

Bank of Albania

ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY

2021 Q2

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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

The data of the Balance of Payments in 2021 Q2 reflected the acceleration of the economic recovery. In contrast with the first quarter, the positive developments were more symmetric, including the services flows as well. This suggests that economic growth was supported from both domestic and foreign demand.

The current account deficit was EUR 243.2 million¹, narrowing by around 35.6% in annual terms. The positive impact was driven mainly by the services sub-account, with a contribution also from secondary income account. The current account deficit was assessed at 6.2% of GDP, or 5.9 percentage point lower than in the same quarter a year earlier.

Trade deficit in goods and services narrowed by around 20.7% in annual terms, driven by the expansion of the services' surplus by 221.5%. The export of services returned to positive trends, recording an increase of 165.5%. The main contributor among them was the increase of travel (tourism). It must be noted here the strong base effect inherited from the second quarter of the previous year, when the impact of the pandemic and the containment measures on the international movement of people was at its peak. The impact is observed also in the rapid increase in the import of services by 122.1% driven, in this case as well, by travel services. Despite the triple-digit increase, service flows are still lower than in 2019 (pre-pandemic). The gap is deeper in the case of imports, reflecting the discrepancy in the easing of measures between foreigners entering Albania and Albanians travelling abroad.

As regards trade of goods, the annual growth of both exports and imports accelerated considerably. The base effect is present also in this case, albeit somewhat lower when compared to services. Exports increased by 97.7%, while imports by 44.3%. The higher share of imports caused an expansion of the specific deficit, similar to the previous quarters. In contrast with services, the flow of goods exceeded (as in the previous quarters) the pre-pandemic levels (2019 Q2).

Primary income account registered a deficit of EUR 87.0 million, which is around EUR 24.6 million higher than a year ago. The increase of investments' income outflows caused the expansion of deficit. On the other hand, the surplus of the secondary income account expanded by 25.7% in annual terms. The annual increase of remittances was 41.8%, driven also by the base effects of the previous year. Net inflows in the capital account recorded EUR 48.8 million, standing around EUR 22.6 million higher than in the same quarter a year earlier.

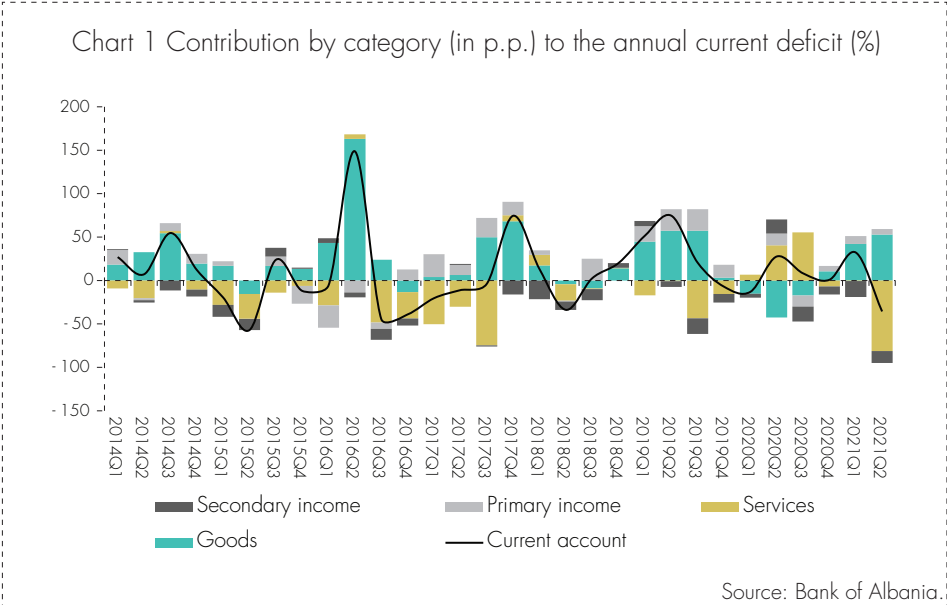
In the financial account, net liabilities recorded EUR 135.1 million, around EUR 155.5 million lower from a year ago. Direct investments inflows expanded by around 1.4%. Net inflows in the capital and financial account managed to cover 75.6% of the current account deficit. The overall balance of payments resulted in the decrease of reserve assets by EUR 117.3 million. The foreign

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.

exchange reserve stock at the end of 2021 Q2 is sufficient to cover 8.4 months of import of goods and services or 300% of the short-term gross external debt.

