



REPUBLIKA E SHqipëRIE
MINISTRIA E FINANCËVE
DHE EKONOMISË



MEDIUM TERM DEBT MANAGEMENT STRATEGY 2022-2026

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1. INTRODUCTION

Central government debt management has faced significant challenges over the last 3 years due to the situation created by the 2019 earthquake and the subsequent spread of the Covid-19 pandemic. Nevertheless, it has been able to successfully manage the debt portfolio during this period in line with the macro-fiscal objectives, government financing needs and medium-term strategic objectives of debt management.

The market's demand in government bonds has responded positively to budget financing needs, therefore borrowing has been carried out in accordance with increased budgetary needs during 2020 and 2021, enabling the government to refinance existing debt, meet liquidity needs and finance the budget deficit. Over the past five years, domestic financing has been the primary source in meeting increasing gross borrowing needs. However, during 2020 and 2021, external borrowing also played an important role in terms of ensuring liquidity and repayment of debt denominated in foreign currency. Borrowing from external sources, which was increased during the last two years, compared to previous periods, was dictated by the drop in interest rates in international markets, as well as by favorable financing conditions from international financial institutions. The main development in this regard was the issuance of the Eurobond, which not only helped government meeting its liquidity needs, but also sent a positive signal to the market regarding its ability to generate funds and the stability of public finances in the Republic of Albania.

Over the last 3 years, the strategic objectives of debt management have generally been met, both in terms of achieving optimal cost-risk trade-offs and in the development of the government securities market.

Lower risk exposure was achieved through increased concentration of domestic borrowing on long-term securities and fixed interest securities. On the other hand, the decline in interest rates coupled with the increased use of bilateral and multilateral sources of external financing, has led to the improvement of the overall cost of borrowing.

At the end of 2021, public debt reached 73.2% of GDP, with the debt rising considerably in the last two years, even though the fiscal policy's objective is to put the debt to GDP ratio on a declining path for the coming years, in accordance with fiscal rules and principles, until it falls to 45%. Despite the high level of debt, caused by extraordinary circumstances that have affected all the countries and the global economy, the effective management of the public debt has enabled maintaining a portfolio with acceptable cost and risk ratios.

2. LEGAL AND REGULATORY FRAMEWORK

The Medium Term Debt Management Strategy (MTDS) is a medium-term plan which outlines the financing plans and the activities that will be undertaken in the medium term to ensure effective management of the public debt. Pursuant to 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, the MTDS is prepared and updated by the Ministry of Finance and Economy on a regular basis.

MTDS preparation and updating is in line with the Annual Budget Law, Macroeconomic and Fiscal Framework, and the monetary policies implemented by the Bank of Albania over the medium term.

The Annual Budget Law, determines the amount of borrowing that will be obtained during the following year and the maximum nominal level (limit) of debt at the end of the fiscal year, in compliance with fiscal rules and principles set out in Law “On the Management of the Budgetary System in the Republic of Albania”. Borrowing is obtained in accordance with the Annual Budget Law, and generally serves to cover the refinancing of existing debt, government liquidity needs and the budget deficit planned for the actual year.

For the preparation of the MTDS, the Ministry of Finance and Economy constantly collaborates with World Bank experts, who support this important process through technical assistance missions established for this purpose.

3. OBJECTIVES AND PURPOSE

The primary objectives of the Medium Term Debt Management Strategy (MTDS), implemented by the Ministry of Finance and Economy, are as follows:

- To meet the government's needs in a timely manner, including the need to service the current debt at the lowest possible cost while maintaining acceptable risk exposure levels;
- To improve and sustain primary market efficiency, supported by further development of the secondary market.

The purpose of MTDS is:

- Efficient management of the central government debt portfolio, which includes government debt and state loan guarantees, with a focus on reducing risk exposure;
- Increased transparency towards investors and stakeholders concerning government borrowing plans; and
- Quantification of short and medium term objectives, to enable consistent monitoring of its implementation.

4. TREND OF INDICATORS RELATED TO THE OBJECTIVES SET OUT IN THE MTDS 2021-2023

In 2021, the central government debt portfolio management has been carried out in accordance with the objectives outlined in the previous strategy 2021-2023, approved by DCM no. 38, dated 27.01.2021. The objectives set out in the 2021-2023 Strategy were: (i) Meeting the government's needs for timely financing, including the need to service current debt at the lowest possible cost while maintaining acceptable risk exposure levels; as well as (ii) Improving and sustaining primary market efficiency, supported by further development of the secondary securities market. The detailed analysis of the progress of the indicators with reference to the established objectives is presented as follows:

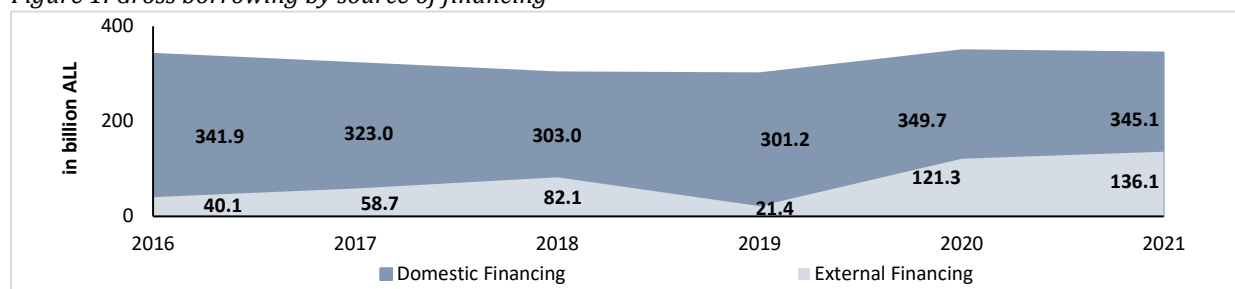
4.1. Meeting the government's funding needs with reference to the objective set in the 2021-2023 SAMB

4.1.1. Meeting government's financing needs in a timely manner

During the last two years 2020, 2021 borrowing needs increased significantly, compared to previous years, due to the 2019 earthquake, the Covid-19 pandemic, and the need to stimulate economic recovery following the recession in 2020. Despite growing financing needs, borrowing has fully met budgetary needs, and existing debt obligations, in a timely and cost-effective manner while maintaining prudent levels of risk exposure.

During 2021, gross borrowing amounted to ALL 481.2 billion, of which 71.7% (or ALL 345.1 billion) was financed through domestic sources (government securities¹) and 28.3% (or ALL 136.1 billion) through external sources. Government securities issued by the Ministry of Finance and Economy in the domestic market amounted to ALL 345.1 billion, of which ALL 296.3 billion served for the refinancing of existing securities. Despite the uncertainty created in the economic environment and in the financial market, most of the new debt consisted of borrowing through long-term securities (about 96.6% of net financing), in line with the medium-term strategic objectives regarding the reduction of the refinancing risk and interest rate risk. During 2021, borrowing in the external market amounted All 136.1 billion. Gross external borrowing has increased by ALL 14.8 billion compared to 2020, with borrowing for Budgetary Support having the largest increase.

Figure 1: Gross borrowing by source of financing

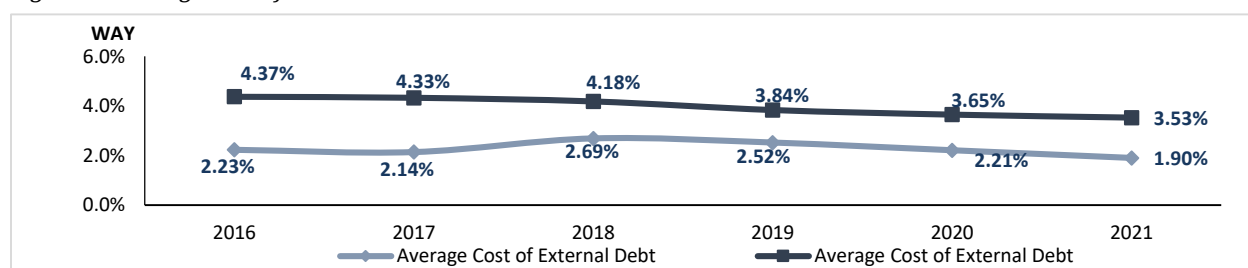


Source: Ministry of Finance and Economy 2022

4.1.2. Meeting government’s financing needs for current debt servicing at the lowest possible cost

The favorable conditions in the domestic and foreign markets related to the demand for sovereign debt and the low level of interest rates, accompanied by a borrowing strategy mostly based on long-term fixed interest rate securities have enabled further reduction of risk exposure while maintaining costs under control. The weighted average cost of the government debt portfolio has continued its downward trend in 2021. The average cost of external debt has decreased by about 0.31 pp and the average cost of domestic debt has decreased by 0.12 pp. The decrease in the average cost of domestic debt was mainly due to low interest rates in the domestic market during 2021, and due to refinancing of maturing debt with less costly long-term debt.

Figure 2: Average cost of debt



Source: Ministry of Finance and Economy 2022

4.1.3. Maintaining risk exposure at a prudent level

The exposure of the debt portfolio to risks has been managed successfully, in line with the medium-term strategic objectives. In this direction, the risk ratios in the domestic debt portfolio have been able to be managed at stable levels. The declining share of short-term securities and variable rate securities in the debt portfolio, were the main determinants of reduction of refinancing risk and interest rate risk. In this regard, the two main indicators such as the Average Time to Maturity and the Average Time to Refixing have shown

improvement until the end of 2021. On the other hand, the other two indicators, specifically, the share of the debt that matures within a year and the share of the debt which refixes within a year, have shown an increase in the most recent year, this in the circumstances of the regular use of short-term instruments (3 and 6-month treasury bills) as well as in the conditions of considerable values of long term maturities during 2022, such as benchmark instruments or bonds denominated in EUR.

