BANK OF ALBANIA

ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY

2019 Q1

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

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I. BALANCE OF PAYMENTS HIGHLIGHTS[1]

The current account recorded a deficit of EUR 243.3 million in 2019 Q1[2], expanding by around 41.4% in annual terms. The current deficit expanded, driven mainly by the goods sub-accounts with additional impacts by the secondary and primary income sub-accounts. The current account deficit was assessed at 8.0% of nominal GDP, or 1.9 percentage points higher than in the same quarter a year earlier. This performance was underpinned by the expansion of the savings-investments gap in the private sector to GDP, mainly as a result of the narrowing of savings ratio (see Box on "Developments in the savings-investments gap").

The exports of goods and services increased by 5.2% in annual terms. The contribution is entirely related to the dynamics of export of services, which expanded by 8.5% compared to the previous year. In this case, the impacts relate to the category of "Manufacturing services on physical inputs" and "other services". Positive impacts were also due to the export of "travel services" which increased by 5.1% compared to the previous year. On the other hand, exports of goods decreased by 4.0% in annual terms, mostly affected by the significant decline in the export of electricity.

Imports of goods and services expanded by 7.4% in annual terms. The expansion of import of goods gave the main contribution by 8.5% in annual terms. The rapid growth of the import of goods is closely related to the import of electricity to make up of the lack of domestic production. In parallel, there is an increase in services imports by about 5.0% year-on-year. This performance has been affected almost entirely by the increase in the import of "travel services", a phenomenon also observed in the past year. As a result of developments in the two trade sub-accounts, the overall trade deficit in goods and services expanded by about 12.6% y-o-y. The trade deficit in goods gave the main impact expanding by 13.0%, while the services surplus had the opposite effect after expanding by about 13.5% compared to a year earlier.

The surplus of the secondary income account narrowed by 5.7%, in annual terms. The main impact derived by the decrease in annual terms of inflow of "general government" revenues. On the other hand, the net remittance inflows expanded by 1.0% in annual terms. The negative surplus in the primary income, expanded by about EUR 14.1 million compared with a year earlier.

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[1] *The latest data on the balance of payments are as at 2019 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.*

[2] *At the end of this materials there is a summarizing table of the main developments of the Balance of Payments during the latest periods including the quarter under review.*

This is a result of the rapid expansion of income outflows related to direct investments. Net inflows in the capital account recorded EUR 17.5 million, standing around EUR 0.8 million lower than in the same quarter a year earlier.

In the financial account, net liabilities recorded a value of EUR 359.3 million, about 24.2% higher compared to the previous year. **The main impact is related to a decrease in the outflow of resident assets mainly in the form of "currencies and deposits"** reported in the sub-account of other investments. Direct investments inflows increased by 1.6% compared with the previous year. Net inflows in capital and financial accounts managed to cover 154.9% of the current account deficit resulting in outflows in the "errors and omissions" item. The overall balance of payments resulted in a **reduction of reserve assets by about EUR 70.7 million.** The foreign exchange reserve stock at the end of 2019 Q1 is able to cover 6.8 months of import of goods and services or 150% of short-term gross external debt.

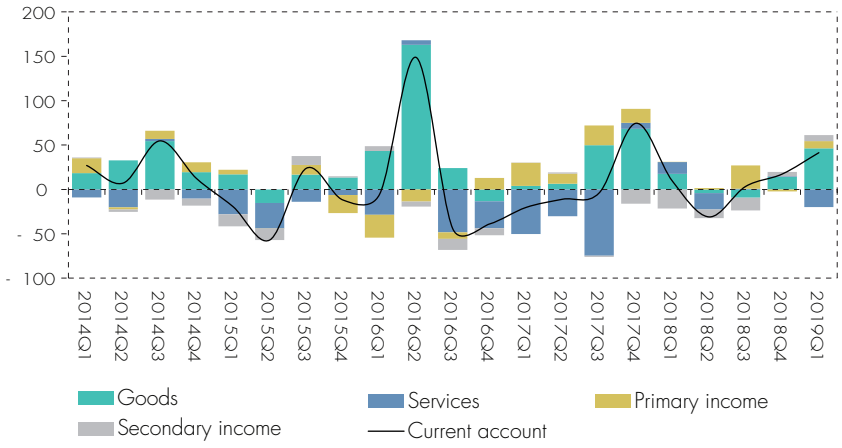
II. CURRENT ACCOUNT

The current account balance deficit recorded EUR 243.3 million in 2019 Q1, expanding by around 41.4% in annual terms. The deficit was assessed at 8.0% of nominal GDP, or 1.9 percentage points higher than in the same quarter a year earlier. Compared to 2018 Q4, the ratio is 2.8 percentage points lower.

