

BANK OF ALBANIA

Press Statement

**EXTERNAL SECTOR DEVELOPMENTS OF THE ALBANIAN ECONOMY
DURING THE FIRST SEMIANNUAL OF 2006**

November of 2006

The overall balance of payments resulted in a surplus of EUR 45 million over the first semiannual of 2006. Capital inflows have financed about 70 per cent of the current deficit.

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

- Intensive activity in the external sector, expressed in the increase of current revenues and expenditures.
- Substantial deepening of trade and current deficit.
- Decrease of the level of private borrowings, compared to the previous year.
- Increase of domestic claims on non-residents, mainly expressed in the increase of the financial assets held by the banking system in the form of deposits abroad.
- Simultaneous increase of foreign assets and liabilities and increase of the monetary authority foreign reserves.

I. Current account

Current transactions during the first half of 2006 are estimated at about EUR 3.2 billion or 19 percent higher than the previous year. Trade exchanges in goods and services lead the volume of Albanian current transactions with the world. During this period, more than 95 percent of current expenditures have been used for the purchase of goods and services, while about 33 percent of current income has entered in the form of current transfers. The services and exports of goods provided respectively 38 percent and 21 percent of the income. Net factor income increased by about 10 percent and they could not reduce the high trade deficit (goods and services). As a result, current account had a deficit of EUR 299 million, with an annual growth of more than 40 percent.

I. 1. Foreign trade

The volume of the foreign trade, imports plus exports, is estimated to be about EUR 1.4 billion, 20 percent higher compared to the same period of the previous year. Trade exchanges in goods during this period held about 43 percent of the current transactions volume.

Import expenses were about EUR 1.1 billion or EUR 190 million more than in the same period of 2005. The income from the export of goods reached the value of EUR 310 million.

The higher increase of the import expenses compared to the export income (respectively 21 and 17 percent), brought a further deepening of the trade deficit, which resulted to be 23 percent higher than the first semiannual of 2005.

According to an analysis in line with the national accounts system, during this semiannual, our country remains intermediate goods oriented, which share almost half of our imports (47 percent), while capital and consumer goods were respectively 11 and 32 percent.

During this semiannual, the most significant growth in imports was in oil and electricity imports (75 percent). Such a growth has been intensified also by the continuous increasing of these goods prices in the foreign markets.

On the exports side, there has been a significant increase in the export of minerals (chrome and iron) toward markets such as China and Macedonia.

Processing industry in the country continues to share the most significant part as far as trade relations with the rest of the world are concerned. The import of raw materials shared 15 per cent of its total, while 70 per cent of export revenues was a contribution of re-exports. Their increasing levels for this semiannual have been almost the same for both categories, around 11 percent.

Regardless the continuous increasing of the global competition of other low-cost production countries (especially China), the strong lek, and the economic

slowdown of Italy and Greece, there have been positive indicators concerning the textile and footwear industry. During the first semiannual of 2006, exports from this industry have improved the performance of the previous year. The exports growth indicator during this period was 5 percent in comparison to a growth of 0.06 percent of the previous year. Moreover, the footwear export has grown by 11 percent compared to the 8 percent growth presented during the first semiannual of 2005.

Regarding our trade partners, the European Union maintains the same share levels to total trade transactions (64 per cent). Around 43 percent of our exports are toward the neighboring countries, Italy and Greece transforming them into our main trade partners. The upward tendency of the imports from the regional countries continues to dominate even during the first semiannual of 2006 (47 percent), stressing here the acceleration of the trade exchanges in imports with Romania, which resulted to be the second between our regional partners. On the other side, during this period there has been a slowdown of the export growth toward these markets (5 percent).

In absolute terms, the import growth over the years has been accompanied by a moderate growth of the exports. However, this year the performance of the exports has been promising. During this period, the level of imports' coverage by exports reached 28 percent from 26 percent of 2005.

