Bank of Albania

GROSS EXTERNAL DEBT ANALYSIS

2013 Q4

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

C O N T E N T S

MAIN CONCLUSIONS

- At the end of the fourth quarter of 2013, the gross external debt stock amounted to around EUR 5.7 billion, estimated at 58.9% of nominal GDP.

- By sectoral breakdown, the external debt stock shows an unchanged profile, with the general government accounting for around 40.4%, the banking system 19.6%, other sectors 19.0%, FDIs 19.6%, and the monetary authority 1.4%.

- By investment instruments, "other investments" dominate the external debt stock, accounting for around 70.4%.

- By maturity composition, around 79.2% of the external debt stock is long-term debt.

- By currency composition, around 57% of the external debt is denominated in euro and 17% in U.S. dollar.

- Albania's net external debt-to-nominal GDP ratio is relatively low, fluctuating below the 20% threshold, primarily due to the increase in foreign exchange reserves at a more accelerated pace than the increase in external debt.

- External debt sustainability, as measured by several indicators of long-term repayment capacity, points to increased weaknesses since 2008.

- The ratio of long-term gross external debt to annual exports of goods and services has been higher than the hypothetical optimal benchmark of 150% since the fourth quarter of 2011.

- Both the net external debt and the foreign exchange reserve-to-short-term external debt ratio do not point to added pressures arising from expected external debt service obligations.

- There is, however, an increasing tendency in the funds necessary to service the external debt.

1. A DETAILED ANALYSIS OF GROSS EXTERNAL DEBT

At the end of 2013 Q4, Albania's gross external debt totalled EUR 5,692.1 million, up around EUR 30.8 million from Q3 and EUR 175.6 million from end-2012. In annual terms, it increased by around 3.2%, to 58.9% of nominal GDP.[1] At end-2012, this ratio stood at 57.9% of nominal GDP.

The central government has the largest share in total external debt stock. At the end of 2013, its debt stock amounted to around EUR 2,301.3 million, or nearly 23.8% of nominal GDP. The share of central government debt in the total debt stock rose by 0.1 percentage point against 2012 Q4, to 40.4%.

At the end of 2013, the banking system's gross external debt amounted to around EUR 1,113.4 million, up about EUR 24.9 million from end-2012. Other sectors' external debt stock totalled around EUR 1,080.6 million, down EUR 18.5 million from 2012 Q4, and up EUR 39.3 million from the accumulated stock in 2013 Q3. Its share in the total external debt stock was around 19.0%, down by 0.9 percentage points from 2012 Q4. The foreign direct investment stock amounted to around EUR 1,117.7 million, up by around EUR 102.5 million from 2012 Q4.

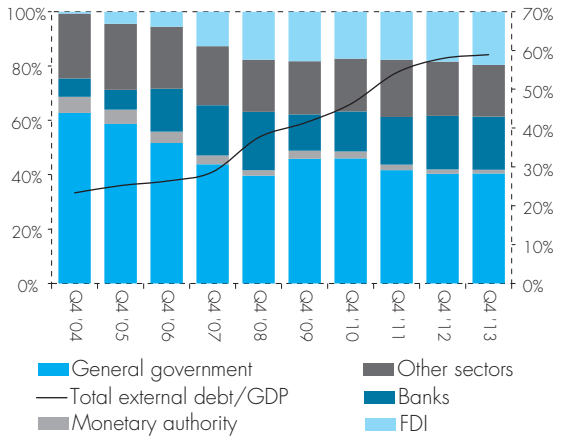
At the end of 2013, around 59.5% of the debt stock (excluding direct investments – intercompany lending) was long-term debt, mainly in the form of loans. For the same period, short-term debt accounted for around 20.8% of total debt stock, mainly in the form of currency and deposits from the banking sector. General government and the monetary authority hold only long-term debt, whereas the banking sector and other sectors hold a composite portfolio of long- and short-term debt.

A. EXTERNAL DEBT BY SECTORS OF ECONOMY[2]

In its sectoral breakdown, the external debt stock shows an unchanged profile, with the general government historically having a major share in the total debt stock. At the end of 2013, the general government (central and local) accounted for around 40.4% of total external debt stock. The rest of the debt stock has been allocated to the banking system[3] 19.6%, other sectors of the

[1] *Four-quarter rolling sum of GDP.*
[2] *Sectors of the economy include the general government, the banking system, other sectors of the economy, foreign direct investments, and the monetary authority.*
[3] *Banking system's liabilities.*

Chart 1 Allocation of external debt stock by institutional sectors as a percentage of the total



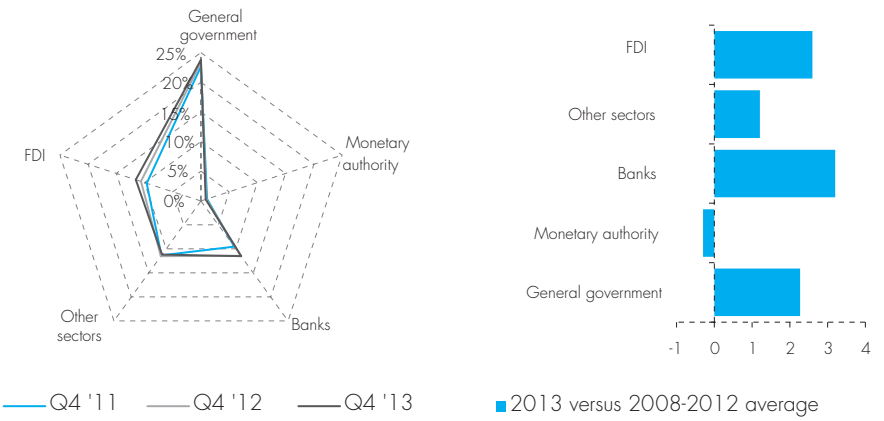
Source: Bank of Albania.

economy[4] 19.0%, FDIs[5] 19.6%, and the monetary authority[6] 1.4%.