The expansion in annual terms is determined by the sub-accounts of trade of goods with contributions from the primary and secondary income. The trade deficit in goods expanded by around 13.0% in annual terms, mainly affected by the increase in the imports of goods by 8.5%. On the other hand, the annual growth of exports of goods decreased by 4.0% during the same period, affected by the electricity.

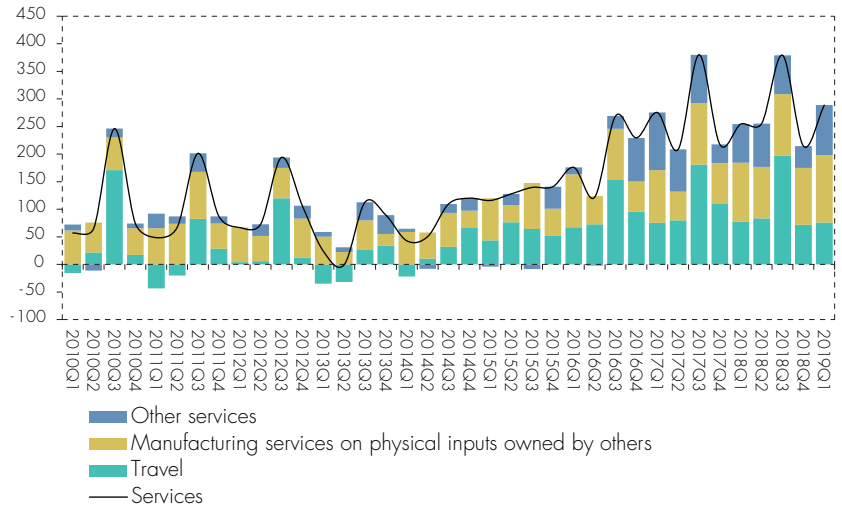
The "services" sub-account surplus expanded by 13.5% in annual terms. The main impact came from the growth in the export of services by about 8.5%. The export of "Manufacturing services on physical inputs" and "other services" contributed also in this regard. Positive impacts also came from exports of "travel services", which reported an annual growth of 5.1%. On the other hand, the increase in import of services was 5.0%, mostly affected by the increase in the import of "travel services".

Chart 1 Contribution by category (in p.p.) to the annual current deficit (%)



Source: Bank of Albania.

Chart 2 Main items in services account (net flows in EUR million)



Source: Bank of Albania.

The **net balance in the primary income account,** resulted in a negative surplus at EUR 28.9 million, from EUR 14.8 million a year earlier. The expansion of the negative surplus is mainly a result of the increase of direct investment income outflows.

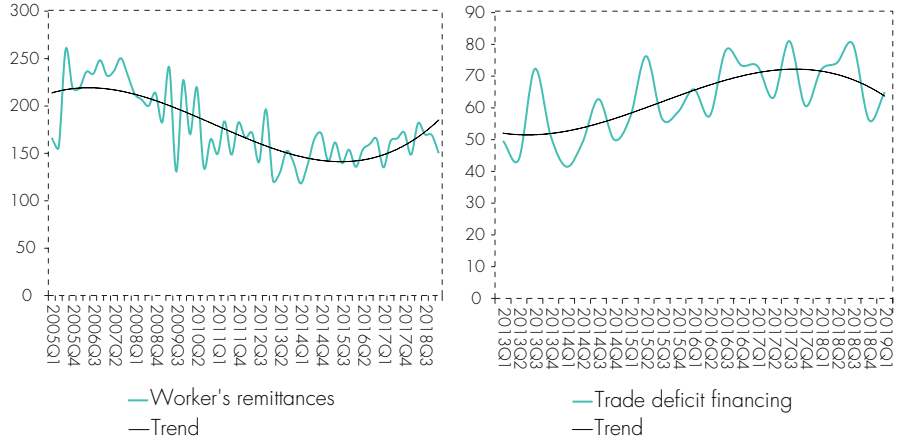
The surplus of the sub-account of secondary income, decreased by EUR 11.6 million (or 5.7 %) in annual terms. The key contribution came from the decrease of income inflows related to the "general government'' (by around EUR 15.1 million). In parallel, net remittance inflows increased by 1.0%.

