



REPUBLIKA E SHQIPËRIË
MINISTRIA E FINANCËVE
DHE EKONOMISË

MONITORING REPORT

- 2022 -

OF THE MEDIUM-TERM DEBT MANAGEMENT STRATEGY

2022-2026

General Directorate of State Debt

Tirana, March 2023

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I. Introduction

The Monitoring Report of the Medium-Term Debt Management Strategy is being prepared for the first time by the Ministry of Finance and Economy. In accordance with Article 6 of Law No. 9665, dated 18.12.2006 "On state borrowing, state debt and state loan guarantees in the Republic of Albania", amended by Law 181/2014 dated 24.12.2014 as well as Law No. 92/2022 dated 22.12.2022, this Monitoring Report is prepared by the Ministry of Finance and Economy and sent to the Economy and Finance Committee of the Assembly of the Republic of Albania as well as published on the Ministry's official website.

The year 2022 has been an atypical one which was accompanied by instability of the financial markets. The ongoing Covid-19 pandemic and the Russia-Ukraine war, events which deepened inflationary pressures and were accompanied by the tightening of financial conditions in most of the regions, directly affected the economic outlook. The increase in the interest rates and their impact on the behavior of investors presented some difficulties in the realization of borrowing for the year 2022.

In July 2022, the Ministry of Finance and Economy updated the Debt Management Strategy. The new Medium Term Debt Management Strategy 2022-2026 was drafted, approved and published. The new strategy, differently from the previous ones, is designed over a wider time horizon, specifically in five years. The extension of the time horizon from three to five years was done in order to have a more comprehensive evaluation of the analyzes that the strategy covers and also favors a more efficient implementation of the strategy compared to previous strategies which were based on a three-year plan. On the other hand, the extension of the time horizon of the strategy makes it necessary to monitor it in annual basis and to undertake measures to update it when it is deemed necessary, or otherwise to update it one year before the end of the deadline.

The publication of this report will serve as a positive step in the direction of increasing transparency towards the public as well as intensifying communication with investors or interested third parties.

II. Macroeconomic developments during 2022

The economic situation in the country but also in the global context has faced a series of challenges in 2022. The economy throughout this year has appeared more resilient compared to expectations as a result of the war in Ukraine, however supply shocks have affected high energy prices, food and basic materials, leading to high inflation rates, increased uncertainty and tightening of financial conditions in most of the countries. Moreover, the post-pandemic effects of COVID-19, along with other factors that occurred in a relatively short time, have significantly impacted the economic outlook.

The European Central Bank and the Federal Reserve have successively increased the basic interest rate, an increase which has also been reflected in the increase in the interest rates of government bonds and loans. The trajectory of the increase in interest rates has been stronger than the initial expectations of the markets and not uniform between banks, leading to increased volatility of interest rates and exchange rates.

The economy in our country has been impacted by developments and expectations for the global economy and especially that of the European Union. The pace of economic growth over the past few years, until the impact of the Covid-19 pandemic, has shown a positive development trend that has been reflected in a number of macroeconomic parameters in the country. Economic activity has maintained its positive growth trend throughout 2022, even under the influence of the latest shock to the global supply of basic goods, which have caused a strong increase in the general level of prices, inflation as well as tightening of financial conditions. Growth through 2022 was mainly generated by domestic demand, both private consumption and investment. Exports, both of goods and services, especially the tourism, have had a fairly good performance. Despite the fact that the imports have also registered a strong increase (reflecting the increase in aggregate demand), the net contribution of foreign demand has been positive. Economic growth for 2022 was evaluated around 3.7%. Regarding the medium-term perspective, economic growth is predicted at a rate of 2.6% for 2023 and an average of about 3.9% per year during the following medium-term period 2024-2026.

Inflation throughout 2022 has recorded an average annual level of 6.7%. The historically high values during this year have been driven by the supply shock in the global context, turning inflation into one of the main macroeconomic issues for our economy, as in many other countries of the world. Consequently, the Bank of Albania has followed a monetary normalization policy during 2022 by increasing the base interest rate from 0.5% at the end of 2021 to 2.75% at the end of 2022.

The domestic financial market has followed the normalization cycle of monetary policy in the country and in international markets, increasing the yields of securities, especially during the third and fourth quarters of the year. The increase in securities yields has been at a higher growth rate than the increase in the base rate in reflection of the market's expectations on the future reactions of the monetary policy. The local currency market is characterized by an appreciation of the local currency against the Euro currency. After a stable Lek/Euro exchange rate of around 121.9 in the first quarter of 2022, the Albanian Currency Lek has continuously appreciated thereafter, reaching an average exchange rate of 116.4 in the fourth quarter. This level represents an appreciation of 4.2% in annual terms.