The general government (central and local) has historically had a major share in total external debt stock. During the last three years, its share in the total debt stock has been estimated at an average of 40.8%, ranging from 41.7% to 40.4%. At the end of 2013, the general government's external debt stock amounted to ALL 2.3 billion, up around ALL 77.7 million from end-2012. The general government holds only long-term debt, mainly in the form of long-term loans, notes and bonds.

The banking sector is the second largest sector in terms of share in total debt stock. After increasing

Chart 2 Gross external debt stock by sector (as a percentage of nominal GDP, left); changes in 2013 debt stock against the average for 2008-2012 (in p.p., right)



Source: Bank of Albania.

considerably in 2011 and 2012, the banking system's share of debt in total debt stock settled at 19.6% at end-2013. Its external debt was around EUR 24.9 million higher y-o-y, and estimated at around 11.5% of nominal GDP. Broken down by maturity, the banking sector shows a clear orientation towards short-term debt. At the end of 2013, the short-term debt held by the banking system accounted for around 93.4% of total banking sector's debt stock.

4 *The debt stock classified under other sectors includes liabilities of other private or public non-financial corporations (including government-guaranteed debt), non-bank financial institutions, and households.*

5 *According to the international methodology, debt liabilities related to Direct Investment are to be separated from other debt liabilities. In the table describing Albania's gross external debt, these liabilities are identified separately and include liabilities of foreign-owned banks operating in Albania to their parent banks. The collection of information on foreign direct investments in other sectors and its separate identification are not yet possible.*

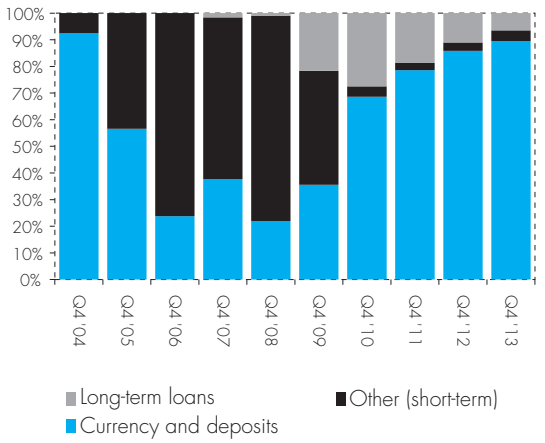
6 *According to international standards classification, external debt data of this group include Bank of Albania's liabilities to abroad. Consistent with BPM5, this also includes the stock of liabilities arising from the use of IMF Credit and Loans.*

Other sectors' debt stock accounted for around 19.0% of the total gross external debt stock, falling progressively since 2012. At the end of 2013, the external debt of other sectors of the economy was estimated at around 11.2% of nominal GDP. Broken down by maturity, 86.5% of other sectors' debt stock was long-term debt and the rest, 13.5%, short-term debt.

The external debt stock in the form of foreign direct investments - intercompany lending accounted for around 19.6% of total external debt stock and 11.6% of nominal GDP.

The monetary authority's gross external debt stock has the lowest share in the total compared to the other sectors of the economy. The monetary authority's liabilities in the form of debt have shrunk continuously across the years. At the end of 2013, they accounted for around 1.4% of total external debt stock and 0.8% of nominal GDP. The monetary authority holds only long-term debt, mainly in the form of other debt liabilities and long-term lending.

Chart 3 Banking system debt stock by instruments



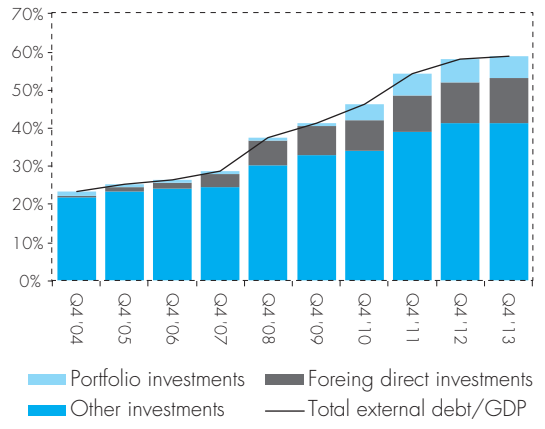
Source: Bank of Albania.

B. EXTERNAL DEBT BY INSTRUMENTS

Broken down by instruments used, investments in the form of other investments[7] have a major share in total external debt stock, around 70.4%. Within this item, long and short-term loans have the main share (around 69.9% in total other investment stock).

Since the beginning of 2008, the share of this instrument in total other investments has maintained a declining trend in favour of other investment instruments, settling at an average of 71.0% during 2013. As of 2010, the share of investments in the form of currency and deposits in total other investments has increased at an accelerated rate. Currently, investments in currency and deposits account for around 25.3% of total other investments. Investment instruments, such as trade credits and other debt liabilities, continue to have a small share in total other investments.

