Bank of Albania

GROSS EXTERNAL DEBT ANALYSIS

2014 Q1

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

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MAIN CONCLUSIONS

- At the end of the first quarter of 2014, Albania's gross external debt stock amounted to EUR 5,724.5 million. In annual terms, it increased by 2.9% to around 57.7% of nominal GDP.

- By sectoral breakdown, the external debt stock shows an unchanged profile, with the general government accounting for around 40.5%, the deposit-taking corporations 20.7%, other sectors 20.2%, FDIs 17.3%, and the monetary authority 1.3%.

- By investment instruments, 'Other investments' dominate the external debt stock, accounting for around 72.4%, or 0.9 percentage point higher year-over-year.

- By maturity composition, around 80.1% of the external debt stock is long-term debt, remaining at a similar level to the corresponding quarter in 2013.

- By currency composition, around 57% of the external debt is denominated in euro and 14% in U.S. dollar, with the respective shares of the two currencies increasing by around 1 percentage point year-over-year.

- Albania's net external debt is relatively low, estimated at 17.8% of nominal GDP, primarily due to the increase in foreign exchange reserves at a faster pace than the 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, a slight increasing tendency in the funds necessary to service the external debt.

1. A DETAILED ANALYSIS OF GROSS EXTERNAL DEBT[1]

At the end of 2014 Q1, Albania's gross external debt totalled EUR 5,724.5 million, up around EUR 70.5 million quarter-over-quarter, and around EUR 161.4 million year-over-year. In annual terms, it increased by around 2.9%, to 57.7% of nominal GDP.[2] At the end of 2013 Q4, this ratio stood at 57.4% of nominal GDP.

The central government has the largest share in total external debt stock, at around 40.5%. Its share in the total external debt stock fell by around 0.4 percentage point from the corresponding quarter in 2013. The central government's external debt stock amounted to around EUR 2,319.6 million, or nearly 23.4% of nominal GDP.

At the end of 2014 Q1, the gross external debt stock of the deposit-taking corporations (except the central bank) amounted to around EUR 1,182.2 million, up around EUR 90.6 million from 2013 Q1.

Other sectors' external debt stock totalled around EUR 1,155.1 million, up around EUR 76.7 million from 2013 Q1, and EUR 74.6 million from 2013 Q4. Its share in the total external debt stock was around 20.2%, increasing by around 0.8 percentage point from 2013 Q1.

The stock of FDIs – intercompany loans amounted to around EUR 991.5 million, down around EUR 37.2 million from 2013 Q1.

At the end of 2014 Q1, around 62.7% of the debt stock (excluding FDIs – intercompany loans) was long-term debt, mainly in the form of loans. For the same period, short-term debt accounted for around 19.9% of total debt stock, mainly in the form of currency and deposits from the deposit-taking corporations (except 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.

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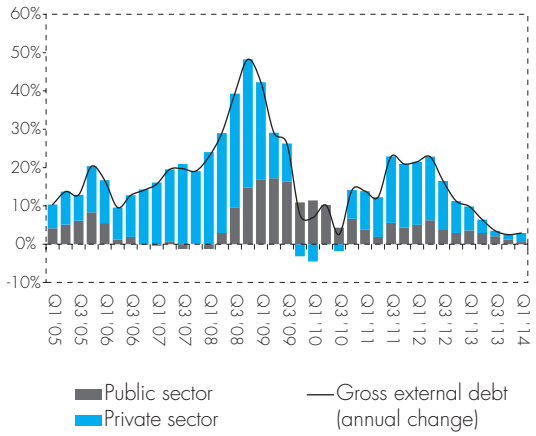
1 The latest external debt data are as of 2014 Q1. The previous year's data have also been revised. Starting from 2014 Q1, Financial Stability and Statistics Department at the Bank of Albania compiles the External Sector Statistics in compliance with the international standards laid down in the sixth edition of the IMF's Balance of Payments Manual. Earlier, they were compiled in compliance with the fifth edition (BPM5). The main differences between the two methodologies are synthesised in the guideline "Publication of external sector tables according to BPM6", published by the Bank of Albania at:
http://www.bankofalbania.org/web/pub/01_commentary_for_changes_in_the_publication_of_external_sector_statistics_according_to_bpm6_june_2014_6689_1.pdf

2 Four-quarter rolling sum of GDP.

A) EXTERNAL DEBT BY SECTORS OF ECONOMY[3]

The increase in the gross external debt stock during 2014 Q1 continued to be driven by the deepening total borrowing from the private sector of the economy (deposit-taking corporations, other sectors and direct investments). In nominal terms, the private sector's debt stock totalled around EUR 3.3 billion, up 4.1% year-over-year.

