

Bank of Albania

GROSS EXTERNAL DEBT ANALYSIS

2015 Q3

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The views expressed herein are solely of the author and do not necessarily reflect those of the Bank of Albania.

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MAIN CONCLUSIONS

- Albania's gross external debt stock totalled EUR 7,475.8 million, around 73.1% of nominal GDP and up by 8.2% on an annual basis.
 - By sectorial breakdown, the general government accounts for around 41% to total, the deposit-taking corporations 17.3%, other sectors 18.2%, FDIs 22.5%, and the monetary authority 1% of the external debt stock.
 - By investment instruments, loans and investments in currencies and deposits dominate external debt stock.
 - By maturity composition, around 80.4% of the external debt stock is long-term debt, up by 0.8 percentage point from the same period in the previous year.
- Indicators of long-term external debt repayment capacity have worsened since 2008.
 - The ratio of long-term gross external debt to annual exports of goods and services stood at 211.7%. It stands above the hypothetical optimal benchmark of 150% since the third quarter of 2011.
- Liquidity adequacy indicators pointed to weak short-term pressures arising from the repayment of gross external debt obligations.
 - Albania's foreign exchange reserve level is sufficient to withstand external negative shocks.

1. A DETAILED ANALYSIS OF GROSS EXTERNAL DEBT¹

At the end of 2015 Q3, Albania's gross external debt totalled EUR 7,475.8 million, up by around 8.2% in annual terms. The recorded amount of debt stock increased by around EUR 569.4 million, compared with its stock as at end-2014 Q3. Current gross external debt is assessed at 73.1% to nominal GDP², around 3.3 percentage points higher from the same period a year earlier. General Government was the main contributor for the expansion of the Albanian gross external debt.

The central government has the largest share in total external debt stock, at around 41%. Its share in the total external debt stock increased by around 3.2 percentage points from the same period a year earlier. The central government's external debt stock amounted to EUR 3.062 million, or nearly 29.9% of nominal GDP.

The gross external debt stock of the deposit-taking corporations (excluding the central bank) amounted to around EUR 1,296.5 million, up around EUR 63.6 million from the previous year.

Other sectors' external debt stock totalled around EUR 1,363.6 million, up around EUR 31.4 million from 2014 Q3. Its share in the total external debt stock was around 18.2%, around 1 percentage point lower from the previous year.

The stock of FDIs – intercompany loans amounted to around EUR 1,678.7 million, up around EUR 21.1 million from 2014 Q3.

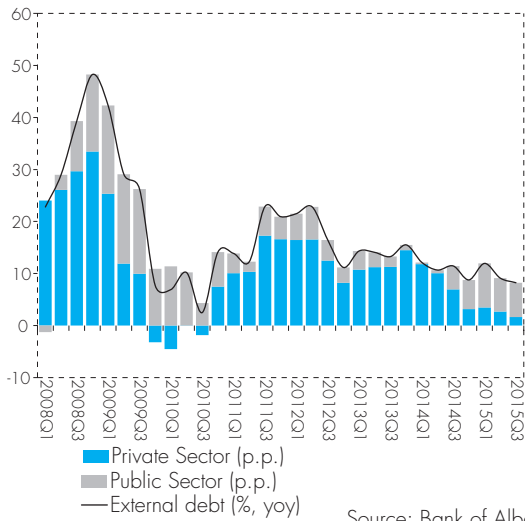
At the end of 2015 Q3, around 80.4% of the debt stock was long-term debt (including FDIs), mainly in the form of loans. Short-term debt accounted for around 19.6% of the total debt stock, mainly in the form of currency and deposits from the deposit-taking corporations (excluding the central bank). General government and the monetary authority hold only long-term debt, whereas the deposit-taking corporations and other sectors hold a composite portfolio of long and short-term debt.

¹ The latest external debt data are as of 2015 Q3. The previous year's data have also been revised. Starting from 2014 Q1, Financial Stability and Statistics Department at the Bank of Albania compiles the External Sector Statistics in compliance with the international standards laid down in the sixth edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6).

² Four-quarter rolling sum of GDP.

