



MONITORING REPORT

-2023-

OF THE MEDIUM-TERM DEBT MANAGEMENT STRATEGY 2022-2026

General Directorate of State Debt

Tirana, March 2024

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I. Introduction

The Monitoring Report of the Medium Term Debt Management Strategy is prepared 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", as amended. This Monitoring Report is prepared by the Ministry of Finance and sent to the Parliamentary Economy and Finance Committee, as well as published on the official website of the Ministry of Finance.

In 2022, the Ministry of Finance updated the Debt Management Strategy, by drafting and publishing the Medium Term Debt Management Strategy 2022-2026¹. 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 complete 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 year after year and to intervene to update it when it is deemed necessary, or otherwise to update it one year before the end of the deadline.

In accordance with Law No. 9665, dated 18.12.2006 "On state borrowing, state debt and state loan guarantees in the Republic of Albania", as amended, in March 2023, the Ministry of Finance drafted and published for the first time the Monitoring Report of the Medium Term Debt Management Strategy for 2022², a report which introduced an analysis on the progress of the implementation of the Medium Term Debt Management Strategy for 2022. In the following years, the Ministry of Finance within the first quarter of each year, will draft a Monitoring Report for the Medium Term Debt Management Strategy Debt for the previous year. The publication of this report will serve as a positive step towards increasing transparency towards the general public as well as intensifying communication with investors or third interested parties.

¹ <https://financa.gov.al/wp-content/uploads/2022/11/Medium-Term-Debt-Management-Strategy-2022-2026-ENG.pdf>

² https://financa.gov.al/wp-content/uploads/2023/04/Monitoring-Report_Year-2022_English-Version.pdf

II. Macroeconomic developments during the year 2023

Economic activity until the end of 2023 has shown a remarkable resilience to the successive shocks that have impacted our country in recent years. The Albanian economy has continued throughout the year 2023 with a positive and relatively high growth in economic activity, employment and wages, despite a global context characterized by rapid growth in prices, uncertainty and financing costs. So far, the main economic and financial foundations, as well as the general macroeconomic stability of the country, have resisted relatively well and it is expected that the economy will continue its positive performance in the medium term.

The economy in our country has been impacted by developments and expectations for the global economy and especially that of the European Union. Financial conditions in international markets are tight, reflecting the high level of base interest rates and inflationary pressures, which, although slowing, still remain high. The European Central Bank and the Federal Reserve have successively increased the base interest rate, an increase which has been reflected in the increase of financing costs and a slowdown in bank lending.

Throughout 2023, despite tighter financing conditions and the slowdown in foreign demand, the Albanian economy has maintained its positive trajectory and is expected to continue this trend in the medium term. During the first nine months of 2023, GDP expanded by around 3.3%, compared to the same period in 2022. The growth was mainly generated by domestic demand, both private consumption and investment. Exports, both of goods and services, especially foreign demand in the sector tourism, have had a good performance while imports have registered a lower growth rate. Economic growth for 2023 is estimated to be around 3.5%, as a result of a particularly strong tourist season, improved performance in the construction, real estate and energy sector. Regarding the medium-term perspective, economic growth is predicted at a rate of 3.7% for 2024 and an average of about 3.9% per year during the following medium-term period 2024-2026.

Inflation throughout the year 2023 has recorded an average annual level of 4.8%, following the downward trend. The downward trend of inflation was dictated by the weakening of foreign inflationary pressures, by the strengthening of the exchange rate of the Albanian Lek, as well as by the impact of the normalization rate of the monetary policy. Consequently, the Bank of Albania has followed a normalization monetary policy during 2023 by increasing the base interest rate by about 0.5 percentage points, from 2.75% at the end of 2022 to 3.25% at the end of 2023, dictating an increase of the interest rates of deposits and loans.

Fiscal consolidation will continue to be the basic objective of the fiscal policy for the medium-term period 2024-2026, in direct function of ensuring the macroeconomic stability of the country, as an essential premise for ensuring a sustainable and comprehensive economic

growth. During the medium-term period, the fiscal policy will continue to target an annual downward trajectory of the public debt, which is estimated to have decreased by 5.2 pp throughout 2023, reaching the level of 59.2% of GDP, and is expected to continue to decline further to around 58.1% in 2024.

III. Medium Term Debt Management Strategy

The Ministry of Finance 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". Currently, this Strategy is in force and is regularly monitored year after year, until the end of its term.

The 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", as amended, and it is in line with the Macroeconomic and Fiscal framework and with the monetary policy of the Bank of Albania.

