

BANK OF ALBANIA

PRESS RELEASE

EXTERNAL SECTOR DEVELOPMENTS  
OF THE ALBANIAN ECONOMY OVER  
THE FIRST NINE MONTHS OF 2006

JANUARY 2007



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### EXTERNAL SECTOR DEVELOPMENTS OF THE ALBANIAN ECONOMY OVER THE FIRST NINE MONTHS OF 2006

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The overall balance of payments for the first nine-month period of 2006 resulted in a surplus of EUR 121.1 million. Capital inflows financed 71.4 per cent of the current deficit.

The main developments in the external sector of the Albanian economy may be summarized in:

- Intensive activity in the external sector, expressed in the increase of current revenues and expenditure.
- Current and trade deficit deepening.
- Increase of the country's financial assets to non-residents, mainly expressed in the increase of financial assets held by the banking system in the form of deposits abroad.
- Increase of the monetary authority foreign reserve.

#### I. CURRENT ACCOUNT

The volume of current transactions is assessed to have grown by about 14.5 per cent, in annual terms, recording a total of EUR 5 billion. More than 96 per cent of current expenditure was used for the purchase of goods and services from non-residents. Around 30 per cent of current revenues were in the form of current transfers, while the exports of goods and services have provided 20 per cent and 38 per cent of revenues, respectively.

Trade deficit, a permanent feature of foreign trade developments, continued to affect the high levels of current account deficit. As opposed to the previous year, current deficit recorded an increase of about 51.6 per cent, amounting to EUR 410.6 million. The increase of trade deficit in goods and services was partly offset by the increase of net revenues and of net factorial revenues in transfer accounts.

##### I. 1. FOREIGN TRADE

Albania's trade activity over the first nine months of 2006 recorded EUR 2.1 billion, accounting for 42 per cent of current transactions volume carried

out over the period. The overwhelming import-orientation of the Albanian economy continues to be considered a characteristic of this period, resulting in further deepening of trade deficit (18 per cent). The coverage of the high demand for consumption and investment by import goods, the continuous expansion of credit to economy over the recent years, and the rise of several products' prices in the international markets remain among the most significant factors for the high imports over this period.

Imports expenditure amounted to EUR 1.7 billion, while exports contributed by EUR 463 million. From the dynamics viewpoint, the growth rates of both imports and exports were almost in the same levels, accounting for 17.3 per cent and 16.3 per cent, respectively. Exports managed to cover only 27 per cent of imports over this period, which is similar to the corresponding period the previous year.

According to an analysis in harmony with the system of national accounts, our country continues to remain oriented to intermediate goods, which share almost half of our imports (47 per cent), while capital and consumer goods shared 11 and 32 per cent, respectively.

Active processing industry, which dominates Albania's trade activity with the rest of the world, was characterized by upward tendencies over this period, following the slowdown displayed over the last two years. Regardless of the continuous increase of global competition from low-cost production countries (China, in particular), of the lek and of the economic slowdown of Italy and Greece (our main exports' markets) over this period, almost all domestic processing sectors have expanded. Exports experienced the most rapid growth by 17 per cent, while raw material imports grew by 13 per cent, compared to the same period the previous year. The share levels of exports and imports for further processing were 70 per cent and 14 per cent, respectively, to the total.

The geographical structure continues to show significant representation of European markets, sharing about 81 per cent of all trade transactions. Except the traditional partners (Italy and Greece), Turkey, China and Germany are among the countries Albania has established import-relations with.

Free trade agreements with the regional countries seem to have provided their effects on exports, as well. Bosnia and Herzegovina, Serbia and Montenegro are among the new markets, while exports with Kosovo have maintained constant trends and a moderate growth.

## I. 2. DEVELOPMENTS IN OTHER ITEMS OF CURRENT ACCOUNT

Trade in services, which has been characterized by upward growth rates over the recent years, is ever-increasingly becoming a pivotal factor of Albania's integration with abroad. Trade transactions in services amounted to about EUR 1.9 billion, which is 22 per cent higher than the same period the previous

year. Services account ended up with a negative balance of EUR 61 million, representing a decrease of about 30 per cent to the previous year deficit. The upgrade of services' deficit position came mainly as a result of the reduction of deficit in "Other services", due to the expansion of exports for this category of services.

This year's deficit in services is attributed to the negative balance in "Transport services" and in "Other services"; while "Travel" maintained its surplus position.

"Tourism" (travel) services continue to make a considerable contribution to this item's inflows and outflows, sharing 69 and 61 per cent, respectively, of the total for this nine-month period. Currently, tourism represents to the Albanian economy one of the main sources of foreign inflows. According to the Bank of Albania estimates, exports on travel services generated about EUR 614 million over the first nine months of 2006, which is about 33 per cent higher than the exports of goods. Income from tourism is assessed to be 19 per cent higher than the same period over 2005, mainly influenced by the increasing number of foreign visitors and expatriates visiting the country over the first months and by the slight increase of daily expenditure estimating coefficients. The number of foreign citizens visiting Albania over the first nine months of 2006 increased by 26 per cent compared to the same period the previous year.

Tourism expenditure has also had an accelerated activity, being characterized by higher annual growth rates. Albanian residents have spent in their travels abroad around EUR 583 million or 85 per cent of total workers' remittances. The increase of Albanian travellers' expenditure abroad is higher than the increase of income, causing the positive balance of this item to reduce from EUR 38 to 30 million over the first nine months of 2006.

