Bank of Albania

GROSS EXTERNAL DEBT ANALYSIS

2014 Q3

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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 third quarter of 2014, Albania's gross external debt stock amounted to EUR 6,618.1 million. In annual terms, it increased by 9.8% to around 66.4% of nominal GDP.
- By sectorial breakdown of the external debt stock the general government accounts for around 39.3% to total, the deposit-taking corporations 18.6%, other sectors 17.6%, FDIs 23.3%, and the monetary authority 1.2%.
- By investment instruments, loans and investments in currencies and deposits dominate the external debt stock.
- By maturity composition, around 81.6% of the external debt stock is long-term debt, up by 0.6 percentage point from the same period a year earlier.
- Indicators of long-term external debt repayment capacity have worsened since 2008.
- The ratio of long-term gross external debt to annual exports of goods and services stood at 182%. It stands above the hypothetical optimal benchmark of 150% since the third quarter of 2011.
- Liquidity adequacy indicators pointed to weak short-term pressures arising from the repayment of gross external debt obligations.
- Albania's foreign exchange reserves are sufficient to withstand external negative shocks.

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

At the end of 2014 Q3 Albania's gross external debt totalled EUR 6,618.1 million, up around EUR 243.5 million from the previous quarter, and around EUR 587.9 million compared to its stock as at end-2013 Q3. In annual terms, it increased by around 9.8%. Current gross external debt is assessed at 66.4% to nominal GDP[2], about 4.4 percentage points higher from the same period a year earlier.

The central government has the largest share in total external debt stock, at around 39.3%. Its share in the total external debt stock increased by around 0.8 percentage point from the corresponding quarter in 2013. As at end-2014 Q3, the central government's external debt stock amounted to EUR 2,604.1 million, or nearly 26.1% of nominal GDP.

At the end of 2014 Q3, the gross external debt stock of the deposit-taking corporations (except the central bank) amounted to around EUR 1,229.0 million, up around EUR 117.5 million from the end of 2013 Q3.

Other sectors' external debt stock totalled around EUR 1,167.4 million, up around EUR 125.6 million from 2013 Q3. Its share in the total external debt stock was around 17.6% in the period under review, up around 0.4 percentage point from 2013 Q3.

The stock of FDIs – intercompany loans amounted to around EUR 1,541.3 million, up around EUR 68.2 million from 2013 Q3.

At the end of 2014 Q3, around 81.6% of the debt stock was long-term debt, mainly in the form of loans. For the same period, short-term debt accounted for around 18.4% 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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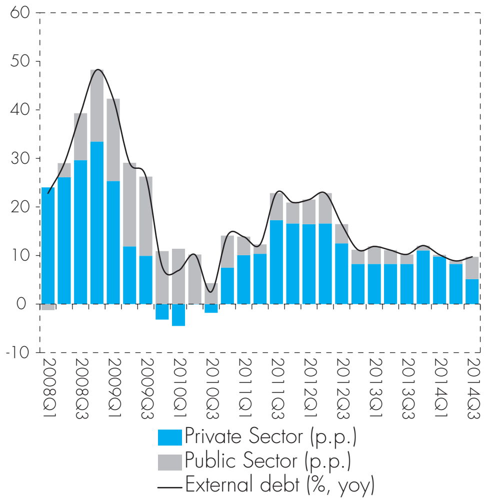
[1] The latest external debt data are as of 2014 Q3. The previous year's data have also been revised. Starting from 2014 Q1, Financial Stability and Statistics Department at the Bank of Albania compiles the External Sector Statistics in compliance with the international standards laid down in the sixth edition of the IMF's Balance of Payments Manual (BPM6). 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 Q3 continued to be driven by the deepening total borrowing from the private sector of the economy (deposit-taking corporations, other sectors and direct investments). However, the positive contribution of the latter in the annual increase of gross domestic debt is lower compared to the two previous quarters. The private sector's debt stock increased by around 8.6% in annual basis, and shared about 53% of the contribution in the annual growth of the gross external debt.

