

Bank of Albania

ANALYSIS OF DEVELOPMENTS  
IN THE EXTERNAL SECTOR  
OF THE ECONOMY

2016 Q1

*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.



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

The net position of the current account recorded a deficit of EUR 257.7 million in 2016 Q1, expanding approximately 7.6% annually. It was estimated at 10.7% of the nominal GDP, approximately 0.1 percentage points higher than in the same quarter of the previous year. By items, the worsening of trade deficit in goods and services, and the decrease in secondary income inflows contributed to this growth. The exports of goods and services decreased by around 2.5%, while imports increased by around 4.4%, in annual terms. The net balance of secondary income decreased by 10.7%. The sub-item of remittances was the primary factor determining this performance. Remittance's inflow continued to fall in annual terms for the third consecutive quarter, decreasing by 10%. The primary income deficit decreased, thus contributing to the narrowing of the annual current account deficit. Under the structural approach, as measured by the gap between national savings and investments, the private sector had the main impact on the formation of the current deficit.

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<sup>1</sup> The latest data on the balance of payments are as of 2016 Q1. 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. The main differences between the two methodologies are synthesised in the guideline 'Publication of Financial Statements of statistics of external sector, in accordance with BPM6-IMF', published by the Bank of Albania at: [http://www.bankofalbania.org/web/pub/01\\_commentary\\_for\\_changes\\_in\\_the\\_publication\\_of\\_external\\_sector\\_statistics\\_according\\_to\\_bpm6\\_june\\_2014\\_6689\\_1.pdf](http://www.bankofalbania.org/web/pub/01_commentary_for_changes_in_the_publication_of_external_sector_statistics_according_to_bpm6_june_2014_6689_1.pdf) For the purposes of internal analysis, the Balance of Payments data from 2002 to 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	2016 Q1
Current account (in EUR million)	-313.2	-377.5	-239.5	-174.4	-327.1	-413.4	-257.7
y-o-y (%)	55.5	13.9	-17.7	-45.1	10.5	8.1	7.6
/ GDP (%)	-11.9	-14.6	-10.6	-6.4	-12.6	-15.2	-10.7
Goods and services	-470.2	-540.8	-372.9	-360.5	-476.3	-564.2	-400.2
y-o-y (%)	18.9	4.3	-7.2	-24.8	1.3	4.3	7.3
Exports, f.o.b.	803.7	720.0	593.5	705.9	785.0	714.8	608.3
y-o-y (%)	-3.6	-7.0	2.9	-1.0	-2.3	-0.7	2.5
Imports, f.o.b.	1273.9	1260.8	966.4	1066.5	1261.4	1279.0	1008.5
y-o-y (%)	3.7	-2.5	-1.2	-10.5	-1.0	1.4	4.4
Travel - net	32.0	66.0	43.6	76.4	64.5	51.6	67.3
Primary income	-24.1	-47.1	-47.4	-24.1	-27.2	-50.3	-18.8
Credit	34.7	30.5	27.2	24.6	30.3	32.0	24.8
Debit	58.8	77.6	74.6	48.7	57.6	82.3	43.6
Net FDI income	-31.6	-38.7	-49.9	-27.7	-32.5	-36.0	-20.1
Secondary income	198.3	205.4	180.7	210.2	176.4	201.0	161.3
Credit	230.6	244.1	211.9	243.3	219.1	247.2	197.2
Debit	32.3	38.8	31.2	33.0	42.6	46.2	35.9
Net remittances	165.1	171.0	141.8	161.7	139.7	153.9	128.0
y-o-y (%)	8.3	22.1	19.9	17.6	-15.4	-10.0	-9.7
Capital account	20.7	21.1	26.0	21.3	45.6	32.8	6.6
Net borrowing/net lending	-275.3	-361.3	-213.6	-153.1	-281.5	-380.6	-251.2
Financial account	-183.2	-292.5	-167.3	-191.9	-114.4	-291.0	-165.9
y-o-y (%)	131.5	17.5	-31.2	-11.1	-37.5	-0.5	-0.9
/ GDP (%)	-7.3	-11.2	-7.4	-7.1	-4.4	-10.7	-6.9
Direct investments	-242.3	-222.8	-257.7	-211.3	-234.0	-167.7	-144.4
y-o-y (%)	-21.1	-3.6	22.2	55.9	-3.4	-24.7	-44.0
Portfolio investments	-12.0	105.1	-74.7	-66.8	-11.2	-172.1	103.1
Financial derivatives	0.0	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	-75.0
Reserve assets	154.0	-38.9	111.8	16.2	312.5	169.1	-49.6
Errors and omissions	92.0	68.9	46.2	-38.8	167.1	89.6	85.3

