



Debt Portfolio Management Quarterly Review

JUNE 2008

The Ministry of Finance submits the fourteenth *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 2008, these targets were quantified by the *Financing and Debt Management Strategy for 2008* released on 3 December 2007 and based on the Finance Minister's decision. The Strategy specifies operating space for the assets and liabilities management through issuance activity, financial investment and active operations on secondary market of government bonds and financial derivatives.

I. Review of Strategic Targets for 2008

The 2008 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 as summarized in the following table.

Financing programme and strategic targets in 2008

Criterion	Guidelines for 2008	June 30, 2008
International issues	Max. 50% of the total annual gross borrowing requirement CZK 0.0 to 89.9 bn	27,0% CZK 48.5 bn
Gross government bonds issues	CZK 75.1 to 165.0 bn	CZK 71.4 bn
Net money market issues	CZK 0.0 to – 20.0 bn	CZK -48.5 bn
Loans from EIB	CZK 14.7 bn	CZK 4.4 bn
Short-term state debt	20% and less	13.8%
Average time to maturity	6.0 to 7.0 years	6.8 years
Interest Rate Re-fixing	30 to 40%	26.1%

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

As regards **international funding**, on June 11th the Czech Republic issued the third public benchmark Eurobond in the amount of **EUR 2.0 billion**, i.e. **CZK 48.5 billion**, which is approximately half of maximal international issuance activity according to declared financial programme for year 2008. Further the Czech Republic has drawn three tranches of loans from the European Investment Bank in the amount of **CZK 3.0 billion**. During the first half of 2008, loans in total amount of CZK 4.4 billion were drawn, which represents 29.9% of the limit in the State Budget Act for 2008.

Regarding **domestic issuance activity**, the net issue of government bonds was **CZK 35.5 billion** in the second quarter (CZK 36.4 bn. during first half) and buy-backs of government bonds were executed in the amount of CZK 0.6 billion. The total gross issuance of government bonds reached **CZK 36.1 billion**, including tap sales in the amount of CZK 5.2 billion via Reuters Dealing system used by the Debt and Financial Assets Management Department. The total gross issuance has reached CZK 71.4 billion, which is about 43.3 % of the maximal supply announced on 3 December 2007.

The volume in issue of money market instruments decreased by **CZK 13.1 billion** during the second quarter, i.e. more than the maximal decrease announced within the programme for net money market instruments issuance due to Eurobond funding in June.

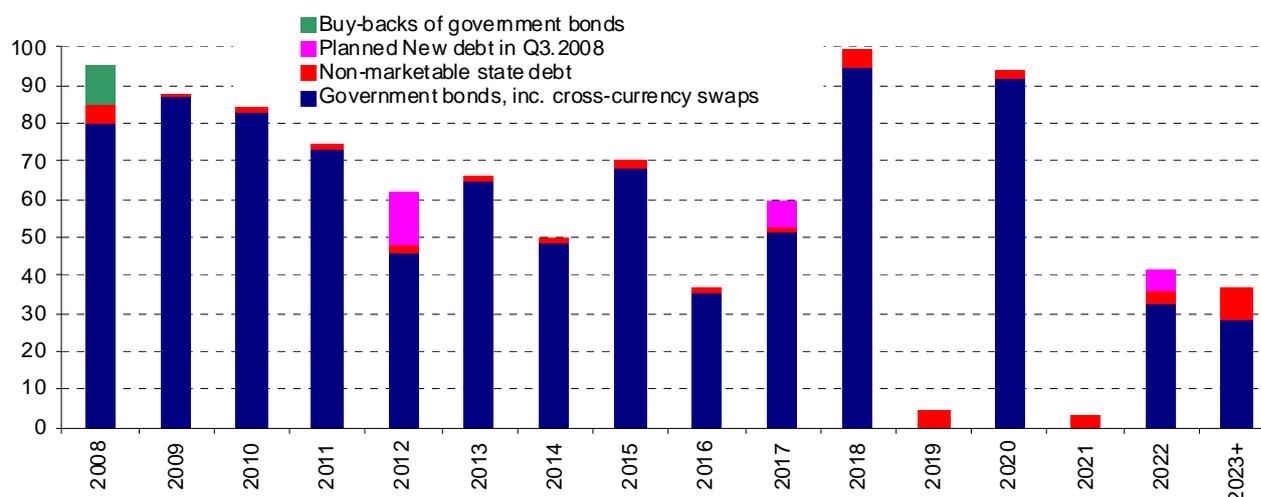
The short-term state debt decreased by 2.7 percentage points and reached the share of **13.8%** at the end of the second quarter. It means that the Ministry of Finance maintains the planned long-term target. Decline in the share was caused by issuance of Eurobond at the long end of the yield curve and by decline in money market instruments at the short end of the yield curve.