III. Medium-Term Debt Management Strategy

Ministry of Finance and Economy updated the Medium Term Debt Management Strategy, which was approved by the Council of Ministers Order No. 534, dated 29.07.2022 "On the approval of the Medium Term Debt Management Strategy 2022-2026".

Medium Term Debt Management Strategy 2022-2026 is in function of the general objectives of debt management specified in Law No. 9665, dated 18.12.2006, "On state borrowing, state debt and state loan guarantees in the Republic of Albania", amended, and it is in line with the macro-fiscal framework and the monetary policies of the Bank of Albania during the medium term.

This Strategy covers the management of Central Government Debt, which includes State Debt and State Loan Guarantees. Its purpose is to guide the defined borrowing toward the selection of instruments with favorable costs and acceptable levels of exposure to risk. Financing levels are defined in the Macro-fiscal framework and in the Medium Term Budget Plan divided into plans/annual borrowing volumes.

In the proces of Drafting the Strategy, were taken into consideration the cost-risk ratios of the existing portfolio, as well as the development of these ratios based on a quantitative analysis carried out for a number of alternative financing scenarios (strategies), the degree of debt exposure to risks and the degree of development of the government securities market. In addition to the base strategy, which refers to the most likely financing scenario, the Debt Management Strategy also presents three alternative financing strategies, assessing for each case the possible impacts on costs, risks and the rate of development of the government securities market .

IV. Realization of MTDS Objectives - Year 2022

IV.I Progress of the general objectives set of in the Medium-Term Debt Management Strategy 2022-2026.

IV.1.1. Meeting government needs for timely financing, including the need to service current debt at the lowest possible cost while maintaining acceptable levels of risk exposure.

Year 2022 has been challenging in terms of securing financing, especially during the first six months of the year. During 2022, the borrowing in gross terms amounted to ALL 386.1 billion, out of which 92.7% (or ALL 357.9 billion) was financed through domestic sources and 7.3% (or ALL 28.3 billion) through foreign sources.

Table 1: Borrowing Realization

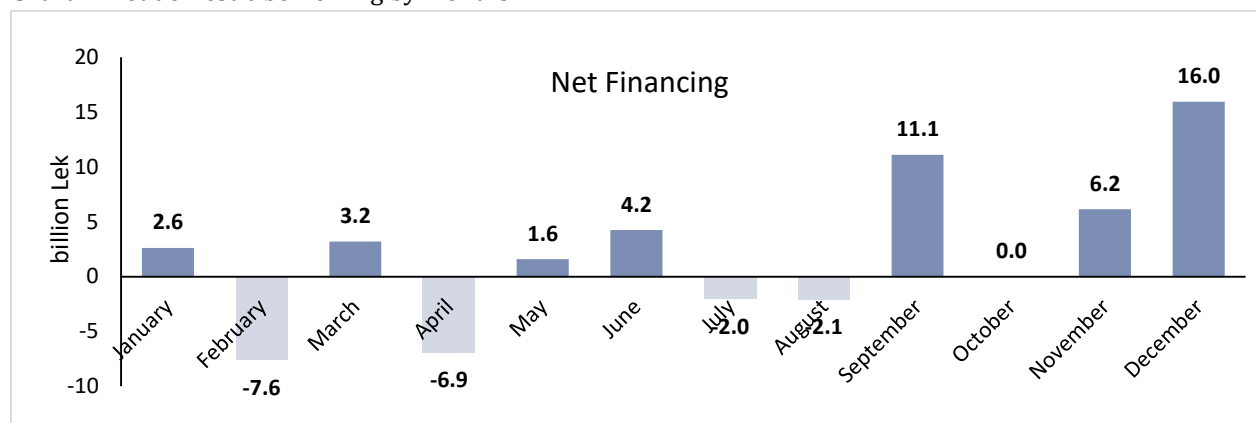
Sources of Borrowing	2021		2022	
	Value (in billion ALL)	%/Total	Value(in billion ALL)	%/Total
Domestic Borrowing	345.1	71.7%	357.9	92.7%
Treasury Bills	215.8	44.9%	245.5	63.6%
Bonds	129.3	26.9%	112.3	29.1%
External Borrowing	136.1	28.3%	28.3	7.3%
Loans for projects financing	16.3	3.4%	11.2	2.9%
Budgetary Support	42.6	8.8%	17.1	4.4%
PBG	-	0.0%	-	0.0%
Eurobonds	77.2	16.0%	-	0.0%
Total Borrowing	481.2	100.0%	386.1	100.0%

