

BANK OF ALBANIA

# ANALYSIS OF DEVELOPMENTS IN THE EXTERNAL SECTOR OF THE ECONOMY

2019 Q3

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*The views expressed herein are solely of the authors and do not  
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## I. BALANCE OF PAYMENTS HIGHLIGHTS<sup>1</sup>

The current account recorded a deficit of EUR 161.2 million in 2019 Q3<sup>2</sup>, expanding by around 10.1% in annual terms. The expansion of the current account deficit was driven mainly by the goods sub-account and by the primary income sub-account. The current account deficit was assessed at 4.6% of GDP, or 0.1 percentage point higher than in the same quarter a year earlier. The closure of the positive surplus in the savings-investment ratio of the public sector contributed in this regard (see the box on: “Developments in the saving-investment gap”).

Trade deficit in goods and services expanded by 4.8% in annual terms. The trade deficit in goods gave the main impact expanding by 11.3%. At the same time, the services surplus provided the opposite impact after expanding by around 17.5% compared to a year earlier.

The exports of goods and services grew by 8.4% in annual terms. The contribution is entirely related to the dynamics of export of services, which expanded by 11.3% compared to the previous year. The increase in the export of services is mainly related to the increase in exports of “travel services” (14.5% in annual terms). On the other hand, the export of goods continued its narrowing trend compared to the previous year, but at a slower pace compared to the second quarter. Annual decline registered 3.9%.

Imports of goods and services expanded by 7.6% in annual terms. The main positive impacts came from goods. In this case, the annual growth was 7.6%. The same growth rate is observed in the case of services. The main impact is again related to “travel services”, which increased by about 8.5% in annual terms.

The primary income account resulted in a deficit of EUR 39.9 million, from a deficit of EUR 17.1 million a year earlier. The expansion of the deficits related to the increase in income outflows related to direct investments. On the other hand, the surplus of the secondary income account expanded by 10.9% in annual terms. Determinants in this regard were the net remittances, which increased by about 8.6%. Net inflows in the capital account recorded EUR 19.7 million, standing around EUR 3.2 million lower than in the same quarter a year earlier.

<sup>1</sup> The most recent data on the balance of payments are as at 2019 Q3. As of 2008 Q1, the Bank of Albania prepares the Balance of Payments Statistics, in compliance with the BPM6 standards published by the IMF. The main differences between the actual and previous methodologies are synthesised in the following guideline:

[https://www.bankofalbania.org/web/pub/01\\_commentary\\_for\\_changes\\_in\\_the\\_publication\\_of\\_external\\_sector\\_statistics\\_according\\_to\\_bpm6\\_june\\_2014\\_6689\\_1.pdf](https://www.bankofalbania.org/web/pub/01_commentary_for_changes_in_the_publication_of_external_sector_statistics_according_to_bpm6_june_2014_6689_1.pdf)

For the purposes of analyses, the Balance of Payments data from 2002 to 2007 are reclassified in line with the new methodology by the Monetary Policy Department.

<sup>2</sup> At the end of this material there is a summarizing table of the main developments of the Balance of Payments during the latest periods including the quarter under review.

In the financial account, net liabilities recorded a value of EUR 15.4 million, around 8.8% lower from the previous year. Direct investment inflows expanded by around 1.4%, but in net terms they decreased by 1.9%. Net inflows in capital and financial accounts managed to cover 21.8% of the current account deficit resulting in inflows in the "errors and omissions" item. The overall balance of payments resulted in the increase of reserve assets by EUR 109.7 million. The foreign exchange reserve stock at the end of 2019 Q3 and is able to cover 6.7 months of import of goods and services or 160% of short-term gross external debt.

## II. CURRENT ACCOUNT

The current account recorded a deficit of EUR 161.2 million, in 2019 Q3, expanding by around 10.1% in annual terms. The deficit was assessed at 4.6% of nominal GDP, or around 0.1 percentage point higher than in the same quarter a year earlier. Compared to 2019 Q2, the ratio is 3.1 percentage points lower.