II. CURRENT ACCOUNT

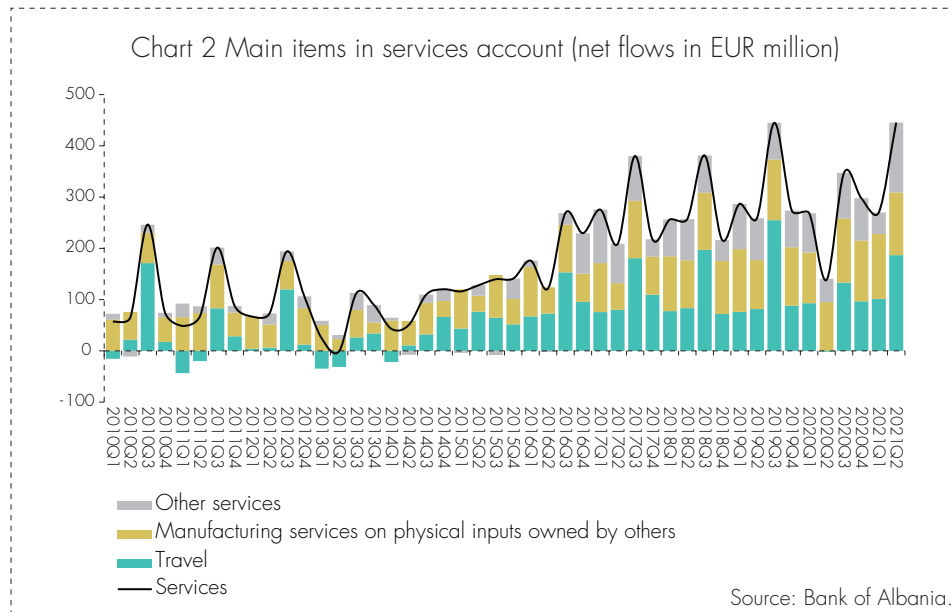
The current account recorded a deficit of EUR 243.2 million, in 2021 Q2, narrowing by around 35.6% in annual terms. The deficit was assessed at 6.2% of nominal GDP, or 5.9 percentage points lower than in the same quarter a year earlier. The performance of “Services” and “secondary income” provided the crucial positive impacts.