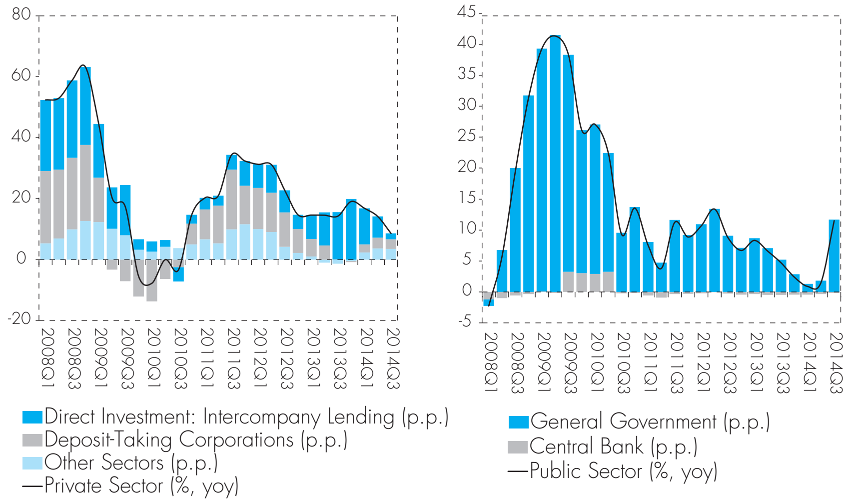
Chart 1 Gross external debt by sector (contribution in percentage points)



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 the period between 2009 Q2 -2010 Q3. The three categories within this sector - deposit-taking corporations, other sectors and direct investments - have progressively increased their share in total debt stock. External debt in the form of intercompany of foreign direct investments loan had the most accelerated growth. As at end-2014 Q3 and for the third successive quarter, the three categories provided an increasing contribution to total gross external debt.

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



Source: Bank of Albania.

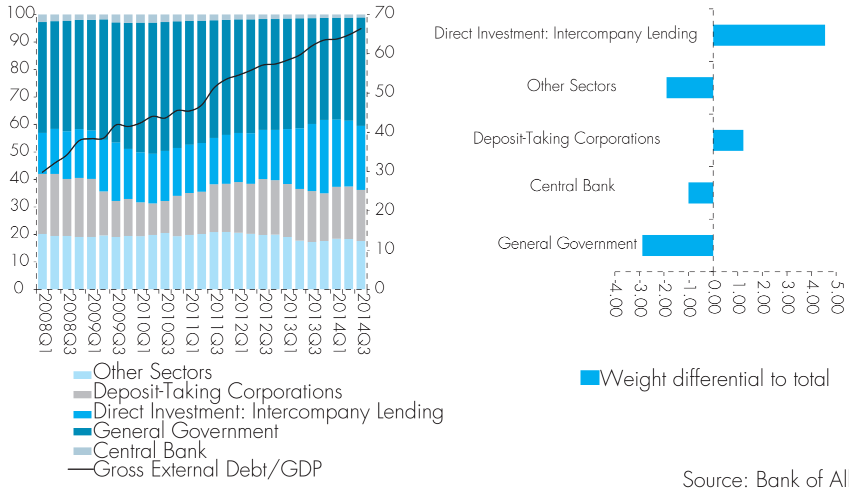
The public sector's (general government and central bank) contribution to total external debt stock trended up during this quarter, after a period of

[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.

eight quarters trending down. In 2014 Q3, the public sector's external debt increased by about 11.5% 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.

In a more detailed sectorial breakdown, the external debt stock of general government historically has a major share in the total debt stock. At the end of 2014 Q3, the general government accounted for around 39.3% of the total external debt stock. The rest of the debt stock has been allocated to the deposit-taking corporations (except the central bank) 18.6%, other sectors of the economy 17.6%, FDIs 23.3%, and the central bank 1.2%.

Chart 3 Share of sectors in total external debt stock (left); debt stock changes during 2014 Q3 against the 2008-2013 average (in percentage points, right)



Source: Bank of Albania.

At the end of 2014 Q3, the general government's external debt stock amounted to EUR 2.6 billion, up around 12.1% in annual terms. This performance is impacted by the increase of general government's external debt in the form of long-term loans. By maturity composition, the general government's external debt stock includes only long-term external debt, mainly in the form of loans and debt securities.

FDIs - intercompany loans were the second largest sector in terms of share in total debt stock in 2014 Q3, accounting for around 23.3% of the total external debt stock and around 15.5% of nominal GDP at the end of the period. Accumulation of this sector's external debt has trended up more rapidly since the data were made available.

