

Bank of Albania

ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY

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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. KEY DEVELOPMENTS IN THE BALANCE OF PAYMENTS¹

The net position of the current account recorded a deficit of EUR 181.3 million in 2015 Q2. For the second consecutive quarter, current account deficit followed a narrowing trend by about 42.9% in annual terms. It was estimated at 6.7% against nominal GDP.

According to current account's component items, the improvement in net exports and higher secondary revenues narrowed, compared with the same quarter in the previous year. Imports of goods and services decreased by 10.6% and exports fell by 1.9% in annual terms. The balance of the secondary revenues' account continued the expansionary trend initiated in 2014 Q2. The main sub-item of this category, inflows of remittances, was approximately 17.6% higher in annual terms. The primary revenues deficit continued the deepening trend for the sixth consecutive quarter. In structural terms, as measured by the national gap between savings and investments, the private sector played a key role in the formation of the current deficit.

Table 1. Indicator of the payments' balance (data in EUR millions)

	T1 '14	T2 '14	T3 '14	T4 '14	T1 '15	T2 '15
Current account (in million euro)	-271.5	-341.0	-313.2	-377.5	-242.0	-181.3
In annual terms	21.3	19.5	64.0	12.0	-16.8	-42.9
/GDP (%)	-11.7	-12.8	-12.6	-14.5	-10.6	-6.7
Goods and services	-396.2	-473.3	-462.8	-536.0	-374.6	-366.9
Exports, f.o.b.	608.8	752.0	838.8	757.1	591.8	699.1
Imports, f.o.b.	1005.0	1225.3	1301.6	1293.1	966.4	1066.0
Net trips	-21.8	10.6	32.0	66.0	43.6	76.4
Primary revenues	-20.6	-43.3	-48.7	-47.0	-48.2	-24.6
Credit	28.7	25.7	28.3	27.8	27.2	24.7
Debit	49.3	69.1	77.0	74.8	75.4	49.3
Income from net FDI	-30.4	-47.1	-56.2	-38.6	-50.7	-28.3
Secondary revenues	145.3	175.6	198.3	205.4	180.7	210.2
Credit	172.6	204.4	230.6	244.1	211.9	243.3
Debit	27.3	28.8	32.3	38.8	31.2	33.0
Remittances -net	118.2	137.5	165.1	171.0	141.8	161.7
Capital account	22.5	22.4	20.7	21.1	26.0	21.3
Net borrowing / Net lending	-249.0	-318.7	-292.5	-356.4	-216.1	-160.0
Financial account	-199.1	-214.5	-206.1	-285.9	-194.9	-175.8
In annual terms (%)	57.2	-18.3	190.7	26.5	-19.8	-18.6
/GDP (%)	-8.6	-8.0	-8.3	-10.9	-8.6	-6.5
Direct investments	-168.0	-150.4	-253.4	-229.4	-278.3	-189.3
Portfolio investments	14.5	14.0	-12.4	104.7	-82.9	-75.2
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0
Other investments	-5.2	-100.6	-94.2	-122.2	54.5	72.6
Reserve assets	-40.3	22.5	154.0	-38.9	111.8	16.2
Errors and omissions	49.9	104.2	86.4	70.5	21.2	-15.8
Net borrowing / Net lending	-249.0	-318.7	-292.5	-356.4	-216.1	-160.0

Source: Bank of Albania

¹ The latest data on the balance of payments are as at 2015 Q2. Starting from 2014 Q1, the Financial Stability and Statistics Department at the Bank of Albania compiles the Balance of Payments Statistics in accordance with the International Standards laid down in sixth edition of the Balance of Payments and International Investment Manual (BPM6), published by the IMF. The main differences between the current and previous methodology are synthesized in the following guidelines:

http://www.bankofalbania.org/web/pub/shpjegues_per_ndryshimet_ne_publikimin_e_statistikave_te_sektorit_te_jashtem_sipas_bpm6_qershor_2014_2_6688_1.pdf

For analysis purposes, the balance of payments data from 2002 until 2012 were reclassified in accordance with the new methodology of the Monetary Policy Department.