Chart 3 Balance of primary income (net flows in EUR million, left) and direct investment income (net flows, in EUR million, right)

Source: Bank of Albania

Net cumulative income from services, primary income and secondary income accounts financed around 65.0% of the trade deficit in goods. This ratio is 7.0% percentage points lower compared to 2018 Q1 and 8.7 percentage points higher compared to the previous quarter.

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

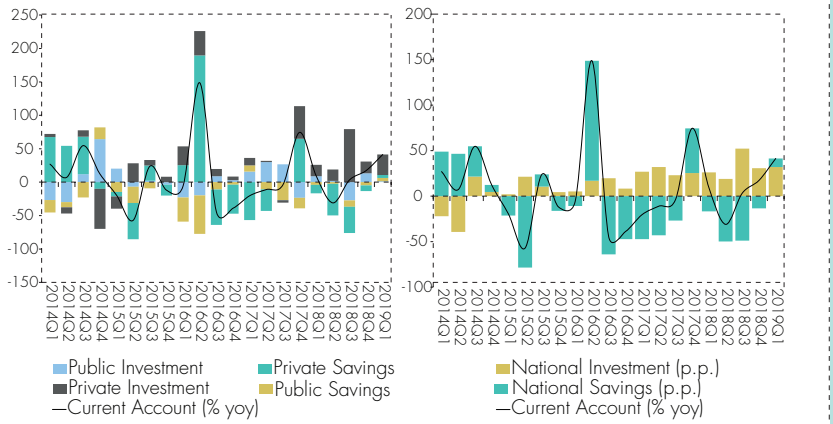
BOX 1. DEVELOPMENTS IN THE SAVING - INVESTMENT GAP

The saving-investment gap of the private sector was assessed at -8.9% of nominal GDP (negative value of the gap means that investments were higher than savings), for 2019 Q1. This ratio is 1.4 percentage points higher compared with the same quarter a year earlier. The ratio of private investments to nominal GDP was assessed at 16.8%, from 16.4%, a year earlier. On the other hand, private savings to nominal GDP were assessed at 8.0%, around 0.9 percentage point lower than a year earlier. Overall, the dynamics of savings have contributed the most to the expansion of the negative gap in the private sector with supplementary contributions from the investments.

Regarding the public sector, a positive gap was observed (savings higher than investments) at 0.9% to nominal GDP. Meanwhile, in the previous year, the positive gap was estimated at 1.4% of nominal GDP. Both, public savings and investments have declined in relation to nominal GDP. But savings slowdown was faster (from 5.2% to 4.5%). On the other hand, the ratio of public investment to nominal GDP decreased from 3.8% to 3.6%.

Overall, the ratio of national investment to GDP increased by 0.2 percentage points. On the other hand, the ratio of national savings to nominal GDP decreased by 1.6 percentage points. The reduction in the national savings ratio has thus been a key determinant of the expansion of current account deficit in annual terms.

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.

III. CAPITAL ACCOUNT

The capital account's positive surplus was EUR 17.5 million in 2019 Q1, about EUR 0.8 million lower than a year earlier. Net capital flows in this account are estimated at 0.6% of nominal GDP. Net capital transfers for the account of "general government" resulted with a positive surplus of EUR 4.1 million, while those in "*financial and non-financial corporations, households and non-profit institutions serving household*", were EUR 13.2 million.