A) EXTERNAL DEBT BY SECTORS OF ECONOMY³

Chart 1 Gross external debt by sector

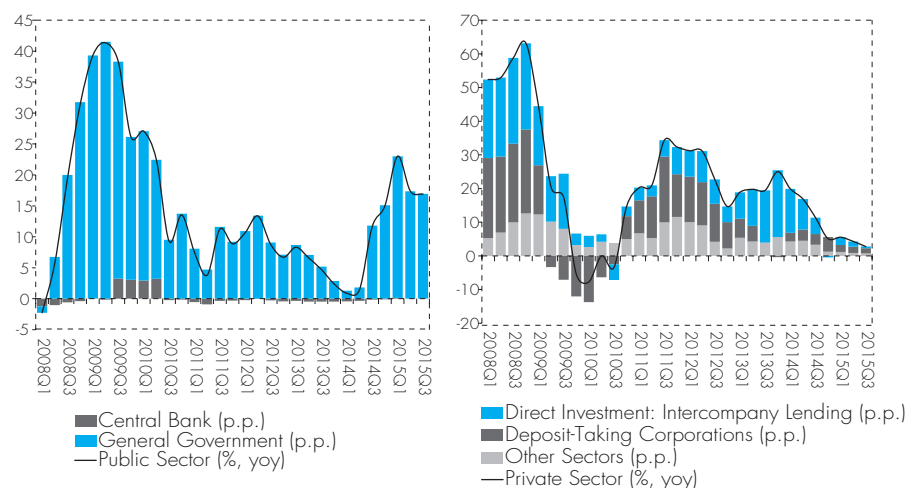


The increase in the gross external debt stock was driven by the deepening of total borrowing from the public sector in economy (general government and the central bank). The public sector's debt stock increased by around 16.9% in annual basis, and shared about 6.6 percentage points of the contribution in the annual growth of the gross external debt.

Contribution of public sector (general government and central bank) to the total gross external debt stock continues to be higher, compared with the data in the previous year. The general government continued to drive the expansion of debt in the public sector, whereas the central bank increased slightly its exposure to the external debt.

Over the years, the private sector has played a dominant role in the dynamics of Albania's gross external debt stock, except the period 2009 Q2 - 2010 Q3, and 2014 Q4 to 2015 Q3. The three categories within this sector - deposit-taking corporations, other sectors and direct investments - have progressively increased their share in total debt stock. External debt in the form of intercompany loans of foreign direct investments had the most rapid growth. At the end of 2015 Q3, the three categories included in the private sector, provided expanding contribution to total gross external debt, but trending down since 2015 Q1.

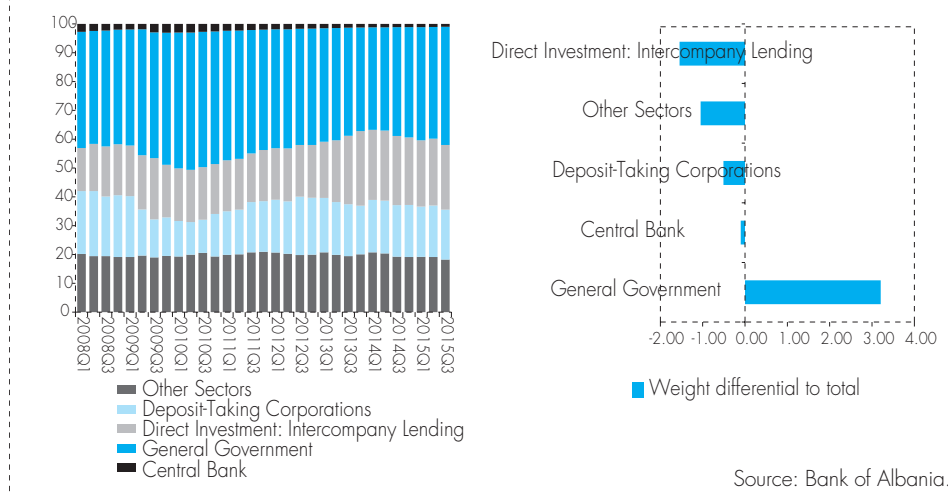
Chart 2 Private and public sector debt



³ According to BPM6, the sectors of the economy include: 1. general government; 2. central bank; 3. deposit-taking corporations excluding the central bank; 4. other sectors; 5. foreign direct investments.

In a more detailed sectorial breakdown, the external debt stock of general government historically has had a major share in the total debt stock. The rest of the debt stock has been allocated to the deposit-taking corporations (excluding the central bank) 17.3%, other sectors of the economy 18.2%, FDIs 22.5%, and the central bank 1.0%.