However, considering the investor base which is not very diversified, the domestic debt remains exposed to the abovementioned risks, making it necessary to continue the measures for the further restructuring of the portfolio and the development of the securities market.

The exchange rate risk has generally been kept under control by remaining below the strategic limit set out in the strategy. However, the indicator for such risk has evolved since the share of debt denominated in foreign currency has increased over the last two years due to the high level of borrowing in external markets, including borrowing for budget support.

Table 1: Evolution of risk indicators

Risk		2017	2018	2019	2020	2021	Medium term Objective 2023
Refinancing Risk	Debt maturing in one year	50.04%	49.42%	47.71%	44.79%	46.61%	Max 45%
	ATM	2.17	2.17	2.19	2.18	2.20	2.2-2.4 years
Interest Rate Risk	Debt re-fixing the interest rate in one a year	56.7%	54.3%	50.9%	46.7%	48.0%	Max 48%
	ATR	1.96	2.06	2.11	2.14	2.19	Min 2.2 Years
Exchange Rate Risk	Debt in foreign currency/Total	48.74%	47.70%	45.60%	47.38%	49.78%	Max 55%

Source: Ministry of Finance and Economy 2022

4.2. Improving and sustaining primary market efficiency, supported by further development of the secondary market.

The primary market of government securities has generally been characterized by positive developments over the last two years, among which we can mention: i) sufficient market demand for government securities to meet financing needs in accordance with the strategic objectives and; ii) activities undertaken towards improvement of the market securities infrastructure.

Market demand for government securities has generally been stable, and has not shown significant volatility in recent years. Domestic (resident) investors constitute the majority of the investors, whereas the banking sector remains the main source of demand. There is significant improvement in the coverage ratio (demand/supply). Despite the increasing financing needs and the uncertainty created by the pandemic during 2020, 2021 and

onwards, the domestic market has fully met the government’s financing needs, reflecting investor confidence in the Republic of Albania and the well capitalized banking sector.

To promote the development of the primary market infrastructure and stimulate the secondary market, MoFE has continued to undertake specific activities, which aim to reduce fragmentation in demand, and create benchmarks and consolidate issuances to reach specific *benchmark* sizes for long-term securities.

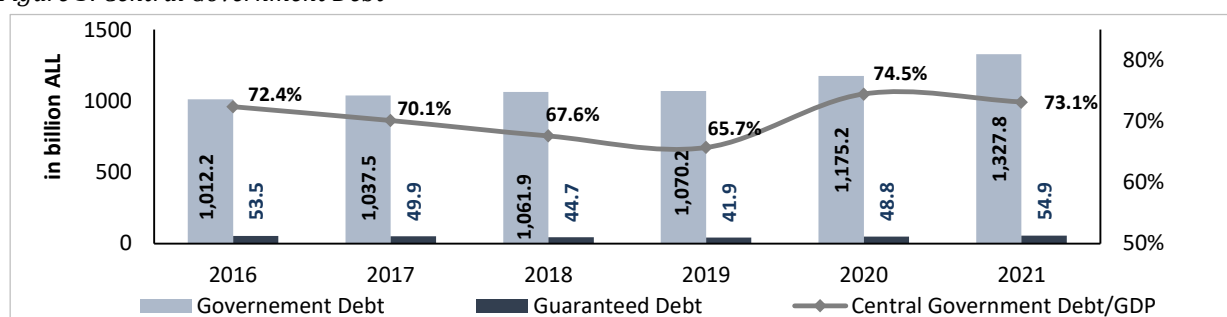
In terms of reaching benchmark sizes, it has continued with the consolidation of the number of auctions for government securities, by reducing the frequency of issuing new securities and reopening of existing securities.

5. CURRENT SITUATION OF THE CENTRAL GOVERNMENT DEBT PORTFOLIO

5.1. Central Government Debt

During 2017-2019, the Central Government Debt was on a downward trajectory marking a decline of 4.4 pp, from 70.1% of GDP at the end of 2017 to 65.7% of GDP at the end of 2019. Whereas during 2020 and 2021, the Central Government Debt increased, reaching to 73.1% of GDP at the end of 2021. The increase of the debt level over the last two years was due to the growing financing needs after the 2019 earthquake, the Covid-19 pandemic, and the need to stimulate economic recovery after the great recession in 2020. The upward revision of projections for the nominal growth of the economy led also to the revision of the debt to GDP indicator, and the debt for 2021 was estimated at 73.1% of GDP, compared to 78.1% forecast of the Ministry of Finance and Economy using the initial GDP estimation.

Figure 3: Central Government Debt



Source: Ministry of Finance and Economy 2022

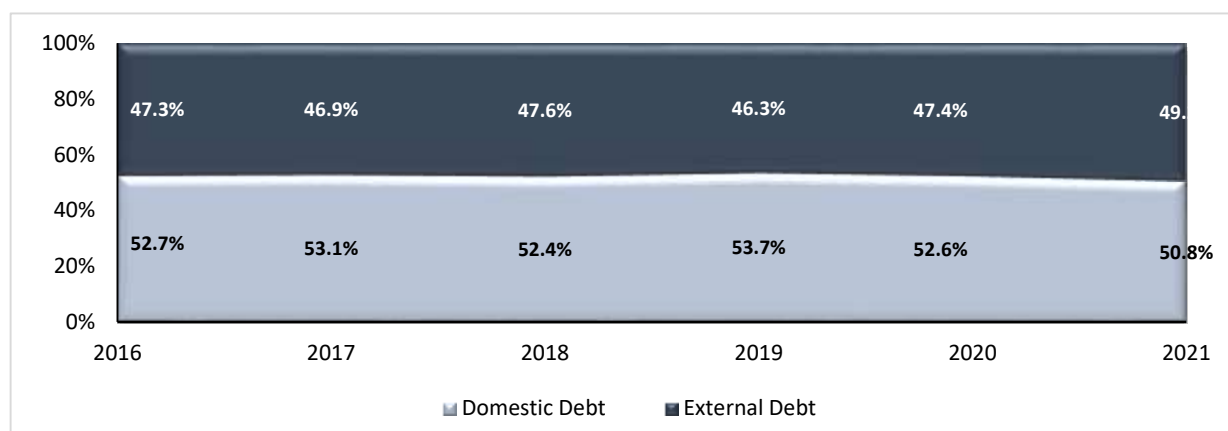
In the total central government debt portfolio, government debt holds the main weight of the portfolio (over 95% of the total portfolio), while guaranteed debt constitutes a small part of the total central government debt portfolio. At the end of 2021, the guaranteed debt portfolio amounts at ALL 54.9 billion, 4.0% of the central government's debt portfolio. More than half of the guaranteed debt portfolio consists of external guarantees, while in terms of composition by sector, more than 60% of the total government guarantees belong to the energy sector, reflecting the government's policies in terms of support of the energy sector, within the framework of improving financial performance, increasing efficiency and support within the framework of the declaration of the state of emergency in the electricity supply.

5.2. Debt Portfolio Composition

5.2.1. Instrument composition of the debt portfolio

External debt rose by 2.3 pp between 2017 to 2021, with the share of external debt in total debt portfolio increasing from 46.9% at end 2017 to 49.2% at end 2021. This increase in the share of external debt was primarily due to higher share of international securities, reflecting the borrowing policies adopted in recent years, aimed to reduce the borrowing pressure in the domestic market to facilitate the restructuring of domestic debt and stimulate lending to the private sector.

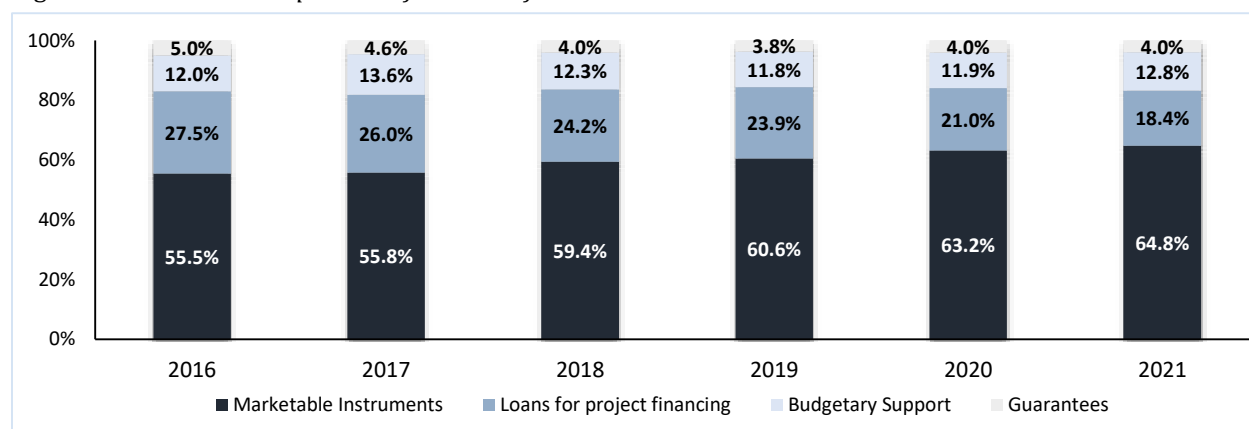
Figure 4: Domestic Debt Vs External Debt



Source: Ministry of Finance and Economy 2022

Regarding the instruments composition of the central government's debt portfolio, marketable instruments continue to hold more than half of the weight (*treasury bills, bonds, eurobonds*), followed by external loans for project financing and loans in the form of budgetary support.

Figure 5: Instrument Composition of Debt Portfolio



Source: Ministry of Finance and Economy 2022

Meanwhile, in the external debt portfolio, the largest share is held by loans for project financing from bilateral and multilateral creditors, even though there was a decrease of their share by 18.4 pp from 2017 to 2021. Meanwhile, the share of securities in international markets (*Eurobond*) has increased by 21.3 pp from 2017-2021.

