Bank of Albania

GROSS EXTERNAL DEBT ANALYSIS

2014 Q2

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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 second quarter of 2014, Albania's gross external debt stock amounted to EUR 6,371.8 million. In annual terms, it increased by 8.8% to around 63.5% of nominal GDP.

- By sectoral breakdown, the external debt stock shows an unchanged profile, with the general government accounting for around 37.4%, the deposit-taking corporations 19.1%, other sectors 18.3%, FDIs 24.0%, and the monetary authority 1.2%.

- 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 81.3% of the external debt stock is long-term debt, remaining at a similar level to the corresponding quarter in 2013.

- 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 has been in an uptrend since the first quarter of 2008. It stands above the hypothetical optimal benchmark of 150% since the fourth 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 reserves are sufficient to withstand external negative shocks.

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

At the end of 2014 Q2, Albania's gross external debt totalled EUR 6,371.8 million, up around EUR 70.5 million quarter-over-quarter, and around EUR 518.0 million year-over-year. In annual terms, it increased by around 8.8%, to 63.5% of nominal GDP.[2] At the end of 2013 Q4, this ratio stood at 62.8% of nominal GDP.

The central government has the largest share in total external debt stock, at around 37.4%. Its share in the total external debt stock fell by around 2.6 percentage points from the corresponding quarter in 2013. The central government's external debt stock amounted to around EUR 2,380.4 million, or nearly 23.7% of nominal GDP.

At the end of 2014 Q2, the gross external debt stock of the deposit-taking corporations (except the central bank) amounted to around EUR 1,220.0 million, up around EUR 121.5 million from 2013 Q2.

Other sectors' external debt stock totalled around EUR 1,165.7 million, up around EUR 125.9 million from 2013 Q2, and EUR 9.9 million from 2014 Q1. Its share in the total external debt stock was around 18.3%, up around 0.5 percentage point from 2013 Q2.

The stock of FDIs – intercompany loans amounted to around EUR 1,529.3 million, up around EUR 237.8 million from 2013 Q2.

At the end of 2014 Q2, around 57.3% 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 18.7% of the 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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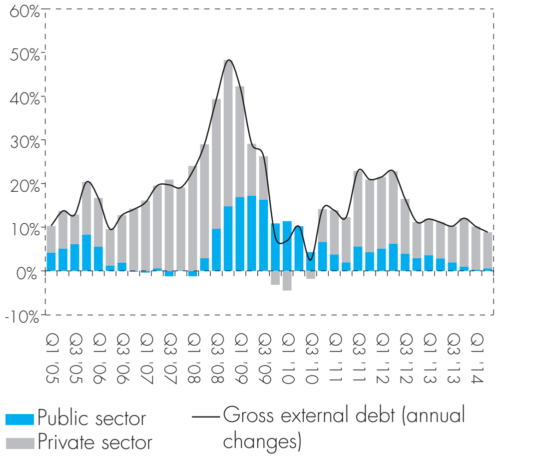
1 The latest external debt data are as of 2014 Q2. The previous year's data have also been revised. Starting from 2014 Q1, Financial Stability and Statistics Department at the Bank of Albania compiles the External Sector Statistics in compliance with the international standards laid down in the sixth 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.

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



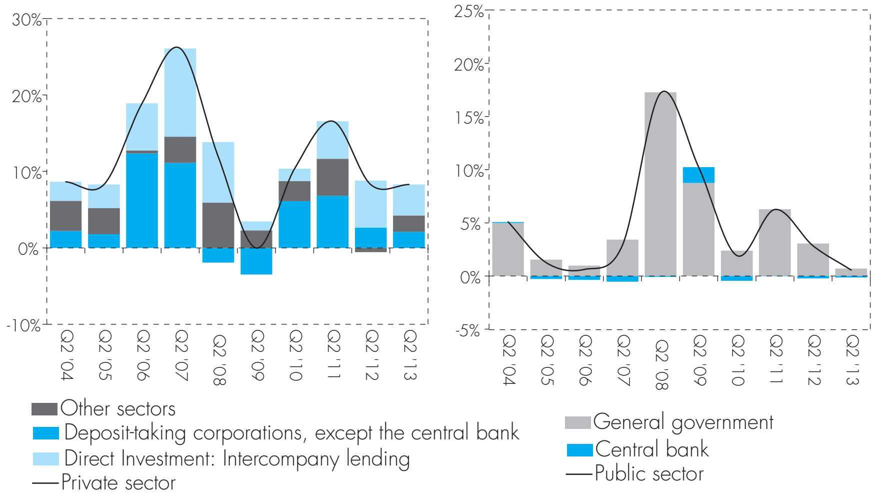
Source: Bank of Albania.