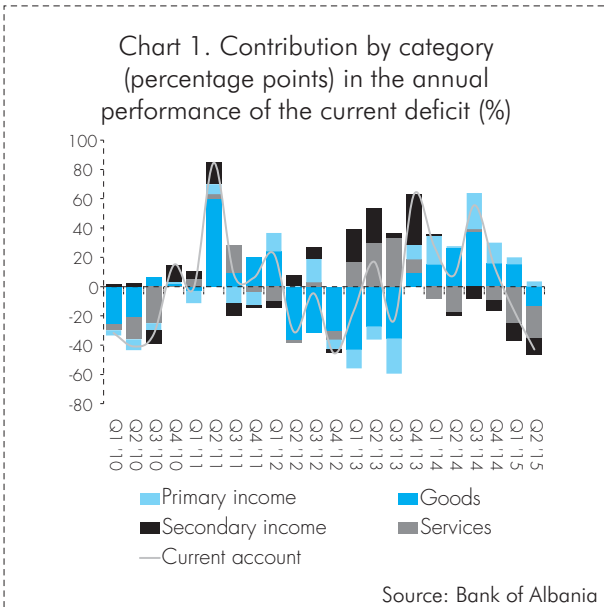
Net inflows in the capital account recorded a value of EUR 21.3 million. Net foreign inflows in the financial account decreased by 18.6% in annual terms and financed 96.9% of the current account deficit. Net foreign direct investment expanded by about 39.7% in annual terms. On the other hand, other net investments were estimated at a positive net surplus of about EUR 72.6 million, mainly due to the increase in domestic funds invested abroad. Conversely, net portfolio investments declined by about EUR 75.2 million. In breakdown of the current deficit financing by debt-creating and non-debt financial flows, the second form of financing provides a more significant support.

The overall balance of payments resulted in the expansion of foreign reserve assets by EUR 16.2 million. At the end of June 2015, the stock of foreign exchange reserves was about EUR 2.38 billion. This level was sufficient to cover 6.3 months of imports of goods and services and 161.7% of short-term external debt.

II. CURRENT ACCOUNT

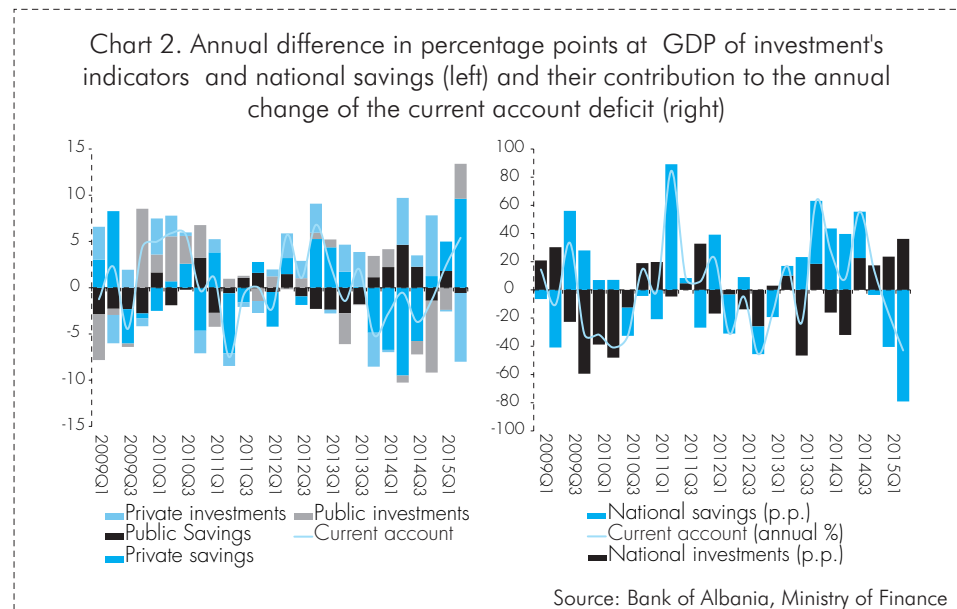
The net position of the current account resulted in a deficit of about EUR 181.3 million in 2015 Q2. Current account deficit continued to shrink at an accelerated pace during this period. The correction, in annual terms is estimated about 42.9%. Current account deficit was at 6.7% against nominal GDP, standing 5.4 percentage points lower than in the same period in the previous year. In terms of contributions, annual narrowing was largely determined by the improvement of the balance of the services account. The correction of the trade deficit as well the increase of the foreign currency flows in the secondary revenues account contributed to the same direction. The highest deficit of the primary income account compared with the previous year, contributed to the expansion of the current deficit.

