

Bank of Albania

ANALYSIS OF DEVELOPMENTS  
IN THE EXTERNAL SECTOR  
OF THE ECONOMY

2016 Q3

*ENIAN ÇELA*  
MONETARY POLICY DEPARTMENT

FEBRUARY 2017

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
<i>II. CURRENT ACCOUNT</i>	6
<i>III. CAPITAL ACCOUNT</i>	10
<i>IV. FINANCIAL ACCOUNT</i>	11
<i>V. PROFILE OF CURRENT DEFICIT FINANCING</i>	14

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

*The net position of the current account recorded a deficit of EUR 207.6 million in 2016 Q3, narrowing by around 33.6% annually. It was estimated at 7.7% of the nominal GDP, approximately 4.4 percentage points lower than in the same quarter of the previous year. By current account items, the improved services account and secondary income with supplementary contribution from primary income contributed to the narrowing side.*

*On the other hand, goods trade account contributed to the expansion side. The exports of goods and services expanded by around 18.1%, while imports increased by around 6.1%, in annual terms. The net positive balance of the secondary income expanded by 18.9%, in annual level. Remittances provided the main source in this performance. Remittances inflows increased in annual terms, for the first time after one year. The annual growth was 13.5%. The primary income deficit narrowed, in annual terms, contributing downward to the annual performance of the current account deficit. Under the structural approach, as measured by the gap between national savings and investments, the private sector had the main contribution to the formation of the current deficit.*

---

<sup>1</sup> *The latest data on the balance of payments are as of 2016 Q3. As of 2008 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 related with these changes are available in the following document: [https://www.bankofalbania.org/web/pub/01\\_commentary\\_for\\_changes\\_in\\_the\\_publication\\_of\\_external\\_sector\\_statistics\\_according\\_to\\_bpm6\\_june\\_2014\\_6689\\_1.pdf](https://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 analysis, the Balance of Payments data, from 2002 to 2007, are reclassified in line with the new methodology by the Monetary Policy Department.*

Table 1 Balance of payments indicators (in EUR million)

	Q1 '15	Q2 '15	Q3'15	Q4 '15	Q1 '16	Q2 '16	Q3'16
Current account (in EUR million)	-230.9	-163.2	-312.7	-397.7	-224.2	-353.8	-207.6
yoy (%)	-20.7	-48.6	5.7	4.0	-2.9	116.7	-33.6
/GDP (%)	-10.2	-6.0	-12.1	-14.7	-9.4	-12.6	-7.7
Goods and services	-372.9	-360.6	-476.3	-564.5	-403.3	-555.2	-410.9
yoy (%)	-7.2	-24.8	1.3	4.4	8.2	54.0	-13.7
Exports, f.o.b.	593.5	705.9	785.0	714.7	608.5	716.8	926.9
yoy (%)	2.9	-1.0	-2.3	-0.7	2.5	1.5	18.1
Imports, f.o.b.	966.4	1066.5	1261.4	1279.1	1011.9	1272.0	1337.8
yoy (%)	-1.2	-10.5	-1.0	1.5	4.7	19.3	6.1
Net Travel	43.6	76.4	64.5	51.6	67.3	72.8	153.1
Primary income	-38.8	-12.9	-12.8	-34.2	10.0	-15.1	-6.5
Credit	36.4	34.5	40.0	43.9	50.8	44.9	42.7
Debit	75.2	47.4	52.8	78.1	40.7	60.1	49.2
Net Direct Investment income	-50.5	-26.4	-27.7	-31.7	-3.8	-23.9	-21.7
Secondary income	180.7	210.2	176.4	201.0	169.1	216.6	209.8
Credit	211.9	243.3	219.1	247.2	205.0	249.7	250.3
Debit	31.2	33.0	42.6	46.2	35.9	33.2	40.5
Net remittances	141.8	161.7	139.7	153.9	135.7	153.6	159.1
yoy (%)	19.9	17.6	-15.4	-10.0	-4.2	-5.0	13.9
Capital account	26.0	21.3	45.6	32.8	6.6	7.2	3.1
Net borrowing/net lending	-205.0	-141.9	-267.1	-364.8	-217.7	-346.6	-204.5
Financial account	-163.5	-177.1	-126.6	-243.3	-163.7	-253.6	-71.9
yoy (%)	-32.7	-17.9	-30.9	-16.8	0.1	43.2	-43.2
/GDP (%)	-7.2	-6.5	-4.9	-9.0	-6.8	-9.1	-2.7
Direct investments	-253.9	-196.5	-248.1	-120.0	-143.6	-240.1	-276.4
yoy (%)	20.3	45.0	2.4	-46.1	-43.4	22.2	11.4
Portfolio investments	-74.7	-66.8	-11.2	-172.1	107.5	-8.7	-2.1
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investments	53.3	70.0	-179.7	-120.3	-77.9	-4.8	262.7
Reserve assets	111.8	16.2	312.5	169.1	-49.6	0.0	-56.1
Errors and omissions	41.5	-35.2	140.5	121.5	54.0	93.0	132.7
Net lending/net borrowing	-205.0	-141.9	-267.1	-364.8	-217.7	-346.6	-204.5

