



**External sector developments of the Albanian economy
during the nine-month period of 2005**

The overall payment balance for the nine-month period of 2005 resulted in a surplus of EUR 44.7 million. The capital inflows have been fully adequate to cover the level of current deficit and have led to increase of monetary authority reserve.

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

- Intensive activity in the external sector, expressed in the increase of income and current expenditures.
- Deepening of trade and current deficit.
- Considerable increase of workers' remittances.
- Decrease of inflows as foreign direct investment compared to the previous year.
- Evident decrease of domestic claims to non-residents, mainly due to withdrawal of our financial assets in the form of portfolio investments and our deposits abroad.
- Increase of monetary authority reserve assets.

I. Current account

Current transactions carried out during the nine-month period of 2005, are estimated at about EUR 4.5 billion or about 22 percent higher than the previous year. Trade exchanges in goods and services lead the volume of Albanian current transactions, with about 73 percent.

During this period, more than 93.6 percent of current expenditures have been used for the purchase of goods and services. About 43 percent of current income has entered in the form of current transfers, while the exports of goods and services provided about 33 percent and 51 percent of the income, respectively.

Despite the increase of about 22 percent, net factorial income could not reduce the high trade deficit in goods and services. As a result, at the end of the nine-month period of 2005, current account had a deficit of EUR 222.5 million, with an annual growth of about 41.5 percent.

I. 1. Foreign trade

The Albanian trade activity during the nine-month period of 2005 was estimated at EUR 1.8 billion, representing 40 percent of current transactions carried out. The Albanian economy and domestic market remain import-oriented, estimated to be 3.6 times higher than export.

Domestic demand continues to push the import increase, while the exports positive performance has not been sufficient to narrow the trade deficit down. Import expenses were estimated at about EUR 1.4 billion, 14.1 percent higher than in 2004.

Import demand increased by pushing imports through appreciation of domestic currency (during January-June, nominal exchange rate was estimated at an average of 3 percent) and growth of investment expenditures. Moreover, the considerable growth of private loaning contributed to import of goods. In terms of volume, imports increased by 2.7 percent compared to the previous year. Processed items imports (which represent about 30 percent of total imports) have increased due to a rise in prices. In terms of volume, foodstuffs imports (which represent 14 percent of total imports) have increased by 2 percent reflecting a fall in prices.

Intermediate goods continued to represent the overwhelming part in the structure of imports by economic categories, having a share of 46 percent of total imports. Their ongoing volume increase indicates a positive performance of processing industry in the country. While, demand for capital goods remains high, with a growth pace of 26 percent. Domestic demand for consumer goods continued even during this nine-month period to maintain a considerable weight to total, about 31 percent.

Meanwhile, exports growth pace is considered to be lower (10.5 percent in euro) compared to 23.6 percent in the previous year. In terms of volume, exports decreased by 1 percent compared to the same period the previous year. Processed items exports (which represent the largest share of our exports, about 70 percent of the total) marked a slight decrease (only 0.4 percent), while the prices have marked a rise. Although prices have risen during this period, metal exports (which represent 12 percent of total exports) have undergone decrease in volume by 6 percent. Total exports volume during 2005 is estimated to be 3 percent lower than in 2004.

Active processing industry results with a surplus of EUR 56 million, due to the positive trend of orderer's material exports, which continue to hold a dominant weight of 70 percent of overall exports volume. At the same time, it should be emphasized that positive tendencies are observed as to internal export.

Hence, the nine-month period of 2005 recorded a trade deficit of EUR 1 billion, which is 14.7 percent higher than the corresponding period of the previous year. The high and growing deficit of foreign trade draws the attention towards policies aiming at replacing imports and pushing exports.

Based on foreign trade structuring by trade partners, Albania continues to carry out most of its transactions with the European Community. Nonetheless, it should be emphasized that Albania is inclined to trade with the regional countries (exports in particular), influenced by the free trade agreements with the neighbouring countries.

I. 2. Developments in other items of current account

Even during this period, service trade and investments, being a significant indicator of competition in international markets and of economic growth, is ever-turning into a crucial factor of Albania's integration with abroad. Trade transactions in services amounted to EUR 1.4 billion and are estimated to be 26 percent higher, compared to the same period in 2004. Service account closed with a negative balance of EUR 97 million. This deficit has been mainly due to a negative balance of transportation services item. As expected, the increase in import of goods volume has caused the increase in import of transportation services.

Other business and cultural services have had a considerable growth. Movements in the services account are significantly influenced by the developments in "Tourism" (travel) services, which contribute considerably to this item inflows and outflows, respectively 74 and 60 percent of the total for this nine-month period. Currently, the tourism activity continues to represent one of the main sources of foreign income to the Albanian economy, and as such, it should be considered as one of the economic growth engines in the country. According to Bank of Albania estimations, during the nine-month period of 2005, export in tourism, generated about EUR 516 million inflows, which is about 30 percent higher than export of goods, and it is estimated to be 17 percent higher than the same period the previous year. This growth has been mainly due to increase in the number of foreign citizens and emigrants visiting the country as well as to the slight increase of daily expenses evaluating coefficients. During this nine-month period, the number of foreign citizens entering the country increased by 21 percent, wherewith the months of July-September represent the main weight of this increase, reflecting the seasonal factor of summer holidays.

