ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY

2018 Q1

ENIAN ÇELE
MONETARY POLICY DEPARTMENT

JULY 2018

The views expressed herein are solely of the author and do not necessarily reflect those of the Bank of Albania.
CONTENTS

I. BALANCE OF PAYMENTS HIGHLIGHTS  
II. CURRENT ACCOUNT  
III. CAPITAL ACCOUNT  
IV. FINANCIAL ACCOUNT  
V. PROFILE OF CURRENT DEFICIT FINANCING
I. BALANCE OF PAYMENTS HIGHLIGHTS

The net position of the current account recorded a deficit of EUR 164.6 million in 2018 Q1, expanding approximately 11.0%, in annual terms. It was assessed at 5.8% of nominal GDP, or around 0.1 percentage point higher than in the same quarter a year earlier. By composing items, developments in the sub-account of goods were the main contributors to the expanding side. The sub-accounts of services and primary income have also contributed in the same direction. On the other hand, the secondary income sub-account contributed to the narrowing of the current deficit.

The exports of goods and services increased by around 8.6% annually, driven mainly by the expansion of the exports of goods by 20.6%. Meanwhile, exports of services also increased by 5.0%, annually. Overall imports expanded by around 10.1%, in annual terms, mainly from the expansion in the import of goods, by around 8.4%, compared with the previous year. The import of services also registered a rapid growth, at 14.3%. As a result of these developments, the overall trade deficit of goods and services expanded by 13.8%, in annual terms, driven mainly by the expansion of the goods account deficit by around 4.6%. At the same time, the positive surplus of the services account narrowed by 5.7%, in annual terms.

The surplus of the secondary income account expanded by 19.2%, in annual terms. Net remittances expanded by around 8.9%, but the main contribution came from the expansion of net official transfers, compared with the previous year. Regarding the primary income account, the negative balance almost doubled, mainly due to the decrease of investment income inflows.

Net inflows in the capital account recorded EUR 18.3 million, standing EUR 5.5 million lower than in the same quarter a year earlier. The net position in the financial account remained largely unchanged from a year earlier. The main impact on this dynamic came from the increase of liabilities in Other Investments and the decrease of assets in Portfolio Investments. The non-debt-creating flows provided the main contribution to the current deficit financing allocation by flow profiles. On the other hand, a decrease of the contribution of debt-creating flows was noted.

Net inflows in the capital and financial account managed to cover 186.3% of the current account deficit. The overall balance of payments resulted in the

---

1 The latest data on the balance of payments are as of 2018 Q1. As of 2008 Q1, the Bank of Albania prepares the Balance of Payments Statistics, in compliance with the BPM6 standards published by the IMF. The main differences between the actual and previous methodologies are synthesised in the following guideline: 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 analyses, the Balance of Payments data from 2002 to 2007 are reclassified in line with the new methodology by the Monetary Policy Department.
The net position of the current account resulted in a deficit of EUR 164.6 million in 2018 Q1, expanding by around 11.0%, in annual terms. The deficit expanded at a slower rate compared with the previous quarter (the deficit increased by around 65.8% in annual terms). It was assessed at 5.8% of nominal GDP, or 0.1 percentage point higher than in the same quarter a year earlier. Compared with the previous quarter, the rate is 3.9 percentage points lower.

II. CURRENT ACCOUNT

The net position of the current account resulted in a deficit of EUR 164.6 million in 2018 Q1, expanding by around 11.0%, in annual terms. The deficit expanded at a slower rate compared with the previous quarter (the deficit increased by around 65.8% in annual terms). It was assessed at 5.8% of nominal GDP, or 0.1 percentage point higher than in the same quarter a year earlier. Compared with the previous quarter, the rate is 3.9 percentage points lower.

---

2 An important contribution to this dynamic is from the flows of excess reserves of commercial banks, which typically increase in the fourth quarter of the year and decrease in the first quarter of the following year. This was also noted in 2018 Q1 and 2017 Q4.
In terms of contributions, the annual expansion of the current deficit was mainly determined by the increase of the goods account deficit, the contraction of the positive surplus of the services account and partially by the dynamic of primary income. Meanwhile, the only tightening contribution came from the secondary income sub-account.

Goods trade deficit expanded by 4.6%, in annual terms. The main impact came from the increase in the import of goods by 8.4%. On the other hand, the export of goods also registered a high increase, in annual terms, by around 20.6%. However, this increase has not been sufficient to offset the impact of imports.

Services sub-account also contributed to the expansion of the current deficit. This phenomenon was also observed during 2017 Q4. The positive surplus of the sub-account contracted by 5.7%, in annual terms. The main impact came from the increase in the import of services by 14.3%, in annual terms, accelerating from the previous quarter (their annual growth in 2017 Q4 was around 9.0%). The main impact in the increase of the import of services came from travel and governmental services. In the case of exports, the annual growth is assessed at 5.0% mainly affected by the sub-categories of tourism services and manufacturing services on physical inputs owned by others. Overall, the services account surplus is assessed at 9.2% of nominal GDP, around 1.4 percentage points lower compared with the previous year and 2.0 percentage points higher compared with the previous quarter.
The net balance of the primary income account was negative. Net foreign-currency flows in this account resulted in EUR 11.2 million deficit, from the EUR 5.6 million deficit in the same period a year earlier. The recorded deficit was estimated at around 0.4% of nominal GDP, mainly determined by the compensation of employees account. On the other hand, the growth of the relevant deficit of the account in annual terms is also determined by the decrease of income inflows and the increase of investment income outflows.

