Bank of Albania

GROSS EXTERNAL DEBT ANALYSIS

2015 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.*

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MAIN CONCLUSIONS

- The Albania's gross external debt stock totalled EUR 7,257.0 million, around 72% of nominal GDP and up by 9.1% on an annual basis.
  - By sectorial breakdown of the external debt stock, the general government accounts for around 38.7% to total, the deposit-taking corporations 17.9%, other sectors 19.2%, FDIs 23.2%, and the monetary authority 1.1%.
  - By investment instruments, loans and investments in currencies and deposits dominate the external debt stock.
  - By maturity composition, around 79.6% of the external debt stock is long-term debt, up by 0.7 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 205%. 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.

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

At the end of 2015 Q2, the Albania's gross external debt totalled EUR 7,257.0 million, up by around 9.1% in annual terms. The recorded amount of debt stock increased by around EUR 605.2 million, compared with its stock as at end-2014 Q2. Current gross external debt is assessed at 72% as a ratio to nominal GDP[2]. This ratio is around 3.5 percentage points higher, compared with the same period a year earlier. General Government was the main contributor for the expansion of the Albanian gross external debt.

The central government has the largest share in total external debt stock, at around 38.7%. Its share in the total external debt stock increased by around 2.9 percentage points from the same period a year earlier. The central government's external debt stock amounted to EUR 2,807.9 million, or nearly 27.9% of nominal GDP.

The gross external debt stock of the deposit-taking corporations (except the central bank) amounted to around EUR 1,296.6 million, up around EUR 76.6 million from the previous year.

Other sectors' external debt stock was assessed at around EUR 1,391.5 million, up around EUR 36.0 million from 2014 Q2. Its share in the total external debt stock was around 19.2%, around 1.2 percentage points lower from the previous year.

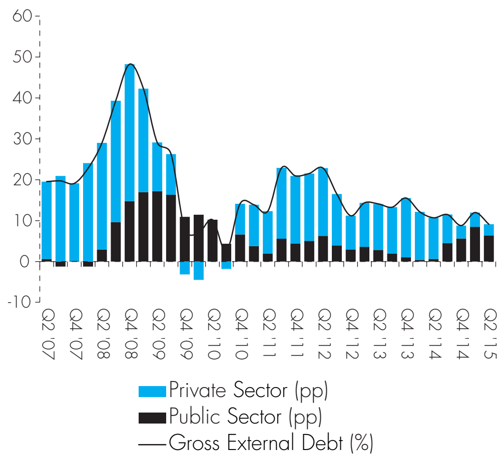
The stock of FDIs – intercompany loans amounted to around EUR 1,683.7 million, up around EUR 68 million from 2014 Q2.

At the end of 2015 Q2, around 79.6% of the debt stock was long-term debt (including FDIs), mainly in the form of loans. Short-term debt accounted for around 20.4% 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.

[1] *The latest external debt data are as of 2015 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 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



Source: Bank of Albania.

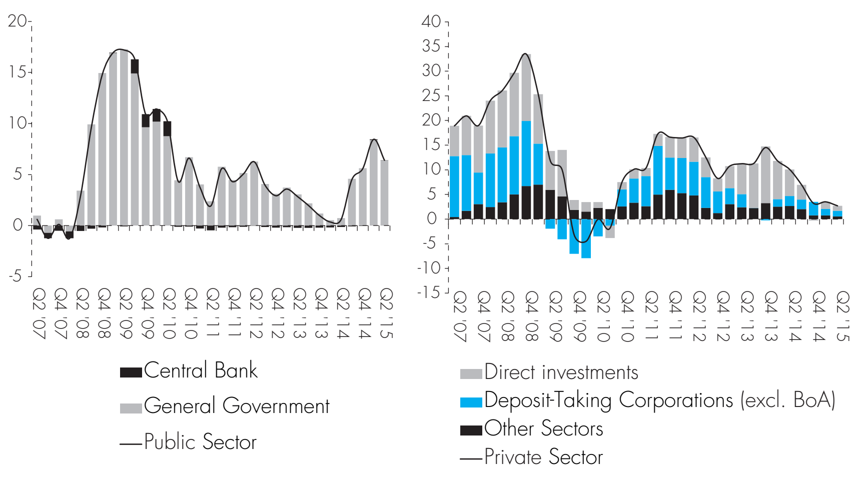
a) External debt by sectors of economy[3]

The increase in the gross external debt stock was driven by the deepening of total borrowing from the public sector in economy (general government and the central bank). The public sector's debt stock increased by around 17.3% on an annual basis, and shared about 6.4 percentage points of the contribution in the annual growth of the gross external debt.

