Bank of Albania

GROSS EXTERNAL DEBT ANALYSIS

2014 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.

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MAIN CONCLUSIONS

- At the end of 2014, Albania's gross external debt stock amounted to EUR 6,655.2 million. In annual terms, it increased by 7.9% to around 66% of nominal GDP.
- By sectoral breakdown of the external debt stock, the general government accounts for around 39.7% to total, the deposit-taking corporations 18.3%, other sectors 17.3%, FDIs 23.5%, and the monetary authority 1.2%.
- By investment instruments, loans and investments in currencies and deposits dominate external debt stock.
- By maturity composition, around 81.8% of the external debt stock is long-term debt, up by 0.5 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 184.4%. It stands above the hypothetical optimal benchmark of 150% since the third quarter of 2011.
- Liquidity adequacy indicators pointed to weak short-term pressures arising from the repayment of gross external debt obligations.
- Albania's foreign exchange reserve level is sufficient to withstand external negative shocks.
- In regional view, Albania is close to the average according to the approaches of the country's solvency and liquidity adequacy.
- The indicator of foreign debt service to export for Albania is among the lowest in the region.

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

At the end of 2014 Q4, Albania's gross external debt totalled EUR 6,665.2 million, up around EUR 42.2 million from the previous quarter, and around EUR 487.9 million compared to its stock as at end-2013 Q4. In annual terms, it increased by around 7.9%. Current gross external debt is assessed 66.0% as a ratio to nominal GDP[2], about 2.5 percentage points higher from the same period a year earlier.

The central government has the largest share in total external debt stock, at around 39.7%. Its share in the total external debt stock increased by around 2.7 percentage points from the corresponding quarter in 2013. The central government's external debt stock amounted to around EUR 2,647.6 million, or nearly 26.2% of nominal GDP.

The gross external debt stock of the deposit-taking corporations (except the central bank) amounted to around EUR 1,218.6 million, up around EUR 143.2 million from the last quarter a year earlier.

Other sectors' external debt stock totalled around EUR 1,155.6 million, up around EUR 70.7 million from 2013 Q4. Its share in the total external debt stock was around 17.3% in the period under review, up around 0.2 percentage point from 2013 Q4.

The stock of FDIs – intercompany loans, in the period under review, amounted to around EUR 1,566.7 million, down around EUR 81.7 million from 2013 Q4.

At the end of 2014, around 81.8% of the debt stock was long-term debt, mainly in the form of loans. Short-term debt accounted for around 18.2% 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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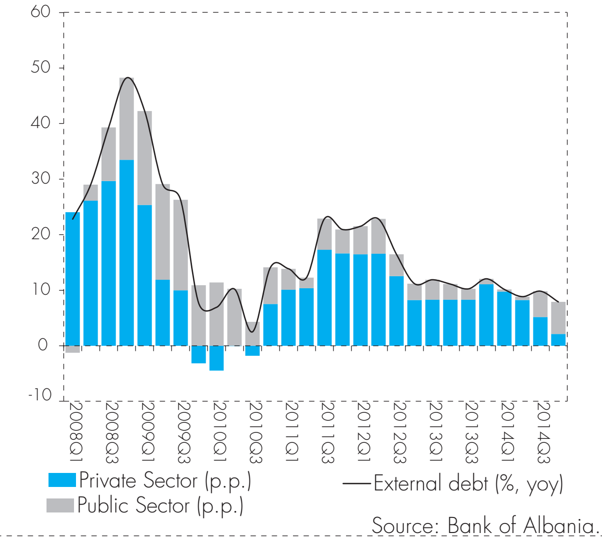
1 The latest external debt data are as of 2014 Q4. The previous year's data have also been revised. Starting from 2014 Q1, Financial Stability and Statistics Department at the Bank of Albania compiles the External Sector Statistics in compliance with the international standards laid down in the sixth edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6). 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 Q4 was driven by the deepening of total borrowing from the public sector of the economy (General Government and Central Bank). The positive contribution of latter in the annual increase of gross external debt is higher compared to the three previous quarters. The public sector's debt stock increased by around 15.0% on an annual basis, and shared about 5.8 percentage points of the contribution in the annual growth of the gross external debt.

