



REPUBLIC OF ALBANIA
BANK OF ALBANIA



Sheshi "Skënderbej", No. 1, Tirana - Albania • **Tel:** ++355 4 222230; 222750; 235568
• **Fax:** ++355 4 223558 • **Website** www.bankofalbania.org • **E-mail:** public@bankofalbania.org

Press Statement

EXTERNAL SECTOR DEVELOPMENTS OF THE ALBANIAN ECONOMY OVER 2006

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The overall balance of payments for 2006 resulted in a surplus of EUR 207 million. Capital inflows were fully sufficient to offset the current deficit.

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

- Current deficit deepening as opposed to the previous year, both in absolute terms and as a percentage to Gross Domestic Product (GDP).
- Progress in exports performance.
- Improvement in the ratio of imports coverage by exports.
- Significant growth of our foreign assets invested abroad.
- Increase of financial liabilities to non-residents, created in the form of non-residents' deposits growth in the banking system.
- Increase of the monetary authority foreign reserve stock.

I. Current account

Year 2006 was characterized by an intensive activity in the foreign sector, expressed in the considerable increase of current income and expenditure. The volume of current transactions grew by 14 per cent compared to 2005, amounting to EUR 6.9 billion. More than 95 per cent of current expenditure was used for the purchase of goods and services. About 35 per cent of current income was in the form of current transfers, while the services and the exports of goods provided 37 per cent and 20 per cent of income, respectively.

Current deficit for 2006 was estimated to total EUR 556 million, increasing by about 13 per cent from 2005, and accounting for about 7.6 per cent of the GDP.

High trade deficit, which characterized the developments in the external sector of the Albanian economy over 2006, neutralized the positive effects of the significant reduction of deficit position in the services account, as well as the growth of positive flows of net factorial income, remaining the main cause for the current deficit deepening over this period.

I. 1. Foreign trade

The volume of trade transactions over 2006 totalled EUR 2.9 billion, sharing 42 per cent of total current transactions. The expenditure on the import of goods amounted to EUR 2.3 billion or EUR 309 million more compared to 2005. Income from the export of goods was estimated at about EUR 631 million, with a nominal growth of about EUR 100 million.

Although the annual growth rate of exports (19 per cent) was higher than that of imports (15 per cent), the high volume of the latter caused the trade deficit to increase by about EUR 209 million or by 14 per cent.

However, there has been a positive development in the improvement of the ratio of imports' coverage by exports, which recorded 27 per cent for this year, increasing by 1 percentage point from 2005.

The slowdown in exports, observed over the previous year – resulting from the increase of competition pressures in key industries of Albanian exports (textiles and footwear),

from the opening of European markets to Far East countries (China and India) and Turkey, followed by the economic growth slowdown in partner countries and the aggravated energy supply situation in the country – was considerably recovered over 2006.

EU's¹ anti-dumping measures influenced on the improvement of domestic processing industry (textiles and footwear) performance overwhelmingly. Trade surplus resulting from this industry over 2006 was 45 per cent higher than the previous year's. Textiles and footwear industry represents the key point of the exporting industry in the country, providing a contribution to the annual revenues from the export of goods by about 55 per cent.

There have also been positive developments in the domestic export (export in cooper, minerals and mineral fuels), providing a considerable contribution to the increase of income from export for 2006.

Imports continue to represent the overwhelming part of Albania's trade exchange flows with the rest of the world, sharing more than 79 per cent of trade volume.

The variety in commodity groups and the large volume of imports (31.8 per cent of the GDP) reflect the economic growth rates in the country and the acceleration of the construction sector activity and investments in infrastructure, which require imports in goods and machinery. Moreover, it reflects a high level of imports in consumer goods, the demand of which, as for construction, is also supplied by workers' remittances.

The unusual rise of oil prices, the high energy imports and the metals price rise in the global markets, accompanied by the high demand for consumer goods, represent the main factors in the increase of imports over 2006.

