

Bank of Albania

ANALYSIS OF DEVELOPMENTS
IN THE EXTERNAL SECTOR
OF THE ECONOMY

2016 Q2

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 HIGHLIGHTS¹

The net position of the current account recorded a deficit of EUR 353.8 million in 2016 Q2, expanding by about 116.7%, annually. It was assessed at 12.5% of nominal GDP, about 6.5 percentage points higher than in the same quarter a year earlier. By current account items, the worsening of trade deficit in goods with additional influences from the services account and primary income contributed to the expansion side. The exports of goods and services expanded by 1.5%, whereas imports increased by around 19.3%, in annual terms. The net positive balance of the secondary income expanded by 3.0%, annually, mainly due to the contribution of the public sector. On the other hand, net remittances continue their downward trend, in annual terms. Remittances' inflows continued to fall, in annual terms, for the fourth consecutive quarter, decreasing by 5.5%. The primary income deficit expanded, in annual terms, contributing upward to the annual performance of the current account deficit. Under the structural approach, as measured by the national gap between saving and investments, the private sector had the main contribution in the formation of the current deficit.

Table 1 Balance of payments indicators (in EUR million)

	Q4 '14	Q1 '15	Q2 '15	Q3'15	Q4 '15	Q1 '16	Q2 '16
Current account (in EUR million)	-382.5	-230.9	-163.2	-312.7	-397.7	-224.2	-353.8
yoy (%)	13.9	-20.7	-48.6	5.7	4.0	-2.9	116.7
/GDP (%)	-14.6	-10.2	-6.0	-12.1	-14.7	-9.3	-12.5
Goods and services	-540.8	-372.9	-360.6	-476.3	-564.5	-403.3	-555.2
yoy (%)	4.3	-7.2	-24.8	1.3	4.4	8.2	54.0
Exports, f.o.b	720.0	593.5	705.9	785.0	714.7	608.5	716.8
yoy (%)	-7.0	2.9	-1.0	-2.3	-0.7	2.5	1.5
Imports, f.o.b.	1260.8	966.4	1066.5	1261.4	1279.1	1011.9	1272.0
yoy (%)	-2.5	-1.2	-10.5	-1.0	1.5	4.7	19.3
Net Trips	66.0	43.6	76.4	64.5	51.6	67.3	72.8
Primary income	-47.1	-38.8	-12.9	-12.8	-34.2	10.0	-15.1
Credit	30.5	36.4	34.5	40.0	43.9	50.8	44.9
Debit	77.6	75.2	47.4	52.8	78.1	40.7	60.1
Net Direct Investment income	-38.7	-50.5	-26.4	-27.7	-31.7	-3.8	-23.9
Secondary income	205.4	180.7	210.2	176.4	201.0	169.1	216.6
Credit	244.1	211.9	243.3	219.1	247.2	205.0	249.7
Debit	38.8	31.2	33.0	42.6	46.2	35.9	33.2
Net remittances	171.0	141.8	161.7	139.7	153.9	135.7	153.6
yoy (%)	22.1	19.9	17.6	-15.4	-10.0	-4.2	-5.0
Capital account	21.1	26.0	21.3	45.6	32.8	6.6	7.2
Net borrowing/net lending	-361.3	-205.0	-141.9	-267.1	-364.8	-217.7	-346.6
Financial account	-292.5	-163.5	-177.1	-126.6	-243.3	-163.7	-253.6
yoy (%)	17.5	-32.7	-17.9	-30.9	-16.8	0.1	43.2
/GDP (%)	-11.2	-7.2	-6.5	-4.9	-9.0	-6.8	-9.1
Direct investments	-222.8	-253.9	-196.5	-248.1	-120.0	-143.6	-240.1
yoy (%)	-3.6	20.3	45.0	2.4	-46.1	-43.4	22.2
Portfolio investments	105.1	-74.7	-66.8	-11.2	-172.1	107.5	-8.7
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investments	-135.9	53.3	70.0	-179.7	-120.3	-77.9	-4.8
Reserve assets	-38.9	111.8	16.2	312.5	169.1	-49.6	0.0
Errors and omissions	68.9	41.5	-35.2	140.5	121.5	54.0	93.0

Source: The Bank of Albania.

