B a n k o f A l b a n i a

GROSS EXTERNAL DEBT ANALYSIS

2016 H1

ENIAN ÇELA
MONETARY POLICY DEPARTMENT

DECEMBER 2016

The views expressed herein are solely of the author 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 June 2016, Albania's gross external debt amounted to EUR 7,880.6 million, growing by 9.0% in annual terms and being estimated at around 75.2% of nominal GDP.**
  - By sectorial breakdown, general government accounted for around 42.6% of the total, deposit-taking corporations 16.5%, other sectors 16.5% FDIs 23.5% and the monetary authority 0.9%.
  - By investment instruments, loans and investments in currency and deposits dominate the gross external debt.
  - By maturity, long-term debt represents 80.9% of the stock of gross external debt, increasing the share to total stock by around 1.3 percentage points, compared with the same period the previous year.
- **Long-term external debt repayment capacity indicators stand above optimal levels since 2008.**
  - The ratio of gross external debt and the annual export of goods and services was estimated at 216.5%. It stands above the theoretical optimum of 150%, since the third quarter of 2011.
- **Liquidity adequacy indicators testify for low short-term pressures arising from the repayments of gross external debt obligations.**
  - The exchange reserve in Albania is sufficient to withstand negative shock from abroad. This reserve covers 7 months of import of goods and services and amounts to 186.3% of the short-term external debt as at the end of the second quarter of 2016.

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

At the end of 2016 H1 the gross external debt stock *totalled EUR 7,880.6 million, increasing by around 9.0%, in annual terms. The registered value of the debt stock increased by EUR 650.3 million compared with its stock at the end of 2015 H1. The actual stock is estimated at 75.2% of nominal GDP[2], a ratio around 3.4 percentage points higher than in the same period of the previous year. The general government was the main contributor to the expansion of Albania's gross external debt. It should be noted that the impact is related to the developments of the re-issuing of Eurobonds during 2015 H2.*

General government has the highest share in the total external debt stock, at around 42.6%. Compared with the same period of the previous year, the share of the central government's debt expanded by 3.8 percentage points. The debt stock of the general government reached EUR 3,360.8 million and was estimated at 32.1% of nominal GDP.

The gross external debt stock of deposit-taking corporations (excluding the central bank) resulted at EUR 1,297.2 million, up by around EUR 0.6 million compared with the previous year.

The external debt stock of other sectors was estimated around EUR 1,300.3 million, decreasing by EUR 29.9 million, year on year. Its share in the total external debt stock was 16.5%, around 1.9 percentage points lower than in the previous year.

The stock of intercompany loans of foreign direct investments was estimated at EUR 1,849.4 million – increasing by around EUR 134.9 million from 2015 H1.

At the end of first half of 2016, around 80.9% of the debt stock was estimated to be long-term debt (including FDIs) mainly in the form of loans. Short-term debt is estimated at around 19.1% of the total, mainly in the form of currency and deposits by deposit-taking corporations (excluding the central bank). General government and the monetary authority hold only long-term debt, while deposit-taking corporations hold a portfolio composed by long and short-term debt.

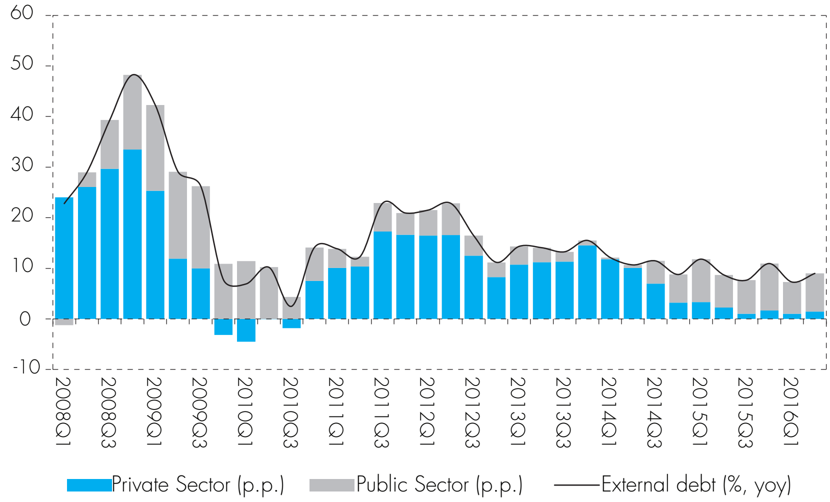
1 The latest external debt data are as of the second quarter of 2016. With the publication of the data for this period the data of the previous year have been reviewed as well. Also, starting with the first quarter of 2014, the Bank of Albania compiles the External Sector Statistics, in accordance with international standards provisioned in the sixth edition of the IMF's Balance of Payments Manual.