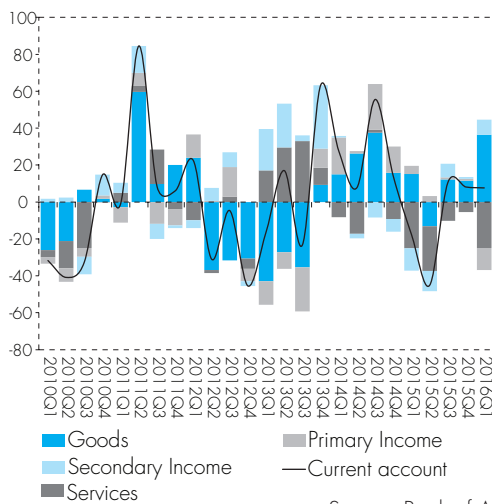
Source: Bank of Albania.

Net inflows in the capital account amounted to EUR 6.6 million, around EUR 19.4 million lower than in the same quarter of the previous year. The net position in the financial account shows a narrowing of the deficit by around 0.9% in annual terms. Net inflows in the capital and financial accounts covered 66.9% of the current account deficit. Errors and omissions financed the remaining deficit. Net foreign direct investments fell by around 44%, in annual terms. Other net investments were estimated with an increase of liabilities by around EUR 54.5 million. Net assets held in the form of portfolio investments stood at EUR 103.1 million. The non-debt-creating inflows provided the main contribution to the financing of the current deficit, while debt-creating inflows produced reversed contributions. The overall balance of payments resulted in the reduction of foreign reserve assets by EUR 49.6 million. At the end of 2016 Q1, the stock of foreign exchange reserves was around EUR 2.8 billion, sufficient to cover 7.3 months of imports of goods and services and 189% of the short-term gross external debt.

## II. CURRENT ACCOUNT

The net position of the current account resulted in a deficit of EUR 257.7 million in 2016 Q1, expanding by around 7.6% in annual terms. It was estimated at 10.7% of nominal GDP, approximately 0.1 percentage points higher than in the same quarter of the previous year. In terms of contributions, the deepening of the trade deficit in goods determined to a large extent the annual expansion. The narrowing of the surplus in the secondary income account provided an added contribution to the expansion of the overall deficit. Services and primary income accounts provided opposite contributions.

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



Source: Bank of Albania

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 deficit<sup>2</sup>. This trend continued for the fourth consecutive quarter

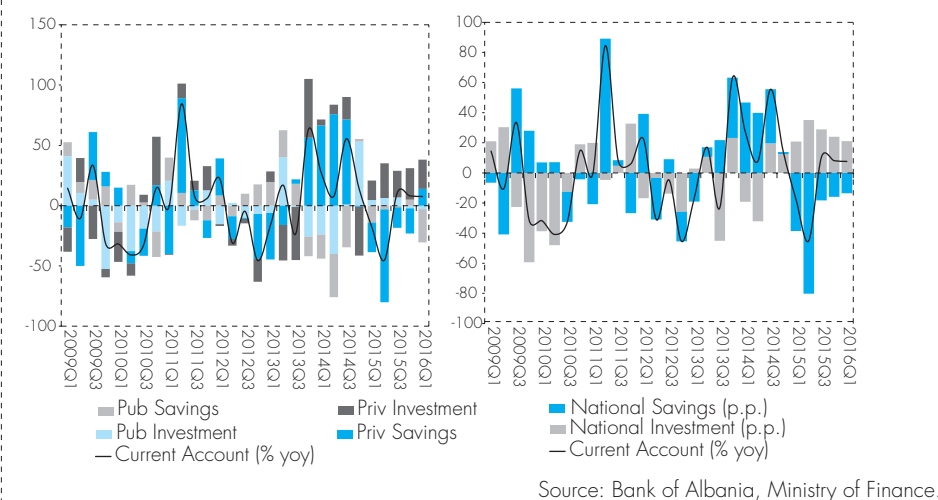
The private sector gap was estimated at 14.7% of nominal GDP, deepening by around 3.1 percentage points, compared to the same quarter a year earlier. Both private investments and savings contributed within this item. Private investments were estimated at 21.2% of GDP, around 1.2 percentage points higher than in the previous year. On the other hand, private savings to GDP narrowed by 1.9 percentage points, in annual terms. Public savings expanded considerably and were estimated at 6.6% of nominal GDP, increasing by 2.5 percentage points, in annual terms. Public investments lost around 0.5 percentage points in their ratio to GDP, estimated at 2.7%.