¹ The latest data on the balance of payments are as of 2016 Q2. As of 2014 Q1, the Bank of Albania prepares the Balance of Payments Statistics, in compliance with the IMF's BPM6 standards. The main differences between the actual and previous methodologies are synthesised in the Commentary for changes in the publication of external sector statistics according to BPM6:

For the purposes of analysis, the Balance of Payments data, from 2002 to 2012, are reclassified in line with the new methodology by the Monetary Policy Department.

Net inflows in the capital account recorded EUR 7.2 million standing EUR 14.1 million lower compared to the same quarter a year earlier. The net position in the financial account indicates an expansion of the debt position by about 43.2%, in annual terms. Net inflows in the capital and financial accounts managed to cover 73.7% of the current account deficit. Errors and omissions covered the rest of this deficit. Net direct investments increased by 22.2%, in annual terms. Other net investments reflect EUR 4.8 million net debt position. Net assets held in the form of portfolio investments stood at EUR -8.7 million. In terms of the current deficit financing, non-debt creating flows remain the major contributors, whilst debt-creating flows increased, compared with the previous year. The overall balance of payments resulted in almost unchanged reserves assets. At the end of 2016 Q2, the stock of foreign exchange reserves was EUR 2.83 billion, sufficient to cover 7 months of import in goods and services and 170% of the short-term gross external debt.

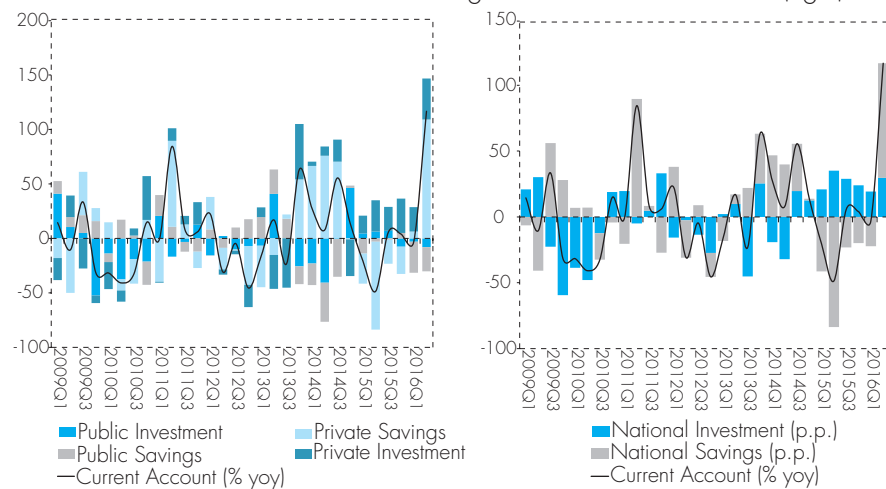
II. CURRENT ACCOUNT

The net position of the current account recorded a deficit of EUR 353.8 million in 2016 Q2, expanding by 116.7%, annually. It was assessed at 12.5% of nominal GDP, about 6.5 percentage points higher than the same quarter a year earlier. Under the structural approach, as measured by the gap in the national savings and investments, the gap between savings and investments in the private sector contributed most to the formation of the current account deficit². This trend had also characterized the formation of the current deficit in previous quarters.

The private sector gap was estimated at 13.3% of GDP, deepening by around 8.2 percentage points, compared to the same quarter a year earlier. These dynamics were mainly influenced by the private savings behaviour. Their ratio to nominal GDP recorded 8%, down by 6.9 percentage points, in annual terms. On the other hand, private investments were estimated at 21.2% of GDP, around 1.3 percentage points higher than in the previous year. Public savings expanded by 1.1 percentage points in their ratio to GDP whilst public investments ratio diminished by 0.7 percentage point.

National savings gave the major contribution to the deepening of the current deficit. They were estimated at 12.6% of GDP, decreasing by 5.8 percentage points, year-on-year. National investments were estimated at 25% of GDP, around 0.7 percentage points higher, compared to the second quarter of the previous year.

