

Bank of Albania

ANALYSIS OF DEVELOPMENTS
IN THE EXTERNAL SECTOR
OF THE ECONOMY

2015 Q4

ENIAN ÇELA
MONETARY POLICY DEPARTMENT

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The views expressed herein are solely of the author 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>	4
II.	<i>CURRENT ACCOUNT</i>	6
III.	<i>CAPITAL ACCOUNT</i>	10
IV.	<i>FINANCIAL ACCOUNT</i>	11
V.	<i>ERRORS AND OMISSIONS</i>	14

I. BALANCE OF PAYMENTS HIGHLIGHTS¹

The net position of the current account recorded a deficit of EUR 413.4 million in 2015 Q4, expanding approximately 8.1% in annual level. It was estimated at 15.1% of the nominal GDP, approximately 0.7 percentage point higher than in the same quarter of the previous year. By items of the current account, an expanding contribution was provided by the worsening of trade deficit in goods and services, and the decrease in secondary income inflows. The exports of goods and services decreased by around 0.7%, while imports increased by around 1.4% in annual terms. The net balance of secondary income decreased by 2.1%, in annual terms. The remittances sub-item was the primary factor in this performance. Remittance's inflows have continued to fall in annual terms for the second successive quarter, decreasing by 10.5%. Primary income deficit declined during this quarter, thus contributing to the narrowing of the annual performance of the current account deficit. Under the structural approach, as measured by the national gap between savings and investments, the private sector had the main impact on the formation of the current deficit. The growth of private investments provided the main positive contribution in this regard. On the other hand, public investments has the opposite effect since they have decreased compared to the previous year.

¹ The latest data on the balance of payments are as of 2015 Q4. As of 2014 Q1, 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 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)

	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4
Current account (in EUR million)	-313.2	-377.5	-239.5	-174.4	-327.1	-413.4
y-o-y (%)	55.5	13.9	-17.7	-45.1	10.5	8.1
/GDP (%)	-11.8	-14.5	-10.6	-6.4	-12.6	-15.1
Goods and services	-470.2	-540.8	-372.9	-360.5	-476.3	-564.2
y-o-y (%)	18.9	4.3	-7.2	-24.8	1.3	4.3
Exports, f.o.b.	803.7	720.0	593.5	705.9	785.0	714.8
y-o-y (%)	-3.6	-7.0	2.9	-1.0	-2.3	-0.7
Imports, f.o.b.	1273.9	1260.8	966.4	1066.5	1261.4	1279.0
y-o-y (%)	3.7	-2.5	-1.2	-10.5	-1.0	1.4
Net travel	32.0	66.0	43.6	76.4	64.5	51.6
Primary income	-24.1	-47.1	-47.4	-24.1	-27.2	-50.3
Credit	34.7	30.5	27.2	24.6	30.3	32.0
Debit	58.8	77.6	74.6	48.7	57.6	82.3
Net FDI income	-31.6	-38.7	-49.9	-27.7	-32.5	-36.0
Secondary income	198.3	205.4	180.7	210.2	176.4	201.0
Credit	230.6	244.1	211.9	243.3	219.1	247.2
Debit	32.3	38.8	31.2	33.0	42.6	46.2
Net Remittances	165.1	171.0	141.8	161.7	139.7	153.9
y-o-y (%)	8.3	22.1	19.9	17.6	-15.4	-10.0
Capital account	20.7	21.1	26.0	21.3	45.6	32.8
Net borrowing / Net lending	-275.3	-361.3	-213.6	-153.1	-281.5	-380.6
Financial account	-183.2	-292.5	-167.3	-191.9	-114.4	-291.0
y-o-y (%)	131.5	17.5	-31.2	-11.1	-37.5	-0.5
/GDP (%)	-7.3	-11.1	-7.4	-7.0	-4.4	-10.7
Direct investments	-242.3	-222.8	-257.7	-211.3	-234.0	-167.7
y-o-y (%)	-21.1	-3.6	22.2	55.9	-3.4	-24.7
Portfolio investments	-12.0	105.1	-74.7	-66.8	-11.2	-172.1
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0
Other investments	-83.0	-135.9	53.3	70.0	-181.7	-120.3
Reserve assets	154.0	-38.9	111.8	16.2	312.5	169.1
Errors and omissions	92.0	68.9	46.2	-38.8	167.1	89.6