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 towards the selection of instruments with favorable costs and acceptable levels of exposure to risk. Financing levels are determined in the Macroeconomic and Fiscal framework and in the Medium-Term Budget Plan divided into plans/annual borrowing volumes.

In the process 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 2023

IV.1 Progress of the general objectives of the Medium-Term Debt Management Strategy 2022-2026.

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

The year 2023 has been a very positive year in terms of securing financing, both in the domestic and foreign markets. Borrowing was carried out in accordance with the Annual Borrowing Plan for 2023 as well as in accordance with the Medium-Term Debt Management Strategy 2022-2026. During 2023, borrowing in gross terms amounted to ALL 466.0 billion, out of which 80.3% (or ALL 374.1 billion) was financed through domestic sources and 19.7% (or ALL 91.9 billion) through foreign sources.

Table 1: Borrowing Realization

Sources of Borrowing	2022		2023	
	Value (in ALL billion)	%/Total	Value (in ALL billion)	%/Total
Domestic Borrowing	357.9	92.7%	374.1	80.3%
Treasury Bills	245.5	63.6%	225.6	48.4%
Bonds	112.3	29.1%	148.5	31.9%
External Borrowing	28.3	7.3%	91.9	19.7%
Loans for project financing	11.2	2.9%	9.4	2.0%
Budgetary Support	17.1	4.4%	19.7	4.2%
Eurobonds	-	0.0%	62.8	13.5%
Total Borrowing	386.1	100.0%	466.0	100.0%

Source: Ministry of Finance, 2024

During 2023, Government issued securities in the domestic market at the amount of ALL 374.1 billion, out of which ALL 225.6 billion belong to Treasury Bills and ALL 148.5 billion belong to Bonds.

In accordance with the Medium Term Debt Management Strategy, during 2023, the frequency and value of long-term instrument issuances has increased, and as a result, the new debt has been financed entirely through long-term instruments, as well as maturing short-term instruments. The demand for government instruments has been higher than the Government's offer in almost all auctions carried out during the year, and net borrowing in the domestic market at the end of 2023 resulted at the amount of ALL 20.8 billion. Out of the total net financing, ALL 41.8 billion was secured through treasury bonds, while as regards short-term instruments, the net financing is negative at the amount of ALL 20.9 billion, which means that during 2023 the matured short term instruments were higher than the issued short term instruments throughout the year.

Chart 1: Net domestic borrowing by months³



Source: Ministry of Finance, 2024

As for external sources of financing, the borrowing during 2023 was realized at the level of ALL 91.9 billion. External borrowing was realized through the issuance of the Eurobond instrument and the disbursement of loans for projects and budget support. In June 2023, Government of Albania issued the sixth Eurobond with a value of EUR 600 million, coupon 5.9%, yield 6.125% and with a final offer (*final book*) of EUR 1.3 billion. Also, during 2023, budgetary support with favorable terms in the total value of around 185 million Euros has been disbursed by international financial institutions and bilateral partners such as the World Bank, KfW and AFD. The rest of the borrowing was realized through the disbursement of loans for the financing of projects mainly in transport, urban infrastructure, as well as water supply and sewerage sector.

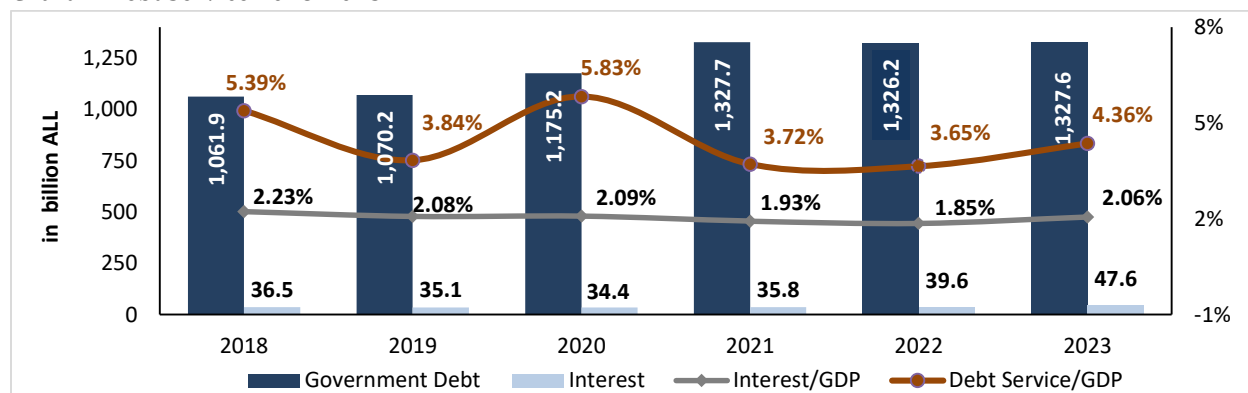
Cost

Regarding the cost and risk ratios in the debt portfolio, the debt portfolio has been managed appropriately, keeping the cost at the lowest possible level according to the market conditions, while the risk indicators have shown improvement in all indicators.