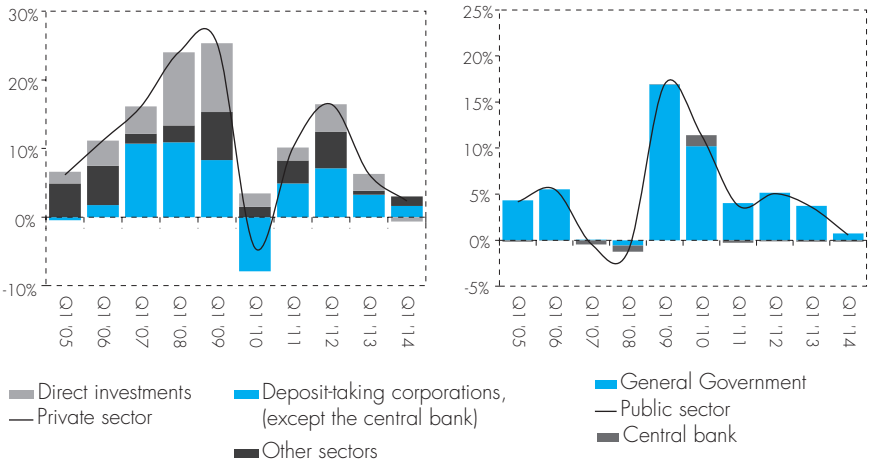
Chart 1 Gross external debt by sector (contribution in percentage points)



Source: Bank of Albania.

Over the years, the private sector has played a dominant role in the dynamics of Albania's gross external debt stock, except 2009-2010. The three categories within this sector - deposit-taking corporations, other sectors and direct investments - have progressively increased their share in total debt stock and nominal GDP over the years. In 2014 Q1, the deposit-taking corporations and other sectors of the economy made increasing contribution to total gross external debt. Conversely, direct investments made a negative contribution. The public sector's (general government and central bank) contribution to the increase in total external debt stock has been on a downward trajectory since end-2009. In the beginning of 2014, the public sector contributed by around 0.6 percentage point to the increase in total gross external debt. The increased debt in the public sector was driven by the general government, whereas the central bank continued to reduce its exposure to the external debt.

Chart 2 Private and public sector debt (contribution in percentage points)

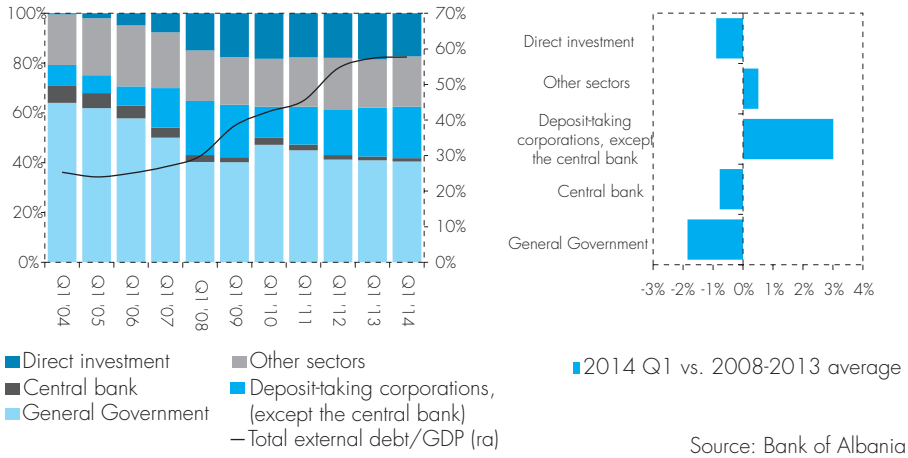


Source: Bank of Albania.