Chart1 Gross external debt by sector (contribution in percentage points)

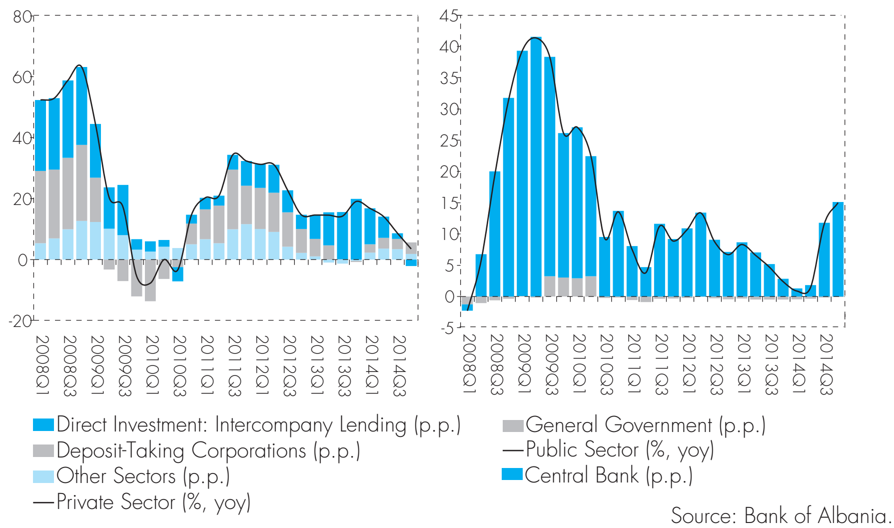


Source: Bank of Albania.

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 rapid growth. At the end of 2014 Q4, both categories included in private sector, other sectors and deposit-taking corporations, provided an increasing contribution. The external debt from direct investments provided a decreasing contribution to the annual performance of the gross external debt stock.

The public sector's (general government and central bank) contribution to the increase in total external debt stock trended up in the quarter under review. The increased debt

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



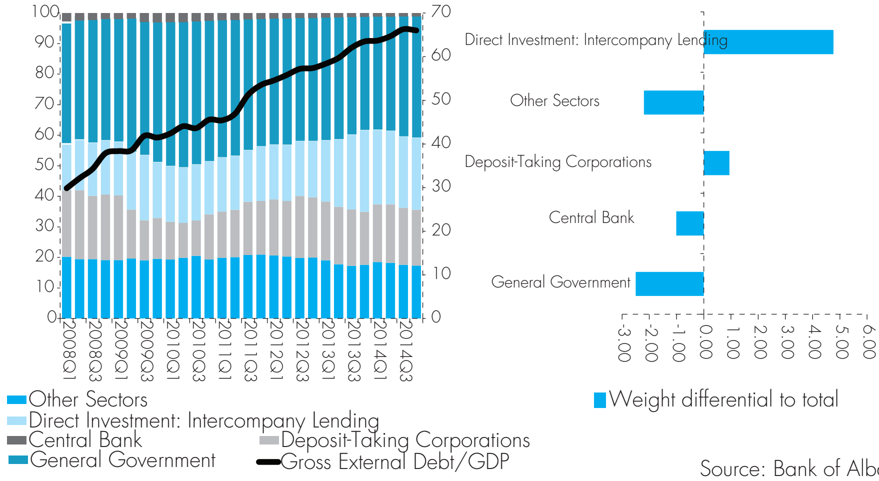
Source: Bank of Albania.

[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 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 sectoral breakdown, the external debt stock of general government historically has a major share in the total debt stock. At the end of 2014 Q4, the general government accounted for around 39.7% of the total external debt stock. The rest of the debt stock has been allocated to the deposit-taking corporations (except the central bank) 18.3%, other sectors of the economy 17.3%, FDIs 23.5%, and the central bank 1.2%.

Chart 3 Share of sectors in total external debt stock (left); debt stock changes during 2014 Q4 against the 2008-2013 average (in percentage points, right)



Source: Bank of Albania.

B) EXTERNAL DEBT BY INSTRUMENTS

Broken down by instruments, investments in the form of other investments[4] have the major share in total external debt stock, around 67.5%. This ratio is around 3.2 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% during 2013 Q4. This trend changed during 2014, and as at end of the fourth quarter, the share of long and short-term loans instruments covered around 73.2% 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 reduced by around 3.2% at annual level.

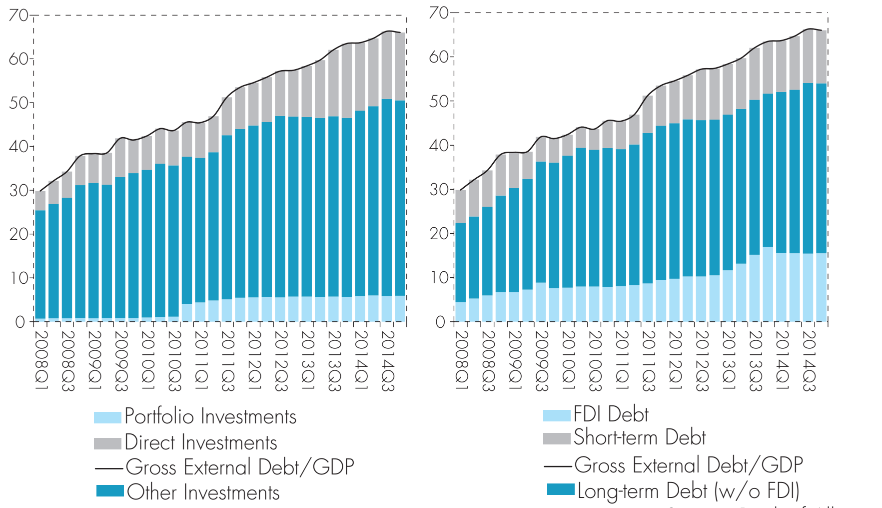
Investments in the form of portfolio investments accounted for around 9% of the total gross external debt and were estimated at around 5.9% of nominal GDP.