Chart 3 Share of sectors in total external debt stock (left); debt stock changes during 2015 Q3 against 2014 Q3 (in percentage points, right)

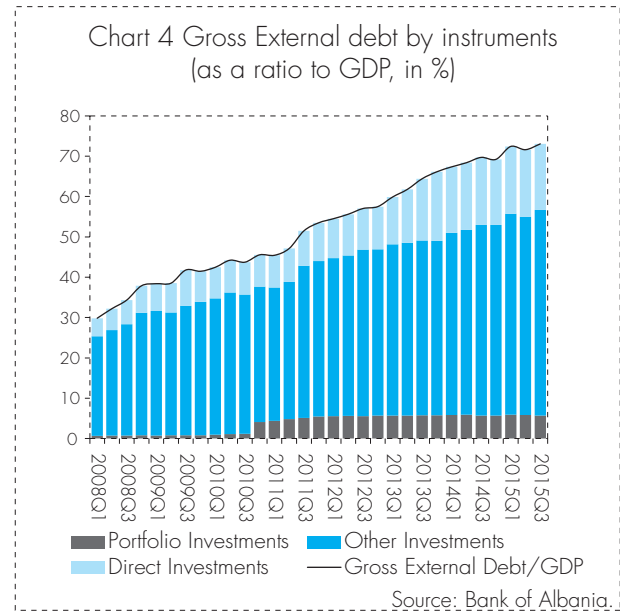


B) EXTERNAL DEBT BY INSTRUMENTS

Broken down by instruments, investments in the form of other investments⁴ account for the major share in total external debt stock, around 69.8% (around 51% of nominal GDP) at the end of 2015 Q3. This ratio is around 3.7 percentage points higher than a year earlier. Long and short-term loans have the main share within this item.

Since early 2008, the share of this instrument in total other investments has trended down in favour of other investment instruments until the end of 2013. The share of this instrument to total other investments represented averagely 69.4%, during 2014. Since 2015 Q1, the share of loans in total other investments has trended up. Other investments in the form of short-term and long-term loans accounted for around 72% of total, in the quarter under review.

From years, the stock of FDIs - intercompany loans showed an accelerated increase, in particular since 2010 Q3, and stabilised at 22-24% in 2014 and 2015. At the end of the period under review, the

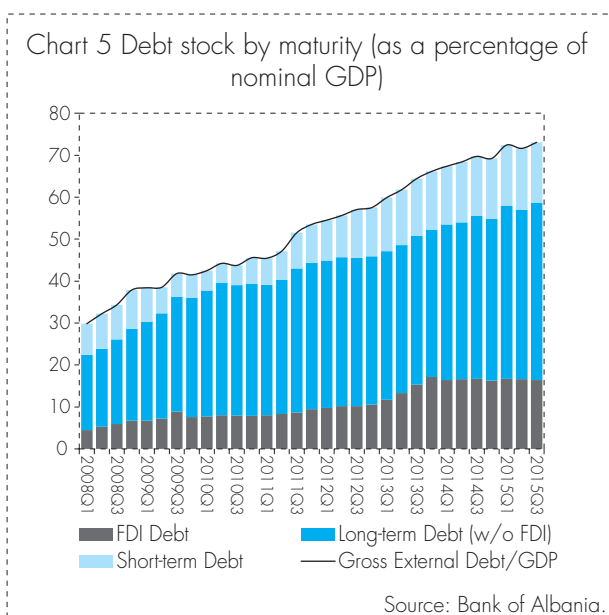


⁴ Other investments include: long and short-term loans, currency and deposits, trade credits and other unspecified liabilities.

share of FDIs stock - intercompany loans in total external debt was around 22.5%, around 1.5 percentage points lower from a year earlier. This fall represents a shift of new FDIs financing in economy from the debt instruments to the capital of the companies and to the profits realised in Albania and further re-invested.

Investments in the form of portfolio investments accounted for around 7.8% of the total gross external debt and were estimated at around 5.7% of nominal GDP.