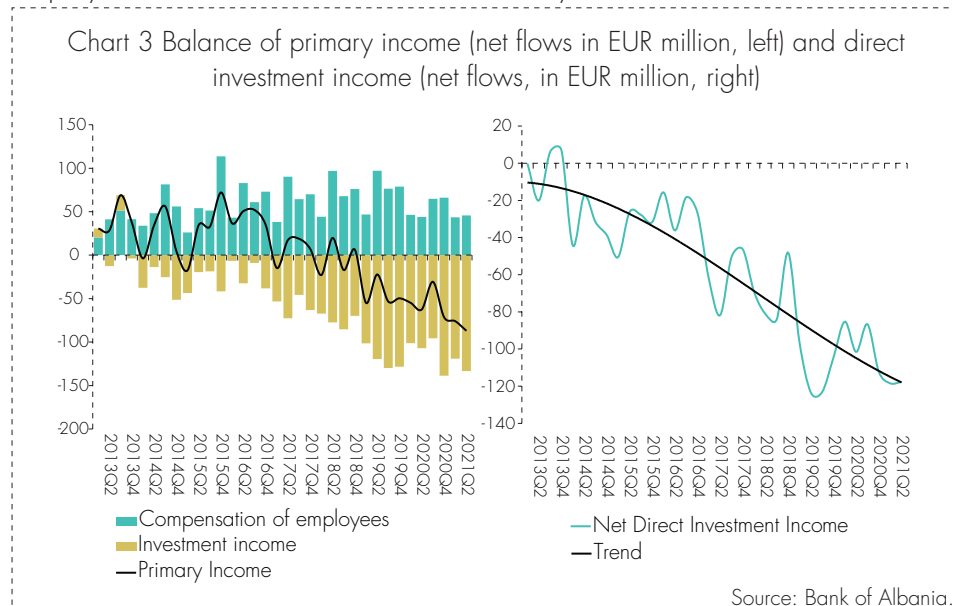
The narrowing of the current deficit is mainly determined by the increase in the surplus of services by 221.5%. The increase of exports (165.5%) and, more specifically, the export of travel services (615.3%) provided the main contribution. A high annual increase was registered for the import of services (122.1%), driven once again by travel services (304.4%). The increase of flows is related to the strong base effect of the previous year, when restrictions were at their peak. Despite the increase, the level of flows remained below the pre-pandemic values (2019 Q2). Also, the recovery was stronger in the case of exports, reflecting a higher easing of the domestic measures on foreigners entering Albania compared to the restrictive measures on Albanian citizens going abroad.

The trade in goods was characterised by high increases. Exports expanded by 97.7%, while imports by 44.3%, due to the strong effects of the base from the previous year. The trade flows of goods, differently from services, have exceeded the pre-pandemic levels (2019 Q2). The specific trade deficit expanded by 30.4% in response to the stronger impact of imports.

Overall trade deficit in goods and services declined by around 20.4%. In contrast with previous quarters, services provided a stronger impact than goods. Presently, foreign demand provides an important contribution to growth compared to domestic demand.



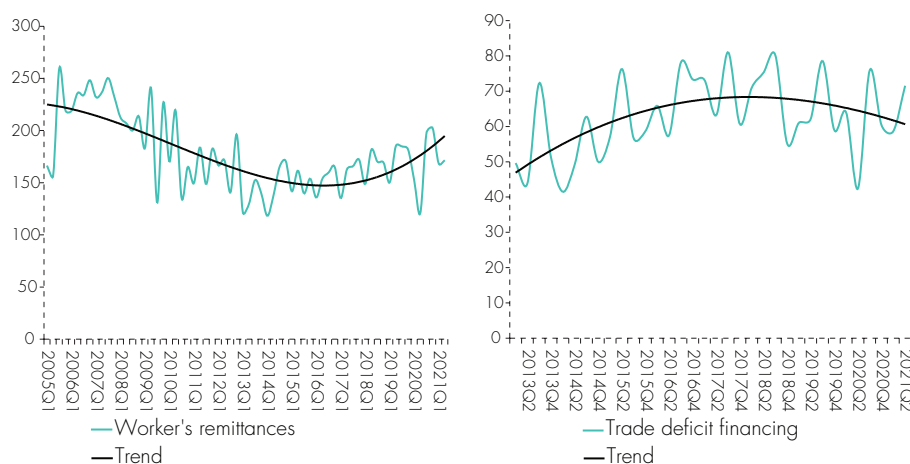
The net balance in the **primary income account** registered a deficit of EUR 87.0 million, up by EUR 24.6 million compared with a year earlier. The contribution continues to be driven by investments' outflow income. Aside for direct investment income, outflows related to portfolio investments provided an impact as well. Employee compensation income inflow returned to positive trends, but the growth rates are still quite low despite the base effect from the previous year. The restriction on the movement of citizens (in this case season employees) are still obstructive to the recovery of this flows.



The surplus of the sub-account of secondary income expanded by around 25.7% in annual terms. Annual growth of remittance inflows was 41.8%, notably accelerated compared to the previous quarters.

Net cumulative inflows from services, primary income and secondary income accounts financed around 71.6% of the trade deficit in goods. This ratio is around 29.2 percentage points higher than a year earlier.