[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. Long-term debt (which methodologically includes FDIs) accounted for around 81.8% of the total gross external debt at the end of 2014. Its share grew by around 0.5 percentage point on an annual basis. Since third quarter of 2013, the increase of long-term external debt has driven the increasing trend of gross external debt.

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 Q4, the short-term debt amounted to around EUR 1.21 billion, up by around 5.2% on an annual basis. The share of short-term debt in total gross external debt stood at 18.2%, during the last year. The deposit-taking corporations and other sectors of the economy hold only short-term debt portfolio. These two sectors' short-term debt consists largely in currency and deposits, and trade credits.

D) GROSS EXTERNAL DEBT SERVICE BY SECTOR

In 2014 Q4, total external debt service (principal plus interest payments) by all sectors of the economy amounted to around EUR 79.4 million, about 3.0% of nominal GDP. Of this, around 85.3% was paid in principal. In debt service by sector, principal payments make up the largest portion of payments.

Table1 Gross external debt service by sector

		2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4
Central Government	Principal payment	11.7	33.6	13.9	36.2	14.6	58.7	18.7	37.7
	Interest payment	6.1	9.0	6.5	8.7	7.8	9.3	7.9	9.7
	New debt	58.0	86.1	21.0	18.8	27.3	107.7	193.3	52.9
Private (long-term and short-term)	Principal payment	27.0	15.0	11.0	24.6	22.1	6.7	32.8	20.9
	Interest payment	0.1	1.3	0.3	0.2	0.8	0.8	0.8	0.8
	New debt	14.1	6.5	5.3	59.1	104.4	8.1	13.8	13.4
Banks (long-term and short-term)	Principal payment	13.5	16.8	5.7	25.6	10.1	9.8	54.8	8.8
	Interest payment	0.5	0.4	0.4	0.5	1.1	0.7	0.4	0.6
	New debt	3.0	4.4	7.0	0.4	23.5	26.0	15.5	3.4
Others	Principal payment	3.9	0.1	3.5	0.3	3.2	0.3	2.9	0.3
	Interest payment	0.1	0.0	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	0.0	0.0
Total debt service		62.9	76.9	41.4	96.8	59.7	87.1	118.3	79.4
New debt in total		75.1	97.0	33.4	78.3	155.3	141.8	222.7	69.7

Source: Bank of Albania.

New external debt disbursements for the entire economy amounted to around EUR 69.7 million. The general government's debt dominated the new debt disbursements, accounting for around 75.9% of the total new disbursed debt for the period. The general government' s new debt marked a considerably higher level compared to the same period a year earlier. The other sectors' new debt increased at a slower pace.

2. EXTERNAL DEBT SUSTAINABILITY INDICATORS

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

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

	2008	2009	2010	2011	2012	2013	2014
Repayment capacity indicators							
Gross external debt/Exports (goods and services)	128.0	142.4	140.3	157.3	172.3	181.0	184.4
Gross external debt/Fiscal revenues	140.6	158.7	174.0	210.5	232.2	264.8	254.4
Central government gross external debt/Fiscal revenues	55.8	72.7	80.0	87.9	93.7	98.2	101.1
Liquidity adequacy indicators							
Short-term external debt to total	24.5	13.2	13.6	17.0	20.2	18.6	18.2
Exports (goods and services)/Short-term external debt	319.0	533.6	524.7	373.1	287.0	296.2	298.3
International reserves/Gross external debt	205.2	348.3	342.0	226.3	177.0	174.9	180.9
Net external debt/GDP	11.9	12.1	11.7	19.0	19.5	23.3	24.0
Net external debt/Exports (goods and services)	40.2	41.5	36.1	56.0	58.4	66.5	67.0
External debt service/Exports (goods and services)*	3.9	5.1	11.9	6.9	8.7	8.1	9.5
External debt service/New debt disbursements*	30.8	49.0	187.1	66.0	91.3	102.7	66.7