Under the structural approach of the gap between national savings and investments, the gap between savings and investment in the private sector has had the main impact in the formation of the current account deficit this quarter². Thus, the private sector gap was estimated at 4.4% to GDP decreasing by 2.2 percentage points compared with the same quarter in the previous year. Within this component, the expansion of private savings has given a substantial impact by



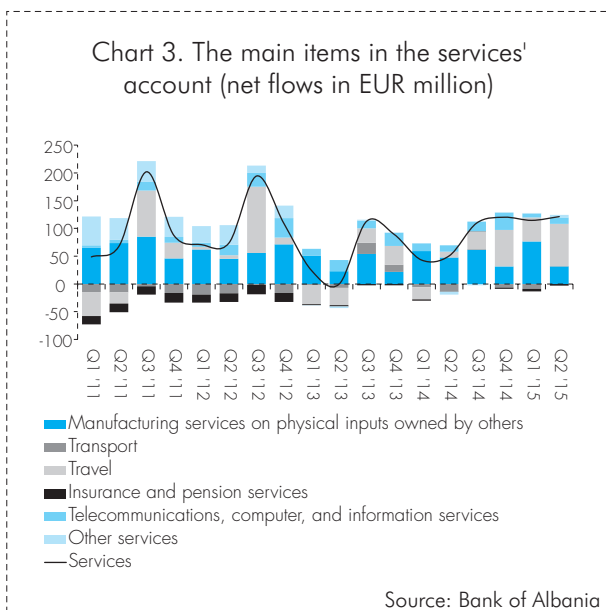
² An alternative but equivalent measure of the net position of the current account for a specific period is the gap method between national savings and investment. Thus, realized net position of the current account is equal to the sum of the gap realized between savings, public and private investment in t period.
 $CA_t = (S_{public} - I_{public})_t + (S_{private} - I_{private})_t$

about 9.6 percentage points at GDP. The gap between savings and public investments was estimated at around 2.3% at GDP. Investments and public saving resulted lower compared with the same quarter of the previous year. Similar to Q1, the highest national savings were the main contributors to the correction of the current deficit. Although national investment expanded as well, they failed to offset the effect of the savings component.



The net balance of the services account improved significantly during the period under review³. Net income from services resulted in about EUR 121.2 million, from EUR 50.5 million in the same quarter a year earlier. Revenues from services rose by 0.8%, while expenditures for services shrank by 17.1%

in annual terms. The net balance of the services account was estimated around 4.5% of the nominal GDP. Revenues from "travel services (personal and business)" and "processing services on physical inputs owned by others" determined the course of developments in the services account. Travel services make up the largest share of revenues and costs of services. Revenues from trips resulted in EUR 76.4 million, from EUR 10.6 million in the same period of the previous year.