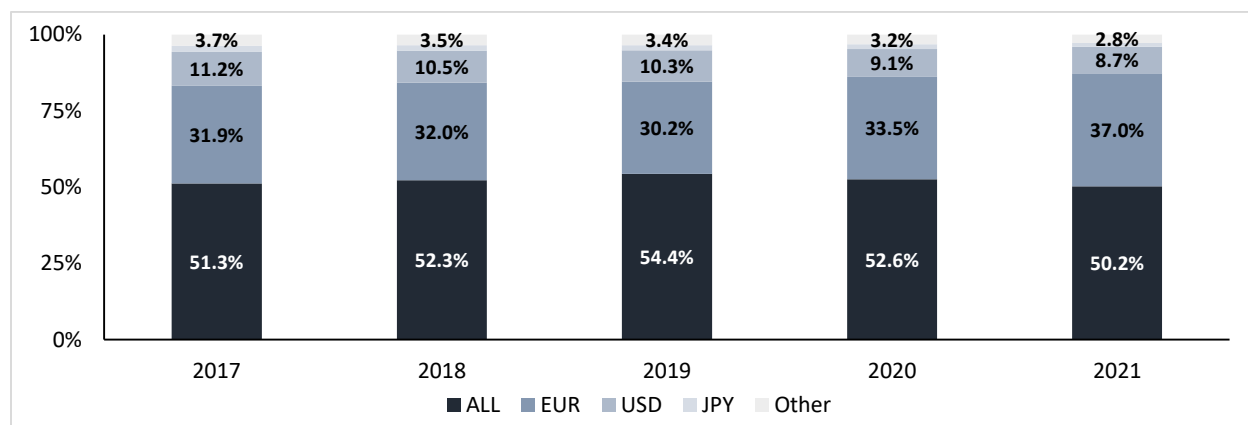
5.2.2. Currency composition of the debt portfolio ²

The largest share of the government debt, over 50% of the total debt, is in local currency, followed by Euro and US dollar. Domestic debt is mostly denominated in local currency, and only a small portion is denominated in Euro.

Whereas, the external debt is entirely denominated in foreign currency, with about 70% denominated in Euro, followed by US dollar. The share of debt denominated in Euro has continued to increase in recent years, due to the Eurobond issuance and the disbursement of certain Budgetary Support loans in euro. However, the high share of debt in euro is in line with the country's integration policies in European Union.

² Guarantees are not included.

Figure 6: Debt Portfolio by Currency

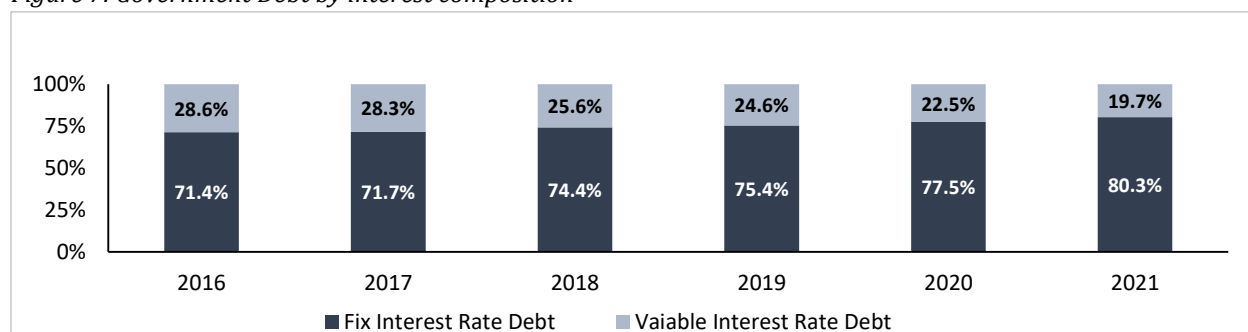


Source: Ministry of Finance and Economy 2022

5.2.3. Interest composition of the debt portfolio ³

The fixed interest rate debt accounts for more than 70% of the total government debt. During 2017-2021 the share of fixed interest rate debt has increased by 8.7 pp in line with the objective of reducing interest rate risk. In the domestic debt portfolio, in line with the objectives for reducing interest rate risk and avoiding the fragmentation of demand for securities with similar maturities, the share of variable interest rate securities has been reduced. Since 2016 no new variable rate securities have been issued. In the external debt portfolio, over 60% of the share is held by fixed interest rate debt, marking an increase of almost 12 pp from 2017 to 2021

Figure 7: Government Debt by interest composition



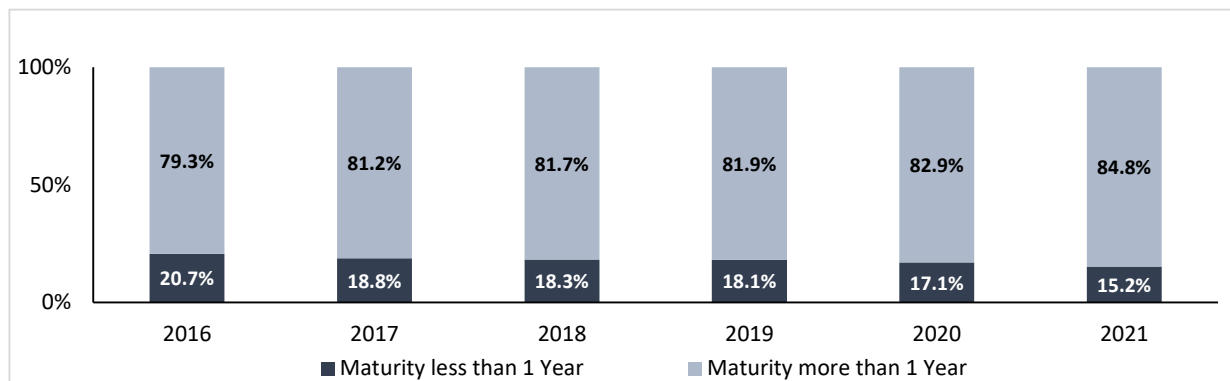
Source: Ministry of Finance and Economy 2022

³ Guarantees are not included.

5.2.4. Maturity composition of the debt portfolio ⁴

The share of the short-term debt decreased by 3.6 pp in the five-year period 2017-2021.

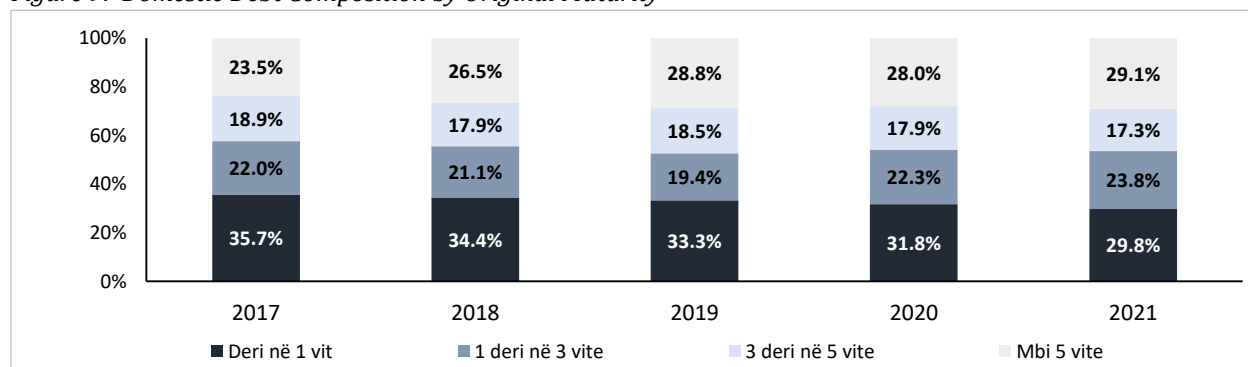
Figure 8: Debt maturity composition



Source: Ministry of Finance and Economy 2022

In the domestic government debt portfolio, short-term securities hold the largest share in the government domestic debt, but their share has been gradually declining in line with the refinancing risk reduction objective. Meanwhile, the share of long-term debt has increased, as a result of securing new financing almost entirely through long-term government bonds. Additionally, a 15-year bond issuance was inaugurated in 2021. Whereas, the external debt portfolio is totally composed of long-term securities.

Figure 9: Domestic Debt Composition by Original Maturity



Source: Ministry of Finance and Economy 2022

⁴ Guarantees are not included.

6. MACROECONOMIC SITUATION AND MEDIUM-TERM PERSPECTIVE

6.1. Credit Rating

Credit rating of the Republic of Albania is carried out by two major agencies: Moody's and Standard & Poor's. Both of these agencies provide annual credit rating reviews for Albania. Recent assessments by the two credit rating agencies have also covered the country's economic growth and sustainability, institutional and governance capacity, fiscal policy, and sensitivity to potential risks. The rating agencies point out that based on the continuous data on indicators used, Albania's credit profile appears to balance the progress on the implementation of reforms in pursuit of joining EU and the continuous structural economic challenges and limited institutional strength, compared to other countries. Nevertheless, Albania's credit profile is exposed to external shocks due the small size of its economy.

Table 2: Albania's credit ratings for the last years

	2019	2020	2021	2022
Moody's	B1 (Stable)	B1 (Stable)	B1 (Stable)	B1 (Stable)
Standard & Poors	B+	B+	B+	B+

Source: Ministry of Finance and Economy 2022

6.2. Macroeconomic Situation

In recent years, until the onset of the Covid-19 pandemic, public finances had embarked on a safe and optimal trajectory of fiscal consolidation, materialized in the most crucial parameters of sustainability. Firstly, the overall deficit narrowed from 5% of GDP in 2013 to less than 2% of GDP in 2019. In 2020, a highly expansionary fiscal policy was undertaken as the main counter response to mitigate the effects of the pandemic shock. Consequently, total deficit reached up to 6.7% of GDP and public debt surged to 74.5% of GDP, or about 9 pp compared to the end of 2019.