Source: Bank of Albania.
* Cumulative annual average

A) *INDICATORS OF REPAYMENT CAPACITY*

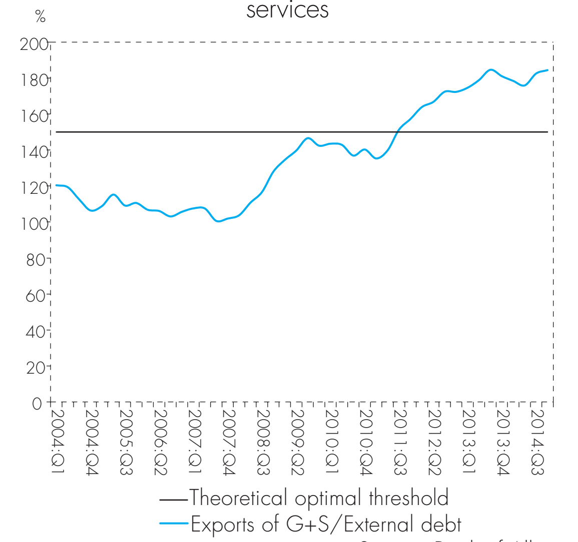
The export of goods and services represents a direct and continuous source of foreign currency inflows into an economy. The synthetic indicator that combines the latter to the gross external debt in foreign currency helps to analyse the long-term repayment capacity and potentiality of a country. The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

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[5] since 2011 Q3. At the end of 2014, this ratio stood at around 184.4%. After a downward trend in the first half of the year, the slowdown in the export of goods and services during the rest of year drove to the deterioration of this indicator. The latter expanded by around 3.4 percentage points annually and by around 1.9 percentage points quarterly.

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

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

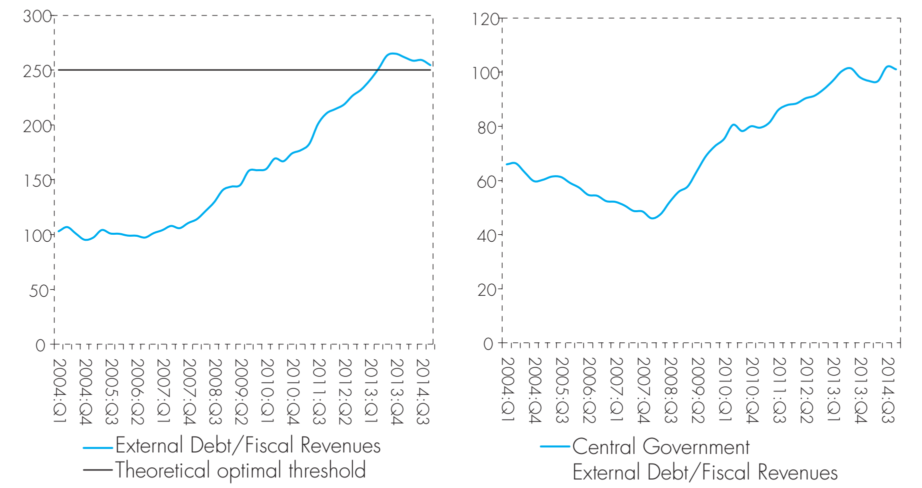
Chart 5 Gross external debt to exports of goods and services



Source: Bank of Albania.

The ratio of gross external debt to fiscal revenues is estimated at 254.4%[6]. This ratio trended down during this year. In the quarter under review, this ratio was 10.4 percentage points lower than a year earlier. At the same time this ratio trended to converge to the optimal hypothetical benchmark as proposed by the literature of the field[7]. The ratio of the central government's gross external debt to fiscal revenues registered an opposite dynamic. The ratio of 101.1% was 2.9 percentage points higher at annual level. This result was attributable to the more rapid growth of the central government's gross external debt against fiscal revenues flows.

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.

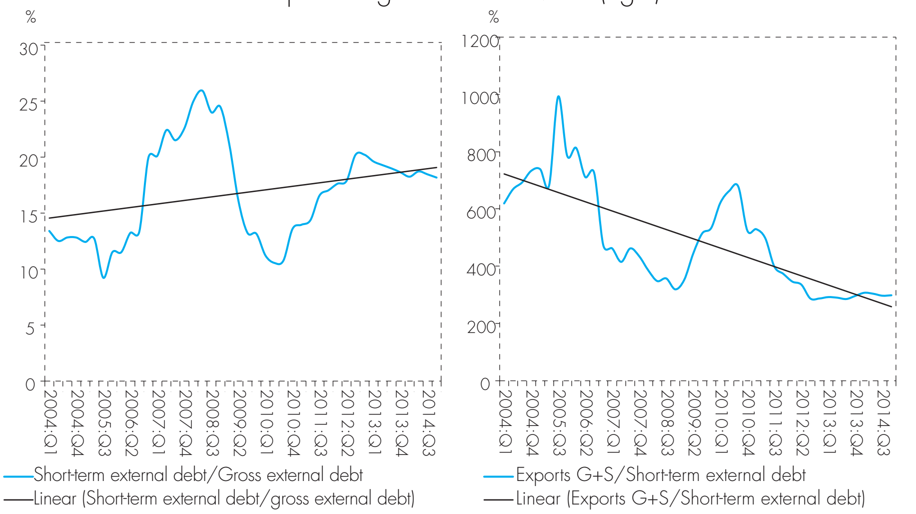
6 Quarterly fiscal revenues have been annualised through a four-quarter rolling sum.
7 IMF (2000), 'Debt- and Reserve-Related Indicators of External Vulnerability', International Monetary Fund, Washington D.C.

