Comments on “Albania: Debt Sustainability and Accessing Internationals Markets”

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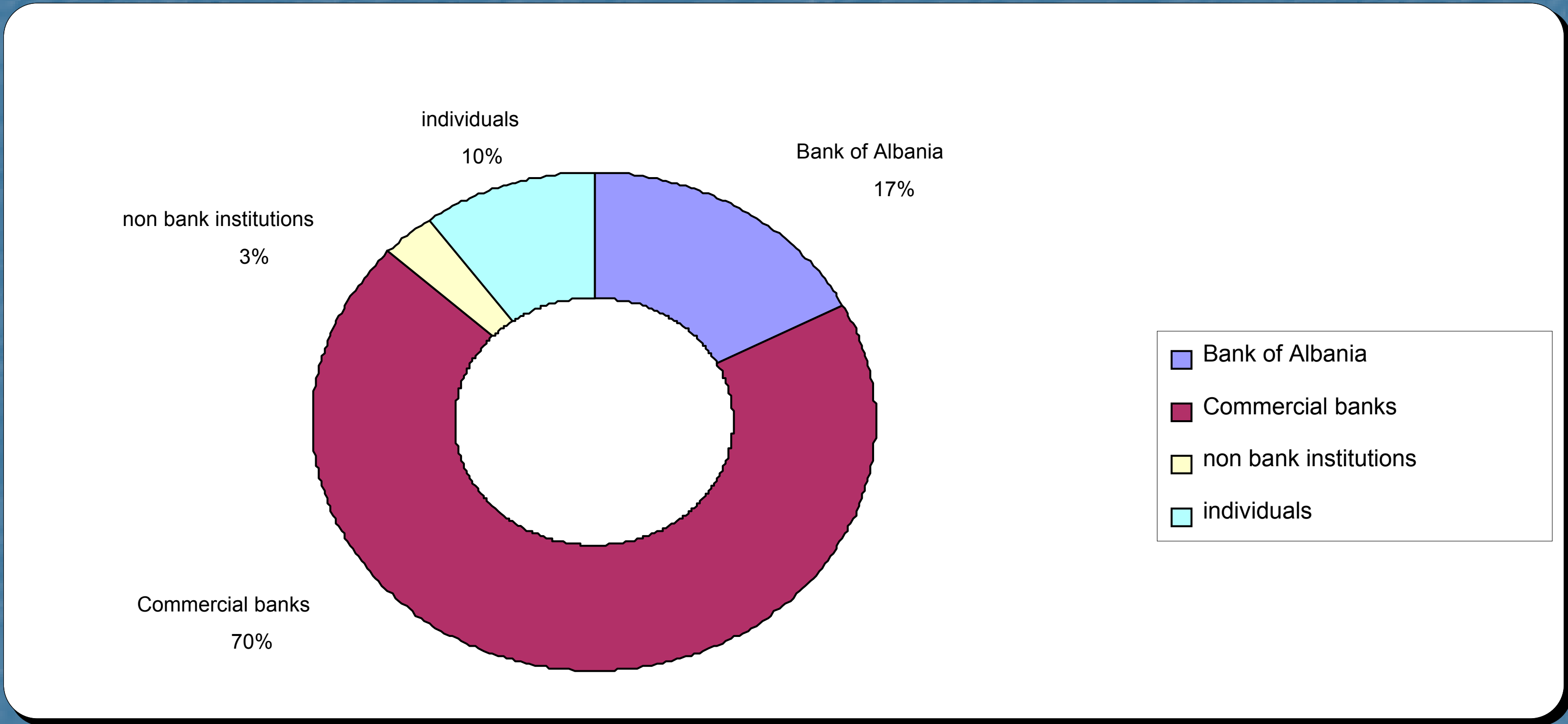
General framework

- Define investment needs.
  - Others + projects (strategy development),
  - absorption possibilities,
  - constraints (macroeconomic framework, debt sustainability) .
- How to finance these needs?
  - domestically (up to now 70 % of total debt),
  - externally (is comfortably low at moment 15.6% of GDP).
- Result: resolve the optimization problem “meet government financing needs at lowest cost and consistent with a prudent degree of risk”.

