Ministry
of Finance

Debt and Financial Assets
Management Department

The Czech Republic Funding and Debt Management Strategy

2016

18 December 2015

Ministry of Finance

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ISSN 2336-226X (Print)
ISSN 2336-2278 (On-line)

Issued semiannually, free distribution

Electronic archive:
www.mfcr.cz/statedebt

The Minister of Finance decided on 11 December 2015 about the structure and method of covering the financing needs in the budget year 2016 and approved the basic absolute and relative limits for issuance activity on the domestic and foreign markets and for active management of the net debt portfolio and liquidity of the treasury single account in the individual currencies (Ref. No. MF-55968/2015/2002).

This defined operational framework in the form of the submitted The Czech Republic Funding and Debt Management Strategy for 2016 enables the Ministry of Finance to act flexibly on the domestic and foreign financial markets while actively securing cash resources for covering the financing needs and ensuring the daily solvent position of the state, meaning the creation of initial conditions for smooth implementation of budget and fiscal policy.

The Czech Republic Funding and Debt Management Strategy for 2016 is consistent with the approved State Budget Act of the Czech Republic for 2016, including the medium-term outlook to 2018, the Fiscal Outlook of the Czech Republic from November 2015 and the Macroeconomic Forecast of the Czech Republic from October 2015.

The Czech Republic Funding and Debt Management Strategy for 2016 is submitted via Debt and Financial Assets Management Department, which is responsible for operations related to the funding of the state, active management of the net debt portfolio, management of the liquidity of the treasury single accounts, and short-term and long-term investment of available cash resources of state financial assets and the treasury single accounts on financial markets.

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List of Abbreviations

CaR	Cost-at-Risk
CNB	Czech National Bank
CZK	Currency code of Czech Koruna
CZSO	Czech Statistical Office
EIB	European Investment Bank
ESA 2010	European System of Account - 2010
EUR	Currency code of Euro
GDP	Gross domestic product
CHF	Currency code of Swiss franc
JCR	Japan Credit Rating Agency
MoF	Ministry of Finance
MTS	Mercato Telematico Secondario
R&I	Rating agency Rating and Investment Information, Inc.
T-Bill	Treasury bill
T-Bond	Medium-term and long-term government bond

Introduction

The Ministry of Finance (hereinafter the Ministry or MoF) presents to the public The Czech Republic Funding and Debt Management Strategy for 2016 (hereinafter thStrategy) in accordance with the calendar of published information, which contains a basic framework for the state funding and sets limits and targets for each monitored state debt portfolio risk indicators for 2016 and medium-term outlook to 2018 including a detailed description of assumed funding in the first half of 2016.

Based on actual development of financing needs, assumed changes in legislative framework regarding particularly state treasury liquidity management, and development of situation on financial markets, the update of this Strategy for the second half of 2016 will be published in June 2016. Due to the need to react more flexibly in the area of issuance and operational framework of state debt management, the quarterly updates of the Strategy may be introduced within The Czech Republic Debt Management Quarterly Report - 1st Quarter of 2016 and The Czech Republic Debt Management Quarterly Report - 1st – 3rd Quarter of 2016 for the purpose of most effective use of market conditions with positive impacts on state budget in 2016.

The detailed description of events in the area of state debt, the evaluation of issuance, the analysis of secondary market of government bonds, the development of interest expenditure of the state budget, the risk management of debt portfolio, and annual performance evaluation of primary dealers will be contained in The Czech Republic Debt Management Annual Report for 2015, which will be published on 12 February 2016.