A country's long-term repayment capacity is closely linked to both the performance of the economy and the distribution of external debt service[8] over time. In order to avoid such a phenomenon, an economy should, at any time, be capable to meet its immediate obligations with respect to the external debt principal and interest payments.

B) LIQUIDITY ADEQUACY INDICATORS

An economy's liquidity adequacy, which serves to repay external debt obligations, is largely affected by the reliance on short-term external financing. Albania's external financing profile has been mainly oriented towards long-term debt. The annual inflows from the exports of goods and services [9] managed to cover the short-term external debt entirely. Although this indicator has manifested a downward trend since 2013 Q4, the ratio between short-term external debt to the exports of goods and services has been increased. Their ratio was estimated at 298.3% during 2014 Q4, around 2.1 percentage points higher annually. This ratio provides evidence of the availability of regular foreign currency inflows in covering the short-term external debt.

Chart 7 Short-term gross external debt to total gross external debt (left) and to the 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 foreign exchange reserves may help cover short-term external debt obligations in cases of unexpected economic shocks. Albania's foreign exchange reserves are sufficient to cover the short-term external debt. The critical benchmark of this indicator is 100%, and the ratios below this benchmark provide evidence of insufficient foreign exchange

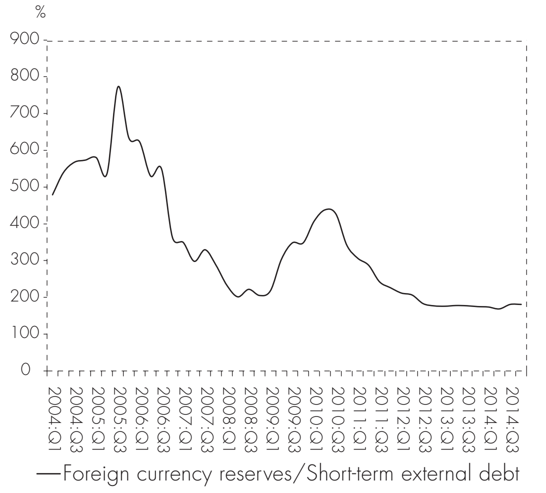
[8] The country's long-term repayment capacity improves if the economy grows at a fast pace in the future and the distribution of external debt servicing is uniform over time. In the opposite case, a country's long-term repayment capacity indicators deteriorate.

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

reserves[10]. In Albania's case, this ratio after showing a downward trend for about four years, increased during the second half of year. At the end of 2014 Q4, the foreign exchange reserves covered around 180.9% of the short-term external debt. This ratio was around 5.9 percentage points higher than at the end of 2013.

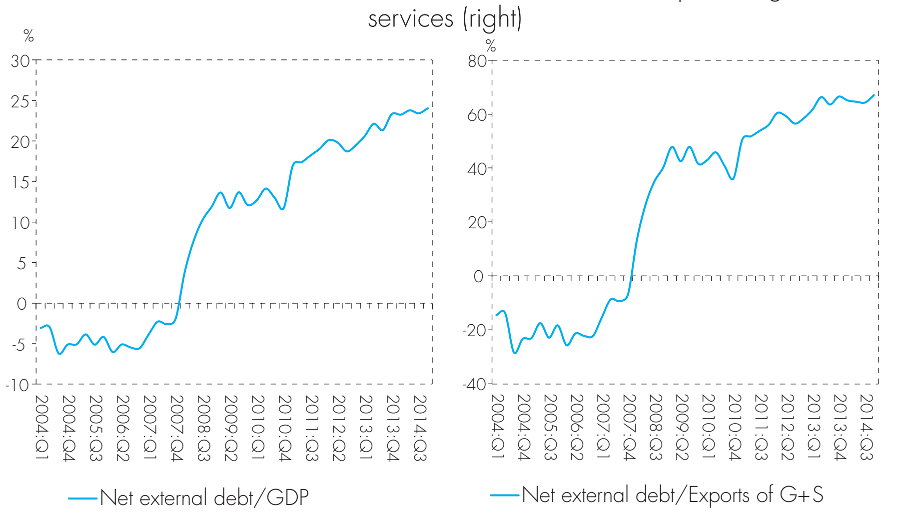
Net external debt helps in monitoring the short-term pressures as a result of expectable obligations within the year. The cumulative sum of banks' net foreign assets and foreign exchange reserves is subtracted from the gross external debt. Albania' net external debt fluctuated below the limit 25% of nominal GDP. At the end of 2014 Q4, net external debt-to-nominal GDP ratio was 24%, around 0.7 percentage points higher from the ratio in 2013 Q4. The net external debt ratio to the export of goods and services expanded for the second successive quarter, being estimated at 67%, at the end of the quarter.

