Bank of Albania

# GROSS EXTERNAL DEBT ANALYSIS

# 2015 Q1

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# C O N T E N T S


*MAIN CONCLUSIONS* 4

*1. A DETAILED ANALYSIS OF GROSS EXTERNAL DEBT* 5

*a) External debt by sectors of economy* 6
*b) External debt by instruments* 7
*c) External debt by maturity* 8
*d) Gross external debt service by sector* 8

*2. EXTERNAL DEBT SUSTAINABILITY INDICATORS* 9

*a) Indicators of repayment capacity* 9
*b) Liquidity adequacy indicators* 11

# MAIN CONCLUSIONS

- *At the end of the first quarter of 2015, Albania's gross external debt stock amounted to EUR 6997.4 million. In annual terms, it increased by 12.1% to around 70% of nominal GDP.*

  o *By sectorial breakdown of the external debt stock, the general government accounts for around 40.8% to total, the deposit-taking corporations 18.1%, other private sectors in Albania 16.9%, FDIs 23.1%, and the monetary authority 1.1%.*
  o *By investment instruments, loans and investments in currencies and deposits dominate external debt stock.*
  o *By maturity composition, around 82.1% of the external debt stock is long-term debt, up by 0.4 percentage point from the same period a year earlier.*

- *Indicators of long-term external debt repayment capacity have worsened since 2008.*

  o *The ratio of long-term gross external debt to annual exports of goods and services stood at 192%. It stands above the hypothetical optimal benchmark of 150% since the third quarter of 2011.*
  o *Liquidity adequacy indicators pointed to weak short-term pressures arising from the repayment of gross external debt obligations.*
  o *Albania's foreign exchange reserve level is sufficient to withstand external negative shocks.*

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

At the end of 2015 Q1, Albania's gross external debt totalled EUR 6,997.4 million, up by around 12.1% in annual terms. The recorded amount of debt stock increased by around EUR 331.4 million, from the end of 2014, and around EUR 757.2 million compared to its stock as at end-2014 Q1. Current gross external debt is assessed at 70.0% as a ratio to nominal GDP[2], around 5.2 percentage points higher from the same period a year earlier. Public Sector (General Government) was the main contributor for the expansion of gross external debt.

The central government has the largest share in total external debt stock, around 40.8%. Its share in the total external debt stock increased by around 3.8 percentage points from the same period a year earlier. The central government's external debt stock amounted to EUR 2,854.0 million, or nearly 28.5% of nominal GDP.

The gross external debt stock of the deposit-taking corporations (except the central bank) amounted to around EUR 1,264.6 million, up around EUR 13.9 million from the last quarter a year earlier.

Other sectors' external debt stock totalled around EUR 1,179.5 million, up around EUR 55.2 million from 2014 Q4. Its share in total external debt stock was around 16.9%, almost similar to the end of 2014.

The stock of FDIs – intercompany loans amounted to around EUR 1,619.6 million, up around EUR 53.2 million from 2014 Q4.

At the end of 2015 Q1, around 82.1% of the debt stock was long-term debt, mainly in the form of loans. Short-term debt accounted for around 17.9% 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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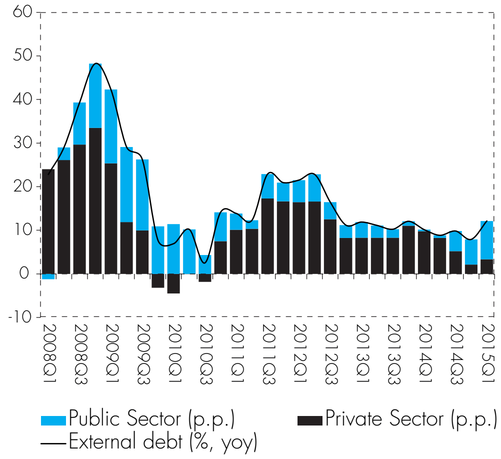
[1] *The latest external debt data are as of 2014 Q4. The previous year's data have also been revised. Starting from 2014 Q1, Financial Stability and Statistics Department at the Bank of Albania compiles the External Sector Statistics in compliance with the international standards laid down in the sixth 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.*

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




Source: Bank of Albania.