Source: Ministry of Finance and Economy, 2023

Government issued securities in the domestic market at the amount of ALL 357.9 billion, out of which ALL 245.5 billion belongs to Treasury Bills and ALL 112.3 billion belongs to Bonds. The year 2022 has been an unusual year in terms of borrowing. The changes in the base rate by the Bank of Albania, the current context marked by a high inflation, as well as the market's expectations for the further reaction of the monetary policy, oriented investors in the search for high yields as well as a preference for short term instruments. As a result, the new debt has been financed entirely through short-term instruments. Net borrowing at the end of 2022 resulted at the amount of ALL 26.3 billion, where ALL 32.4 billion of net financing was realized through short term instruments, while as for Bonds, the net financing is negative at the level of ALL -6.0 billion, which means that during 2022 the Bonds matured were higher than the issued Bonds throughout the year.

Most of the net financing was realized during the fourth quarter of the year. In the conditions of materialization with concrete and intensified measures of the monetary policy authority, more relaxing circumstances were created in terms of price discovery for investors, consequently, there was a positive reaction to the demand for government securities.

Chart 1: Net domestic borrowing by months¹



Source: Ministry of Finance and Economy, 2023

Net financing, compared to 2021, is significantly lower (about ALL 20 billion lower than 2021). However, the realization of a lower borrowing than expected for 2022, has not affected public finances since this period, has been characterized by positive developments in terms of budget revenues, and a sufficient level of liquidity during the whole period.

As for external sources of financing, the borrowing during 2022 was realized at the level of ALL 28.3 billion. Compared to 2021, external borrowing has decreased because no Eurobond was issued in 2022, the level of budget support was lower than last year and also the value of loans disbursed for project financing was lower than in 2021. Over 70% of external borrowing during 2022 belongs to disbursement of loans in the form of budget support and the rest for projects, mainly from transport projects, followed by the health services sector, urban infrastructure, as well as supply with water and sewage.

Cost

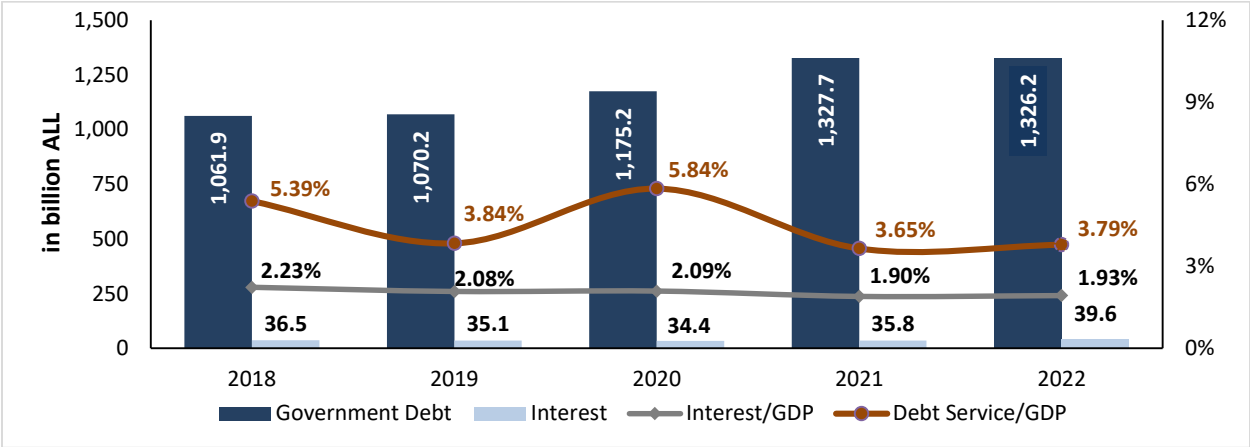
Regarding the cost and risk ratios in the debt portfolio, in the conditions where the year 2022 has been unusually influenced by unfavorable developments in the financial markets, among which we reiterate the increase in the basic interest rate within the country by the Central Bank, a policy which has also been followed by the international monetary authorities, the domestic debt portfolio has been managed appropriately, keeping the costs at the lowest possible level in the given market conditions, while the risk indicators have showed a temporary deterioration.