2 Last four quarters moving sum of GDP.

A) EXTERNAL DEBT BY SECTORS[3]

The increase of the gross external debt stock is driven by the deepening of total borrowing from the public sector (general government and the central bank). The debt stock of the **public sector** increased by 18.9% in annual terms, contributing 7.5 percentage points to the annual increase of the gross external debt.

Chart 1. Gross external debt by sectors



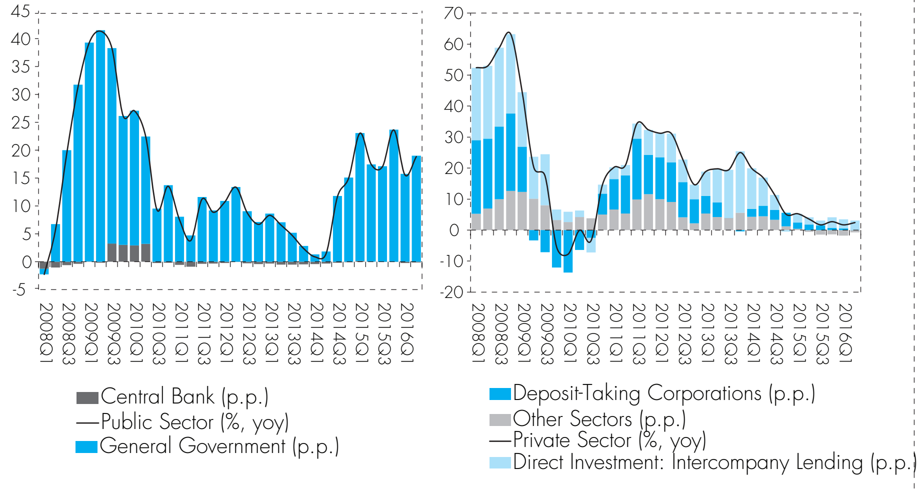
Source: Bank of Albania.

The contribution of the public sector (general government and the central bank) to the total stock of external debt continues to be higher than in the previous year. In the public sector, the debt expansion continued to be driven by the general government, while the central bank decreased slightly its exposure in terms of external debt.

The **private sector** generated a contribution of 1.5 percentage points to the annual growth of the external debt, during the period under review. The most significant increase was registered in the "intercompany loans of direct investments", whose stock expanded by 7.9%. A slight increase was noted in the "deposit-taking corporations" stock, while the "other sectors" stock contracted by around EUR 29.9 million, compared with the previous year.

[3] According to BPM6, the sectors of economy include: 1. The general government; 2. The central bank; 3. Deposit-taking corporations excluding the central bank; 4. Other sectors; 5. Foreign direct investments (FDIs).