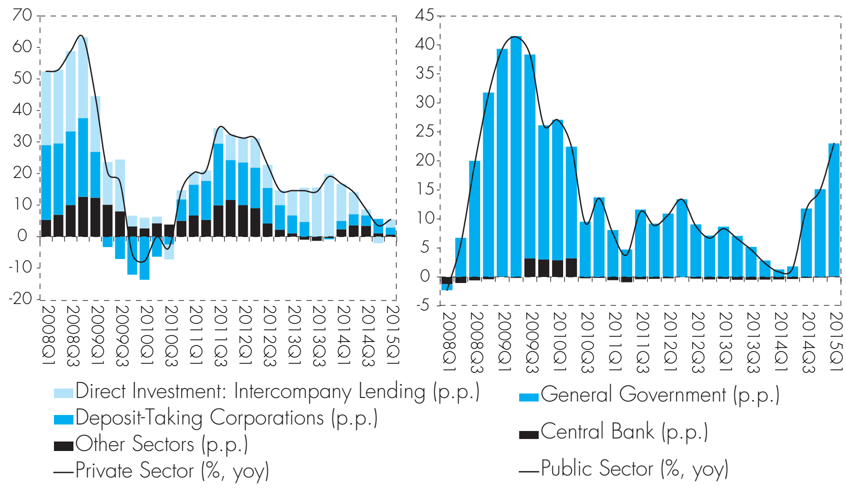
## a) External debt by sectors of economy[3]

The increase in the gross external debt stock was driven by the deepening of total borrowing from the private sector of the economy (General Government). The positive contribution of public sector in the annual increase of gross external debt is higher compared to 2014. The public sector's debt stock increased by around 23.6% in annual basis, and shared about 8.8 percentage points of the contribution in the annual growth of the gross external debt.

Contribution of public sector in the total external debt stock continued to trend up since 2014 Q2. The general government continued to drive the expansion of debt in public sector, whereas the central bank increased slightly its exposure to the external debt.

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 2015 Q1, the three categories included in the private sector, provided increasing contribution to total gross external debt.

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

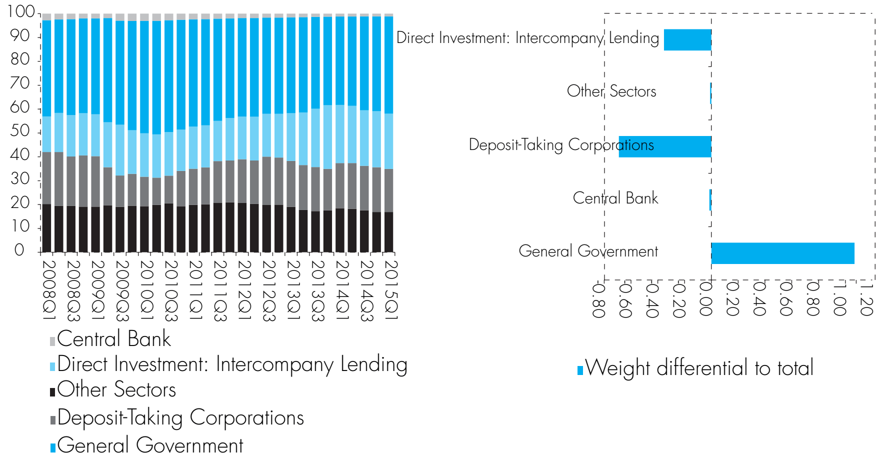



Source: Bank of Albania.

[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 a more detailed sectoral breakdown, the external debt stock of general government historically has a major share in the total debt stock, by around 40%. The rest of the debt stock has been allocated to the deposit-taking corporations (except the central bank) 18.1%, other sectors of the economy 16.9%, FDIs 23.1%, and the central bank 1.1%.