Source: Bank of Albania.

Net inflows in the capital account amounted to EUR 3.1 million, around EUR 42.5 million lower than in the same quarter of the previous year. The net position in the financial account indicates a narrowing of the debt position by around 43.2% in annual level. Net inflows in the capital and financial accounts managed to cover 36.1% of the current account deficit. Errors and omissions covered the rest of this deficit. Net direct investments expanded by around 11.4%, in annual terms. Other investments reflect net assets at EUR 262.7 million. Net assets held in the form of portfolio investments stood at EUR -2.1 million. The non-debt-creating inflows provided the main contribution to the financing of the current deficit. The overall balance of payments resulted in the reduction of foreign reserve assets by around EUR 56.1 million. At the end of 2016 Q3, the stock of foreign exchange reserves was around EUR 2.76 billion, sufficient to cover 6.8 months of imports of goods and services and 170% of the short-term gross external debt.

## II. CURRENT ACCOUNT

The net position of the current account resulted in a deficit of EUR 207.6 million in 2016 Q3, narrowing by around 33.6% in annual level. It was estimated at 7.7% of nominal GDP, approximately 4.4 percentage points lower than in the same quarter of the previous year. 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 deficit.<sup>2</sup> This trend had also characterized the formation of the current deficit in previous quarters.

The private sector gap was estimated at 6.2% of nominal GDP, narrowing by around 4.2 percentage points, compared to the same quarter a year earlier. The growth in private savings provided the main contribution to this dynamic. Private savings to nominal GDP ratio was 15.4%, expanding by around 5.4 percentage points in annual level. On the other hand, private investments were estimated at 21.5% of GDP, around 1.2 percentage points higher than in the previous year. Public savings expanded by around 1.1 percentage points as a ratio to nominal GDP, while public investments ratio to nominal GDP increased by 0.9 percentage point.

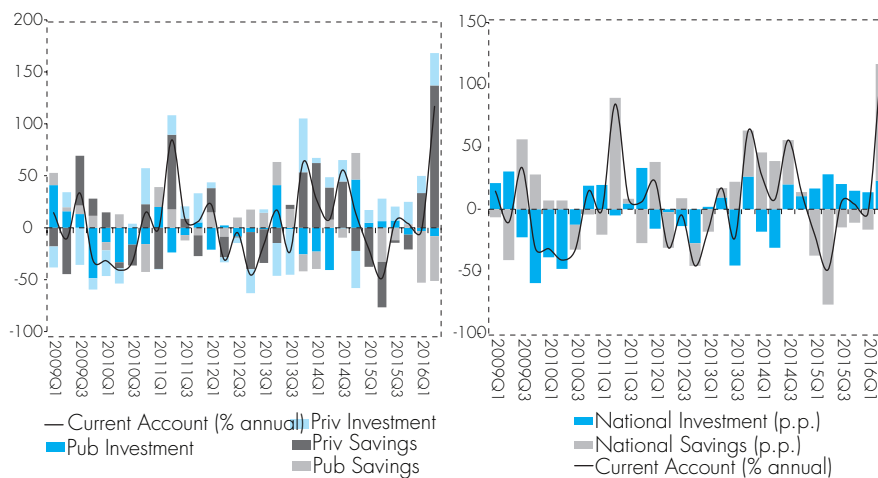
National savings provided the main contribution to the narrowing of the current deficit. They were estimated at 18.9% of GDP, up by 6.5 percentage points, year-on-year.