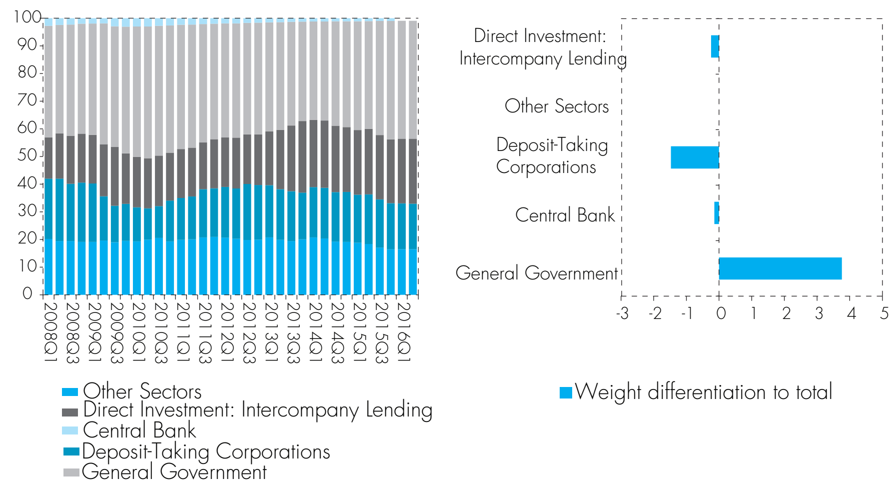
Chart 2. The debt of the public and private sectors(contributions in percentage points)



Source Bank of Albania.

In a more detailed breakdown by sectors, historically the external debt stock of the **general government** has had the highest share in the total. The other part of the stock has been distributed between: deposit-taking corporations (excluding the central bank) by 16.5%, other sectors of the economy by 16.5%, FDIs by 23.5% and the central bank by 0.9%.

Chart 3. Sectors' share against total external debt stock (left); debt stock changes during 2016Q2, compared with 2015Q2 (in percentage points, right)



Source: Bank of Albania.

B) EXTERNAL DEBT BY USED INSTRUMENTS

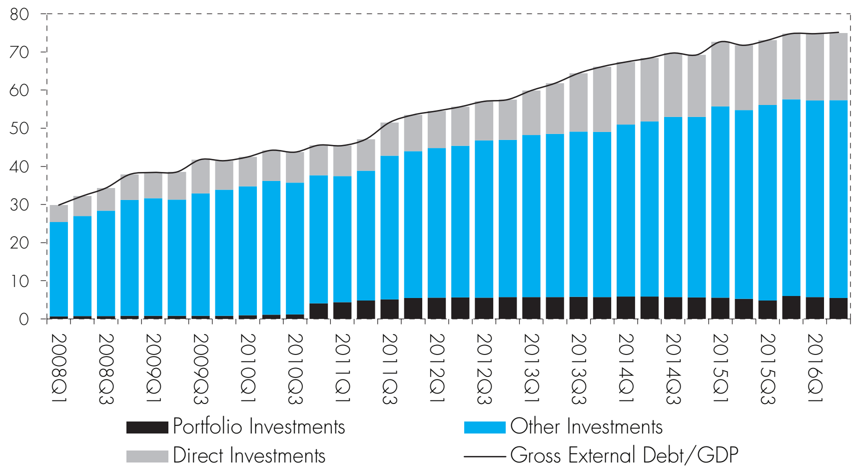
In the breakdown by instruments, investments have the main share in the total external debt stock in the form of **other investments**[4], around 68.9% of the total (51.8% of the nominal GDP) at the end of the first half of 2016. This

[4] Here are included: short and long-term loans, currency and deposits, commercial loans and other unspecified obligations.

ratio is almost unchanged from the previous year. Within this item, short and long-term loans constitute the main share.

Starting from the beginning of 2008 to the end of 2013, the share of this instrument against the total other investments has trended downward in favour of other investment instruments. During 2014, the share of loans against the total other instrument registered 69.7% in average. Since 2015 Q1, the share of this instrument against the total other investments has trended upward. During period under review, other instruments in the form of short and long-term loans represented around 71.6% of the total.

Chart 4. Gross external debt by instruments (against GDP, in %)



Source: Bank of Albania.

During the years, the stock of **foreign direct investments – intercompany loans** has shown an accelerated upward trend, particularly starting from 2010 Q3 and stabilizing within 22-24% during 2014 and 2015. At the end of the period under review, the share of foreign direct investments – intercompany loans against the total external debt resulted around 23.5%, about 0.2 percentage point lower than in the previous year.