Average time to maturity reached the level of **6.8 years**, i.e. within the announced target band 6.0–7.0 years for 2008.

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 2008* sets the average yearly range between 30 and 40%. This risk measure increased to 26.1% at the end of the second quarter and is stabilised below the lower limit.

Redemption profile of state debt (CZK billion)

(end of 2007; updated on 30 June 2008)



Note: Without money market instruments in circulation.

Source: MF CR.

II. State debt costs and Cost-at-Risk in the first half 2008

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

Planned and actual budgetary expenditures and revenues on state debt in 2008

Measure (CZK mil)	Actual H1 2007	Budget 2008		Actual H1 2008	% Execution	Index 2008/2007 (%)
		Approved	After changes			
1	2	3	4	5	5:4	5:2
Total balance	17 048	45 460	45 454	19 885	43,7	116,6
	-	(-) 1 460	(-) 1 460	(-) 3 370	230,8	-
1. Total interest costs	16 986	45 141	45 141	19 779	43,8	116,4
	-	(-) 1 460	(-) 1 460	(-) 3 338	228,7	-
Domestic debt	14 246	38 847	38 847	16 058	41,3	112,7
	-	(-) 1 460	(-) 1 460	(-) 3 030	207,6	-
<i>Of which:</i>						
Money market instruments	832	2 484	2 484	911	36,7	109,5
	-	(-) 1 460	(-) 1 460	(-) 1 398	95,8	-
Government bonds	13 414	36 363	36 363	15 147	41,7	112,9
	-	-	-	(-) 1 632	-	-
Foreign debt	2 740	6 294	6 294	3 721	59,1	135,8
	-	-	-	(-) 308	-	-
<i>Of which:</i>						
International issues	2 252	4 653	4 653	2 977	64,0	132,2
	-	-	-	(-) 308	-	-
EIB loans	488	1 641	1 641	744	45,3	152,4
	-	-	-	-	-	-
2. FX gain/loss	-	-	-	(-) 32	-	-
3. Total fees	62	300	294	94	32,0	152,1
4. Redemption of state debt	-	19	19	12	60,4	-

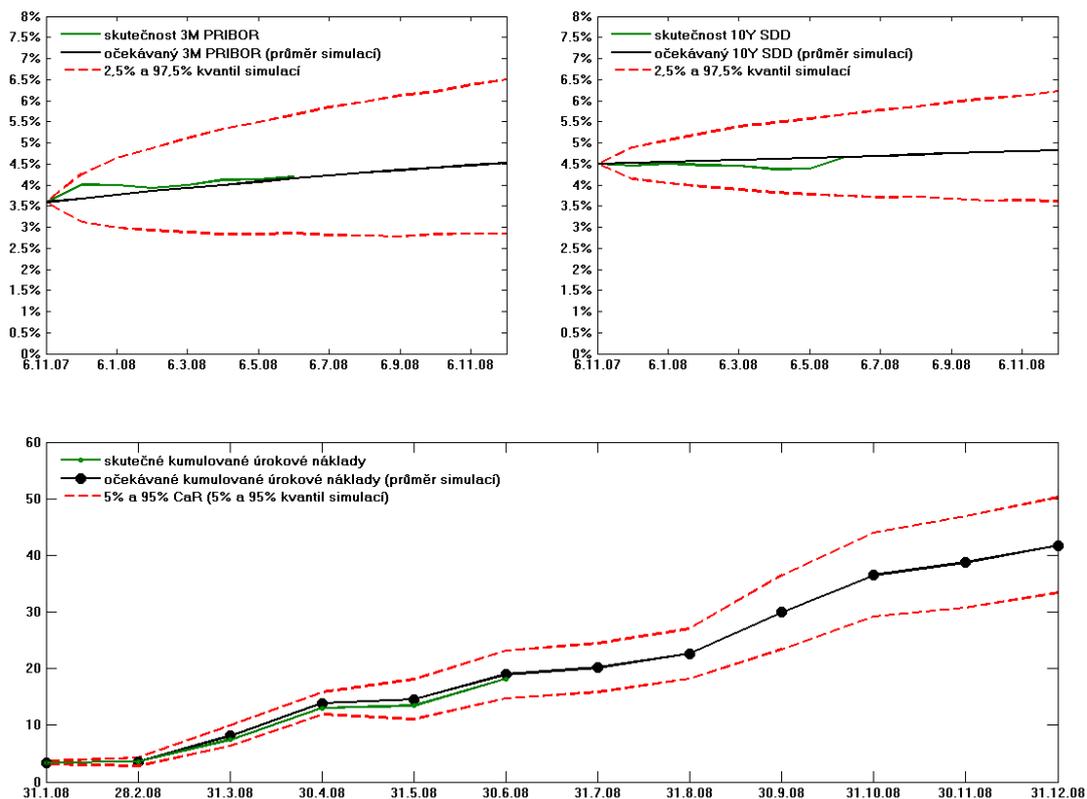
Note: (-) means revenues (gains). Source: MF CR.

