

Bank of Albania

ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY

2023 Q1

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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

Data of the Balance of Payments 2023 Q1 show a significant contraction of the current deficit. High tourists' inflows and rapid growth of remittances were the main factors that drove to this improvement.

The current account recorded a deficit of EUR 135.2 million¹, decreasing by around 45.9%. It was assessed at 3.0% of GDP, or 3.4 percentage points lower. The current deficit narrowed mainly on the back of the increase in the export of services (38.4%), caused by the growth in tourism inflows (by 52.6%).

On the other hand, the pick-up in the export of goods appears to have slowed down (0.9% compared to 29.8% in the previous quarter). This performance is related to the decelerated international prices as a result of the base effect from the previous year when commodity prices rose significantly after the outbreak of the conflict in Ukraine. At the same time, there is also a fall in exported quantities for certain categories.

Total imports grew at 14.5%, affected mainly by the upsurge in the import of services by 38.4%. The growth in imports was driven by the increase in tourism outflows (34.5%). Imports of goods also grew, but at slightly slower rate compared to the previous quarter.

The overall trade deficit narrowed by 20.0% as the impact from export growth was higher compared to the opposite impact from the increase in imports. The deficit stands at 7.3% as a ratio to GDP, down by 3.2 percentage points.

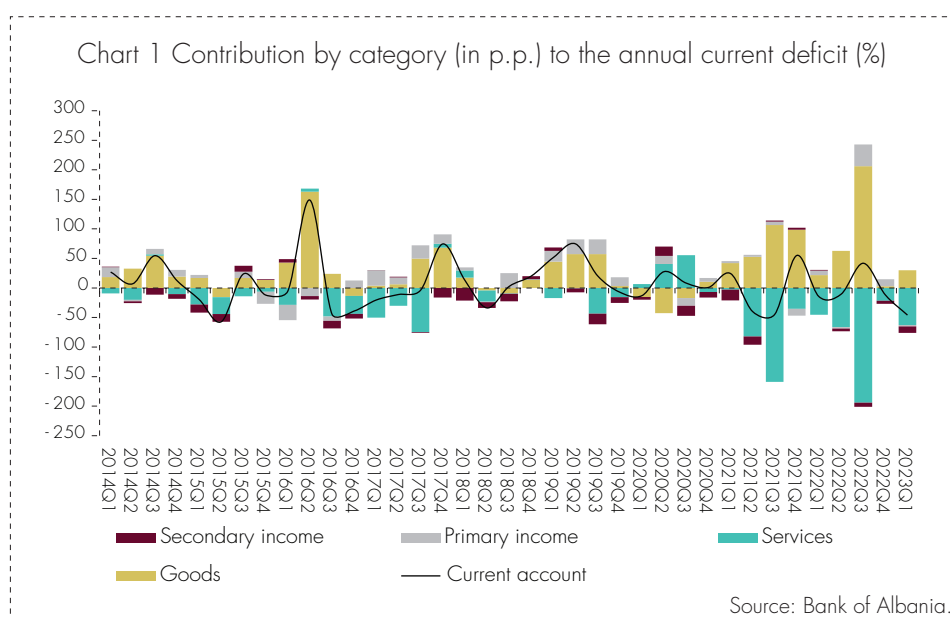
The primary income account recorded a deficit of EUR 79.2 million, edging down compared to the previous year. For the first time after a long time, the effect of the growth in income inflows from labour was higher compared to that of income outflows from investments. At the same time, the positive surplus of secondary income has improved as a result of the growth in remittances by 16.0%.

In the financial account, net inflows amounted to EUR 64.9 million. Direct investment inflows grew at a slow pace (1.9%), but were still able to fully finance the current account deficit given the latter's decline. Reserve assets grew by EUR 83.3 million. The foreign exchange reserve stock at the end of 2023 Q1 is sufficient to cover 6.8 months of import of goods and services or 333.0% of short-term gross external debt.

¹ At the end of this material there is a summarizing table of the main developments of the Balance of Payments during the latest periods including the quarter under review.