National investments were estimated at 26.6% of GDP, around 2.1 percentage points higher from the third 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 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  $t$ .

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

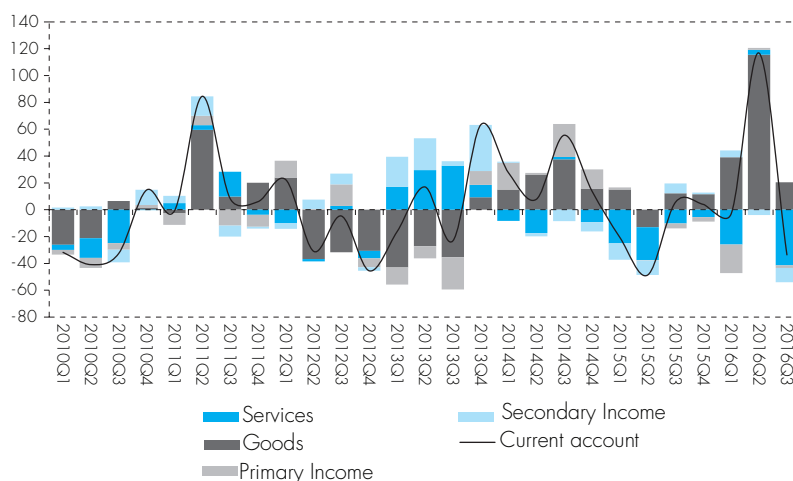
Chart 1 Annual change in p.p. of national investments and savings to GDP (left) and their contribution to the annual change of current account deficit (right)



Source: Bank of Albania, Ministry of Finance.

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

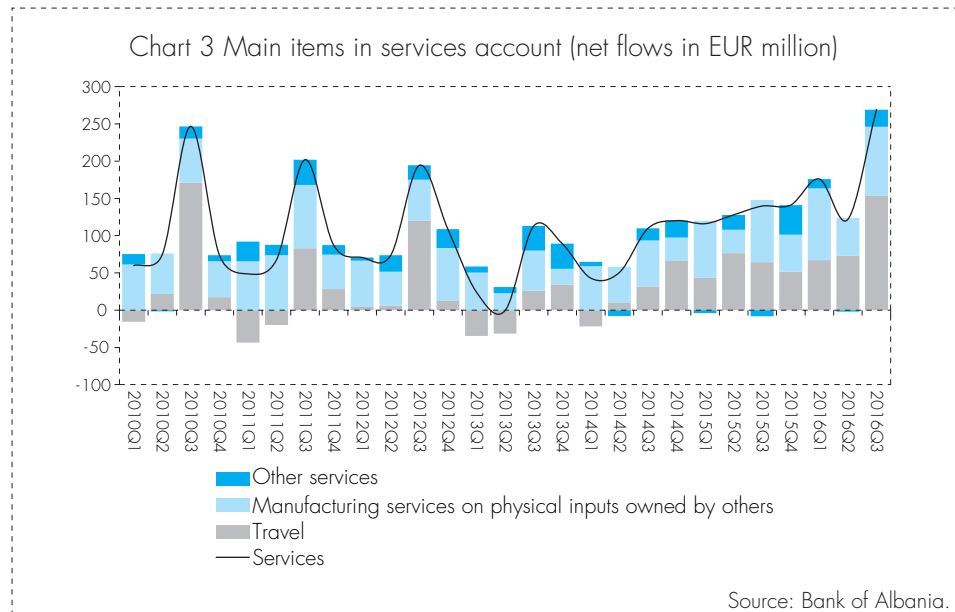
Chart 2 Contribution by category (in p.p.) to the annual current deficit (%)