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

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 and nominal GDP. At the end of 2014 Q1, the general government accounted for around 40.5% of the total external debt stock. The rest of the debt stock has been allocated to the deposit-taking corporations (except the central bank) 20.7%, other sectors of the economy 20.2%, FDIs 17.3%, and the central bank 1.3%.

Chart 3 Share of sectors in total external debt stock (left chart); debt stock changes during 2014 Q1 against the 2008-2013 average (in percentage points, right chart)



Source: Bank of Albania.

During the last three years, the share of the general government debt in the total debt stock has been estimated at an average of 40.9%, ranging between 40.3% and 41.7%. At the end of 2014 Q1, the general government's external debt stock amounted to EUR 2.3 billion, up around EUR 41.4 million from end-2013 Q1 or around 1.8% year-over-year. It was estimated at around 23.4% of nominal GDP, or 0.1 percentage point lower year-over-year. By maturity composition, the general government continued to hold long-term external debt, mainly in the form of loans, notes and bonds.

The deposit-taking corporations (except the central bank) are the second largest sector in terms of share in total debt stock. The trend of their share in total debt was upward during 2011-12, settling at around 19.0% at the end of 2013. In the beginning of 2014, this sector's debt increased again by around EUR 90.6 million from end-2013, and around EUR 106.8 million from 2013 Q1. The deposit-taking corporations' external debt stock was estimated at around 11.9% of nominal GDP, up 0.7 percentage point year-over-year. Broken down by maturity, the deposit-taking corporations show a clear orientation towards short-term debt. At the end of 2014 Q1, the short-term debt held by the deposit-taking corporations accounted for around 85.3% of this sector's total debt stock.

Other sectors' debt stock accounted for around 20.2% of the total gross external debt stock. Their debt stock has been falling progressively since

2012, to later rise again in the beginning of 2014. At the end of 2014 Q1, the external debt of other sectors of the economy was estimated at around 11.6% of nominal GDP. Broken down by maturity, 88.5% of other sectors' debt stock was long-term debt and the rest, 11.5%, short-term debt.

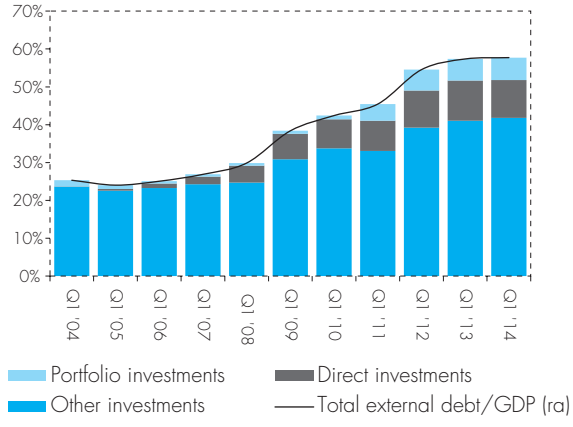
The external debt stock in the form of FDIs – intercompany loans accounts for around 17.3% of the total external debt stock, and around 10.0% of nominal GDP. During the quarter under review, FDIs' external debt stock fell by around 3.6% in annual terms, or around EUR 37.2 million.

The central bank's gross external debt stock has the lowest share in the total stock compared to the other sectors under review. The monetary authority's liabilities in the form of debt have shrunk continuously across the years. At the end of 2014 Q1, they accounted for around 1.3% 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 loans.

B) EXTERNAL DEBT BY INSTRUMENTS

Broken down by instruments, investments in the form of other investments[4] have a major share in total external debt stock, around 72.4%. Within this item, long and short-term loans have the main share (around 72.4% in total other investment stock).

Chart 4. Classification of debt stock by investment instruments



Source: Bank of Albania.

Since early 2008, the share of this instrument in total other investments has been declining in favour of other investment instruments, settling at an average of 71.1% during 2013. Starting from 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 17.0% of total external debt stock. Investment instruments, such as trade credits and other debt liabilities, continue to have a small share in total other investments.

The share of FDIs – intercompany loans in total gross external debt has maintained a sustained growing rate across the years. At the end of 2014 Q1, the stock of FDIs – intercompany loans was estimated at around 17.3% of the total debt stock, and around 10.0% of nominal GDP.