For the year 2023, expenses for debt interest were evaluated at the value of ALL 47.6 billion, respectively ALL 29.0 billion for domestic debt interest and ALL 18.6 billion for external debt interest. Repayments of the external debt for 2023 were evaluated at the value of ALL 53.2 billion (principal payments). Compared to 2022, interest expenses increased by ALL 8.0 billion (20.1% higher than 2022), mainly as a result of the increase in interest rates in the domestic and foreign markets. The increase in interest expenses was within the forecasts and in accordance with the 2023 Budget Project.

³The net funding for each month divided by the previous months was calculated.

Chart 2: Debt Service 2018-2023



Source: Ministry of Finance, 2024

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

Compared to the year 2022, which was characterized by uncertainty in the domestic market as well as a decrease in the demand for government bonds, during 2023 the situation improved significantly and the demand for government bonds returned to satisfactory levels, exceeding the Government's offer for government securities. The coverage ratio has been over 1 in almost all the auctions carried out both in the category of short-term instruments and in the category of long-term instruments. The demand for government securities has continued to rely on local (resident) investors, while the banking sector remains the main source of demand with a share over 60% of the domestic debt stock.

Within the framework of the development of the infrastructure of the primary market and the stimulation of the secondary market, activities have continued to be undertaken, which have as their objective the reduction of demand fragmentation, as well as the consolidation of *benchmark* sizes for long-term titles. The 3-year and 5-year reference bonds were successfully issued in two emission lines during 2023: specifically, the 3-year reference Bond was issued in the total amount of ALL 27.3 billion and the 5-year reference Bond was issued in the total amount of ALL 34.1 billion.

In terms of creating *benchmark* measures such as the consolidation of the number of auctions of government securities, reducing the frequency of issuance of new securities and using the reopening of existing securities have continued. In total, 98 auctions were carried out during 2023, out of which 41 auctions for short-term securities, 51 auctions for long-term securities and 6 buyback auctions for 3 and 5-year reference securities.

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, during 2023, the Ministry of Finance has conducted for the first time the evaluation of the 5 market maker banks for the year 2023. This evaluation was carried out in accordance with the Methodology for the Evaluation of Market Maker Banks (*Instruction of the Minister of Finance no. 30, dated 07.11.2022*). The purpose of this document is to describe the standard methodology followed by the Ministry of Finance in the framework of the evaluation and periodic monitoring of the performance of the activity of the 5 market maker banks related to the reference government securities. The evaluation of the activity of these banks helps in the further development of the Government securities market, in the promotion of the secondary market and further more helps in the increase of liquidity. The results of the assessment based on this methodology are presented in a consolidated report for 2023, which has been previously shared with experts of the World Bank for comments and suggestions, and as further step will be discussed with the participating banks.

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

The Ministry of Finance, for the second consecutive year, drafted and published in December 2023 the Annual Borrowing Plan for the upcoming year, concretely the year 2024⁴. The Annual Borrowing Plan for 2024 aims to support the annual borrowing activity of the Ministry of Finance, as well as to increase transparency towards investors and interested third parties.

The Annual Borrowing Plan provides in detail the instruments that will be used in the domestic market, the corresponding issuances according to each instrument as well as the frequency of issuance of each instrument. Also, the Annual Borrowing Plan details borrowing in the foreign market, specifying the value of foreign borrowing for 2024, as well as the instruments that will be used in the foreign market. Based on the Annual Borrowing Plan of 2024, quarterly borrowing calendars in the domestic market will be prepared accordingly. However, we emphasize that Ministry of Finance reserves the right to change the frequency or amount issued per instrument/month, adapting to the current market conditions.

⁴ <https://financa.gov.al/wp-content/uploads/2023/12/Plani-Vjetor-i-Huamarries-2024.pdf>

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

Continuing the initiative started in 2022, also during 2023, Ministry of Finance has assessed the possibilities of using new financing alternatives, in addition to traditional sources of borrowing. For this reason, several meetings were organized with representatives of the World Bank regarding the details of these instruments, advantages/disadvantages, the possibility of implementation, procedures and conditions for their implementation, etc.