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 23.9% of nominal GDP, expanding by 0.8 percentage points, year-on-year. National savings were estimated at 13.1% of GDP, around 0.6 percentage point higher, compared to the first quarter in the previous year.

<sup>2</sup> 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 national investments and savings to GDP (left) and their contribution to the annual change of current account deficit (right)

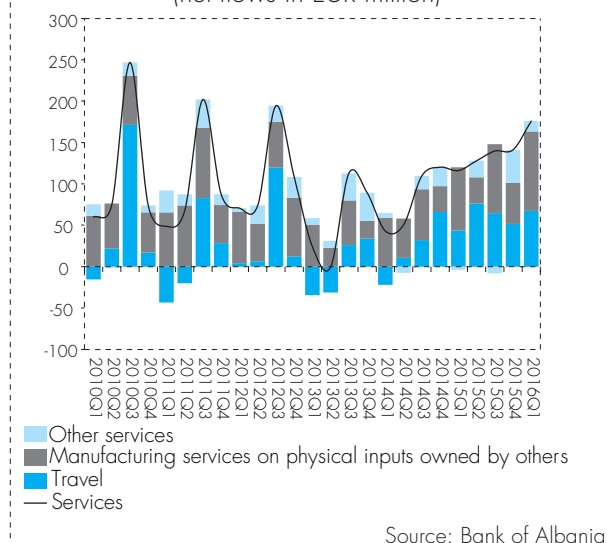


The net balance of services recorded an expansion of its surplus during the period under review. Net income from services resulted around EUR 175.9 million, from around EUR 116 million in the same quarter of the previous year. Net income increased by around 51.6%, in annual terms. The expansion of the services' export by around 14.6% in annual terms provided a considerable contribution to this performance. On the other hand, services' imports expanded by 0.5%. In terms of the nominal GDP, the net balance of services was estimated at around 7.3%. 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 higher compared to the previous year. The net position expanded at EUR 67.3 million, from EUR 43.6 million in the same period of the previous year.