II. CURRENT ACCOUNT

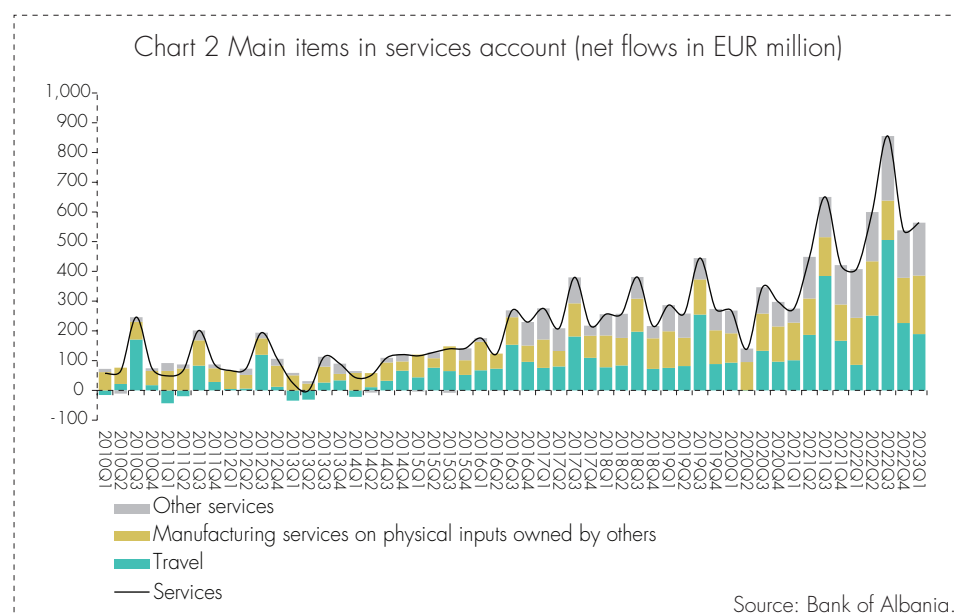
The current account recorded a deficit of EUR 135.2 million, in 2023 Q1, decreasing by around 45.9% compared with the previous year. The deficit was assessed at 3.0% of GDP or about 3.4 percentage points lower than in the same quarter of the previous year. The improvement of the current deficit was driven by the increase in tourism flows and remittances.



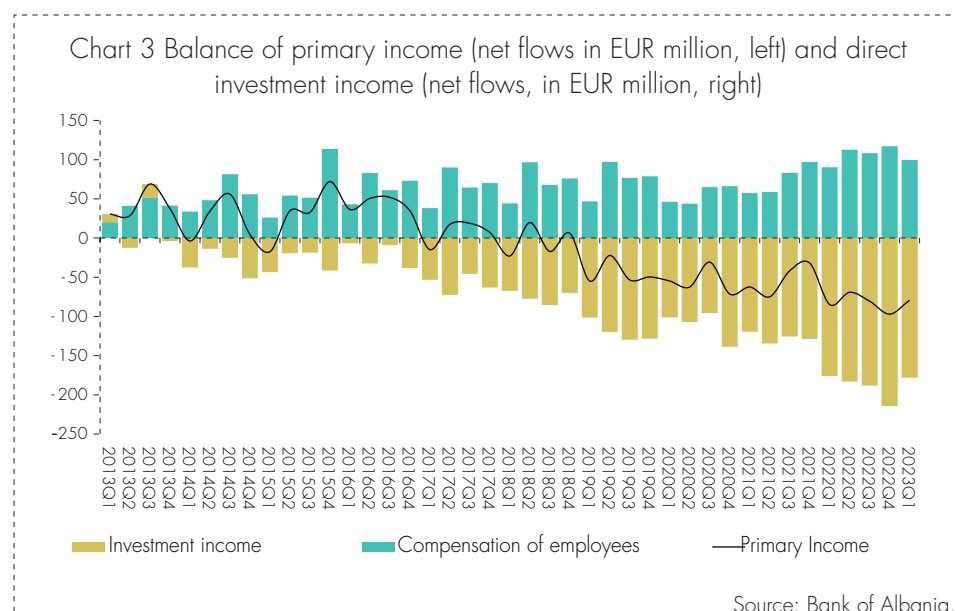
The total growth of exports was 25.0%, driven by the expansion in the export of services by 38.4%. The expansion in the export of services is related to the tourist services inflows that continue to grow at high rates (52.6%). On the other hand, the export of goods grew at a slowed pace (0.9% from 29.8% in the fourth quarter of the previous year). The slowdown in export growth is initially related to a lower increase in international prices. This performance reflects the base effect from last year when international prices rose sharply as a result of the start of the conflict in Ukraine. Also, the decelerated growth in the export of goods is also related to the contraction of the exported quantities for certain groups of goods.