The expansion in annual terms is determined mainly by the sub-account of trade in goods with additional contributions from the primary income. The trade deficit in goods expanded by around 11.3%, mainly affected by the increase in the imports of goods by 7.6%. On the other hand, exports continued to decline in annual terms, but at a slower pace compared to the previous quarter (3.9% in 2019 Q3 compared to 12.8% in the 2019 Q2).

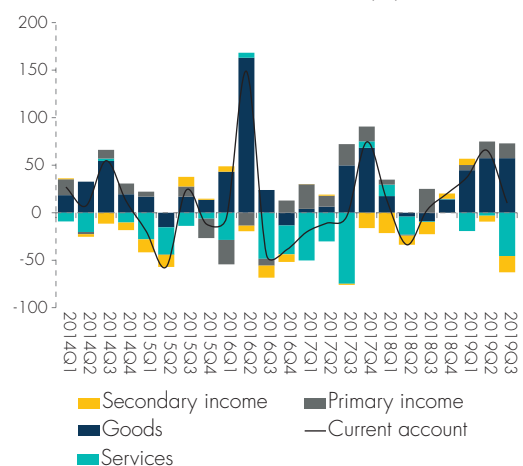
The “services” sub-account surplus expanded by 17.5% in annual terms. The main impact came from the growth in the export of services by about 11.3%. The main contribution came from the rapid growth of “travel services” by 14.5%. On the other hand, the increase in import of services recorded a value of 7.6%, also affected by the increase in the import of “travel services” by 8.5% compared to the previous year.

The net balance in the primary income account, resulted in a deficit of EUR 39.9 million, from EUR 17.1 million a year earlier. The expansion of the deficit is related to the increase in income outflows related to direct investments. In parallel, it is reported that there is an increase in income inflows from employment, albeit insufficient to offset the impact of income from investments.

The surplus of the sub-account of secondary income, expanded by around 10.9% in annual terms. Remittance inflows gave the main contribution as a result of their expansion by 8.4%.

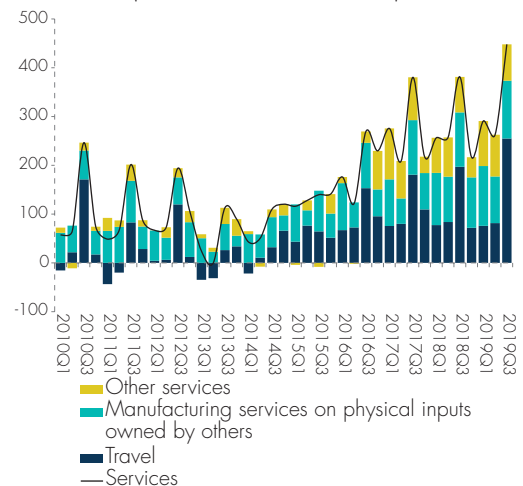
Net cumulative income from services, primary income and secondary income accounts financed around 80.5% of the trade deficit in goods. This ratio was 0.2 percentage points higher than in 2018 Q3 and 16.3 percentage points higher compared to the previous quarter.

Chart 1. Contribution by category (in p.p.) to the annual current deficit (%)



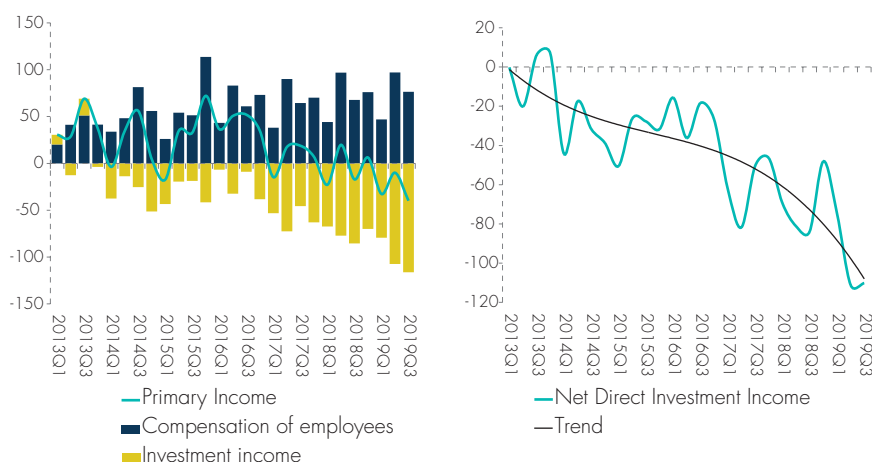
Source: Bank of Albania.