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



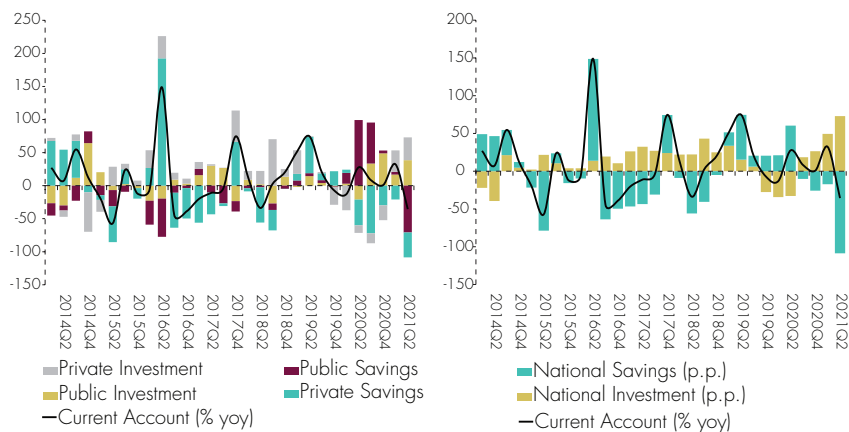
Source: Bank of Albania.

BOX 1 DEVELOPMENTS IN THE SAVING-INVESTMENT GAP

The contraction of the current annual deficit was caused mainly by the expansion of public savings. They were assessed at 18.6% of nominal GDP, up by 8.3 percentage points in annual terms. On the other hand, national investments had an impact on the opposite direction. They were assessed at 24.8% of GDP, up by 2.4% in annual terms.

The saving-investment gap of the private sector was assessed at -2.0% of nominal GDP for 2021 Q2, around 0.9 percentage point narrower compared with a year ago. The ratio of private investments to nominal GDP was assessed at 17.2%, around 0.3 percentage points lower than a year earlier. Private savings to nominal GDP were assessed at 15.3%, around 0.6 percentage points higher than a year earlier. The private gap narrowed mainly due to the effect of the growth in savings, but the decline in investments had a contribution as well.

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



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

The public gap is -4.2% of GDP, narrowing by 5.1 percentage points compared to the previous year. Public savings were estimated at 3.4% of nominal GDP, up by 7.7 percentage point in annual terms. Public investments were estimated at 7.6% of nominal GDP, around 2.7 percentage point higher compared to the previous year. The growth in private savings was a determinant factor for the narrowing of the respective gap.

III. CAPITAL ACCOUNT

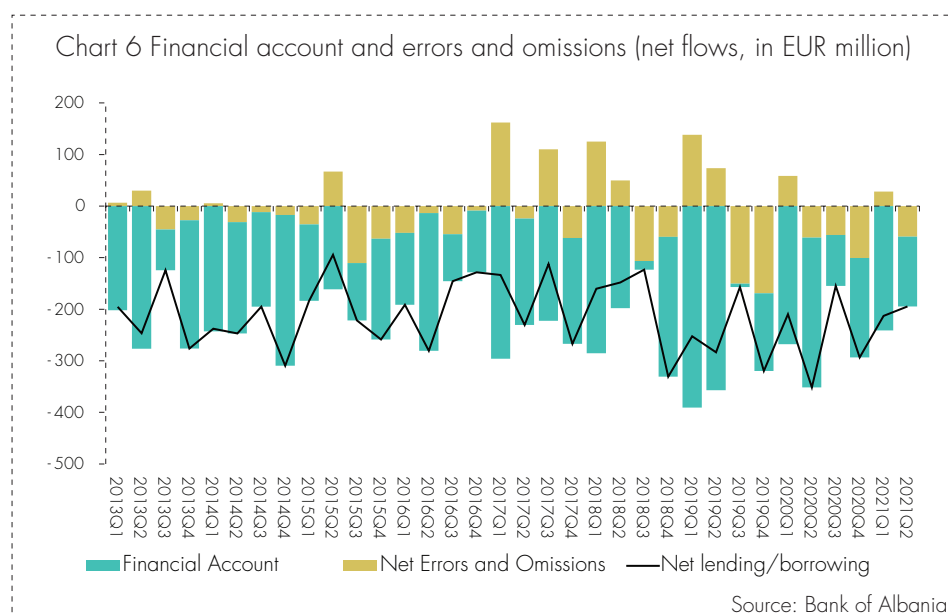
The capital account's surplus was around EUR 48.8 million, around EUR 22.6 million higher compared with a year ago. Net capital flows in this account are estimated at 1.2% of nominal GDP. The main impact is related to the private sector.