Imports grew by 14.5%, at similar levels to the previous quarter (14.1%). The increase in the import of services (38.4%) and specifically in the tourism outflows (34.5%) gave the main contributions in this regard. Tourism outflows began the post-pandemic recovery later in time compared to the tourism inflows, but growth rates accelerated significantly over the past year and continue at comparable rates through 2023 Q1. On the other hand, the growth of the import of goods remains slow like in the previous quarter (6.1% in 2023 Q1 against 7.7% in the previous quarter). The slowed growth in imports is related to the weaker upswing in international prices, as in the case of the export of goods. On the other hand, unlike exports, there is no evident decrease in imported quantities.

The overall trade deficit in goods and services narrowed by 20.0% due to the stronger exporting impact. It stands at 7.3% of GDP, down by 3.2 percentage points, compared to the previous year.

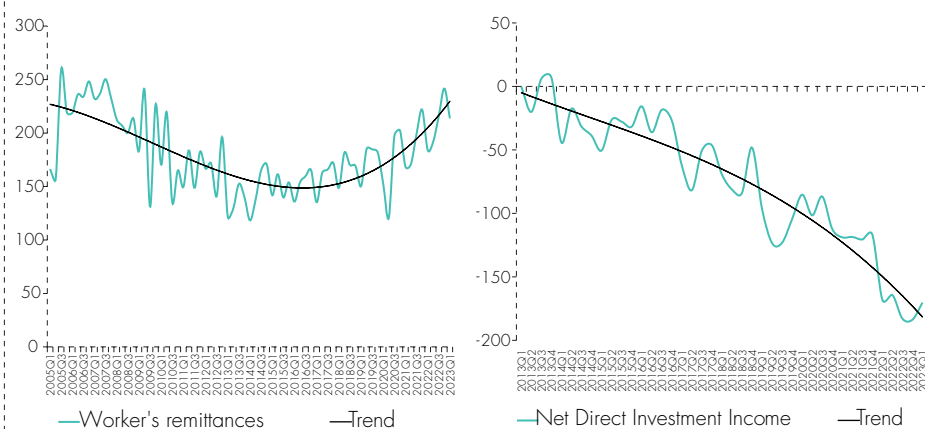


Primary income account recorded a deficit of EUR 79.2 million, down by 6.7%. For the first time after some time, the deficit has narrowed due to the stronger impact from the growth in the employee compensation income inflows. Investment income outflows also show high growth rates, but they were not able to offset the effect of income inflows.



The surplus of the secondary income sub-account of expanded by around 11.3%, an accelerated rate compared with the previous quarter. Growth in remittances, jumping to 16.0%, from 8.9% in the previous quarter, determined this expansion.

Chart 4 Remittances (net flows, in EUR million, left) and financing of trade deficit from net primary and secondary income and from services (right)



Source: Bank of Albania.

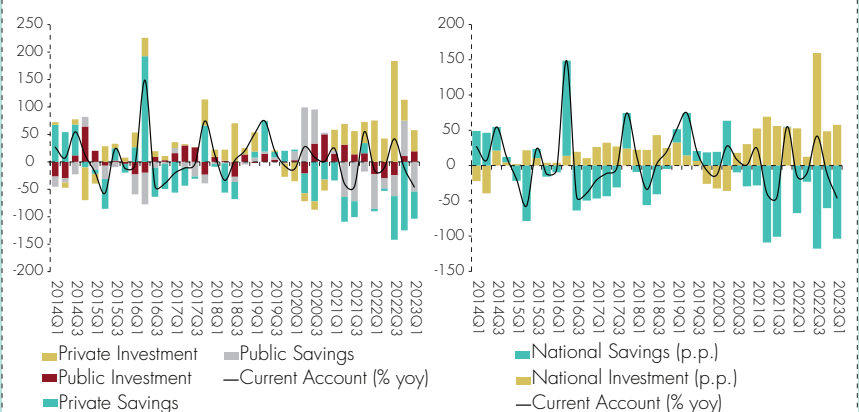
BOX 1 DEVELOPMENTS IN NATIONAL SAVINGS AND INVESTMENTS

The decrease in the current deficit ratio to the GDP is mainly a result of the increase in savings in both the private and public sectors. Total savings in the economy are assessed at 18.3% of GDP, up by 3.9 percentage points. On the other hand, the ratio of investments to GDP stands at 21.3%, up by only 0.5 percentage point. As a result of the stronger impact from the increase in savings, the current deficit ratio to GDP narrowed by 3.4 percentage points.