Chart 3 Share of sectors in total external debt stock (left); debt stock changes during 2015 Q1 against 2014 Q4 (in percentage points, right)

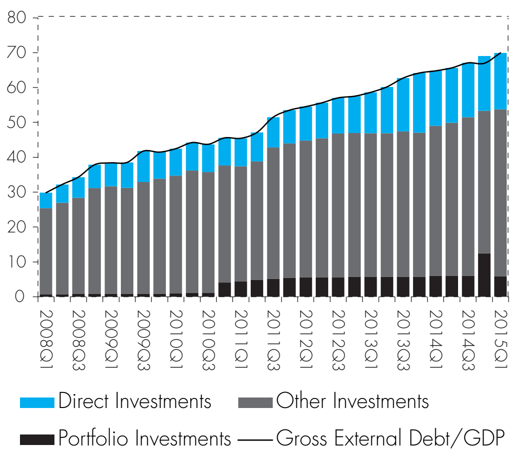



Source: Bank of Albania.

## 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 68.5% (around 47.9% of nominal GDP at the end of 2015 Q1. This ratio is around 2.1 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 until the end of 2013. Since the beginning of 2014, investments in the form of short- and long-term loans trended slightly up, by representing around 74.1% to total, in the quarter under review.

Chart 4 Gross External debt by instruments (as a ratio to GDP, in %)



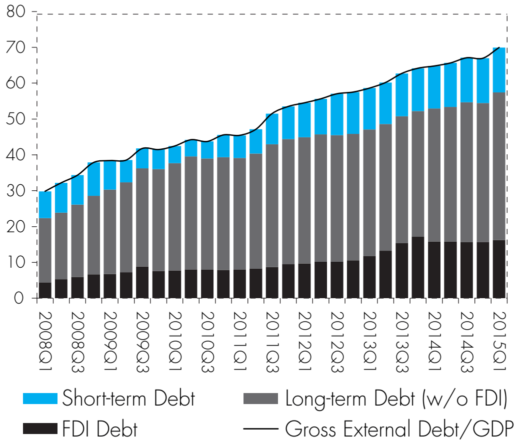

Source: Bank of Albania.

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 share of FDIs stock share - intercompany loans to total external debt was around 23.1%, lower around 1.1 percentage points from a year earlier. They were estimated at 16.2% of the nominal GDP.

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

Investments in the form of portfolio investments accounted for around 8.3% of the total gross external debt and were estimated at around 5.8% of nominal GDP.

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




Source: Bank of Albania.

## c) External debt by maturity

Broken down by maturity, the largest portion of the external debt stock is long-term debt (around EUR 5745.3 million). Long-term debt (which methodologically includes FDIs) accounted for around 82.1% of the total gross external debt. Its share increased by around 0.4 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. The general government and the central bank hold only long-term debt.

At the end of 2015 Q1, the short-term debt amounted to around EUR 1252.1 million, up by around 9.9% on an annual basis. Short-term debt to total external debt stood at 17.9%, and was estimated around 12.5% to nominal GDP. The deposit-taking corporations and other sectors of the economy hold only short-term debt portfolio. These two sectors' short-term debt consists largely of currency and deposits, and trade credits.

## d) Gross external debt service by sector

The total external debt service (principal plus interest payments) by all sectors of the economy amounted to EUR 73.2 million, around 3.2% of nominal GDP. In debt service by sector, principal payments comprise the largest portion of payments. Hence, around 82.5% of total payments of economy sectors went for the principal.