For the year 2022, expenses for debt interest were evaluated at the level of ALL 39.6 billion, respectively ALL 24.2 billion for domestic debt interest and ALL 15.4 billion for external debt interest. Repayments of the external debt for the year 2022 were evaluated at the level of ALL 38.4 billion (payments for the external debt principal). Compared to 2021, interest

¹The net funding for each month separated by the previous months.

expenses increased by ALL 3.8 billion (10.8% more than 2021), mainly as a result of the increase in the debt stock in nominal value as well as the increase in interest rates, although the increase in interest rates is expected to have a greater effect in 2023 and beyond. The increase in interest expenses was within the projections and in accordance with the 2022 Budget Project.

Chart 2: Debt Service 2018-2022



Source: Ministry of Finance and Economy, 2023

IV.1.2. *Improving and sustaining the primary market efficiency, supported by the further development of the secondary market of domestic government securities*

Year 2022 was characterized by an uncertainty in the domestic primary market. The high uncertainty, the increase in the basic interest rate in the domestic market, as well as the expectations for further increases in interest rates in response to increased inflation, influenced the decrease in the demand for government securities during the first 9 months of the year. This situation improved significantly in the last quarter of the year where the demand for government securities returned to satisfactory levels, and managed to meet the government's borrowing needs. The demand for government securities has been mainly directed towards short-term instruments. It has continued to rely on local investors (residents), while the banking sector remains the main source of demand.

Within the framework of the development of the infrastructure of the primary market and the stimulation of the secondary market, several activities have continued in this regard, which have as their main objective the reduction of demand fragmentation, as well as the creation and consolidation of benchmark sizes for long-term titles.

In terms of creating benchmark sizes, the measures such as the consolidation of the number of auctions, reducing the frequency of new issuances and using the reopening of existing securities has continued.

IV.1.3. Development of the government securities market

The development of the government securities market is intended to be realized through activities which aim to: a) increase liquidity; b) increase efficiency; and c) increase transparency.

The realization of the above objectives is a long-term goal, while the development of activities and the taking of various measures is a process which has begun and will continue to be carried out and further strengthened continuously. Specifically, an improvement in the operation of the Market Maker program, with concrete steps initiated at the end of 2022 with the development of an evaluation and monitoring framework, will contribute towards increasing the liquidity of government securities and development of the secondary market of these titles.

IV.1.4. Drafting and publication of an annual borrowing plan

The Ministry of Finance and Economy drafted and published for the first time in December 2022 an Annual Borrowing Plan for 2023². The Annual Borrowing Plan for 2023, which was prepared with the assistance of the World Bank, aims to support the annual borrowing activity of the Ministry of Finance and Economy, as well as to increase transparency towards investors.

The Annual Borrowing Plan gives in detail the instruments that will be used in the domestic market in 2023, the corresponding issuances according to each instrument as well as the frequency of emission of each instrument. Based on the Annual Borrowing Plan of 2023, quarterly borrowing calendars in the domestic market will also be prepared accordingly. However, as the Annual Borrowing Plan itself expressly determines, in the ground of a high uncertainty that the year 2023 presents as well, the MFE reserves the right to change the frequency or amount issued per instrument/month according to market conditions.

IV.1.5. Assessment of potential use of new alternative financing sources (Green, Social, etc.)

During 2022, Ministry of Finance and Economy has undertaken few steps towards evaluation of the possibilities of using new financing alternatives, in addition to traditional sources of borrowing. For this reason, several virtual meetings have been organized with

² <https://financa.gov.al/plani-vjetor-i-huamarrjes-2023/>

representatives of the World Bank regarding the details of these instruments and their advantages/disadvantages.

In the conditions where these types of instruments still present a set of unknowns, the Ministry of Finance and Economy will continue to explore aiming a more complete and comprehensive knowledge of the prerequisites, benefits and suitability or readiness of our country to advance with the initiatives of green or social security's issuance in the international financial markets.

On a wider environmental and social prospect, the Ministry of Finance and Economy has taken concrete steps in the direction of ensuring a higher awareness of the environmental and social impact, with the revision of public investment management procedures. In December 2022, they were approved by the Council of Ministers, through Decision No. 887 dated 27.12.2022, the new public investment management procedures, which, in the entirety of the improvements they bring in this field, present an advanced approach regarding the environmental, climatic and social impact of investment projects. Every potential investment project that is intended to be financed, will be evaluated considering the environmental assessment and climate impact also, as an important element/principle of evaluation.