Chart 4 Classification of debt stock by investment instruments



Source: Bank of Albania.

The share of foreign direct investments in total gross external debt has maintained a sustained growing rate. At the end of 2013, the stock of foreign

[7] *Other investments include: long and short-term loans, currency and deposits, trade credits and other unspecified liabilities.*

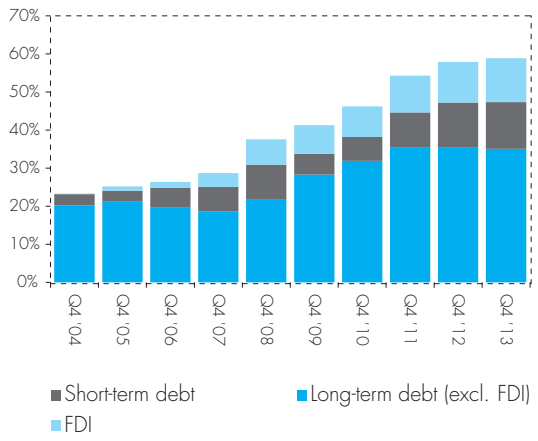
direct investments – intercompany loans was estimated at around 19.6% of total debt stock and 11.6% of nominal GDP.

Investments in the form of portfolio investments have also shown an upward tendency. At the end of 2013, they accounted for around 9.9% of total gross external debt stock and were estimated at around 5.9% of nominal GDP.

C. EXTERNAL DEBT BY MATURITY

Broken down by maturity, the largest portion of the external debt stock is long-term debt. At the end of 2013, the long-term debt stock (which also includes FDIs methodologically) accounted for around 79.2% of the total gross external debt stock and was estimated at around 46.6% of nominal GDP. The share of long-term debt, minus FDIs, was estimated at around 59.5% of total external debt stock.

Chart 5 Debt stock by maturity
(as a percentage of nominal GDP)



Source: Bank of Albania.

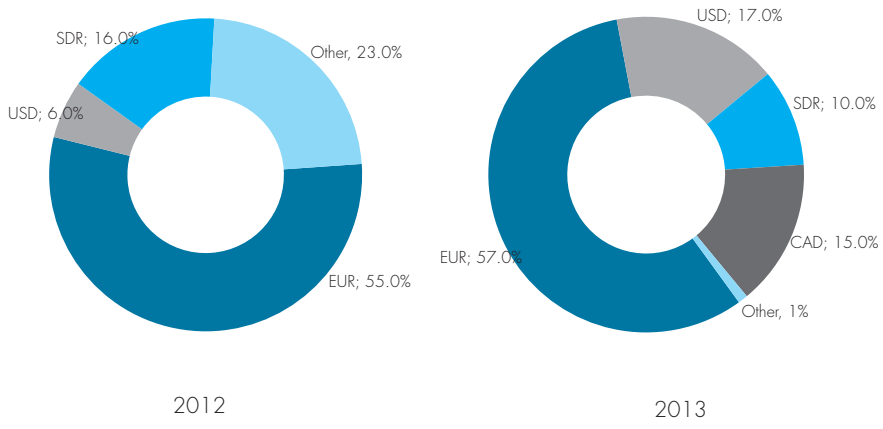
At the end of 2013 Q4, short-term debt amounted to around EUR 1.2 billion, against around EUR 1.1 billion at end-2012. The share of short-term debt in total gross external debt stock increased slightly to 20.8%. The general government and the monetary authority hold only long-term debt. The investment instruments used by the central government include loans, notes and bonds. The banking sector and other sectors of the economy have a more diversified portfolio, consisting of both long and short-term debt. These two sectors' short-term debt consists largely of currency and deposits, and trade credits.

D. EXTERNAL DEBT BY CURRENCY

Most of Albania's external debt is denominated in euro, accounting for around 57.0% of the total at end-2013. The share of debt denominated in SDRs[8] in the total has been falling progressively in the past three years. On the other hand, the stock of debt denominated in U.S. dollar rose substantially to around 17.0% at end-2013, from 6.0% at end-2012.

[8] *Special Drawing Rights (SDRs) are international reserve assets, created by the International Monetary Fund to supplement its member countries' other official reserves. The International Monetary Fund may periodically allocate SDRs to member countries in proportion to their quotas.*

Chart 6 Gross external debt by currency



Source: Bank of Albania.

E. GROSS EXTERNAL DEBT SERVICE BY SECTOR

During 2013 Q4, total external debt service (principal plus interest payments) amounted to EUR 96.8 million. Out of this value, around 90.2% was paid in principal and 9.8% in interest. In debt service by sector, principal payments make up the largest portion of payments.

Table 1 Gross external debt service by sector

	2013 Q1	2013 Q2	2013 Q3	2013 Q4
General government				
Principal payments	11.7	34.2	13.9	36.8
Interest payments	6.1	9.1	6.5	8.8
New debt	58.0	86.1	21.0	18.8
Private (long-term and short-term)				
Principal payments	27.0	15.0	11.0	24.6
Interest payments	0.1	1.3	0.3	0.2
New debt	14.1	6.5	5.3	59.1
Banks (long-term and short-term)				
Principal payments	13.5	16.8	5.7	25.6
Interest payments	0.5	0.4	0.4	0.5
New debt	3.0	4.4	7.0	0.4
Total debt service	62.9	76.9	41.5	96.8
Total new debt	75.1	97.0	33.4	78.3

Source: Bank of Albania.