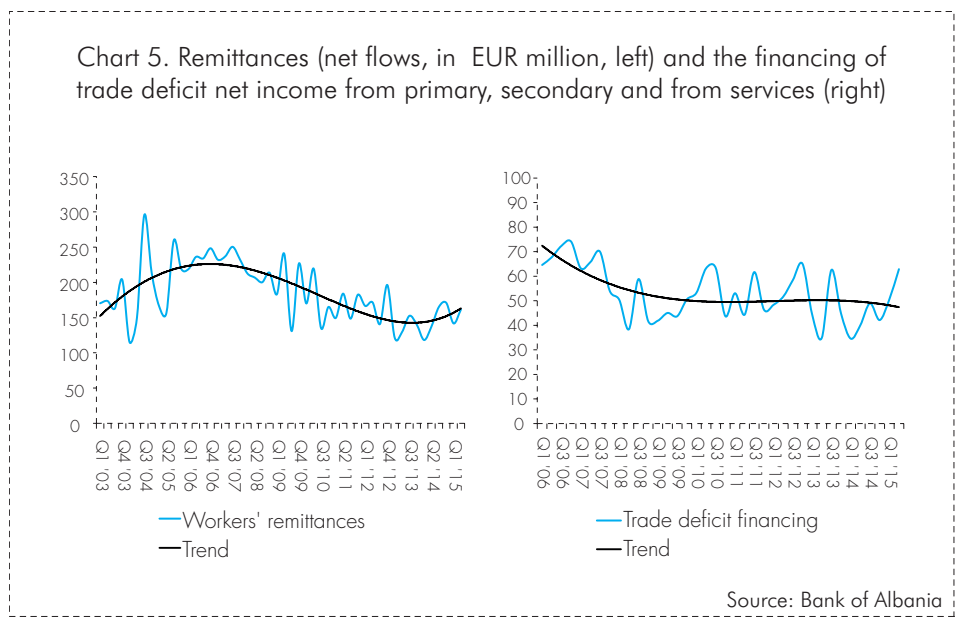
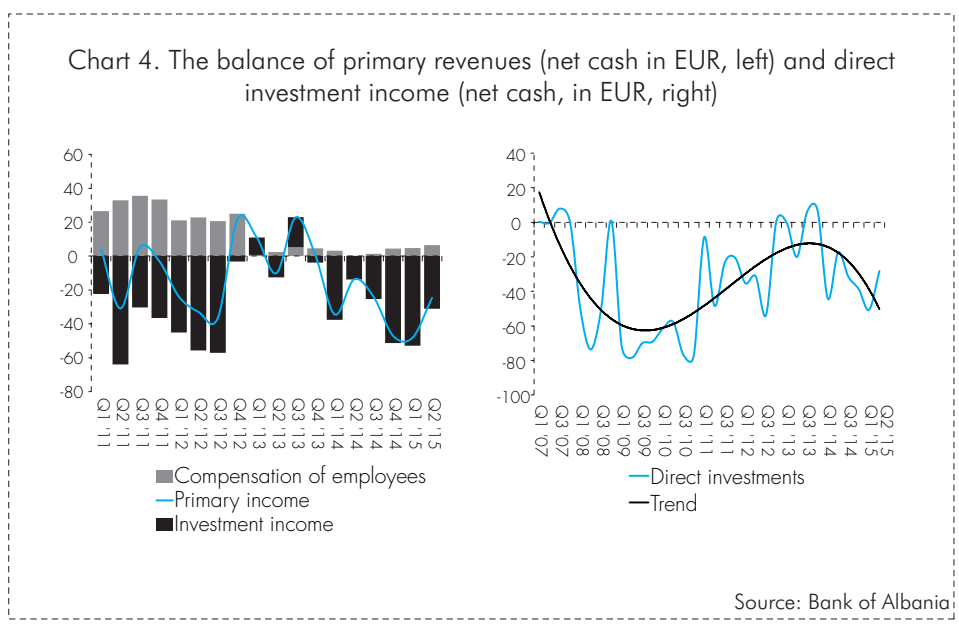


The net balance of the primary income account resulted negative. This trend has characterized this account throughout 2014 and continued in the first six months of 2015. Net foreign flows in this account resulted in a deficit of EUR 24.6 million from EUR 13.7 million in the same period a year earlier. Recorded deficit was estimated at

³ Partly due to the effect of methodological changes (application of new coefficients of transport and insurance of trade in goods)

0.9% against nominal GDP. Similar to the previous five quarters, direction of developments in this account is determined by the deficit deepening in the “income from investments”.

Direction of developments in “income from investments” continues to be determined by the increased cash outflows of revenues from foreign direct investments. The net income deficit of “foreign direct investments” was EUR 28.3 million, decreasing by 10.7% in annual terms. The repatriation of revenue from investments in equity and from the shares in investment funds played the main role. At the same time, the balance of income “portfolio investment” recorded a positive value of EUR 5.1 million. As a result of repayment of loan interests, the revenues from “other investments” recorded a negative balance of about EUR 8.0 million.



The net balance of secondary revenues account continued the upward trend of its surplus, started a year earlier. This account recorded net foreign inflows of EUR 210.2 million this quarter, up by about 19.7% compared with the same period in the previous year.

In terms of nominal GDP, foreign currency inflows in the secondary income account were estimated 7.8%. Inflows in the form of remittances have given the main contribution to this trend⁴. During this period, they accounted for EUR 162.5 million, up by 17.6% in annual terms. Compared to the nominal GDP, they were estimated at 6%, 0.8 percentage points higher compared with the same period a year earlier.