An accelerated activity was noticed in services to tourism, which have displayed higher annual rates growth in recent years. Albanian residents have spent in their travels abroad about EUR 478 million or 67.4 percent of total workers' remittances. Albanian economy benefits foreign income from seasonal workers' labour and investments of the banking system foreign reserve in non-resident financial institutions, and at the same time pays external debt interests.

The positive balance at the end of the year is estimated at about EUR 106 million. This surplus is mainly due to income from seasonal workers' labour and customs' income, and interests accumulated from the investment of the banking system foreign reserve in non-resident financial institutions as well as interests from investments of our banking system in the form of portfolio investments.

Current transfers balance at the end of the nine-month period estimated at about EUR 791 million or 8.6 percent higher than the same period the previous year. Albanian workers' remittances continue to represent the main weight (about 77 percent) of income in this item. During this period, these transfers have amounted to the level of EUR 709.4 million, which is 21 percent higher than the same period the previous year. These transfers represent the main source of trade deficit financing (in goods and services) with more than 63.3 percent. Workers' remittances have also been associated by state transfers, mainly in the form of technical assistance (EUR 33 million), estimated at a growth of 5 percent compared to the previous period.

II. Capital and financial account

During this nine-month period, capital net flows recorded EUR 248 million, thus fully enabling current deficit financing, and contributing to the increase of foreign reserve. Behind this positive figure, there are inflow capital transfers of EUR 75 million and the positive balance of the financial account amounting to about EUR 173 million. Compared to the same period the previous year, capital and financial account net position is estimated at about EUR 26 million lower. Let us remind that during the first semester of 2004, were recorded high capital flows owing to privatisation.

Capital transfers during this period, decreased by about EUR 2.6 million, while the positive balance of financial account is estimated to have decreased compared to the previous year (by about EUR 23 million). Financial account position during this quarter is defined as an increase of Albania's financial liabilities with the world (with about EUR 211 million) and an increase of our assets held abroad (about EUR 38 million). However, compared to the first nine-month period in the previous year, financial liabilities net flow is estimated to be lower, about EUR 138 million and Albania's financial liabilities to the rest of the world are also set at a lower level (EUR 115 million).

The increase of financial liabilities to the world during this nine-month period has been mainly due to capital inflows in the form of direct investments (EUR 149

million) and borrowings from abroad (EUR 107 million). Foreign direct investments are estimated at EUR 85 million lower than the same period the previous year, where more than 60 percent of foreign direct investments flow entered in the form of privatisation.

During this nine-month period, the granting of long-term and soft loans from abroad, which remain another important factor in the increase of Albania's financial liabilities to the world, was EUR 17 million lower: state borrowing decreased slightly by about EUR 3 million. While unlike the previous year, where it was observed the private sector presence in long-term loaning, this year loan disbursements of this sector were EUR 14 million lower. External debt services in the form of principal and interest are estimated at about EUR 25.5 million, equivalent to 10 percent of goods export.

Financial assets stock in the form of portfolio investments amounted to EUR 123 million at the end of the period, with an increasing nine-month flow of EUR 7 million. Regarding their structural composition by currency, 72 percent are in US dollars, 24 percent in EUR. Foreign assets held by the banking system in the form of deposits abroad, increased by about EUR 9 million. As to their composition, deposits in US dollars hold 53 percent, while EUR deposits hold 42 percent.

Foreign assets inflows in the form of financial capital were reflected in growth of the monetary authority foreign reserve by about EUR 45 million. At the end of the period, the level of gross foreign reserve was estimated at EUR 1.72 billion, sufficient to cover 4.6 months of import of goods and services.

Balance of Payments

in millions of EUR

	Q3 2004	Q4 2004	Q1 2005	Q2 2005	Q3 2005
Current Account	-25.5	-129.0	-51.6	-103.9	-67.0
Export of Goods	121.6	125.0	121.5	143.3	133.7
Import of Goods	-450.9	-514.4	-398.0	-507.0	-515.9
Trade Balance	-329.3	-389.4	-276.5	-363.7	-382.2
Services: Credit	223.8	201.1	196.5	237.4	262.0
Services: Debit	-229.0	-230.4	-225.9	-261.0	-306.2
Income: Credit	55.8	39.3	37.4	39.5	51.2
Income: Debit	-5.1	-6.8	-5.1	-9.6	-7.6
Private Unrequired Transfers	244.5	242.3	210.2	243.3	295.0
Official Unrequired Transfers	16.7	18.5	11.8	10.1	20.8
Capital Account	29.1	28.5	35.5	14.6	25.0
Financial Account	-15.2	110.7	24.4	134.4	4.6
Direct Investments	58.7	42.6	45.3	50.3	53.0
Portfolio Investments	98.2	-95.9	-42.9	-5.3	40.9
Other Capital*	-172.2	164.0	21.9	89.4	-89.3
Net Errors and Omissions	84.9	35.6	-3.3	-43.7	66.2
Overall Balance	78.1	45.9	9.7	1.4	33.7
Reserve and Related Items					
Reserve Assets	-78.1	-45.9	-9.7	-1.4	-33.7
Use of Credit and Loans by the IMF	4.8	0.0	4.6	0.0	4.8
Memorandum Items					
Total Change in Reserves	-84.4	-95.2	15.7	35.3	-30.1
of which: Change due to Exchange Rate	6.3	49.3	-25.4	-36.7	-3.6

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