The total value of disbursements or new debt for the entire economy amounted to around EUR 78.3 million in 2013 Q4. Private debt (long and short-term) dominated the new debt disbursements, accounting for around 75.5% of total new debt. General government's new debt (long-term) hit a considerably low level compared to the first three quarters of 2013, accounting for around 24.0% of total new debt.

2. EXTERNAL DEBT SUSTAINABILITY INDICATORS

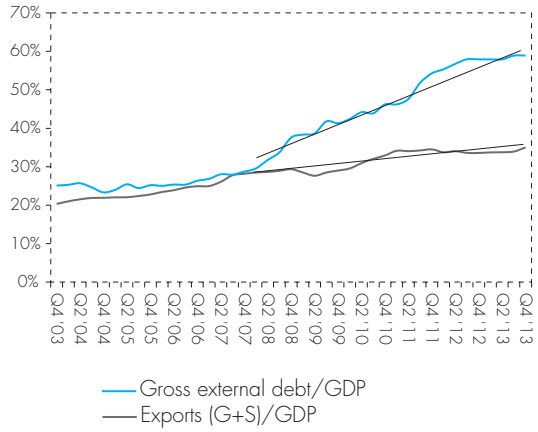
The analysis of gross external debt based on the performance over time of its main sub-items by sector, instrument and maturity shows a static overview of its situation and evolution, without reaching any conclusions on its dynamics and its sustainability. For such an analysis, we need to compare the time trends of gross external debt against other closely related economic variables. The indicators used to evaluate the external debt sustainability are generally classified into two categories: (a) indicators that measure a country's continuous and uninterrupted repayment capacity against its international lenders, (b) indicators that measure the adequacy of liquidity in case of obligation to repay immediate liabilities.

A. INDICATORS OF REPAYMENT CAPACITY

The export of goods and services is considered a direct and continuous source of foreign currency inflows into an economy. At the same time, if viewed in a comparative approach against the gross external debt denominated in foreign currency, it may serve as an analytical indicator that approximates a country's long-term repayment potential and capacity.

The gross external debt growth at a more accelerated pace than total exports of goods and services signals a country's weaker long-term repayment capacity, which may, in turn, cause a country to face difficulties in meeting contractual external debt obligations in the long-run. As of 2008 Q1, the gross external debt to nominal GDP for Albania showed a similar tendency to the exports of goods and services.[9] Beyond this quarter, the upward trend of the gross external debt stock-to-GDP ratio registered an accelerated growth rate, causing a marked divergence in the long-term trajectory of these two indicators. However, in 2013 Q4, the exports of goods and services increased more than gross external debt.

Chart 7 Gross external debt stock and exports of goods and services as a percentage of nominal GDP



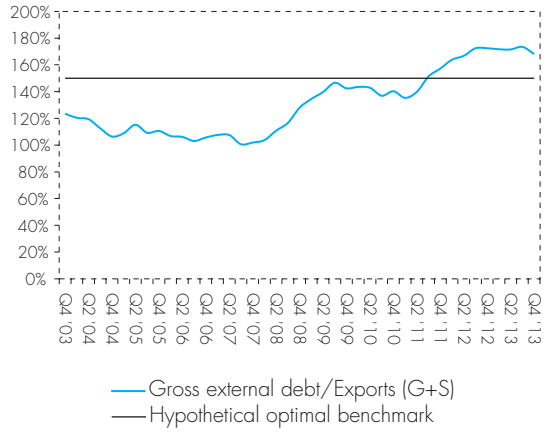
Source: Bank of Albania.

The divergence between the long-term performance of gross external debt and the export of goods and services is also confirmed by their worsening ratio.

[9] *The inflow of exports of goods and services, and the quarterly nominal GDP, have been annualised to ensure that end-of-period ratios to the external debt stock are comparable and consistent. The three variables are denominated in euro.*

More specifically, this ratio stood at around 100% until 2008 Q1. In the subsequent period, the gross external debt increased at a faster pace than the export of goods and services, and 2008 Q1 and 2011 Q1 marked turning points in this tendency. The ratio of gross external debt to the export of goods and services was around 168.1% at end-2013, down by 4.4 percentage points annually. Compared to the benchmarks proposed through empirical analysis by the international financial institutions for this indicator, which vary depending on a country's institutional development, this ratio stands slightly higher than the hypothetical optimal benchmark Albania could be classified into.[10]