A) EXTERNAL DEBT BY SECTORS OF ECONOMY[3]

The increase in the gross external debt stock during 2014 Q2 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 3.9 billion, up 14.1% year-over-year.

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 Q2, the three categories made increasing contribution to total gross external debt. 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 2014 Q2, the public sector recorded slight increase by 1.4%, in annual terms. 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)

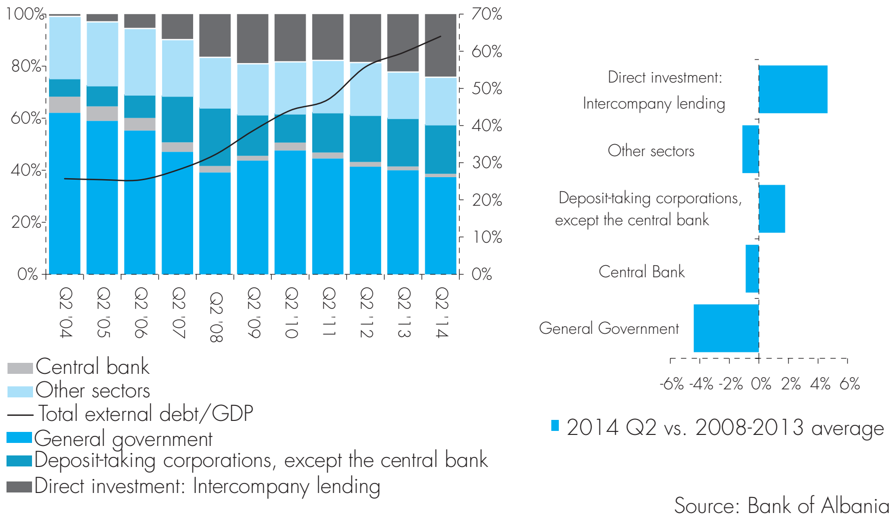


Source: Bank of Albania.

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 Q2, the general government accounted for around 37.4% of the total external debt stock. The rest of the debt stock has been allocated to the deposit-taking corporations (except the central bank) 19.1%, other sectors of the economy 18.3%, FDIs 24.0%, and the central bank 1.2%.

Chart 3 Share of sectors in total external debt stock (left); debt stock changes during 2014 Q2 against the 2008-2013 average (in percentage points, right)



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 40.2%, ranging between 44.5% and 37.0%. At the end of 2014 Q2, the general government's external debt stock amounted to EUR 2.38 billion, up around EUR 41.4 million from end-2013 Q2 or around 1.8% in annual terms. It was estimated at around 23.7% of nominal GDP, or around 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.

FDIs – intercompany loans were the second largest sector in terms of share in total debt stock in 2014 Q2, accounting for around 24.0% of the total external debt stock and around 15.2% of nominal GDP. During the period under review, FDIs' external debt stock increased by around 18.4% in annual terms, or around EUR 237.8 million.

The share of the external debt stock in the form of deposit-taking corporations (except the central bank) in total debt stock pursued an increasing trend during 2011-12, settling at around 17.4% at the end of 2013. In 2014, this sector's debt increased again by around EUR 121.5 million from 2013 Q2. The deposit-taking corporations' external debt stock was estimated at around 12.2% of nominal GDP, up 1.0 percentage point year-over-year. Broken down by maturity, the deposit-taking corporations show clear and increasing orientation towards short-term debt. At the end of 2014 Q2, the short-term debt held by the deposit-taking corporations accounted for around 86.4% of this sector's total debt stock.