Table 2: Progress of General Objectives

	General qualitative objectives	2022	2023	2024	2025	2026
1	Meeting government needs for timely financing, including the need to service current debt at the lowest possible cost while maintaining acceptable levels of risk exposure.	✓				
2	Improving and preserving the efficiency of the primary market, supported by the further development of the secondary market of domestic government securities	✓				
3	Development of the government securities market	✓				
4	Drafting and publication of an annual borrowing plan	✓				
5	Assessment of potential use of new alternative financing sources (Green, Social, etc.)	In progress				

Source: Ministry of Finance and Economy, 2023

IV.2. Progress of the specific quantitative objectives of the medium-term debt management strategy 2022-2026.

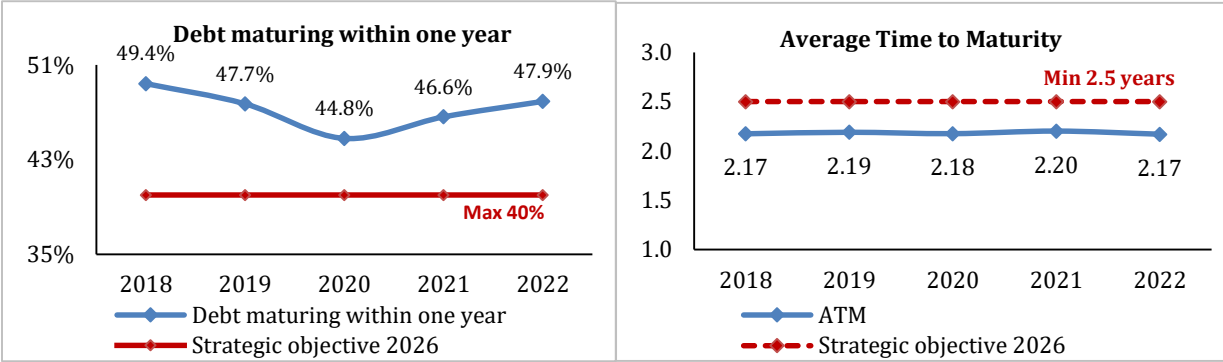
The Medium-Term Debt Management Strategy aims to further improve the debt structure (mainly the structure of the domestic debt portfolio), in terms of reducing exposure to risks,

as well as keeping costs at the lowest possible levels. During 2022, in the tight conditions of the markets, the borrowing was not easy to be accomplished in line with the strategy guidance. In the circumstances of a demand mainly oriented towards the short-term instruments, many of the risk indicators did not show improvement compared to previous years, and in some of them there was marked a regression, which is estimated to be temporary.

Refinancing Risk

One of the main objectives of MTDS is to reduce the refinancing risk mainly in the domestic debt portfolio, since the external debt presents less risk as it is composed of instruments with long maturity and amortization profiles extended over the time. During 2022, as a result of the increased issuance of short-term instruments for the purpose of ensuring the necessary financing, the refinancing risk indicators did not show improvement. Specifically, the average time to maturity of the domestic debt has decreased by 13 days, from 793 days at the end of 2021 to 780 days at the end of 2022. Also, the share of debt maturing within one year has increased from 46.6% in December 2021 to 47.9 % in December 2022.