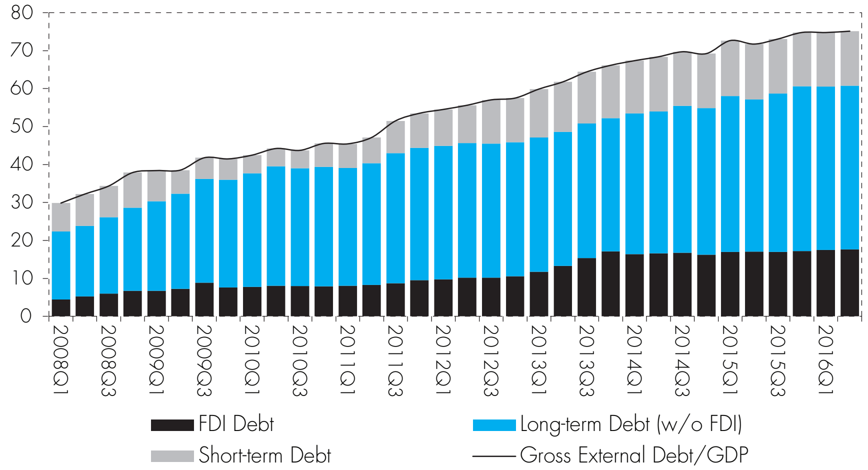
Portfolio investments represented 7.6% of the total gross external debt and were estimated around 5.7% of the nominal GDP.

C) EXTERNAL DEBT BY MATURITY

Broken down by maturity, external debt stock is composed mainly by long-term debt (around EUR 6375.9 million). **Long-term debt** (which methodologically includes FDIs as well) represented around 80.9% of the total gross external debt stock. Its share grew by around 1.3 percentage points in annual terms. Since 2014 Q1, the expansion of the long-term external debt has driven the upward trend of the gross external debt. General government and the central bank hold only **long-term debt** in their portfolio. **Short-term debt** registered around EUR 1504.7 million at the end of 2016 H1, increasing by around

2.2% in annual terms. Short-term debt against the total external debt registered 19.1% and was estimated around 14.4% of the nominal GDP. Only deposit-taking corporations and other sectors of the economy hold short-term debt in their portfolio. The short-term debt of these two sectors is constituted mainly by the currency and deposits instruments, as well as by the commercial loans instruments.

Chart 5. Classification of debt stock by maturity (in percentage of nominal GDP)



Source: Bank of Albania.

D) GROSS EXTERNAL DEBT SERVICE BY SECTORS

In 2016 H1, total debt service (principal and interests) by all sectors of the economy was EUR 164.1 million, approximately 3.1% of the aggregate nominal GDP of the period. This ratio is almost identical with that in 2015 H1. By sector, principal payments constitute the main part of the payments during 2015. Thus, around 81.7% of total payments of the sectors of the economy went for principal payments.

Table 1 External debt service and new gross debt by sector

		2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2
General government	Principal payments	31.8	22.3	64.0	24.8	42.4	24.3	67.8
	Interest payments	8.4	10.1	10.7	9.5	10.8	13.3	11.7
	New debt	52.9	96.2	52.9	292.3	86.5	108.8	79.1
Private (long and short term)								
	Principal payments	27.6	33.9	18.0	8.2	3.4	9.9	11.0
	Interest payments	2.2	2.0	0.8	0.7	0.1	0.8	1.2
	New debt	16.4	20.6	21.8	10.0	16.4	16.0	9.3
Banks (long and short term)								
	Principal payments	8.8	4.4	11.4	32.6	32.6	11.9	9.2
	Interest payments	0.6	0.8	0.4	0.5	0.5	1.8	1.3
	New debt	3.4	6.6	37.1	11.8	12.8	8.1	6.7
External debt service		79.4	73.4	105.4	76.2	89.6	61.9	102.2
New debt in total		72.7	123.5	111.9	314.1	115.8	132.9	95.0

Source: Bank of Albania.