The savings-investment gap of the private sector was assessed at -9.0% of GDP, improved by about 2.1 percentage points from a year ago. This was caused by the expansion of private savings by around 1.7 percentage points. Private investments have encouraged narrowing of the relevant gap as they have decreased by 0.3 percentage point to GDP.

In regard to the savings-investment gap of the public sector, the gap is estimated at 6.0% of GDP (positive values mean higher savings compared to investments), improved by 1.2 percentage point. The growth in public savings by 2.1 percentage points determined this dynamics. On the other hand, public investments expanded by 0.8 percentage points, affecting the public gap in the opposite direction.

Chart 5 Contribution of investments and savings indicators in the deficit dynamic (left) and their contribution to the annual change of the current account deficit (right)



Source: Bank of Albania, Ministry of Finance and Economy, INSTAT and author's estimations.

III. CAPITAL ACCOUNT

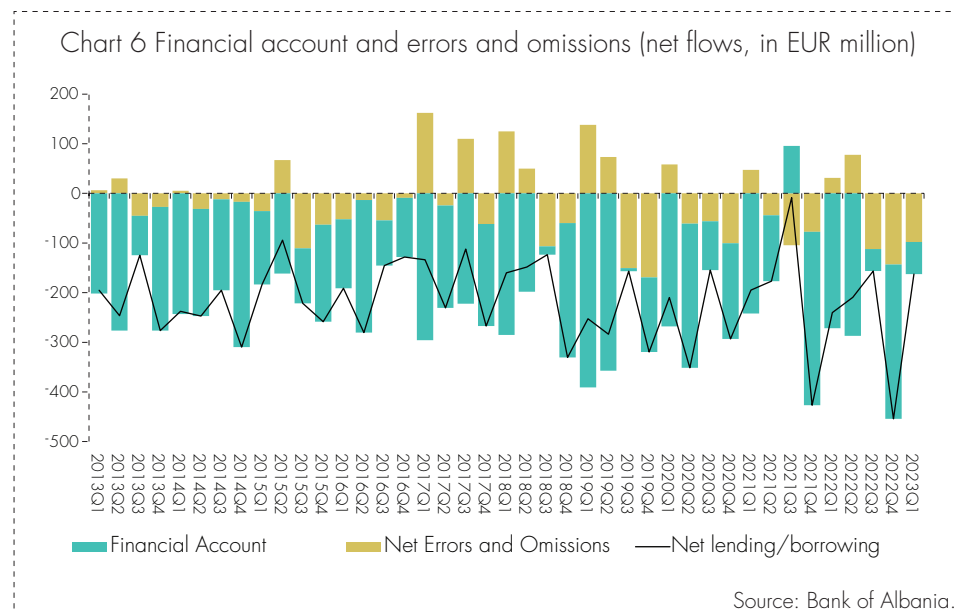
Capital account closed with a negative balance of EUR 27.5 million, deepened by around EUR 37.1 million compared to a year ago. The faster increase in private outflows gave the main impact in this trend. Net capital flows in this account are estimated at -0.6% of nominal GDP.

In 2023 Q1, our economy reflects a net borrowing position of EUR 162.7 million. This ratio is about 32.3% lower compared to a year ago.