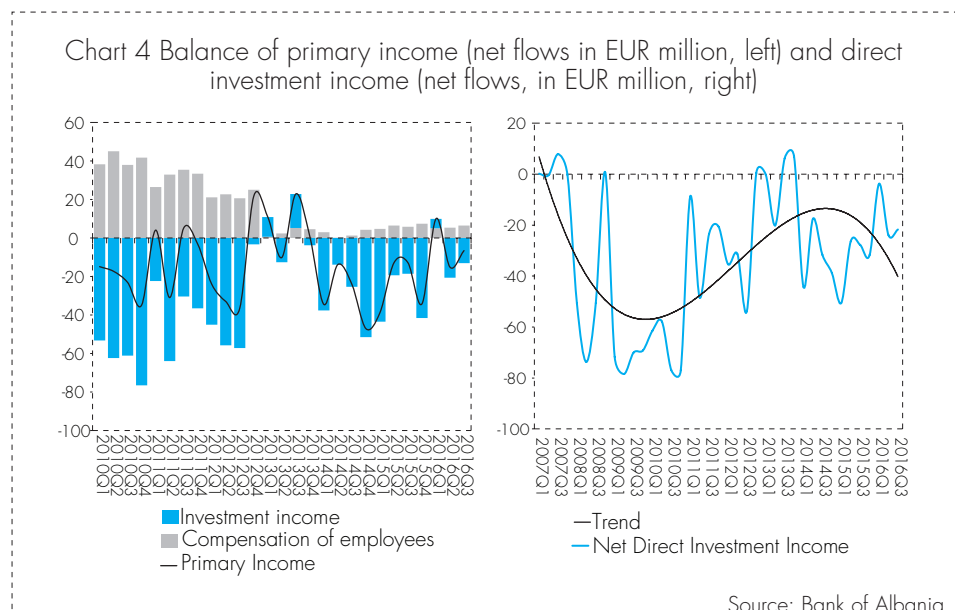
Source: Bank of Albania.

The net balance of the services account recorded an expansion of its surplus during the period under review. Net income from services resulted around EUR 269.1 million, from around EUR 139.7 million in the same quarter a year earlier, up by around 92.6%.

The expansion of export in services by around 24.1%, in annual level, was the main determinant to this performance. On the other hand, imports of services increased by around 3.6% in annual level. In terms of nominal GDP, the surplus in services account was estimated at 10% with travel services providing the main contribution. Net income from travel services, including net flows from tourism, resulted higher compared to the previous year. The net position expanded at EUR 153.1 million, from EUR 64.5 million in the same period of the previous year.

