

BANK OF ALBANIA

PRESS STATEMENT

EXTERNAL SECTOR
DEVELOPMENTS IN THE
ALBANIAN ECONOMY
DURING 2007

MARCH 2008

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The general balance of payments for 2007 yielded a surplus of 149m euros. Inflows of capital have serviced/covered up to 96% of the current deficit.

Main developments in the external sectors of the Albanian economy can be summarized as follows:

- Considerable deepening of the trade and current deficits relative to 2006, in absolute terms and expressed as a percentage of GDP.
- Positive developments in the trade of services.
- Expansion of incoming capital flows in the form of FDIs.
- Expansion of forex reserves stock within the monetary authority.

I. CURRENT ACCOUNT (CA)

The external sector saw intensive activity during 2007, in terms of a considerable growth in current spending and revenues. The current transactions' volume expanded by approx 20% relative to 2006, reaching up to 8.3b euros, of which 60% have been spent.

Over 95% of current spending has been allocated to the purchase of goods and services. Meanwhile, 60% of revenues have been accumulated from the export of goods and services and the rest has been accrued from current transfers (33%) from returns to labor and from investments (7.4%).

The 2007 current deficit reached 878m euros, expanding by 64% relative to 2006, which is equivalent to 11% of GDP.

The high trade deficit that has featured (marked) during the 2007 developments in the external sector of the economy has neutralized any positive effect deriving from significantly narrowing the deficit gap in the service account as well as the positive net growth in revenue flows –thus the trade deficit is the main causal factor in deepening the current deficit during 2007.

I. 1. FOREIGN TRADE

The year 2007 saw a high level of commercial /trade exchanges, which resulted in a volume trade of 3.8b euros, 26% higher than the previous year. The trade of goods contributed with 44% in the 2007 CA. The intensified commercial activity during this year was owed to an increase in general prices, fluctuations in the forex market, as well as the gradual decline in custom duties, all part of the trade liberalization process.

Even though the trade dynamic shows increasing rates of growth in imports (26%), and in exports (25%), the low export base did not help to improve the trade deficit. The trade deficit reached 2.3b euros or 27% higher than 2006.

The productivity capacity at home, quite insufficient to address the domestic growing demand for goods, has led to imports overwhelming exports, and the latter being at low levels, counting for 26%.

Foreign trade transactions attest to a high concentration in intermediate goods, which made up 53% of imports during 2007. At the same token, consumption goods have fallen by 7 points as a share of imports, making up for 30% of total imports. The noticeable growth of capital goods by 36% has granted them a high share of 14 % of the total 2007 imports.

Unfavorable climate conditions and the growing demand in a developing economy have boosted power imports by 3.5 x times, relative to 2006. This resulted in a monetary value 6 times as high compared to last year, reflecting higher costs of electric power in international markets.

The high volume of machinery and equipment entering into the domestic market during 2007 (an increase by 30%) is owed primarily to the construction sector developments at home and investments in infrastructure. Obviously, such construction goods lead to higher fuel consumption, which in turn explains higher expenditures for oil imports.

Exports manifest sizeable growth in almost every good category. We may refer to mineral products, which were 3x times as higher relative to 2006. Chromium exports mainly destined toward China and Sweden provided the greatest contribution in mineral exports.

Fuel (oil) goods constituted the category of good with the highest growth during 2007 (130%). Crude oil exports, which made up 72% of the share of exported fuel, were mainly destined to refineries in the neighboring country of Italy.

Trade activity in the processing industry sector remained the key contributor to trade in this country during 2007. Imports of raw material composed 13% of the total, while 67% of export revenues were owed to re-exports. The surplus that has characterized this industry for years, reached an absolute vale of 120m euros.

I. 2. DEVELOPMENTS IN OTHER COMPONENTS OF CA

The year 2007 saw positive growth in the service trade. The net value of services reached 3m euros, performing far better than the previous year (-67m euros).

During this year, export revenues attributed to services grew at a higher rate

than expenditures for importing services, respectively with 22 and 15% relative to 2006. Tourism has constantly taken the lead in generating revenues of 69% and expenditures of 64% of the total.

Annual growth in revenues accrued from tourism reached approx 24%. This is due to the increasing number of foreign visitors and immigrants that have visited the country (62%) and due to the increase in daily expenditures. Meanwhile, expenditures of Albanian travelers abroad mount up to 923m euros. The volume of travel-related expenditures during 2007 grew by 20% more than in 2006. This was owed to the increase in the number of travelers by 48%, while coefficients that measure the duration of stay abroad and daily average expenditures have dropped mildly.

During 2007, we can notice an improved trade balance in all service industries. Albania continues to be a net importing country in transport and insurance services, a phenomenon that naturally relates to increased imports of goods and that directly impacts the deficit in service trade. Financial, communication and business-related services also show higher rates of development, manifesting for competitive advantages of Albania in the international market of services.

The positive outcome in factorial revenues at end-year (216m euros) marked an annual growth of 4%. This is attributed to revenues collected from our investments abroad through built-up interest on invested forex reserves in our banking system, in non-resident financial institutions and in portfolio investments. At the same token, returns to labor during 2007 dropped by 10%.

Like every year, current transfers accumulate in the form of remittances. These represent the main source of financing the deficit in the trade of goods and services.

During 2007, remittances came up to 947m euros (with a light annual growth of 1.3%), or 12% of GDP. Remittances contributed in narrowing the 2007 trade deficit gap by 44%, which was 11 percentage points lower relative to 2006.