Grafik 1. Annual gap in p.p. of national savings and investments to GDP (left) and their contribution to the annual change of current account deficit (right)



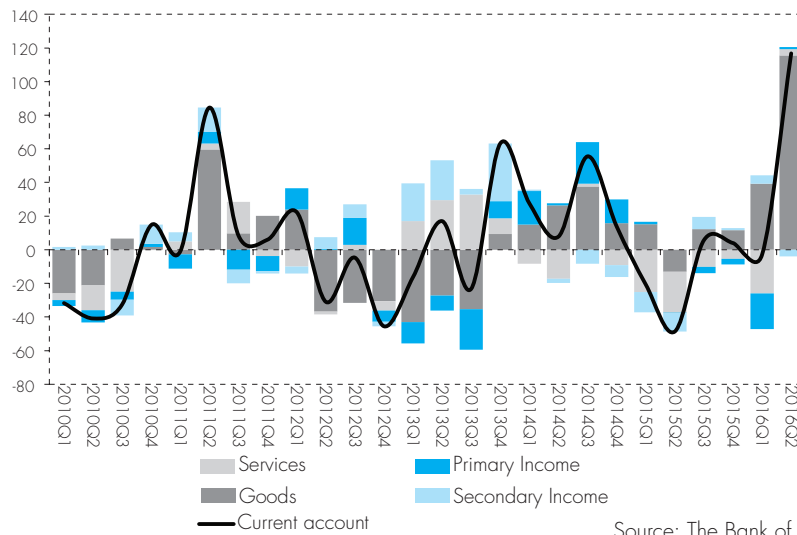
Source: Bank of Albania, Ministry of Finance.

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

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

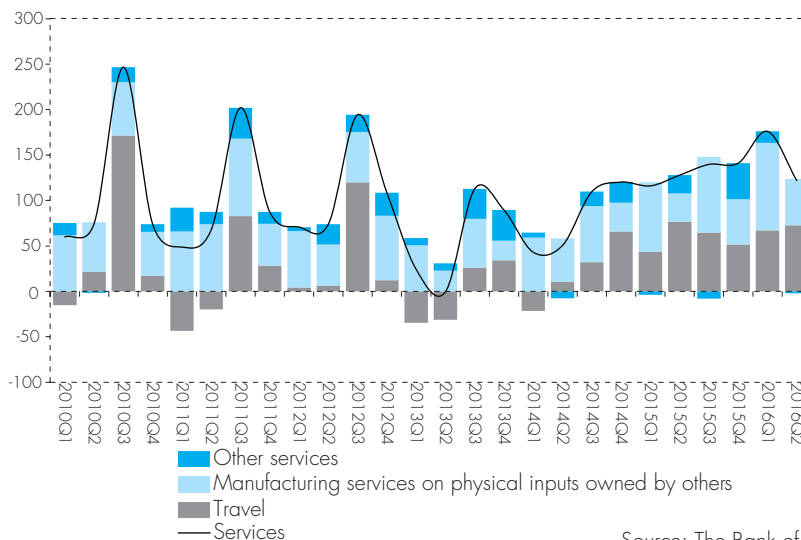
In terms of contributions, the deepening of the trade deficit in goods determined largely the annual expansion. Supplementary contributions have arisen from the services and primary income sub-accounts. The only contribution to the narrowing side of the current deficit is relevant to the secondary income sub-account.

Grafik 2. Contribution by category (in p.p.) to the annual current deficit (%)



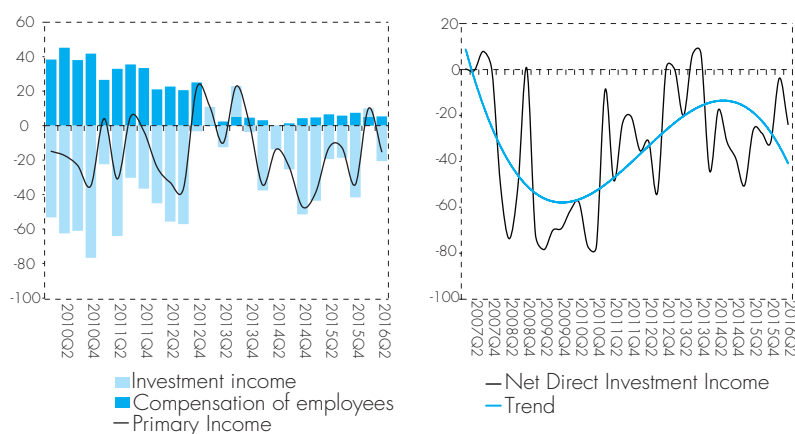
The net balance of the services account recorded a shrinking of its surplus during the period under review. Net income from services resulted around EUR 121.8 million, from around EUR 127.9 million in the same quarter of the previous year. Net income from services decreased by 4.7%, in annual terms. The expansion of imports in services by around 22.3%, in annual terms, provided a considerable contribution to this performance. Services' exports also increased, year-on-year, but this increase was insufficient to offset the impact from the performance of imports. In terms of nominal GDP, the net balance of services account was estimated at 4.3%, with travel services providing the main contributions. Net income from travel services, including net flows from tourism, resulted lower compared to the previous year. The net position narrowed at EUR 72.8 million, from EUR 76.4 million in the same period of the previous year.