C) EXTERNAL DEBT BY MATURITY



Broken down by maturity, the long-term debt has the largest share in the external debt stock (around EUR 6008.8 million). Long-term debt (which methodologically includes FDIs) accounted for around 80.4% of the total gross external debt. Its share increased by around 0.8 percentage point on an annual basis. Since 2014 Q1, the increase of long-term external debt has driven the increasing trend of gross external debt. The general government and the central bank hold only long-term debt in their portfolio. At the end of 2015 Q3, the short-term debt amounted to around EUR 1467.1 million, up by around 4% on an annual basis. Short-term debt to total external debt stood at 19.6%, and was estimated around 14.3% to nominal GDP. The deposit-taking corporations and other sectors of the economy hold only short-term debt portfolio. These two sectors' short-term debt consists largely of currency and deposits, and trade credits.

D) GROSS EXTERNAL DEBT SERVICE BY SECTOR

The total external debt service (principal plus interest payments) by all sectors of the economy amounted to EUR 105.5 million, around 2.9% of nominal GDP, or 1.8 percentage points lower than in the same period in the previous year. In debt service by sector, principal payments make up the largest portion of payments. Hence, around 86% of total payments of economy sectors went for the principal.

Table 1 External debt service and new gross debt by sectors

		2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3
Central Government	Principal payments	51.6	17.3	31.8	22.0	64.0	24.8
	Interest payments	7.9	6.9	8.4	10.1	10.7	9.5
	New debt	107.7	192.9	52.9	95.6	52.1	292.1
Private (long-term and short-term)							
	Principal payments	14.8	37.8	27.6	33.9	18.0	8.2
	Interest payments	2.3	1.8	2.2	2.0	0.8	0.7
	New debt	13.3	15.5	16.4	20.6	21.8	10.0
Banks (long-term and short-term)							
	Principal payments	9.8	54.8	8.8	4.4	11.4	32.6
	Interest payments	0.7	0.4	0.6	0.8	0.4	0.5
	New debt	26.0	15.5	3.4	6.6	37.1	11.8
External debt service		87.1	118.9	79.4	73.1	105.4	76.2
New debt in total		147.0	223.9	72.7	122.8	111.0	313.9

Source: Bank of Albania.

New external debt disbursements for the entire economy amounted to around EUR 313.9 million. As in the previous year, the general government's debt dominated the new debt disbursements, accounting for around 93.1% of the total new disbursed debt for the period. The general government's new debt was 51.4% higher compared to the same period in the previous year. In 2015 Q3, disbursements in the form of banking system and private sector's debt decreased in annual level.

2. EXTERNAL DEBT SUSTAINABILITY INDICATORS

The gross external debt sustainability is monitored over time based on two categories: (a) indicators that measure a country's continuous and uninterrupted repayment capacity to its international lenders; and (b) indicators that measure the adequacy of liquidity in case of obligation to repay short-term liabilities.

Table 2 Indicators of repayment capacity and indicators of the adequacy of liquidity in years

	2008	2009	2010	2011	2012	2013	2014	2015Q1	2015Q2	2015Q3
Repayment capacity indicators										
Gross external debt/Exports (goods and services)	128.0	142.4	140.3	157.3	172.3	181.0	184.4	205.5	204.4	211.7
Gross external debt/Fiscal revenues	140.6	158.7	174.0	210.5	232.2	264.8	265.5	278.5	264.3	289.5
Central government gross external debt/Fiscal revenues	55.8	72.7	80.0	87.9	93.7	98.2	101.5	109.3	102.3	118.6
Liquidity adequacy indicators										
Short-term external debt to total	24.5	13.2	13.6	17.0	20.2	18.6	20.7	20.1	20.3	19.6
Exports (goods and services)/Short-term external debt	319.0	533.6	524.7	373.1	287.0	296.2	244.2	242.1	240.4	240.7
International reserves/Short Term external debt	205.2	348.3	342.0	226.3	177.0	174.9	152.5	164.3	161.7	183.5
Net external debt/GDP	11.9	12.1	11.7	19.0	19.5	25.6	27.0	26.9	26.4	24.7
Net external debt/Exports (goods and services)	40.2	41.5	36.1	56.0	58.4	66.5	76.5	76.4	75.4	71.5
External debt service/Exports (goods and services) ¹	3.9	5.1	11.9	6.9	8.7	8.1	9.8	10.1	10.6	9.5
External debt service/New debt disbursements ¹	20.6	28.8	142.3	60.7	91.3	98.0	58.4	64.0	71.2	53.8

Source: Bank of Albania, Ministry of Finance.

¹ Cumulative annual average.