*Table 1 External debt service and new gross external debt service by sectors*

| | | 2014 Q1 | 2014 Q2 | 2014 Q3 | 2014 Q4 | 2015 Q1 |
|---|---|---|---|---|---|---|
| General government | Principal payments | 14.6 | 59.4 | 18.7 | 38.3 | 19.6 |
| | Interest payments | 7.8 | 9.4 | 7.9 | 9.7 | 10.0 |
| | New debt | 27.3 | 107.7 | 193.3 | 52.9 | 95.2 |
| Private (long-term and short-term) | Principal payments | 22.1 | 6.7 | 32.8 | 20.9 | 33.8 |
| | Interest payments | 0.8 | 0.8 | 0.8 | 0.8 | 2.0 |
| | New debt | 104.4 | 8.1 | 13.8 | 13.4 | 20.6 |
| Banks (long-term and short-term) | Principal payments | 10.1 | 9.8 | 54.8 | 8.8 | 4.4 |
| | Interest payments | 1.1 | 0.7 | 0.4 | 0.6 | 0.8 |
| | New debt | 23.5 | 26.0 | 15.5 | 3.4 | 6.6 |
| Others | Principal payments | 3.2 | 0.3 | 2.9 | 0.3 | 2.7 |
| | Interest payments | 0.1 | 0.0 | 0.1 | 0.0 | 0.1 |
| | New debt | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| TOTAL DEBT SERVICE | | 59.7 | 87.1 | 118.3 | 79.4 | 73.2 |
| NEW DEBT IN TOTAL | | 155.3 | 141.8 | 222.7 | 69.7 | 122.4 |

*Source: Bank of Albania*

New external debt disbursements for the entire economy amounted to around EUR 122.4 million. As in the previous year, the general government's debt dominated the new debt disbursements, accounting for around 77.7% of the total new disbursed debt for the period. The general government's new debt pointed to a considerable higher level compared to the same period a year earlier. Disbursements in the form of banking system and other sectors' debt slowed down in the first quarter of year.

## 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 to its international lenders; and (b) indicators that measure the adequacy of liquidity in case of obligation to repay 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 | 2015Q1 |
|---|---|---|---|---|---|---|---|---|
| Repayment capacity indicators | | | | | | | | |
| Gross external debt/Exports (goods and services) | 128.0 | 142.4 | 140.3 | 2614.1 | 135.3 | 181.0 | 184.4 | 191.9 |
| Gross external debt/Fiscal revenues | 140.6 | 158.7 | 174.0 | 210.5 | 232.2 | 264.8 | 254.5 | 268.2 |
| Central government gross external debt/Fiscal revenues | 55.8 | 72.7 | 80.0 | 87.9 | 93.7 | 98.2 | 101.1 | 109.4 |
| Liquidity adequacy indicators | | | | | | | | |
| Short-term external debt to total | 24.5 | 13.2 | 13.6 | 17.0 | 20.2 | 18.6 | 18.7 | 17.9 |
| Exports (goods and services)/Short-term external debt | 319.0 | 533.6 | 524.7 | 373.1 | 287.0 | 296.2 | 290.4 | 291.2 |
| International reserves/Short Term external debt | 205.2 | 348.3 | 342.0 | 226.3 | 177.0 | 174.9 | 176.1 | 191.8 |
| Net external debt/GDP | 11.9 | 12.1 | 11.7 | 19.0 | 19.5 | 23.6 | 24.3 | 24.3 |
| Net external debt/Exports (goods and services) | 40.2 | 41.5 | 36.1 | 56.0 | 58.4 | 66.5 | 67.1 | 66.7 |
| External debt service/Exports (goods and services)[1] | 3.9 | 5.1 | 11.9 | 6.9 | 8.7 | 8.1 | 9.5 | 9.8 |
| External debt service/New debt disbursements[1] | 20.6 | 28.8 | 142.3 | 60.7 | 91.3 | 98.0 | 58.4 | 64.3 |

*1 Cumulative annual average*

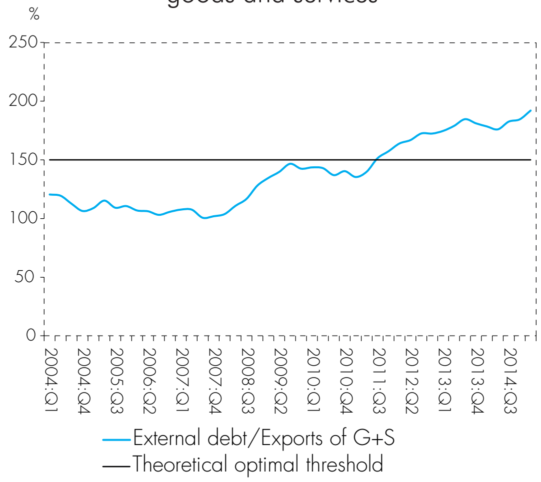
### a) Indicators of repayment capacity

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 of this indicator signals a reduction of the long-term repayment capacity of a country.