IV. FINANCIAL ACCOUNT

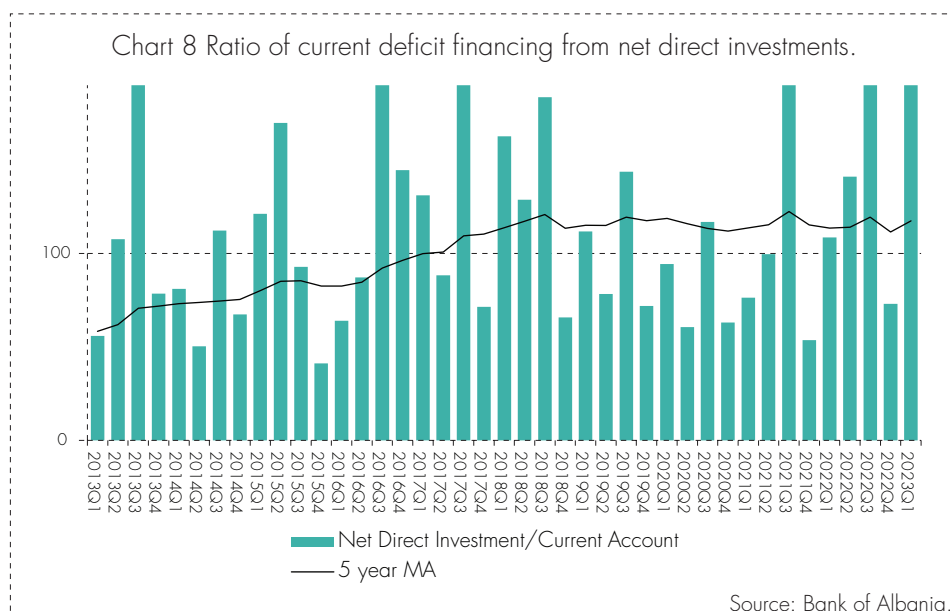
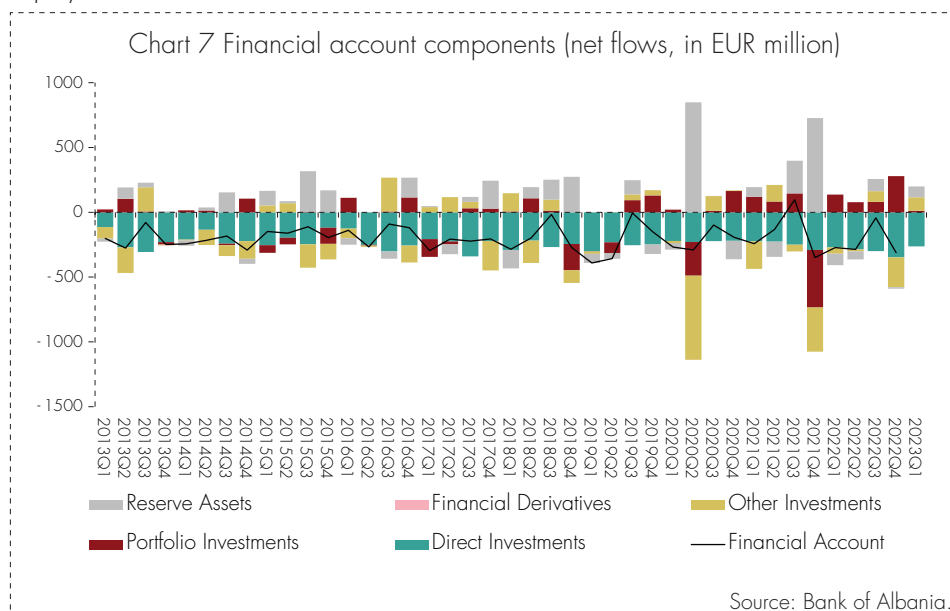
The financial account recorded net inflows amounting to EUR 64.9 million, around EUR 206.9 million lower compared to a year ago. **Direct Investment inflows remain high, but growth has slowed down (1.9% compared to 28.5% in the previous quarter)**. FDI flows have been affected by the base effect of the previous year when growth was quite high. This effect is expected to be felt throughout the other quarters of 2023. Despite the slowdown in the growth rate, the level of FDIs is sufficient to fully cover the current deficit (exceeding it).

Direct investment inflows are concentrated in the sectors of "Mining", "Financial and insurance activities", "Real estate" and "Energy". The annual growth of flows was supported by the "Financial and insurance activities" and "Energy" sectors. Meanwhile, the sectors that have supported the performance of FDIs in the previous year ("Real Estate" and "Energy") show a contraction of the respective flows compared to a year ago.