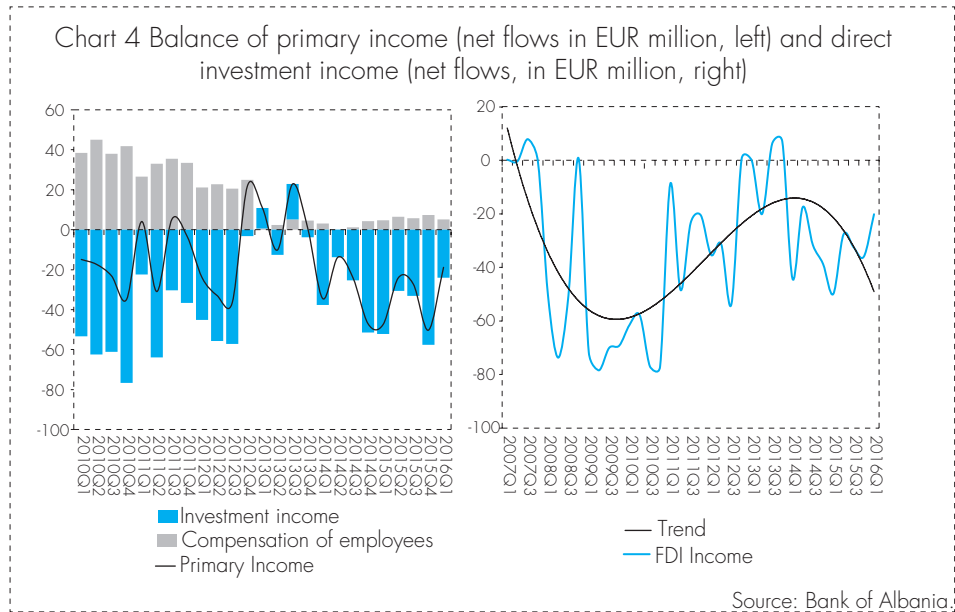
The net balance of primary income account was negative. This trend characterized this account throughout 2014, and continued during 2015. Net foreign-currency inflows in this account resulted in EUR 18.8 million deficit, from EUR 47.4 million, in the same period a year earlier. The recorded deficit was estimated at around 0.8% 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, the deficit of net income from 'foreign direct investment' determined the overall balance. This deficit narrowed by around 59.7%, in annual terms. The reduction in outflowing income was the main determinant in this performance. On the other hand, income account surplus from 'portfolio

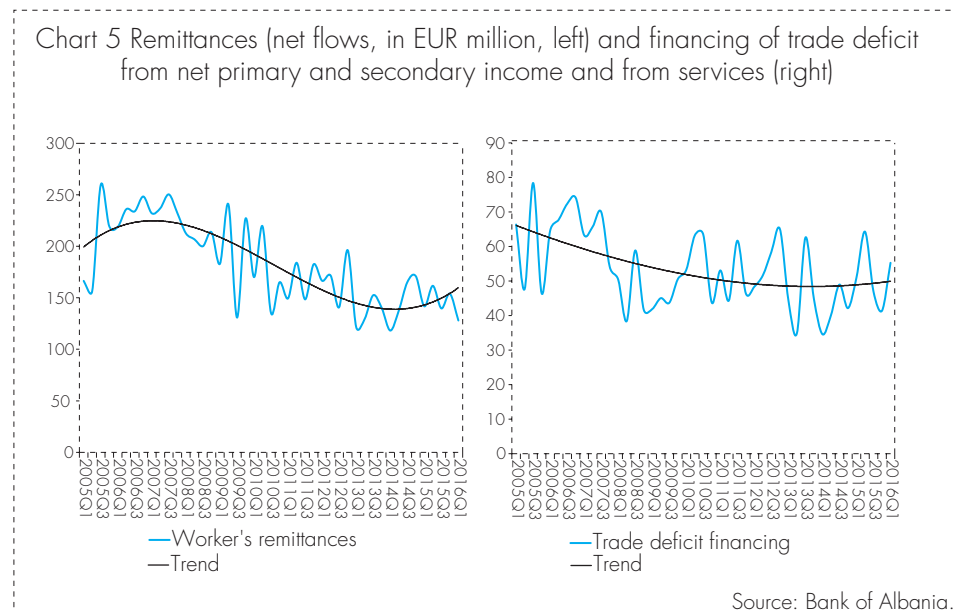
Chart 3 Main items in services account (net flows in EUR million)



investment' slightly narrowed compared to the previous year (around EUR 0.5 million). The deficit of 'other investment sub-item showed a slight narrowing trend.



The net balance in the surplus of secondary income account was reduced compared to the same quarter a year earlier, following the same dynamic as the previous quarter. Secondary income surplus was estimated at EUR 161.3 million, down by around 10.7% in annual terms.



In terms of the nominal GDP, the foreign currency flows in the secondary income account were estimated at 6.7%, down by around 1.3 percentage points, in annual terms. The decline of remittances' flows provided the main contribution to this performance. In 2016 Q1, they stood at EUR 128 million, down by 9.7% year-on-year.



Net cumulative income from services account, primary income account and secondary income account financed around 55.3% of the trade deficit. This ratio expanded by 4.3 percentage points compared to 2015 Q1, and by 13.9 percentage points compared to 2015 Q4.