The combination of net transactions of the current and capital accounts provides the net position of the domestic economy, as net lender (surplus), or net borrower (deficit) against non-resident economies. In 2021 Q2, our economy reflects a net borrowing position of EUR 194.5 million. This figure is about 44.7% lower than a year ago.

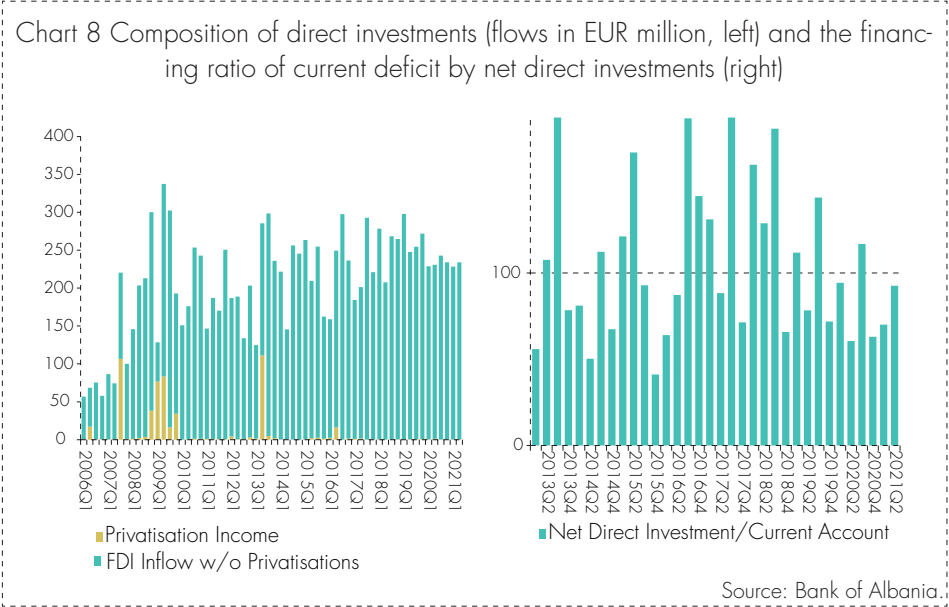
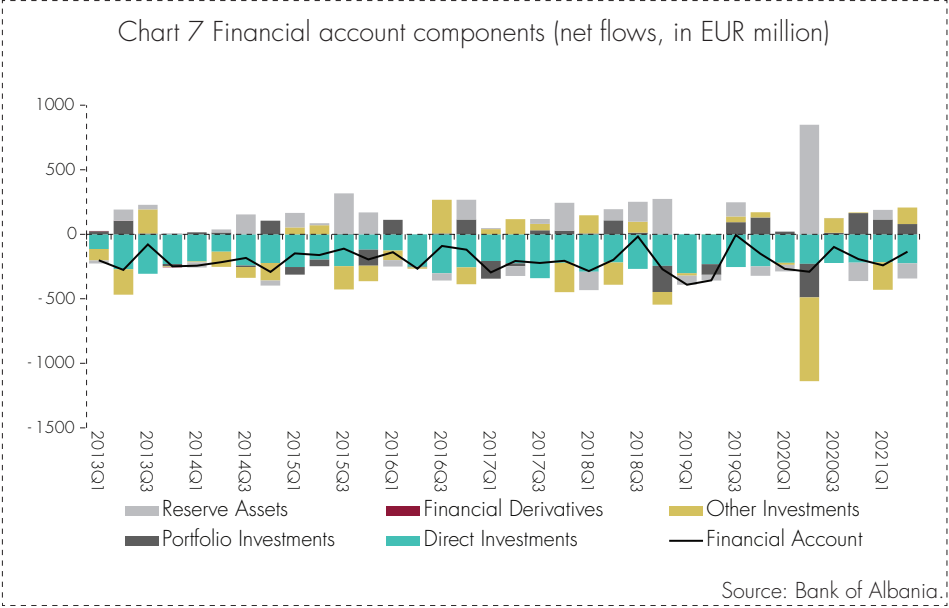
IV. FINANCIAL ACCOUNT