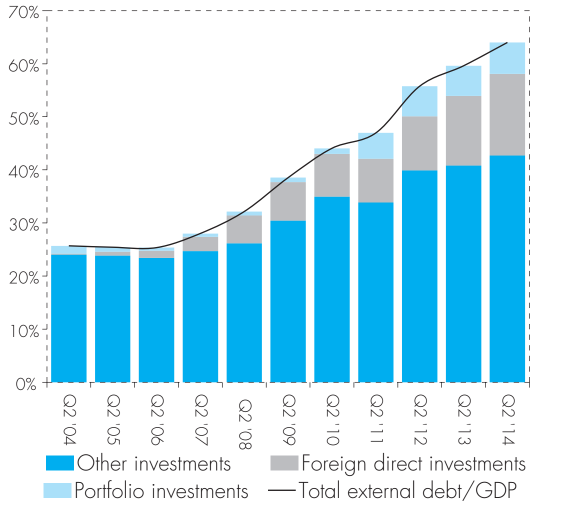
Other sectors' debt stock accounted for around 18.3% of the total gross external debt stock. Their debt stock has been falling progressively since 2012, to later rise again in 2014. At the end of 2014 Q2, the external debt of other sectors of the economy was estimated at around 11.6% of nominal GDP. Broken down by maturity, 88.0% of other sectors' debt stock was long-term debt and the rest, 12.0%, short-term debt.

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 over the years. At the end of 2014 Q2, they accounted for around 1.2% of the total external debt stock and around 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 the 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 over the years. At the end of 2014 Q2, the stock of FDIs – intercompany loans was estimated at around 17.3% of the total debt stock, and at 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.

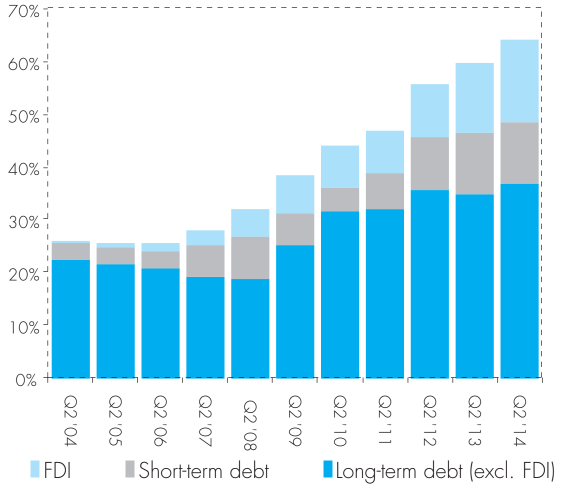
4 Other investments include: long and short-term loans, currency and deposits, trade credits and other unspecified liabilities.

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 Q2, the long-term debt stock (which also includes FDIs methodologically) accounted for around 81.3% of the total gross external debt stock, and was estimated at around 51.6% of nominal GDP. The share of long-term debt, minus FDIs, was estimated at around 57.3% of the total external debt stock.

At the end of 2014 Q2, the short-term debt amounted to around EUR 1.19 billion, against around EUR 1.13 billion at the end of 2013 Q2. The share of short-term debt in total gross external debt reached 18.7%. 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.

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



Source: Bank of Albania.