Chart 2. Main items in services account (net flows in EUR million)



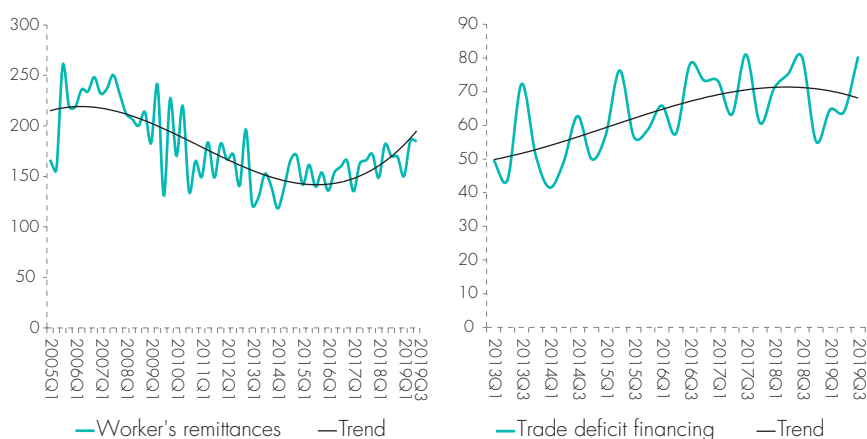
Source: Bank of Albania.

Chart 3. Balance of primary income (net flows in EUR million, left) and direct investment income (net flows, in EUR million, right)



Source: Bank of Albania.

Chart 4. Remittances (net flows, in EUR million, left) and financing of trade deficit from net primary and secondary income and from services (right)



Source: Bank of Albania.

#### BOX: DEVELOPMENTS IN THE SAVING-INVESTMENT GAP

The saving-investment gap of the private sector was assessed at -4.7% of nominal GDP (negative value of the gap means that investments were higher than savings) for 2019 Q3. This ratio is 0.3 percentage point lower compared with the same quarter a year earlier. The ratio of private investments to nominal GDP was assessed at 17.9%, from 19.0%, a year earlier. On the other hand, private savings to nominal GDP were assessed at 13.3%, around 0.8 percentage points lower than a year earlier. Overall, the dynamics of investments have contributed the most to the narrowing of the negative gap in the private sector, while savings affected the opposite direction.

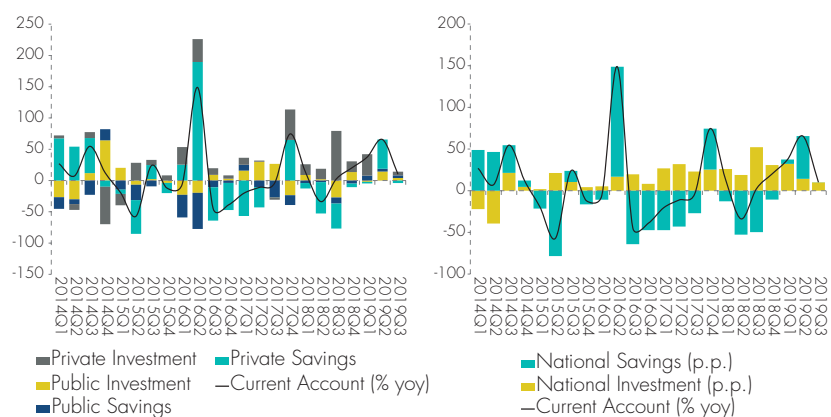
In regard to the public sector, the gap is (0% of GDP), while a year earlier it recorded a positive surplus at 0.4% of GDP. Public savings were assessed at 4.1% to nominal GDP, annually down by 0.5 percentage point. On the other hand, public savings



were assessed at 4.1% to nominal GDP, declining by around 0.1 percentage point y-o-y. This way, the reduction in public savings has also led to a reduction in the positive surplus of the public sector.