Investments in the form of portfolio investments accounted for around 10.3% of the total gross external debt and were estimated at around 5.9% of nominal GDP.

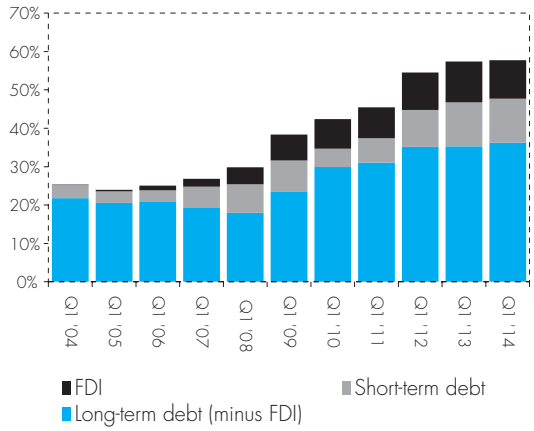
[4] Other investments include: long and short-term loans, currency and deposits, trade credits and other unspecified liabilities.

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 2014 Q1, the long-term debt stock (which also includes FDIs methodologically) accounted for around 80.1% of the total gross external debt stock and was estimated at around 46.2% of nominal GDP. The share of long-term debt, minus FDIs, was estimated at around 62.7% of the total external debt stock.

At the end of 2014 Q1, the short-term debt amounted to around EUR 1.14 billion, against around EUR 1.11 billion at the end of 2013 Q1. The share of short-term debt in total gross external debt reached 19.9%. The general government and the central bank hold only long-term debt. The investment instruments used by the central government include loans, notes and bonds. The deposit-taking corporations 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 and advances.

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

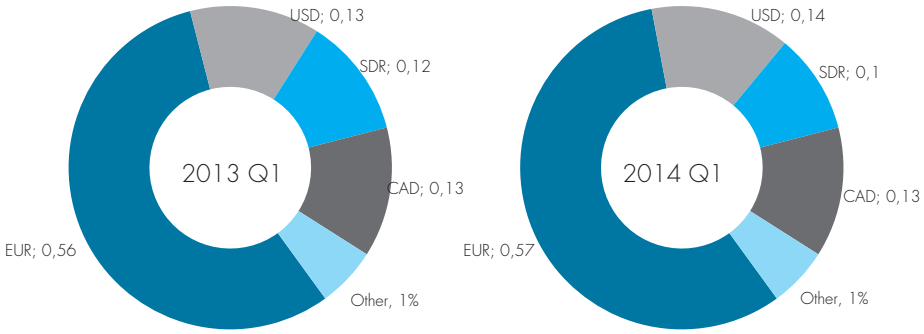


Source: Bank of Albania.

D) EXTERNAL DEBT BY CURRENCY

Most of Albania's external debt is denominated in euro, accounting for around 57.0% of the total at the end of 2014 Q1. The share of debt denominated in SDRs[5] in the total stock has been falling progressively in the past three

Chart 6 Gross external debt by currency



Source: Bank of Albania.

[5] 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.

years. On the other hand, the stock of debt denominated in U.S. dollar rose substantially during 2013-14, to around 14.0% at end-2014 Q1, from 6.0% at end-2012 Q4.

E) GROSS EXTERNAL DEBT SERVICE BY SECTOR

During 2014 Q1, total external debt service (principal plus interest payments) amounted to EUR 58.8 million. Of this, around 84.1% was paid in principal and 15.9% in interest. In debt service by sector, principal payments make up the largest portion of payments.

Table 1 Gross external debt service by sector

	Q1 '13	Q2 '13	Q3 '13	Q4 '13	Q1 '14
General government					
Principal	11,7	34,2	13,9	36,8	14,1
Interest	6,1	9,1	6,5	8,8	7,8
New debt	58	86,1	21	18,8	26,6
Private (long and short-term)					
Principal	27	15	11	24,6	22,1
Interest	0,1	1,3	0,3	0,2	0,8
New debt	14,1	6,5	5,3	59,1	104,4
Banks (long and short-term)					
Principal	13,5	16,8	5,7	25,6	10,1
Interest	0,5	0,4	0,4	0,5	0,7
New debt	3	4,4	7	0,4	23,5
Total debt service	62,9	76,9	41,5	96,8	58,8
Total new debt	75,1	97	33,4	78,3	154,6

Source: Bank of Albania.