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



The net balance of the primary income account was negative. This trend characterized this account during 2014 and 2015 (excluding 2016 Q1, where the balance was in surplus). Net foreign-currency inflows in this account resulted in EUR 15.1 million deficit, from EUR 12.9 million, in the same period a year earlier. The recorded deficit was estimated at 0.5% of nominal GDP, largely determined by the account of investments income.

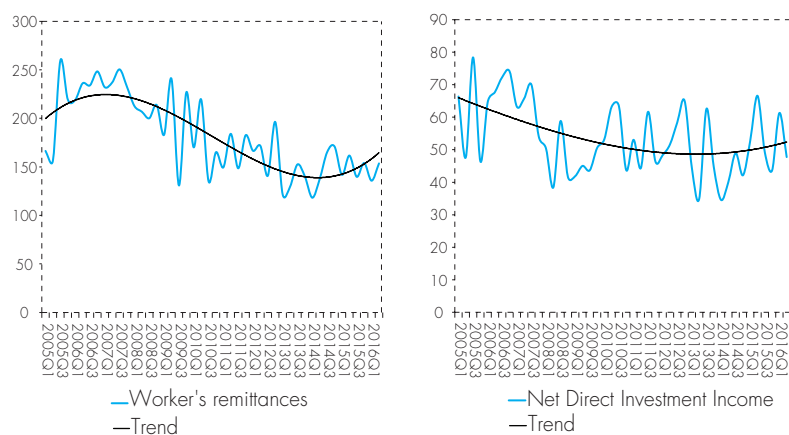
Grafik 4. Balance of primary income (net flows in EUR million, left) and direct investment income (net flows, in EUR million, right)



Source: The Bank of Albania.

The net surplus balance of the secondary income account expanded compared to the same quarter a year earlier. The relevant surplus was estimated at EUR 216.6 million, up by around 3.0% in annual terms, driven by higher net inflows from the public sector, up by EUR 12.8 million annually. Meanwhile, net inflows of remittances continued to decline in annual terms for the fourth consecutive quarter. Net inflows of remittances in 2016 Q2, resulted in EUR 153.6 million, down by 5%, in annual terms.

Grafik 5. Remittances (net inflows, in EUR million, left) and financing of trade deficit from net primary and secondary incomes and from services (right)



Source: The Bank of Albania.

Net cumulative income from services account, primary income account and secondary income account financed around 47.7% of the trade deficit in goods. This ratio narrowed by 13.6 and 18.8 percentage points, respectively, compared to 2016 Q1 and to 2015 Q2.

III. CAPITAL ACCOUNT

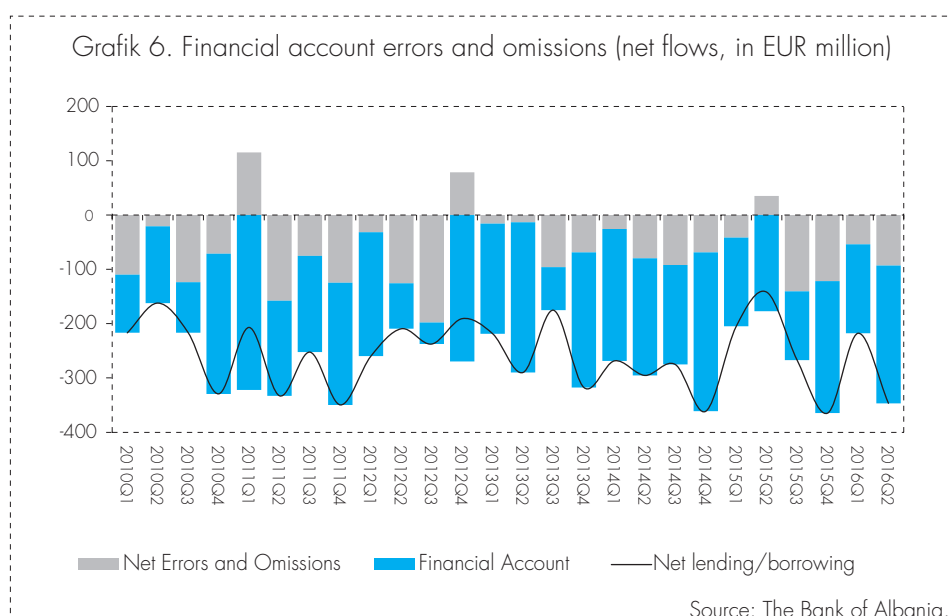
The capital account debits and credits all the transactions for non-produced, non-financial assets/goods and the capital transfers³ between residents and non-residents (on which there is no economic value in the exchange). In 2016 Q2, the capital account's positive surplus was around EUR 7.2 million, down by around EUR 14.1 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 "general government" amounted to EUR 8.6 million, whereas those of "financial and non-financial corporates", "households and non-profit institutions serving households" were about EUR -1.4 million.