The surplus in the secondary income account expanded by around 19.2% compared with the same quarter a year earlier. The relevant surplus registered EUR 201.4 million, equivalent to 7.1% of nominal GDP. Remittance inflows contributed to this trend expanding by around 8.9% in annual terms, but the main impact came from the increase of official transfers.
Net cumulative income from services, primary income and secondary income accounts financed around 73.2% of the trade deficit in goods. This ratio decreased by 1.5 percentage points compared with 2017 Q1, but it is around 10.6 percentage points lower compared with 2017 Q4.

**BOX 1. DEVELOPMENTS IN THE SAVING - INVESTMENT GAP**

The saving-investment gap of the private sector registered -7.2% of nominal GDP (negative value means that investments were higher than savings). This ratio is 0.4 percentage point lower compared with the same quarter a year earlier. The ratio of private investments to nominal GDP registered 16.7%, from 16.3%, a year earlier. On the other hand, private savings to nominal GDP remained largely unchanged (9.5% compared with 9.4% a year earlier).

In the case of the public sector, a tightening of the positive saving-investment gap was observed. The ratio for 2018 Q1 is assessed at 1.3% compared with 1.8% a year earlier. This performance was determined by both the decrease of the ratio of public savings (5.2% compared with 5.4% a year earlier), and the increase of the ratio of public investment (3.8% compared with 3.6% a year earlier).

Overall, the ratio of national investments to GDP remained almost unchanged compared with a year earlier (20.5% in 2018 Q1 compared with 20.6% in 2017 Q1). At the same time, the national savings to nominal GDP ratio decreased at 14.6% from 14.8% a year earlier. The faster decrease of savings compared with investments (against nominal GDP) also caused the increase of the current deficit against nominal GDP ratio by 0.1 percentage point compared with the previous year.
### 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\(^3\) between residents and non-residents (on which there is no economic value in exchange). In 2018 Q1, the capital account’s positive surplus was around EUR 18.3 million, or around EUR 5.5 million lower than a year earlier. Net capital flows in this account are estimated at 0.7% of nominal GDP. Net capital transfers of the “central government” resulted with a positive surplus of EUR 6.5 million, while those in “financial and non-financial corporations, households and non-profit institutions serving households” were EUR 11.8 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, in 2018 Q1, our economy represents a net borrower position, of around EUR 146.3 million, which is financed by the financial account and “errors and omissions” item. This level is 17.4% higher than a year earlier, but around 41.9% lower than 2017 Q4.

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

The financial account recorded a debt position of EUR 288.2 million in 2018 Q1, almost at the same level as in the previous year. Net liabilities of this account were estimated at around 10.2% of nominal GDP, and financed around 175.1% of the current deficit recorded during the period under review.

On the liabilities side, the flow increased by around 3.2%, driven mainly by the increase of “Direct investment”. The latter increased by around 61.6%, overwhelmingly affected by the growth in the “Energy” sector. On the other hand, developments in the “Direct investments” sub-account were offset by developments in other accounts. Particularly, there has been an increase of assets in the form of “Other investments” affected by the sub-items of “Currencies and deposits”.

Source: Bank of Albania.
In the long-term, “Direct investments” constitute an important foreign currency inflow for financing the current deficit of Albania. In 2018 Q1, the ratio of net “Direct investment” flows financed around 176.6% of the recorded current deficit. This ratio was 43.3 percentage points higher than in the same quarter a year earlier, and 102.5 percentage points higher than in the previous quarter.

Net portfolio investments registered a net balance surplus of EUR 2.8 million, from EUR -137.5 million in the previous year. This dynamic was defined by the increase in domestic asset flows that resulted higher than liability flows.

The overall balance of payments resulted in a decrease of reserve assets by EUR 142.4 million. At the end of March 2018, the stock of the international reserve was around EUR 2.83 billion. This level was sufficient to cover 6.2 months of imports of goods and services or 152% of the gross short-term external debt.

As a result of problems that may be encountered in information sources and during the preparation 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 capital account balance). In 2018 Q1, “net errors and omissions” recorded an outflow of EUR 142.0 million and was assessed at around 5.0% of nominal GDP.

Chart 8 Composition of direct investments (flows in EUR million, left) and the financing ratio of current deficit by net direct investments (right)

Source: Bank of Albania
V. PROFILE OF CURRENT DEFICIT FINANCING

Regarding the financing profile of the current deficit, it is important to monitor the reliance on debt-creating inflows, against the more desirable non-debt-creating inflows. Thus, non-debt-creating financial flows from net direct investments and the capital account were assessed at 11.0% of nominal GDP. These were around 2.4 percentage points higher compared with the previous year. The debt-creating financial flows were estimated at -5.1% of nominal GDP, around 8.9 percentage points lower compared to the previous year.

---

4 This breakdown serves to monitor the impact of financial and capital flows on Albania’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.
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 current account financing stood at 13.5%, implying a decrease in reserve assets by EUR 142.4 million. This ratio was around 92.4 percentage points lower compared with the previous year and 159.7 percentage points lower compared with the previous quarter.