The financial account recorded net liabilities amounting to EUR 135.1 million, around 53.5% lower than a year earlier. Net liabilities of this account were estimated at around 3.4% of nominal GDP and financed 55.5% of current account deficit during this period.

Direct investments inflows expanded by 1.4%. Higher flows were noted in the sectors of "Mining" and "Real estate." On the other hand, the flows in the sector of "Energy" have declined significantly, as a result of the completion of major investments. There is an annual decline recorded in the "Financial" and "Information and Communication" sectors as well.



Portfolio investments reported net assets amounting to EUR 78.9 million, whereas they registered net liabilities of EUR 260.5 million a year ago. The second quarter of 2020 corresponds to the Eurobond issuance, thus creating a solid base effect. Meanwhile, during the quarter under review assets in the form of “debt securities” have expanded. Other investments reported net assets amounting to EUR 128.4 million, reflecting the increase in “Currencies and deposits” and “Borrowing.” Concurrently, the liabilities of the “General government” debt are reported downwards.

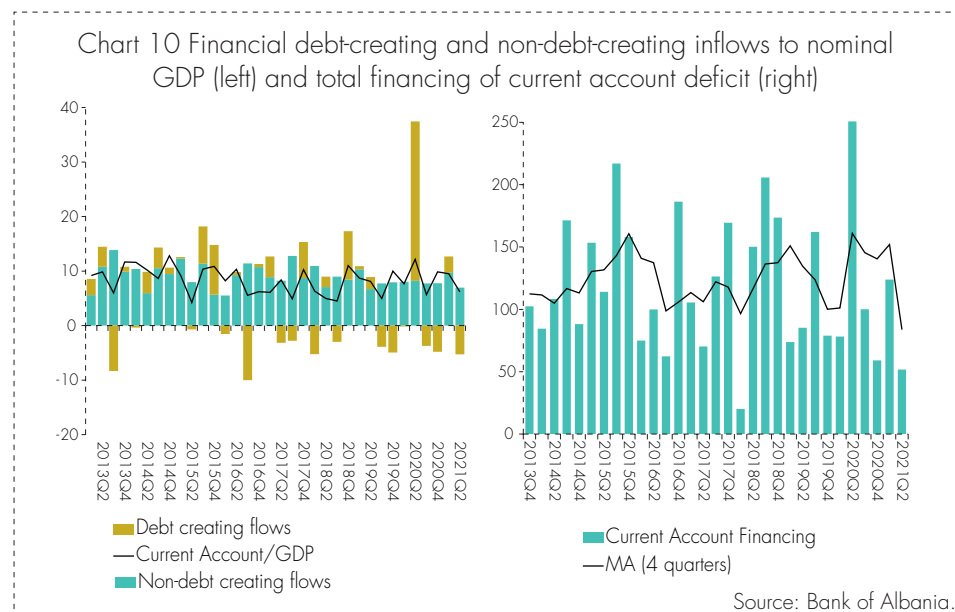


The overall balance of payments resulted in a decrease of reserve assets by EUR 117.3 million. At the end of June 2021, the foreign exchange reserve stock was considered sufficient to cover 8.4 months of import of goods and services or 300% of short-term gross external debt. Finally, “net errors and omissions” item resulted in an inflow of EUR 59.4 million, which is assessed at 1.5% of nominal GDP.