D) GROSS EXTERNAL DEBT SERVICE BY SECTOR

During 2014 Q2, total external debt service (principal plus interest payments) by all sectors of the economy amounted to EUR 88.0 million. Of this, around 85.6% was paid in principal and 14.4% 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	2014 Q1	2014 Q2
General Government	Principal	11.7	33.6	13.9	36.2	14.6	58.7
	Interests	6.1	9.0	6.5	8.7	7.8	9.3
	New debt	58.0	86.1	21.0	18.8	26.7	105.5
Private (long and short-term)	Principal	27.0	15.0	11.0	24.6	22.1	6.7
	Interests	0.1	1.3	0.3	0.2	0.8	0.8
	New debt	14.1	6.5	5.3	59.1	104.4	8.1
Banks (long and short-term)	Principal	13.5	16.8	5.7	25.6	10.1	9.6
	Interests	0.5	0.4	0.4	0.5	1.8	1.8
	New debt	3.0	4.4	7.0	0.4	23.5	25.8
Other	Principal	3.9	0.1	3.5	0.3	3.2	0.3
	Interests	0.1	0.0	0.1	0.0	0.1	0.0
	New debt	0.0	0.0	0.0	0.0	0.0	0.0
Total debt service		62.9	76.9	41.4	96.8	60.5	88.0
Total new debt		75.1	97.0	33.4	78.3	154.7	139.4

Source: Bank of Albania.

New external debt disbursements for the entire economy amounted to around EUR 139.4 million in 2014 Q2. The general government's debt dominated the new debt disbursements, accounting for around 75.7% of the total. The private sector's new debt hit a considerably lower level compared to 2014 Q1, accounting for around 5.8% of the total new debt.

2. EXTERNAL DEBT SUSTAINABILITY INDICATORS

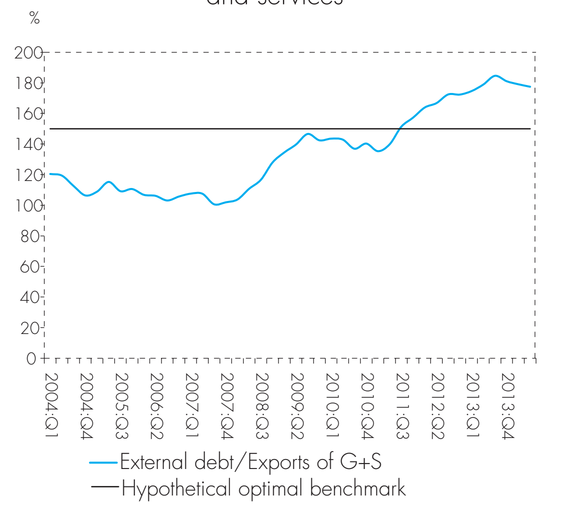
To monitor the dynamics and sustainability of gross external debt over time, we compare its performance against other closely-related economic variables. The indicators used to evaluate the external debt sustainability are classified into two categories: (a) indicators that measure a country's continuous and uninterrupted repayment capacity against its international lenders; and (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 growth of gross external debt at a more accelerated pace than the growth of 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.

The relative ratio of gross external debt to the exports of goods and services has exceeded the hypothetical optimal benchmark proposed through empirical analysis by the international financial institutions, which varies depending on a country's institutional development.[5] The ratio of gross external debt to the exports of goods and services was around 177.5% at the end of 2014 Q2, down by around 1.4 percentage points annually. After reaching a record high of 184.6% at the end of 2013 Q3, this ratio showed a declining trend for the third consecutive quarter, driven by the increased exports of goods and services and the reduced pace of external debt accumulation relative to the previous year.

Chart 6 Gross external debt to exports of goods and services



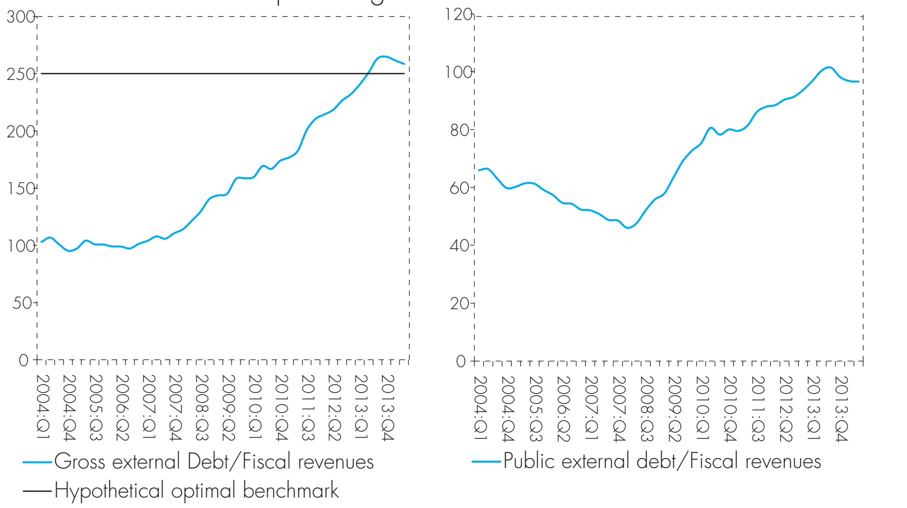
Source: Bank of Albania.