The share of the external debt stock in the form of deposit-taking corporations (except the central bank) was around 18.6% at the end of 2014 Q3. The deposit-taking corporations' external debt stock was estimated at around 12.3% of nominal GDP, up 0.9 percentage point from the ratio recorded in the previous year. Broken down by maturity, the deposit-taking corporations' debt is mainly a short-term debt. At the end of 2014 Q3, it accounted for around 87.4% of the total external debt stock of this sector.

Other sectors' debt[4] stock accounted for around 17.6% of the total gross external debt stock, as at end-2014 Q3. Their debt stock has been falling progressively since 2012, to later rise again in 2014. At the end of the period under review, the external debt of other sectors of the economy was estimated at around 11.7% of nominal GDP. Broken down by maturity, 87.6% of other sectors' debt stock was long-term debt and the rest, 12.4%, short-term debt.

The central bank's gross external debt stock has the lowest share in the total stock compared to the other sectors of economy. The monetary authority's liabilities in the form of debt have shrunk continuously since 2010 Q3. At the end of 2014 Q3, 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 INSTRUMENTS

Broken down by instruments, investments in the form of other investments[5], have a major share in total external debt stock, around 67.7%. This ratio is around 1.4 percentage points higher than a year earlier. Long and short-term loans have the main share within this item. Since early 2008, the share of this instrument in total other investments has trended down in favour of other investment instruments, settling at the lowest value of 70.5% to total of other investments during 2013 Q4. This trend changed during 2014, and as at end of the third quarter, the share of long and short-term loans instruments covered around 72.9% of other investments.

From years, the stock of FDIs intercompany loans showed the most accelerated increasing trend, concentrated in the periods 2007-2009 and 2011-2013. At the end of the period under review, the stock of FDIs – intercompany loans was estimated at around 23.3% of the total debt stock.

Investments in the form of portfolio investments accounted for around 9% of the total gross external debt and were estimated at around 6.0% of nominal GDP.

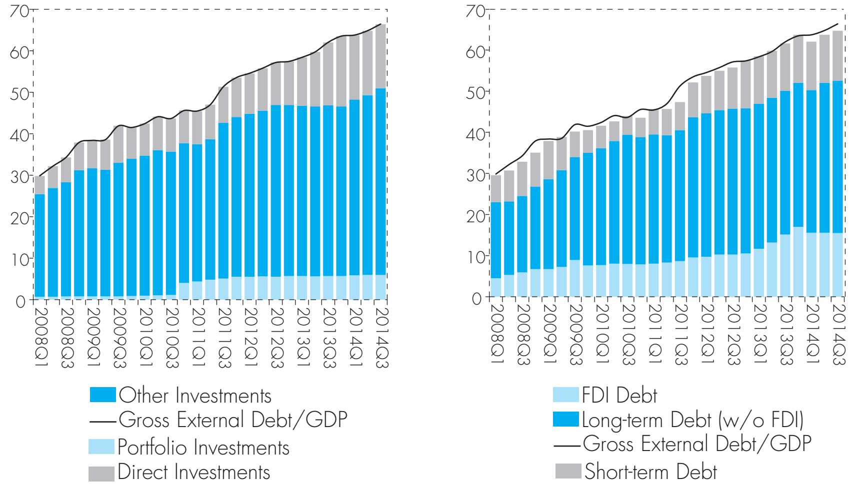
C) EXTERNAL DEBT BY MATURITY

Broken down by maturity, the largest portion of the external debt stock is long-term debt. At the end of 2014 Q3, the long-term debt stock (which also includes FDIs methodologically) accounted for around 81.6% of the total gross external debt stock, up by around 0.6 percentage point in annual terms. Since 2013 Q3, the contribution share of gross external long-term debt's increase to total performance has continuously trended up.

4 It consists in pension funds, insurance corporates, non-financial corporates, non-profit organisations serving to families and families.

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

Chart 4 Classification of debt stock by investment instruments (left) and Debt stock by maturity as a percentage of nominal GDP (right)



Source: Bank of Albania.

At the end of 2014 Q3, the short-term debt amounted to around EUR 1.22 billion, up by around 6.4% in annual terms. The share of short-term debt in total gross external debt stood at 18.4%, during the last year. The deposit-taking corporations and other sectors of the economy hold only short-term debt. These two sectors' short-term debt consists largely of currency and deposits, and trade credits.