Contribution of public sector (general government and central bank) in the total gross external debt stock continues to be higher and up, compared with the data in the previous year. The general government continued to drive the expansion of debt, in the 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 Q2, 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)

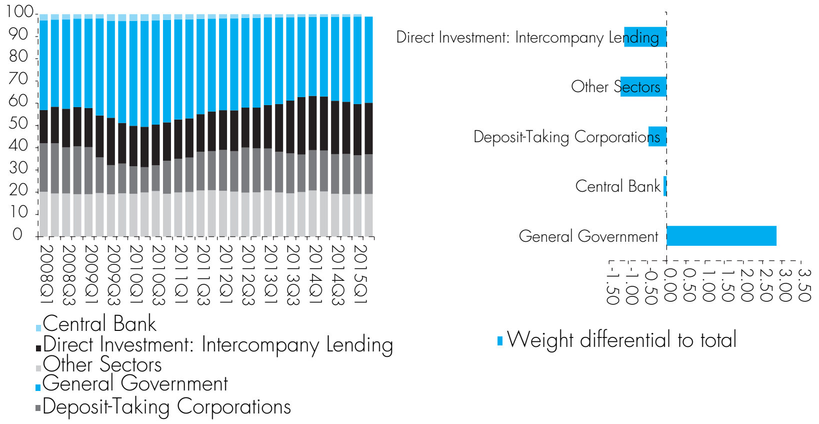


Source: Bank of Albania.

[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 sectorial breakdown, the external debt stock of general government historically has a major share in the total debt stock. The rest of the debt stock has been allocated to the deposit-taking corporations (except the central bank) 17.9%, other sectors of the economy 19.2%, FDIs 23.2%, and the central bank 1.1%.

Chart 3 Share of sectors in total external debt stock (left); debt stock changes during 2015 Q2 against 2014 Q2 (in percentage points, right)

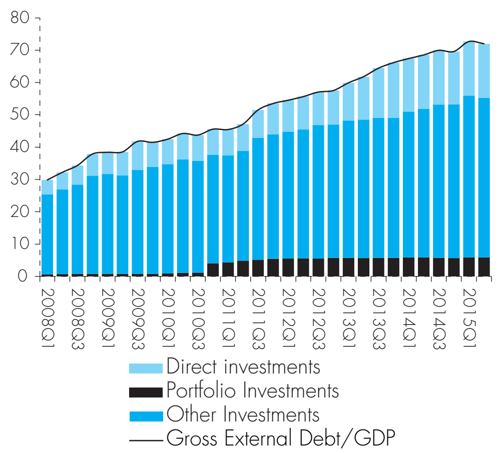


Source: Bank of Albania.

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 68.6% (around 49.4% of nominal GDP) at the end of 2015 Q2. This ratio is around 3.4 percentage points higher compared with the previous year. 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 investments' instruments until the end of 2013. The share of this instrument to total other investments represented averagely 69.4%, during 2014. Since 2015 Q1, share of loans to total other investments has trended up. Other investments in the form of short-term and long-term loans accounted for around 70.7% of total, in the quarter under review.

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

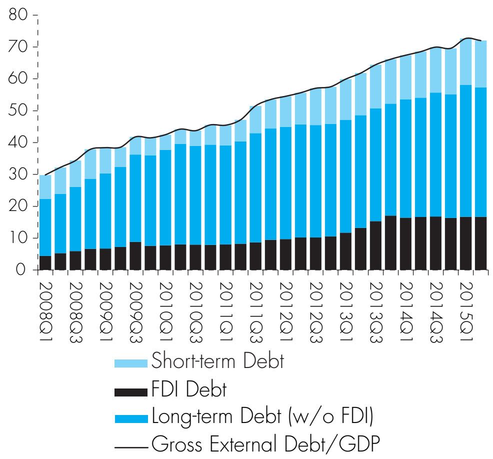


Source: Bank of Albania.

From years, the stock of FDIs intercompany loans showed the accelerated increasing trend, in particular starting since 2010 Q3 and 2013 Q3. At the end of the period under review, the share of FDIs stock - intercompany loans to total external debt was around 23.2%, around 1.1 percentage points lower from a year earlier. They were estimated at 16.7% of the nominal GDP.

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

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



Source: Bank of Albania.