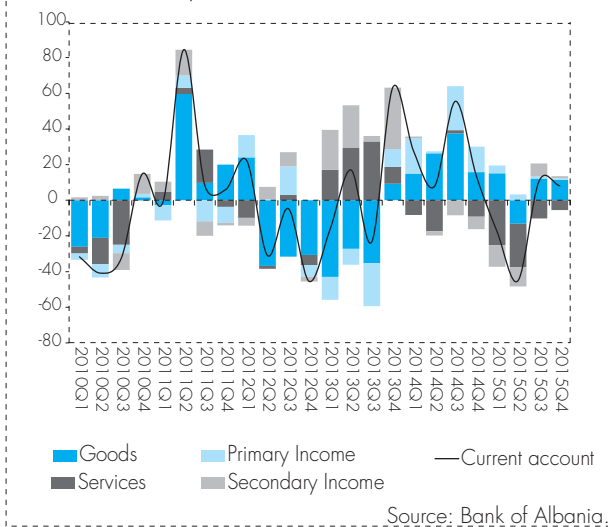
Source: Bank of Albania.

Net inflows in the capital and financial accounts covered 78.3% of the current account deficit. Errors and omissions financed the rest of this deficit. These flows amounted to EUR 32.8 million, around EUR 11.7 million higher than in the same quarter of the previous year. The net position in the financial account shows a reduction of the country's assets by around 0.5% in annual terms. Net foreign direct investments reduced around 24.7% in annual terms. Other net investments were estimated with an increase of liabilities by around EUR 48 million. Net assets held in the form of portfolio investments showed a deficit, attributable to the increase of liabilities by around 127 million euro. The debt-creating inflows provided the highest contribution to the financing of the current deficit. In terms of percentage to GDP, the flows increased by 9.5 percentage points in annual terms.

The overall balance of payments resulted in the expansion of foreign reserve assets by EUR 169.1 million. At the end of 2015, the stock of foreign exchange reserves was around EUR 2.88 billion, sufficient to cover 7.5 months of imports of goods and services and 197.8% of the short-term external debt.

II. CURRENT ACCOUNT

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



The net position of the current account resulted in a deficit of around EUR 413.4 million in 2015 Q4, increasing by around 8.1% in annual terms. It was estimated at 15.1% of nominal GDP, around 0.7 percentage points higher than in the same quarter of the previous year. In terms of contributions, the deepening of the trade deficit in goods broadly determined the annual expansion. The narrowing of the surplus in the secondary income account and the expansion in primary income deficit provided an added contribution to the expansion of the overall deficit. Services account provided a positive contribution.

According to the gap approach between national savings and investments, it was the gap between savings and investments in the private sector that provided the main impact on the formation of the current account deficit². This trend continued for the fourth consecutive quarter.

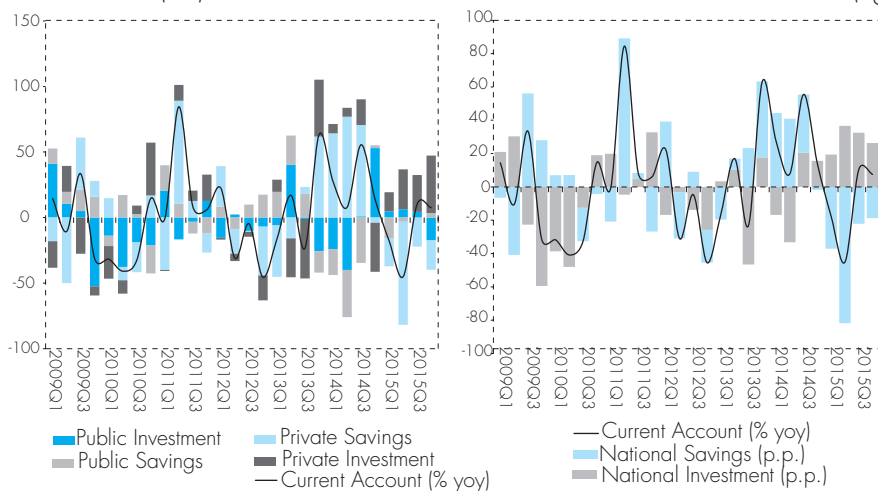
The private sector gap was estimated at 8.2% of GDP, deepening by around 2.8 percentage points, compared to the same quarter a year earlier. The expansion of private investments provided a considerable impact within this item. They were estimated at 27.2% of GDP, around 5.34 percentage points higher than in the previous year. Private savings to GDP expanded by 2.52 percentage points, in annual terms. Public savings to GDP resulted slightly lower than in the same quarter of the previous year, while the level of public investments to GDP lost around 2.9 percentage points.