The meeting of domestic demand with energy and the energy price rise – following the oil price developments, increased fivefold the expenditure on imports of this category, while the imported quantity also increased considerably, by about 3.5 times compared to the previous year. The import of fuels was 22 per cent higher than in 2005. The

¹ Over 2006, an EU anti-dumping investigative commission discovered state subsidies in the footwear industry in China and Vietnam. The EU decided to impose an additional customs duty of about 19 per cent for the imports from these countries.

contribution of energy and fuels to the total growth of import is assessed at 8 per cent and 12 per cent, respectively.

I. 2. Developments in other items of current account

Net export of services for 2006 was estimated at EUR - 65 million, being much lower than that of EUR -140 million recorded as of end 2005.

The export of services continues to be dominated by tourism. According to the Bank of Albania estimates, tourism generated about EUR 804 million inflows in services or about 28 per cent more than the export of goods. The increase in the number of non-residents entering the country by 21.2 per cent remains the main factor for the increase of income in this activity by 16 per cent, compared to 2005. Meanwhile, the estimating coefficients of daily expenses and duration of stay slightly decreased, compared to the previous year.

Albanians have spent in their travels abroad a total of EUR 768 million or 82 per cent of total workers' remittances. The volume of travel expenses for 2006 is assessed to be about 21 per cent higher than over the previous year, due to the increase in the number of travellers by 22.4 per cent, while the coefficient of average duration of stay dropped by 10 per cent and the average daily expenses are assessed to have maintained the previous year's levels.

Compared to the previous year, income from tourism increased slower than expenditure for the same item of services. As of end-year, the positive balance of this item was estimated at EUR 37 million, from EUR 56 million in 2005.

There has been an improvement in the trade balance of almost all sectors of services. The developments in the sectors of services are characterized by the market liberalization, the enhancement of technology in information services, the variety of cultural services and by the growth in the volume of financial services.

Meanwhile, Albania continues to be net importer of transport and provision of goods services. This phenomenon is naturally related to the increase of goods import and it has a direct impact on the trade of services deficit.

The positive balance factorial income as of end-year (EUR 215 million) has increased considerably compared to the previous year, by 58 per cent. This year increase does not only attribute to income from seasonal and border workers' labour and to the accumulated interests from the investment of the banking system foreign reserve in non-resident financial institutions, but also to income from our direct investments abroad and from financial assets investments in the form of portfolio investments. Income from labour shared about 58 per cent of positive balance of income, while net income, in the form of interest from investment, grew by 42 per cent. Albania has paid EUR 24 million over 2006 to settle the interests on its external debt, which are assessed to have slightly decreased compared to 2005 (4 per cent).

Current transfers were in the form of workers' remittances. The latter represent the main source of financing the deficit on trade in goods and services. Over 2006, they amounted to EUR 933 million or 12.8 per cent of the GDP. The contribution of remittances to reducing trade deficit is estimated at about 55.4 per cent or 5 percentage points less than the previous year.

Workers' remittances were also followed by official transfers, mainly in the form of technical assistance (EUR 39 million), which are assessed to have dropped by 17 per cent compared to the previous year.

II. Capital and financial account

Year 2006 was characterized by large capital inflows and outflows. Except for one-sided capital transfers, financial account for 2006 may be translated into large increase of Albania's financial liabilities with the rest of the world and of our assets abroad. However, the year ended with a positive balance of capital and financial account (about EUR 558 million), enabling the complete financing of current deficit.

Capital transfers, which are mainly characterized by investment grants both in the public and private sector, were estimated at being EUR 167 or about 68 million more than the previous year.

As far as financial account is concerned, there has been a significant growth of our foreign assets invested out of the Albanian economy, mainly those of the banking system, represented by short- and medium-term investments. The considerable

accumulation of foreign assets in the banking system forced the latter to choose the option of increasing their investment in foreign financial institutions.

Foreign assets held by the banking system in the form of deposits abroad, which represent the main share of this growth, are assessed to have grown by about 157 million, compared to their decrease over the past year. As far as their composition is concerned, USD assets share 55 per cent, while the rest is shared by EUR (39 per cent) and the British pound (6 per cent). The growth of these assets came as a result of the growth of residents and non-residents' deposits in our banking system, which invested them in financial institutions abroad. There has also been a change in the ratio of investment assets. This year, the banking system preferred the shift of assets from portfolio investment to deposits with abroad. As a result, financial assets in the form of portfolio investment amounted to EUR 84.3 million, recording an annual decrease by about EUR 27 million. In terms of structural composition by currency, portfolio investments are dominated by USD investment by about 77 per cent, EUR 16 per cent and the British pound 7 per cent.