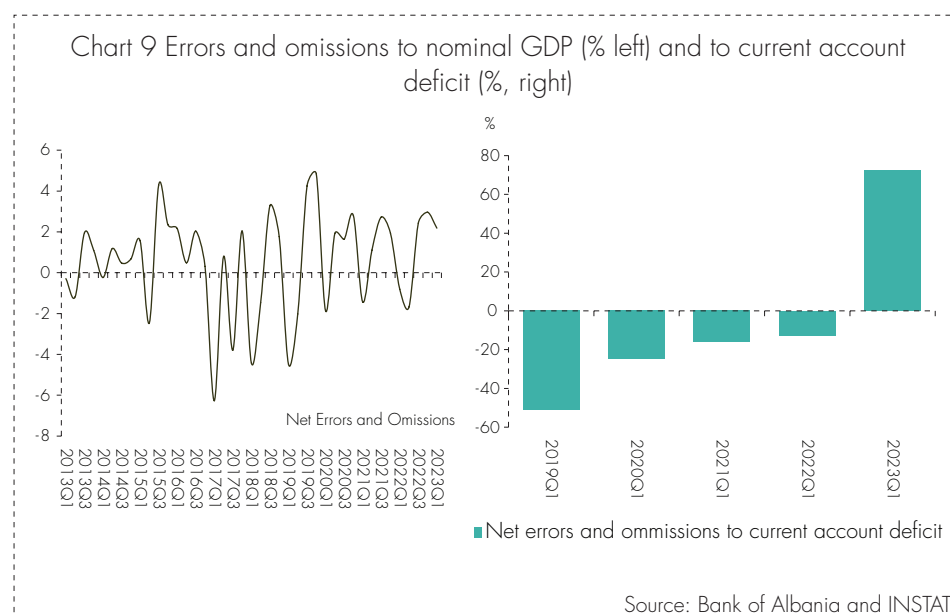


Portfolio investments reported net assets amounting to EUR 10 million. A decrease is observed for both assets and liabilities with a higher magnitude in

the second case. The decrease in portfolio liabilities continues to be fuelled by the transfer of Eurobond ownership from non-residents to the resident banking sector. **Other investments report an increase in assets and a decrease in liabilities, amounting for a net asset result of EUR 105.0 million.** Assets expanded in the form of "International Reserve", "Currencies and deposits" and "Commercial credit". Liabilities decreased mainly as a result of loan repayments from the "General Government".



The overall balance of payments resulted in an increase of reserve assets by EUR 83.3 million. At the end of March 2023, the foreign exchange reserve stock was EUR 5.02 billion and is considered sufficient to cover 6.8 months of imports of goods and services or 333.0% of short-term gross external debt. Finally, the "net errors and omissions" item resulted in an inflow of EUR 97.8 million, and was estimated at 2.2% of nominal GDP.



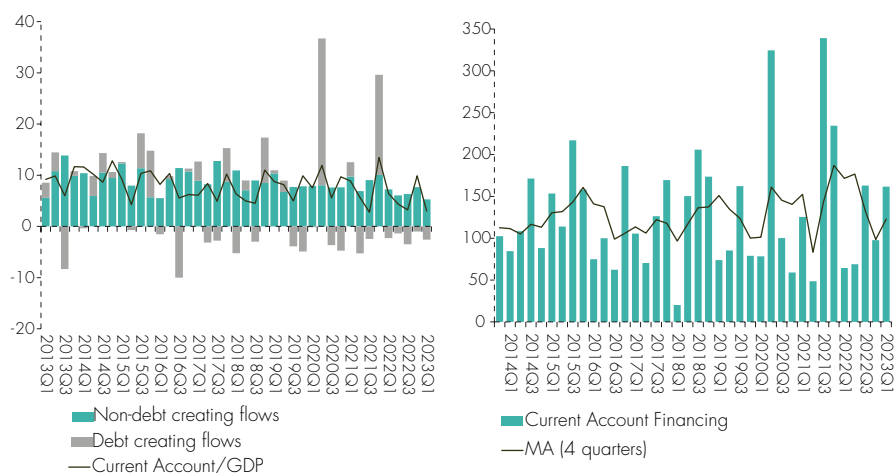
V. PROFILE OF CURRENT DEFICIT FINANCING

The **profile of current deficit financing** is determined by the performance of debt-creating inflows against the non-debt-creating inflows². Non-debt-creating financial flows from net direct investments and from the capital account were assessed at 5.3% of GDP. These were around 1.9 percentage points lower than a year earlier. The debt-creating financial flows were estimated at -2.6% of GDP, around 0.3 percentage point lower than the previous year. The negative ratio of debt-creating flows to GDP means that the repayment of existing liabilities has exceeded the new borrowing inflows, a phenomenon that has been observed almost during the entire 2022. This is reflected in ever decreasing external debt to GDP ratios during the same period. In 2023 Q1, the relevant ratio stands at 52.3%, while at the end of 2021, it was 64.3%.