The combination of net non-financial transactions of the current and capital accounts 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 of around EUR 346.6 million, which is financed by the net income in the financial account and "errors and omissions".

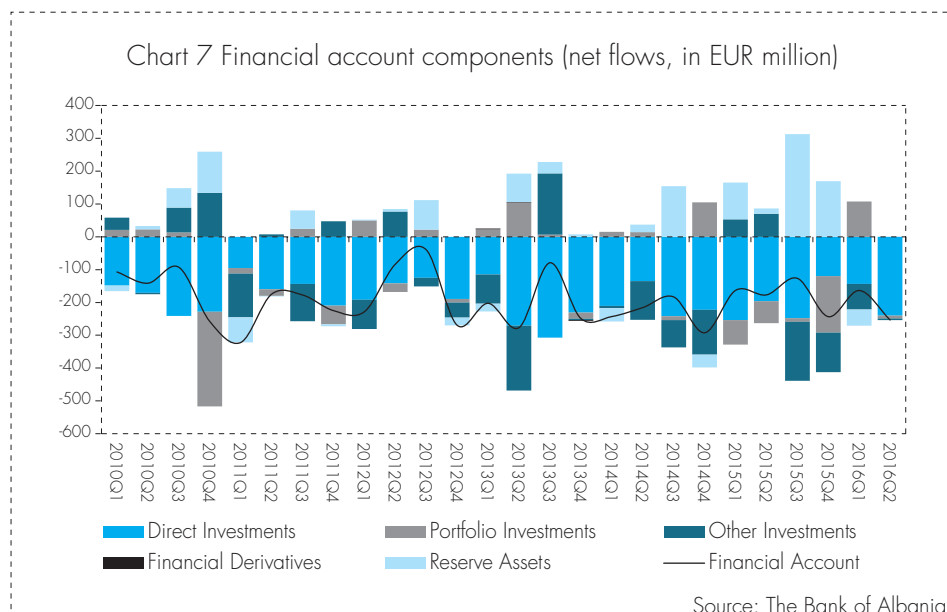
³ Capital transfers consist of: 1. debt forgiveness; 2. non-life insurance claims; 3. grants; 4. guarantees; 5. taxes (for inheritance, gifts, etc.); 6. other capital transfers.

IV. FINANCIAL ACCOUNT

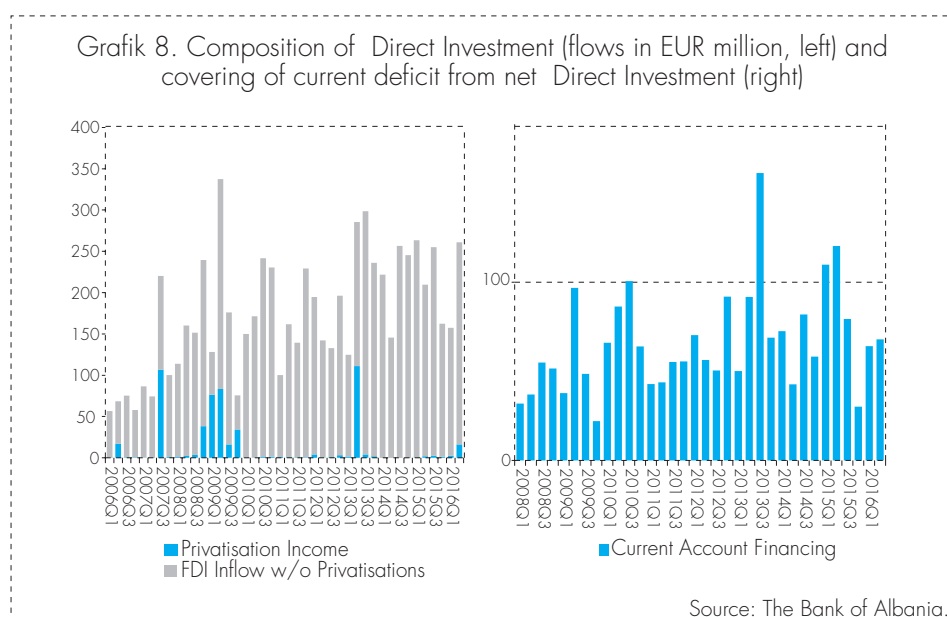
The financial account records a debtor position of EUR 253.6 million for 2016 Q2. This result represents an expansion of the net borrowing position of residents to non-residents, by 43.2%, in annual terms. Net foreign currency flows in this account were estimated at around 8.9% of nominal GDP, and financed around 71.7% of the current deficit, recorded during the period under review.