New external debt disbursements for the entire economy amounted to around EUR 154.6 million in 2014 Q1. Private debt (mostly long-term debt) dominated the new debt disbursements, accounting for around 67.1% of the total new debt disbursements. The general government's new (long-term) debt hit a considerably low level compared to the previous three years, accounting for around 17.2% of the total new debt.

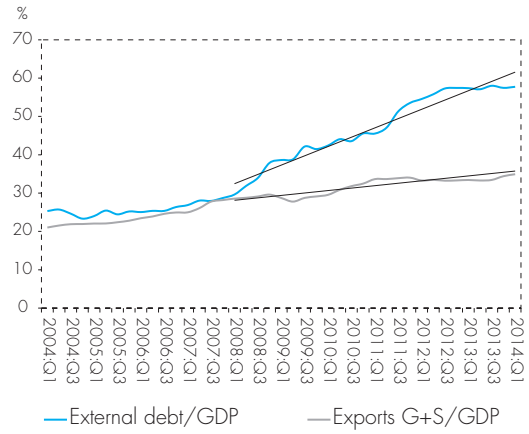
2. EXTERNAL DEBT SUSTAINABILITY INDICATORS

The analysis of gross external debt based on the performance over time of its main sub-items by sector, instruments and maturity shows a vertical overview of its profile and evolution, without reaching any substantial conclusions on its dynamics and sustainability. For this purpose, we need to compare the performance 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 represents a direct and continuous source of foreign currency inflows into an economy. 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 performance of external debt and exports of goods and services as a percentage of nominal GDP[6] for Albania has shown a similar tendency. Beyond this quarter, the gross external debt stock-to-GDP ratio has increased at a more accelerated pace than the exports-to-GDP ratio, providing evidence of the deterioration of this indicator. However, in 2013 Q4 and 2014 Q1, it improved slightly due to the lower gross external debt-to-GDP ratio and, vice-versa, the increased exports-to-GDP ratio.

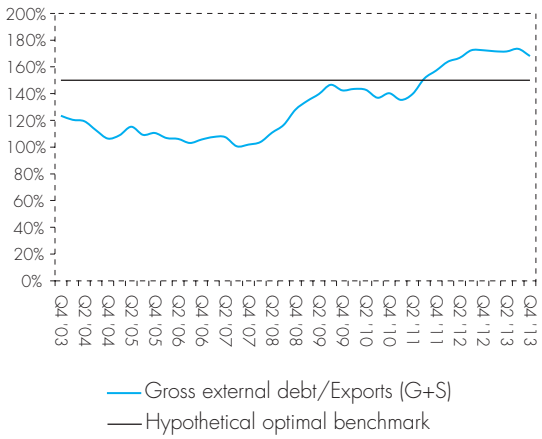
Chart 7 Gross external debt stock and exports of goods and services as a percentage of nominal GDP



Source: Bank of Albania.

[6] The inflows 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.

Chart 8 Gross external debt to exports of goods and services

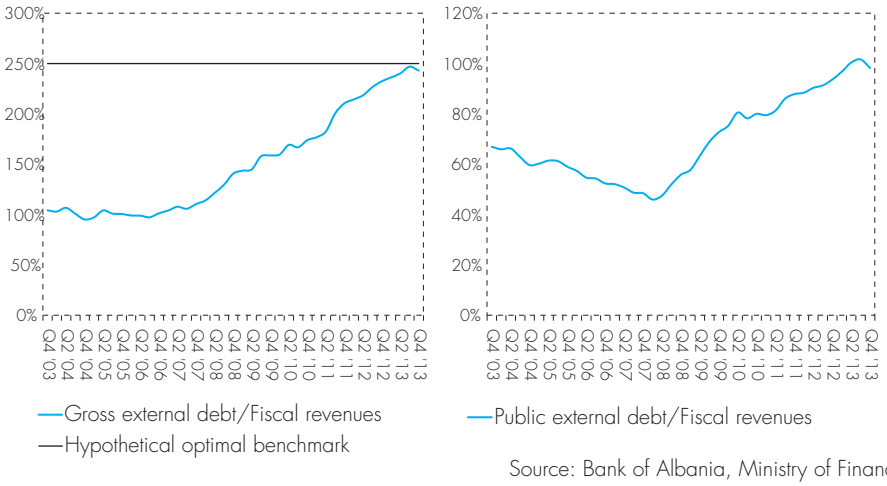


Source: Bank of Albania.

