart 5 FDIs income (net flows, in EUR million)



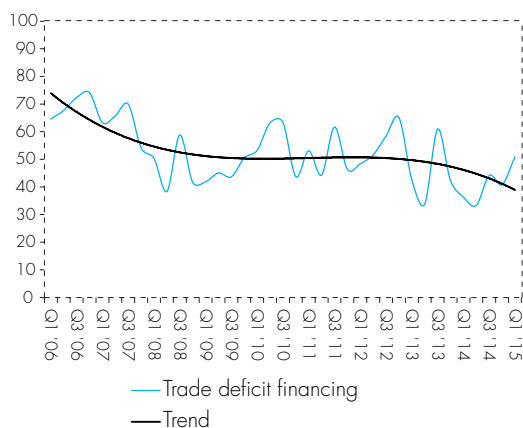
Source: Bank of Albania

Chart 6 Remittances (net flows, in EUR million)



Source: Bank of Albania

Chart 7 Financing of trade deficit from net primary and secondary income and from services



Source: Bank of Albania

recorded net inflows amounting to EUR 184.9 million, up by around 27.3%, from the same period in the previous year.

In terms of nominal GDP, the foreign currency flows in the secondary income account were estimated at 8.1%. Foreign currency flows in the form of remittances<sup>5</sup> provided the main contribution to this performance. They were EUR 146.6 million, up by 23.8% in annual terms. The remittances accounted for around 6.4% of nominal GDP, or around 1.1 percentage points higher than in the same period in the previous year.

Net cumulative income from services account, primary income account and secondary income account were up by around 54.3%, in annual terms, and financed around 50.9% of the recorded trade deficit in goods in the first quarter of 2015. The considerable recorded improvement in the services account and secondary income account was estimated to have improved by around 14.6 percentage points the ration of trade deficit account, in annual terms.

### III. CAPITAL ACCOUNT<sup>6</sup>

In 2015 Q1, this account recorded EUR 26.0 million surplus, up by around 15.2% in annual terms. Net capital flows in this account were estimated at around 1.1% of nominal GDP. Net capital transfer for the account of "central government" amounted to EUR 10.8 million, while those in "financial and non-financial corporates", "households and non-profit institutions serving households" were around EUR 15.1 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. This result should be 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 204.1 million, which is financed by the income in the financial account (minus errors and omissions).

<sup>5</sup> Estimations about the quarterly remittances are preliminary. These data are considered as completed upon the conduction of the survey on remittances in December 2015.

<sup>6</sup> Capital account debits and credits all the transactions on the acquisition and disposal of non-produced, non-financial assets/goods and the capital transfers between residents and non-residents (on which there is no economic value in the exchange).



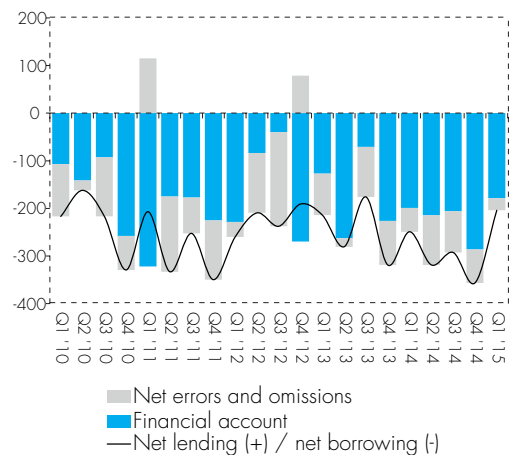
## IV. FINANCIAL ACCOUNT<sup>7</sup>

In 2015 Q1, the net position of financial account was EUR 179.0 million, down by around 10.1% in annual terms. Net foreign currency flows in this account were estimated at around 7.9% of nominal GDP, and financed around 77.8% of the current deficit recorded during the considered period.

Residents' financial liabilities to non-residents amounted EUR 326.9 million, around EUR 74.0 million higher from the same period in the previous year. The increase in domestic liabilities was mainly attributable to the high direct investment flows<sup>8</sup> in Albania. On the other side, total Albanian assets invested in non-resident economies, during this quarter, was EUR 147.9 million, around EUR 94.1 million higher compared to 2014 Q1<sup>9</sup>. Foreign reserve assets and the increase in the investments in the form of other investments are the main determinants in domestic assets invested abroad.