A) INDICATORS OF REPAYMENT CAPACITY

The export of goods and services represents a direct and continuous source of foreign currency inflows into an economy. The synthetic indicator that combines the latter to the gross external debt in foreign currency helps to analyse the long-term repayment capacity and potentiality of a country. The deterioration of this indicator signals a reduction of the long-term repayment capacity of a country.

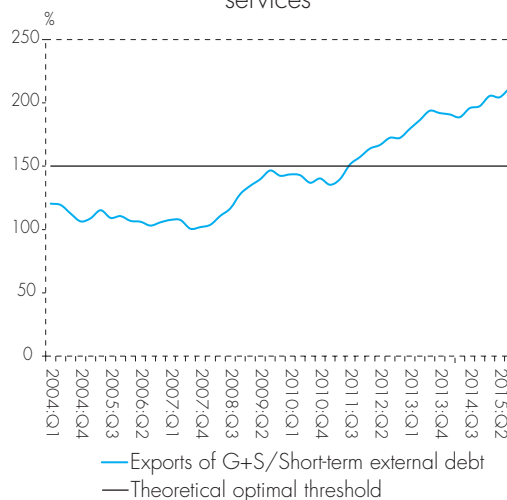
The relative ratio of gross external debt to the exports of goods and services has exceeded the hypothetical optimal benchmark proposed through empirical analyses by international financial institutions⁵, which varies depending on a country's institutional development, since 2011 Q3. In the quarter under review, this indicator stood at around 211.7%, expanding by around 15.9 percentage points annually.

⁵ IMF (2003), "External Debt Statistics: Guide for Compilers and Users", International Monetary Fund, Washington D.C. The optimal theoretical benchmark changes according to the institutional development of a country.

Fiscal revenues flow helps to construct the two other indicators that measure the solvency of a country. The flows should be sufficient to cover a certain ratio of the external debt and the central government's external debt stock. The first indicator monitors the central government's space to prevent the loss of the country confidence among foreign investors in times of crises. The second indicator monitors the risk that fiscal revenues may be reallocated from public expenses in funds for the amortisation of the external public debt.

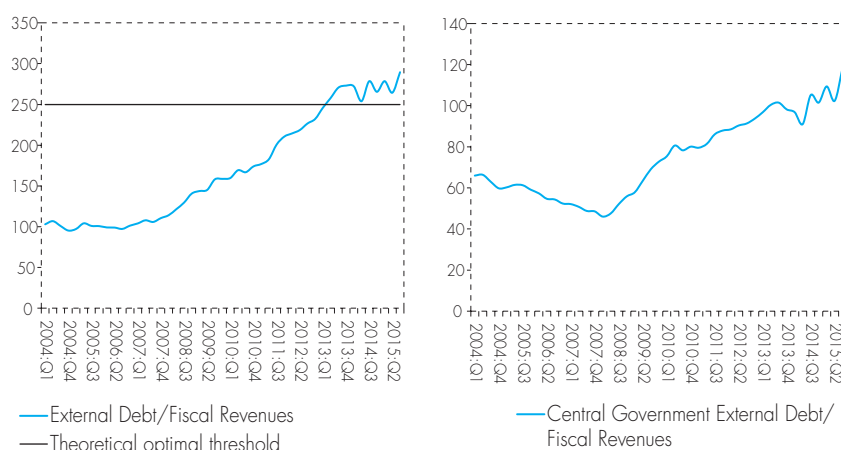
The ratio of gross external debt to fiscal revenues is estimated at 289.5%⁶. This ratio expanded by around 11 percentage points from a year earlier, and by 25.1 percentage points from the previous quarter. The ratio of the central government's gross external debt to fiscal revenues registered a similar dynamic. The ratio of 118.6% was 13.4 percentage points higher at annual level, and 16.2 percentage points at quarterly level. Both indicators are considerably higher than the theoretical levels proposed by the literature of this field⁷.

Chart 6 Gross external debt to exports of goods and services



Source: Bank of Albania.

Chart 7 Gross external debt (left) and central government's gross external debt (right) as a percentage of annual fiscal revenues



Source: Bank of Albania, Ministry of Finance.

A country's long-term repayment capacity is closely linked to both, the performance of the economy and the distribution of external debt service⁸ over time. In order to avoid such a phenomenon, an economy should, at any time, be capable to meet its immediate obligations with respect to the external debt principal and interest payments.

