



Ministry of Finance of the Czech Republic

DEBT AND FINANCIAL ASSETS MANAGEMENT DEPARTMENT

Debt Portfolio Management Quarterly Review

DECEMBER 2007

The Ministry of Finance submits the twelfth *Debt Portfolio Management Quarterly Review* to present the underlying debt portfolio risk management measures and performance with respect to the planned annual financing programme and achieving the medium-term strategic targets of debt management policy. For the year 2007, these targets were concretised and quantified by the *Financing and Debt Management Strategy for 2007* released on 1 December 2006 and based on the Finance Minister's decision. It specifies an operational framework for the tactical management of state debt and financial assets through the active financial operations on the secondary market.

I. Review of Strategic Targets for 2007

The 2007 state debt management policy is guided by the set of quantitative targets and criteria approved by the Minister of Finance for issuance activities and the active management of debt portfolio. Implementation of the planned financing programme was affected by a reduction of the gross borrowing requirement from the planned CZK 159.2 billion to the amount of CZK 145.2 billion and by the decision of the Minister of Finance not to execute a benchmark eurobond issue. The state debt increased by CZK 89.9 billion during the year 2007.

Gross borrowing requirement in 2007 (CZK billion)

State budget income	-1 025.9
State budget expenses	1 092.3
State Budget Deficit	66.4
Extra-budgetary funding of the Czech Consolidation Agency	13.3
Net financing requirement	79.7
Redemptions on government bonds	43.0
Buy-backs of government bonds	10.0
Repayment of non-marketable state debt	1.7
Gross financing requirement	134.4
Special Pension Insurance Account	0.0
Other changes in state financial assets accounts	0.2
Creation (+) /drawing (-) financing reserves	10.6
Gross borrowing requirement	145.2
Net change in money market instruments	9.8
Gross borrowing requirement, inc. net drop in money market instruments	155.0
Total redemptions on state debt	-64.5
FX and notes value differences	-0.6
Gross State debt increment	89.9

Note: Without revolving money market instruments.
Source: MF ČR.

The Ministry succeeded in performing in the area of strategic targets and the planned financing programme was consistent with the real development as summarized in the following table.

Financing programme and strategic targets in 2007

Criterion	Guidelines for 2007	December 31, 2007	
International issues	Max. 50% of the total annual gross borrowing requirement	0.0%	
	CZK 0.0 to 80.0 bn	CZK 0.0 bn	
Gross T-Bonds issues	CZK 72.8 to 152.8 bn	CZK 151.2 bn	
Net money market issues	CZK 0.0 to - 30.0 bn	CZK - 9.8 bn	
Loans from EIB	CZK 6.4 bn	CZK 3.8 bn	
Short-term state debt	20% and less	State debt	18.7%
		inc. Guarantees	18.2%
Average time to maturity	6.0 to 7.0 years	State debt	6.4 years
		Inc. Guarantees	6.3 years
Interest Rate Re-fixing	30 to 40%	State debt	26.0%
		Inc. Guarantees	25.9%

Note: EIB – European Investment Bank. Source: MF ČR.

As regards **international financing**, the Czech Republic has drawn loans from the European Investment Bank in the total annual amount of **CZK 3.8 billion** which represents 59.4% of the approved limit in the State Budget Act for 2007.

Regarding **domestic issuance activity**, the net issue of government bonds was CZK 22.4 billion and buy-backs of government bonds were executed in the amount of CZK 10.0 billion in the fourth quarter. The total gross issuance of government bonds reached **CZK 151.2 billion**; it is about 99% of the maximal supply announced on 1 December 2006.

The volume in issue of money market instruments decreased by **CZK 9.8 billion** during the four quarters of 2007 in accordance with the announced programme for net money market issuance.

The short-term state debt increased by one percentage point and reached the share of **18.7%** at the end of 2007. It means that the Ministry of Finance maintains the planned long-term targeted limit of 20% and less during 2007.

Average time to maturity reached the level of **6.4 years**, i.e. within the announced target band 6.0 – 7.0 years for 2007.

Beginning with the year 2006, **the interest rate re-fixing** up to one year replaces the modified duration targeting in the area of market risk management. The *Financing and Debt Management Strategy for 2007* sets the average yearly range between 30 and 40%. This risk measure increased slightly to 26.0% at the end of the fourth quarter and is stabilised below the lower limit.