Investments in the form of portfolio investments accounted for around 8.2% of the total gross external debt and were estimated at around 5.9% of nominal GDP.

c) External debt by maturity

Broken down by maturity, the largest portion of the external debt stock is long-term debt (around EUR 5780.1 million). Long-term debt (which methodologically includes FDIs) accounted for around 79.6% of the total gross external debt. Its share increased by around 0.7 percentage point on an annual basis. Since 2013 Q3, 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 Q2, the short-term debt amounted to around EUR 1476.9 million, up by around 5.6% on an annual basis. Short-term debt to total external debt stood at 20.4%, and was estimated around 14.6% 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 105.5 million, around 3.9% of nominal GDP. In debt service by sector, principal payments make up the largest portion of payments. Hence, around 88.7% of total payments of economy sectors consisted in the principal payments.

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

		2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2
General government	Principal payments	51.60	17.33	31.82	18.00	57.23
	Interest payments	7.88	6.93	8.38	9.09	9.38
	New debt	107.72	192.88	52.89	95.06	50.34
Private (long-term and short-term)						
	Principal payments	14.79	37.75	27.63	38.17	24.79
	Interest payments	2.32	1.77	2.16	2.86	2.15
	New debt	13.33	15.54	16.44	20.61	21.84
Banks (long-term and short-term)						
	Principal payments	9.83	54.76	8.79	4.37	11.43
	Interest payments	0.67	0.39	0.58	0.83	0.37
	New debt	25.96	15.48	3.35	6.64	37.12
External debt service		87.10	118.94	79.36	73.33	105.36
Total new debt		147.01	223.89	72.68	122.31	109.30

Source: Bank of Albania.

New external debt disbursements for the entire economy amounted to around EUR 109.3 million. As in the previous year, the general government's debt dominated the new debt disbursements, accounting for around 46% of the total new disbursed debt for the period. The general government's new debt level was twice lower than a year earlier. In 2015 Q2, disbursements in the form of banking system and private sector's' debt accelerated in annual level.

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

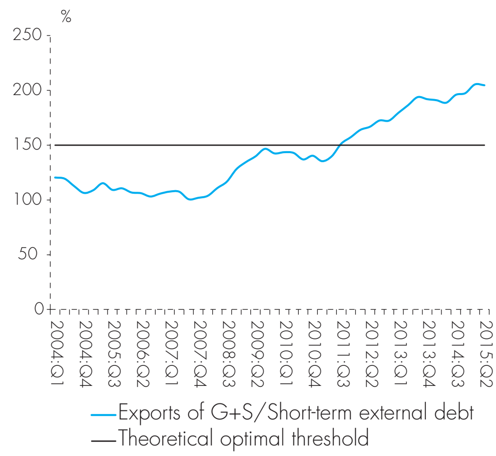
	2008	2009	2010	2011	2012	2013	2014	2015Q1	2015Q2
Repayment capacity indicators									
Gross external debt/Exports (goods and services)	128.0	142.4	140.3	157.3	172.3	181.0	184.4	205.3	204.6
Gross external debt/Fiscal revenues	140.6	158.7	174.0	210.5	232.2	264.8	0.0	0.0	0.0
Central government gross external debt/Fiscal revenues	55.8	72.7	80.0	87.9	93.7	98.2	0.0	0.0	0.0
Liquidity adequacy indicators									
Short-term external debt to total	24.5	13.2	13.6	17.0	20.2	18.6	14.1	14.2	14.1
Exports (goods and services)/Short-term external debt	319.0	533.6	524.7	373.1	287.0	296.2	0.0	0.0	0.0
International reserves/Short Term external debt	205.2	348.3	342.0	226.3	177.0	174.9	0.0	0.0	0.0
Net external debt/GDP	11.9	12.1	11.7	19.0	19.5	0.0	0.0	0.0	0.0
Net external debt/Exports (goods and services)	40.2	41.5	36.1	56.0	58.4	66.5	0.0	0.0	0.0
External debt service/Exports (goods and services)[1]	3.9	5.1	11.9	6.9	8.7	8.1	0.0	0.0	0.0
External debt service/New debt disbursements[1]	20.6	28.8	142.3	60.7	91.3	98.0	58.4	0.0	0.0

Source: Bank of Albania, Ministry of Finance.
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.

Chart 6 Gross external debt to exports of goods and services



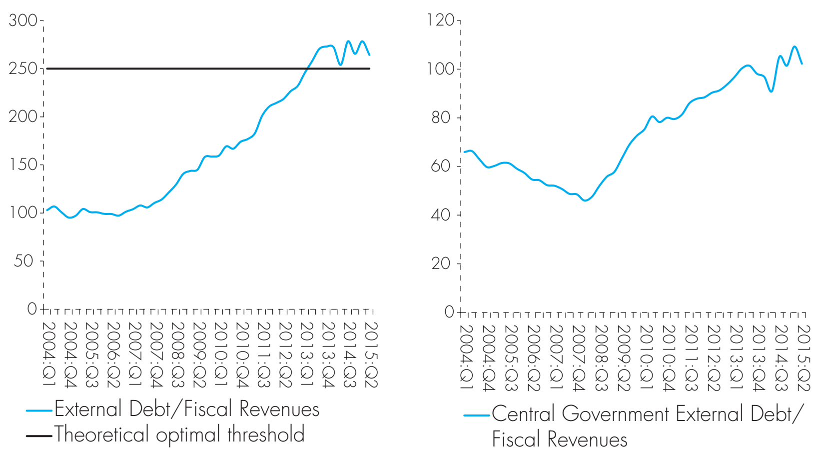
Source: Bank of Albania.