Similarly to the last quarter, national investments provided the main contribution to the formation of the current deficit, although at a lower extent. National investments were estimated at 35.3% of GDP, expanding by 2.5 percentage points, y-o-y. National savings were estimated at 20.25% of GDP, around 2 percentage points higher, compared to the fourth quarter of the previous year.

² An alternative, but equivalent measuring of the current account net position for a specific period is the gap method between savings and national investments. Thus, the net realized position of the current account is equal to the amount of the gap realized between savings and public and private investments in period t .

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

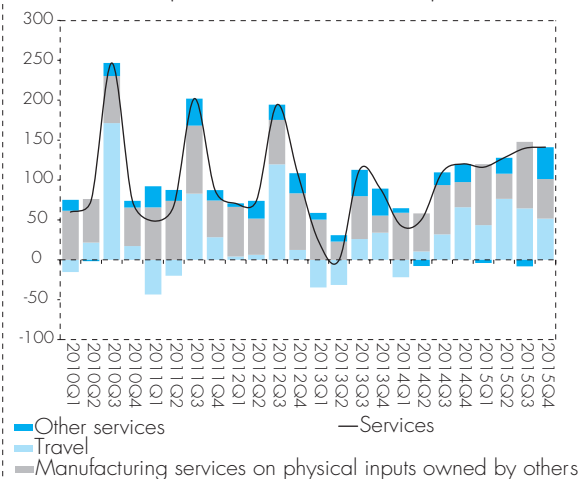
Chart 2 Annual spread in p.p. of savings-investments gap of private and public sectors to GDP (left) and their contribution to the annual current account deficit (right)



Source: Bank of Albania, Ministry of Finance.

The net balance of services account recorded an expansion of its surplus during the period under review. Net income from services resulted in about EUR 141.2 million compared to EUR 120.1 million in the same quarter of the previous year. Net income from services increased by around 17.5%, in annual terms. In this performance, the expansion of the services' export by 8.8% in annual terms provided a considerable impact. On the other hand, services imports has increased by 6.1%. In terms of the nominal GDP, the net balance of services was estimated at around 5.2%. Travel services have the highest share in the income and costs of services. Net income from travel services, including the net flows from tourism, resulted lower compared to the previous year. The net position reduced at EUR 51.6 million, from EUR 66 million in the same period of the previous year.