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], which varies depending on

[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.*

Chart 6 Gross external debt to exports of goods and services



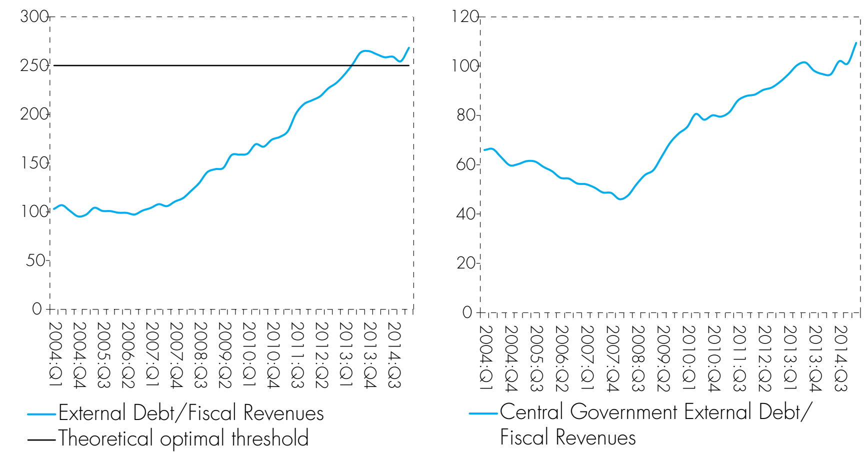

Source: Bank of Albania.

a country's institutional development, since 2011 Q3. In the quarter under review, this indicator stood at around 192%, up by around 13.5 percentage points annually, and by 7.5 percentage points quarterly. The accelerated expansion of gross external debt stock impacted the deterioration of this indicator.

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.

The ratio of gross external debt to fiscal revenues is estimated at 268.2%[6]. This ratio expanded by around 6.6 percentage points from a year earlier, and by 13.8 percentage points from the previous quarter. This result was attributable to the more rapid increase of the central government's gross external debt against annual fiscal revenues. The ratio of the central government's gross external debt to fiscal revenues registered a similar dynamic. The ratio of 109.4% was 12.6 percentage points higher at annual level. Both indicators are higher than the theoretical levels proposed by the literature of this field[7].

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.

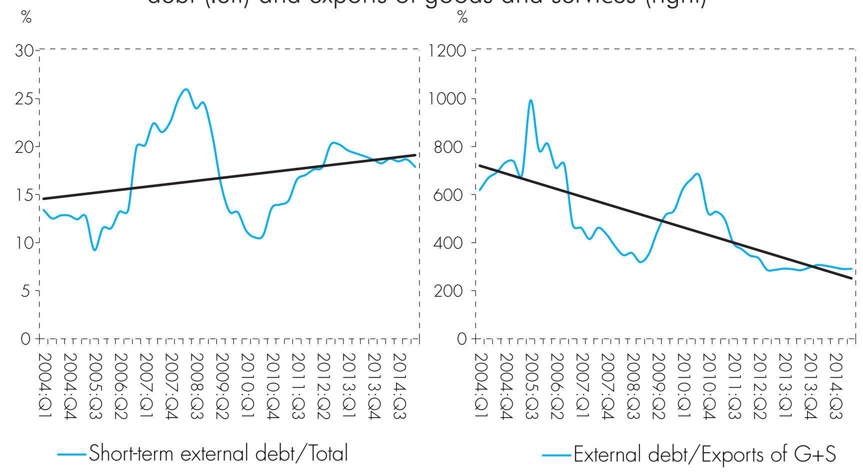
6 *Quarterly fiscal revenues have been annualised through a four-quarter rolling sum.*
7 *IMF (2000), 'Debt- and Reserve-Related Indicators of External Vulnerability', International Monetary Fund, Washington D.C.*