D) GROSS EXTERNAL DEBT SERVICE BY SECTOR

During the quarter under review, total external debt service (principal plus interest payments) by all sectors of the economy amounted to around EUR 111.0 million, about 4.5% of nominal GDP. Of this, around 90.7% was paid in principal. In debt service by sector, principal payments make up the largest portion of payments.

Table 1 Gross external debt service by sector

		2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Central government	Principal payments	11.2	28.0	10.8	51.3	14.4
	Interest payments	5.5	7.2	6.7	7.9	6.9
	New debt	19.8	18.8	27.3	107.7	189.7
Private (short-term and long-term)						
	Principal payments	13.0	25.2	25.9	14.8	36.6
	Interest payments	0.3	0.3	1.9	2.3	1.7
	New debt	6.6	59.1	104.4	8.1	11.3
Banks (short-term and long-term)						
	Principal payments	6.1	26.1	10.1	9.8	46.8
	Interest payments	0.4	0.5	1.8	2.0	1.6
	New debt	7.4	1.3	23.5	26.0	7.5
Others						
	Principal payments	3.8	7.9	3.2	0.3	2.9
	Interest payments	1.1	1.5	0.1	0.0	0.1
	New debt	0.0	0.0	0.0	0.0	0.0
External debt service		41.4	96.8	60.5	88.4	111.0
New debt in total		33.8	79.2	155.3	141.8	208.4

Source: Bank of Albania

New external debt disbursements for the entire economy amounted to around EUR 208.4 million. The general government's debt dominated the new debt disbursements, accounting for around 91% of the total new disbursed debt for the period. The general government's new debt hit a considerably higher level compared to the same period a year earlier. The other sectors' new debt increased at lower paces.

2. EXTERNAL DEBT SUSTAINABILITY INDICATORS

The monitoring of the gross external debt sustainability over time is based on 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.

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

	2008	2009	2010	2011	2012	2013	2014Q3
Repayment capacity indicators							
Gross external debt/Exports (goods and services)	128.0	142.4	140.3	157.3	172.3	181.0	182.0
Gross external debt/Fiscal revenues	140.6	158.7	174.0	210.5	232.2	264.8	258.9
Central government gross external debt/Fiscal revenues	55.8	72.7	80.0	87.9	93.7	98.2	101.9
Liquidity adequacy indicators							
Short-term external debt to total	24.5	13.2	13.6	17.0	20.2	18.6	18.4
Short-term external debt/Exports (goods and services)	31.3	18.7	19.1	26.8	34.8	33.8	33.5
International reserves/Gross external debt	205.2	348.3	342.0	226.3	177.0	174.9	181.5
Net external debt/GDP	11.9	12.1	11.7	19.0	19.5	23.1	23.2
Net external debt/Exports (goods and services)	40.2	41.5	36.1	56.0	58.4	66.5	64.1
External debt service/Exports (goods and services)	5.1	7.7	33.7	9.3	10.0	10.1	11.2
External debt service/New debt disbursements*	16.0	132.8	607.7	80.1	102.4	123.6	53.2

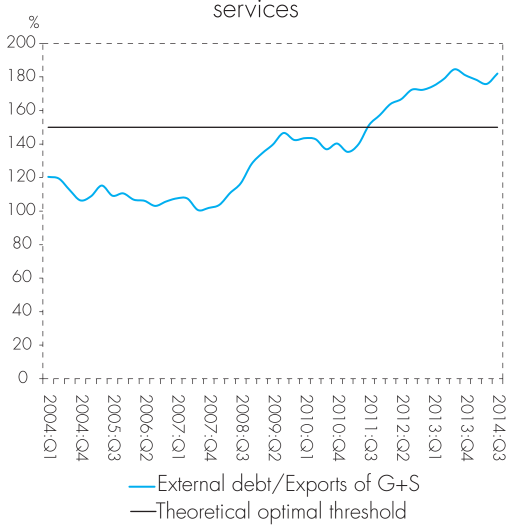
Source: Bank of Albania, MF.
*Ratio for the last quarter of the year.

A) INDICATORS OF REPAYMENT CAPACITY

The export of goods and services represents a direct 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[6], since 2011 Q3. The ratio of gross external debt to the exports of goods and services was around 182% at the end of 2014 Q3, down by around 7.2 percentage points annually, but up by around 6.2 percentage points quarterly. This performance was affected by the more moderated growth of the exports of goods and services in quarterly terms, compared to the recorded trend of the gross external debt.