Measuring a country's repayment capacity 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 is of prime importance. The first ratio

[5] According to the International Monetary Fund and the World Bank.

serves to signal the central government's room to intervene in times of crisis and prevent the country's loss of credibility across international lenders. While the second ratio helps monitor the riskiness of the government's external debt level. If the latter is too high, it may affect the transfer of fiscal revenues from the more efficient expenditures with an effect on the economic performance to amortization disbursements. As of the end of 2014 Q2[6], the ratio of gross external debt to fiscal revenues for Albania was estimated at 258%. After reaching a record high in 2013 Q3, this ratio has shown a declining trend during the last three quarters. However, this ratio has, since 2013 Q2, been standing above the hypothetical optimal benchmark proposed by the literature.[7] 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 101.4% in 2013 Q3 to 96.6% at the end of 2014 Q2.

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.

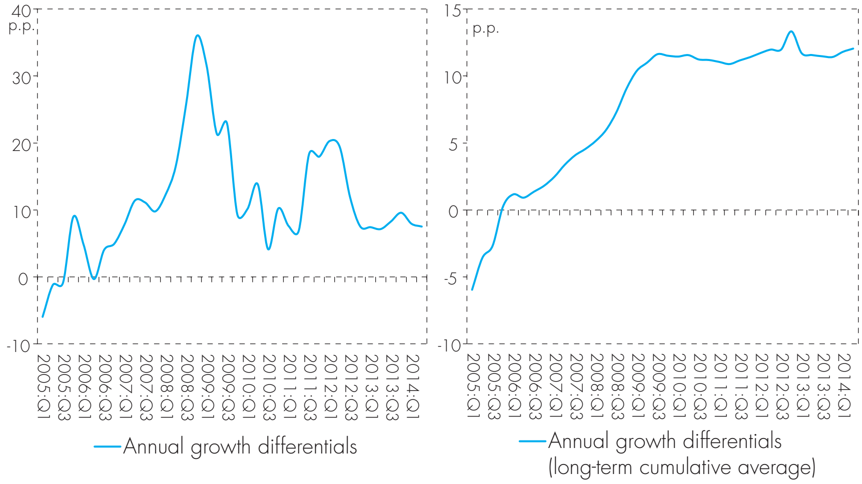
Theoretically, the accumulated external debt may be followed by an accelerated economic growth if its flows are channelled into efficient investment activities and produce value added in the economy. As of 2014 Q2, the difference between the annual gross external debt and nominal GDP does not confirm this performance. In 2014 Q2, this ratio pointed to a difference of around 7.5 percentage points between the increase in gross external debt and nominal GDP. At the same time, the long-term cumulative average[8] of the difference between the annual performance of the gross external debt and nominal GDP was estimated at around 12 percentage points at the end of 2014 Q2. This average is around 0.5 percentage point lower year-over-year.

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 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.

Chart 8 Annual growth difference between gross external debt and nominal GDP by quarters (left) and long-term cumulative average (right)



Source: Bank of Albania.