Financial inflows in the form of residents' liabilities to non-residents amounted EUR 307.3 million. They resulted in EUR 57.2 million higher compared to the same quarter in the previous year. The increase in liabilities was mainly attributable to the increase of direct investment and other investment in flows. On the other hand, liabilities in the form of portfolio investment, decreased. During this quarter, the total flows of Albanian assets were EUR 53.8 million, around EUR 19.3 million lower, compared to the same quarter a year earlier. This trend was determined by the reduction of assets in the form of other investments. On the other hand, assets in the form of direct investments and portfolio investments are higher compared with a year earlier.



Net direct investments showed an expansion trend, in annual terms, for the first time after several quarters, at 22.2%, in annual terms. Net Direct Investment to nominal GDP ratio was estimated at 8.5%, standing 1.2 percentage points higher than in the same period in the previous year.

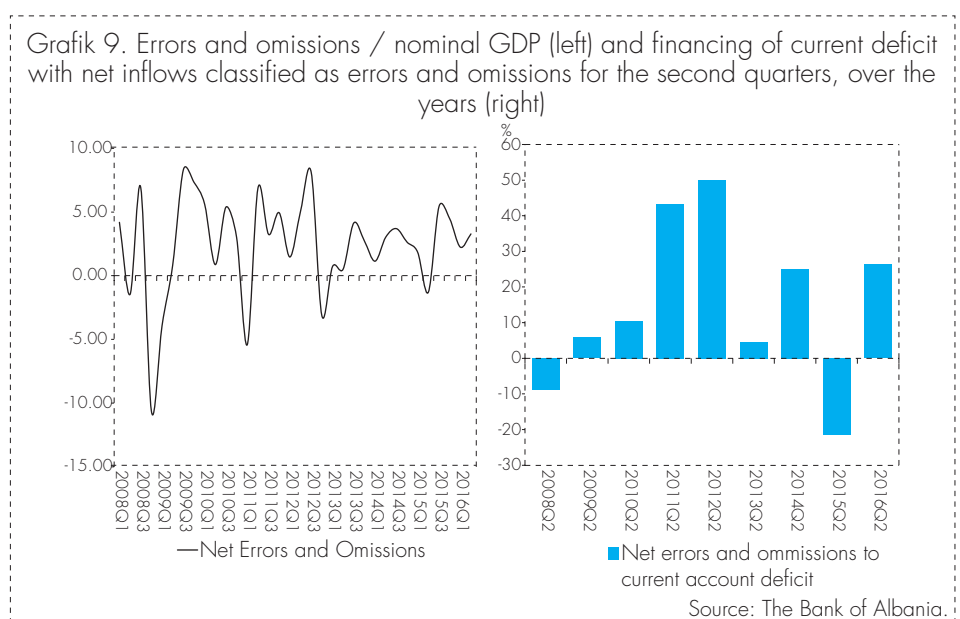


In the long run, Direct Investment constitute an important foreign currency inflow in financing the current deficit of Albania. For this quarter, the ratio of net Direct Investment flows financed around 67.9% of the recorded current deficit. This ratio was 52.5 percentage points lower than in the same quarter a year earlier, and 3.8 percentage points higher compared to the previous quarter.