Cumulative net income from services account, of primary and secondary revenues, increased by 44.5% in annual terms and financed about 62.9% of the trade deficit. The registered significant improvement in the services account and secondary revenues is estimated to have contributed to the improvement of the ratio of trade deficit funding.

III. CAPITAL ACCOUNTS

The capital account records in debit and credit, all the transactions for non-produced and non-financial assets/goods and also the capital transfers⁵ between residents and non-residents (for which there is no economic value in return). In 2015 Q2, capital account surplus was EUR 21.3 million, down by 4.7% in annual terms. Net capital flows in this account are estimated at 0.8% of nominal GDP. Net capital transfers on behalf of "central government" were EUR 16.0 million, while those of "financial and non-financial corporations, households and non-profit institutions serving to households", resulted about EUR 5.3 million.

The combination of net non-financial transactions of the current and the capital account gives the net position of the domestic economy as net lending (surplus) and net borrowing (deficit), compared to 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 is financed by non-residents. In quantitative terms, our economy is in a net borrower position by about EUR 160.0 million, financed by revenues in financial account (minus errors and omissions).

⁴ Estimates for the quarterly revenues of immigrants are preliminary. These data are considered as definitive with the commission of the survey on remittances in December of 2015.

⁵ Capital transfers include: 1. Forgiven debt; 2. claims for non-life insurance branch; 3. grants; 4. guarantees; 5. taxes (for inheritance, gifts, etc.); 6. Other capital transfers.

IV. FINANCIAL ACCOUNT⁶

The financial account net position for 2015 Q2, recorded a decrease in assets by about EUR 175.8 million, down by 18.6% in annual terms. Net inflows in this account were estimated at 6.5% of nominal GDP and they financed about 96.9% of the current deficit recorded during this period.

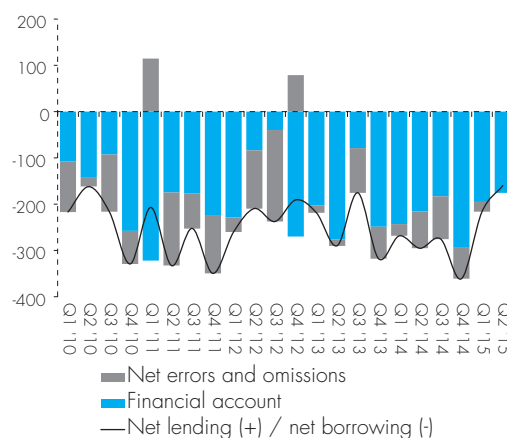
Financial cash inflows in the form of residents' liabilities to non-residents were EUR 244.3 million, about EUR 12.3 million lower than in the same period in the previous year. In the most part, the decline in liabilities was due to the lower inflows from other investments. On the other hand, the total of domestic assets invested in foreign economies during this quarter was EUR 68.6 million, about EUR 27.8 million more than in the same quarter of the previous year⁷. The main determinants of the developments in our assets invested abroad appear to be in the form of other investments and foreign assets.

Net foreign direct investment increased by 39.7% in annual terms. In relation to nominal GDP, net FDI were estimated around 7%. This ratio is 1.8 percentage points higher compared to that recorded in the same period in the previous year.

Broken down by investment instruments, the increase of investments in the form of "capital and shares in investment funds"⁸ gave the main contribution to the growth of domestic liabilities in the form of foreign direct investment. On the other hand, direct investment in the form of invested revenue and debt instruments, resulted in decline.

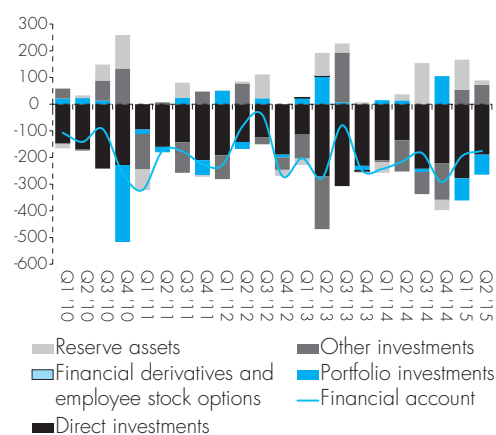
In the long term, foreign direct investments constitute a significant influx of foreign input in financing the current deficit of Albania. For this quarter, the ratio of net FDI flows funded the registered current deficit. Reported funding was 104.4%, expanding by around 61.7 percentage points, compared with the previous year.