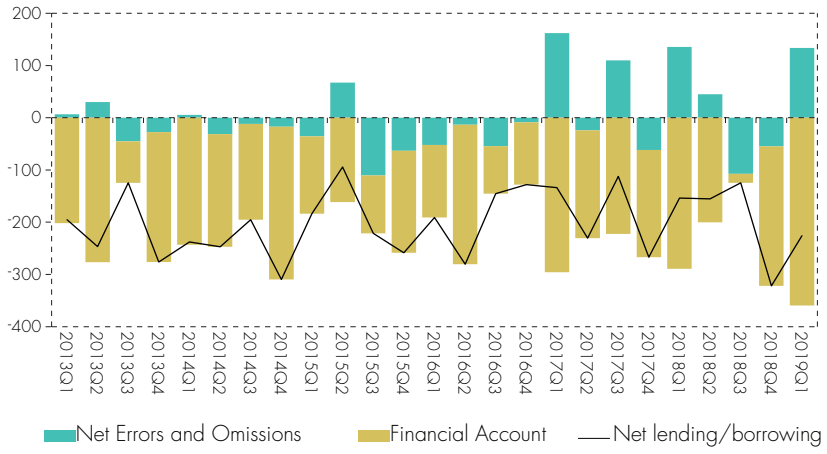
The combination of net transactions of the current and capital accounts provides the net position of the domestic economy, as net lender (surplus), and net borrower (deficit) against non-resident economies. In quantitative terms, in 2019 Q1 our economy represents a net borrower position of EUR 225.8 million, which is financed by the financial account and "errors and omissions" item. This is 46.8% higher compared with a year earlier and around 29.9% lower compared with the previous quarter.

IV. FINANCIAL ACCOUNT

The financial account recorded a net liabilities flow of EUR 259.3 million in 2019 Q1, around 24.2% higher than a year earlier. Net liabilities of this account were estimated at about 11.7% of nominal GDP and financed 147.7% of current account deficit during this period.

The annual dynamics of net inflows is determined by the performance of the sub-account assets of other investments. There is a decrease in residents' items in the form of "currencies and deposits" by about EUR 145.2 million compared to a year earlier. These funds relate to the sector of "deposit-taking corporations".

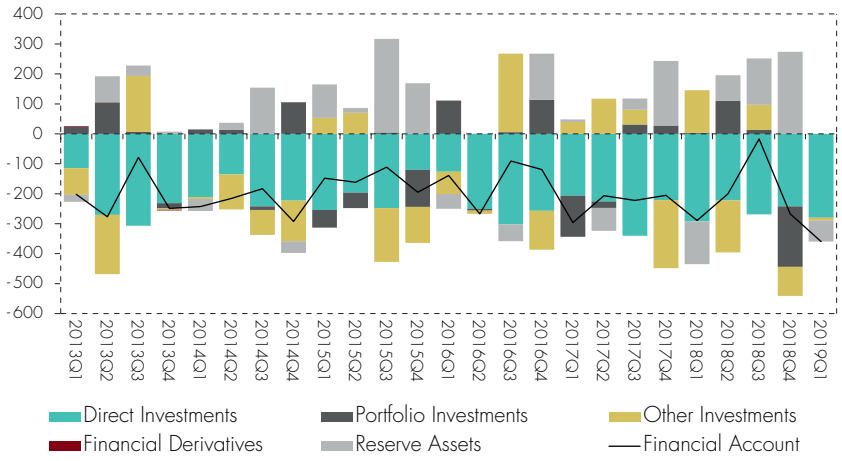
Chart 6 Financial account errors and omissions (net flows, in EUR million)



Source: Bank of Albania.

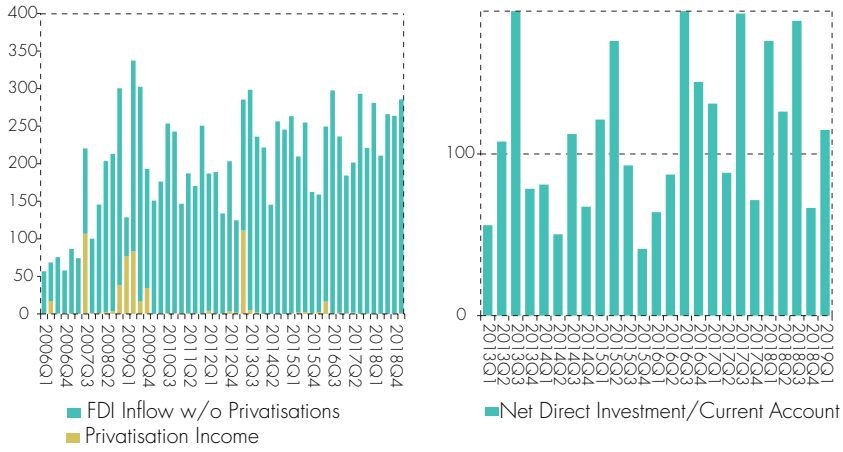
Direct Investment inflows expanded by 1.6%. The flows are concentrated in the "energy" sector followed by the hydro-carbon sector. Total direct investment inflows account for about 9.3% of nominal GDP. In the quarter under review, the ratio of net Direct Investments flows financed around 114.9% of the recorded current deficit. This ratio is 55.0 percentage points lower compared with the same quarter a year earlier.