In the conditions where these types of instruments still present a set of unknowns, Ministry of Finance 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. The World Bank has offered assistance to the Ministry of Finance and other relevant structures in deepening the assessments in this regard.

On a wider environmental and social prospect, Ministry of Finance 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 possible investment project that is intended to be financed will be evaluated considering also, as an important element/principle, environmental assessment and climate impact.

Table 2: Progress of the General Objectives

General qualitative objectives		2022	2023	2024	2025	2026
1	Meeting the government's needs for timely financing, including the needs 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	In progress			

Source: *Ministry of Finance, 2024*

IV.2. Progress of the specific quantitative objectives of the Medium-Term Debt Management Strategy 2022-2026

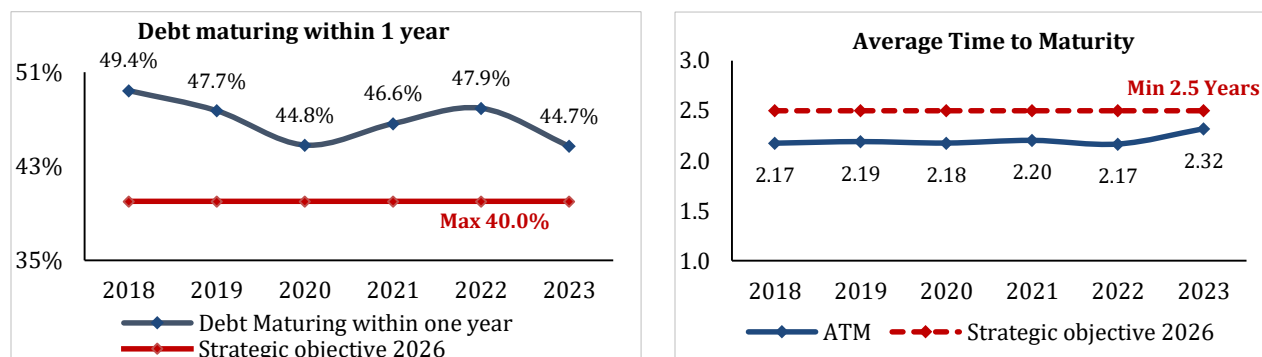
Medium-Term Debt Management Strategy aims to further improve the debt structure (*mainly the structure of the domestic debt portfolio*), in terms of reducing exposure to risks, as well as keeping costs at the lowest possible levels, based on the current conditions of the markets. During 2022, in the tight conditions of the markets, borrowing was not easy to be achieved and in the circumstances of a demand mainly oriented towards short-term instruments, the risk indicators did not show improvement compared to previous years. Meanwhile, the year 2023 has been a very positive year in terms of borrowing, and as a result, the risk indicators have shown improvement in all categories compared to the end of 2022, as well as improved compared to the base year of the strategy: the year 2021, despite the deterioration during 2022.

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 since it is composed of instruments with long maturity and amortization profiles extended over time. During 2023, in accordance with the Medium-Term Debt Management Strategy, Ministry of Finance has increased the share of medium and long term instrument issuances in the domestic market and as a result, the refinancing risk indicators have shown a significant improvement compared to the end of 2022, as well as have shown improvement compared to the base year of the Strategy (year 2021). Specifically, the average time to maturity of domestic debt has increased by 55 days, from 780 days at the end of 2022 to 835 days at the end of 2023, while compared to the end of 2021 this indicator has increased by 42 days (ATM at the end of 2021: 793 days).

Also, the share of debt that matures within one year has decreased from 47.9% in December 2022 to 44.7% in December 2023. At the same time, this indicator has improved compared to the base year of MTDS, where at the end of 2021 it was 46.6%.