⁶ Quarterly fiscal revenues have been annualised through a four-quarter rolling sum.

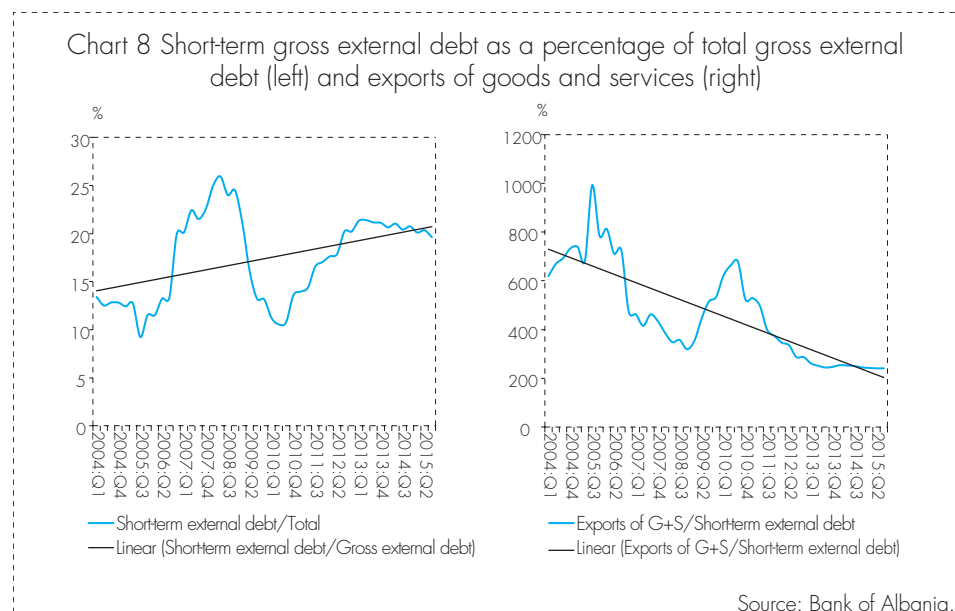
⁷ IMF (2000), 'Debt- and Reserve-Related Indicators of External Vulnerability', International Monetary Fund, Washington D.C.

⁸ The country's long-term repayment capacity improves if the economy grows at a fast pace in the future and the distribution of external debt servicing is uniform over time. In the opposite case, a country's long-term repayment capacity indicators deteriorate.

B) LIQUIDITY ADEQUACY INDICATORS

An economy's liquidity adequacy, which serves to repay external debt obligations, is largely affected by the reliance on short-term external financing. Albania's external financing profile has been mainly oriented towards long-term debt. The annual inflows from the exports of goods and services⁹ managed to cover the short-term external debt entirely.

In the last two quarters, the ratio between the export of goods and services and the short-term external debt showed a falling trend. The ratio was estimated at 240.7% in the quarter under review, around 9.4 percentage points lower in annual basis. This indicator was reduced during the last two quarters due to the fall in financial inflow from the export of goods and services. Nevertheless, the recorded ratio provides evidence of the availability of regular foreign currency inflows in covering the short-term external debt.



Foreign exchange reserves availability in covering short-term external debt is another important indicator of liquidity adequacy. Against an incomplete access to international capital markets, the foreign exchange reserves may help cover short-term external debt obligations in cases of unexpected economic shocks.

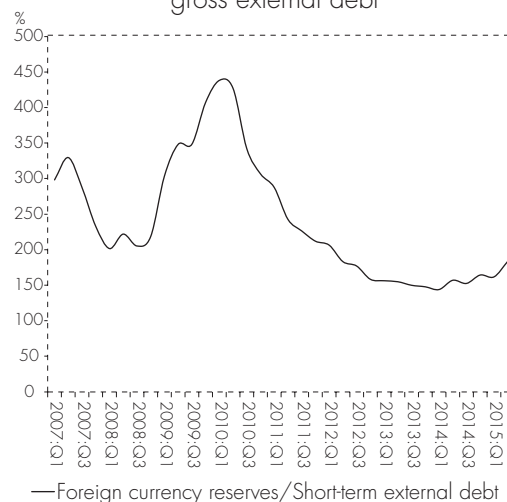
Albania's foreign exchange reserve stock is sufficient to cover the short-term external debt. The critical benchmark of this indicator is 100%, and the ratios below this benchmark provide evidence of insufficient foreign exchange reserve stock¹⁰. Since 2015 Q1, this indicator expanded at an accelerated annual pace attributable to the higher foreign exchange assets. At the end of the period, the foreign exchange reserve stock covered around 183.5% of the short-term external debt.