II. Budgetary expenditures and Cost-at-Risk in 2007

Planned and actual budgetary expenditures in relation to debt service are captured in the following table.

Planned and actual budgetary expenditures on state debt in 2007

Measure (CZK million)	Actual 2006	Budget 2007		Actual 2007	% Execution	Index 2007/2006 (%)
		Approved	After changes			
1	2	3	4	5	5:4	5:2
Total expenditures	31 608	38 102	37 545	34 126	90.9	108.0
1. Total interest costs	31 515	37 802	37 245	33 981	91.2	107.8
Domestic debt	28 171	32 777	32 220	29 500	91.6	104.7
<i>Of which:</i>						
T-Bills	2 800	3 185	2 627	1 767	67.3	63.1
T-Bonds	25 371	29 592	29 592	27 733	93.7	109.3
Short-term loans	0	-	-	-	-	-
Foreign debt	3 344	5 025	5 025	4 481	89.2	134.0
<i>Of which:</i>						
International issues	2 648	3 924	3 924	3 381	86.2	127.7
EIB loans	696	1 101	1 101	1 100	99.9	158.0
2. Total fees	94	300	300	145	48.4	154.6

Source: MF CR.

Interest costs in 2007 increased by 7.8% in comparison with 2006. Total budgetary expenditures related to state debt represent 90.9% of planned (budgeted) annual expenditures (after changes) in 2007, which means total expenditures saving in the amount of CZK 3 419 mil.

The model CaR, **Cost-at-Risk**, of interest costs and its most important output in the form of expected interest costs and interest costs at risk (95% CaR), was first set out in the Czech conditions in the *Financing and Debt Management Strategy for the year 2006* released on December 1, 2005. The comparison between the actual development of interest costs and the development of the simulated interest costs in the four quarters of 2007 is summarized in the following table.

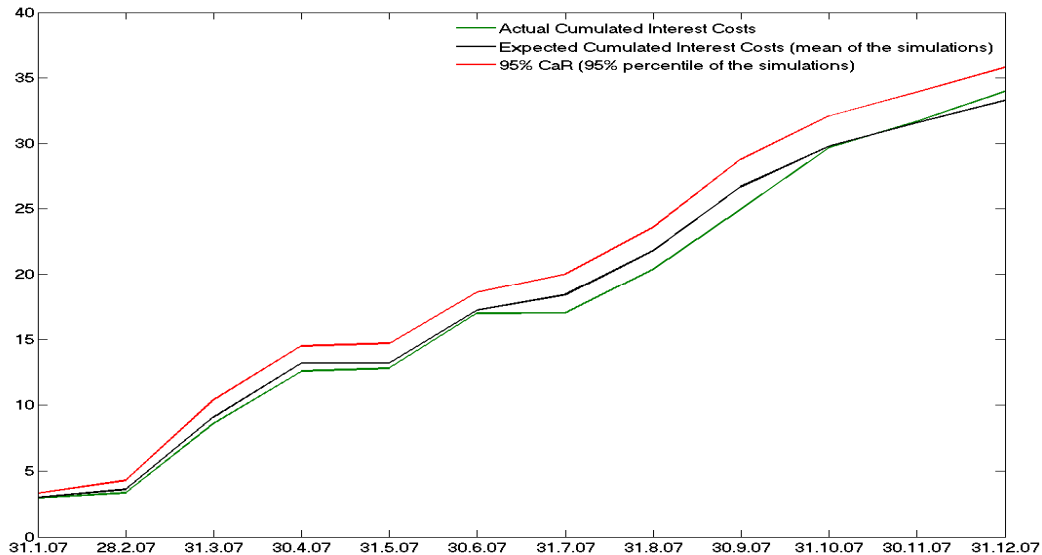
Cost-at-Risk deviation from the actual interest costs in 2006 and 2007

	2006	2007 original	2007 revised
Actual interest costs (CZK billion)	31.5	34.0	34.0
Expected (simulated) costs (CZK billion)	32.4	35.7	33.3
Cost-at-Risk 95% (CZK billion)	36.6	38.2	35.8
Expectation bias (%)	2.9	5.0	-2.1

Source: MF CR.

The development of the actual interest costs and simulated model of Cost-at-Risk from January to December 2007 is shown in the following figure.