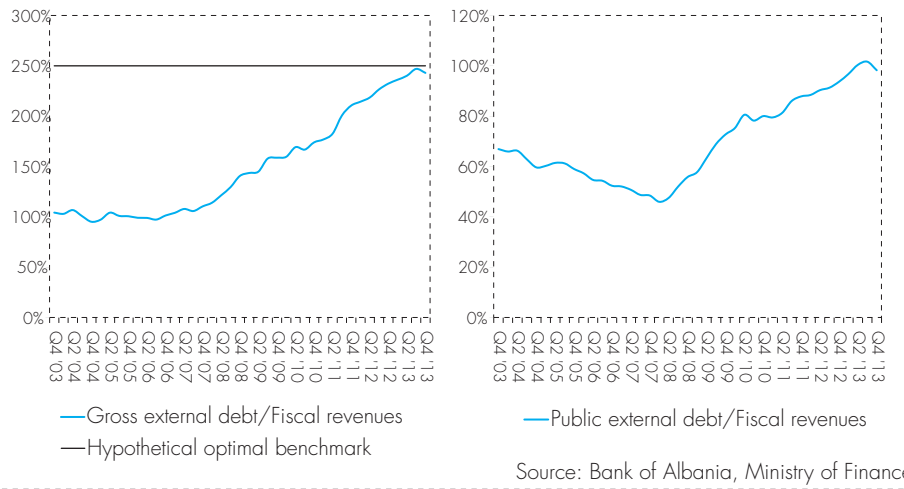
Chart 8 Gross external debt to exports of goods and services



Source: Bank of Albania.

In parallel, a country's repayment capacity can be also measured by estimating whether the intake of fiscal revenues is sufficient to cover a certain ratio of the gross external debt or of the central government's external debt stock. The first indicator serves to signal the central government's capacity to intervene in times of crisis and prevent the country's loss of credibility across the international lenders. While the second indicator facilitates the monitoring of the stability of the government's external debt level, which, if too high, may affect the transfer of fiscal revenues from the more efficient expenditures with an effect on the economic performance to external debt amortization. At the end of 2013, the ratio of gross external debt to fiscal revenues for Albania was estimated at 243%[11], around 7 percentage points below the hypothetical optimal benchmark proposed by international institutions.[12]

Chart 9 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.

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

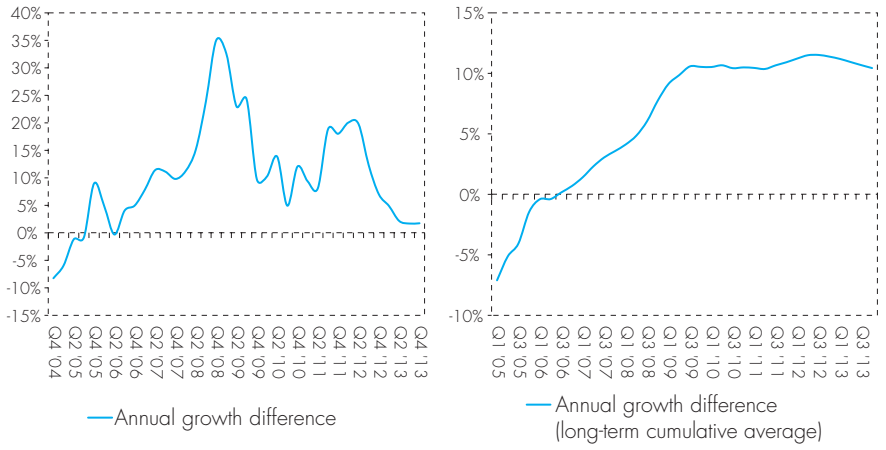
[11] *Quarterly fiscal revenues have been annualised through a four-quarter rolling sum.*

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

Moreover, the ratio of the central government's gross external debt to fiscal revenues has maintained an upward trend since 2008 Q1. At the end of 2013, this ratio stood at 98.2%, around 4.6 percentage points higher, y-o-y.

Theoretically, accumulated external debt may be followed by an accelerated economic growth if its flows are channelled into efficient investment activities or value added operations in the economy. By the end of 2013, the difference between the annual performance of gross external debt and nominal GDP does not yet confirm this performance. Excluding 2005 and 2006 Q2, the gross external debt stock has increased at a more accelerated pace than nominal GDP. At the same time, the long-term cumulative average[13] of the difference between the annual performance of gross external debt and nominal GDP was estimated at around 10.5 percentage points in 2013 Q4, considerably lower than the corresponding quarter in 2012.

Chart 10 Annual growth difference between gross external debt and nominal GDP by quarters (left) and long-term cumulative average (right)



Source: Bank of Albania.

Despite the slight worsening of the long-term repayment capacity since 2008, its performance for the period ahead has been closely linked to both the performance of the domestic economy and the distribution of external debt service over time.[14] Under optimal conditions, external debt servicing should not have a direct negative impact on the economy, which may arise from the allocation of financial resources to this function. At the same 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. The accumulation of arrears on external debt service obligations or continuous payment rescheduling may increase the risk premiums

[13] *This indicator is constructed using the annual growth for each period in time "T" and before that, as a cumulative average. Suppose that there are 12 periods of time in period T_{12}. Their average provides the cumulative average of the period until T_{12}. The move to T_{13} is achieved by adding the value of T_{13} and averaging it again.*