The relative ratio of gross external debt to exports of goods and services reconfirms the divergence in the above-mentioned trends in the beginning of 2008. This ratio stands higher than the hypothetical optimal benchmark proposed through empirical analysis by the international financial institutions, which varies depending on a country's institutional development.[7] The ratio of gross external debt to the exports of goods and services was around 165.3% at the end of 2014 Q1, down by around 6.4 percentage points annually. After reaching a record high at the end of 2013 Q3, this ratio showed a declining trend for the second consecutive quarter, mainly due to increased exports of goods and services.

Paralelly, 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 total gross external debt or of the central government's external debt stock. The first ratio serves to signal the central government's capacity to intervene in times of crisis and prevent the country's loss of credibility across international lenders. While the second ratio 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. As of the end of 2014 Q1[8], the ratio of gross external debt to fiscal revenues for Albania was estimated at 240%. After reaching a record high in 2013 Q3, this ratio showed a declining trend in the next two quarters, standing around 10.2 percentage points below the hypothetical optimal benchmark proposed by

Chart 9 Gross external debt (left) and central government's gross external debt (right) as a percentage of annual fiscal revenues



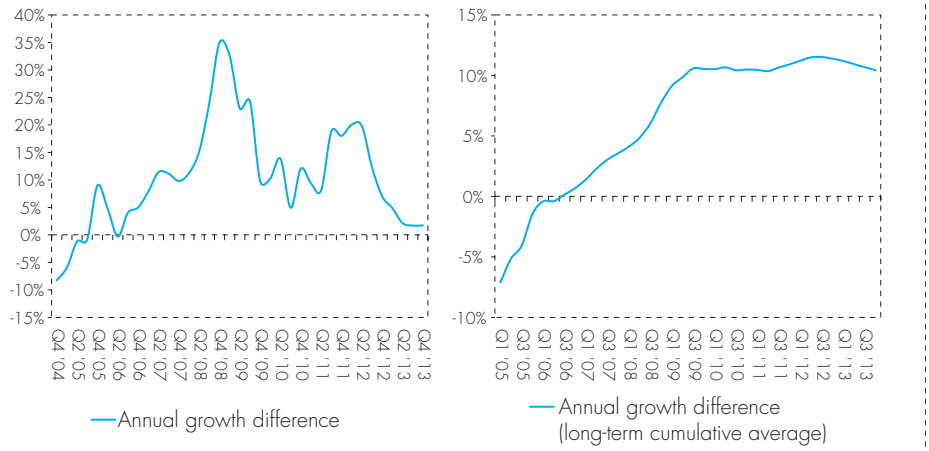
Source: Bank of Albania, Ministry of Finance.

[7] According to the International Monetary Fund and the World Bank.
[8] Quarterly fiscal revenues have been annualised through a four-quarter rolling sum.

international institutions.[9] The ratio of the central government's gross external debt to fiscal revenues has also shown a similar performance, reducing from the peak level of 101.7% in 2013 Q3 to 97.2% at the end of 2014 Q1.

Theoretically, the accumulated external debt may be followed by an accelerated economic growth if its flows are channelled into efficient investment activities and produce value added in the economy. As of 2014 Q1, the difference between the annual gross external debt and nominal GDP does not yet confirm this performance. During 2008 Q1-2009 Q3 and 2011 Q3-2012 Q3, this indicator reached the peak. In the last two quarters, this indicator provided evidence of a difference of less than 1 percentage point between the increase in gross external debt and nominal GDP. At the same time, the long-term cumulative average[10] of the difference between the annual performance of the gross external debt and nominal GDP was estimated at around 10.5 percentage points at the end of 2014 Q1. This average is nearly 1.1 percentage point lower year-over-year.