Actual versus simulated monthly interest costs in 2007 (CZK billion)

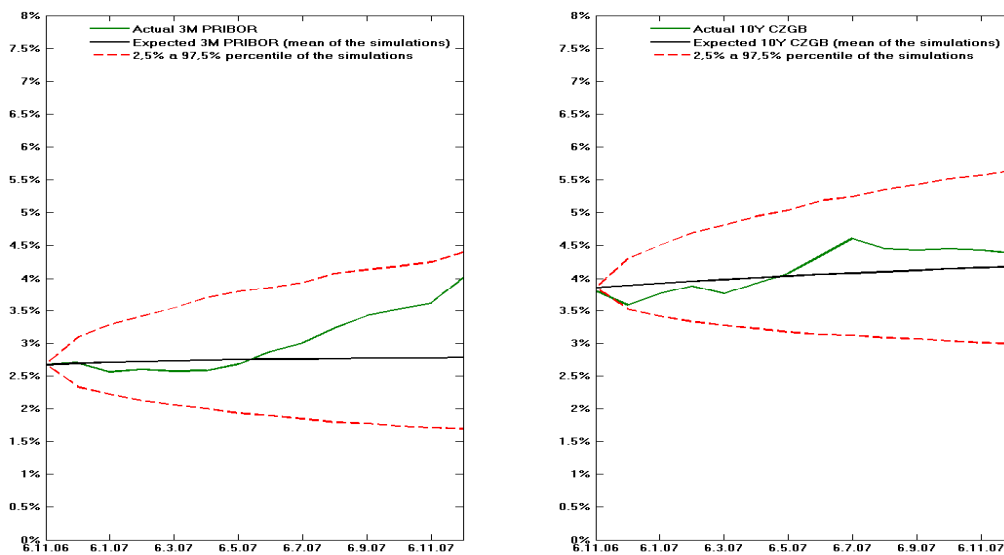


Note: Interest costs are calculated on the cash principle relevant for the current methodology of the state budget.

Source: MF CR.

The actual development of the yield curve for PRIBOR 3 months and 10-year government bond confirms acceptable performance of the interest rate modeling approach.

Actual versus simulated development of the Czech interest rates in 2007



Source: MF CR.

III. Integrated portfolio of state debt and risky state guarantees at the end of 2007

Debt management carried out the integrated approach to evaluate and analyse the portfolio of government liabilities in accordance with the *Financing and Debt Management Strategy for 2005, 2006 and 2007*.

Measures of the integrated portfolio of state debt and risky state guarantees

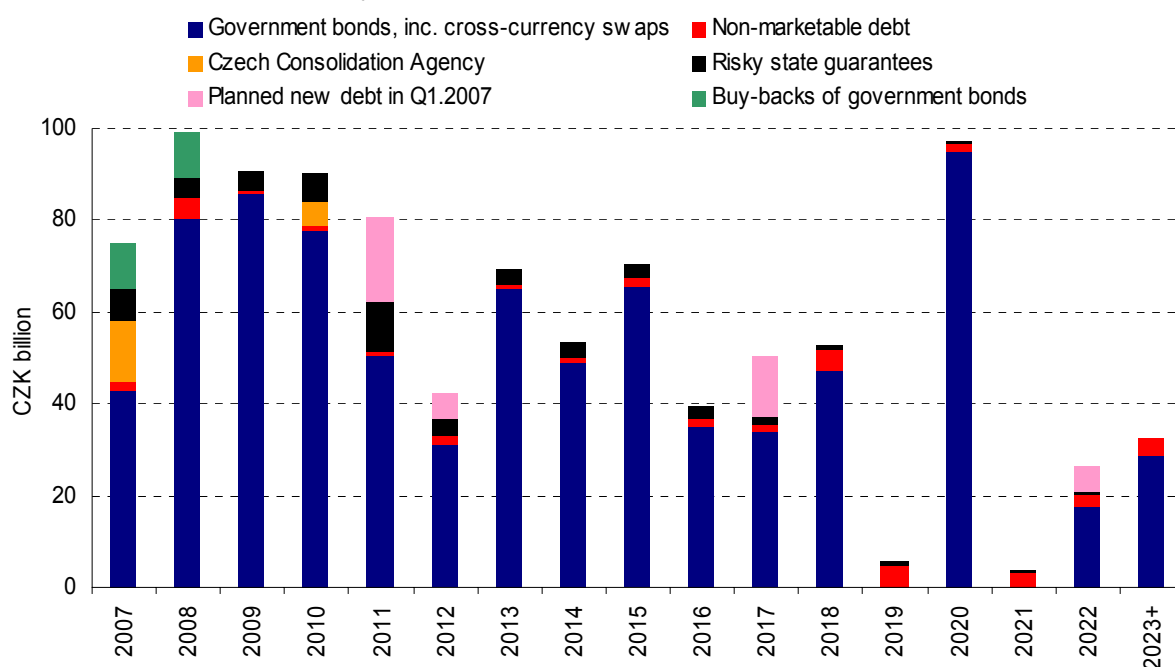
	Nominal amount (CZK bn)	Market value (CZK bn)	Foreign currency liabilities (%)	Variable-rate liabilities (%)	Short-term liabilities (%)	Interest rate refixing (%)	Average life (years)	Modified duration (years)
Total state debt	892.3	899.5	0.6	4.1	18.7	26.0	6.4	3.8
Risky state guarantees	48.4	48.9	41.9	24.0	8.5	23.0	4.7	3.2
Portfolio total	940.7	948.5	2.7	5.1	18.2	25.9	6.3	3.8