Net portfolio investments recorded a negative balance of EUR 8.7 million, or EUR 58.1 million lower compared with a year earlier. This is largely determined by the increase in domestic assets by EUR 51.6 million, and more specifically by the increase at around EUR 48.6 million in assets in the form of debt instruments. On the other hand, liabilities reduced by EUR 6.5 million compared with a year earlier. The reduction of liabilities in the form of "equity and investment fund shares" contributed to this performance. Regarding liabilities held by non-residents in the form of debt instruments, the flow expanded by about EUR 5.9 million, in annual terms.

The net balance of other investments account shows a net borrowing position of EUR 4.8 million, about EUR 74.7 million lower compared with a year earlier. Domestic assets invested in foreign economies stood at EUR 36.7 million, while liabilities to non-residents were estimated at EUR 41.5 million. "Currency and deposits" resulted in a negative balance of EUR 22.5 million, compared to the positive balance of EUR 121.8 million in the same period in the previous year. Total liabilities in the form of loans recorded EUR 7.3 million, down by EUR 11.1 million compared to a year earlier. The general government remains the main contributor to the total flow and the main determinant in its annual change. Also, other sectors resulted in reduced liabilities compared to the previous year.

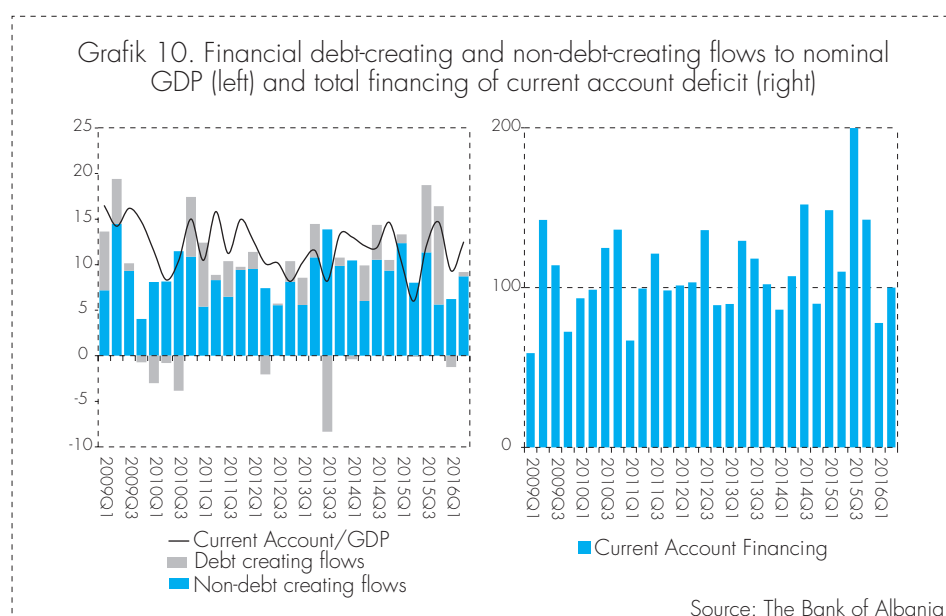
The overall balance of payments resulted in an almost unchanged level of reserve assets. At the end of June, the stock of the foreign exchange reserve stood at EUR 2.83 billion. This level was sufficient to cover 7 months of imports in goods and services and 170% of the short-term gross external debt. As a result of problems that may arise from data sources and during the compilation of external sector statistics, the balance of payments may feature discrepancies. 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 Q2, "net omissions and errors" recorded the positive rate of EUR 93 million, estimated at around 3.3% of nominal GDP.



V. PROFILE OF CURRENT DEFICIT FINANCING

Regarding the profile of the current deficit financing, it is important to monitor the reliance on debt-creating inflows rather than on the more desirable non-debt-creating inflows⁴. Thus, non-debt-creating financial flows from net direct investments and from the capital account were estimated at 8.7% of nominal GDP. These were 0.7 percentage point higher compared with a year earlier and debt-creating financial flows were estimated at 0.5% of nominal GDP, expanding by around 0.7 percentage point, compared to the previous year.

The overall financing of the current deficit is calculated 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 the current account financing stood at 100%, implying an almost constant situation in the foreign exchange reserve stock. The ratio of errors and omissions to current deficit was about 26.3%.



⁴ This breakdown serves to monitor the impact of financial and capital flows on Albanian's external debt. Non-debt creating flows include direct investments and net flows of the capital account, whilst debt-creating flows include portfolio investments and other net investments.