Chart 5 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 serves to monitor 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.

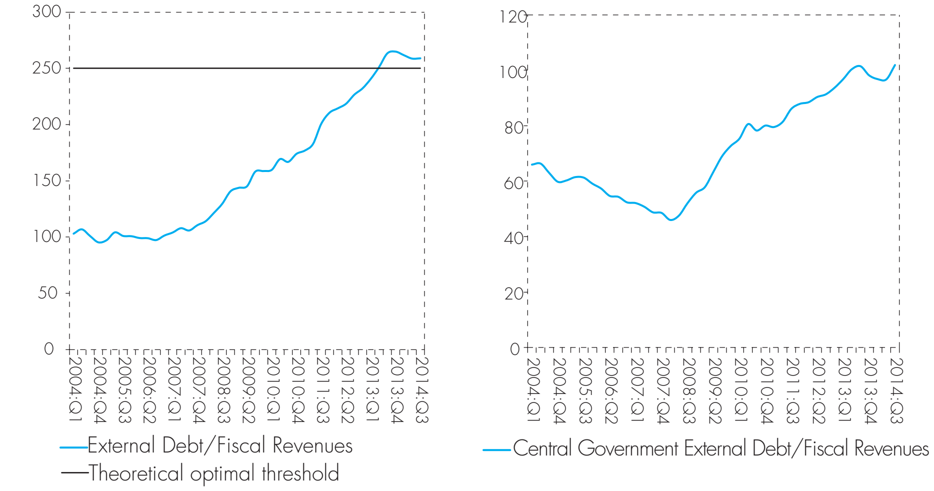
At the end of 2014 Q3 the ratio of gross external debt to fiscal revenues for Albania was estimated at 258.9%.[7] This ratio has shown a declining trend during the last three quarters. In the quarter under review the recorded ratio was 4.4 percentage points lower than a year earlier. However, this ratio has, since 2013 Q2, been standing above the hypothetical optimal benchmark proposed by the literature[8]. The ratio of the central government's gross external debt to fiscal revenues registered an opposite trend. This ratio stands 0.4 percentage point higher at annual level, due to the accelerated increase in the stock of central government's gross external debt. The value of 101.9% is the historical peak level of this indicator.

A country's long-term repayment capacity is closely linked to both the performance of the economy and the distribution of external debt service[9] over time. 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

6 IMF (2003), "External Debt Statistics: Guide for Compilers and Users", International Monetary Fund, Washington D.C.
7 Quarterly fiscal revenues have been annualised through a four-quarter rolling sum.
8 IMF (2000), 'Debt- and Reserve-Related Indicators of External Vulnerability', International Monetary Fund, Washington D.C.
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.

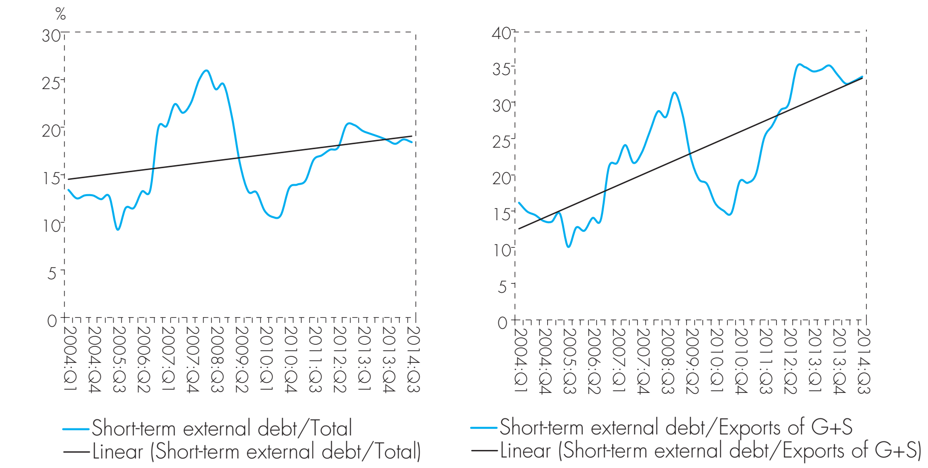
payment rescheduling may increase the risk premiums in the economy and exert pressure on economic activity at a later time.

Chart 6 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.

Chart 7 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.