New debt taken by all the economy in 2016 H1 was EUR 445.4 million. Like in the previous year, withdrawals were dominated by the general government debt, which accounted around 42.2% of the total new debt disbursed. New debt taken by the general government was 26% higher compared with the same period of the previous year. The disbursements in the form of banking system and private sector debt decreased in annual level.

2. EXTERNAL DEBT SUSTAINABILITY INDICATORS

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

Table 2. Repayment capacity and liquidity adequacy indicators over years

	2008	2009	2010	2011	2012	2013	2014	2015	2016H1
Repayment capacity indicator									
Gross external debt / exports (goods and services	128.0	142.4	140.3	157.3	172.3	191.9	197.4	217.9	221.4
Gross external debt / Fiscal revenues	140.6	158.7	174.0	210.5	232.2	273.0	264.4	282.4	275.8
Gross external debt of the central government / Fiscal revenues	55.8	72.7	80.0	87.9	93.7	98.2	101.1	121.0	117.6
Liquidity adequacy indicator									
Short-term debt to totat	24.5	13.2	13.6	17.0	20.2	21.1	20.7	18.9	19.1
Exports (goods and services) / short-term external debt	319.0	533.6	524.7	373.1	287.0	246.8	244.2	242.6	236.5
Foreign reserves / short-term gross external debt	205.2	348.3	342.0	226.3	177.0	149.9	152.5	198.1	186.3
net external debt / GDP	11.9	12.1	11.7	19.0	19.5	25.6	26.9	25.7	26.2
Net external debt / exports (goods and services)	40.2	41.5	36.1	56.0	58.4	74.1	76.5	74.7	77.3
External debt service / export (goods and services)1	3.9	5.1	11.9	6.9	8.7	8.4	9.8	10.6	10.1
External debt service / new debt withdrawal*	16.0	132.8	607.7	80.1	102.4	123.6	109.2	91.7	106.1

Source: Bank of Albania and Ministry of Finance.
*Annual cummulative average.

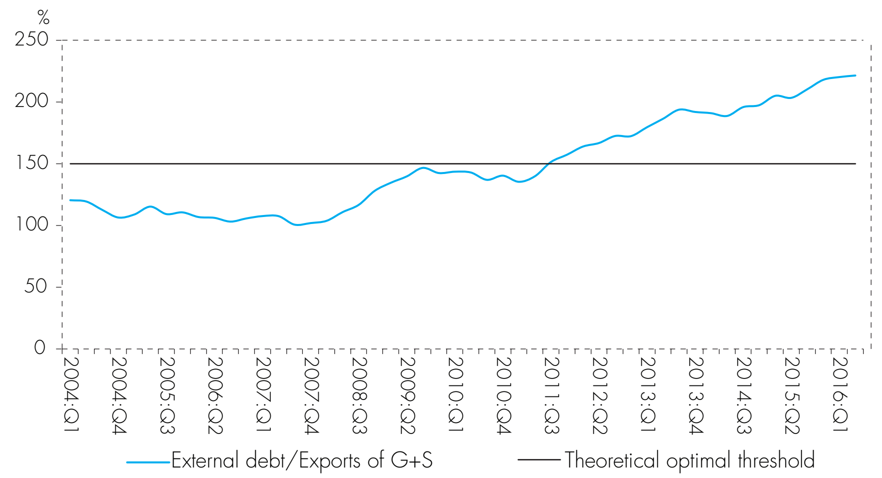
A) REPAYMENT CAPACITY INDICATORS

The export of goods and services represents a direct and continuous source of foreign currency inflows into an economy. The ratio that combines this with the gross external debt expressed in foreign currency helps in analysing the long-term repayment capacity and potential of a country. The deterioration of this indicator signals a decrease of the long-term repayment capacity of a country.