Chart 3: Refinancing Risk Indicators



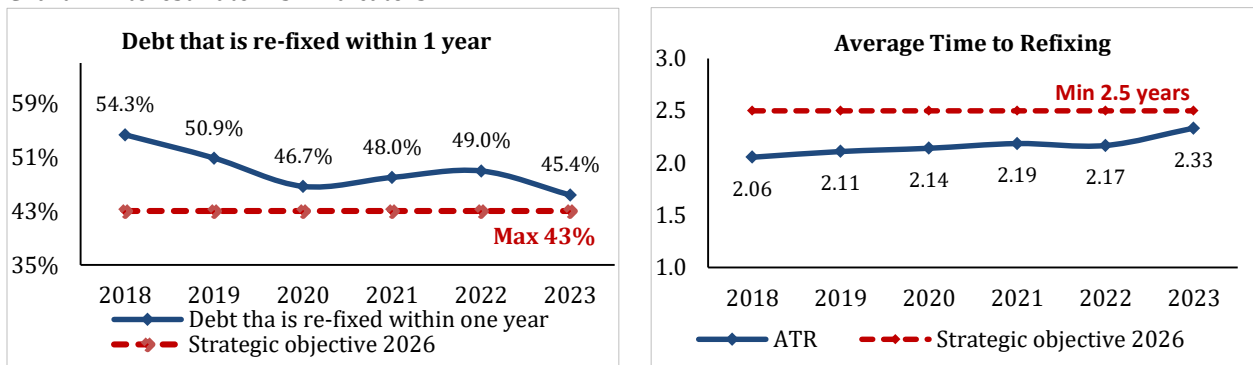
Source: Ministry of Finance, 2024

Interest Rate Risk

The interest rate risk has also improved during 2023, this in the circumstances of the increased use of medium and long-term securities as well as the result of the issuances only with fixed interest rates in the domestic market. Specifically, the share of the total debt which refixes the interest rate within one year has decreased significantly from 49.0% at the end of 2022 to 45.4% at the end of 2023. This indicator has also improved compared to the base year of MTDS, where it was evaluated at the level of 48.0 %.

Also, the average time to refixing has increased from 2.17 years at the end of 2022 to 2.33 years at the end of 2023. This indicator has significantly improved compared to the base year of the Strategy, given that in 2021 this indicator was estimated at 2.19 years.

Chart 4: Interest Rate Risk Indicators

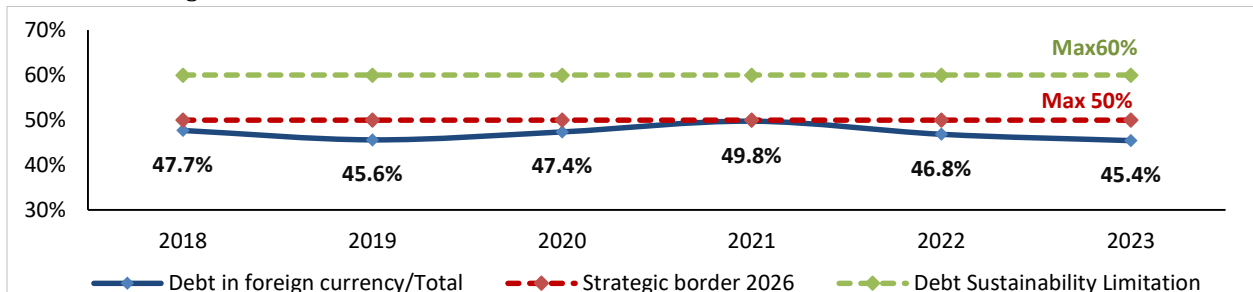


Source: Ministry of Finance, 2024

Exchange Rate Risk

Exchange rate risk has been kept under control, staying below the strategic boarder in the strategy. Specifically, the share of the total debt stock denominated in foreign currency to the total debt stock was 45.4% at the end of 2023, decreasing by 1.4 pp compared to the end of 2022, and also decreased by 4.4 pp compared to the end of 2021, showing a significant improvement. During 2023, this indicator was mainly influenced by the depreciation of the majority of foreign currencies, mainly Euro and USD, against the Albanian Lek.

Chart 5: Exchange Rate Risk



Source: Ministry of Finance, 2024

Table 3: Risk Indicators

Specific quantitative objectives	Baseline 2021	Strategic Objective 2026	Reporting Year-2023			
			Status 2022	Status 2023	ACTIVITIES	reviews
Improving Refinancing Risk						
ATM domestic debt (years)	2.20	Min 2.5	2.17	2.32	Predicted a level of borrowing which would be gradually increasingly relied on medium and long-term titles	During 2023, was enabled the intended support in medium and long-term titles, which guaranteed an improvement in the risk indicators.
Domestic debt maturing in 1 year (% of total)	46.6%	Max 40%	47.9%	44.7%		
Improving Interest Rate Risk						
ATR domestic debt (years)	2.19	Min. 2.5	2.17	2.33	The borrowing only with fixed interest rate instruments was anticipated	Borrowing was carried out only with fixed rate instruments.
Domestic debt re fixed in 1 year (% of the total)	48.0%	Max 43%	49.0%	45.4%		
Improving Exchange Rate Risk						
	49.8%	Max.50%	46.8%	45.4%	Anticipated that foreign resources will serve as complements to domestic resources.	This indicator was mainly influenced by the devaluation of most foreign currencies, mainly Euro and USD, against the ALL.

Source: Ministry of Finance, 2024