As a result of the recession, the economy shrank by 3.5 percent in 2020, with GDP reaching -11.1 percent in the second quarter due to the global pandemic, but showing signs of recovery and returning to positive territory in the last quarter of the following year. During 2021, the country's economy showed encouraging signs, registering a rapid recovery represented by a GDP increase of 8.5 percent in 2021 compared to 2020, according to the latest estimates from INSTAT. A wide range of factors contributed to this recovery which was reflected in almost all sectors of the economy. The reduction (almost removal) of travel restrictions as the number of Covid-19 cases continued to decline, especially due to mass vaccination, the increased business and consumer confidence, the economic recovery of its

trading partners, and continued fiscal and monetary policy support have contributed to consumption, public and private investments, and exports growth. The manufacturing and service sectors have also benefited from these developments, contributing to business and employment recovery and creating good premises for the medium perspective.

The Albanian economy experienced a strong rebound in 2021 following previous year's recession. The government managed to keep the effects of the pandemic under control through fiscal and monetary policies intertwined with regulatory measures. Growth turned out to be stronger and more broadly based than anticipated. Electricity production also had a basic effect and impact on growth. Demand recovered rapidly and production surpassed pre-earthquake and pre-pandemic levels. Labor market indicators have also improved, reflecting an increase in employment and decrease in the unemployment rate. The manufacturing and service sectors have also benefited from these developments, contributing to business and employment recovery and creating good premises for the medium term outlook.

Based on the economic outlook, growth is projected to remain on positive levels and retain stability over the medium term, assuming that the evolution of the pandemic will stay within some moderate limits in the upcoming months, and that the major economic and financial foundations will not suffer any problematic shocks and are normally expected to continue to remain relatively solid.

Growth at 8.5% in 2021 represents a very strong rebound, significantly above the initial forecast. In the medium term, growth is projected to converge and stabilize to around 4%, which is the potential growth rate estimated by the Ministry of Finance and Economy. Albania's medium-term economic growth is projected at 3.2% in 2022, 3.9% in 2023 and 4.0% in 2024.

In line with medium-term growth forecasts, employment is expected to increase at an average rate of 1.3% per year during the period 2022-2024. A higher labor force participation rate will be the main driver of labor supply growth.

From 2022 onwards, the medium term fiscal policy will be oriented towards fiscal consolidation, in line with the fiscal rules set out in the Organic Budget Law (OBL). Fiscal consolidation and public debt reduction are essential steps to minimize debt-related vulnerabilities that hinder growth and cause macroeconomic instability.

The fiscal policy target will be to put the public debt in a downward path i.e. a gradual annual downward trajectory, with the primary balance expected to return to positive levels from 2024 onwards, in accordance with the fiscal rule set out in the OBL. The primary balance is

still expected to be negative in 2022, at around -2.0 percent, but with a slight improvement from the level of about - 2.6 percent in 2021. The fiscal deficit is targeted at 4.5 percent of GDP in 2022, remaining unchanged from 2021. Current fiscal balance (the difference between public investment and fiscal deficit) is projected to be positive in 2022, at an average of 1 percent of GDP from an expected positive level of 2.3 percent for 2021, in accordance with the respective fiscal rule (the “golden rule” of the budget).

The budget deficit in the medium term 2022-2024 is forecasted to be about 3.0 percent on average per year. More specifically, the overall fiscal balance is targeted at -4.5, -2.2 and -2.2 percent for 2022, 2023 and 2024 respectively. The primary balance during the medium-term 2022-2024 is forecasted to be about -0.1 percent on average per year.

Therefore, the level of public debt is projected to resume a downward path from 2022, in line with the respective fiscal rule, and is expected to fall from about 73.2 percent in 2021 to about 71.3 percent of GDP. By end of 2023, public debt is expected to fall to about 70.2 percent of GDP and about 68.6 percent in 2024. The primary balance is expected to return to positive levels (primary surplus) from 2023 onwards. This objective is already legally sanctioned in the fiscal rule set out in the OBL stating that in each annual budget law starting from 2024 and onwards, the actual primary balance cannot be negative, it must be at least balanced (zero) or positive. Under the baseline scenario, public debt is expected to fall to around 66.7 percent by 2025 and further to around 58.9 percent by 2028.

At the same time, the central government will maintain a level of annual public investment on average around 5.6 percent of GDP per year during 2022-2024, which is essential to support potential growth in the medium and long term.

Interest rates in foreign and domestic markets are expected to increase in the medium term for all debt instruments. In 2022, the Bank of Albania increased the policy rate from 0.5% to 1%, which was instantly reflected in all sovereign debt instruments. Also, based on the Federal Reserve and the ECB statements which articulate their expectation of rising interest rates, new loans disbursed during 2022 had higher interest rates compared to 2021.

The key component of the financing need in the medium term is the government’s need to finance its deficit. In addition to deficit financing, borrowing serves to meet liquidity needs, to refinance existing debt, and to manage foreign currency debt liabilities. Financing needs are projected to remain high in the medium term (2022-2026), based on the latest macroeconomic projections.

7. FINANCING SOURCES

In order to service existing debt and to meet the government's financing needs, a preliminary assessment of the conditions in domestic and international capital markets has been carried out to determine the potential sources of financing.

In the domestic market, close contacts are kept mostly with the banking sector. Domestic borrowing conditions are monitored closely in order to adapt to market preferences, market demand (to revise the borrowing calendar when necessary) and adjust the type of instruments issued (based on the government's needs for liquidity).

Assessments have also been carried out in the external markets to identify the terms and conditions under which foreign investors would provide financing to the Republic of Albania. Based on these assessments, the potential sources of financing in the medium term 2022-2026 have been determined.

7.1. Domestic Financing Sources

The outburst of the Russia-Ukraine conflict and the situation caused by the global Covid-19 pandemic, has significantly increased the challenges faced by governments to borrow, due to the growing financing needs.

In the medium term, the domestic market will continue to be the main source of financing, covering most of the central government's borrowing needs. The main instruments that will be used to raise funding are government securities (Treasury Bills and Treasury Bonds). The issuance of short-term securities will allow an active management of liquidity needs and will aim an improvement of the annual maturity profile. Meanwhile, the new debt, intended to cover part of the overall deficit, will be intended to be covered through long-term bonds. Long-term securities are planned to be issued with fixed interest rates, however, not excluding the issuance of securities with variable interest rates in the medium term, depending on the conditions of the domestic market (demand preferences, interest rate trends, etc.), to ensure the improvement of costs in accordance with the objectives set to manage the risks of the debt portfolio.

Domestic borrowing will continue to rely mostly on the banking sector, despite the positive intentions on the increase of activity of non-financial institutions, non-resident investors and individuals in the government securities market.

The banking sector will tend to be mostly oriented towards treasury bills and medium-term securities due to parent bank policies and restrictions related to liquidity ratios, capital burden and exposure to sovereign debt. However, the orientation of the banking sector towards short-term securities is expected to be offset by the increase in demand in other categories and their orientation towards long-term securities.

7.2. External Financing Sources

External sources of financing are a good complement to domestic sources and will, among other things, be used to decrease the debt cost, because these sources are well diversified and provide financing opportunities not only under commercial terms, but also in concessional/semi concessional terms. The main instruments that the government plans to use in securing external financing are: i) semi concessional loans, which will finance existing projects and new projects considered as a priority by the government for the development of the country; ii) soft loans granted by international financial institutions to support the country in recovering from disasters (such as the November 2019 earthquake and the Covid-19 pandemic, including the crises created by the Russia-Ukraine conflict) and to support development policies and reforms undertaken by the government; and iii) capital market financial instruments on an opportunistic basis, mainly to enable the management of foreign currency debt liabilities and to optimize portfolio risks.

7.3. New financing alternatives

In addition to traditional borrowing instruments, the Ministry of Finance and Economy is also considering the use of other alternative financing instruments. As climate change is becoming a potential threat to societies and economies, and is therefore associated with elevated environmental, economic and social costs, new alternatives are being evaluated to address these challenges which require increased efforts from the governments. Based on international experience, in recent years, new instruments such as *Green Bonds*, *Social Bonds*, *Sustainability Bonds* and *Sustainability-Linked Bonds* have become important tools to address the impacts of climate change and the challenges associated with them. Some of these new alternatives that are under evaluation are provided below:

- *Green bonds*: are any type of bond instrument where the proceeds, or an equivalent amount, will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible green projects (*ICMA, Green Bond Principles, 2021*). The “green projects” categories recommended by the Green Bond principles include: energy, buildings, transportation, water and wastewater, pollution prevention and control, sustainable management of living natural resources including land use,

agriculture and forestry, energy-intensive industries, and information and communication technology (ICT).

- *Social bonds*: are any type of bond instrument where the proceeds, or an equivalent amount, will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Social Projects (*ICMA, Social Bonds Principles, 2021*). Social project categories include affordable basic infrastructure, access to essential services, affordable housing, employment generation, food security, and socio-economic advancement.
- *Sustainability Bonds*: are any type of bond instrument where the proceeds, or an equivalent amount, will be exclusively applied to finance or re-finance a combination of both green and social projects (*ICMA, Sustainability Bond Guidelines, 2021*).
- *Sustainability-Linked Bonds*: (“SLBs”) are any type of bond instrument for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined Sustainability/ ESG (environmental, social and governance) objectives (*ICMA, Sustainability-Linked Bond Principles, 2020*).

