

BANK OF ALBANIA

PRESS STATEMENT

EXTERNAL SECTOR
DEVELOPMENTS IN THE
ALBANIAN ECONOMY
DURING THE FIRST
QUARTER OF 2008

JUNE 2008

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The overall balance of payments resulted for the first quarter of 2008 in the reduction of foreign assets by 25.7 million euros. Net capital inflows have covered up to about 73% of current deficit.

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

- Overwhelming intensive activity in the external sector, expressed in the increase of current spending and revenues.
- Deepening of current and trade deficit.
- Increase of Albania's financial liabilities to the rest of the world, mainly expressed in the growth of foreign direct investments and other short term investments.
- Decreased foreign reserve of the monetary authority.

I. CURRENT ACCOUNT

The external sector of the Albanian economy saw an intensive activity in the first quarter of 2008, expressed in the considerable growth of current spending and revenues. The volume of current transactions has grown by about 12% relative to the first quarter the previous year, reaching up to 1.8 billion euros.

Over 94% of current spending has been allocated for the purchase of goods and services. About 35% of current revenues have been accumulated through transfers, while services and the export of goods provided 34% and 23% of foreign currency revenues.

Current deficit was estimated at 298.3 million euros for this quarter, estimated about 1.6 times higher than the one at the same period of 2007.

The high trade deficit, which characterized the developments in the external sector of the Albanian economy during the first quarter, offset the positive effect of the balance of services factorial income, remaining the main causal factor for the current deficit deepening during the first quarter of 2008.

I. 1. FOREIGN TRADE

The high trade exchanges flow continued to characterize the beginning of 2008. Total trade volume reached 942 million euros, which is 17% higher than the same period the previous year.

In relative terms, high growth rates by 13% and 18%, respectively, were recorded for both exports and imports.

Trade deficit amounted to 531 million euros for this quarter or 20% higher relative to the first quarter of 2007.

The ratio of imports' coverage by exports remains low (28%), providing evidence for the importing nature of foreign trade, as a result of the insufficient capacity of domestic production.

As of end the first quarter 2008 exports' revenues amounted to 205 million, growing by 23 million euros (13%) in absolute terms, relative to the first quarter of the previous year. This growth attributes to the increase in both categories: exports of active processing and of domestic production.

Processing industry makes up the most overwhelming share of Albania's exports, accounting for 70%, while the export of domestic production shares only 30%. However, the share to total exports has changed slightly during this quarter. Processing industry has dropped by 2%, while the export of domestic production has grown by 2%, providing evidence for the improved productive capacity at home.

Exports of processing industry were 10% higher relative to the previous year. Exports of textile processing (which share 44% of processing industry) have expanded by 19% relative to the same period the previous year. Export of base metals grew by 9% during this quarter. The footwear industry has dropped by 10%, despite being among the main sectors of active processing.

On the other hand, Albania's domestic exports have grown by 20% relative to the first quarter of 2007. Mineral products and base metals share the main weight in the domestic export by 34.6% and 35.5%, respectively. Exports of mineral products have increased by 3%, while base metals have increased overwhelmingly by 73%.

With regard to imports, the available data provide evidence for positive performance and further increase in the imports of main products. Albania spent approx. 737 million euros for the purchase of goods.

Albania's main imports are represented by imports of processing industry, foods and beverages, agricultural raw material, oil and metals. They shared 62% of total imports in the first quarter of 2008.

Processing industry at home shares 26.7% of total imports for the first quarter of 2008, estimated to have grown by 4.3%.

Foods imports have grown by about 21 million euros (26%) in absolute terms, accounting for 13% of Albania's total imports. Meanwhile, 'alcoholic and non-alcoholic beverages' have increased at lower rates relative to the previous year, only by 18% from 48% growth in 2007.

The imports of machinery and appliances (which share 16.2% of total imports) indicate positive and promising performance, providing evidence for the growth of investment at home. Relative to the previous year, they grew by 22%, while the imports of mineral products grew by 11.1% during this quarter. Albeit to a relatively low share in total imports (only 7%), the high growth rates of vegetable products by 37% have provided their contribution to the increase of the Albanian imports.