Note: including currency and interest rate derivatives of the MF and CMZR Bank and excluding liabilities of CCA, former National Property Fund and the IPB guarantee in the amount of CZK 157 bn.

Source: MF CR, Czech-Moravian Guarantee and Development Bank, Bloomberg.

Redemption profile of state debt, risky state guarantees and the CCA's funding needs

(end of 2007; updated on 8 January 2008)



Note: Without money market instruments in circulation and non-standard state guarantees.

Source: MF CR, Czech Consolidation Agency, Czech-Moravian Guarantee and Development Bank.

IV. State Debt Parameters (end of quarter)

Debt Parameter	Dec 2006	Mar 2007	Jun 2007	Sep 2007	Dec 2007
Total state debt (CZK billion)	802.5	811.7	856.1	842.7	892.3
Market value, inc. derivatives (CZK billion)	844.2	846.5	870.1	859.9	899.5
Short-term state debt (%)	17.1	18.3	16.0	17.8	18.7
Share of money market instruments (%)	11.5	9.6	7.7	6.5	9.2
Average time to maturity (years)	6.2	6.5	6.4	6.5	6.4
Interest rate refixing up to one year, inc. derivatives (%)	25.4	26.0	23.4	25.5	26.0
Variable-rate state debt (%)	4.3	4.2	4.2	4.3	4.1
Modified duration (years)	3.8	4.0	3.8	3.9	3.8
Modified duration, exc. IRS (years)	3.5	3.6	3.5	3.6	3.5
Foreign currency state debt (%)	0.7	0.7	0.6	0.6	0.6
Foreign currency debt, exc. cross-currency swaps (%)	9.3	9.4	9.1	8.9	8.1
Nonmarketable state debt (%)	4.7	4.6	4.6	4.7	4.4
Marketable state debt (CZK billion)	765.0	774.4	817.0	803.3	853.0
Market value (CZK billion)	806.7	809.1	830.9	820.5	860.2
Short-term marketable debt (%)	17.6	18.4	15.9	18.0	19.0
Share of money market instruments (%)	12.0	10.1	8.1	6.8	9.6
Average time to maturity (years)	6.1	6.4	6.3	6.4	6.3
Interest rate refixing up to one year, inc. derivatives (%)	22.0	22.7	20.0	22.1	22.9
Variable-rate marketable debt (%)	0.0	0.0	0.0	0.0	0.0
Modified duration (years)	4.0	4.1	4.0	4.1	3.9
Modified duration, exc. IRS (years)	3.6	3.8	3.7	3.8	3.7
Foreign currency marketable deb (%)	0.7	0.7	0.7	0.7	0.6
Foreign currency debt, exc. cross-currency swaps (%)	9.8	9.8	9.5	9.3	8.5

Notes: **Interest rate refixing up to one year** = Money market instruments + Fixed-rate short-term debt + Variable-rate state debt + Effect of interest rate derivatives. Source: MF CR, Bloomberg.

This publication is available also on the website:
www.mfcr.cz/statedebt

The next issue of Quarterly Review will be published on April 8, 2008, at 2.00 pm.

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