Chart 8 Foreign exchange reserves to short-term gross external debt



Source: Bank of Albania.

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



Source: Bank of Albania.

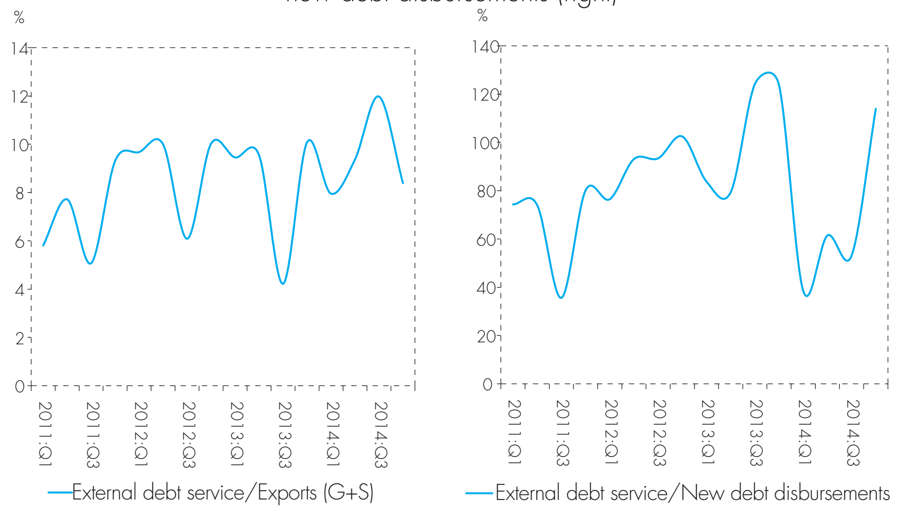
The indicators based on regular principal and interest payments flow help to monitor the pressures on the country's finances coming from the service of the external debt. The level of amortization is closely linked to the maturity of external debt in various sectors of economy. Also, the prolongation of the period, during which there exist temporal concessions with regards to contractual obligations against amortisation, provided considerable impact. A

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

monitored indicator is the ratio of the relative size of external debt servicing to foreign currency inflows from the export of goods and services. This indicator stood at 8.4% at the end of year, being reduced by around 1.7 percentage points annually. For the whole year, the ratio of external debt servicing to the export of goods and services averaged 9.5%. This ratio is around 1.4 percentage points higher than a year earlier. The slight increase of the level of external debt service provided a key role in this performance. Nevertheless, the ratio of this indicator stands considerably below the critical benchmark of 20% as suggested by the international organisations[11].

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 84.8% since 2008 Q1. This ratio implies the rollover of the amortised debt with new debt with a factor of 1.2. The ratio of external debt rollover stood at 113.9% during the quarter under review. That shows lower disbursement of the new debt compared to the amortisation of the existing debt.

Chart 10 Ratio of external debt service to export of goods and services (left) and new debt disbursements (right)

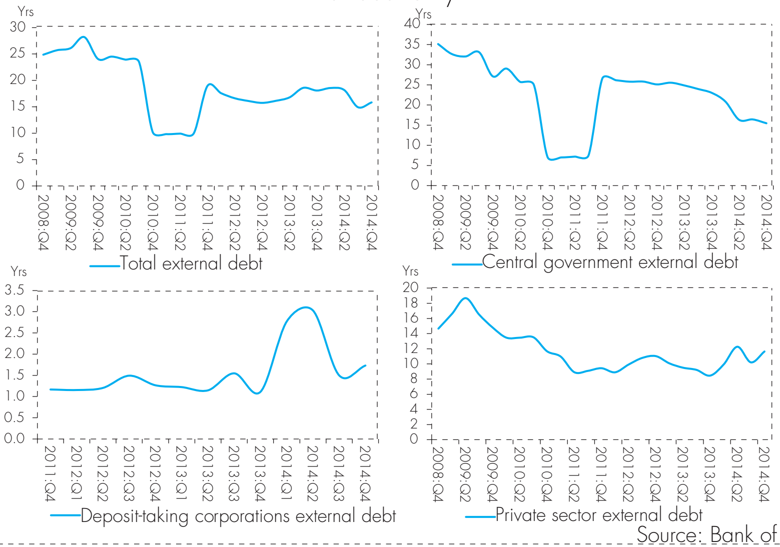


Source: Bank of Albania.