Since 2011 Q3, the indicator of gross external debt against goods and services export has exceeded the optimal theoretical threshold proposed empirically by the international financial institutions[5]. At the end of 2016 Q2, the value of this indicator was around 221.4%, expanding by 18.1 percentage points, in annual terms.

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

Chart 6. Gross external debt against goods and services export

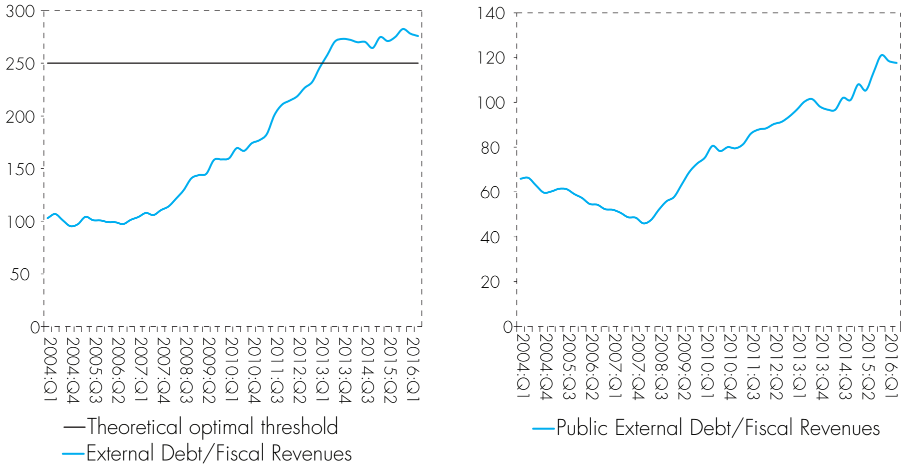


Source: Bank of Albania.

The flow of fiscal revenue helps build two other indicators that measure the repayment capacity of a country. These flows must suffice to cover a certain portion of the gross external debt and of central government external debt stock. The first indicator monitors the space that the central government enjoys to avoid credibility loss of the country with the foreign creditors in times of crisis, whereas the second indicator monitors the risk that fiscal revenues are redistributed by public spending in fund for the amortization of the public external debt.

The ratio of the gross external debt against fiscal revenues is estimated at 275.8%[6]. This indicator has expanded by 4.8 percentage points from the previous year. The indicator of the central government external debt against fiscal revenues has shown the same dynamic. The 117.6% registered ratio stands 12.2 percentage points higher, in annual terms.

Chart 7. Gross external debt (left) and central government gross external debt (right) against fiscal revenues as annual flow



Source: Bank of Albania, Ministry of Finance.

[6] The fiscal revenues as a quarterly flow have been turned into annually flows through a moving sum of four quarters.

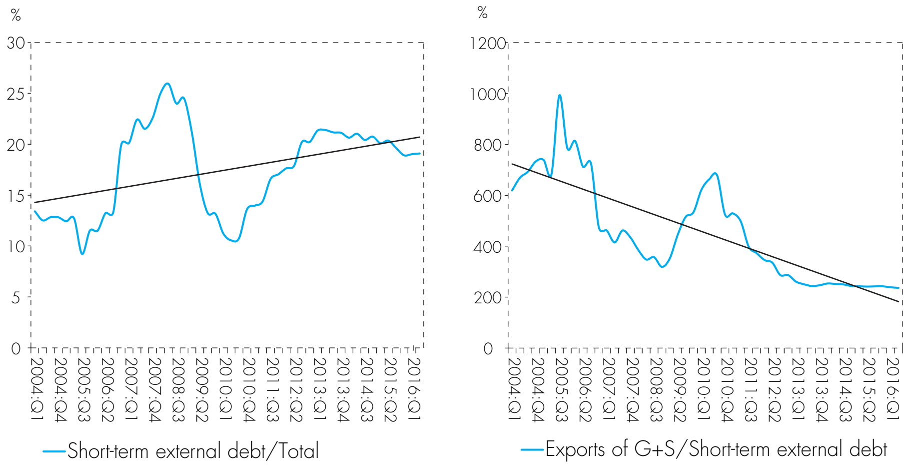
The long-term repayment capability of Albania is tightly related to the performance of the economy, as well as to the time distribution of the external debt service[7]. To avoid the concentration of the financial resources toward the repayment function, the economy must be able to fulfil its immediate obligations toward principal and interest repayments of the external debt.