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

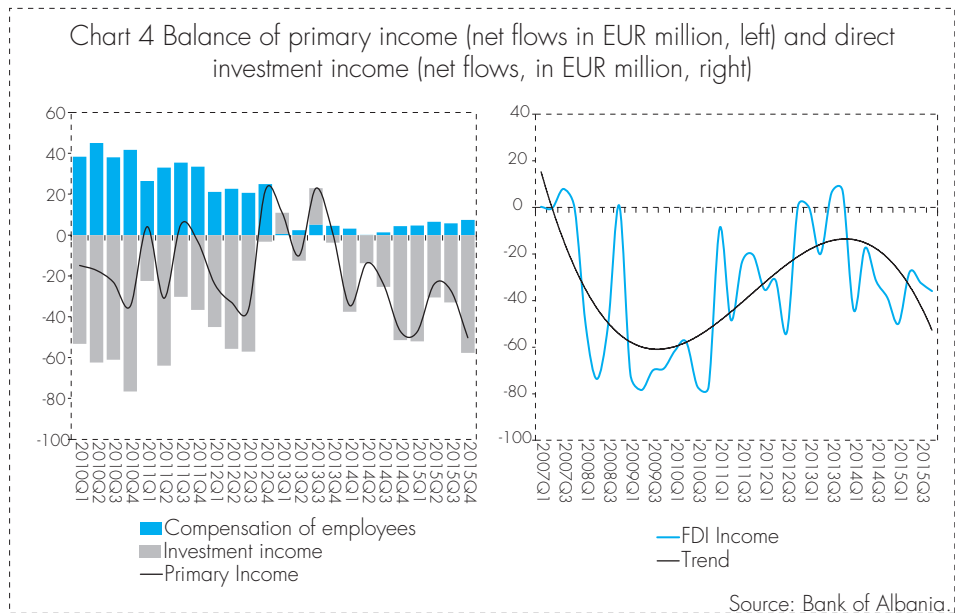


Source: Bank of Albania.

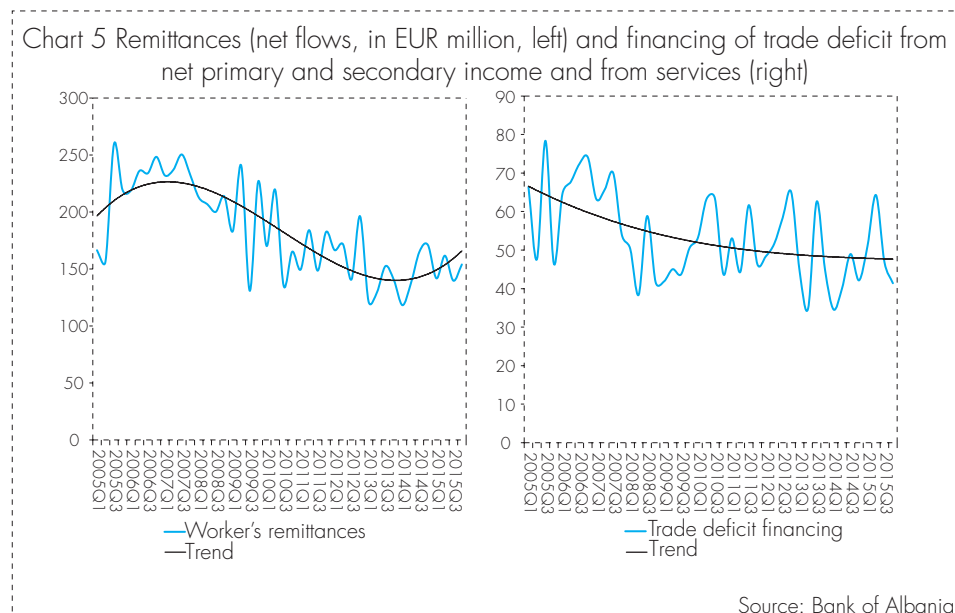
The net balance of primary income account was negative. This trend characterized this account throughout 2014, and continued throughout 2015. Net foreign-currency inflows in this account resulted in EUR 50.3 million deficit, from EUR 47.1 million, in the same period a year earlier. The recorded deficit was estimated at around 1.8% of nominal GDP.

Similar to the previous quarters, the deepening of the deficit in "investment income", determined the direction of developments in this account. In this case as well, net income deficit from "foreign direct investment" determined the overall balance, This deficit narrowed by around 7.2%, in annual terms. This phenomenon is related to the increase of the Albanian investments income abroad. "Portfolio investment" item affected the expansion of the primary

income total deficit. This account deficit stood at EUR 13 million, expanding by around 40%, in annual terms. Lastly, "other investments" deficit narrowed slightly at EUR 1.4 million.



The net balance in the surplus of secondary income account shrunk compared to the same quarter a year earlier, following the same dynamic as the previous quarter. Secondary income surplus was estimated at EUR 201 million, down by around 2.1% in annual terms.



In terms of the nominal GDP, the foreign currency flows in the secondary income account were estimated at 7.4%, decreasing around by 0.4 percentage points, on an annual basis. The decline of remittances' flows provided the main contribution to this trend. In 2015 Q4, they were EUR 153.9 million, down by 10%, in annual terms.