Base metals dropped by about 10%, reducing the import of metals to 51 million euros from about 55 million euros the first quarter the previous year. Energy price rose by 3% relative to the previous year. The import of energy during the first quarter of 2008 reduced both in volume and value by 16% and 14% respectively, accounting for only 5.6% of total domestic import.

The import of fuels increased considerably by about 46.7% in the same quarter. Out of this figure, only 1.5% attributes to the growth of demand for fuels, while the rest (44.5%) is a result of the price rise. Imported fuels accounted for 6.7% of total imports in the first quarter of 2008.

According to a disaggregating in harmony with the System of National Accounts, intermediate goods share almost as much as half of imports (49%).

In addition, the ever-increasing need for consumer goods has boosted their increase, deepening further the trade gap and consequently the current deficit. These type of goods share 36.4% of Albania's total imports and they have been assessed to have grown considerably by 36.6%. Capital goods account for 15% of total imports, growing by 26% relative to the previous year. Import of machinery and appliances provided the main contribution growing by about 22%.

The Stabilization and Association Agreement with the EU continued to provide its positive effect during this quarter, being evidenced in the considerable growth of exports to EU countries. Additionally, the entry into force of the CEFTA in July 2007 had a positive impact on our exports. However, the distribution of exports by country has not been uniform, being concentrated mainly in the neighboring countries, Italy and Greece, which account for 70% and 9% of total exports.

As in the first quarter of 2007, our exports to regional countries continue to grow. Consequently, exports to these countries grew by 25%. This growth mainly derived from exports to Kosovo, sharing 47% of total exports to the regional countries. Exports to the latter increased their share to total exports, accounting for 10%.

Italy and Greece remain Albania's main partners in terms of imports. In real terms, imports from these two countries amounted to 320 million euros, growing by about 48 million euros relative to the previous year.

While imports from most EU countries continue to grow, imports from regional countries have dropped. Imports from Turkey, which have fallen by 4% this

quarter, represent a considerable part of this group's imports. The same has been shown in the imported goods from Serbia and Montenegro, which have fallen overwhelmingly by 90%. On the contrary, the import of goods from Macedonia and Bulgaria has increased by 16% and 13%, respectively. Goods imported from China are of great importance given the share they have in Albania's foreign trade (7%). Imports from China have recorded high growth rates, growing by 12% relative to the first quarter of 2007.

I. 2. DEVELOPMENTS IN OTHER ITEMS OF CURRENT ACCOUNT

Transactions in services amounted to about 621 million euros, assessed to be 11% higher than the previous year, given the concurrent growth of exports and imports by 12% and 11%.

Trade in services ended in a negative balance of 30 million euros, being in the levels of the first quarter of 2007.

Travel spending continues to share the main weight in services trade. The export and import of this item's services share about 75% and 66% of services' export and import, growing by 10% and 14% relative to the first quarter of 2007.

According to the Bank of Albania assessments, the export of travel services has generated 221 million euros of revenues, recording an annual growth of 30%. This growth mainly attributes to the increase in the number of nonresidents visiting Albania (43%), 55% out of which are Albanian emigrants living abroad. In addition, it reflects the price rise of goods and services offered which increases travel spending in Albania.

Meanwhile, the import of travel services in the form of resident travelers' expenditures abroad reached 214 million euros, which is about 21% higher than the first quarter the previous year. This growth attributes to the increase in the number of travelers by 37% and of their spending, given the price rise in Europe as the Albanian residents mainly have the Euro area countries as their main destination countries.

The import of goods' transportation has increased, being a natural outcome of the growth in the import of goods. As a result, deficit in transportation services has doubled relative to the previous year.

Improved figures have been also shown in the communication, financial and business services.

The positive balance of factorial returns as of end period (30.8 million euros) is assessed to be 42% lower than the first quarter in 2007. This fall is reflected in both items of returns: returns from labour and from investment by 52% and 36%, respectively.

Returns from investment share about 58% of revenues' positive balance and they have been assessed to have recorded a surplus of 18 million. Revenues inflow is mainly represented by the interests on the banking system's foreign reserve, while the outflows are mainly represented by external debt interests. During the first quarter of 2008 Albania has paid 3.4 million euros to pay off the interests on its external debt, which have slightly increased (0.2 million euros) relative to the same period the previous year.