The ratio of national investment to GDP narrowed by 1.2 percentage points in annual terms. On the other hand, the ratio of national savings to nominal GDP decreased by 1.3 percentage points. The reduction in the national savings ratio has thus been a key determinant of the expansion of current account deficit in annual terms.

Chart 5. Contribution of investments and savings indicators in the deficit dynamic (left) and their contribution to current account annual performance (right)



Source: Bank of Albania, Ministry of Finance.

### III. CAPITAL ACCOUNT

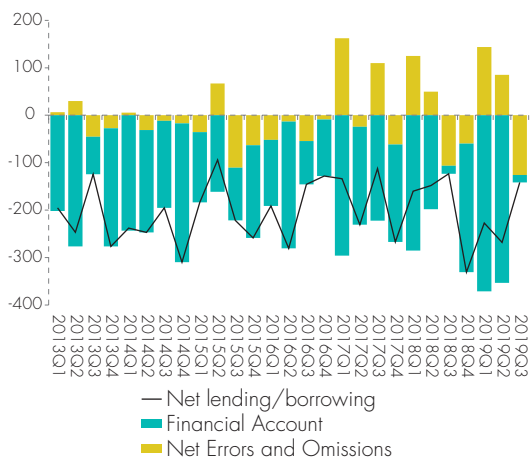
The capital account's positive surplus was around EUR 19.7 million, in 2019 Q3, around EUR 3.2 million lower compared with the previous year. Net capital flows in this account are estimated at 0.6% of nominal GDP. Net capital transfers for the account of "general government" resulted with a positive surplus of EUR 2.7 million, while those in "financial and non-financial corporations, households and non-profit institutions serving household", were EUR 16.5 million.

The combination of net transactions of the current and capital accounts provides the net position of the domestic economy, as net lender (surplus), and net borrower (deficit) against non-resident economies. In quantitative terms, in 2019 Q3, our economy represents a net borrower position of around EUR 141.5 million, which is financed by the financial account and the "errors and omissions" item. This is 14.6% higher compared with a year earlier but 47.2% lower compared with the previous quarter.

### IV. FINANCIAL ACCOUNT

The financial account recorded a net liabilities flow of EUR 15.4 million in 2019 Q3, around 8.8% lower than a year earlier. Net liabilities of this account were estimated at about 0.4% of nominal GDP and financed 9.6% of current account deficit during this period.

Chart 6. Financial account and errors and omissions (net flows, in EUR million)



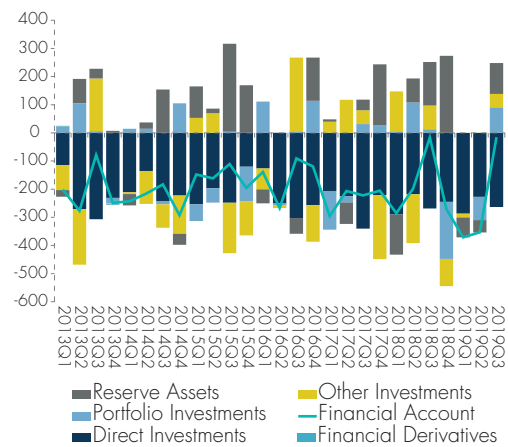
Source: Bank of Albania.

Residents' assets increased by around EUR 195.2 million. Specifically, assets in the form of "Reserve" and "Portfolio Investment" expanded.