I. 2. Developments in other items of the current account

Service trade, under rising paces during the last years, is becoming more and more a crucial integration element of Albania with other countries. Trade service transactions reached to EUR 1.2 billion and were estimated to be 23 percent higher, compared to the first semiannual of 2005. Service account closed with a negative balance of EUR 37 million, which is estimated to be in decline (around 23%) toward the deficit recorded on the same period of the previous year. The reduction of the service trade deficit has been mainly due to an increase of the surplus in the travel services as well as to a narrowing of deficit in other services item.

Movements in the services account were significantly influenced by the performance of services in tourism (travel), which contributed considerably to the inflows and outflows of this item, respectively 70 and 62 percent of the total for this semiannual. Actually, the tourism activity continues to represent to the Albanian economy, one of the main sources of foreign income. According to Bank of Albania estimations, the export in tourism during the first semiannual of 2006 generated about EUR 393 million income flows, which is about 27 percent higher than the value of export of goods. Income from tourism, during this

semiannual, were estimated to be 23 percent higher than this period in 2005, mainly influenced by the increasing flow of foreign citizens and emigrants visiting the country as well as a slight increase of evaluating coefficients of daily expenses. During the first semiannual of 2006, the number of foreign citizens visiting the country increased by 17 percent compared to the same period in the previous year.

An accelerated activity was noticed in services of tourism, which in the last years displayed higher increasing annual rates. Albanian residents spent in their travels abroad nearly EUR 367 million or 85 percent of the total workers' remittances. Increase of traveler's expenses abroad was due to an increase in the number of Albanians traveling abroad of 16 percent, as well as to an increase of the daily expenses of 11 percent.

Other services item resulted in a deficit of EUR 17 million, against a deficit of EUR 25 million in the first semiannual of 2005. This decrease is mainly due to an increase in culture and business services items and in governmental services.

Albanian economy benefits foreign income from the work of seasonal workers and investments of foreign reserves of the banking system in financial non-resident institutions, and at the same time it pays the external debt interest. Net transactions result on income remained positive even during this semiannual and it was estimated at about EUR 91 million.

Work income compared to the first semiannual of the previous year, rose by about EUR 11 million, reaching the level of EUR 54 million. A growth was also recorded in the interest income from investing our foreign reserve in nonresident institutions, as well as the interest income received from portfolio investments in resident institutions abroad.

At the end of the first semiannual, current transfers balance was estimated at about EUR 432 million, slightly increasing compared to the first semiannual of the previous year. Albanian workers' remittances from abroad remained the main contribution to the income of this item (about 86 percent). During this period, these transfers reached to EUR 432 million, being 12 percent higher than those of the same period in the previous year. These transfers represent the main source of trade deficit financing (in goods and services) with more than 50 percent. Worker's remittances (EUR 432 million) were also associated by state transfers, mainly in the form of technical assistance (EUR 31 million), which during this period were estimated to be increasing by 41 percent.

II. Capital and financial account

During the first semiannual of 2006, capital flows recorded a net income of EUR 208 million, and enabled the financing of the current deficit by 70 percent. Behind this positive figure, there are inflow capital transfers of EUR 76 million and the

financial account positive balance of about EUR 133 million. Capital and financial account net position has kept the same level of the same period in previous year.

Capital transfers during this period, grew by around EUR 26 million, while financial account positive balance was estimated to have decreased compared to the previous year (by about EUR 26 million).

Financial account position during this quarter was defined as an increase of Albania's financial liabilities held with the world (by about EUR 207 million) and an increase of our assets held abroad (by around EUR 76 million). However, compared to the first semiannual in the previous year, financial liabilities net flow was estimated to be lower, about USD 5 million, while Albania's financial claims on the rest of the world were also set at a higher level (EUR 32 million).

The increase of financial liabilities to the world, during this semiannual, was mainly due to capital inflows in the form of direct investments and borrowings from abroad.

Foreign direct investments were estimated at EUR 125 million, or 17 percent higher than the same period in the previous year. These capital flows have been transformed into a dominant factor in the increase of financial liabilities and in the development of domestic capital and financial transactions.