Current transfers continued to be mainly represented by workers' remittances. The latter amounted to about 219 million euros and have financed 41% of the trade deficit in goods. Relative to the same period the previous year, these transfers have lowered by 5% as a result of the shift of foreign currency flows from for current use purposes to flows for investment purposes. Workers' remittances have been also followed by other private and official transfers, amounting to 16 and 6 million euros, respectively.

II. CAPITAL AND FINANCIAL ACCOUNT

Net capital flows amounted to 218 million euros during this first quarter of 2008, financing the current deficit by about 75%. Capital transfers totaled 13 million euros and they were mainly in the form of investment grants to the public and private sectors.

Financial account ended in a positive balance of about 205 million euros, which is 35% higher than the early 2007. The Albanian economy has increased both the financial liabilities and assets by 228.6 and 23.6 million euros, respectively.

The increase in the financial liabilities for the first quarter of 2008 mainly attributes to capital inflows in the form of foreign direct investments, short-term investments in the banking sector and public sector's long-term borrowing.

Foreign direct investments amounted to about 119 million euros. Worth to be highlighted is that capital inflows to the financial and communication sector during the first quarter have played the main role in these investments, followed by processing industry.

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, amounted to 20.3 million euros, out of which 81% was intended for the Government and public sector. This increase has mainly financed investments in infrastructure, being also reflected in the increase of imports of capital goods. Meanwhile private borrowing seems to have decelerated its growth rates and has amounted to 3.8 million euros.

External debt services, in the form of principal and interest payments, totaled about 12.9 million euros, which is equal to 6.2% of exports of goods, providing evidence for the paying off ability within accepted levels.

The increase of financial assets during the first quarter of 2008 is fully attributed to the banking system's short-term investments in non-resident financial institutions. Meanwhile, a change in the ratio of investment assets is shown. Assets in the form of portfolio investment shifted to the banking system's reserve investment in the international market in the form of short term loans and deposits. These assets' increase totaled 30 million euros for the first quarter of 2008.

Monetary authority's reserve assets fell by 25.7 million euros. As of end the first quarter of 2008, these reserves stood at 1.41 billion euros, sufficient enough to finance about 3.3 months of imports of goods and services.

Table 1 Balance of Payments (in millions of EUR)

	Q-1 2007	Q-2 2007	Q-3 2007	Q-4 2007	Q-1 2008
Current Account	-176.5	-187.3	-170.0	-297.6	-289.3
Merchandise: Exports	182.3	209.8	197.3	196.9	205.2
Merchandise: Imports	-625.1	-710.5	-724.7	-830.1	-736.5
Trade Balance	-442.7	-500.6	-527.4	-633.3	-531.3
Services: Credit	265.1	337.5	454.3	358.3	295.8
Services: Debit	-292.7	-324.1	-443.1	-342.5	-325.5
Income: Credit	62.0	56.6	95.0	65.0	43.2
Income: Debit	-8.7	-13.1	-20.6	-19.4	-12.4
Private Unrequired Transfers	223.8	244.9	254.7	259.3	235.0
Official Unrequired Transfers	16.6	11.6	17.0	14.9	6.0
Capital Account	26.9	16.5	21.8	24.9	13.0
Financial Account	151.8	142.4	276.2	169.7	205.0
Direct Investment	91.4	55.9	223.1	95.2	124.7
Portfolio Investment	18.5	0.0	-19.2	19.2	1.4
Other Capital*	39.1	86.6	69.6	55.3	81.9
Net Errors and Omissions	12.3	51.4	7.1	79.0	45.6
Overall Balance	14.5	23.1	135.1	-24.1	-25.7
Reserve Assets	-14.5	-23.1	-135.1	24.1	25.7
Use of IMF Credit and Loans	2.8	0.0	2.7	0.0	-2.9
Total Change in Reserves	13.3	13.4	120.0	-47.7	-54.6
of which: Change due to Exchange Rate	-1.2	-9.6	-15.1	-23.6	-29.0

* Not included Use of IMF Credit and Loans
Source: Bank of Albania