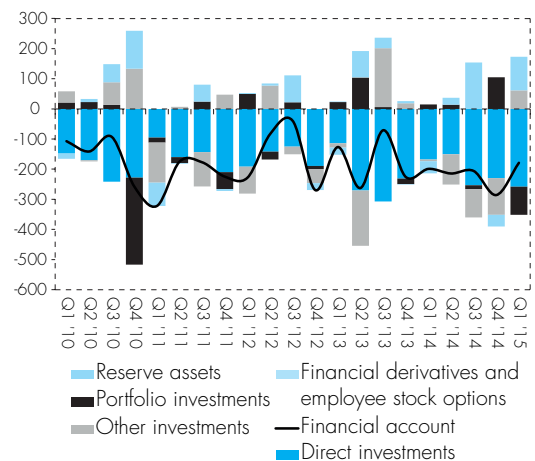
Net foreign direct investments grew by around 53.4%<sup>10</sup>, on an annual level. Against the nominal GDP, net FDIs stood at 11.3%. This ratio stands 3.8 percentage points higher than in the same period in the previous year.

Chart 8 Financial account, errors and omissions (net flows, in EUR million)



Source: Bank of Albania

Chart 9 Financial account components (net flows, in EUR million)



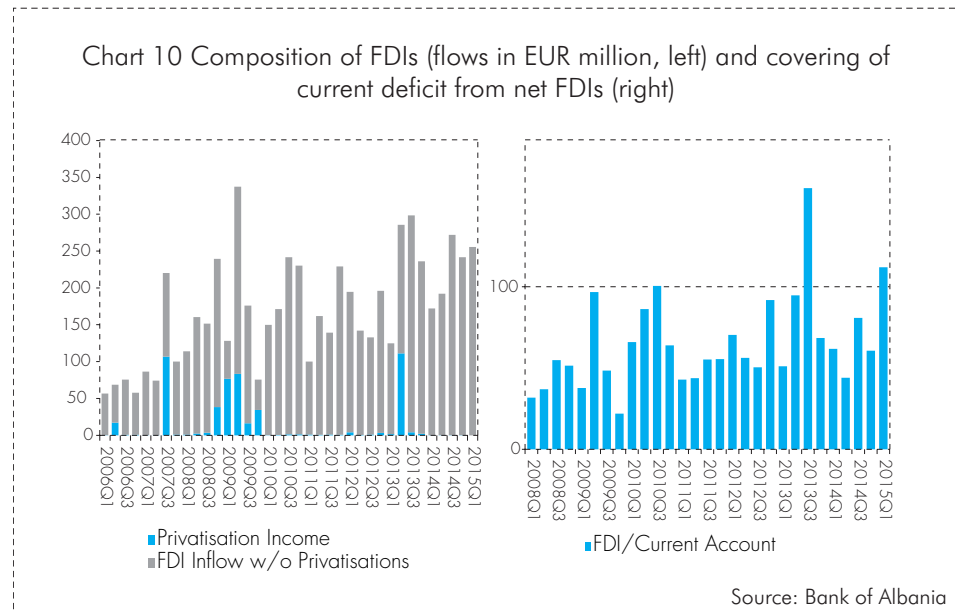
Source: Bank of Albania

<sup>7</sup> In accordance with standards laid down in the Sixth Edition of the IMF's Balance of Payments 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>8</sup> The data on quarterly direct investments are preliminary. These data will be considered as final in September 2016 upon the realisation of the annual survey on Foreign Direct Investments. The quarterly data are revised due to the obtained data from the FDIs' annual survey.

<sup>9</sup> In addition to methodical amendments stipulated in BPM6, total domestic financial assets invested in foreign economies include also the foreign assets (reserve assets).

<sup>10</sup> Quarterly estimation on foreign direct investments, during the year, is made based on the data obtained from banks and are not included in the information on borrowing/lending in the foreign direct investment relationship in Albania. This information is provided only by the annual survey of Foreign Direct Investments (FDI) at the enterprises, which is published in September of the successive year. 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 for 2014. With the publication of data for 2014 Q4, net FDIs were revised up for the previous three quarters, by around EUR 45.9 million.



The breakdown by instruments of investment<sup>11</sup> reveals a considerable increase in the re-investment of profits obtained by the companies which are active in market and the higher use of debt instruments received by other companies. On the other hand, direct investment direct investments as capital and stocks as investments fund decreased on an annual level. Nevertheless, this type of investments has the highest share in the structure of FDIS' flow in Albania.

In the long run, FDI is an important foreign-currency inflow in financing the current deficit in Albania. In 2015 Q1, the ratio of net FDI flows totally financed the recorded current deficit. The financing ratio stood at 112%, expanding by around 50 percentage points from the previous year.

In 2015 Q1, the net portfolio investment, recorded a fall in assets invested abroad by around EUR 94.1 million, from the increase of around EUR 14.5 million in the previous year. For the period under review, residents' assets (depositing corporates, excluding the Bank of Albania) invested abroad fell (withdrawals of portfolio investments) by around EUR 66.8 million (mainly invested in debt securities). Liabilities in the form of portfolio investments of non-residents in Albania increased by around EUR 27.3 million. Non-residents mainly invested in capital and equities in investments funds and less in debt securities.