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 in Albania's 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.[11] 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

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

10 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.

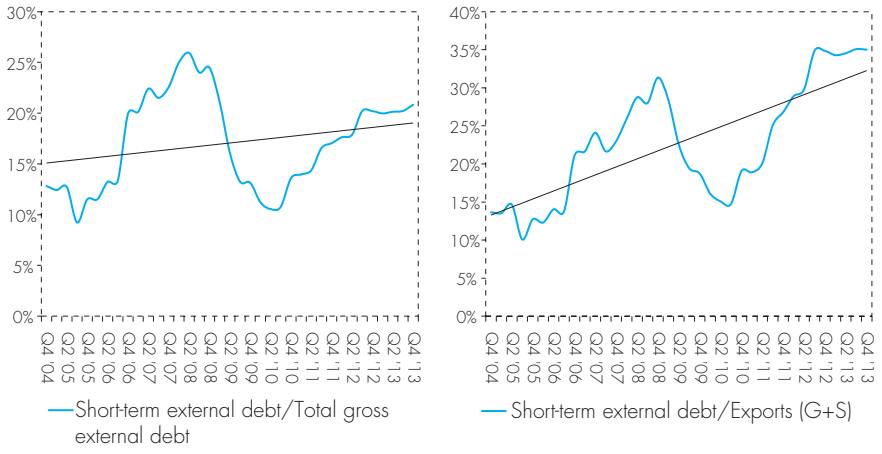
11 The country's long-term repayment capacity improves if the economy grows at a fast pace in the future and the distribution of external debt servicing is uniform over time. In the opposite case, a country's long-term repayment capacity indicators deteriorate.

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 in the economy and exert pressure on economic activity at a later time.

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. The short-term debt has ranged between 9% and 26% of the total external debt stock. During the quarter under review, the share of short-term external debt stock fell slightly to 19.9% of the total stock. The annual inflows from the exports of goods and services managed to cover the short-term external debt entirely. The total short-term external debt as a percentage of total exports of goods and services was estimated at 33% during 2014 Q1. Despite the slight deterioration since 2010 Q4, this indicator provides evidence of the availability of regular foreign currency inflows in covering the short-term external debt.

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

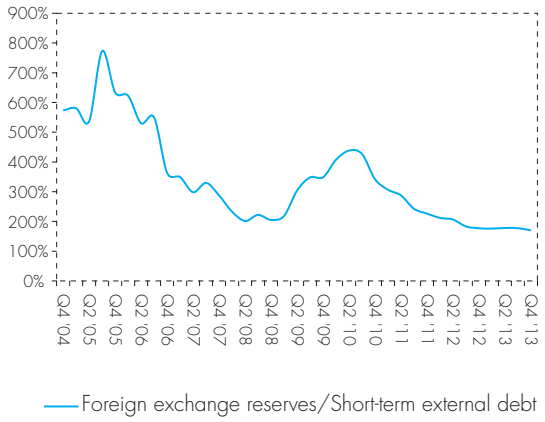


Source: Bank of Albania.

Foreign exchange reserves availability in covering short-term external debt is another important indicator of liquidity adequacy. Against an imperfect access to international capital markets, the adequacy of foreign exchange reserves may help cover short-term external debt obligations. Albania's current foreign exchange reserve level is sufficient to withstand external negative shocks, which may hinder the country's routine capacity to repay its short-term external debt. The critical benchmark of foreign exchange reserve

cover of short-term external debt is 100%, and the ratios below this benchmark provide evidence of insufficient foreign exchange reserve stock.[12] In Albania's case, this ratio has never been less than 100%, albeit showing a downward trend. At the end of 2014 Q1, the foreign exchange reserve stock covered around 174% of the short-term external debt, around 2.4 percentage points less than in the corresponding quarter of 2013.