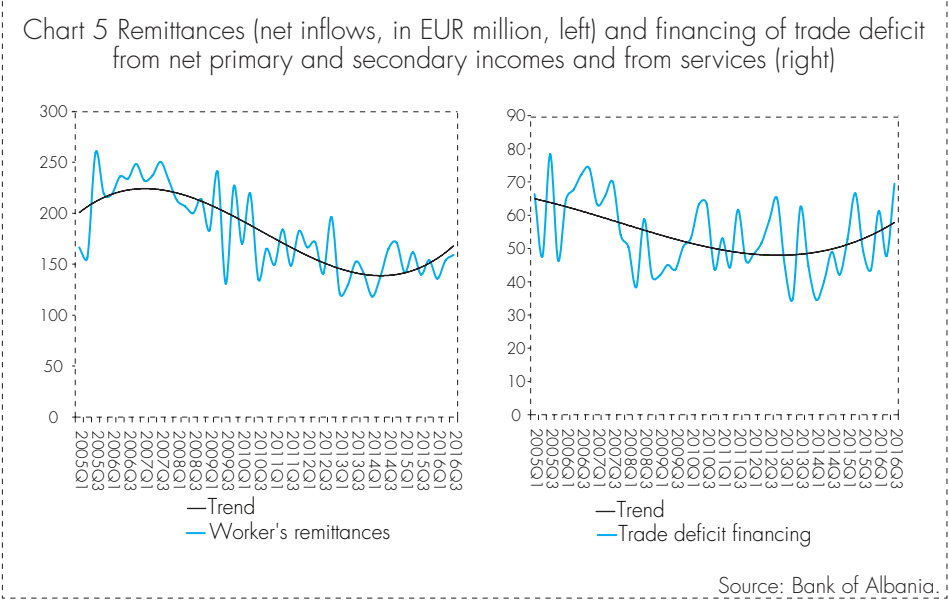


The net balance of the **primary income account** was negative. This trend characterized this account over 2014 and 2015 (excluding 2016 Q1, where the balance was in surplus). Net foreign-currency inflows in this account resulted in EUR 6.5 million deficit, from EUR 12.8 in the same period a year earlier. The recorded deficit was estimated at 0.2% of nominal GDP, mainly determined by the account of investments income.





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 209.8 million, up by around 18.9% in annual terms, driven by higher net inflows of remittances, up by EUR 19.4 million, in annual level. Net inflows of remittances grew by around 13.5% in annual level. These flows increased in annual terms for the first time after one year.



Net cumulative income from services account, primary income account and secondary income account financed around 69.5% of the trade deficit in goods. This ratio expanded by 21.7 and 20.2 percentage points, respectively, compared to 2016 Q2 and to 2015 Q3.

### III. CAPITAL ACCOUNT

*The capital account debits and credits all the transactions for 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 Q3, the capital account's positive surplus was around EUR 3.1 million, down by around EUR 42.5 million, year-on-year. Net capital flows in this account are estimated at 0.1% of nominal GDP. Net capital transfers for the account of "general government" amounted to EUR 9.8 million, whereas those of "financial and non-financial corporates, households and non-profit institutions serving households", were EUR -6.7 million.*

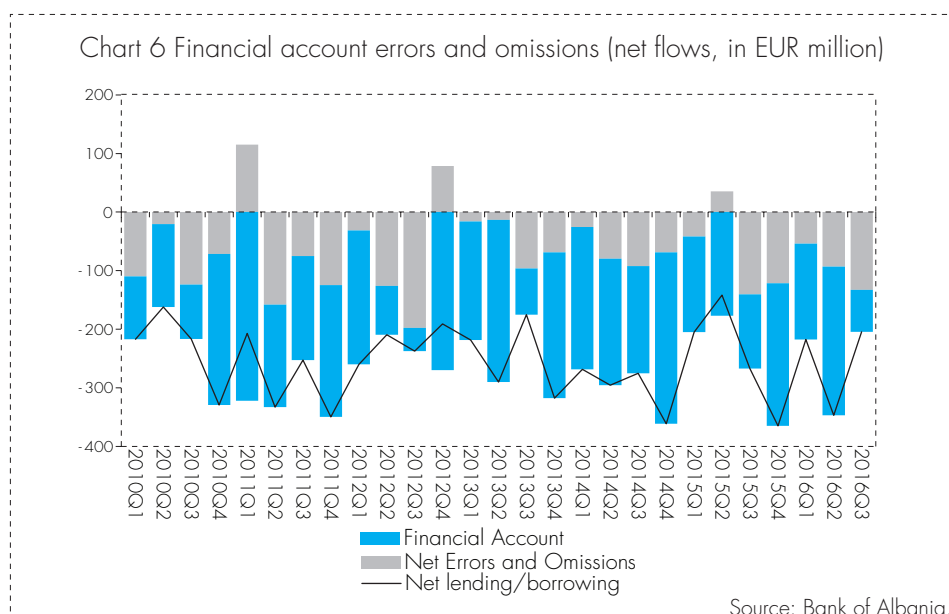
The combination of net transactions of the current and capital accounts provides the net position of the domestic economy, as net lender (surplus) and net borrower (deficit) against non-resident economies. In quantitative terms, our economy represents a net borrower position of around EUR 204.5 million in 2016 Q3, which is financed by the net income in the financial account and "errors and omissions".