Net cumulative income from services account, primary income account and secondary income account financed around 41.4% of the trade deficit. This ratio decreased by 0.7 percentage points compared to the third quarter a year earlier, and by 5.5 percentage points compared to 2015 Q3.

III CAPITAL ACCOUNT

The capital account debits and credits all the transactions on the acquisition and disposal of non-produced, non-financial assets/goods and the capital transfers³ between residents and non-residents (on which there is no economic value in the exchange). In 2015 Q4, capital account surplus was around EUR 32.8 million, up by around EUR 11.7 million y-o-y. Net capital flows in this account are estimated at 1.2% of nominal GDP. Net capital transfers for the account of “central government” amounted EUR 21.6 million, while those in “financial and non-financial corporations, households and non-profit institutions serving households”, were around EUR 11.2 million.

The combination of net non-financial transactions of the current and capital account provides the net position of the domestic economy, as net lender (surplus) and net borrower (deficit) against non-resident economies. In quantitative terms, our economy represents a net borrower position, around EUR 380.6 million, which is financed by the income in in the financial account and “errors and omissions”.

³ Capital transfers consist of: 1. debt forgiveness; 2. non-life insurance claims; 3. grants; 4. guarantees; 5. taxes (for inheritance, gifts, etc.); 6. other capital transfers.

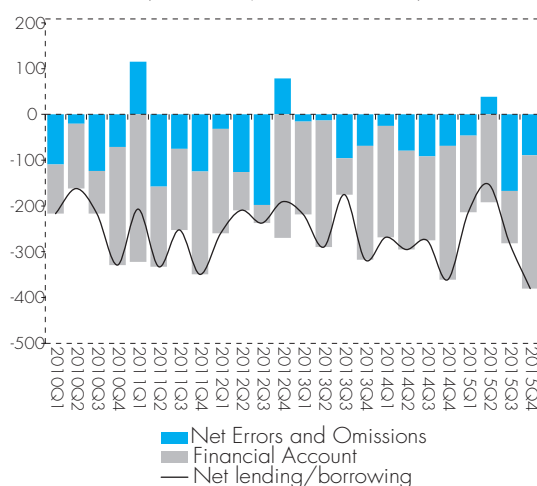
IV. FINANCIAL ACCOUNT

The net position of financial account, recorded a decrease in assets owned by residents, by around EUR 291 million, in 2015 Q4. This result represents a narrowing of the net borrowing position of residents against non-residents, by around 0.5%, in annual terms. Net foreign currency flows in the form of increased financial liabilities were estimated at around 10.6% of nominal GDP, and financed about 70% of the current deficit recorded during this period.

Financial inflows in the form of residents' liabilities to non-residents amounted EUR 342.1 million, EUR 98.9 million higher compared to the same quarter in the previous year. The increase in liabilities was mainly attributable to higher inflows of the portfolio investment and others. In 2015 Q4, the total Albanian assets were EUR 51.1 million, around EUR 100.4 million higher from 2014 Q4. This performance was driven by the increase of assets invested abroad, in the form of currencies and deposits, and as the increased foreign reserve assets.

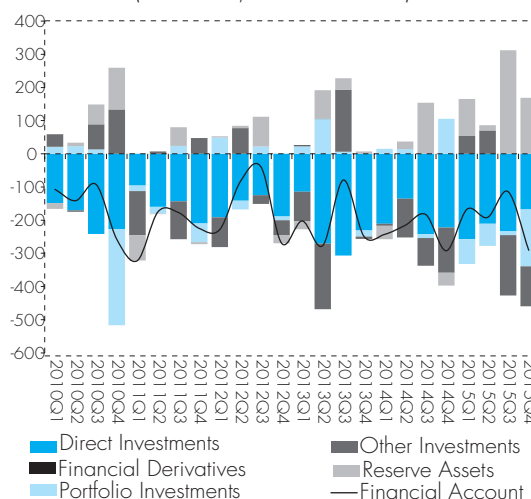
The net foreign direct investments continued in the downward trends, in terms of annual change, for the second consecutive quarter, reflecting a different dynamic in the second half of the year, compared to the first one. The annual fall stood at 24.7%. Net FDIs ratio to nominal GDP was estimated at 6.1%, 2.3 percentage points lower from the same period in the previous year.