In case of liabilities, the overall flow was EUR 210.6 million, around 6.0% lower compared with a year earlier. The main impact in this regard is related to the reduction of liabilities in the form of "Other Investments" and "Portfolio Investments". On the other hand, Direct Investment inflows expanded by 1.4%. Direct investment inflows account for around 7.8% of GDP. In the quarter under review, the ratio of net Direct Investments flows financed around 163.6% of the recorded current deficit. This ratio is 20.0 percentage points lower compared with the same quarter a year earlier.

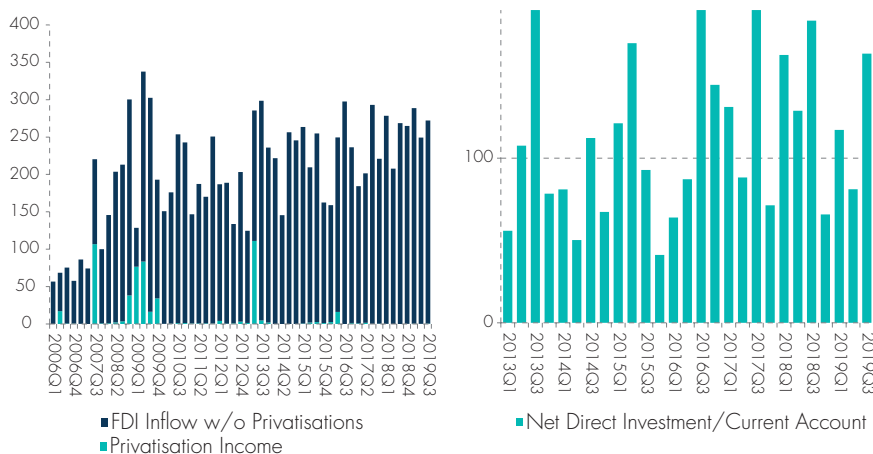
The sub-account of the portfolio investments reports a net asset surplus of EUR 90.8 million, while a year earlier there was a net asset surplus of EUR 13.1 million. The main impact is related to the increase of the assets of “deposit-taking corporations” in the of “debt obligations”. On the other hand, liabilities in this sub-account have decreased impacted by “debt obligations” again. In the case of the other investments sub-account, a total assets reduction by EUR 4.4 million has been verified. The reduced assets are those in the form of loans of “deposit-taking corporations”, but these have been somewhat offset by the assets increase in the form of “currency and deposits”. In parallel, liabilities in the form of “Other investments” decreased by EUR 52.0 million. Contributions relate to liabilities in the form of loan of “deposit-taking corporations” and “general government”.

Chart 7. Financial account components (net flows, in EUR million)



Source: Bank of Albania.

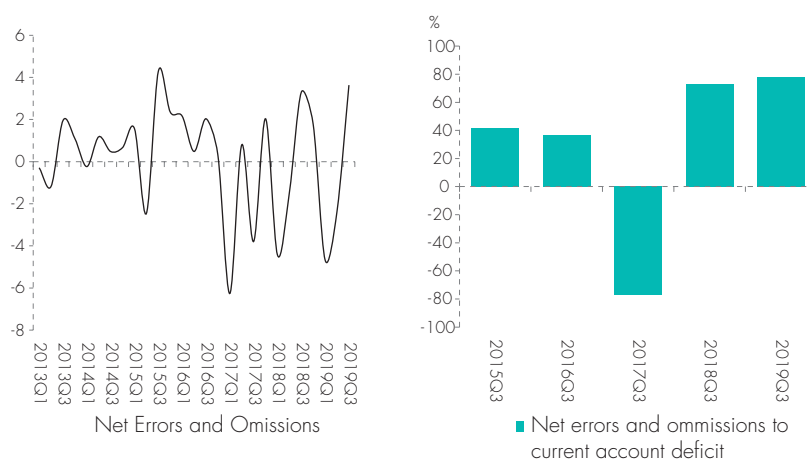
Chart 8. Composition of direct investments (flows in EUR million, left) and the financing ratio of current deficit by net direct investments (right)



Source: Bank of Albania.