Indicators of average maturity performance of long-term external debt stock show a slight extension over time of the latter in 2014 Q4. Given the lower disbursement of the new debt for the central government, the extension of the average term to maturity of the external debt of deposit-taking corporates and of other components of the private sector provided the main impact. Thus, unlike the previous quarter, the average external debt maturity of public sector was reduced by about one year. In contrast, average maturities of private sector and deposit-taking corporates extended the term to maturity by one year and five months and by 3 months, respectively.

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

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

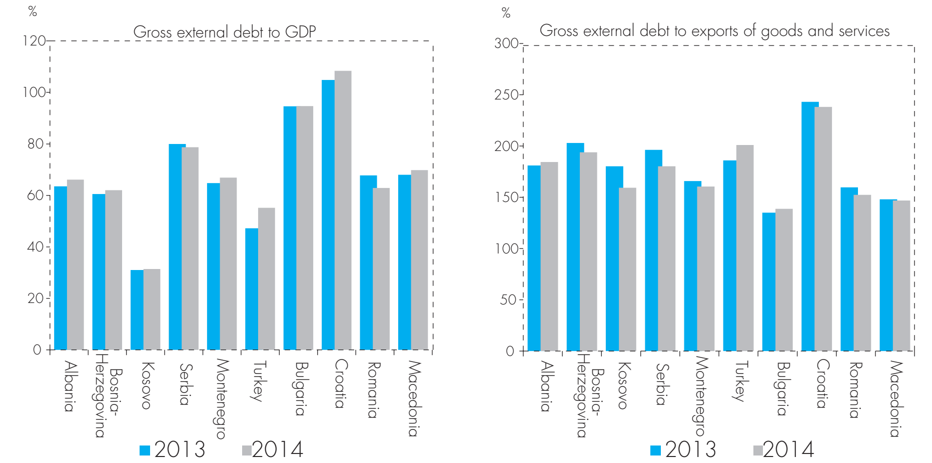


Source: Bank of Albania.

3. A REGIONAL APPROACH TO EXTERNAL DEBT SUSTAINABILITY INDICATORS

In the light of comparative approach of the external debt sustainability indicators of Albania, there are attained the data of some regional countries for a range main indicators[12]. The analysed indicators are the ratio of gross external debt to GDP and to goods and services sector, the ratio of foreign reserve and the export of goods and services to short-term external debt, and the ratio of external debt service to the export of goods and services. Related to the last indicator, the data for 2015 are available only for Albania and Romania. Related to other indicators, the published data for 2014 include all countries, except for Bosnia & Herzegovina and Montenegro. The latest available data of 2013 are used for both countries.

Chart 12 Short-term gross external debt as a percentage of total gross external debt (left) and exports of goods and services (right)*



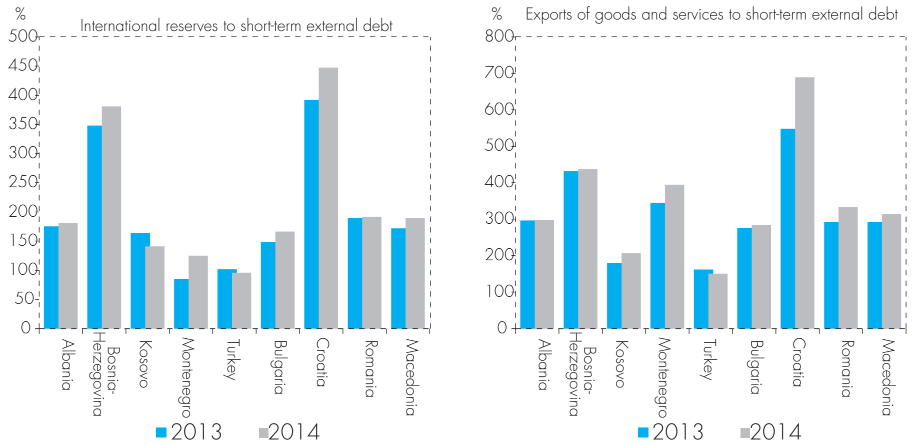
*The data for Bosnia & Herzegovina and Montenegro are for the years 2012 and 2013.
Source: Bank of Albania, World Bank, the respective central banks, authors' calculations.

