

BANK OF ALBANIA

PRESS STATEMENT

EXTERNAL SECTOR
DEVELOPMENTS OF THE
ALBANIAN ECONOMY
DURING 2005

MARCH 2006

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The external sector of the Albanian economy during 2005 is presented with a deep negative balance on current account, caused by a high trade deficit. The trade deficit deepened as a result of the slowdown in the export growing paces and the rapid import increase.

Capital inflows have by and large been sufficient in compensating the current deficit, as such allowing an overall positive balance.

Foreign reserve at the end of 2005 marked EUR 1.204 billion, fully adequate to meet about 4.6 months of goods and services import.

I. CURRENT ACCOUNT

The volume of current transactions increased by 21 per cent compared to the previous year, marking a level of EUR 6.2 billion. More than 93 per cent of current expenditures were used for the purchase of goods and services by non-residents. About 43 per cent of current income was in the form of current transfers, while the export of goods and services has provided 32 per cent and 18 per cent of income, respectively.

Trade deficit, a permanent feature of foreign trade developments, has affected the high levels of current account deficit during this year, as well. Compared to the previous year, current deficit increased by about EUR 168 million, recording EUR 454 million. The increase of trade deficit in goods and services was in part balanced by the increase of net income in the transfer and income accounts. Service trade, a significant item in the current account marked growth both in income and expenditure during 2005. Compared to 2004, expenditures increased more rapidly than income. Net result of service transactions led to the increase of this account deficit by about EUR 127 million.

I. 1. FOREIGN TRADE

The volume of foreign trade, imports plus exports, was estimated at about EUR 2.5 billion, contributing to total current transactions by about 41 per cent. Expenditures for the import of goods marked about EUR 2 billion or EUR 245 million more, compared to the 2004.

Trade deficit for 2005 reached to EUR 1.5 billion, which is 16 per cent higher than the previous year. Export slowed the growing paces down. The

annual increase in exports was estimated at about 9 per cent, compared to 23 per cent during the previous year. Despite the lack of competitive abilities (developments in the exchange rate), the exports slowdown is deemed to have been due to the enhancement of competition in the textiles sector with the opening of European markets towards China and India. Thus, the degree of import coverage by exports resulted in 25 per cent, marking a slight decrease compared to the level of 27 per cent during the previous year, as such contributing to the further deepening of the trade deficit. At the same time, the high oil prices in the international markets and the increase of the lending activity (new credit to the economy marked an annual growth of about 74 per cent) led to the increase of imports by about 16 per cent.

Export of goods is mostly represented by the export of textiles, footwear and base metal. Exports for active manufacturing realized 70 per cent of annual income in the export of goods. During 2005, it was observed a significant increase of domestic production exports, contributing to the total by 30 per cent, compared to 25 per cent in the previous year.

Import demand remains high. It is positive that the annual increase in imports has considerably been due to the increase of imports in machinery, equipment and vehicles. Their weight to the total is about 24 per cent, as such maintaining the same levels as in the previous year. The high demand of the private sector for capital goods is a positive indicator for the level of investment, renovation of the technological basis and its productivity. Imports of raw materials for the active manufacturing industry in the country, mainly concentrated in textiles, footwear and metal, increased contributing to the total by 15 per cent, compared to 17 per cent in the previous year.

Based on the foreign trade structure by trade partners, Albania continues to carry out most of its transactions with the European Union. However, worth mentioning is the fact the Albania is inclining towards trade (in particular exports) with the regional countries, pushed by the free trade agreements with the neighbouring countries. Exports and imports with the European Union share 88 and 60 per cent, respectively, of the total exports. Italy and Greece remain Albania's main trade partners.

Meanwhile, trade with the regional countries of South Eastern Europe, which are under the free trade agreement with Albania, increased both in exports and imports by 19 and 31.5 per cent, respectively, compared to the previous year. Currently, Kosovo and Macedonia represent the biggest market for Albanian products' exports.

I. 2. DEVELOPMENTS IN OTHER ITEMS OF CURRENT ACCOUNT

Service trade balance ended with a negative balance of EUR 167 million, increasing considerably compared to the EUR 40 million deficit recorded in 2004. This deficit was mainly due to a negative balance in other cultural and business services item.

Income from tourism services reinforces the fact that this sector is providing concrete trade opportunities to the Albanian economy, regardless of the level of developments in this sector. According to the Bank of Albania estimations for 2005, tourism services export generated EUR 692 million of income, which is about 30 per cent higher than the export of goods. Such an increase was mainly caused by the increase in the flow of foreign citizens and emigrants visiting the country and the slight increase of estimating coefficients of daily expenses. During 2005, the number of foreign citizens visiting Albania increased by about 21 per cent, compared to 2004, wherein the main weight of this increase was observed in seasonal periods of holiday and end year. An increase with high annual rates was also observed in the import of tourism services. 2005 recorded a figure of about EUR 635 million, which is 68 per cent of workers' remittances.