The overall balance of payments resulted in the expansion of reserve assets by EUR 109.7 million. At end-September 2019, the foreign exchange reserve stock was around EUR 3.4 billion. This level is considered sufficient to cover 6.7 months of import of goods and services or 160% of short-term gross external debt. Finally, the “net errors and omissions” resulted in an inflow of EUR 126.0 million which is estimated at 3.6% of nominal GDP.

Chart 9. Errors and omissions to nominal GDP (% left) and to current account deficit (% right)

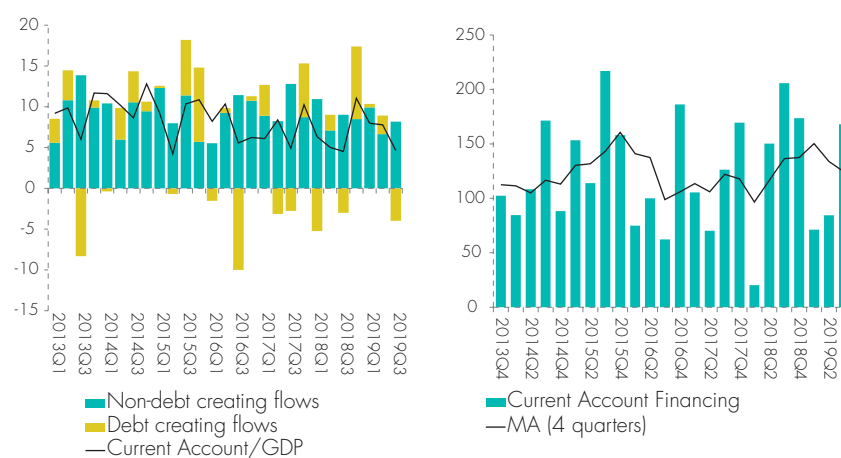


Source: Bank of Albania.

## V. PROFILE OF CURRENT DEFICIT FINANCING

The sustainability of current deficit financing is determined by the performance of debt-creating inflows against the most desirable non-debt-creating inflows<sup>3</sup>. Thus, non-debt-creating financial flows from net direct investments and from the capital account were assessed at 8.2% of nominal GDP. These were around 0.9 percentage point lower than a year earlier. The debt-creating financial flows were estimated at -4.0% of nominal GDP, around 1.0 percentage points lower compared to the previous year.

Chart 10. Financial debt-creating and non-debt-creating inflows to nominal GDP (left) and total financing of current account deficit (right)



Source: Bank of Albania.

<sup>3</sup> This breakdown serves to monitor the impact of financial and capital flows on Albanian's external debt. Non-debt creating flows include Direct Investments and net inflows of the capital account, whilst debt-creating flows include portfolio investments and other net investment.

By adding to foreign currency net debt-creating and non-debt-creating flows also the net errors and omissions, we obtain the overall financing of the current deficit. During the quarter under review, the current account financing ratio was at 168.1%, translating into an increase in the reserve by EUR 109.7 million. This ratio is about 37.7 percentage points lower than in the previous year, but 83.6 percentage points higher than in the previous quarter.

Table 1 Balance of payments indicators (in EUR million)