---

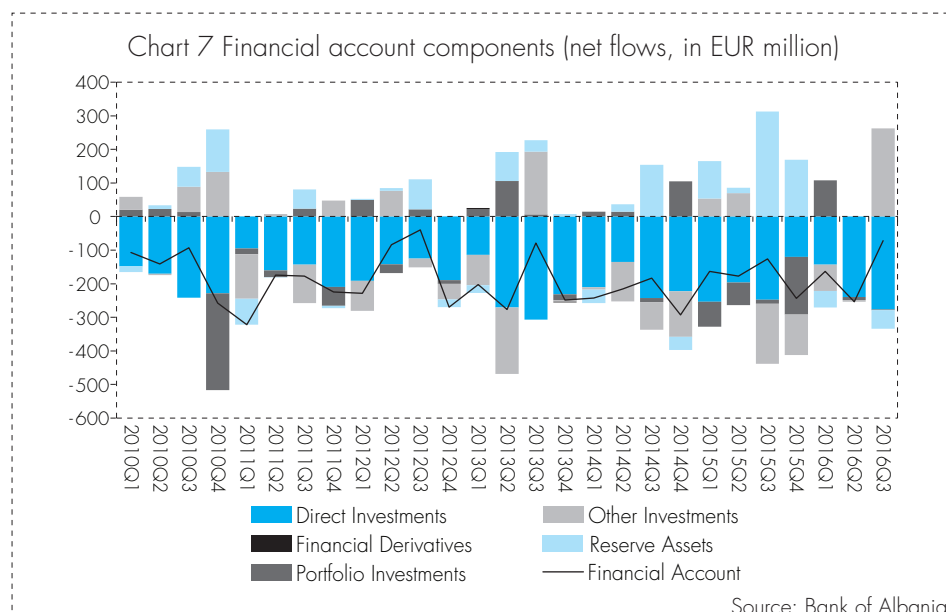
<sup>3</sup> Capital transfers consist of: 1. debt forgiveness; 2. non-life insurance claims; 3. grants; 4. guarantees; 5. taxes (for inheritance, gifts, etc.); 6. other capital transfers.

## IV. FINANCIAL ACCOUNT

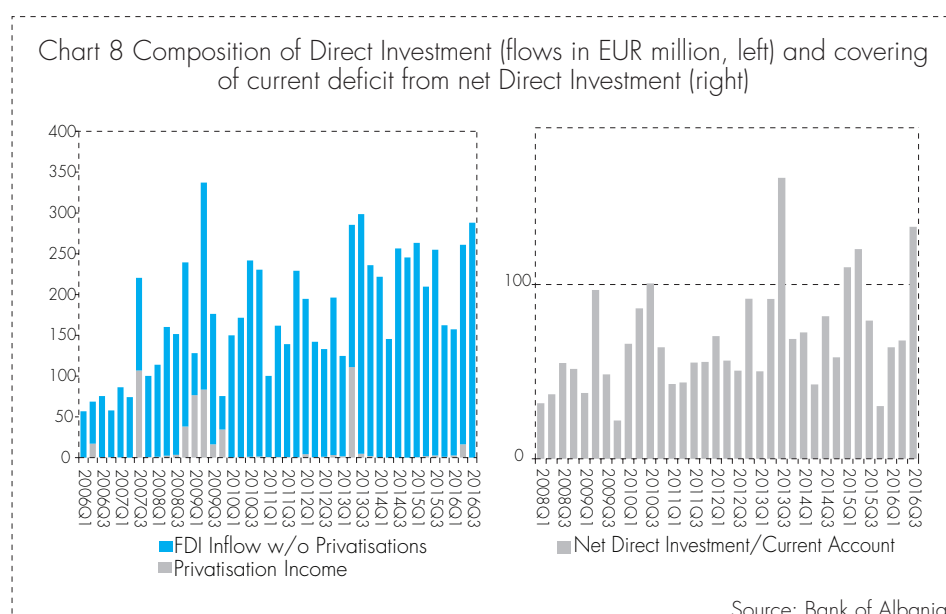
The financial account records a debtor position of EUR 71.9 million for 2016 Q3. This result represents a narrowing of the net borrowing position of residents to non-residents, by 43.2% in annual terms. Net foreign currency flows in this account were estimated at around 2.7% of nominal GDP, and financed around 34.6% of current deficit recorded during the period under review.