It is now recognized that transportation and insurance services follow the developments in the trade activity of goods. The increase of import volume caused the increase of services import of these categories. At the end of the year, services imports of these categories were estimated at about 12 and 38 per cent, respectively, higher than those in 2004. Each year, the Albanian economy benefits currency sources from the work of seasonal workers and investments of foreign currency reserves of the banking system in non-resident financial institutions, paying at the same time interests for the foreign debt. The positive income balance at the end of 2005 was estimated at about 144 million, which is 4 million higher than in 2004. Income from labour represents about 70 per cent of the positive income balance. Net income flow of this category decreased by about 3 per cent compared to the previous year when the Olympic Games kept the demand for labour force in the neighbouring country high, and as a consequence generated high income flows from labour. Meanwhile, net income in the form of interest from investment increased (by about 19 per cent or EUR 7 million). During 2005 Albania paid EUR 22 million to settle the interests on its foreign debt or 19 per cent more than during the previous year.

Like in the previous years, workers' remittances made the most considerable contribution to the current transfers. Workers' remittances represent a significant supporting source to the Albanian economy, providing a continuous flow of financing to the current deficit. Their total for 2005 was estimated at about EUR 939 million or 14 per cent of the GDP. Their contribution to the decrease of trade deficit was estimated at about 64 per cent.

II. CAPITAL AND FINANCIAL ACCOUNT

Capital flows during 2005 resulted in a net flow of about EUR 423 million, making the financing of the current deficit possible by 93 per cent. Capital transfers were estimated at EUR 99 million or 7 million less than the end 2004, while the financial account ended with a positive balance of EUR 323 million.

Albania's financial liabilities with the rest of the world increased by about EUR 346 million and were estimated to be 22 per cent less than the previous year. This increase was mainly due to the foreign direct investment inflows and the foreign debt.

Foreign direct investment flow reached EUR 213 million in 2005, compared to EUR 278 million in the previous year. It is worth mentioning that capital inflows in the form of privatisation were a determining factor in 2004 with regard to the volume and character of foreign investment in the country.

The stock of financial assets in the form of portfolio investment reached to EUR 120 million, marking an annual increase of about EUR 2 million.

The borrowing of long-term and soft loans from abroad still remains another crucial factor in the increase of Albania's financial liabilities with the rest of the world. In 2005 it was estimated at EUR 208 million, out of which 66 per cent was channelled in the government sector. This increase was mainly used to finance investment and consumption, reflected also in the increase of consumer imports and the needs of companies for capital and/or capital goods.

Financial liabilities in the form of non-residents' deposits held with the Albanian banking system decreased by about EUR 30 million. Liabilities in the form of commercial credit increased by about EUR 8 million, which was also reflected in the increase of imports for this period. Other foreign liabilities in the form of short-term loans by non-resident entities had a considerable increase by EUR 47 million.

Albania's financial claims with the rest of the world increased by EUR 22 million. The increase of other foreign assets in the form of short-term and medium-term loans extended by resident entities abroad holds the largest share in this increase by about EUR 69 million or about 44 million higher than the end 2004.

Foreign assets inflows in the form of financial capital were reflected in the increase of foreign reserve of the monetary authority by about EUR 197 million. Foreign reserve at the end 2005 marked the level of EUR 1.204 billion, fully sufficient to cover about 4.6 months of import of goods and services.

Balance of Payments						
in millions of EUR						
	2004	Q1-2005	Q2-2005	Q3-2005	Q4-2005	2005
Current Account	(286.2)	(53.0)	(106.1)	(63.7)	(230.9)	(453.7)
Export of Goods	485.6	121.5	143.3	133.7	131.7	530.2
Import of Goods	(1,762.3)	(398.1)	(507.1)	(516.1)	(585.7)	(2,006.9)
Trade Balance	(1,276.7)	(276.6)	(363.8)	(382.3)	(454.0)	(1,476.7)
Services: Credit	807.5	196.5	237.4	262.0	234.5	930.4
Services: Debit	(848.0)	(225.9)	(261.0)	(306.2)	(304.4)	(1,097.5)
Income: Credit	164.0	40.1	41.9	54.9	46.4	183.3
Income: Debit	(23.3)	(9.1)	(14.0)	(8.0)	(8.0)	(39.1)
Private Unrequired Transfers	829.7	210.2	243.3	295.0	235.9	984.5
Official Unrequired Transfers	60.7	11.8	10.1	20.8	18.6	61.4
Capital Account	106.2	35.5	14.6	25.0	24.1	99.2
Financial Account	297.4	25.1	116.8	(20.3)	192.4	313.9
Direct Investment	267.4	43.33	50.3	53.0	62.59	209.26
Portfolio Investment	4.6	(42.8)	(5.4)	40.9	5.4	(2.0)
Other Capital*	25.4	24.55	71.9	(114.3)	124.44	106.65
Net Errors and Omissions	106.5	(2.5)	(23.9)	87.9	94.5	156.0
Overall Balance	233.7	9.7	1.4	33.7	80.1	124.8
Reserve and Related Items						
Reserve Assets	(233.7)	(9.7)	(1.4)	(33.7)	(80.1)	(124.8)
Use of Fund Credit and Loans	9.6	4.6	-	4.8	-	9.4
Memorandum Items						
Total Change in Reserves	(276.1)	15.7	35.3	(30.1)	(68.3)	(47.4)
of which: Change due to Exchange Rate	42.4	(25.4)	(36.7)	(3.6)	(11.8)	(77.4)

* / Use of Fund Credit and Loans is not included

Source of data: Bank of Albania