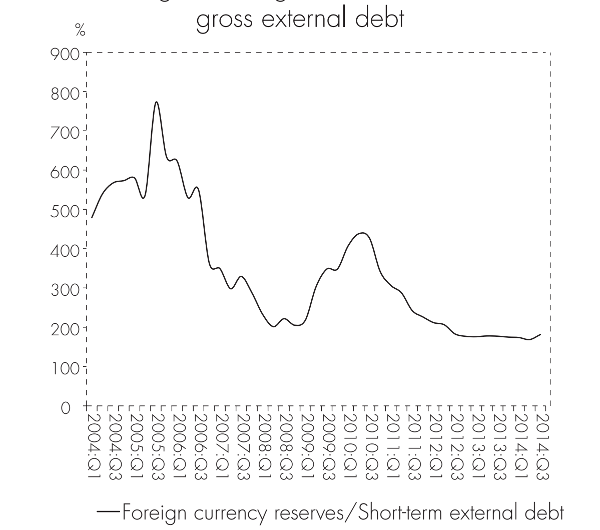
B) LIQUIDITY ADEQUACY INDICATORS

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 the minimum of 9.2% and the maximum of 25.9% of the total external debt stock. The annual inflows from the exports of goods and services[10] managed to cover the short-term external

[10] Stated through a four-quarter rolling sum.

debt entirely, albeit this indicator has showed an increasing long-term trend. The total short-term external debt as a percentage of total exports of goods and services was estimated at 33.5% during 2014 Q3, around 1.5 percentage points lower annually. This ratio provides evidence of the availability of regular foreign currency inflows in covering the short-term external debt.

Chart 8 Foreign exchange reserve stock to short-term gross external debt



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 foreign exchange reserves may help cover short-term external debt obligations in cases of unexpected economic shocks. Albania's foreign exchange reserve level is sufficient to withstand external negative shocks. 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[11]. In Albania's case, this ratio, after showing a downward trend for about four years, increased during the quarter under review. At the end of 2014 Q3, the foreign exchange reserve stock covered around 181.5% of the short-term external debt, around 4.3 percentage points higher than in the corresponding quarter of 2013.

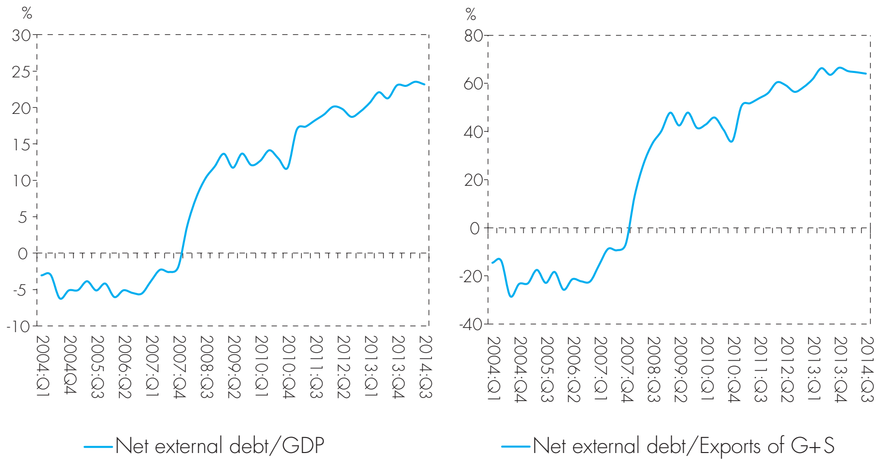
Net external debt helps in monitoring the short-term pressures as a result of expectable obligations within the year. The cumulative sum of banks' net foreign assets and foreign exchange reserves is subtracted from the gross external debt. Albania's net external debt is relatively low, fluctuating below 25% of nominal GDP[12], mainly due to banks' net foreign assets increasing faster than the gross external debt. At the end of 2014 Q3, net external debt-to-nominal GDP ratio was 23.2%, around 1.9 percentage points higher from the ratio in 2013 Q3. Following the reduction in the previous quarter, net external debt indicator to the export of goods and services returned to the increasing tendency, estimated at 64.1% at the end of the quarter.

The indicators based on regular principal and interest payments flow 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 supervising pressures of external debt servicing. The level of amortization is closely linked to the maturity of external debt in various sectors of economy. Also, the initial time, during which there exist temporal concessions with regards to contractual obligations against amortisation. An important indicator in monitoring the significance and the relative size of external debt servicing

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

[12] 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.