### 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 transfers<sup>3</sup> between residents and non-residents (on which there is no economic value in the exchange). In 2016 Q1, capital account surplus was around EUR 6.6 million, down by around EUR 19.4 million, year-on-year. Net capital flows in this account are estimated at 0.3% of nominal GDP. Net capital transfers for the account of 'central government' amounted to EUR 11.5 million, while those in 'financial and non-financial corporates', 'households and non-profit institutions serving households' were about EUR -4.9 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 251.2 million, which is financed from the financial account and 'errors and omissions'.

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<sup>3</sup> 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.

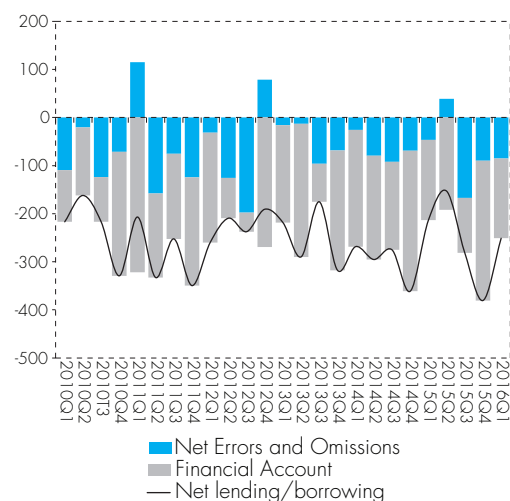
## IV. FINANCIAL ACCOUNT

The net position of financial account, recorded a decrease in assets owned by residents, by around EUR 165.9 million, in 2016 Q1. This result represents a narrowing of the net borrowing position of residents against non-residents, by around 0.9%, in annual terms. Net foreign currency flows in the form of increased financial liabilities were estimated at around 6.9% of nominal GDP, and financed about 64.4% of the current deficit recorded during this period.

Financial inflows in the form of residents' liabilities to non-residents amounted to EUR 262.2 million, or EUR 72.6 million lower compared to the same quarter in the previous year. The decrease in liabilities was mainly attributable to higher inflows of the portfolio investment and the decrease in Foreign Direct Investments flows. Other investments affected the expansion of the financial deficit. In 2016 Q1, the total Albanian assets were EUR 96.3 million, around EUR 71.2 million lower compared to the same quarter a year earlier. This performance was driven by the lowering in assets of other investments and the decreased foreign reserve assets.

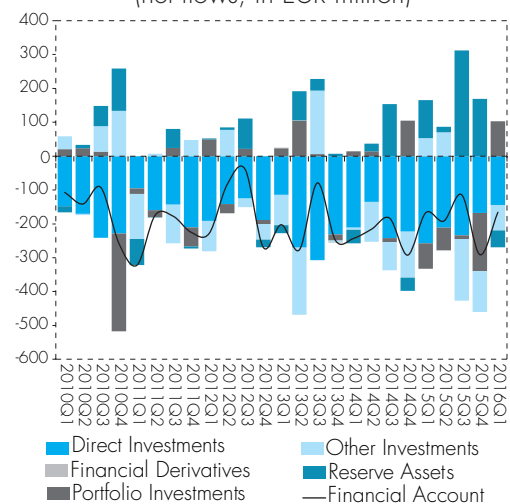
The net foreign direct investments continued the downward trend, in terms of annual change, for the third consecutive quarter. The annual fall stood at 44%. Net FDIs ratio to nominal GDP was estimated at 6.1%, or 2.3 percentage points lower from the same period in the previous year.