	Q1'18	Q2'18	Q3'18	Q4'18	Q1'19	Q2'19	Q3'19
<b>Current account (in EUR million)</b>	<b>-178.4</b>	<b>-169.4</b>	<b>-146.4</b>	<b>-372.2</b>	<b>-245.2</b>	<b>-280.4</b>	<b>-161.2</b>
Y-o-y (%)	13.3	-33.8	2.5	20.1	37.4	65.5	10.1
/GDP (%)	-6.3	-5.0	-4.5	-11.0	-8.0	-7.8	-4.6
<b>Goods and services</b>	<b>-358.3</b>	<b>-427.2</b>	<b>-359.7</b>	<b>-614.8</b>	<b>-403.7</b>	<b>-518.9</b>	<b>-376.8</b>
<b>Y-o-y (%)</b>	<b>14.9</b>	<b>-12.2</b>	<b>-3.8</b>	<b>7.8</b>	<b>12.7</b>	<b>21.5</b>	<b>4.8</b>
Exports, f.o.b.	841.8	1024.0	1240.4	952.8	885.2	1058.2	1345.0
Y-o-y (%)	8.8	14.5	11.7	8.8	5.2	3.3	8.4
Imports, f.o.b.	1200.1	1451.2	1600.1	1567.6	1288.9	1577.1	1721.8
Y-o-y (%)	10.6	5.1	7.8	8.4	7.4	8.7	7.6
Net Travel	77.6	83.5	197.1	72.1	75.9	81.5	254.9
<b>Primary income</b>	<b>-22.8</b>	<b>19.8</b>	<b>-17.1</b>	<b>6.3</b>	<b>-32.7</b>	<b>-10.0</b>	<b>-39.9</b>
Credit	70.3	123.6	94.0	105.0	78.7	132.5	108.7
Debit	93.1	103.8	111.0	98.7	111.4	142.5	148.6
Net income from Direct Investments	-69.4	-81.2	-83.9	-48.1	-74.6	-111.2	-110.2
<b>Secondary income</b>	<b>202.7</b>	<b>238.0</b>	<b>230.4</b>	<b>236.4</b>	<b>191.2</b>	<b>248.6</b>	<b>255.6</b>
Credit	224.5	260.9	254.8	265.2	220.1	274.2	280.8
Debit	21.7	22.9	24.4	28.8	28.9	25.6	25.2
Net Remittances	148.6	181.7	170.0	169.2	150.2	185.2	184.6
Y-o-y (%)	10.0	11.7	2.6	-1.7	1.0	1.9	8.6
<b>Capital account</b>	<b>18.3</b>	<b>21.2</b>	<b>22.9</b>	<b>41.6</b>	<b>17.9</b>	<b>12.3</b>	<b>19.7</b>
<b>Net borrowing/net lending</b>	<b>-160.1</b>	<b>-148.2</b>	<b>-123.5</b>	<b>-330.6</b>	<b>-227.3</b>	<b>-268.0</b>	<b>-141.5</b>
<b>Financial account</b>	<b>-285.2</b>	<b>-198.0</b>	<b>-16.9</b>	<b>-271.0</b>	<b>-371.1</b>	<b>-353.2</b>	<b>-15.4</b>
Y-o-y (%)	-3.6	-4.1	-92.4	32.0	30.1	78.4	-8.8
/GDP (%)	-10.1	-5.9	-0.5	-8.0	-12.1	-9.8	-0.4
<b>Direct investments</b>	<b>-290.3</b>	<b>-218.2</b>	<b>-268.7</b>	<b>-244.9</b>	<b>-287.2</b>	<b>-227.5</b>	<b>-263.6</b>
Y-o-y (%)	40.6	-3.4	-21.0	10.7	-1.1	4.3	-1.9
<b>Portfolio investments</b>	<b>5.5</b>	<b>108.3</b>	<b>13.1</b>	<b>-203.0</b>	<b>-0.2</b>	<b>-82.4</b>	<b>90.8</b>
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Other investments</b>	<b>142.0</b>	<b>-173.3</b>	<b>83.9</b>	<b>-96.9</b>	<b>-12.9</b>	<b>0.4</b>	<b>47.6</b>
<b>Reserve assets</b>	<b>-142.4</b>	<b>85.1</b>	<b>154.8</b>	<b>273.9</b>	<b>-70.7</b>	<b>-43.6</b>	<b>109.7</b>
<b>Errors and omissions</b>	<b>-125.1</b>	<b>-49.8</b>	<b>106.5</b>	<b>59.7</b>	<b>-143.8</b>	<b>-85.1</b>	<b>126.0</b>

Source: Bank of Albania, INSTAT and author's estimations