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



Source: Bank of Albania

Chart 7. Components of the financial account (net flows in EUR millions)



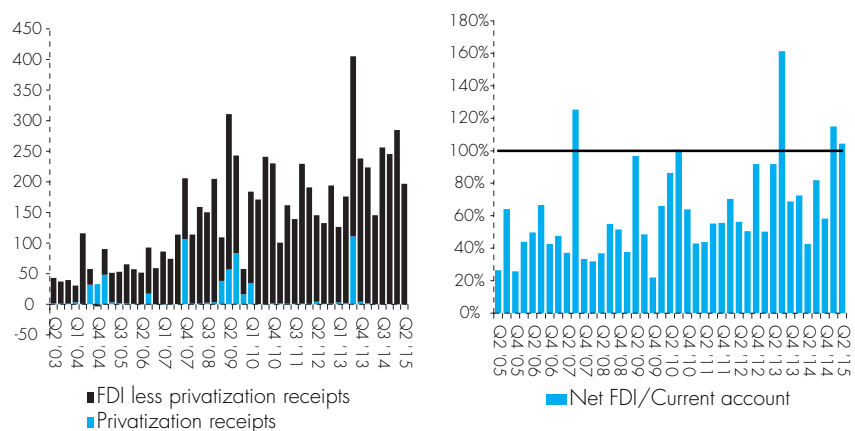
Source: Bank of Albania

⁶ According to the foreseen standards of the 6th Manual of the Balance of Payments (BPM6), the increase in assets and liabilities is presented with a positive sign; reduction is presented with a negative sign. The net balance of the financial account is calculated as the difference between assets and liabilities.

⁷ With methodological changes foreseen in BPM6, the total of domestic funds invested in foreign economies includes the foreign-exchange reserves assets.

⁸ Based on the standards foreseen in BPM6, direct investments are realized through three main instruments: 1. stocks and shares in investment funds; 2. reinvested profit; 3. debt instruments.

Chart 8. The composition of foreign direct investments (cash, in EUR mln on the left) and the ratio of current deficit financing of net FDI (right)

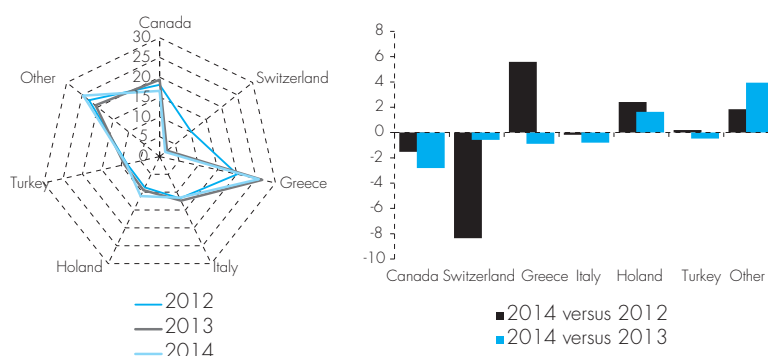


Source: Bank of Albania

FOREIGN DIRECT INVESTMENT BY ORIGIN AND ECONOMIC SECTORS⁹

In the end of 2014, the stock of foreign direct investments (FDI) was EUR 4,553.4 million. Compared with a year earlier, the stock of FDIs rose by 10.7%. Data on the distribution of direct investment by country of origin indicate a slight decrease in their concentration. Thus, six of the largest investors accounted for about 81.4% of the total stock of FDIs in 2014, from 85.3% that they represented in the previous year. Greece has the biggest share in the stock of FDIs in 2014 by about 25.7% of the total. The second most important partner is Canada, sharing approximately 16.6% of the total stock of FDIs. Italy and the Netherlands have almost the same share in the total stock of FDIs. "Transport, storage and communications" had the largest share in 2014 in the distribution of the stock of FDIs by sector of the economy. Within