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



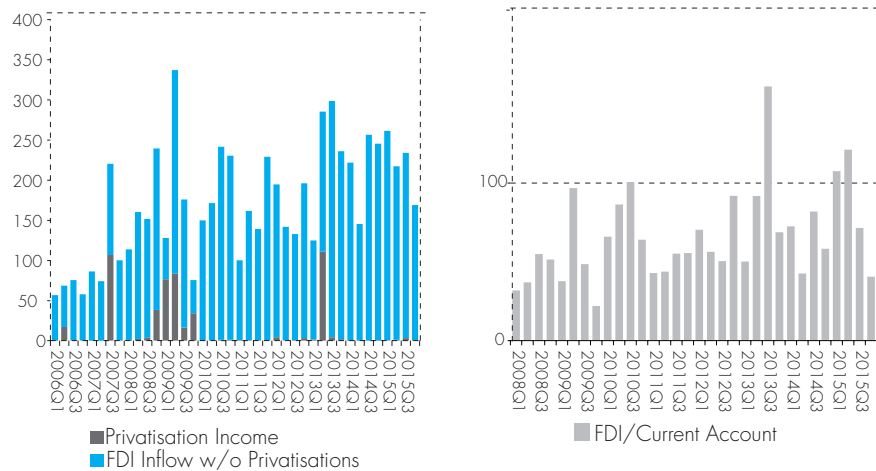
Source: Bank of Albania.

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



Source: Bank of Albania.

Chart 8 Composition of FDIs (flows in EUR million, left) and covering of current deficit from net FDIs (right)



Source: Bank of Albania.

Broken down by instruments of investment⁴, the lower foreign direct investments in the form of “capital and stocks in investment funds”, provided the main contribution to the decline in domestic liabilities in the form of foreign direct investments. On the other hand, liabilities related to “reinvested profit” increased in annual terms.

In the long run, FDIs constitute an important foreign currency inflow in financing the current deficit of Albania. In 2015 Q4,, the ratio of net FDI flows financed 40.5% of the recorded current deficit. This ratio was 17.7 percentage points lower than the same quarter a year earlier, and 31 percentage points lower compared to the previous quarter.

Net portfolio investments had a negative balance for the fourth consecutive quarter. Net decrease of assets owned by residents was 172.1 million euro, while a year earlier these assets expanded by 105.1 million euro. In the period under review, residents’ assets (depository corporations, excluding the Bank of Albania) invested abroad have decreased by around 150.3 million euro. Liabilities, in the form of portfolio investments of non-residents in the domestic economy, increased by around EUR 127 million. Investments in the form of equity and shares in investment funds by non-residents increased this quarter and the same happened with liabilities in the form of debt.

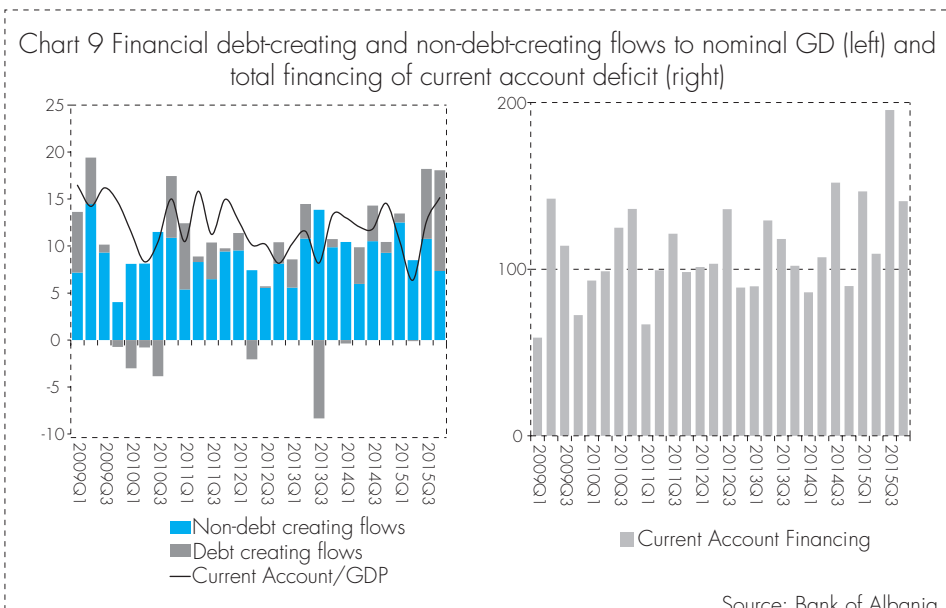
Net balance of other investments account shows an increase of the borrowing position in Albania, by around EUR 120.3 million, by reflecting the Albania’s increased liabilities to non-residents. Albanian assets invested abroad stood at -77.3 EUR million, while liabilities to non-residents were estimated at EUR 42.9 million. “Net currency and deposits” sub-item resulted in a net negative balance of EUR 113.4 million compared to 164.3 million euro, in the same period in the previous year. Total liabilities in the form of loans recorded