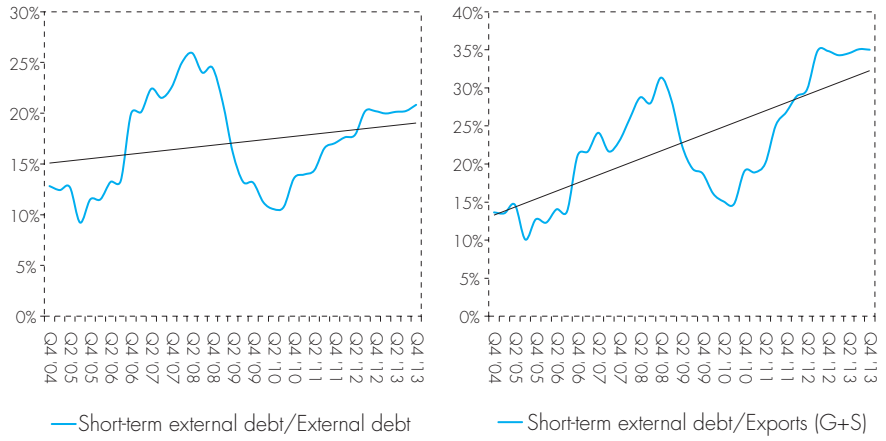
[14] *The country's long-term repayment capacity improves if the economy grows at a rapid pace in the future and the distribution of external debt servicing is uniform over time. In the opposite case, a country's long-term repayment capacity indicators deteriorate.*

in the economy and exert pressure on economic activity at a later time. An economy should, therefore, have sufficient liquidity to meet these immediate contractual obligations or create a buffer for the country against any negative shocks arising from the external economy.

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. That is, if the use of this form of external financing with a maximum maturity of one year is disproportionately concentrated, the immediate obligations towards the external debt are considered to be high for the year ahead. Albania's external financing profile has been mainly oriented towards long-term debt. In the meantime, the short-term debt has ranged between 9.2% and 25.9% of total external debt stock. In 2013 Q4, the share of short-term external debt stock increased slightly in annual terms. However, the annual inflows from the export of goods and services have managed to cover the short-term external debt entirely. Total short-term debt stock, as a percentage of total exports of goods and services, was estimated at 35% in 2013 Q4.

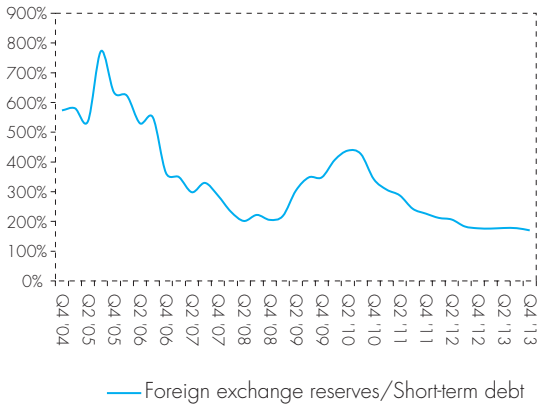
Chart 11 Short-term gross external debt as a percentage of total gross external debt (left) and exports of goods and services (right)



Source: Bank of Albania.

Foreign exchange reserves availability in covering short-term external debt is one of the most important indicators of liquidity adequacy. Against an imperfect access into international capital markets, foreign exchange reserves adequacy may help cover short-term external debt obligations. This indicator becomes even more important against the backdrop of a difficult external financial environment, which may increase the probability of external negative shocks and hinder the country's routine capacity to repay its short-term external debt. Albania's current foreign exchange reserve level is sufficient to withstand such a scenario. The critical benchmark of foreign exchange reserve cover of short-

Chart 12 Foreign exchange reserve stock to short-term gross external debt

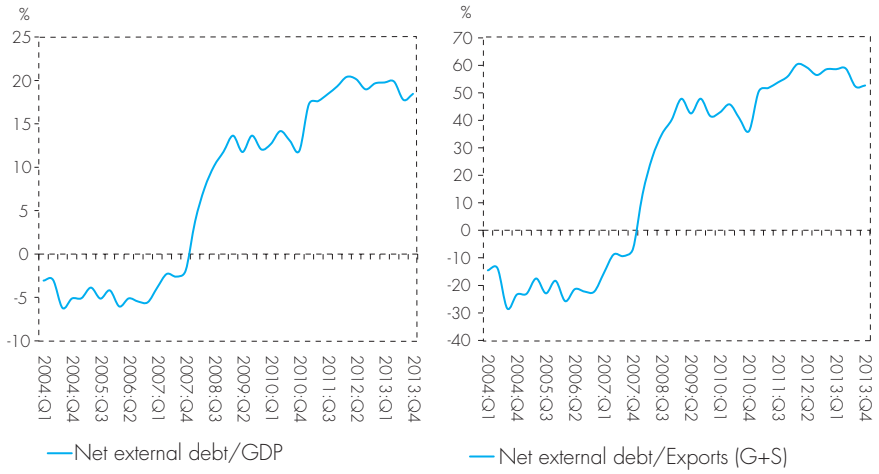


Source: Bank of Albania.

term external debt is 100%, and the ratios below this benchmark provide evidence of insufficient foreign exchange reserve stock.[15] In Albania's case, this ratio has never been less than 100%, albeit showing a downward trend. At the end of 2013, the foreign exchange reserve stock covered around 170% of the short-term external debt, around 7 percentage points less than in the corresponding quarter of 2012.

The measurement of the external debt level with a view to identifying the short-term pressures arising from the expected liabilities is achieved by deriving and monitoring the net external debt. The cumulative sum of banks' net foreign assets and foreign exchange reserves are subtracted from the gross external debt. Albania's net external debt is relatively low, fluctuating below 20% of nominal GDP[16], mainly due to banks' net foreign assets and foreign exchange reserves increasing faster than gross external debt. At the end of 2013, the net external debt to the nominal GDP ratio was 18.5%, around 1.2 percentage points lower than at end-2012.

Chart 13 Net external debt to nominal GDP (left) and exports of goods and services (right)



Source: Bank of Albania.