Financing the needs domestically

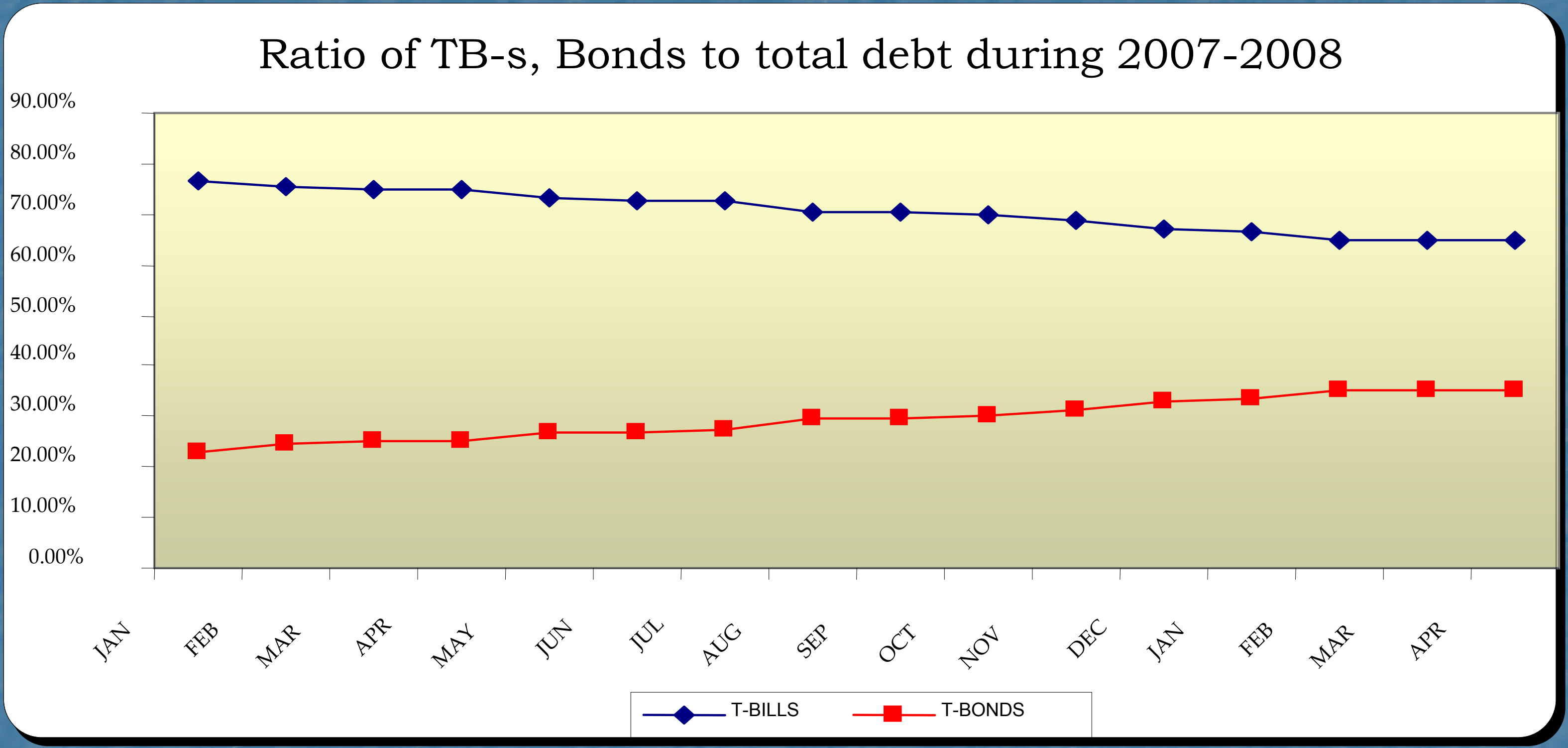
- Features of domestic security market:
  - excessive concentration,
    - in domestic banking sector
    - in one commercial bank
  - short maturity,
  - no active secondary market,
  - steep yield curve (spread between 3 and 12 months is 185 bp),
  - No “crowding out effect” from credit activity.
- Risks to fulfill the needs domestically:
  - rollover risk,
  - dependent from one bank behavior.

Distribution of government domestic debt



- Just one bank does have 49% of commercial banking part
- Non banking institutions almost unchanged
- Pension reform will help to broaden the market

Composition of domestic debt by instruments



- Ratio of TB is going down, but still is high
- Average maturity of domestic debt is around 360 days
- Extending the average maturity will create condition for more liquid market

Strategic movement

- Follow active policy to gradually replace higher cost, lower maturity domestic debt with lower cost, longer maturity external debt.
- External funds will serve better for infrastructure projects.
- This could bring:
  - reduction of borrowing cost,
  - reducing the pressure in domestic government security market,
  - possible yield curve flattening,
  - support credit activity in domestic currency.
- Risk. Using more instruments will “cut the pie in more pieces” and will be less probability for development of domestic security market

Sensitivity of domestic debt toward the shape of yield curve

Correlation coefficient of yields

	12-M TB rate	2-Y Bond rate	3-Y Bond rate	5-Y Bond rate
12-M TB rate	1.0000	0.9733	0.7239	(0.5923)
2-Y Bond rate	0.9733	1.0000	0.7745	(0.5732)
3-Y Bond rate	0.7239	0.7745	1.0000	(0.4366)
5-Y Bond rate	(0.5923)	(0.5732)	(0.4366)	1.0000

- If the spread between 3 and 12 is narrowed by 25 bp, due to reduction of demand for domestic government papers or development of government security market, will be a saving of around 700 mn lek on yearly basis.

Financing the need externally

- Positive and negative effects can come out from this movement:
  - (+) more possibility for diversification and broadening the investor base;
  - (+) more room to increase the debt maturity;
  - (+) lower financing cost;
  - (+) reduction of roll over risk;
  - (+ and -) it's a need for more analytical capacity;
  - (-) more exchange rate risk (no lunch free, a prudent fiscal and monetary policy is a prerequisite).

Thank you for your attention