Financial inflows in the form of residents' liabilities to non-residents amounted EUR 338.2 million. They resulted in EUR 166.6 million lower compared to the same quarter in the previous year. This dynamic is largely determined by the reduction of liabilities in other investment account. On the other hand, liabilities, in the form of direct investments, increased. During this quarter, the total flows of Albanian assets were EUR 266.3 million, around EUR 111.9 million lower, compared to the same quarter a year earlier. This performance was determined by the reduction of reserve assets. On the other hand, assets in the form of direct investments, portfolio investments and other investments are higher compared with a year earlier.



Net direct investments showed expansion trends, at 11.4%, in annual terms, similar to the second quarter of the year. Net Direct Investment to nominal GDP ratio was estimated at 10.2%. This ratio is 0.6 percentage points higher compared to the same period a year earlier.



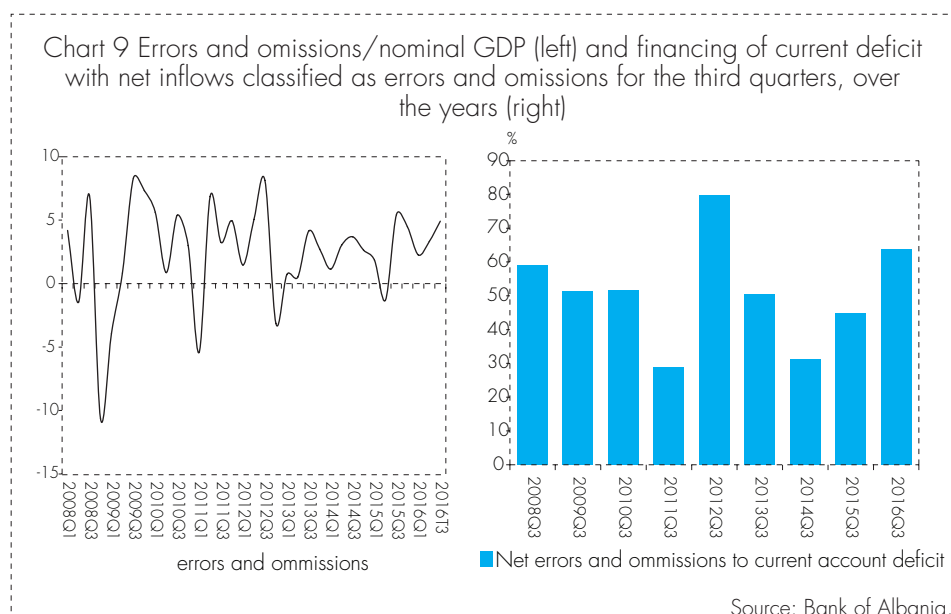
In the long run, direct investments constitute an important foreign currency inflow in financing the current deficit of Albania. For this quarter, the ratio of net Direct Investment flows financed around 133.1% of the recorded current deficit. This ratio is 53.8 percentage points higher than in the same quarter a year earlier, and 65.3 percentage points higher compared to the previous quarter.