During the evaluation of new instruments, the Ministry of Finance and Economy shall consider the following components for each of the instruments.

Table 3: Principles of Financial Instruments⁵

Green, Social, Sustainability Bonds	Sustainability-Linked Bonds (“SLBs”)
Core components:	Core components:
1- Use of proceeds	1- Selection of Key Performance Indicators (KPI)
2- Process of Project Evaluation and Selection.	2- Calibration of Sustainability Performance Targets (SPTs)
3- Management of proceeds	3- Bond characteristics
4- Reporting	4- Reporting
Key recommendations:	5- Verification
1- Regulatory framework	
2- External reviews	

Source: (*ICMA, Green Bond Principles, 2021*).

⁵ Green Bond Principles, through the core components and main recommendations, highlights the transparency, accuracy and integrity of the required information that will be disclosed and reported by issuers to stakeholders.

Advantages and Disadvantages of these alternative financing instruments are presented below.

Advantages:

- Strong investor demand as they provide financial returns and at the same time support environmental, social and governance causes.
- Positive environmental and/or social impacts.
- Signaling. The signal of commitment prompts others' mobilization for the cause. Diversification.
- Reputational benefits (e.g. marketing can highlight the issuer's green/social credentials and support to green investments).
- Access to "economies of scale" as majority of issuance costs are in setting up the processes.
- Increased transparency and accountability on the use and management of proceeds, becoming an additional risk management too.

Disadvantages:

- Challenges and uncertainties regarding the issuance of these new financing instruments, as the market is still under-developed.
- Green, Social, Sustainability Bonds are no longer "cheaper".
- The combination of promises to bond buyers and fiscal austerity may have unpleasant unintended consequences.
- It is not easy to identify "impact" of project implementation.
- Over time, linking bond proceeds to specific public expenditures can lead to more expensive funding, or even under-funding.

8. ALTERNATIVE STRATEGIES AND SELECTION OF THE BASE STRATEGY

Based on the World Bank/IMF framework for the preparation of the Medium Term Debt Management Strategy⁶ (MTDS Model), the following alternatives of the Borrowing Strategy have been analyzed. The model generated the results of the key indicators for each of the Alternative Strategies, which are summarized in the following table 4 “Risk Indicators of the alternative strategies”.

Table 4: “Risk Indicators of the alternative strategies”⁷

Risk Indicators		End of 2026			
		S1	S2	S3	S4
Interest expenditure as % of GDP		3.2	3.1	3.2	3.2
Average interest rate (percentage)		5.6	5.5	5.6	5.6
Refinancing Risk	Debt maturing within one year (percentage of total)	28.7	34.9	25.4	25.7
	Debt maturing within a year (% of GDP)	17.5	21.3	15.5	15.7
	Average Time to Maturity of External Debt (years)	6.9	6.6	7.1	7.2
	Average Time to Maturity of Domestic Debt (years)	3.0	2.6	3.3	2.9
	ATM Total Portfolio (years)	4.7	4.7	5.0	5.3
Interest rate Risk	Average Time to Re-fixing (years)	3.7	3.4	3.9	3.9
	Debt re-fixing within one year (percentage of total)	42.0	46.4	39.5	43.3
	Fixed rate instruments (percentage of total)	85.8	87.6	85.0	81.5
	Treasury bills (percentage of total)	14.6	20.8	11.2	12.5
Exchange rate Risk	Share of external debt to total	44.8	39.8	45.2	55.0

Source: Ministry of Finance and Economy 2022

Strategy (S1) – represents the current strategy and is based on continuity of implementation using the last year’s trend. According to this strategy the domestic financing sources meet most of the total financing needs (about 85% on average over the strategy period), whereas the external financing sources are used to meet the remaining part of the financing needs (about 15% on average). This strategy assumes that domestic financing for 2022-2026 shall be managed through the issue of stable amounts of treasury bills over the years of about 63% of total domestic borrowing on average, followed by medium-term instruments such as 2, 3 and 5-years bonds on an average of about 26% of total domestic

⁶ The methodology and operation of the MTDS Model is presented in Annex 1

⁷ These result have come out considering baseline macroeconomic indicators.

borrowing, and long-term instruments, at about an average of 11% of total domestic borrowing. Issuing Eurobonds in the international capital markets, is planned to be an important source of external financing, with a number of issues in the international markets foreseen to take place during the five-year term of the strategy. Financing through other external sources, mostly loans provided by International Financial Institutions and other development project partners, shall be the same as the amounts forecasted in macroeconomic projections for projects financed through foreign funds/loans, whereas the remaining gaps will be financed through budgetary support loans, with the intention to use all the opportunities to obtain these types of financing means, in order to improve the cost of debt.

Strategy (S2) - represents a strategy that highly depends on domestic financing, which would be a possible financing alternative in a hypothetical situation where international markets would show a constraint on meeting financing needs. According to this alternative strategy, the total financing needs are met using domestic sources of financing at about 90% on average over the strategy period, whereas external sources would meet the remaining part of the financing needs (about 10% on average). As far as the financing through domestic sources would be significantly higher, this source of financing will be largely based on short-term instruments (67% on average) in order to meet the financing needs. External financing will mainly be based on loans for financing development projects and available budgetary supports. According to this strategy, only one Eurobond will be issued during the whole strategy period, and this issuance will take place during the maturity year of one of the existing instruments issued in the international markets.

Strategy (S3) - represents a strategy, which like S1, uses mainly the domestic sources of financing to meet the financing needs, 85% on average, whereas external sources will meet the remaining part of the financing needs, 15% on average. Unlike S1, this strategy assumes that domestic financing in 2022-2026 will be based on issuance of treasury bills in a downward trend over the years, about 58% on average of total domestic borrowing during the strategy period, followed by issuance of medium-term instruments, which will be in an upward trend year by year (29% on average of total domestic borrowing), and long-term instruments at an average of 13% of total domestic borrowing. Issuing Eurobonds in international capital markets, is planned to be an important source of external financing, with 2 to 3 issues in the international markets foreseen to take place during the five-year term of the strategy. Financing through other external sources, mostly loans provided by International Financial Institutions and other development project partners, shall be the same as the amounts forecasted in macroeconomic projections for projects financed through foreign funds/loans, whereas the remaining gaps will be financed through budgetary support loans, with the intention to use all the opportunities to obtain these types of loans, in order to improve the cost of debt.

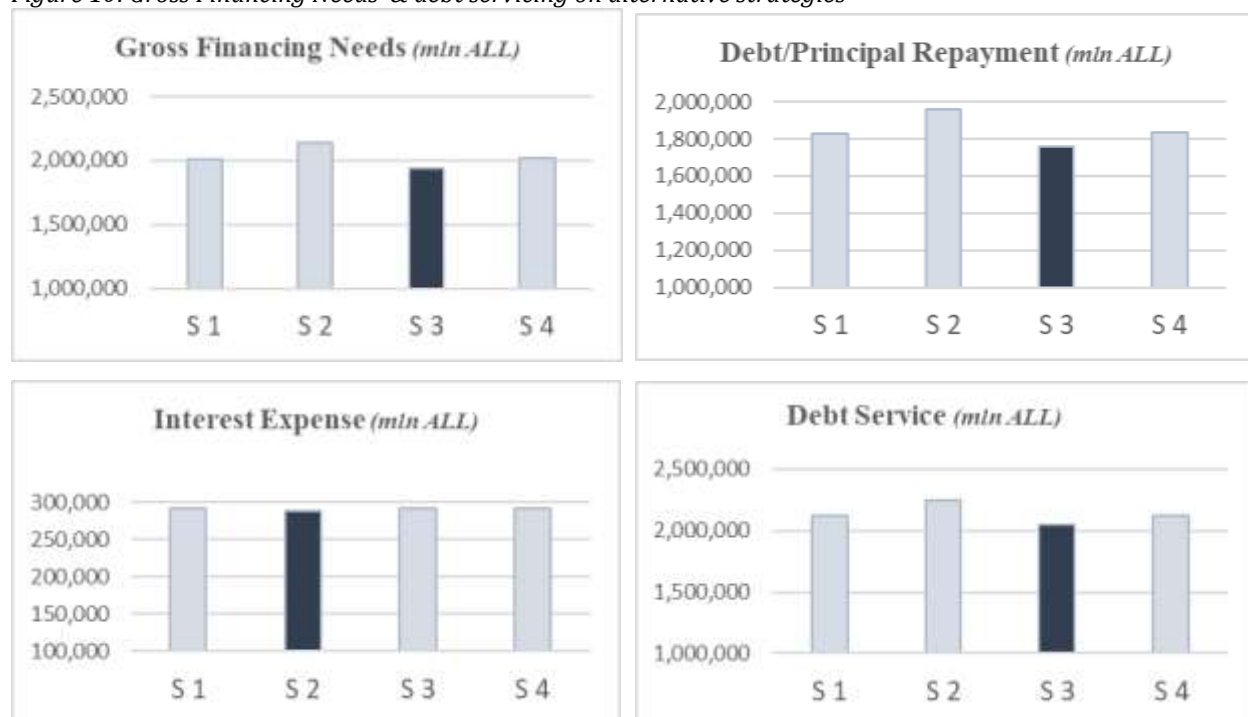
Strategy (S4) - represents a strategy with a broader reliance on external funding sources, which would be a possible financing alternative in a situation with significant capacity limitations of the domestic market to meet the financing needs. According to this alternative strategy, domestic sources of financing are used to meet about 80% of the total financing needs over the strategy period, whereas external sources will be used to meet the remaining part of the financing needs (about 20% on average). External financing will be used mainly through the issuance of instruments in international markets, with an issuance to take place every year, and through loans for financing development projects and available budgetary support.