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 a country's institutional development, since 2011 Q3. In the quarter under review, this indicator stood at around 205%, up by around 15.9 percentage points annually.

Fiscal revenues flow helps to construct the two other indicators that measure the country's solvency. 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 is 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 264.3%[6]. This ratio expanded by around 10.4 percentage points from a year earlier, and decreased by 14.2 percentage points from the previous quarter. The ratio of the central government's gross external debt to fiscal revenues registered a similar dynamic. The ratio of 102.2% was 11.3 percentage points higher at

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.

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.

6 Quarterly fiscal revenues have been annualised through a four-quarter rolling sum.

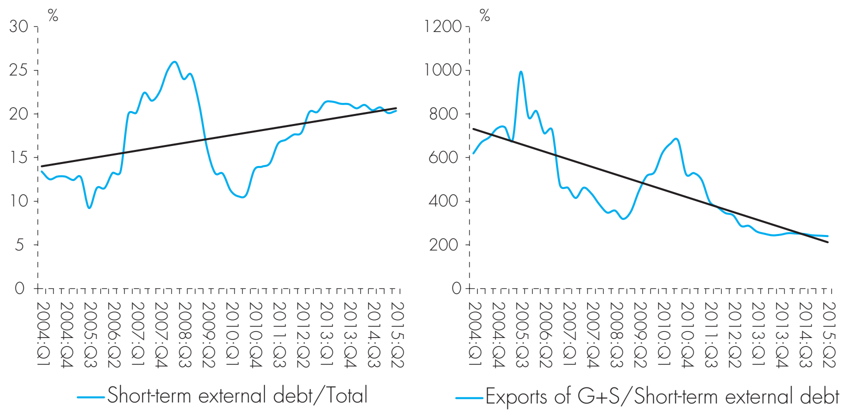
annual level. Both indicators are higher than the theoretical levels proposed by the literature of this field[7].

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 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 three quarters, the ratio between the export of goods and services and the short-term external debt showed a falling trend. Their ratio was estimated at 240.2% in the quarter under review, around 11.8 percentage points lower at annual level. 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.

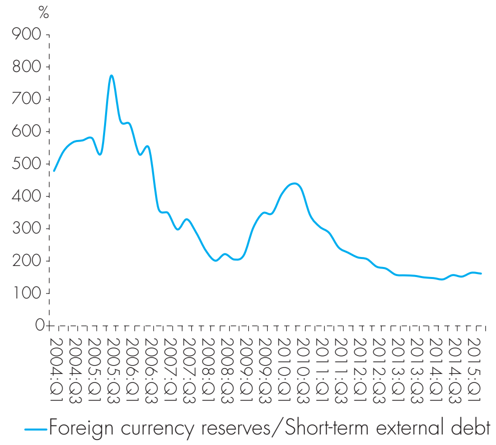
Foreign exchange reserves availability in covering short-term external debt is another important indicator of liquidity adequacy. Against a partial access to international capital markets, the foreign exchange

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

[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

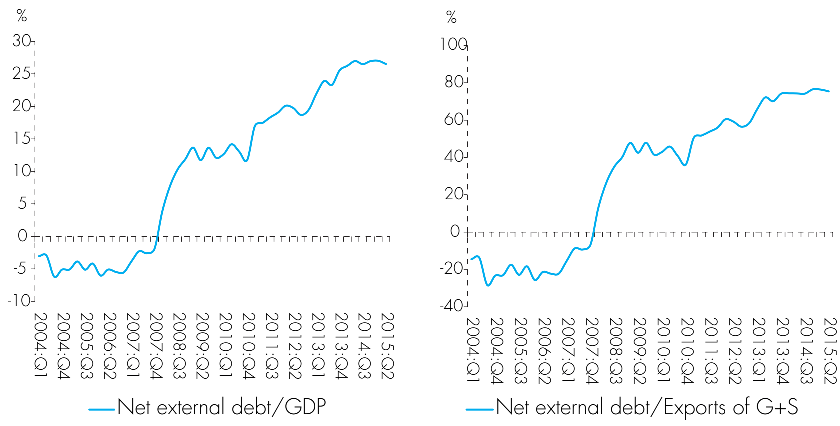


Source: Bank of Albania.

reserves may help to 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 stock[10]. Since 2014 Q3, 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 161.7% 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 Q2, net external debt-to-nominal GDP ratio was 26.5%, around 0.5 percentage points lower from the ratio in 2014 Q2. The ratio of net external debt to the export of goods and services was estimated at 75.4% as at end 2015 Q2, expanding by 1.1 percentage points on an annual basis.