The net interest costs on the state debt in the first half 2008 amounts **CZK 16.5 billion**. Financial investments on the money market gain CZK 1.4 billion and accrued interest income and T-bonds premiums achieve CZK 1.6 billion. The gross interest costs reached CZK 19.9 billion.

The state debt interest costs model **Cost-at-Risk (CaR)** for the year 2008 was published in the *Financing and Debt Management Strategy for the year 2008*. Calculations of the CaR values are based on future interest rates simulations.

The actual versus simulated development of the PRIBOR 3M and 10-year government bond benchmark from November 2007 till March 2008 is in the upper part of the figure. The actual versus simulated interest costs for the first quarter of 2008 is in the lower part of the figure.

Actual versus simulated evolution of the interest rates and the actual versus simulated monthly gross interest costs (CZK billion)



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

The comparison between the actual development of interest costs and the development of the simulated interest costs in the first half of 2008 in comparison with the same period of the last year is summarized in the following table.

Cost-at-Risk deviation from the actual interest costs in the first half of 2007 and 2008

	2007	2008
Actual interest costs (CZK billion)	17.0	18.2
Expected (simulated) costs (CZK billion)	19.5	18.9
Cost-at-Risk 95% (CZK billion)	21.1	23.2
Expectation bias (%)	-14.7	-3.8

Source: MF CR.

III. State Debt Parameters (end of quarter)

Debt Parameter	Jun 2007	Sep 2007	Dec 2007	Mar 2008	Jun 2008
Total state debt (CZK billion)	856,1	842,7	892,3	860,1	933,3
Market value, inc. derivatives (CZK billion)	870,1	859,9	899,5	867,9	921,4
Short-term state debt (%)	16,0	17,8	18,7	16,5	13,8
Share of money market instruments (%)	7,7	6,5	9,2	5,5	3,6
Average time to maturity (years)	6,4	6,5	6,4	6,7	6,8
Interest rate refixing up to one year, inc. derivatives (%)	23,4	25,5	26,0	24,2	26,1
Variable-rate state debt (%)	4,2	4,3	4,1	3,9	3,9
Modified duration (years)	3,8	3,9	3,8	4,0	4,0
Modified duration, exc. IRS (years)	3,5	3,6	3,5	3,7	3,9
Foreign currency state debt (%)	0,6	0,6	0,6	0,6	0,9
Foreign currency debt, exc. cross-currency swaps (%)	9,1	8,9	8,1	8,1	12,0
Nonmarketable state debt (%)	4,6	4,7	4,4	4,2	4,3
Marketable state debt (CZK billion)	817,0	803,3	853,0	823,6	893,1
Market value (CZK billion)	830,9	820,5	860,2	831,4	884,6
Short-term marketable debt (%)	15,9	18,0	19,0	17,1	14,3
Share of money market instruments (%)	8,1	6,8	9,6	5,7	3,7
Average time to maturity (years)	6,3	6,4	6,3	6,6	6,7
Interest rate refixing up to one year, inc. derivatives (%)	20,0	22,1	22,9	21,1	23,0
Variable-rate marketable debt (%)	0,0	0,0	0,0	0,0	0,0
Modified duration (years)	4,0	4,1	3,9	4,1	4,1
Modified duration, exc. IRS (years)	3,7	3,8	3,7	3,9	4,0
Foreign currency marketable deb (%)	0,7	0,7	0,6	0,6	1,0
Foreign currency debt, exc. cross-currency swaps (%)	9,5	9,3	8,5	8,4	12,5

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 October 8, 2008, at 2.00 p.m.

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