**Net portfolio investments** recorded a negative balance of EUR 2.1 million, or EUR 9.2 million lower compared with a year earlier.

This is largely determined by the increase in domestic assets, in the form of debt instruments, by around EUR 20.7 million. Also, liabilities expanded by around EUR 11.5 million compared to the previous year. The increase of liabilities held by non-residents in the form of debt instruments contributed in this regard. The flow expanded by around EUR 23.7 million, in annual level.

The net balance of **other investments account** shows a net borrowing position of around EUR 262.7 million. Albanian assets invested abroad were EUR 306.4 million, while liabilities to non-residents were estimated at EUR 43.8 million. 'Net currency and deposits' sub-item resulted in a positive balance of EUR 179.7 million, from EUR 80.2 million in the same period a year earlier. Total liabilities in the form of loans recorded EUR 41.8 million, lowering by EUR 206.8 million compared with the previous year. 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 during the third quarter compared to the previous year. Depositing corporates are excluded.

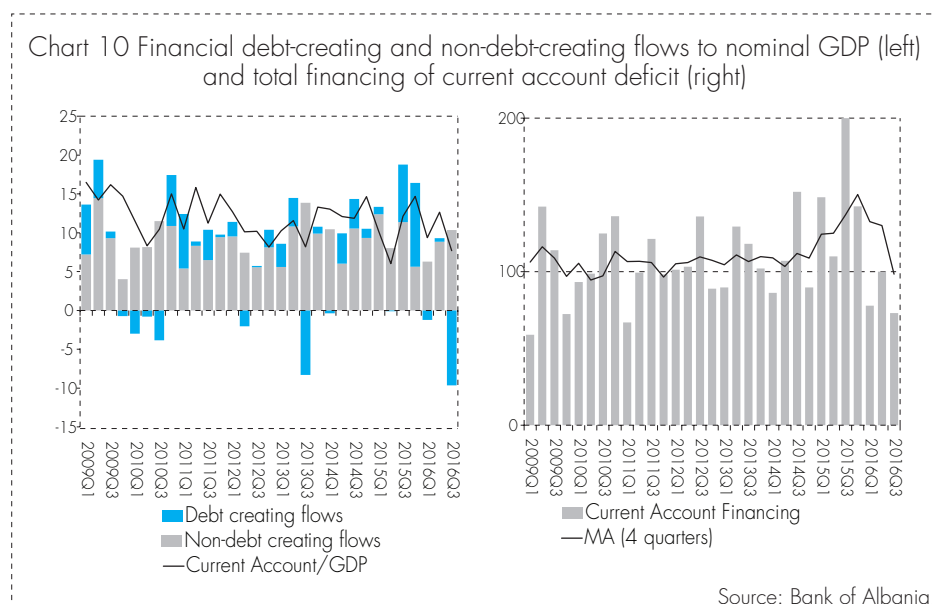
The overall balance of payments resulted in reduction of reserve assets at EUR 56.1 million. At the end of September, the stock of the foreign exchange reserve stood at EUR 2.76 billion. This level was sufficient to cover 6.8 months of imports in goods and services and 170% of the short-term gross external 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 Q3, "net omissions and errors" recorded the positive rate of EUR 132.7 million and was estimated at 4.9% 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 inflows.<sup>4</sup> Thus, non-debt-creating financial flows from net direct investments and from the capital account were estimated at 10.4% of nominal GDP. These were 1.0 percentage point lower compared with a year earlier, and debt-creating financial flows were estimated at -9.7% of nominal GDP, narrowing by around 17.1 percentage points, 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 73%, implying a reduction in reserve assets by EUR 56 million. The following Chart shows that the moving average (4 quarters) of financing ratio settles continuously above 100%. Developments in the third quarter relate to the unusual reduction of non-debt-creating flows, arising from the performance of "other investments" account. The ratio of errors and omissions to current deficit was around 63.9%.



<sup>4</sup> 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.