



# Ministry of Finance of the Czech Republic

DEBT AND FINANCIAL ASSETS MANAGEMENT DEPARTMENT

## Debt Portfolio Management Quarterly Review

JUNE 2007

The Ministry of Finance submits the tenth 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 set 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. The Ministry succeeded in performing in this area and the planned financing programme was consistent with the real development as summarized in the following table.

Criterion	Guidelines for 2007	June 30, 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 97.9 bn	
Net T-Bills issues	CZK 0.0 to – 30.0 bn	CZK - 23.4 bn	
Loans from EIB	CZK 6.4 bn	CZK 1.7 bn	
Short-term state debt	20% and less	State debt	16.0%
		inc. Guarantees	15.8%
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	23.4%
		inc. Guarantees	23.9%

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

As regards **international financing**, the Czech Republic has drawn loans from the European Investment Bank in the amount of CZK 1.7 bn in the second quarter, i.e. 27% of the annual limit approved for the year 2007. As for further operations of the Ministry on the foreign market, finance minister made no relevant decision in this area.

Regarding **domestic issuance activity**, the net issue of T-Bonds was CZK 54.8 bn in the second quarter. The total gross issuance of T-Bonds reached CZK **97.9 bn**; it is about 64.0% of the maximal supply announced in December 2006.

**The volume in issue of T-Bills** decreased by CZK **23.4 bn** during the first half according to the announced financing programme.

**The short-term state debt** decreased by more than two percentage points and reached the share of **16.0%**. It means that the Ministry of Finance maintains the planned long-term targeted limit of 20% and less during the first half.

**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 refixing** 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 decreased slightly to 23.4% at the end of the first half and is stabilised below the lower limit.

## II. Budgetary expenditures and Cost-at-Risk of the State Debt in the first quarter 2007

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

Measure (CZK mil)	Actual H1. 2006	Budget 2007		Actual H1. 2007	% Execution	Index 2007/2006 (%)
		Approved	After changes			
1	2	3	4	5	5:4	5:2
<b>Total expenditures</b>	<b>17 157</b>	<b>38 102</b>	<b>38 102</b>	<b>17 048</b>	<b>44.7</b>	<b>99.4</b>
<b>1. Total interest costs</b>	<b>17 118</b>	<b>37 802</b>	<b>37 802</b>	<b>16 986</b>	<b>44.9</b>	<b>99.2</b>
<b>Domestic debt</b>	<b>14 868</b>	<b>32 777</b>	<b>32 777</b>	<b>14 246</b>	<b>43.5</b>	<b>95.8</b>
Of which:						
T-Bills	1 200	3 185	3 185	832	26.1	69.4
T-Bonds	13 668	29 592	29 592	13 414	45.3	98.1
<b>Foreign debt</b>	<b>2 250</b>	<b>5 025</b>	<b>5 025</b>	<b>2 740</b>	<b>54.5</b>	<b>121.8</b>
Of which:						
International issues	1 942	3 924	3 924	2 252	57.4	116.0
EIB loans	309	1 101	1 101	488	44.3	158.1
<b>2. Total fees</b>	<b>38</b>	<b>300</b>	<b>300</b>	<b>62</b>	<b>20.6</b>	<b>160.8</b>

Interest costs in the first half of 2007 decreased by 0.6% in comparison with the same period of the year 2006. Total budgetary expenditures related to state debt represent 44.7% of planned annual expenditures in 2007 and are 5.3 percentage points below the respective share for the first half 2007.

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 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 model of CaR from January to June 2007 is shown in the following table.

	H1. 2006	H1. 2007
Actual interest costs (CZK bn)	17.1	17.0
Expected (simulated) costs (CZK bn)	17.5	19.5
Cost-at-Risk 95% (CZK bn)	19.5	21.1

Following table documents that higher simulation bias in comparison with the first half of 2006 occurred especially in June.

Months	1.	2.	3.	4.	5.	6.
Actual interest costs (CZK bn)	2.9	3.3	8.6	12.6	12.8	17.0
Expected (simulated) costs (CZK bn)	3.0	3.6	9.1	13.2	13.2	19.5
Cost-at-Risk 95% (CZK bn)	3.3	4.3	10.4	14.5	14.7	21.1

The main drivers behind the bias are amendments of the planned issuance calendar and to certain extent also replication error within the debt and derivatives portfolio. The following table represents the revised path of expected interest costs and Cost-at-Risk for the second half.

### Revised expected interest costs for the second half of 2007

Months	7.	8.	9.	10.	11.	12.
Expected (simulated) costs (CZK bn)	18.4	21.8	26.7	29.8	31.6	33.3
Cost-at-Risk 95% (CZK bn)	20.0	23.6	28.8	32.1	33.9	35.8

### III. Integrated portfolio of state debt and risky state guarantees at the end of June 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*.