B) LIQUIDITY ADEQUACY INDICATORS

The liquidity adequacy of the economy in order to repay external debt obligations is affected by the reliance of the economy on short-term external financing. Albania's external debt method is mainly through long-term debt. Annual income inflows from goods and services export[8] manage to completely cover the short-term external debt stock.

During the last three quarters, the ratio between goods and services export and the short-term external debt has shown a downward trend. This ratio was estimated at 236.5% at the end of the 2016 H1, about 5.1 percentage points lower, in annual terms. The registered ratio testifies about the adequacy of foreign currency regular inflows to cover the short-term external debt.

Chart 8. Short-term gross external debt against total (left) and against goods and services export (right)



Source: Bank of Albania.

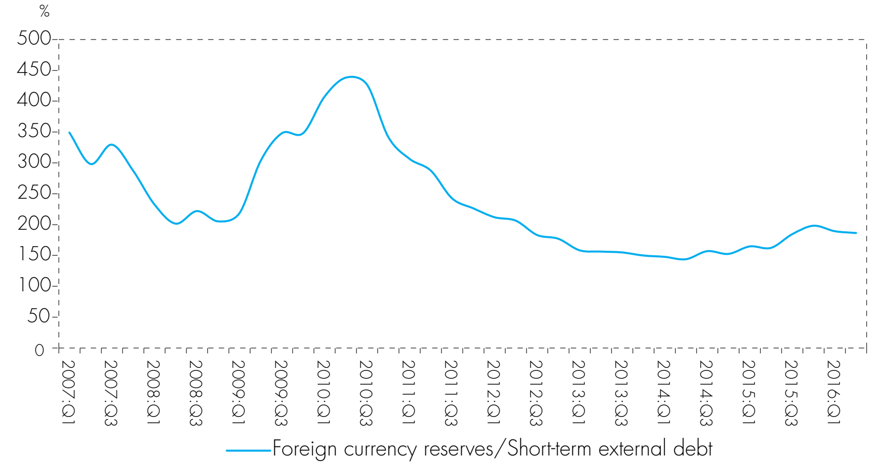
Another important indicator is the level of coverage of the short-term external debt stock by the foreign exchange reserve stock. In the conditions of an incomplete access to international capital markets, the foreign exchange reserve may help facing short-term external debt obligations in case of unexpected economic shocks.

[7] If in the future the economy registers faster growth and the distribution in time of the external debt service is consistent, the long-term repayment capacity of Albania is improved. Vice versa, long-term repayment capacity indicators deteriorate.

[8] Expressed in moving sum of four quarters.

The foreign exchange reserve stock in Albania is sufficient to cover the short-term external debt. The critical threshold of this indicator is 100% and the ratios under this threshold testify for an insufficiency of the foreign exchange reserve stock[9]. Since 2015 Q1, this indicator expanded with an annual accelerated pace as a consequence of higher foreign assets. At the end of the year, the foreign exchange reserve stock covered around 186.3% of the short-term external debt.