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



Source: Bank of Albania.

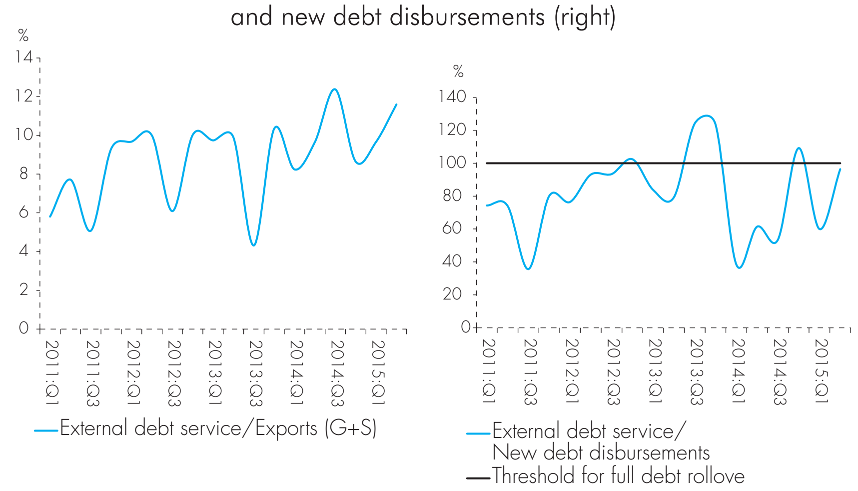
The indicators based on regular principal and interest payments flow help to monitor the pressures on the country's finances coming from the service of the external debt. The level of amortization is closely linked to the maturity of external debt and to the prolongation of the period, during which there 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

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

servicing to foreign currency inflows from the export of goods and services. This indicator stood at 11.6% at the end of the quarter, up around 1.9 percentage points at annual level. The increase by around 21% of external debt service by all sectors of economy 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 81% 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 96.4% 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)

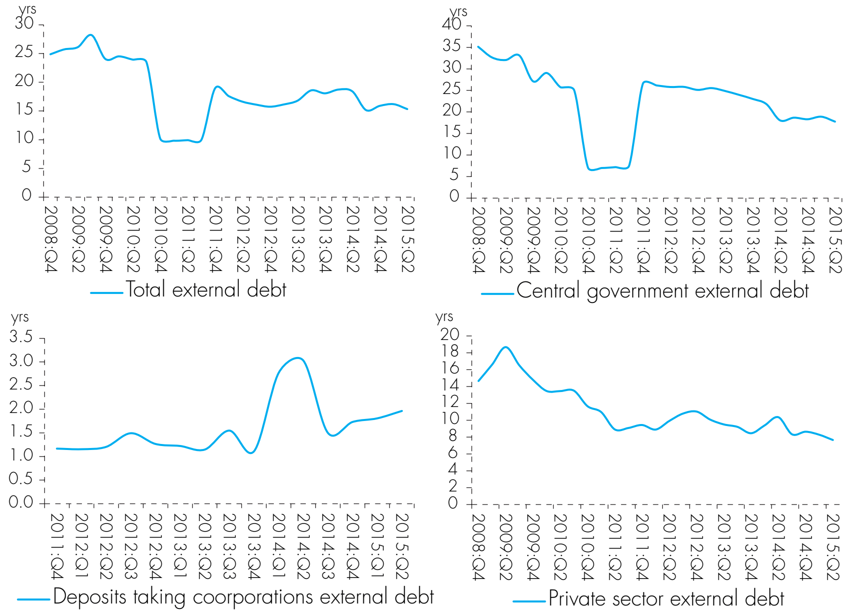


Source: Bank of Albania.

Indicators of average maturity performance of long-term external debt stock show a slight reduction over time of the latter, compared to the previous quarter. The reduction of the average term to maturity of the external debt of general government and of private sector provided the main impact. Thus, unlike the previous quarter, the average external debt maturity of public sector was reduced by around 14 months, whereas of private sector by around seven months. In contrast, the average external debt maturity of deposit-taking corporations was extended by around two months.

[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.