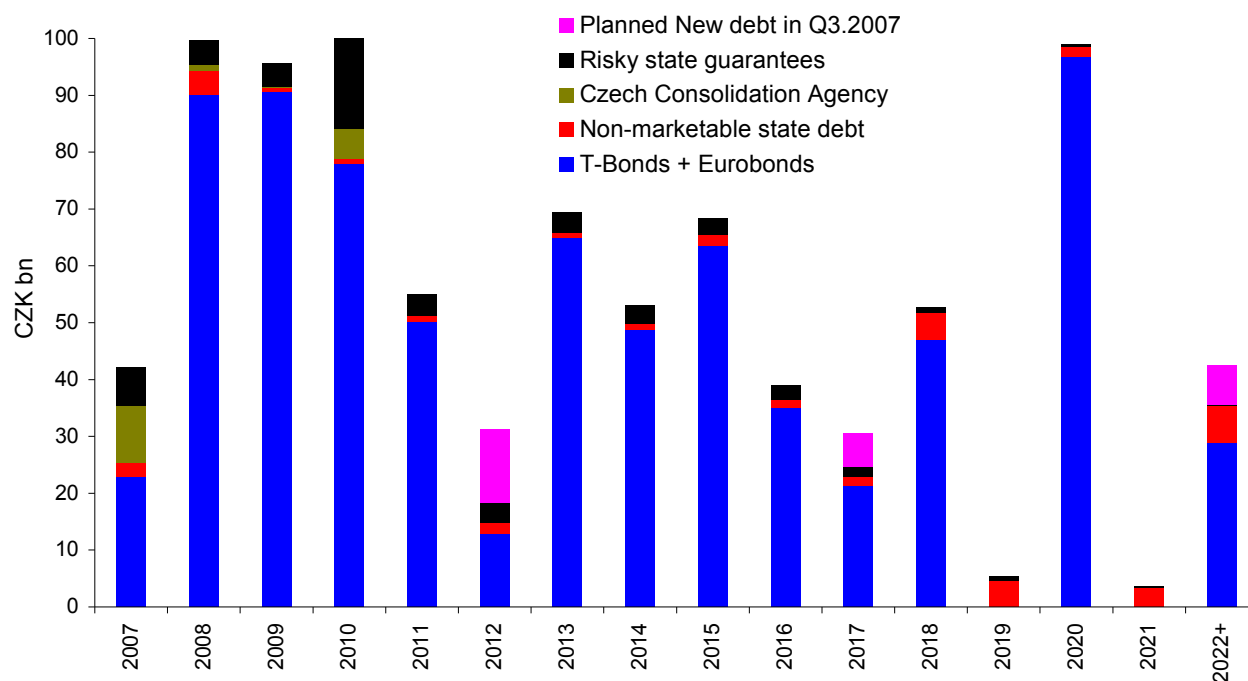
#### Measures of the integrated portfolio of state debt and risky state guarantees

	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	856.1	870.1	0.6	4.2	16.0	23.4	6.4	3.8
Risky state guarantees	55.1	55.8	41.9	27.4	12.3	31.1	4.8	3.2
<b>Portfolio total</b>	<b>911.2</b>	<b>925.9</b>	<b>3.1</b>	<b>5.6</b>	<b>15.8</b>	<b>23.9</b>	<b>6.3</b>	<b>3.8</b>

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 outlook of the CCA's funding needs (updated on 9 July 2007, excluding T-Bills outstanding)



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

#### IV. State Debt Parameters (end of quarter)

Debt Parameter	Jun 2006	Sep 2006	Dec 2006	Mar 2007	Jun 2007
<b>Total state debt (CZK bn)</b>	<b>728.9</b>	<b>746.3</b>	<b>802.5</b>	<b>811.7</b>	<b>856.1</b>
Market value, inc. derivatives (CZK bn))	765.2	778.7	844.2	846.5	870.1
Short-term state debt (%)	17.6	19.5	17.1	18.3	16.0
Share of T-Bills (%)	10.9	9.6	11.5	9.6	7.7
Average time to maturity (years)	6.1	5.9	6.2	6.5	6.4
Interest rate refixing up to one year, inc. derivatives (%)	26.6	28.2	25.4	26.0	23.4
Variable-rate state debt (%)	4.4	4.4	4.3	4.2	4.2
Modified duration (years)	3.6	3.6	3.8	4.0	3.8
Modified duration, exc. IRS (years)	3.2	3.3	3.5	3.6	3.5
Foreign currency state debt (%)	0.9	0.8	0.7	0.7	0.6
Foreign currency debt, exc. cross-currency swaps (%)	10.7	10.4	9.3	9.4	9.1
Nonmarketable state debt (%)	4.5	4.7	4.7	4.6	4.6
<b>Marketable state debt (CZK bn)</b>	<b>696.1</b>	<b>711.3</b>	<b>765.0</b>	<b>774.4</b>	<b>817.0</b>
Market value (CZK bn)	732.4	743.5	806.7	809.1	830.9
Short-term marketable debt (%)	18.3	20.1	17.6	18.4	15.9
Share of T-Bills (%)	11.4	10.1	12.0	10.1	8.1
Average time to maturity (years)	5.9	5.7	6.1	6.4	6.3
Interest rate refixing up to one year, inc. derivatives (%)	23.2	24.8	22.0	22.7	20.0
Variable-rate marketable debt (%)	0.0	0.0	0.0	0.0	0.0
Modified duration (years)	3.7	3.8	4.0	4.1	4.0
Modified duration, exc. IRS (years)	3.4	3.4	3.6	3.8	3.7
Foreign currency marketable deb (%)	0.9	0.9	0.7	0.7	0.7
Foreign currency debt, exc. cross-currency swaps (%)	11.2	10.9	9.8	9.8	9.5

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

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