Chart 9 Net external debt to nominal GDP (left) and exports of goods and services (right)

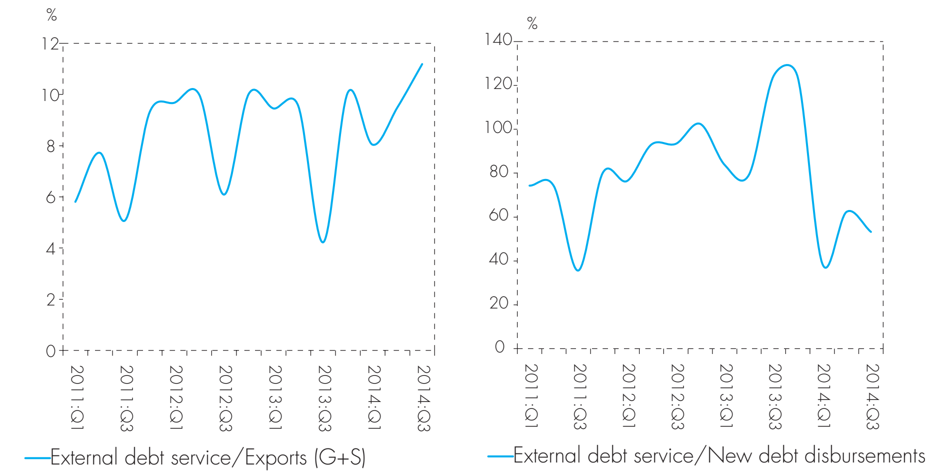


Source: Bank of Albania.

is the ratio of the latter to foreign currency inflows from the exports of goods and services. In 2014 Q3, this indicator stood at 11.2%, up by around 7 percentage points on an annual level. This indicator's ratio stands considerably below the critical benchmark of 20% as suggested by the international organisations[13].

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 83.8% since 2008 Q1. If we exclude 2010 Q4, which is an outlier, the average falls to 63.7%. During the quarter under review, the ratio of external debt rollover was 53.2%, showing a new debt disbursement twice higher than the amortisation of the previous debt.

Chart 10 Annual moving average of external debt service to exports of goods and services (left) and new debt disbursements (right)

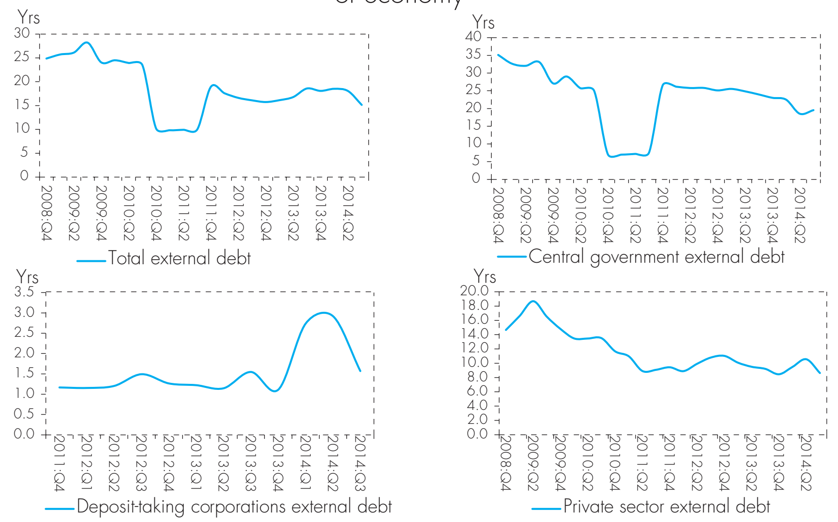


Source: Bank of Albania.

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

Indicators of average maturity performance of long-term external debt stock show a slight decrease of the latter in 2014 Q3. Given the higher disbursement of the new debt for the central government and consequently the extended time of the average maturity of this sector's external debt, depositing corporates and other components of private sector have provided the main impact to the reduction of the average maturity in years. The average maturity of public sector's external debt increased by about one year, of private sector's decreased by about two years and of deposit-taking corporations decreased by about one year and four months.

Chart 11 Average maturity in years for gross external debt stock by various sectors of economy



Source: Bank of Albania.