Chart 7 Financial account components (net flows, in EUR million)



Source: Bank of Albania.

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

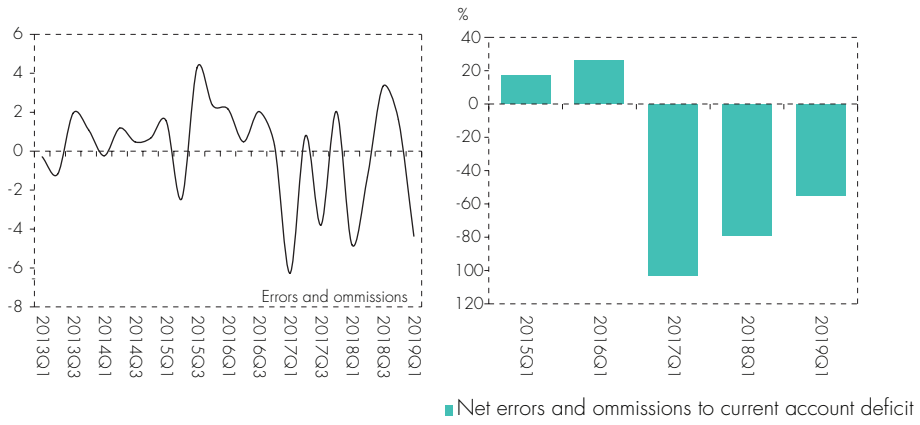


Source: Bank of Albania.

The sub-account of the portfolio investments reports a net inflow surplus of EUR 0.1 million, while a year earlier there was a net asset surplus of EUR 3.5 million. The main impact is related to the reduction of the assets of "deposit-taking corporations" in the form of "capital" and in the form of "debt obligations". On the other hand, liabilities reduced in the form of "debt" but increased in the form of "capital". **In the case of the sub-account of other investments**, in addition to the asset developments discussed earlier, an expansion of "debt liabilities" and "trade credit" is reported.

The overall balance of payments resulted in a decrease of reserve assets by EUR 70.7 million. At the end of March 2019, the foreign exchange reserve stock stood at about EUR 3.4 billion. This level is considered sufficient to cover 6.8 months of import of goods and services or 150% of short-term gross external debt. Finally, the "*net errors and omissions*" account resulted in an outflow of EUR 133.5 million and was estimated at 4.4% of nominal GDP.

Chart 9 Errors and omissions to nominal GDP (% left) and to current account deficit (%, right)

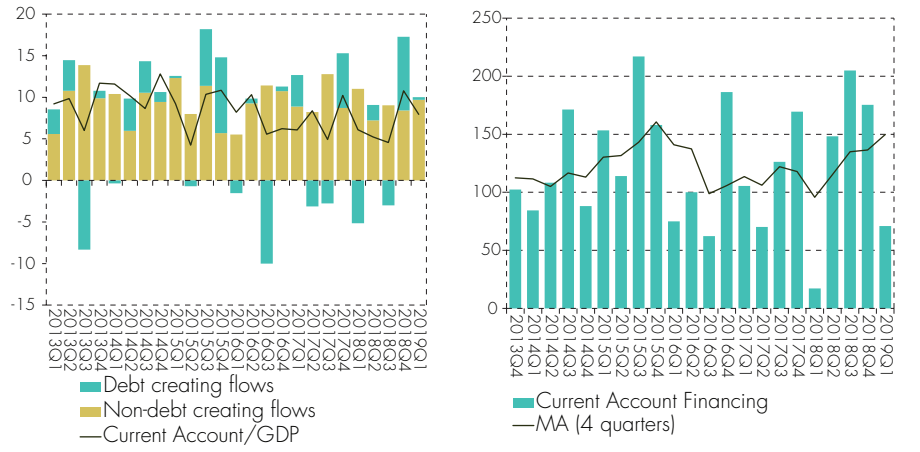


Source: Bank of Albania.