The developments in "Other services", accounting for 21 per cent to total volume, provide evidence for an increasing trade activity, both in terms of income and of expenditure.

This period has recorded a deficit of EUR 29 million, against the deficit of EUR 56 million recorded over the same period the previous year. The export of these services increased by 50 per cent, while the import by 20 per cent to the previous year. This category of services is headed by trade transactions in communication, cultural and business services.

The positive balance of income at the end of the period is assessed to have totalled about EUR 161 million or EUR 60 million more than the same period the previous year. Unlike the previous years, when revenues from labour constituted the main contribution to the country's net factorial revenues, over the first nine months we observe an acceleration of investment revenues flow. Net revenues from portfolio investment are assessed to have increased by about four times as high as compared to the first nine months of 2005, contributing to the increase of revenues surplus by 80 per cent for this period.

The rest of revenues, provided by revenues from labour, increased by about 17 per cent.

As in the previous years, current transfers were in the form of workers' remittances. The latter represent one of the main sources of financing the deficit in the trade of goods and services. Over the first nine-month period of 2006 they amounted to EUR 683 million, which is EUR 24 million more than the same period the previous year.

Workers' remittances were also accompanied by official transfers, mainly in the form of technical assistance (EUR 42 million), which are assessed to have maintained the previous year level.

## II. CAPITAL AND FINANCIAL ACCOUNT

Net capital flows amounted to about EUR 293 million over the first nine months, enabling the financing of current deficit at 71 per cent and contributing to the increase of foreign reserve. Behind this positive figure rest the incoming capital transfers totalling EUR 143.7 million and the positive balance of financial account amounting to about EUR 150 million.

Financial account for this period may be defined in the increase of Albania's financial liabilities with the rest of the world (by about EUR 320 million) and in the increase of our assets abroad (about EUR 171 million). As opposed to the same period the previous year, financial liabilities flow is assessed to have increased by 39.3 per cent, while Albania's financial claims on the rest of the world were assessed as increasing by twice as high. However, the net flow of financial liabilities is estimated to have increased by only EUR 5 million, compared to the previous year.

The increase of financial liabilities to the rest of the world over the first nine months was mainly a consequence of the capital inflows in the form of direct investment (EUR 201 million) and of borrowing from abroad (EUR 101 million).

Foreign direct investments are assessed to be 5.3 per cent higher than the same period the previous year. These capital flows have now turned into a dominating factor in the increase of financial liabilities and in the development of the country's capital and financial transactions.

The borrowing of long-term and soft loans from abroad, which remain another important factor in the increase of Albania's financial liabilities to the rest of the world, recorded EUR 101 million, out of which only 91 per cent flows from public borrowing. Unlike the previous year, when there was an increase of private sector's liabilities through borrowing, they have increased by only EUR 8.6 million over the first nine-month, which accounts for only 18 per cent of the previous year increase.

Foreign debt services in the form of principal and interest payments totalled

about EUR 45 million, which is equal to 9.7 per cent of the exports of goods.

On the other hand, Albania's financial claims on the rest of the world increased by EUR 171.1 million. The increase of these assets was mainly determined by the increase of financial assets held by the banking system in the form of deposits abroad. Meanwhile, portfolio investments of resident entities abroad have been decreasing.

Financial assets stock in the form of portfolio investment recorded EUR 90.6 million as of end period, representing a decrease of EUR 23 million. In terms of structure by denomination, 78 per cent is shared by the USD and 17 per cent by the EUR.

Foreign assets held by the banking system in the form of deposits abroad increased by about EUR 191 million, over the first nine months. Such an increase came due to the increase of residents and non-residents' deposits held in our banking system, which were invested in the international financial institutions. This increase also derives from the shift of assets from portfolio investment to deposits with abroad. In terms of structure by denomination, USD deposits share 60.2 per cent, while EUR deposits share 35.2 per cent.

Foreign assets inflows in the form of financial capital were reflected in the increase of the monetary authority's foreign reserve by about EUR 121 million. The level of gross foreign reserve, as of end period, amounted to EUR 1.294 billion, fully sufficient to cover 4.4 months of imports of goods and services.

Balance of Payments  
In millions of EUR

	9M- 2005	9M- 2006
Current Account	(270.8)	(410.6)
Export of Goods	398.5	463.3
Import of Goods	(1,421.3)	(1,663.2)
Trade Balance	(1,022.7)	(1,199.8)
Services : Credit	714.1	895.4
Services : Debit	(801.1)	(956.2)
Revenues: Credit	131.3	182.3
Revenues : Debit	(31.0)	(21.7)
Private Unrequired Transfers	696.0	655.2
Official Unrequired Transfers	42.7	34.3
Capital Account	75.1	143.7
Financial Account	135.2	143.8
Direct Investment	160.3	200.8
Portfolio Investment	(7.3)	23.3
Other Capital*	(17.8)	(80.3)
Net Errors and Omissions	95.8	238.4
Overall Balance	44.8	121.1
Reserve and Related Items		
Reserve Assets	(44.7)	(121.1)
Use of IMF Credit and Loans	9.4	5.8
Memorandum Items		
Total Change in Reserves	20.9	(89.4)
of which : Change due to Exchange Rate	(65.6)	(31.8)

\* / Use of IMF Credit and Loans is not included.

Source of data : Bank of Albania