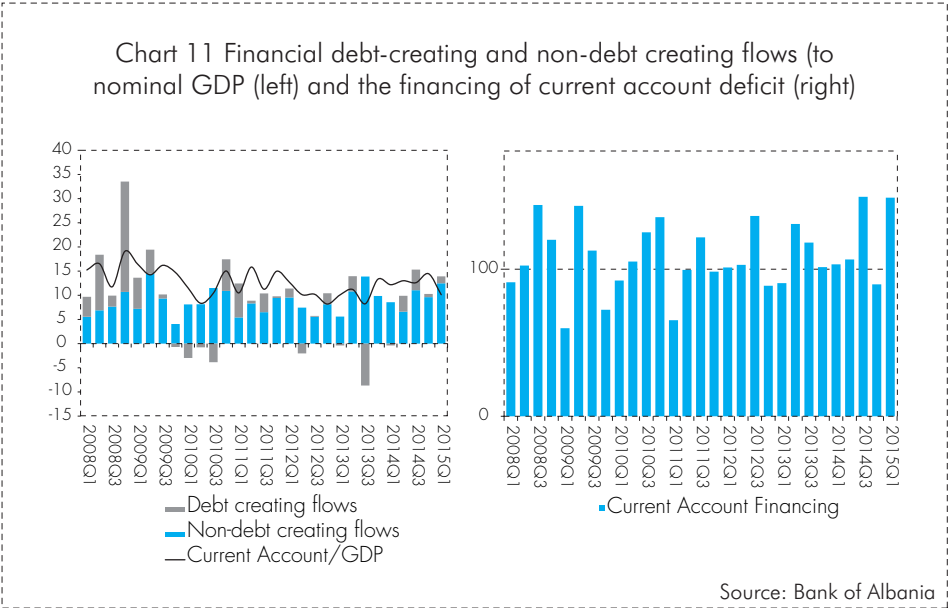
Net balance of other investments account was EUR 61.2 million. Albanian assets invested abroad stood at EUR 104.9 million, while liabilities to non-residents were estimated at EUR 43.7 million. As in 2014, the sub-item "borrowing" fluctuated considerably in 2015 Q1. Depositing corporates (except Bank of Albania) continued to maintain a net lending position granting loans to non-residents for around EUR 97.6 million. Loans taken by general government,

<sup>11</sup> In accordance with BPM6 standards, direct investments are realised through three main instruments: 1. shareholders capital in investment funds; 2. reinvested earnings; 3. debt instruments.

excluding the payments carried out for the principal and interests were around EUR 79.9 million. "Net currency and deposits" sub-item recorded a positive balance of around EUR 12.3 million, from around EUR 89.7 million in the same period in the previous year, attributable to the lowering in liabilities.

As regards the profile of financing the current deficit, it is important to monitor the reliance on debt-creating inflows rather than the more desirable non debt-creating inflows<sup>12</sup>. Thus, non-debt-creating financial flows from net FDI and from the capital account were estimated at 12.5% of nominal GDP, around 3.9 percentage points higher compared to the first quarter in the previous year. The debt-creating financial flows were estimated at 1.4% of the nominal GDP. This indicator of the current deficit financing trended up for four successive quarter, mainly due to the higher foreign public borrowing.

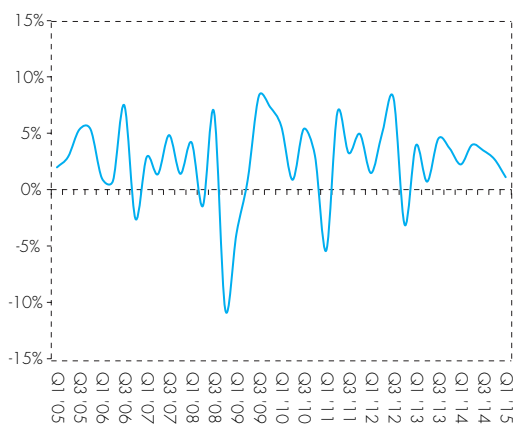
The overall financing of the current account deficit is estimated by adding net errors and omissions to net debt-creating and non-debt creating foreign-currency flows. During the quarter under review, the ratio of current account financing stood at 148.6%, implying a rapid expansion in the foreign exchange reserve stock.



Foreign exchange reserve assets grew by EUR 111.8 million. At the end of March, the stock of the foreign exchange reserve stood at around EUR 2.4 billion, sufficient to cover 5.3 months of imports of goods and services and 192% of the short-term foreign debt.

<sup>12</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

Chart 12 Errors and omissions (against GDP)



Source: Bank of Albania

## V. 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). In 2015 Q1, "net omissions and errors" recorded the positive rate of EUR 25.1 million, estimated at around 1.1% of nominal GDP.