Data on the ratio of external debt to GDP show this indicator is trending up in all regional countries, excluding Serbia and Romania. In absolute terms, in 2014, Croatia, Bulgaria and Serbia were the countries with the highest external debt against GDP. In 2014, Albania stood at around 3.5 percentage points below the average of the region. Turkey had the more rapid increase of external debt to GDP. Serbia and Romania implemented policies to reduce the gross external debt during the last two years. The ratio of gross external debt to the export of goods and services appears differently. This indicator improved for the major part of regional countries, particularly in Albania, Bulgaria and Turkey. The highest absolute rate during 2014 was recorded in Croatia, Turkey and in Bosnia & Herzegovina. This ratio stays around 9

[12] This model of countries include: Bosnia & Herzegovina, Kosovo, Serbia, Montenegro, Turkey, Bulgaria, Croatia, Romania and Macedonia.

percentage points above the region average. At the same time, it manifested the more rapid increase in the region, expanding by around 82.5 percentage points since 2007.

Chart 13 Foreign reserve to short-term external debt, excluding Serbia, (left) and the ratio of total export to short-term external debt, without Serbia (right)*



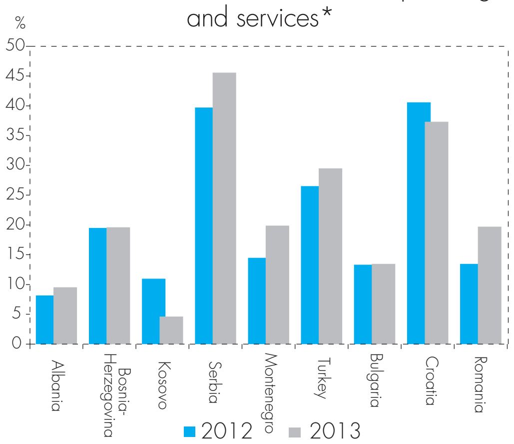
* The data for Bosnia & Herzegovina and Montenegro are for the years 2012 and 2013.
Source: Bank of Albania, World Bank, the respective central banks, authors' calculations.

The indicator of foreign exchange reserve adequacy to cover short-term flows of external debt improved in the major part of countries. Here are excluded only Kosovo and Turkey. The highest ratio in the region is recorded in Serbia[13] mainly impacted by the two financial agreements with IMF in 2009 and 2011[14]. For that reason, and with the aim at making the data comparable, Serbia is excluded from the group of regional countries. In absolute terms, Croatia and Bosnia & Herzegovina have the the highest rate of short-term gross external debt covering from foreign reserve. Albania stays below the recorded average of the region. If excluding Bosnia & Herzegovina, which recorded rapid growth of foreign exchange reserve stock, and Croatia, which decreased considerably the short term lending, Albania stays above the average of regional countries. Turkey, whose short-term external debt grew considerably in the last five years, is the only one that does not meet the condition of foreign exchange reserve adequacy.

Covering ratio of short-term external debt stock to the export of goods and services, show a similar indicator with the previous ratio. Albania stays above the region average, if excluding again Bosnia & Herzegovina and Croatia, and below the average, if including both countries in the calculation. While, this ratio improved for all the countries of the region. Turkey is excluded again, as it showed deteriorating trend during 2014 and has the lowest ratio in the region.

[13] In 2014, Serbia recorded the ratio of 10118%.
[14] For more information, see: http://www.imf.org/external/np/sec/pr/2009/pr09169.htm and http://www.imf.org/external/np/sec/pr/2011/pr11353.htm.

Chart 14 External debt service to the export of goods and services*



*The data for Albania and Romania are for the years 2013 and 2014. Data for Croatia are not available.

Source: Bank of Albania, World Bank, the respective central banks, authors' calculations.

The ratio of external debt service to the export of goods and services is the last analysed indicator. As discussed in Chapter two, the rate of external debt amortisation is closely related with the initial time of disbursement, when there are temporal waivers on contractual obligations to the payment of principal and interest. The countries of the region are in different stages of their external debt maturity, thus the payment for its amortisation are different. Nevertheless, regional approach serves to compare the current rates, and to provide the image of a possible trajectory that debts service may follow for the countries which have been introduced to international capital markets later.

In the region, Albania is assessed to have the second lowest rate, following Kosovo, of the external debt amortisation against inflows of goods and services export. This ratio trended up in many of the countries under review, compared to 2008. Here are mentioned Kosovo, Turkey and Bulgaria. Montenegro and Serbia recorded the more rapid deterioration of this indicator. The maintaining of the low rate of external debt of Albania against foreign exchange flows from export is expected to be effected naturally by the dynamic of exports, and the allocation in time of debt amortisation payment.