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. In the last two quarters, the ratio between the export of goods and services and the short-term external debt reduced at annual level. Their ratio was estimated at 291.1% in the quarter under review, around 15.8 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 Short-term gross external debt as a percentage of total gross external debt (left) and exports of goods and services (right)



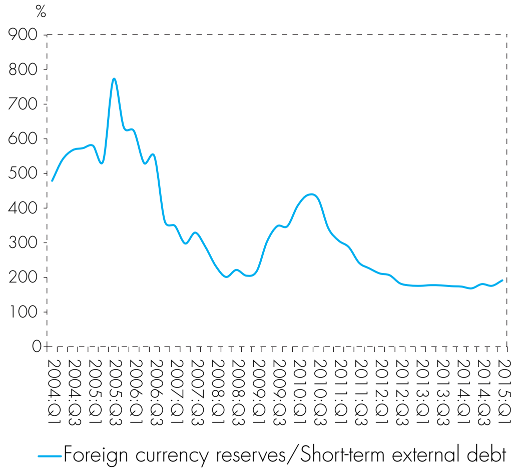

Source: Bank of Albania.

Foreign exchange reserves availability in covering short-term external debt is another important indicator of liquidity adequacy. Against a partial 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 stock is 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 reserve

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.*

Chart 9 Foreign exchange reserve stock to short-term gross external debt

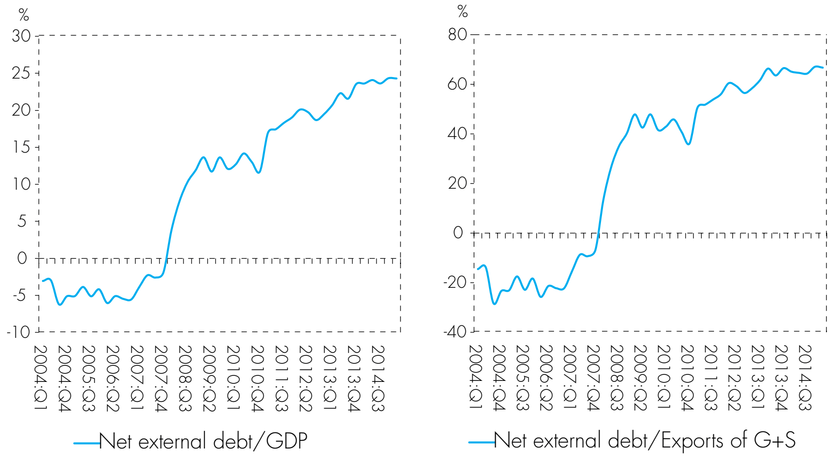



Source: Bank of Albania.

stock[10]. In 2015 Q1, this indicator expanded at an accelerated pace attributable to the higher foreign exchange assets. At the end of the period, the foreign exchange reserve stock covered around 191.8% of the short-term external debt.

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. At the end of 2015 Q1, net external debt-to-nominal GDP ratio was 24.3%, around 0.7 percentage points higher from the ratio in 2014 Q1. The net external debt ratio to the export of goods and services expanded for the second successive quarter, being estimated at 66.7%, at the end of the quarter under review.

Chart 10 Net external debt to nominal GDP (left) and exports of goods and services (right)




Source: Bank of Albania.