The indicators based on principal and interest payments provide an evaluation of the foreign exchange resources in the economy, which are commonly used to service the gross external debt. They are important in monitoring short-

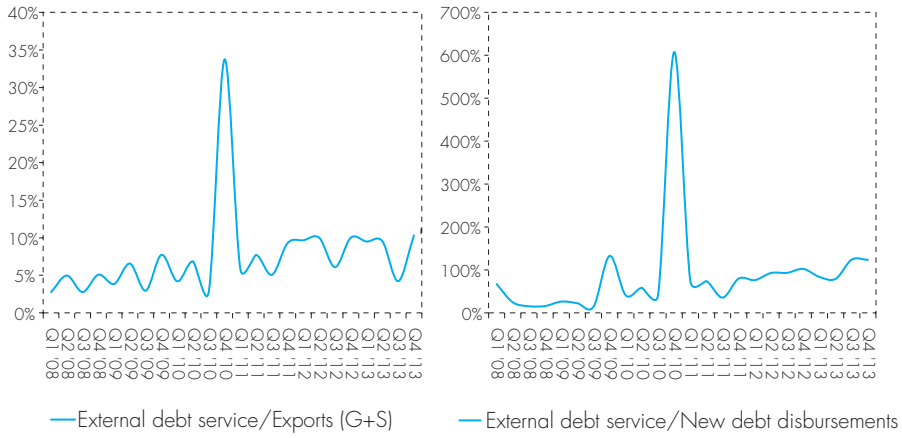
[15] *According to Guidotti–Greenspan rule. For more information: IMF, "Assessing reserve adequacy", 2011.*

[16] *By the end of 2012, Albania's net external debt to GDP ratio of 19.8% was below the regional countries' average. Net external debt to GDP ratio for the countries in the region was 30.4% in 2012, ranging from the minimum ratio of -13% and 11.5% in Kosovo and Macedonia, to the peak ratio of 59.8% and 50.6% in Croatia and Montenegro.*

term pressures of external debt servicing and in avoiding the unexpected movement of financial flows from productive activities in the economy to expected amortization disbursements on the external debt. However, the level of amortization is closely linked to the allocation of new debt in previous periods but also on the time of disbursement, where lenders may have agreed to a grace period with regards to contractual obligations of principal and interest payments. Albania's external debt service as a percentage of exports of goods and services ranges between 2.8% and 10.3%, with 2010 Q4 acting as an outlier, a quarter when the central government carried out high principal payments. This indicator's ratio stands well below the critical benchmark of 20% as suggested by the international organisations.[17]

On the other hand, the ratio of external debt amortization to new debt disbursements measures the extent of debt rollover. A ratio below 100% indicates larger new external debt disbursements than repayments of old debt. In the case of Albania, the ratio of external debt rollover has averaged at around 95.3% since 2008 Q1. If we exclude 2010 Q4, which is an outlier, the average falls to 65%. For the entire period, this indicator points to larger new external debt disbursements than the amortization of previous disbursements. However, in the last two quarters of 2013, the external debt amortization was around 23.7% higher than new disbursements.

Chart 14 External debt service to exports of goods and services (left) and new debt disbursements (right)



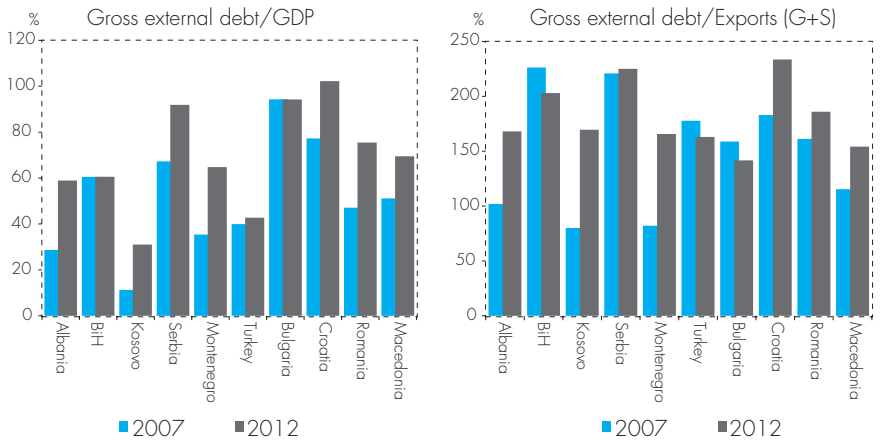
Source: Bank of Albania.

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

3. A REGIONAL APPROACH TO EXTERNAL DEBT SUSTAINABILITY INDICATORS

For a comparative approach to Albania's gross external debt sustainability, we compare data for selected countries in the region on some of the most important indicators.[18] The data for these countries are available until 2012, whereas for Albania we use the latest available data until 2013. The analysed indicators include the ratio of gross external debt to GDP and exports of goods and services, foreign exchange reserve to short-term external debt, and external debt service to exports of goods and services.