⁹ Stated through a four-quarter rolling sum.

¹⁰ According to Guidotti-Greenspan rule. For more information: IMF, "Assessing reserve adequacy", 2011.

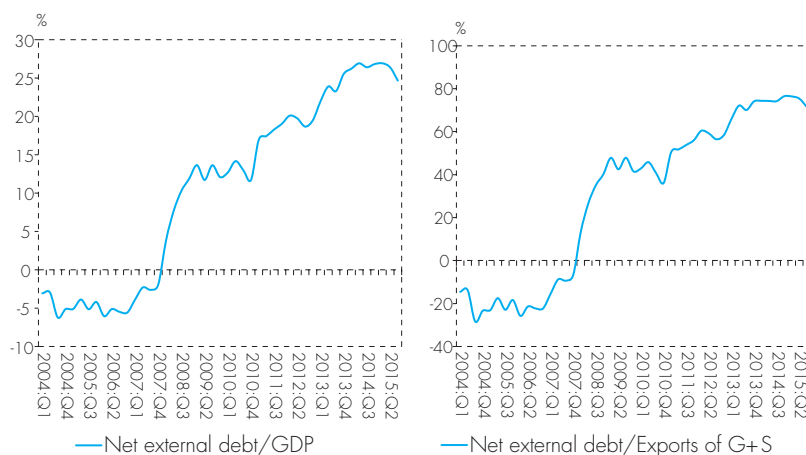
Net external debt helps in monitoring the short-term pressures as a result of expectable obligations within the year. The cumulative sum of banks' net foreign assets and foreign exchange reserves is subtracted from the gross external debt. At the end of 2015 Q3, net external debt-to-nominal GDP ratio was 24.7%, around 1.7 percentage points lower from the ratio in 2014 Q3. Net external debt has trended down since 2015 Q2 driven by the expansion of the international reserve stock. The ratio of net external debt to the export of goods and services was estimated at 71.5% as at end 2015 Q3, decreasing by 2.7 percentage points on an annual basis.

Chart 9 Foreign exchange reserve stock to short-term gross external debt



Source: Bank of Albania.

Chart 10 Net external debt to nominal GDP (left) and exports of goods and services (right)

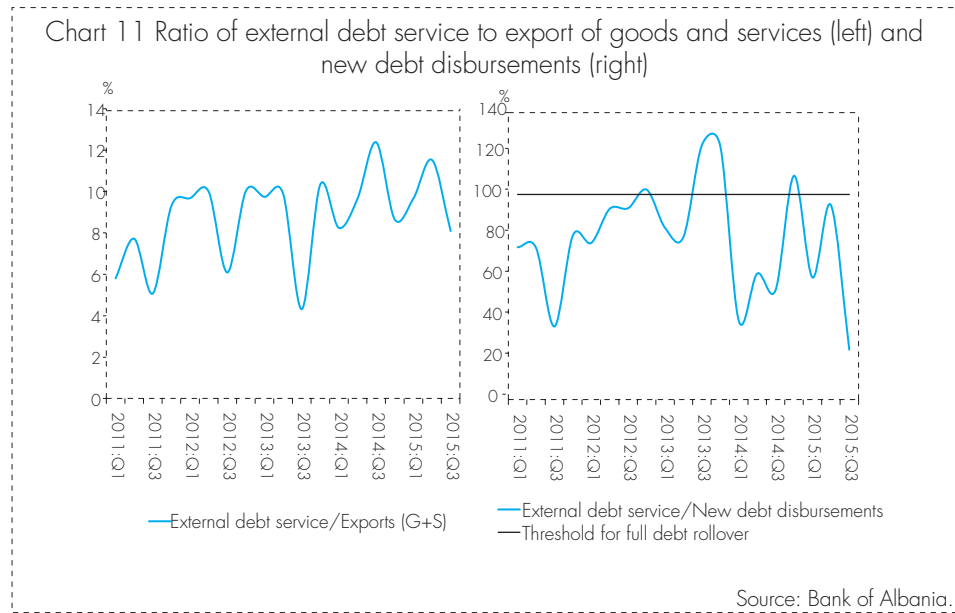


Source: Bank of Albania.