One other important factor in the increase of the financial liabilities have been the extension of long term loans and of soft loans from abroad, which have increased Albania's external debt by EUR 81 million. This debt includes also the use of IMF credit and loans of EUR 2.9 million. State borrowing has increased by around EUR 19 million, while unlike the previous 2 years trend, where it was noticed the private sector presence in long-term loans, during this semiannual, loan disbursement of this sector has been lower (less than about EUR 24 million).

External debt services in the form of principal and interest amounts were estimated at about EUR 39 million, equivalent to 13 percent of export of goods.

On the other hand, Albania's financial claims on the rest of the world grew by EUR 32 million. Assets growth was mainly determined by the increase in banking system assets in the form of deposits abroad, while portfolio investments of resident units abroad have been decreasing.

Financial assets stock in the form of portfolio investments, by the end of the period amounted to EUR 112.6 million with a decreasing semiannual flow of EUR 1.6 million. Regarding the structural composition by currency, 76 percent were in USD, 19 percent in EUR and 5 percent in British pound. Foreign assets held with the banking system in the form of deposits abroad are estimated to be about EUR 536 million. In the composition of deposits held by the banking system, the US dollar occupies 54 percent, while the remaining part is in EUR (41 percent) and in British pound 4 percent. Cash foreign assets were estimated to be decreasing. In the structural composition by currency, cash foreign assets denominated in US dollar were 38 percent, in EUR 56 percent and in the British pound 5 percent.

Inflows of foreign currency assets as financial capital were reflected in the growth of foreign exchange reserves of the monetary authority, by about EUR 45 million. By the end of the period, the level of foreign exchange reserve was estimated at EUR 1.25 billion, a sufficient level to cover 4.5 months of imports.

Balance of Payments

In million of EUR

	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006	Q2 2006
Current Account	(60.8)	(147.2)	(62.7)	(221.3)	(123.5)	(175.4)
Export of Goods	121.5	143.3	133.7	131.7	144.4	165.7
Import of Goods	(398.1)	(507.1)	(516.1)	(585.7)	(515.2)	(579.5)
Trade Balance	(276.6)	(363.8)	(382.3)	(454.0)	(370.8)	(413.8)
Services: Credit	203.8	239.5	270.8	253.2	276.9	281.7
Services: Debit	(227.9)	(263.3)	(309.9)	(306.6)	(303.8)	(291.7)
Revenues: Credit	39.8	38.0	53.5	47.1	58.5	51.4
Revenues: Debit	(9.1)	(14.0)	(8.0)	(11.2)	(7.5)	(11.4)
Private Unrequired Transfers	197.3	206.3	292.4	231.6	207.1	198.8
Official Unrequired Transfers	11.8	10.1	20.8	18.6	16.2	9.7
Capital Account	35.5	14.6	25.0	24.1	36.1	39.5
Financial Account	37.3	117.0	(19.1)	194.7	55.8	73.9
Direct Investment	56.9	50.3	53.0	63.9	56.8	68.6
Portfolio Investment	(42.8)	(5.4)	40.9	5.4	4.6	(3.1)
Other Capital*	23.2	72.1	(113.1)	125.5	(5.6)	8.3
Net Errors and Omissions	(6.9)	17.0	85.7	82.6	44.3	91.5
Overall Balance	9.7	1.4	33.7	80.1	15.6	29.5
Reserve and Related Items						
Reserve Assets	(9.7)	(1.4)	(33.7)	(80.1)	(15.6)	(29.5)
Use of IMF Credit and Loans	4.6	-	4.8	-	2.9	-
Memorandum Items						
Total Change in Reserves	15.7	35.3	(30.1)	(68.3)	(8.2)	(6.5)
of which: Change due to Exchange Rate	(25.4)	(36.7)	(3.6)	(11.8)	(7.4)	(23.0)

* / Use of IMF credit and loans is not included.

Source of data: Bank of Albania.