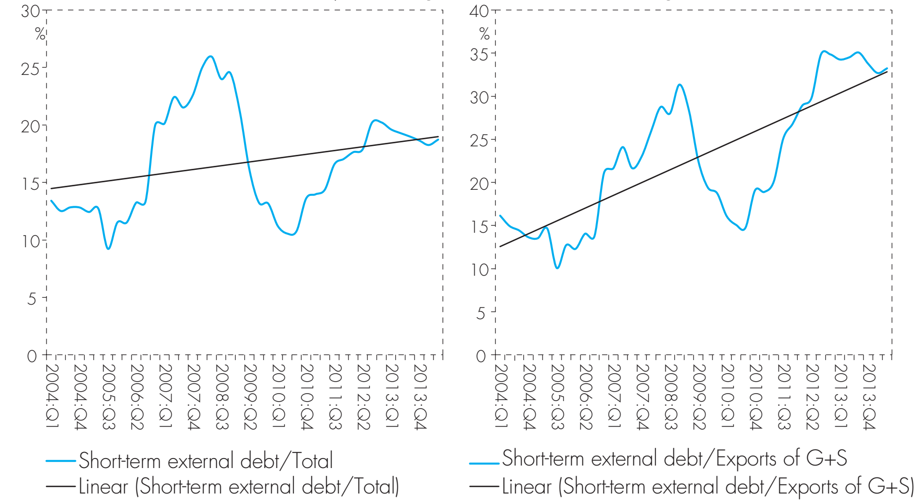
A country's long-term repayment capacity is closely linked to both the performance of the economy and the distribution of external debt service over time.[9] Under optimal conditions, external debt servicing should not have a negative impact on the economy, which may arise from the allocation of financial resources to this function. 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 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. Albania's external financing profile has been mainly oriented towards long-term debt. The short-term debt has ranged between 9.2% and 25.9% of the total external debt stock. During the quarter under review, the share of short-term external debt stock fell slightly by 0.6 percentage point to 18.7% 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 33.2% during 2014 Q2, around 1.3 percentage points lower annually. Despite the slight deterioration since 2010 Q4, this ratio provides evidence of the availability of regular foreign currency inflows in covering the short-term external debt.

[9] 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.

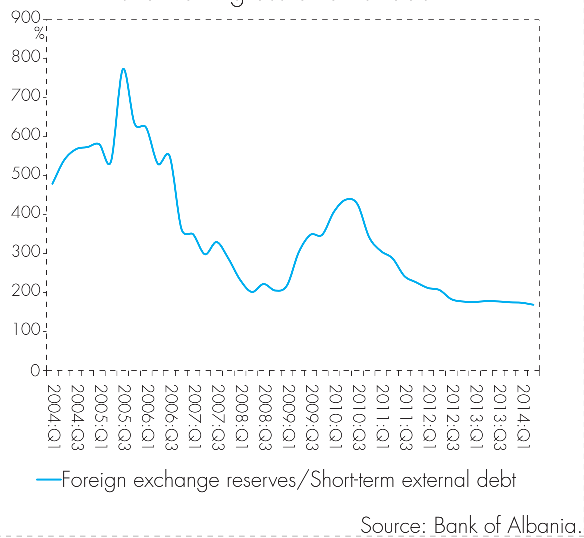
Chart 9 Short-term gross external debt as a percentage of total gross external debt (left) and exports of goods and services (right)



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 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.[10] In Albania's case, this ratio has shown a downward trend but has never been less than 100%. At the end of 2014 Q2, the foreign exchange reserve stock covered around 168.7% of the short-term external debt, around 9.2 percentage points less than in the corresponding quarter of 2013.

Chart 10 Foreign exchange reserve stock to short-term gross external debt



Source: Bank of Albania.