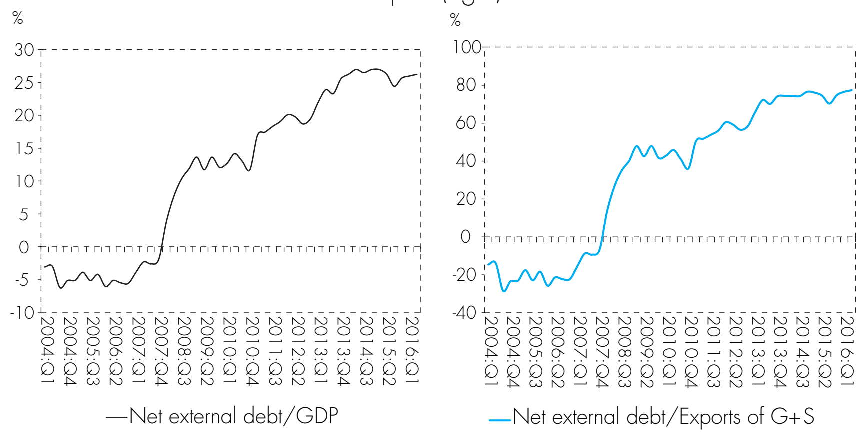
Chart 9 The foreign exchange reserve stock against the short-term external debt



Source: Bank of Albania.

Net external debt helps in monitoring short-term pressures, as a result of the expected liabilities within a year. The cumulative value of foreign assets of banks and foreign exchange reserve is detracted from the gross external debt. At the end of 2016 H1, net external debt was estimated at 26.2% of nominal GDP, almost unchanged compared with the previous year. The net external debt against goods and services export was estimated at 77.3% at the end of the first half of the year, increasing 2.9 percentage points in annual terms.

Chart 10. Net external debt to nominal GDP (left) and to goods and services export (right)



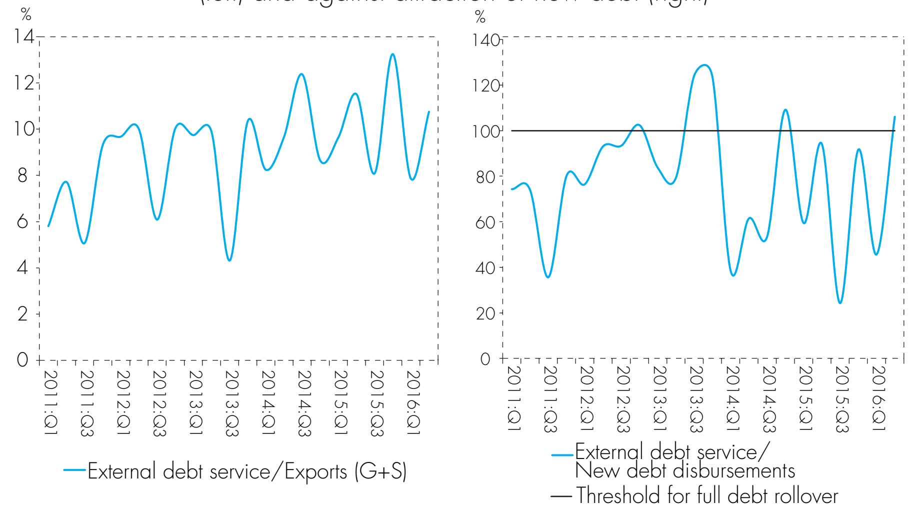
Source: Bank of Albania.

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

Indicators built on the basis of the regular flow of principal and interest payments help in monitoring the pressures on the finances of the country by external debt service. The level of amortization is closely related to the maturity of the external debt and the duration of the grace period, when there are temporary concessions on interest and principal payments. A monitored indicator is the ratio of the relative size of the external debt service against the foreign currency inflows from the goods and services export. This indicator was at 10.75% at the end of the first half of the year, tightening by around 0.8 percentage points in annual terms. A key role in this trend was played by the decreasing by around 4.4% of the external debt service. The registered ratio of this indicator is significantly under the critical threshold of 20%, suggested by international financial entities[10].

The indicator of external debt amortization to new debt disbursements measures the extent of debt roll-over. For this indicator, the ratio under the 100% threshold indicates an accelerated new external debt disbursement, compared with the repayment for its amortization. The ratio of external debt rollover was at 106.1% at the end of the first half of the year, and 66.9% on average for the last four quarters. The factors of rollover of amortized debt would be 0.9 and 1.5, respectively.

Chart 11. The ratio of the external debt service against goods and services export (left) and against attraction of new debt (right)



Source: Bank of Albania.

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