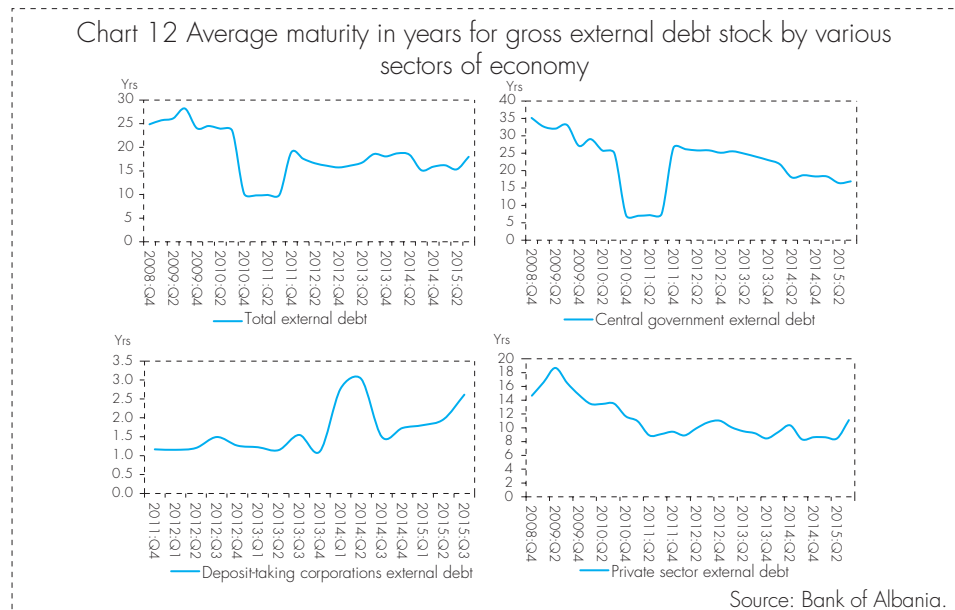
The indicators based on regular principal and interest payments flow help to monitor the pressures on the country's finances from the service of the external debt. The level of amortization is closely linked to the maturity of external debt and to the prolongation of the period, during which temporary concessions exist with regards to the payments of interest and principal of the debt. A monitored indicator is the ratio of the relative size of external debt servicing to foreign currency inflows from the export of goods and services. This indicator stood at 8.1% at the end of the quarter, down by around 4.3 percentage points annually. The fall by around 36% of external debt service by all sectors of economy provided a key role in this performance. This indicator's ratio stands well below the critical benchmark of 20%, as suggested by international organisations¹¹.

¹¹ IMF (2003), "External Debt Statistics: Guide for Compilers and Users", International Monetary Fund, Washington D.C.

The ratio of external debt amortization to new debt disbursements measures the extent of debt rollover. A ratio below 100% indicates a more accelerated new external debt disbursements than repayments of old debt. In the case of Albania, the ratio of external debt rollover has averaged 82.2% since 2008 Q1. This ratio implies the rollover of the amortised debt with new debt with a factor of 1.2. The ratio of external debt rollover stood at 24.3% during the quarter under review. That shows the rollover of the amortised debt with a new debt with a factor 4.1.



Indicators of average maturity performance of long-term external debt stock show a slight reduction over time of the latter compared to the previous quarter, by around 6 months. The reduction of the average term to maturity of the external debt of general government and of private sector provided the main impact. Thus, differently from the previous quarter, the average external debt maturity of public sector was extended about two years and eight months. The



same trend is registered for the average maturities of the central government and deposit-taking corporations' external debt. Thus, the average maturity of central government's external debt was extended by six months, while that of deposit-taking corporations was extended by around eight months.

Indicators of the average interest rate performance for the total remaining external debt stock show it has been falling since 2012 Q3. Overall, this performance has characterised all the sectors, but the more accelerated fall of the average interest is materialised in the external debt owned by the deposit-taking corporations. For this sector, the average interest is estimated to have fallen from the 5% peak in 2012, to around 0.2% in the current quarter. The high share of the short-term external debt for this sector has contributed to the fast fall of the applicable interest rate. In 2015 Q3, the average interest for the central government and for the private sector was estimated at 1.4% and 0.6%, respectively.