By adding to foreign currency net debt-creating and non-debt-creating flows also the net errors and omissions, we obtain the overall financing of the current deficit. During the quarter under review, the ratio of current account financing stood at 122.7%, implying an expansion in the reserve assets.

² 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 inflows of the capital account, whilst debt-creating flows include portfolio investments and other net investment.

Chart 10 Financial debt-creating and non-debt-creating inflows to nominal GDP (left) and total financing of current account deficit (right)



Source: Bank of Albania

Table 1 Balance of payments indicators (in EUR million)

	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4	2023 Q1
Current account (in EUR million)	-105.5	-540.6	-249.9	-203.4	-149.7	-477.3	-135.2
y-o-y (%)	-44.8	55.1	-14.7	-10.6	41.8	-11.7	-45.9
/GDP (%)	-2.8	-13.5	-6.4	-4.4	-3.2	-9.9	-3.0
Goods and services	-347.2	-802.7	-408.4	-398.1	-360.2	-701.1	-326.8
y-o-y (%)	-22.4	37.9	-14.5	-2.0	3.7	-12.7	-20.0
Exports, f.o.b.	1509.3	1205.5	1348.3	1724.5	2071.6	1589.5	1684.9
y-o-y (%)	77.0	44.9	58.5	45.5	37.3	31.9	25.0
Imports, f.o.b.	1856.5	2008.3	1756.7	2122.6	2431.7	2290.6	2011.6
y-o-y (%)	42.8	42.0	32.2	33.4	31.0	14.1	14.5
Net Travel	384.6	167.2	85.8	251.7	505.4	226.3	189.5
Primary income	-41.8	-31.8	-84.8	-69.2	-80.6	-97.0	-79.2
Credit	105.4	123.0	118.6	143.3	148.9	169.1	149.7
Debit	147.2	154.9	203.4	212.4	229.5	266.2	228.9
Net income from Direct Investments	-120.6	-116.8	-168.2	-164.3	-183.0	-183.7	-170.3
Secondary income	283.5	293.9	243.3	263.8	291.1	320.9	270.7
Credit	327.3	336.5	284.1	303.9	330.4	361.8	309.7
Debit	43.8	42.6	40.8	40.0	39.4	40.9	39.0
Net Remittances	199.3	221.9	184.1	192.0	215.9	241.7	213.7
y-o-y (%)	1.0	9.5	9.2	12.2	8.3	8.9	16.0
Capital account	96.9	113.8	9.5	-5.9	-6.6	23.1	-27.5
Net borrowing/net lending	-8.6	-426.8	-240.4	-209.4	-156.3	-454.1	-162.7
Financial Account	95.8	-349.4	-271.8	-287.1	-44.0	-311.0	-64.9
y-o-y (%)	-197.3	81.3	12.3	116.3	-145.9	-11.0	-76.1
/GDP (%)	2.5	-8.7	-7.0	-6.2	-0.9	-6.4	-1.4
Direct investments	-249.8	-290.1	-271.2	-287.0	-300.3	-348.3	-263.8
y-o-y (%)	11.9	32.0	21.3	26.7	20.2	20.1	-2.7
Portfolio investments	145.6	-444.9	136.7	77.4	79.8	278.9	10.7
Financial derivatives	0.0	1.0	2.0	3.0	4.0	5.0	6.0
Other investments	-52.3	-341.0	-48.3	-14.1	82.3	-230.0	105.0
Reserve assets	252.4	726.6	-88.9	-63.3	94.1	-11.6	83.3
Errors and omissions	104.4	77.4	-31.4	-77.7	112.3	143.1	97.8

Source: Bank of Albania, INSTAT and author's estimations.