Chart 15 Gross external debt to GDP (left) and exports of goods and services (right)



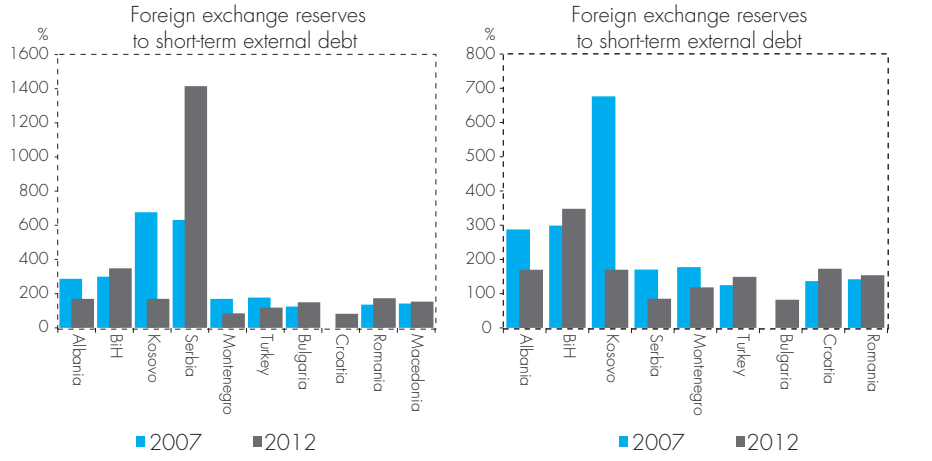
Source: Bank of Albania, World Bank and authors' calculations.

The external debt to GDP data provides evidence of an increasing trend of this indicator since 2007 for all the countries of the region, excluding Bulgaria and Bosnia and Herzegovina. In 2012, in absolute terms, Croatia, Bulgaria and Serbia had the highest gross external debt to GDP. Albania's gross external debt to GDP in 2013 stood below the region's average for 2012. It should be noted, however, that this average level is very high due to the bias introduced by the external debt figures of the above three countries. If we exclude their debt ratios from the regional average, Albania's external debt to GDP ratio stands at a level similar to the region. The ratio of gross external debt to the export of goods and services shows a slightly more complex situation. It has worsened over time in most countries of the region, excluding Bosnia and Herzegovina, Bulgaria and Turkey. In 2012, this ratio hit the highest registered level in Croatia, Serbia, and Bosnia and Herzegovina. For the entire period under review, it worsened most considerably in Albania,

[18] *The sample of countries includes Bosnia and Herzegovina, Kosovo, Serbia, Montenegro, Turkey, Bulgaria, Croatia, Romania and Macedonia (FYROM).*

Kosovo and Montenegro, with the difference between the initial period (year 2007) and end of period (2013 for Albania and 2012 for the other two countries) standing at 66.2, 89.6 and 83.5 percentage points.

Chart 16 Foreign exchange reserves to short-term external debt for all the countries in the region (left) and excluding Serbia (right)

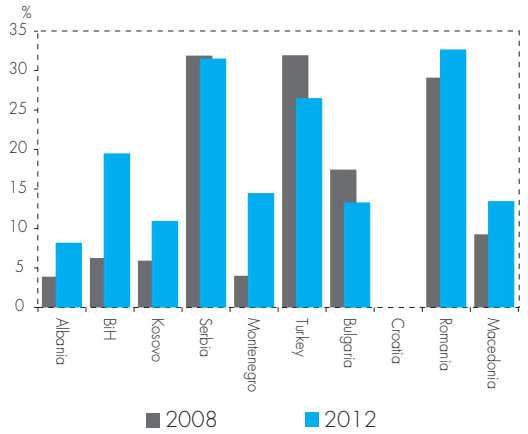


Source: Bank of Albania, World Bank and authors' calculations.

Foreign exchange reserve cover of short-term external debt shows a slightly more diverse situation in terms of the current ratios and performance of this indicator over time. Serbia hit the highest ratio in the region for 2012, mainly thanks to two financial arrangements with the IMF concluded in 2008 and 2011.[19] To assure data, Serbia has been excluded from the sample. Foreign exchange reserve cover of short-term gross external debt fell in Albania, Kosovo, Montenegro and Turkey, and increased in Bosnia and Herzegovina, Bulgaria, Romania and Macedonia (FYROM). The foreign exchange reserve adequacy condition is met by all countries bar Montenegro and Croatia whose foreign exchange reserve stock does not manage to cover the short-term external debt entirely.

The external debt service to the export of goods and services is the final reviewed indicator. As noted above, external debt amortisation is closely linked to the time of disbursement, where a negotiated grace period might exist on contractual obligations of principal and interest payments. The countries of the region stand at different stages of external debt maturity and, consequently, the respective amortization payments differ. However, this regional approach helps compare the current levels and visualize a possible trajectory of debt servicing obligations for the countries in the preliminary stages of gross external debt maturity.

Chart 17 Gross external debt service to exports of goods and services



Source: World Bank, IMF, Bank of Albania and authors' calculations.

[19] *For more information: http://www.imf.org/external/pubs/ft/survey/so/2008/car111708a.htm; http://www.imf.org/external/np/sec/pr/2011/pr11319.htm*

Albania has the lowest ratio of external debt amortization to inflows of exports of goods and services in the region. Relative to 2008, this ratio has shown an increasing trend in most countries under review, bar Serbia, Turkey and Bulgaria. This indicator deteriorated faster in Montenegro and Bosnia and Herzegovina, increasing by 9.3 and 10.8 percentage points, respectively. For the subsequent period, the preservation of a low external debt service to exports ratio in Albania is expected to be conditional on a positive trend of exports and an equal distribution of debt amortization payments over time.