Other private and state transfers have been added to remittances during 2007, leading to reports of 1b euros in net transfers.

II. CAPITAL AND FINANCIAL ACCOUNT

The year 2007 saw high flows of capital in both directions, mainly as inflows. Not counting for unilateral capital transfers, the 2007 financial account reveals larger financial obligations that Albania owes to the world, as well as an increase in our financial means (claims?) abroad. There was a volume of 836m euros in net capital flows during 2007, which financed for up to 95% of the current deficit.

Capital transfers that consist of grants intended for investments in the public and private sectors come up to 90m euros.

We may observe a higher rate of forex obligations in the financial account, in the form of FDIs, long-term soft borrowing as well as other short and long-term investments. The latter consist of deposits from non-resident financial institutions in our banking system.

The Albanian economy has been a receiver (importer) of foreign capital inflows, which have expanded her obligations by 806m euros. Relative to 2006, its obligations grew by 45%.

FDIs flows generated 463m euros during 2007, with a 205m euros in annual change, as compared with 2006. This is primarily owed to investments in the communication field, triggered by the privation process and the growth of foreign capital stock / shares in the Albanian financial sector.

FDI flows have been followed by capital flows of approximately 129m euros through borrowing. 93% of which have been allocated to the public sector. The obligation augmentation has led to higher future payments on the foreign / external debt. Simultaneously, by servicing the foreign debt, our obligations have been reduced by 54m euros during 2007, which makes up only 7% of our exports and shows our capability to pay and/or service our debt within given thresholds. At the same token, it appears that private borrowing may have slowed down its growth rate. Vis a vis 2006, private obligations in 2007 were as much as 27% of 2006 inflows and equals only 7% of the total borrowing.

Financial obligations accrued as a result of short-term investments are of particular significance in 2007. Worthy of note are larger non-resident deposits and other obligations generated by the financial and the non-financial sectors (250m euros). These obligations are held at a great extent in euros (66%) and in dollars (34%). Interestingly enough, this expansion in financial obligations has been brought in by immigrants' deposits in our banking system, which attests to immigrants' heightened propensity to invest in the Albanian economy.

Obligations accrued by 2007 commercial loans grew by 11.8m euros – a result of import expansion during this period.

Capital outflows in the form of investments abroad have expanded the stock of our financial assets abroad by 54.7m euros. Currency shares, in the form of claims over deposits abroad, owned by our banking system reached 55m euros, being the key contributor to the growth of our assets. In currency terms, 57% of our assets are held in US dollars, 36% are held in euros and 7% in British pounds. The growth in financial assets is owed not only to a build-up (boost) in public deposits in the banking system, but also to a share change in the investment portfolio. The banking system in 2007 reallocated our assets from portfolio investments to deposits abroad. In terms of currency structure,

portfolio investments are overwhelmingly carried in dollars, approx 66%, 23% in euros and 10% in British pounds.

Inflows of currency assets in the form of financial capitals led to an expansion of forex reserves within the monetary authority, by approx 148.6m euros. The forex reserve stock at 2006 end-year reached 1.5b euros, sufficient enough to finance approx 4 months of imports of goods and services.

Table 1 Balance of Payments (In millions of EUR)

	2006	Q-1	Q-2	Q-3	Q-4	2007
Current Account	(535.1)	(183.4)	(162.9)	(215.7)	(316.2)	(878.1)
Merchandise: Exports	630.6	182.3	209.8	197.3	196.9	786.3
Merchandise: Imports	(2,316.0)	(632.0)	(717.7)	(732.8)	(838.9)	(2,921.5)
Trade Balance	(1,685.4)	(449.7)	(507.9)	(535.5)	(642.1)	(2,135.1)
Services: Credit	1,194.8	273.5	346.6	464.6	370.5	1,455.2
Services: Debit	(1,261.5)	(303.5)	(336.7)	(456.0)	(356.1)	(1,452.4)
Income: Credit	263.0	62.3	60.1	91.5	64.2	278.1
Income: Debit	(54.4)	(8.7)	(13.1)	(20.6)	(19.4)	(61.8)
Private Unrequired Transfers	966.0	226.1	276.6	223.3	251.8	977.8
Official Unrequired Transfers	42.5	16.6	11.6	17.0	14.9	60.1
Capital Account	143.4	26.9	16.5	21.8	24.9	90.1
Financial Account	408.7	140.1	137.2	261.2	210.1	748.6
Direct Investment	250.3	88.5	52.9	220.1	90.9	452.4
Portfolio Investment	27.2	18.5	0.0	(19.2)	19.2	18.5
Other Capital*	125.4	30.3	84.3	57.6	100.0	272.3
Net Errors and Omissions	189.5	30.9	32.2	67.8	57.1	188.0
Overall Balance	206.6	14.5	23.1	135.1	(24.1)	148.6
Reserves and Related Items						
Reserve Assets	(206.6)	(14.5)	(23.1)	(135.1)	24.1	(148.6)
Use of Fund Credit and Loans	5.8	2.8	-	2.7	-	5.5
Memorandum Items						
Total Change in Reserve Assets	159.2	13.3	13.4	120.0	(47.7)	99.0
Of Which: Change Due To Exchange Rate	(47.9)	(1.2)	(9.6)	(15.1)	(23.6)	(49.5)

* / Not Included Use of Fund Credit and Loans.

Source: Bank of Albania