Foreign capital inflows continued over this year, causing the Albanian economy to increase its liabilities by about EUR 546 million. This increase, which is assessed to be 51 per cent higher than in 2005, mainly results from direct investments, soft long-term borrowing, as well as from liabilities deriving from deposits held in our banking system by non-residents.

Foreign direct investments for 2006 totalled EUR 260 million, from EUR 224 million the previous year. They remain a dominating factor in the increase of financial liabilities and in the performance of Albanian capital and financial transactions.

Foreign direct investments inflows were followed by capital flows in the form of borrowing, leading to the increase of Albania's external debt. The borrowing of long-term and soft loans from abroad, which remain another important factor in the increase of Albania's financial liabilities with the rest of the world, amounted to EUR 147 million, out of which 80 per cent were used for the Government sector. The increase of these liabilities led to the increase of impending external debt payments. At the same time, external debt service for 2006 has reduced our liabilities by about EUR 55 million, representing only 3 per cent of our exports over 2006 and providing evidence for

Albania's solvency within the accepted levels. Meanwhile, private borrowing seems to have slowed its growth rates down. Compared to 2005, the increase of this sector's liabilities is assessed to be half as much as the previous year's inflows and it shares only 20 per cent of the borrowing. The structure of external debt created by borrowing is dominated by the SDR (58 per cent), followed by the EUR and the USD.

Financial liabilities, created in the form of growth of non-residents' deposits in the banking system by EUR 119 million, is a remarkable performance. Worth emphasizing is that this growth has also been a consequence of emigrant's deposits in our banking system, implying for an increasing interest of emigrants to invest in the Albanian economy.

Liabilities in the form of commercial loans grew by EUR 7.5 million, which was also reflected in the increase of imports for this period.

Foreign assets inflows in the form of financial capital were reflected in the increase of the monetary authority foreign reserve by about EUR 207 million. As of end 2006, foreign reserve stock totalled EUR 1.3 billion, fully sufficient to cover about 4.5 months of imports of goods and services.

Table 1 Balance of Payments (in millions of EUR)

	2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	2006
Current account	-492.1	-127.9	-152.4	-113.7	-162.4	-556.4
Merchandise: exports	530.2	144.4	165.7	153.2	167.3	630.6
Merchandise: imports	-2006.9	-515.2	-579.5	-568.5	-652.9	-2316.0
Trade balance	-1476.7	-370.8	-413.8	-415.3	-485.6	-1685.4
Services: credit	967.3	277.4	282.0	337.2	298.2	1194.9
Services: debit	-1107.7	-312.7	-291.5	-355.8	-300.4	-1260.3
Income: credit	178.4	61.9	58.1	63.3	79.3	262.6
Income: debit	-42.3	-7.4	-12.5	-2.9	-24.4	-47.3
Private unrequired transfers	927.6	207.4	212.6	254.4	262.1	936.5
Official unrequired transfers	61.4	16.3	12.7	5.3	8.2	42.5
Capital account	99.2	36.1	39.5	68.1	23.5	167.2
Financial account	329.9	55.6	89.3	21.0	219.0	384.8
Direct investment	224.1	56.8	68.6	75.5	59.0	259.8
Portfolio investment	-2.0	4.6	-3.1	21.7	3.9	27.2
Other capital*	107.7	-5.8	23.7	-76.2	156.1	97.8
Net errors and omissions	178.6	48.9	53.1	97.9	5.3	205.2
Overall balance	125.1	15.6	29.5	76.1	85.4	206.6

Reserve assets	-125.1	-15.6	-29.5	-76.1	-85.4	-206.6
Use of Fund credit and loans	9.4	2.9	0.0	2.8	0.0	5.8
Total change in reserve assets	-179.0	-8.2	-6.5	-74.7	-67.9	-157.3
Of which: change due to exchange rate	53.9	-7.4	-23.0	-1.4	-17.5	-49.3

* Not included use of Fund credit and loans.

Source: Bank of Albania