The alternative borrowing strategies were analyzed and compared with each other by considering two indicators in parallel: the cost of debt and developments of risk indicators for each strategy. For comparison purposes, the focus was put on the results of the strategies analyzed, at the end 2026.

Under the baseline macroeconomic scenario at the end of 2026, Strategy S2 turns out to have a slightly lower cost than the other three strategies, mainly because funding according to this strategy relies to a considerable extent on short-term securities. On the other hand, the S2 strategy shows a significant constraint towards the further development of the internal market of government securities, and results that do not show any improvement of the refinancing risk and interest rate indicators. The S3 strategy shows obvious advantages in terms of risk indicators. This strategy improves significantly the maturity profile, and consequently the refinancing risk and interest rate indicators. Strategy S3 also brings positive developments in terms of exchange rate risk, enabling a gradual decline of the share of foreign currency debt from about 50% at the end of 2021, to a projected level of about 45 % at the end of the strategy period. Strategy alternatives S1 and S2 also improve this risk indicator, whereas strategy S4 leads to a deterioration of this indicator, due to the characteristics of this financing strategy, which relies heavily on external financing sources.

The above considerations show that selecting and applying the S3 strategy for financing the debt in the coming period will provide satisfactory results in terms of balancing debt portfolio risks and cost. Additionally, in order to select the most appropriate strategy a number of other indicators were analyzed. Strategy S3 also shows advantages in terms of the level of gross financing needs during the strategy period, with significantly lower level compared to Strategy S2, but also lower than the other strategies. Strategy S3 has the level of debt service and principal repayments lower than the other three strategy alternatives due to increased maturity of borrowing enabling higher share of principal payments carried out beyond the analysis period. In terms of the level of interest expenses, strategy S2 shows a non-significant advantage over the other three strategies.

Figure 10: Gross Financing Needs & debt servicing on alternative strategies



Source: Ministry of Finance and Economy 2022

9. SENSITIVITY ANALYSIS

Forecasts on the debt and cost levels under the baseline scenario may be subject to change, in case of changes in assumptions for macro-fiscal and market indicators. The following analysis presents the sensitivity of key debt indicators to changes in market indicators.

Given the level of debt, and the level of risk exposure, the interest rate in the domestic and foreign markets is estimated to be a factor with high impact on state budget expenditures. Based on the current situation of the Russia-Ukraine conflict and the latest statements by Federal Reserve and the European Central Bank, an increase in foreign market interest rates is expected in the short and medium term. Additionally, the Bank of Albania in 2022 announced the increase of the policy interest rate by 0.5 percentage points, from 0.5% to 1.0%. Based on these interest rate increase expectations in foreign and domestic markets, a sensitivity analysis was conducted by applying an increase in interest rates on each group of debt portfolio instruments according to the following two scenarios:

Table 5: Interest Rates Shock 1 (Moderated Shock)

	2022	2023	2024	2025	2026
Interest Rates in Domestic Market	0.80%	1.00%	0.20%	0.20%	0.20%
Interest Rates in Foreign Market	0.60%	0.50%	0.20%	0.20%	0.20%

Source: Ministry of Finance and Economy 2022

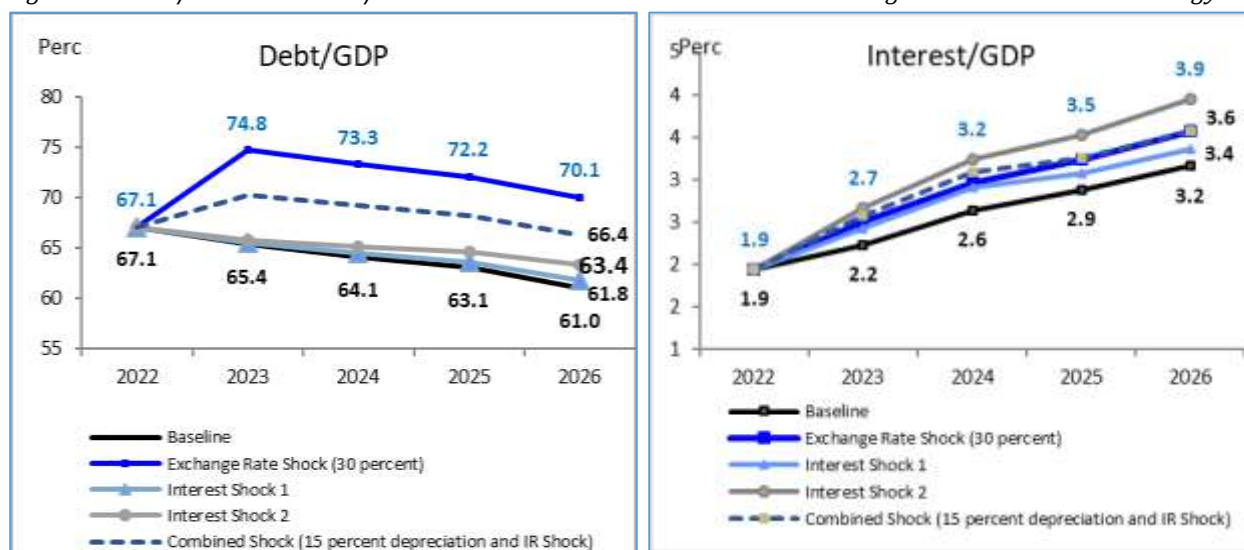
Table 6: Interest Rates Shock 2 (Extreme Shock)

	2022	2023	2024	2025	2026
Interest Rates in Domestic Market	1.50%	1.75%	1.50%	1.50%	1.50%
Interest Rates in Foreign Market (EUR)	1.00%	2.00%	1.50%	1.50%	1.50%
Interest Rates in Foreign Market (USD)	2.00%	1.50%	1.50%	1.50%	1.50%

Source: Ministry of Finance and Economy 2022

A potential depreciation of the domestic currency beyond expectations, against the Euro or other currencies that make up the foreign debt portfolio, would have an impact on the debt level trend, slowing down the planned decline pace. Additionally, a depreciation of the local currency would also have an impact on the cost of debt. A 15% shock is applied on EUR/ALL and USD/ALL exchange rates for 2023, whereas in the second scenario a 30% shock on EUR/ALL and USD/ALL exchange rate for 2023 is applied. The outputs generated by the MTDS Toolkit model, after applying the shocks/stress scenarios on the selected strategy (S3), are shown in the following figures.

Figure 11: Debt/GDP & Interests/GDP evolution under stress scenarios according to the selected base strategy



Note: The combined shock includes the moderate interest rate shock

Source: Ministry of Finance and Economy 2022

The sensitivity analysis shows that: a simultaneous increase of interest rates in the domestic and foreign markets, may increase the ratio of interest to GDP by 0.2pp in the first scenario

and 0.8pp in the second scenario. Whereas, a 30% depreciation of the domestic currency in the extreme scenario would increase the interest rate to GDP ratio by 0.4 pp.

10. MAIN DIRECTIONS AND SPECIFIC OBJECTIVES OF THE STRATEGY

10.1. Debt Cost

Main focus of MTDS 2022-2026 will be lowering the risk exposures, particularly the risks associated with the domestic debt portfolio. Reducing risk exposure in the debt portfolio will contribute to reducing risk premiums, thereby lowering the cost of debt servicing. Additionally, the development of the government securities market, for which purpose the Government has started a Market Maker Program (described in the Annex III), that will aim to reduce risk premiums that currently stem from the low liquidity of government securities, will also help to keep debt cost under control.

10.2. Risk Management

The risk management of the debt portfolio includes a number of medium term key objectives, which aim to reduce the risks in the medium term.

10.2.1. Refinancing risk

The existing debt level and the structure of annual payments of principal raise the need for significant refinancing in annual amounts up to 20% of GDP, and about 90% of these amounts on average is required for the domestic debt. Therefore, it is necessary to continue the implementation of the measures undertaken to further reduce the exposure to refinancing risk, with the following objectives: a) increasing the share of medium and long-term securities in the domestic debt portfolio, through gradual reduction of financing through short-term securities (T-bills) in line with the opportunities offered by the domestic market; and b) smoothening the maturity profile, by assessing the possibility of using bond buybacks and exchanges auctions. The current conditions in the financial markets are estimated to continue to offer the possibility of extending the average maturity and balancing the maturity profile, together with reducing the share of short-term debt in the total domestic debt portfolio.

Table 7: Medium-term indicative refinancing risk indicators

	Risk Indicator	Indicator 2021	Objective End Year 2026
Refinancing Risk	ATM for domestic debt	2.20	Min 2.5 years
	Domestic debt maturing within 1 year (% of total)	46.6%	Max 40%

Source: Ministry of Finance and Economy 2022

10.2.2. Interest rate risk

Given the high level of short-term debt, and the expectations for an increase in market interest rates, the long-term increase of the reference market interest rates would represent a significant threat to fiscal sustainability, and consequently increase the debt substantially. In the short run, this threat has been mitigated by the existing interest rate structure, where fixed interest rate instruments account for more than 90% of the domestic debt stock. In this regard, despite the measures for reducing the share of short-term securities, the share of variable interest rate securities will be kept under control, in line with market opportunities and investor preferences.

Table 8: Medium-term indicative interest rate risk indicators

	Risk Indicator	Indicator 2021	Objective End Year 2026
Interest Rate Risk	ATR for domestic debt	2.19	Min 2.5 years
	Domestic debt re-fixed in 1 year (% of total)	48.0%	Max 43%

Source: Ministry of Finance and Economy 2022

10.2.3. Exchange rate risk

Exchange rate risk is the risk that the debt position will deteriorate due to depreciation of ALL exchange rate against other currencies. Currently, the exchange rate risk is kept under control, and foreign exchange reserves are actively managed according to the guidelines set for foreign exchange composition. The exchange rate risk will continue to be kept on acceptable levels in the medium term by undertaking activities that aim to: a) monitor and maintain the foreign currency debt to total government debt ratio at acceptable levels; b) concentrate the foreign currency borrowing into Euro and composite currencies; c) increase the foreign currency debt stock (nominal stock / in the medium term) in line with the increase of exports and foreign exchange reserves; and d) assess the potential use of financial derivatives to control this risk if required.