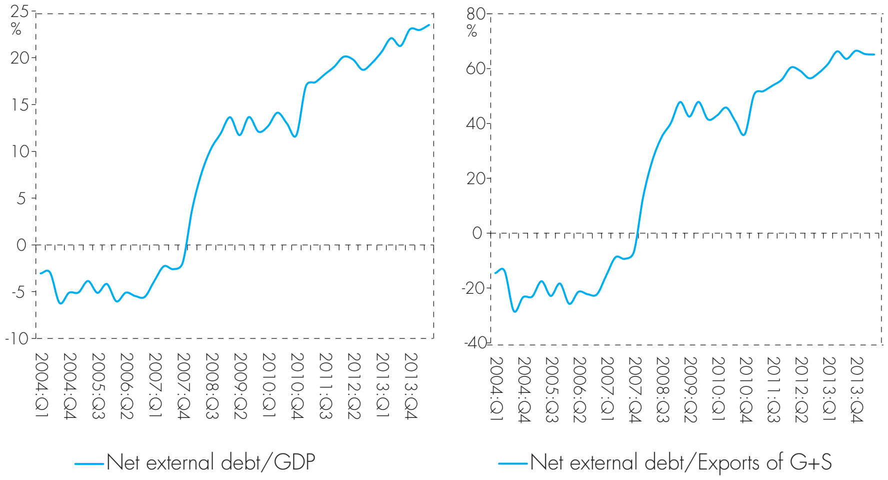
The measurement of the external debt level with a view to identifying the short-term pressures arising from the expected liabilities is achieved by deriving and monitoring the net external debt. The cumulative sum of banks' net foreign assets and foreign exchange reserves is subtracted from the gross external debt. Albania's net external debt is relatively low, fluctuating below 25% of nominal GDP[11], mainly due to banks' net foreign assets increasing faster than the gross external debt. At the

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

[11] 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.

end of 2014 Q2, net external debt-to-nominal GDP ratio was 23.5%, around 1.4 percentage points higher year-over-year. After a three-year period of increase, the ratio of net external debt to exports of goods and services decreased during 2014 Q2, being estimated at 65.2%.

Chart 11 Net external debt to nominal GDP (left) and exports of goods and services (right)



Source: Bank of Albania.

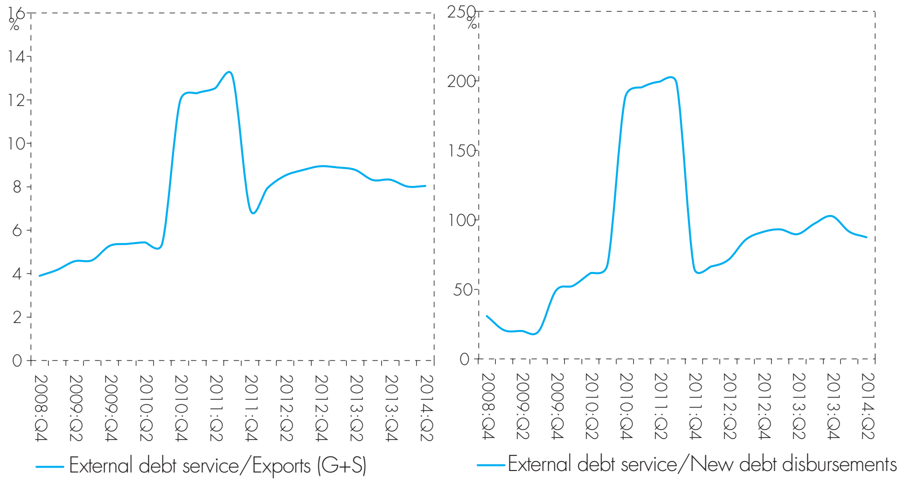
The indicators based on principal and interest payments provide an evaluation of the foreign exchange resources in the economy, which are commonly used to service the gross external debt. They are important in monitoring short-term pressures of external debt servicing and in avoiding the unexpected movement 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 10.1%, 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.[12]

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% since 2008 Q1. If we exclude 2010 Q4, which is an outlier, the average falls to 64.1%. For the entire period since 2008 Q1, this ratio points to a cumulative value of the new external debt disbursements 1.6 times higher than the amortization of previous disbursements. During 2014 Q2, the external

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

debt amortization was 14.4% higher on an annual level, whereas the ratio of external debt rollover was 63.1%.

Chart 12 Annual moving average of external debt service to exports of goods and services (left) and new debt disbursements (right)



Source: Bank of Albania.