⁴ 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

EUR 23.2 million, expanding by around EUR 18.7 million compared to the previous year. The increase of external debt by the central government was the only upward contribution to this performance. By contrast, pre-depository corporations, other sectors and the central bank reduced the flow of attracting new debt and improved their net borrowing position with abroad.

Regarding the current deficit financing profile, it is important to monitor the reliance on debt-creating inflows rather than on the more desirable non-debt-creating inflows⁵. Thus, non-debt-creating financial flows from net foreign direct investments and from the capital account were estimated at 7.34% of nominal GDP, around 1.9% lower compared to the previous year. The debt-creating financial flows were estimated at 10.7% of nominal GDP, expanding by around 9.5 percentage points compared to the previous year. The share of this item increased considerably, constituting 59.3% of the total financing, increasing by 48.1 percentage points in annual terms.

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. During 2015 Q4, the ratio of current account financing stood at 140.9%, implying an expansion in the foreign exchange reserve stock. "Errors and omissions" constituted 1/5 of the recorded current deficit.



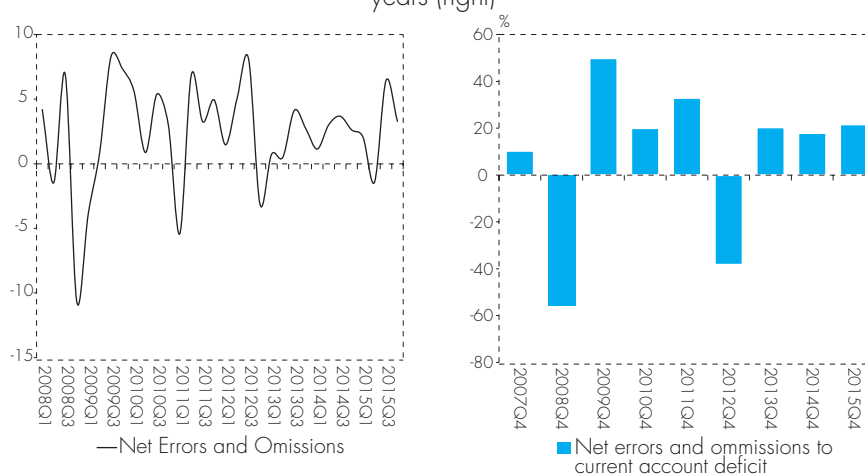
The overall balance of payments resulted in the expansion of foreign reserve assets by 169.1 million euro. At the end of December, the stock of foreign currency reserve was about EUR 2.88 billion. This level was sufficient to cover 7.5 months of imports of goods and services and 197.8% of the short-term external debt.

⁵ 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 whereas portfolio investment and other net investment are included in debt-creating flows.

V. ERRORS AND OMISSIONS

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

Chart 10 Errors and omissions / nominal GDP (left) and financing of current deficit with net inflows classified as errors and omissions for the third quarters, over the years (right)



Source: Bank of Albania.

Thus, in the balance of payments, these discrepancies are summarized in the errors and omissions item, which is determined as residual (difference between the financial account balance and the current account balance plus the balance of the capital account). In 2015 Q4, "net errors and omissions" recorded the positive rate of EUR 89.6 million, estimated at around 3.3% of nominal GDP.