Table 9: Medium-term indicative exchange rate risk indicators

	<i>Risk Indicator</i>	<i>Indicator 2021</i>	<i>Objective End Year 2026</i>
Exchange Rate Risk	Foreign currency debt/Total	49.8%	Max 50%

Source: Ministry of Finance and Economy 2022

10.2.4. Operational risk

Reducing the operational risk will have an important focus throughout the strategy time horizon. It will aim strengthening the public debt management unit through: a) well-defined functions in the debt management unit; b) standardization and formalization of procedures in debt management activities; and c) increase human resources stability in accordance with the approved structure and improve management capacity.

10.2.5. Liquidity risk

In addition to activities to reduce refinancing and interest rates risks that have an impact on liquidity risk, the Ministry of Finance and Economy will undertake activities that will aim to achieve: a) a more active cooperation between the structure responsible for debt management and the structure responsible for revenue management and forecasting in order to improve cash management; b) higher contribution towards better asset/liabilities management.

10.3. Management of contingent liabilities arising from Government Guarantees

The level of government guarantees is set in the annual budget laws. Whereas, in the medium term, the level of government guarantees is planned to remain below 5% of the total debt of the central government.

In order to control/reduce the risk arising from the issuance of government guarantees, and to benefit from the advantages arising from the use of these instruments as state economic policies, the following criteria will be applied for the issuance of government guarantees in the medium term:

- Government guarantees will be issued to state-owned enterprises, which have undertaken a reform initiative with an impact on strengthening their financial situation;
- Government guarantees will be issued to finance investment projects;
- Government guarantees may also be issued to support measures that can be taken in the event of a financial system crisis;

- Government guarantees may be issued for the purpose of restructuring the government guarantee portfolio through the reduction or exchange of guaranteed loans with a high level of potential risk.

10.4. Development of the government securities market

The government securities market will be developed through activities that will aim to achieve: a) higher liquidity; b) higher efficiency; and c) increased transparency.

Achieving these objectives is a long-term goal, whereas undertaking the activities and implementing the various measures is a process that has already begun and will continue to be carried out continuously.

10.4.1. Increasing liquidity

The measures and activities undertaken to increase liquidity will contribute to the elimination of premiums arising from the limited level of liquidity of government securities. Additionally, these activities will contribute to increase the demand from that part of investors who have an interest in investing in liquid assets and not in holding them to maturity. The above factors are expected to reduce the interest rate premiums in the medium and long term, thereby reducing the cost of debt.

The main activities that are planned to be undertaken in the medium term are:

- Establishing *benchmark*⁸ sizes during the development of a yield curve towards medium-term and long-term government securities through regular reopening;
- Elimination of securities that have similar characteristics and compete with each other in order to reduce demand fragmentation;
- Adaptation of borrowing policies (including buy back and exchange of government securities) to market conditions and demand for certain securities.

Despite the fact that the above processes are already considered active, the aim for the medium term is to draft an action plan, which will clearly define the targeted instruments and indicative values, and will formalize the rules of the processes related to the management of government securities in the primary market.

10.4.2. Increasing efficiency

⁸ Ongoing process.

Increasing efficiency in the government securities market aims to reduce borrowing costs. The achievement of this objective will include measures that will have an impact not only on the primary market of government securities, but also on the secondary market. Measures and activities planned to be undertaken include:

- Analyzing the results of the Market Maker Project for the issuance of 5-year and 3-year reference bonds and considering the potential of including other long-term securities, in cooperation with key market players;
- Removal of technical restrictions and improvement of the legal basis for the securities market;
- Maintaining contacts with investors to exchange information and to consult on the initiatives to be undertaken;
- Further broadening the investor base, to include not only domestic but also foreign investors, in order to gradually build relations and promote the domestic market of government securities;
- Active participation in conferences with the main investors;
- Establishment of electronic and physical communication channels with domestic and foreign investors.

10.4.3. Increasing transparency

The measures and activities undertaken to achieve this objective will contribute to the reduction of uncertainties and the increase of predictability in the government securities market, including:

- Transparent and timely communication of monthly, quarterly and annual borrowing plans;
- Publication of auction results in the shortest possible time;

10.4.4. Drafting and publishing an annual borrowing plan

In order to increase the transparency, predictability and effectiveness of the borrowing process, and to ensure the implementation of the strategy towards the achievement of the objectives, the Ministry of Finance and Economy will establish the necessary practice for preparation and publication of an annual borrowing plan, before the start of the new calendar year. The ministry will start the implementation of this process with the support of the World Bank Technical Assistance, which will aim to adopt and implement the best practice for this purpose.

10.5. Assessment of the feasibility of using new alternative sources of financing

The assessment of using alternative sources of financing such as Green and Social instruments, or even further, sustainability instruments, aims to enable:

- Assessing the adequacy of budget plans, and whether there is potential to use Eurobonds of this type - the use of funds includes conditions on budget expenditures in areas according to the theme to be labelled (Environment, Energy Efficiency, Renewable Energy, etc.);
- Involvement of relevant institutions;
- Creation of a regulatory framework following the assessments made on the possibilities of borrowing through these types of instruments.

11. MONITORING REPORT

The Ministry of Finance and Economy, at the end of each year, assesses the progress on the implementation of the Medium Term Debt Management Strategy, and drafts the relevant monitoring report, according to the templates defined in Annex 2. The monitoring report is prepared after the end of the calendar year and published on the website of the Ministry of Finance and Economy.

ANNEX I

METHODOLOGY USED IN THE QUANTITATIVE ANALYSIS

The quantitative analysis (cost/risk) of alternative financing strategies was conducted by using an analytical model for the Medium-Term Debt Strategy (*MTDS analytical tool*) developed by the World Bank and IMF to assist developing countries in Debt Management process. The model used is a deterministic model, where the *outputs* depend on the initial values and parameters used (existing debt parameters). The model is designed in such a way as to project medium term debt flows depending on the inputs data that are entered into the model for each of the strategies. The *output* of the model is the quantification of the cost and risk respectively for each of the strategies analyzed.

1. Inputs

The main *inputs* used in the model are i) current debt flows (interests and principal) with the estimated debt for end of 2021, ii) macroeconomic and fiscal indicators⁹ (primary deficit, GDP, foreign exchange reserves, exports) which drive the country's financing needs, iii) alternative financing strategies, and iv) market indicators such as interest rates and exchange rate.

Inputs data for the current debt flows are entered into the model after they are preliminarily categorized into groups with similar risk characteristics. In this case, the flows of the existing debt are categorized into 13 groups, of which 7 groups for domestic currency instruments (domestic debt) and 6 groups for foreign currency instruments (external debt).

Alternative financing strategies differ from each other by i) by the financing mix between domestic and external debt and ii) financing mix between groups with similar risk characteristics respectively for domestic and external debt.

2. Outputs

The output of the model consists of cost and risk quantification for each strategy taken into consideration. The model illustrates the results of each strategy considered, under the market indicators scenarios, and provides information about the risks that the debt structure will carry at the end of the medium term for each of the strategies considered.

⁹ Macro Fiscal Indicators refer to the data of the Draft Macroeconomic and Fiscal Framework for 2022-2024.

3. Scenarios

- The baseline scenario is defined as the scenario with the highest probability of occurrence (the most probable scenario) and it is used to determine the costs (debt/GDP and interest/GDP, etc.).
- Shock scenarios are defined as alternative scenarios and they are designed by the shocks that are applied on financial variables (interest rates and exchange rates).

The deviation of cost in shock scenarios from the baseline scenario cost in each of the strategies defines the risk.

Theoretically, an unlimited number of shock scenarios can be applied, whereas in this case two shock scenarios on interest rate and two shock scenarios on exchange rate have been applied.

4. Timeframe

The analysis period is set to 5 years in order for each of the considered strategies to give visible effects on the structure risks and debt costs. The differentiation of outputs for each of the strategies analyzed is relatively low in shorter time periods, limiting the identification of differences between costs and risks for each of the respective strategies.

5. World Bank Assistance

Data processing required to perform the analysis using this methodology, including populating the Model (MTDS Tool), was carried out in close cooperation with World Bank experts, who also provided the necessary guidance on the analysis of results.

ANNEX II

Strategy implementation reporting template

Table 1: Overall Objectives of the Medium Term Debt Management Strategy 2022-2026.

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.)					

Table 2: Specific Quantitative Objectives of the Medium Term Debt Management Strategy 2022-2026.

Specific quantitative objectives	Baseline 2021	Reporting Year		
		Status	Activities	Comments
Reducing Refinancing Risk <i>ATM of Domestic debt</i> <i>Domestic debt maturing in 1 year (% of total)</i>				
Reducing Interest Rate Risk <i>ATR of domestic debt</i> <i>Domestic debt Re-fixed in 1 year (% of total)</i>				
Reducing Exchange Rate Risk				

ANEX III- Market Maker Program Description

In order to further develop the Government securities market, promote the secondary market and increase liquidity, a Market Maker Program has been implemented in Albania since 2018 with the participation of 5 banks in the role of Market Developers/Makers.

These banks have been selected by the Ministry of Finance and Economy after meeting certain criteria defined as: capital requirements, good financial results, size of activity in the government bond market and appropriate technology.