V. PROFILE OF CURRENT DEFICIT FINANCING

The sustainability of current deficit financing is determined by the performance of debt-creating inflows against the most desirable non-debt-creating inflows². Non-debt-creating financial flows from net direct investments and from the capital account were assessed at 7.0% of nominal GDP. These were around 1.2 percentage point lower than a year earlier. The debt-creating financial flows were estimated at -5.3% of nominal GDP, around 34.5 percentage points lower than a year earlier. This is related to the solid base effect from the previous year caused by the issuance of Eurobond.

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 current account financing ratio stood at 51.8%, translating into a decline in reserves. The financing ratio was around 272.8 percentage points lower compared with the previous year. The impact of the comparative base related to the Eurobond issuance has also been determinant to the annual change.



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.

Table 1 Balance of payments indicators (in EUR million)

	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q1
Current account (in EUR million)	-345.8	-235.1	-377.7	-191.2	-348.7	-310.9	-243.2
yoy (%)	-7.1	-13.1	27.6	8.3	0.8	32.3	-35.6
/GDP (%)	-10.0	-7.7	-12.1	-5.7	-9.9	-9.5	-6.2
Goods and services	-569.3	-384.4	-517.0	-447.4	-582.0	-482.0	-409.8
yoy (%)	-7.4	-5.7	-1.2	17.8	2.2	25.4	-20.7
Exports, f.o.b.	1019.1	847.3	488.2	852.6	831.8	846.4	1180.3
yoy (%)	7.0	-4.5	-53.9	-36.7	-18.4	-0.1	141.8
Imports, f.o.b.	1588.5	1231.7	1005.2	1299.9	1413.8	1328.4	1590.1
yoy (%)	1.3	-4.9	-36.5	-24.7	-11.0	7.8	58.2
Net Travel	88.2	93.0	-1.9	133.1	96.9	101.4	186.8
Primary income	-49.6	-54.8	-62.5	-30.6	-71.4	-76.0	-87.0
Credit	108.5	69.7	80.8	96.6	90.0	69.8	71.9
Debit	158.1	124.5	143.3	127.3	161.4	145.8	158.9
Net income from Direct Investments	-104.5	-85.3	-101.6	-86.7	-112.3	-118.5	-117.7
Secondary income	273.1	204.2	201.7	286.9	304.7	247.1	253.5
Credit	310.4	244.1	241.9	333.5	350.3	286.5	293.8
Debit	37.3	39.9	40.2	46.6	45.5	39.4	40.3
Net Remittances	181.9	152.4	120.9	197.4	202.7	168.5	171.6
yoy (%)	7.5	1.5	-34.7	6.9	11.4	10.6	41.9
Capital account	26.2	25.4	26.1	36.6	55.4	98.0	48.8
Net borrowing/net lending	-319.6	-209.6	-351.6	-154.6	-293.3	-212.9	-194.5
Financial Account	-150.5	-268.0	-290.6	-98.5	-192.7	-241.2	-135.1
yoy (%)	-44.5	-31.4	-18.6	1451.5	28.1	-10.0	-53.5
/GDP (%)	-4.3	-8.7	-9.3	-2.9	-5.4	-7.4	-3.4
Direct investments	-248.5	-221.6	-228.8	-223.3	-219.8	-217.9	-225.1
yoy (%)	1.4	-26.7	-1.3	-12.0	-11.5	-1.7	-1.6
Portfolio investments	129.8	20.1	-260.5	10.6	163.9	114.8	78.9
Financial derivatives	0.0	0.0	1.0	0.7	1.7	2.7	3.7
Other investments	41.2	-15.3	-649.4	114.0	5.8	-212.6	128.4
Reserve assets	-73.0	-51.1	848.2	0.3	-142.7	74.5	-117.3
Errors and omissions	169.1	-58.3	61.0	56.1	100.5	-28.3	59.4

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