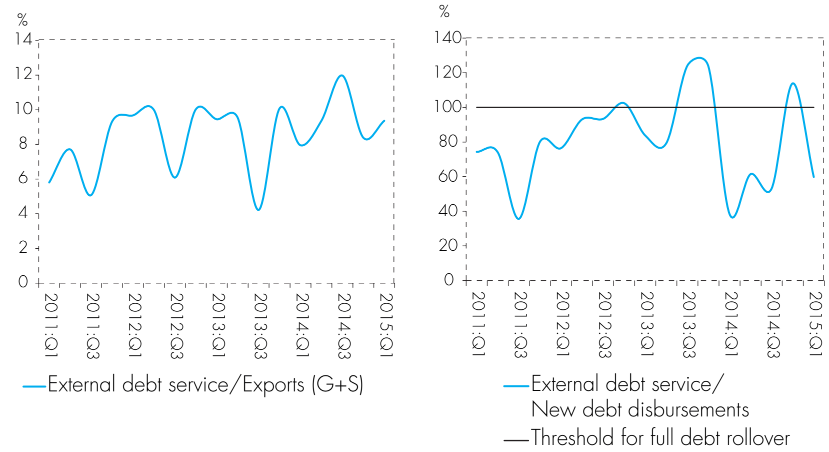
The indicators based on regular principal and interest payments flow help to monitor the pressures on the country's finances coming from the service of the external debt. The level of amortization is closely linked to the maturity of external debt and to the prolongation of the period, during which there exist temporal concessions with regards to the payments of interest and principal of the debt. A 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 9.4% at the end of the quarter, up by around 2.0 percentage points annually. The increase by around 22.6% of external debt service by all sectors of economy provided a key role in this performance.

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

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% 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 59.8% during the quarter under review. That shows higher disbursement of the new debt compared to the amortisation of the existing debt.

Chart 11 Ratio of external debt service to export of goods and services (left) and new debt disbursements (right)

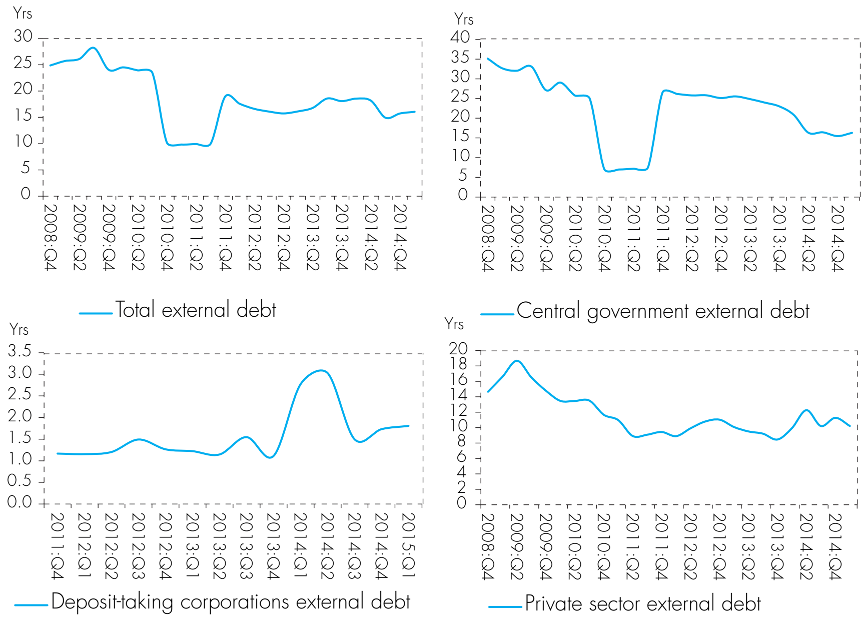



Source: Bank of Albania.

Indicators of average maturity performance of long-term external debt stock show a slight extension over time of the latter, compared to the previous quarter. The extension of the average term to maturity of the external debt of general government and of deposit-taking corporates provided the main impact. Thus, unlike the previous quarter, the average external debt maturity of public sector was reduced by around ten months, whereas of deposit-taking corporates by around three months. In contrast, the average external debt maturity of public sector was reduced by about one year.

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

Chart 12 Average maturity in years for gross external debt stock by various sectors of economy




Source: Bank of Albania.