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

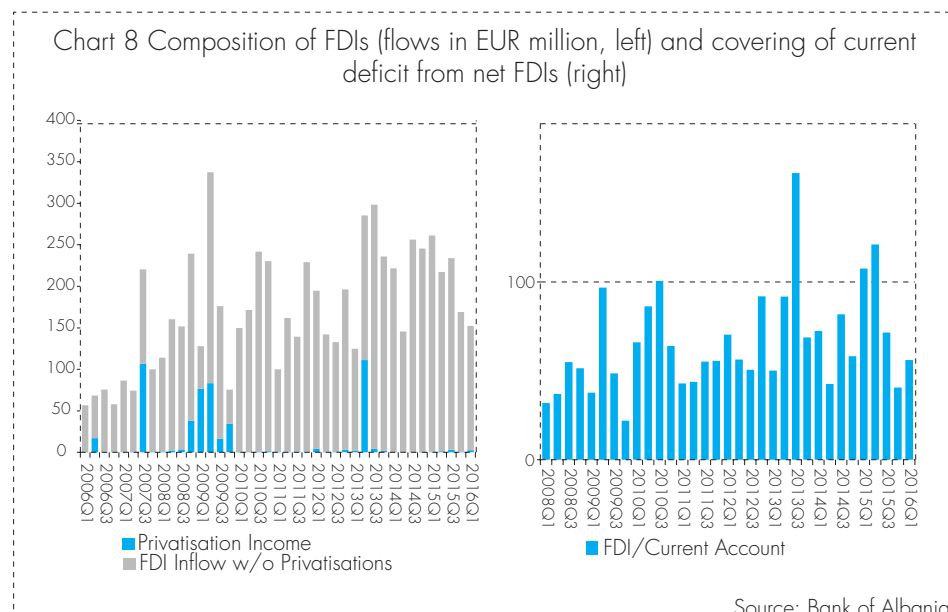


Source: Bank of Albania.

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



Source: Bank of Albania.



Broken down by instruments of investment<sup>4</sup>, 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. Liabilities related to 'reinvested profit' also decreased in annual terms.

In the long run, FDIs constitute an important foreign currency inflow in financing the current deficit of Albania. In 2016 Q1, the ratio of net FDI flows financed 56% of the recorded current deficit. This ratio was 51.5 percentage points lower than the same quarter a year earlier, and 15.5 percentage points higher compared to the previous quarter.

Net portfolio investments recorded a positive balance, for the first time, after four quarters of deficit. Net return of assets owned by residents was EUR 103.1 million, while a year earlier these assets decreased by EUR 74.7 million. For the period under review, residents' assets (depositing corporates, excluding the Bank of Albania) invested abroad rose by around EUR 159.8 million. Liabilities, in the form of portfolio investments of non-residents in the domestic economy, decreased by around EUR 18 million. Investments, in the form of equity and shares in investment funds by non-residents, decreased in this quarter, compared to the previous year, 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 75 million, by reflecting the Albania's increased liabilities to non-residents. Albanian assets invested abroad stood at EUR 45.1 million, while liabilities to non-residents were estimated at EUR 120.1 million. 'Net currency and deposits' sub-item resulted in a net negative

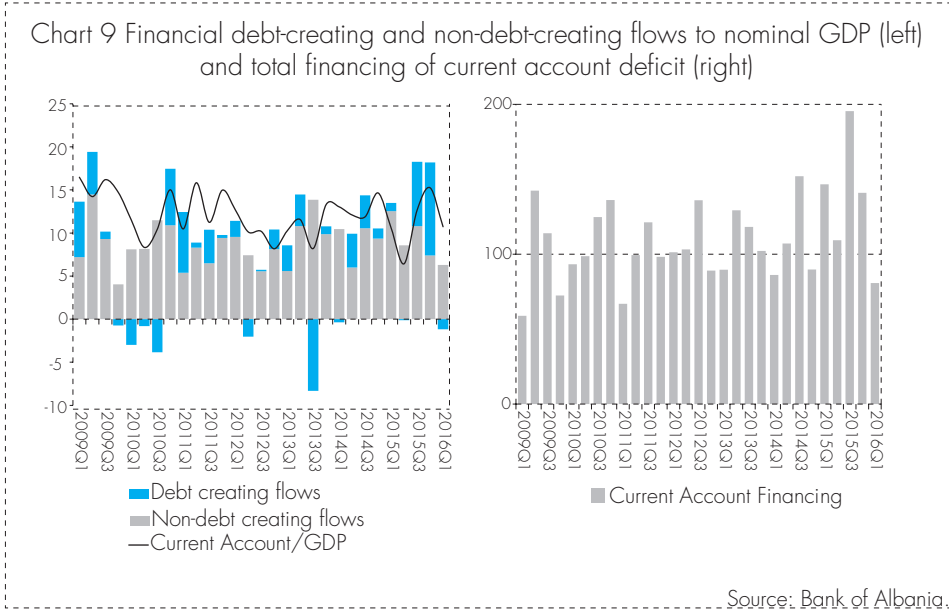
<sup>4</sup> In accordance with BPM6 standards, direct investments are realised through three main instruments: 1. shareholders capital in investment funds; 2. reinvested earnings; 3. debt instruments.