Chart 3: Refinancing Risk Indicators

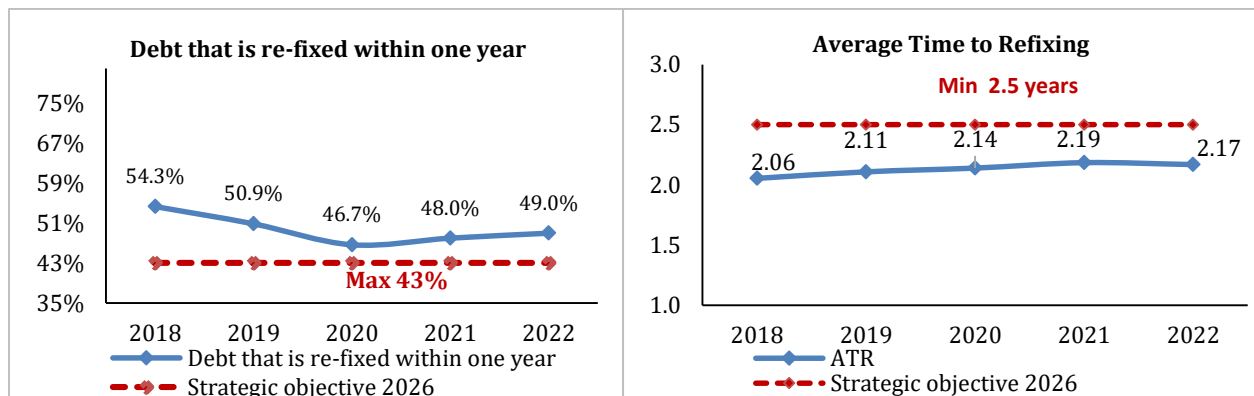


Source: Ministry of Finance and Economy, 2023

Interest Rate Risk

The interest rate risk also showed no improvement during the year, this in the circumstances of the regular use of short-term instruments (3, 6 and 12 month treasury bills). Specifically, the share of the debt which re-fixes the interest rate within 1 year has increased from 48.0% to 49.0%, while the average time to re-fixing has decreased from 2.19 years to 2.17 years.

Chart 4: Interest Rate Risk Indicators



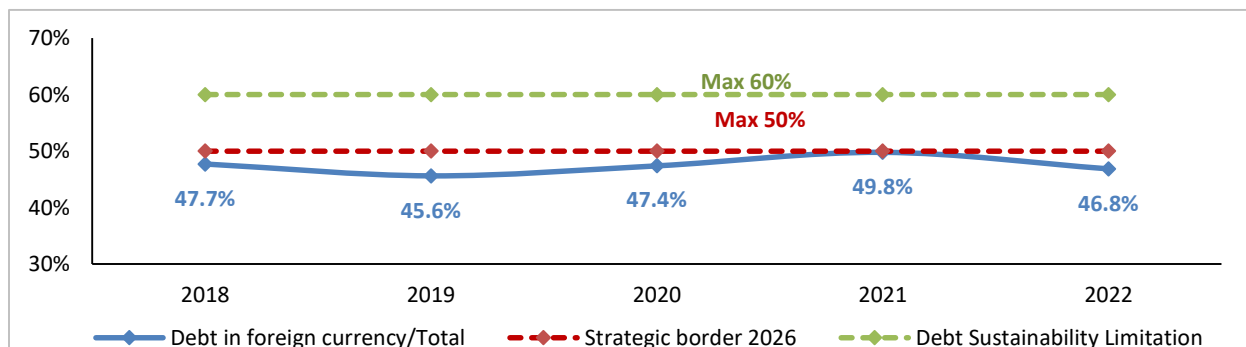
Source: Ministry of Finance and Economy, 2023

Exchange Rate Risk

The exchange rate risk has generally been kept under control throughout the midterm, staying below the strategic objective. Specifically, the share of the total debt stock in foreign currency to the total debt stock was 46.8% at the end of 2022, decreasing by 3 p.p., a significant improvement compared to the end of 2021. However, during the last three years the share of debt denominated in foreign currency has had an overall upward trend, due to a greater borrowing through intensified issuances in the international markets, and also increased funding in the form of budget support.

During 2022, the share of debt denominated in foreign currency, is partially influenced by the depreciation of most of the foreign currencies, mainly the Euro, against the Albanian Currency Lek, but it also a result of a lower borrowing from external sources, which in net terms (the difference between annual gross external borrowing with the external debt repaid during the year) has been at a negative level.

Chart 5: Exchange Rate Risk



Source: Ministry of Finance and Economy, 2023

Table 3: Risk Indicators

Specific quantitative objectives	Baseline 2021	Strategic Objective 2026	Reporting Year-2022		
			Status	Activities	Comments
Improving Refinancing Risk					
ATM domestic debt	2.20	2.5	2.17	Predicted a level of borrowing which would be gradually increasingly relied on medium-term and long-term titles	During 2022, the intended support in medium and long-term instruments that would guarantee improvement was not feasible
Domestic debt maturing in 1 year (% of total)	46.6%	40%	47.9%		
Improving Interest Rate Risk					
ATR domestic debt	2.19	2.5	2.17	The borrowing only with fixed interest rate instruments was anticipated	Borrowing was carried out only with fixed-rate instruments, but the maturity of the debt also affects this indicator
Domestic debt refixed in 1 year (% of total)	48.0%	43%	49.0%		
Exchange Rate Risk	49.78%	Max. 50%	46.85%	It is anticipated that foreign sources will cover an average of 15% of financing needs	Foreign borrowing in the amount of about 6% of the financing needs has contributed, among other factors, to the improvement of this indicator

Source: Ministry of Finance and Economy, 2023