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 inflows.[3]. Thus, non-debt-creating financial flows from net direct investments and from the capital account were assessed at 9.7% of nominal GDP. These were around 1.3 percentage points lower than a year earlier. The debt-creating financial flows were estimated at 0.3% of nominal GDP, around 5.5 percentage points higher compared to the previous year.

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

[3] *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.*

By adding to foreign currency net debt-creating and non-debt-creating flows also net errors and omission, is obtained the overall financing of the current deficit. During the quarter under review, the current account financing ratio was at 70.9%, translating into a reduction in the reserve by EUR 70.7 million. This ratio is about 53.7 percentage points higher than in the previous year, but 104.4 percentage points lower than in the previous quarter.

Table 1 Balance of payments indicators (in EUR million)

	2017 Q3	2017 Q4	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1
Current account (in EUR million)	-142.8	-309.9	-172.1	-176.5	-147.5	-363.6	-243.3
Y-o-y (%)	-3.9	74.5	9.3	-31.0	3.3	17.3	41.4
/GDP (%)	-4.9	-10.2	-6.1	-5.2	-4.6	-10.8	-8.0
Goods and services	-373.8	-570.2	-360.1	-429.0	-361.4	-616.4	-405.6
Y-o-y (%)	-9.0	30.5	15.5	-11.8	-3.3	8.1	12.6
Exports, f.o.b.	1110.0	875.6	840.0	1022.1	1238.7	951.1	883.8
Y-o-y (%)	19.8	2.2	8.6	14.3	11.6	8.6	5.2
Imports, f.o.b.	1483.8	1445.8	1200.1	1451.2	1600.0	1567.6	1289.4
Y-o-y (%)	10.9	11.7	10.6	5.1	7.8	8.4	7.4
Net Travel	180.9	109.6	77.6	83.5	197.1	72.1	75.9
Primary income	18.8	7.1	-14.8	13.7	-18.9	14.6	-28.9
Credit	106.6	98.4	72.1	125.4	95.7	104.9	80.2
Debit	87.8	91.2	86.8	111.7	114.6	90.3	109.1
Net income from Direct Investments	-50.6	-46.4	-63.1	-89.1	-87.5	-41.3	-72.4
Secondary income	212.2	253.1	202.8	238.9	232.8	238.3	191.2
Credit	236.7	284.7	224.4	260.5	253.9	264.1	219.2
Debit	24.5	31.6	21.6	21.6	21.2	25.8	28.0
Net remittances	165.8	172.1	148.6	181.7	170.0	169.2	150.2
Y-o-y (%)	3.9	4.1	10.0	11.7	2.6	-1.7	1.0
Capital account	30.4	42.9	18.3	21.2	22.9	41.6	17.5
Net borrowing/net lending	-112.3	-267.1	-153.8	-155.2	-124.6	-322.0	-225.8
Financial account	-222.3	-205.4	-289.3	-200.1	-17.1	-267.3	-359.3
Y-o-y (%)	144.2	72.0	-2.2	-3.0	-92.3	30.2	24.2
/GDP (%)	-7.7	-6.8	-10.3	-5.9	-0.5	-7.9	-11.7
Direct investments	-340.2	-221.3	-292.4	-222.6	-268.9	-242.1	-279.4
Y-o-y (%)	12.5	-13.8	41.6	-1.5	-20.9	9.4	-4.4
Portfolio investments	31.2	27.9	3.5	110.6	13.1	-202.3	-0.1
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investments	49.1	-227.3	142.0	-173.3	83.9	-96.8	-9.1
Reserve assets	37.6	215.4	-142.4	85.1	154.8	273.9	-70.7
Errors and omissions	-110.0	61.7	-135.5	-44.9	107.5	54.7	-133.5