Under this Program, the Banks included in the program, have the exclusive right to participate in the primary market and to trade the 3-year and 5-year reference bonds. In their role as Market Makers, these entities usually do not have to pay commissions, in order to encourage them to narrow the spread between buying and selling. These banks, in addition to the privilege secured to participate in the auction on behalf of themselves or their clients, have also undertaken the obligation to quote the purchase and sale prices of the securities. From the second half of 2018 until the second half of 2022, 9 reference bonds have been issued in the primary market, of which 4 are 3-year bonds and 5 are 5-year bonds, which are traded through the Market Maker system.

This type of system is applied in many countries as a way to develop the primary and secondary market of Government securities. From the experience in these countries, this system can also be associated with disadvantages such as the lack of competition due to low participation in the system or the risk of agreements between participants when their number is low. In addition, it may also happen that Market Makers take advantage of securities with good interests and hold them to maturity instead of selling them.

In order to evaluate the activity of the Market Development banks, to ensure that the participating banks operate respecting the agreement signed with the Ministry of Finance and Economy, the latter is in the process of establishing a methodology, and plans to start the evaluations by starting from 2023.

Overall, after the successful Pilot Project "Market Maker" in 2018, the introduction of the permanent Market Maker agreement for the 3- and 5-year reference bonds has not yet brought the expected results. One of the reasons is that there are a limited number of Benchmark bonds that are traded on the Market Maker system and are available for sale. Market Makers, participants in the Market Maker system, treat bonds differently; some have all of it in their portfolio available for sale, while others hold some of it to maturity. In order to facilitate the development of the secondary market, all market makers must have bonds available for sale in significant quantities.

Finally, further development with an increase in the typology of investors in the secondary market is a necessity for the development of this system. A high demand from non-bank sources would ensure a steady demand as well as stability in the auction market. In view of this objective, the Ministry of Finance and Economy and the Bank of Albania have worked on providing the international ISIN code for government bond issues, which is expected to be applied starting from 2023 for new issues in the primary market.

ANEX IV-Acronyms and Technical Vocabulary

EUR	European Union Currency
IMF	International Monetary Fund
INSTAT	Institute of Statistics
ATM	Average Time to Maturity
ATR	Average Time to Re-fix
ALL	Domestic Currency LEK
NPL	Non Performing Loans
GDP	Gross Domestic Product
PBG	Policy Based Guarantee
BP	Basis Points
PP	Percentage Points
MTDMS	Medium Term Debt Management Strategy
USD	The national currency of the United States of America
YEN	National Currency of Japan
WAY	Weighted Average Yield

Debt - Referred to as “Total Debt” or “Total Debt Obligations”, consists of all liabilities that are debt instruments.

Long-term debt - Debt with a maturity of more than one year.

Domestic Debt - Debt liabilities of residents of a country toward the residents of the same country.

External Debt - Obligations of residents’ debt of a country towards non-residents.

Guaranteed Public Debt - Debt of public and private sector debt, whose service is guaranteed by agreement from public sector entities.

Buyback - Is the mutual form of issuing a government security, which allows you to mature a government security ahead of time.

Disbursement - Transaction of making available financial resources.

Eurobond - A bond (*financial security*) with a maturity term of more than one year issued and traded in international financial markets outside the country's borders.

Bilateral Creditor - The type of creditors such as their governments and agencies.

Concessional Loans - Loans with terms more favorable than market ones.

Multilateral Creditor - Type of creditors including financial institutions such as World Bank, IMF, etc.

Private creditors - Creditors that are not Government or public sector agencies. These include private holders of government securities, private banks and other financial institutions.

ATM – An indicator of Refinancing Risk. ATM is the average period in days or years that a debt portfolio requires to mature. The longer the projected maturity date of an instrument is, the lower the risk of re-financing and the higher the value of this indicator. ATM for debt instruments is calculated according to the following formula:

$$KMM = \frac{\sum_{t \in T} t N_t}{\sum_{t \in T} N_t}$$

From where:

t – Maturity date;

T – the aggregate of all maturity dates;

N_t – Nominal value to be paid at date t .

ATR – An indicator of Interest Rate Risk. It provides information about debt portfolio exposure versus interest rate change. ATR is interpreted as the average time (*in years*) that the debt portfolio needs to re-fix the interest rate. The greater the amount of short-term instruments and the amount of variable interest rate instruments in the debt portfolio, the higher the interest rate risk, and the smaller this indicator and vice versa. ATR for debt instruments is calculated according to the following formula:

$$\text{KMR} = \frac{\sum_{r \in R} r N_r + \sum_{t \in T} t N_t}{\sum_{r \in R} N_r + \sum_{t \in T} N_t}$$

From where:

r – *Coupon* payment date of the instrument with variable interest rates;

t – *Maturity* date of the instrument with fixed interest rates;

N_r – Nominal value of the instrument with variable interest rates;

N_t – Nominal value of the instrument with fixed interest rates;

R – *Aggregate* (set) of all maturity dates for variable interest rate instruments;

T – *Aggregate* (set) of all maturity dates for fixed interest rate instruments.

Coverage Ratio - The ratio between the demand (*by investors*) and the amount offered (*by the government*) in the auctions of government securities. It serves to evaluate the level of auction completion and the liquidity level.

Exchange Rate Risk - refers to the impact of the currency exchange rate fluctuation on the level of debt and its service to a certain extent above expectations. For example: “The appreciation or depreciation of a domestic currency against a foreign currency, which is an integral part of the debt portfolio, may result in a proportional decrease or increase in the volume of debt or its service (*denominated in domestic currency*)”.

Liquidity risk - The risk associated with the loss of Budget ability to pay its current liabilities and execute expenditures on time. In order to minimize this risk, the state must have access to a certain amount of liquid assets in order to guarantee the provision of availability of funds in case of temporary crisis, when the provision of funds becomes difficult or too costly.

Interest rate risk - The risk that debt service payments will change because of changes in interest rates. This risk arises from the need to serve the maturing debt and the payments of coupons of variable interest rate instruments in the future.

Operational risk - The risk associated to increased debt management cost or increased level of other risks resulting from human error, electronic devices damage, natural disasters, etc. Operational risk is a relatively difficult risk to be measured and evaluated. Reducing operational risk exposure may be achieved by integrating debt management procedures into an organizational structure, having the structure, infrastructure and procedures run by efficient operational activities for the management of public administration and financial markets.

Refinancing risk - The risk associated with the ability to issue instruments or borrow/receive loans in order to refinance and service current debt. The greater the maturing volume and the closer in time, the higher the refinancing risk and vice versa. The refinancing risk is affected by the level of existing debt and amortization profile. Increased debt maturity and distribution of maturity dates contributes to reducing the refinancing risk.

Debt stock - Debt principal balance at a given moment of time.

Debt service - Principal and interest payments in accordance with the terms set out in the agreement.

Primary Market - It is the physical or functional area in which the Albanian Government issues securities for the first time.

Secondary Market - It is the physical or functional area where transactions with securities are made as they have been issued in the primary market.

Midterm Securities - refers to government debt securities with a maturity of 2 to 5 years.

Long-term Securities - refers to government debt securities with a maturity of over 5 years.

Reference Instruments (*benchmark*) – It is the most recent issue of Albanian government bonds for a certain maturity. The auction for the reference title can be reopened periodically until reaching a predetermined value by the Ministry of Finance and Economy. This security is used as a benchmark for evaluating other government securities with similar maturity, issue amount and coupon rate.

In general, reference securities enjoy higher liquidity than ordinary issues, due to the obligation of the Market Developers to quote purchase/sale prices in the secondary market according to the conditions defined in the contract with the Ministry of Finance and Economy.

Government Securities - Treasury bills and government bonds issued by the Ministry of Finance and Economy in accordance with Law no. 9665, dated 18.12.2006 "On State Borrowing, State Debt and Loan State Guarantees in the Republic of Albania", as amended; law no. 9879, dated 21.02.2008 "On Securities", and by-laws.

ANEX V- ADDITIONAL INFORMATION

1. Legal basis and sub-legal acts in the framework of public debt management

- Law No. 9665, dated 18.12.2006, "On State Borrowing, State Debt and Loan State Guarantees in the Republic of Albania", as amended by law 181/2014, dated 24.12.2014;
- Law No. 9936, dated 26.06.2008, "On the management of the budget system in the Republic of Albania", as amended by law no. 57, dated 02.06.2016;
- Law No. 43/2016, dated 21.04.2016, "On international agreements in the Republic of Albania";
- Law No. 8269, dated 23.12.1997, "On the Bank of Albania", as amended;
- Annual Budget Law;
- Instruction of the Minister of Finance No. 30, dated 26.12.2013, "On issuing treasury bills in registration form by the government of the Republic of Albania";
- Instruction of the Minister of Finance No. 31, dated 26.12.2013, "On issuance of bonds in registration form by the Government of the Republic of Albania", added with the Instruction of the Minister of Finance No. 21, dated 22.06.2018;
- "Instruction of the Minister of Finance No. 35, dated 05.11.2008, "On the implementation of law No. 9869, dated 04.02.2008 "On Local Government Borrowing"";
- Instruction of the Minister of Finance No. 36, dated 10.08.2009, "On the compilation of the Government Debt Register and Loan's Government Guarantees";
- Agreement between the Bank of Albania and the Ministry of Finance and Economy, dated 20.01.2015, "On the organization of auctions of Albanian government securities, settlement of operations and keeping the register of these securities".

2. Periodic Publications of the Ministry of Finance and Economy regarding Debt

- Bulletin of Public Debt on an annual and quarterly basis:
<http://www.financa.gov.al/al/raportime/borxhi/treguesit-e-borxhit>
- Public Debt Issuance Registry:
<http://www.financa.gov.al/al/raportime/borxhi/regjistri-i-borxhit>
- Information on auctions of government securities issuance:
<http://www.financa.gov.al/al/raportime/borxhi/ankandet-e-emetimit-te-letrave-me-vlere-te-qeverise>