Chart 9. Share in the total stock of FDI and changes in weight



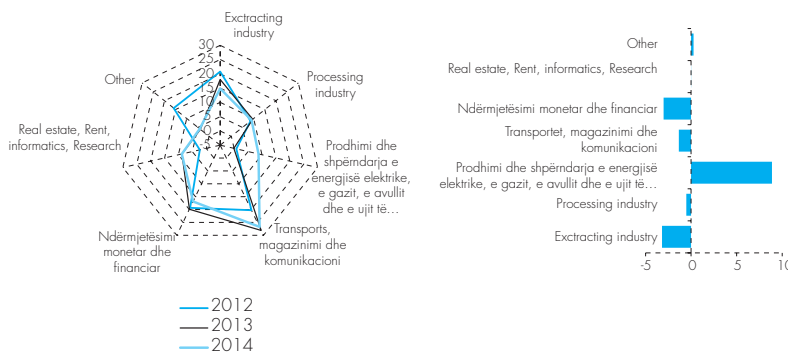
Source: Bank of Albania

⁹ Data on FDI by country by origin and economic activity were published in accordance with the methodology prescribed in BPM6 and belong to 2012-2014.

this sector, major investments were absorbed by “posts and telecommunications” (approximately 96.8% of investment in “Transport, storage and communications”).

The second sector with the largest share is “Financial and monetary intermediation” (about 16.9% of the total stock of FDI) “Quarrying” ranked third in the stock of FDIs against the total with around 14.9% of the investments. “Production and distribution of electricity, gas, steam and hot water” is estimated to have had a more significant growth in the share against the total stock of FDIs in 2014. By withdrawing all of the investments’ stock in 2013, inflows of foreign investment in the industry are registered in 2014, changing the share of the sector to 8.8% of the total stock of direct investments.

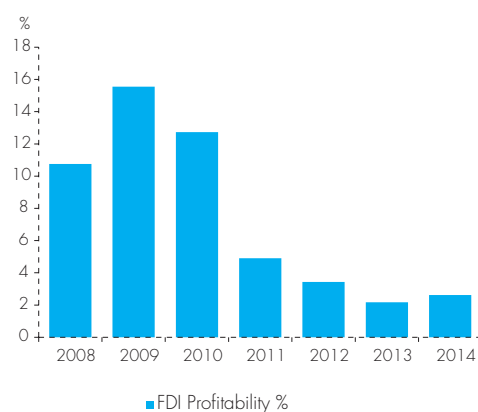
Chart 10. Distribution by economic activity of the FDI stock and changes in weight for 2014 -2013



Source: Bank of Albania

An important factor in attracting new FDIs in Albania is the profitability of existing FDIs with consolidated activity, sending signals to potential future investors. To assess this indicator, the stock of FDIs, the flow of invested gains and net inflow of FDI's revenues, are used. Albania continues to be a market where foreign investors generate profits. Although it continues to be positive, it should be noted that since 2010 the level of profitability of FDIs is significantly reduced. For 2014, the indicator of profitability is estimated to be slightly higher than in the previous year.

Chart 11. The level of profitability of the country FDI in years (in%)