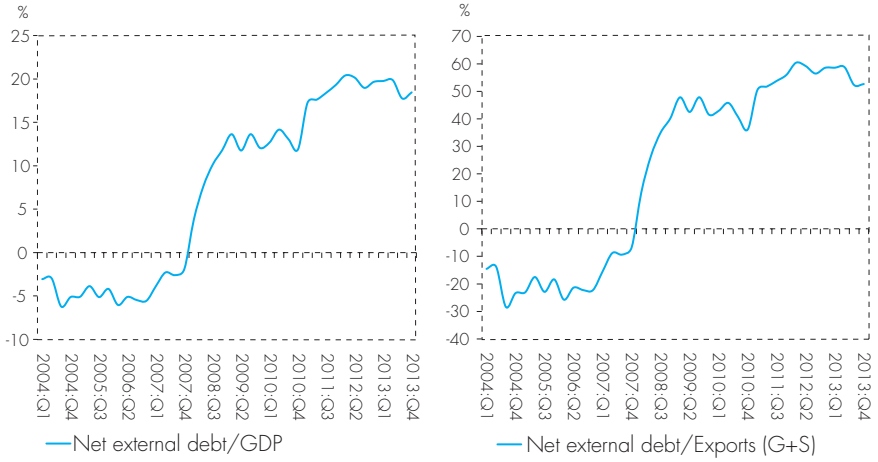
Chart 12 Foreign exchange reserve stock to short-term gross external debt



Source: Bank of Albania.

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 is subtracted from the gross external debt. Albania's net external debt is relatively low, fluctuating below 20% of nominal GDP[13], mainly due to banks' net foreign assets and foreign exchange reserves increasing faster than the gross external debt. At the end of 2014 Q1, net external debt-to-nominal GDP ratio was 17.8%, around 1.8 percentage points lower year-over-year. Net external debt-to-exports of goods and services maintained a downward trend for three consecutive quarters, being estimated at 50.8% at the end of 2014 Q1.

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



Source: Bank of Albania.

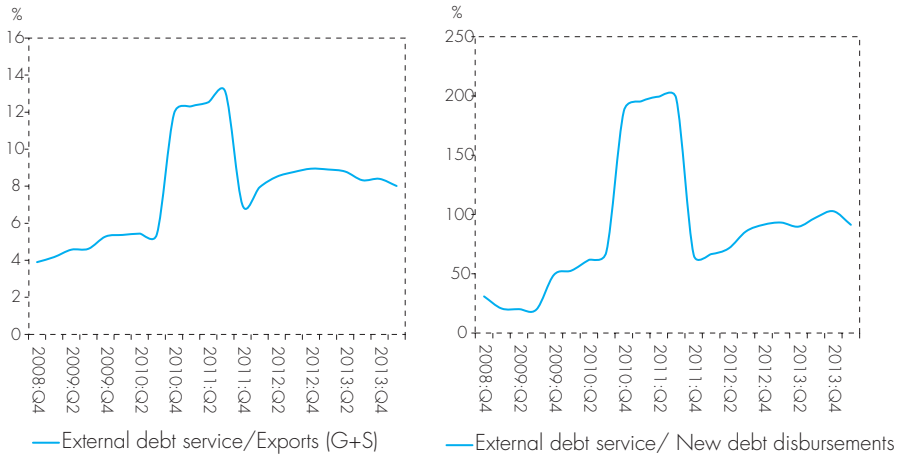
[12] According to Guidotti–Greenspan rule. For more information: IMF, "Assessing reserve adequacy", 2011.

[13] By the end of 2012, Albania's net external debt-to-GDP ratio of 19.5% was below the regional countries' average. Net external debt-to-GDP ratio for the countries in the region averaged 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.

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-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. The level of amortization is closely linked to the allocation of new debt in the previous periods but also to the time of disbursement, where lenders may have agreed to a grace period with regards to contractual obligations of principal and interest payments. An important indicator in monitoring the significance and the relative size of external debt servicing is the ratio of the latter to foreign currency inflows from the exports of goods and services. In the case of Albania, this ratio 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.[14]

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 85.8% since 2008 Q1. If we exclude 2010 Q4, which is an outlier, the average falls to 64%. For the entire period since 2008 Q1, this indicator points to a cumulative value of the new external debt disbursements 1.6 times higher than the amortization of previous disbursements. During 2014 Q1, the external debt amortization was 6.5% lower on an annual level, whereas the ratio of external debt rollover was 38%.

Chart 14 Annual moving average of external debt service to exports of goods and services (left) and new debt disbursements (right)



Source: Bank of Albania.

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