balance of EUR 4.3 million, from EUR 12.3 million in the same period in the previous year. Total liabilities in the form of loans recorded EUR 85.6 million, expanding by EUR 22.6 million compared to a year earlier. This increase was mainly attributable to the external borrowing of other sectors and slightly of the central government. By contrast, pre-depository corporations reduced the flow for 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 inflows<sup>5</sup>. Thus, non-debt-creating financial flows from net foreign direct investments and from the capital account were estimated at 6.3% of nominal GDP, around 6.3 percentage points lower compared to the previous year. The debt-creating financial flows were estimated at -1.2% of nominal GDP, down by around 2.1 percentage points, compared to the previous year.

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. In this quarter, the ratio of current account financing stood at 80.8% reflecting a decrease in the foreign exchange reserve stock. 'Errors and omissions' constituted 1/3 of the recorded current deficit.

The overall balance of payments resulted in the reduction of foreign reserve



assets by EUR 49.6 million. At the end of March, the stock of foreign currency reserve was around EUR 2.8 billion. This level was sufficient to cover 7.3 months of imports of goods and services and 189% of the short-term external debt.

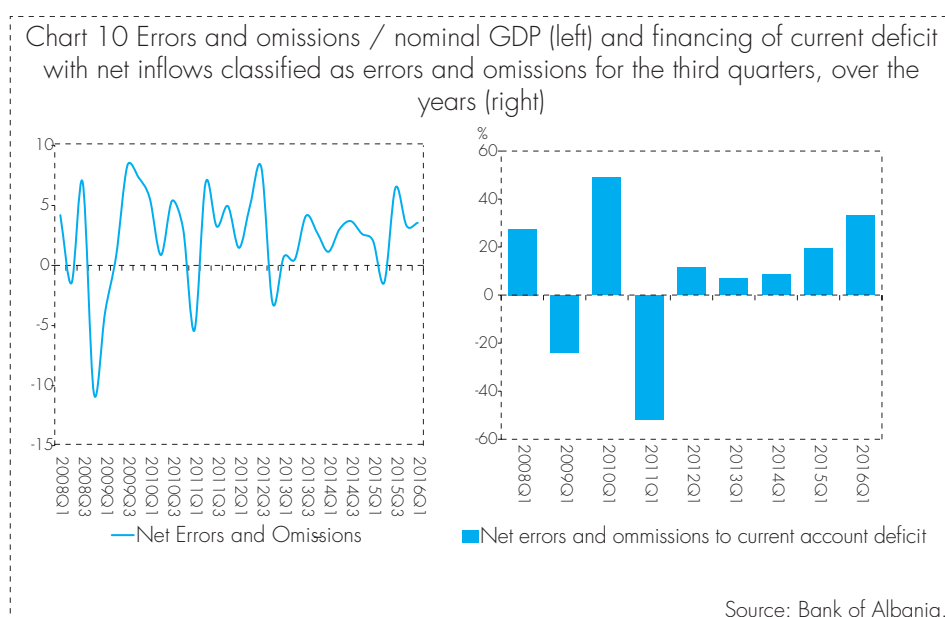
As a result of problems that may be encountered in sources of information

<sup>5</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 whereas portfolio investment and other net investment are included in debt-creating flows.

## V. ERRORS AND OMISSIONS

and during the compilation of external sector statistics, the balance of payments may feature discrepancies.

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 2016 Q1, 'net omissions and errors' recorded the positive rate of EUR 85.3 million, estimated at around 3.5% of nominal GDP.