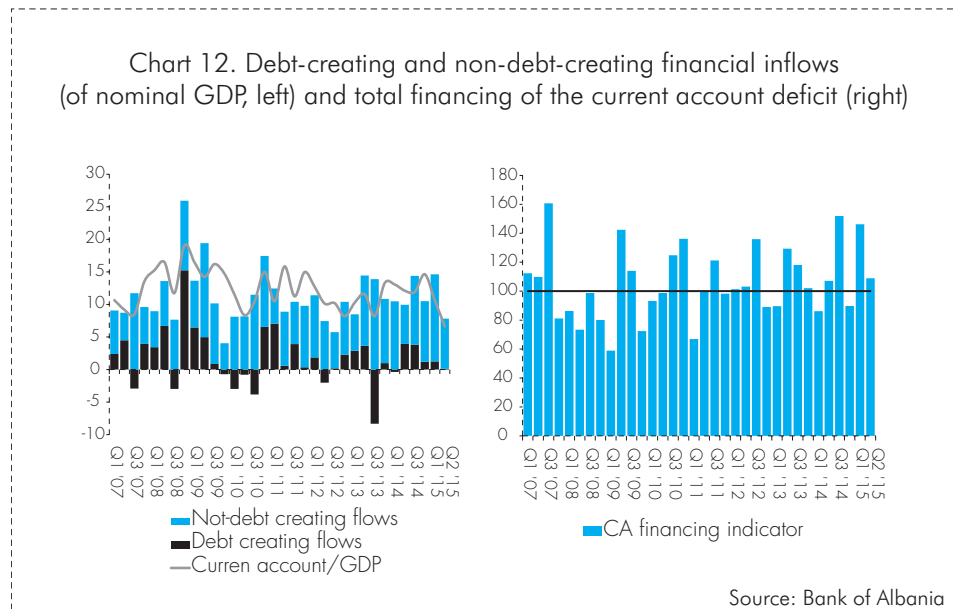
Source: Bank of Albania

For the second consecutive quarter, net portfolio investments resulted in a negative balance of about EUR 75.2 million, from a positive of EUR 14.3 million a year earlier. In the period under review, residents' assets (depository corporations, excluding the Bank of Albania) invested abroad, decreased (withdrawal of portfolio investments) by about EUR 55.4 million (mainly invested in debt securities). Liabilities in the form of portfolio investments of non-residents in the domestic economy grew by about

EUR 19.8 million. Non-residents have invested mainly in equity and shares in investment funds.

The net balance of other investment account was EUR 72.6 million, reflecting the domestic assets invested in higher foreign economies. Resident funds invested in foreign economies amounted to EUR 99.2 million, while non-residents' liabilities were estimated at EUR 26.6 million. Net currency and deposits resulted in a positive balance of about EUR 121.8 million, from a deficit of around EUR 44.5 million in the same period a year earlier. Although at first glance no significant changes are noted in the flow of borrowing compared with a year earlier, loan component items show a different performance. Corporations survey, result to have passed by creditors to debtors, by about EUR 53.3 million. Also, the central government has reduced borrowing flow. In the financing profile of the current deficit, it is important to monitor the debt-creating inflows' dependence against the most desirable non-debt-creating inflows¹⁰. Thus, financial non-debt-creating flows of net FDIs and of the capital account are estimated at 7.8% of the nominal GDP. These were 1.8 percentage points higher compared with the second quarter of the previous year. Non-debt-creating financial flows were estimated at 0.1% of nominal GDP and with a decline of 3.8 percentage points compared with a year earlier.

After net errors and omissions are added entirely to the net debt-creating foreign flows and non-debt-creating flows, the total amount of financing of the current deficit is obtained. This quarter, the current account financing rate was at 109%, indicating the expansion of the foreign reserve assets' stock.



¹⁰ This division serves to monitor the impact that financial and capital flows have on the country's external debt. Non-debt-creating flows are classified FDI and capital inflows, while debt-creating inflows include portfolio investment and other net investments.

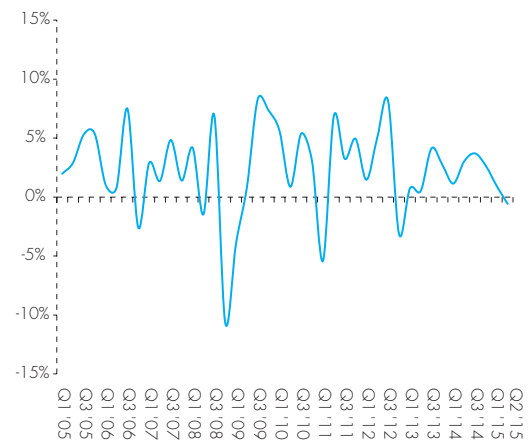
Reserve assets increased by EUR 16.2 million, mainly due to the increase of funds in the form of "SDR". At the end of June, the stock of foreign exchange reserves was about EUR 2.38 billion, sufficient to cover 6.3 months imports of goods and services and 161.7% of short-term external debt.

V. ERRORS AND OMISSIONS

As a result of problems that may be encountered in the sources of information and during the drafting of external sector statistics, the balance of payments may have discrepancies.

Thus, in the balance of payments, these discrepancies are summarized in the errors and omissions, which is calculated as the "rest" (the difference between the financial account balance and the current account balance plus the balance of the capital account). For 2015 Q2, the "net errors and omissions" account, resulted in a negative value of EUR 15.8 million and was estimated at about 0.6% of nominal GDP.

Grafik 13. Errors and omissions / nominal GDP



Source: Bank of Albania