Key Events in 2016

Financing Needs of CZK 342.0 Billion

- budgeted state deficit of CZK 70.0 billion
- redemptions of three CZK-denominated issues of medium-term and long-term government bonds issued in 2001, 2008 and 2013 in total nominal value of CZK 142.6 billion
- redemption of foreign issue of government bonds issued in 2009 in total nominal value of CHF 500 million
- redemptions of four issues of savings government bonds in total nominal value of CZK 30.0 billion
- re-financing of treasury bills issues in total nominal value of CZK 84.4 billion
- involvement of available cash resources of treasury into covering of the part of financing needs during the year and development of single treasury accounts administration system and liquidity management in relation to the legislative changes under preparation

Government Bonds Issuance

- issuance of medium-term and long-term government bonds on domestic market in total nominal value of CZK 150.0 billion minimum
- issuance of new issues of CZK-denominated government bonds with maturity particularly in 2018 to 2022
- possibility of issuance of new issues of CZK-denominated government bonds with maturity from 2023 in dependence on expressed demand from the primary dealers and investors
- possibility of issuance of new zero-coupon medium-term and long-term government bonds along the whole yield curve, including the option of issuance of some issues in a single tranche
- re-opening of already issued fixed-rate and variable-rate CZK-denominated government bonds with maturity from 2017
- benchmark foreign issue of government bonds in case of cost-favourable conditions
- tap sales of CZK-denominated government bonds on secondary market in dependence on market conditions, demand from the primary dealers, and availability of CZK-denominated government bonds on Ministry’s asset account
- possible substitution of treasury bills issuance fo issuance of medium-term and long-term government bonds with relatively short time to maturity
- treasury bills will be issued in all available maturities up to 1 year for the purpose of satisfying specific demand from investors and realization of interest revenue of the state budget

Primary and Secondary Government Bond Markets

- adjustment of Rules for the Primary Sale of Government Securities Organized by the Czech National Bank with effect from 1 January 2016 for the purpose of increasing the issuer's flexibility primarily regarding thefirst tranches of new issues of government bonds with expected positive impact on achieved auction prices

- the fulfilment of primary dealers' quoting obligations on secondary market will be executed through the MTS Czech Republic platform also in 2016, which was designated for 2016 and 2017 by the decision of 12th Primary Dealers Committee on 16 October 2015

- government bonds buy-backs and exchanges programme in dependence on the demand from the primary dealers will be launched in January and will be implemented during the course of 2016 mainly for the purpose of the state debt maturity profile management

- active support of lending facilities of medium-term and long-term government bonds in the form of collateralized loans of medium-term and long-term government bonds, which were newly launched in a pilot operation in December 2015, under which the Ministry provides government bonds of the Czech Republic from own asset account against another government bond or CNB bill for a short period of time

Rating of the Czech Republic

The Czech Republic belongs among the exceptionally reliable issuers and enjoys considerable interest from domestic and foreign investors, as confirmed by its high credit rating with a stable outlook from all the major credit rating agencies with international scope of activity. The Czech Republic has the highest total rating of all the countries in Central and Eastern Europe and has had a higher rating than the Euro Area member countries average for several years.

Table 1: The Czech Republic's Credit Rating in 2015

Rating agency	Domestic long-term liabilities	Outlook	Foreign long-term liabilities	Outlook	Granted/ affirmed
Moody's	A1	Stable	A1	Stable	19/7/2013
Standard & Poor's	AA	Stable	AA-	Stable	24/7/2015
Fitch Ratings	AA-	Stable	A+	Stable	16/10/2015
JCR	AA-	Stable	A+	Stable	25/7/2015
R&I	AA-	Stable	A+	Stable	2/12/2014

Source: Moody's, Standard & Poor's, Fitch Ratings, JCR, R&I

Financing Needs and State Debt Development

The financing needs are determined by the standard components that must be covered by cash resources in a given year, i.e. the budgeted state budget cash deficit, and all redemptions, early redemptions, and buy-backs and exchanges of nominal values (principals) of state debt, including the related derivatives. Financing operations on the side of state financial assets and within the single treasury accounts then take place on the side of cash resources that can be involved into the covering of the financing needs simultaneously with the state borrowing operations on financial markets.

For 2015 it is expected that the cash budget deficit will not exceed CZK 70.0 billion, which is CZK 30.0 billion lower than budgeted deficit and it is one of the main causes of lower financing needs in 2015 compared to the original plan. The financing needs of the Czech Republic have been relatively stable with moderate downward trend, while its decrease under 7% of GDP is expected in 2018 horizon. Compared to the medium-term outlook published on 17 December 2014, there is a decrease in financing needs amounting to CZK 64 billion in 2016 and CZK 31 billion in 2017.

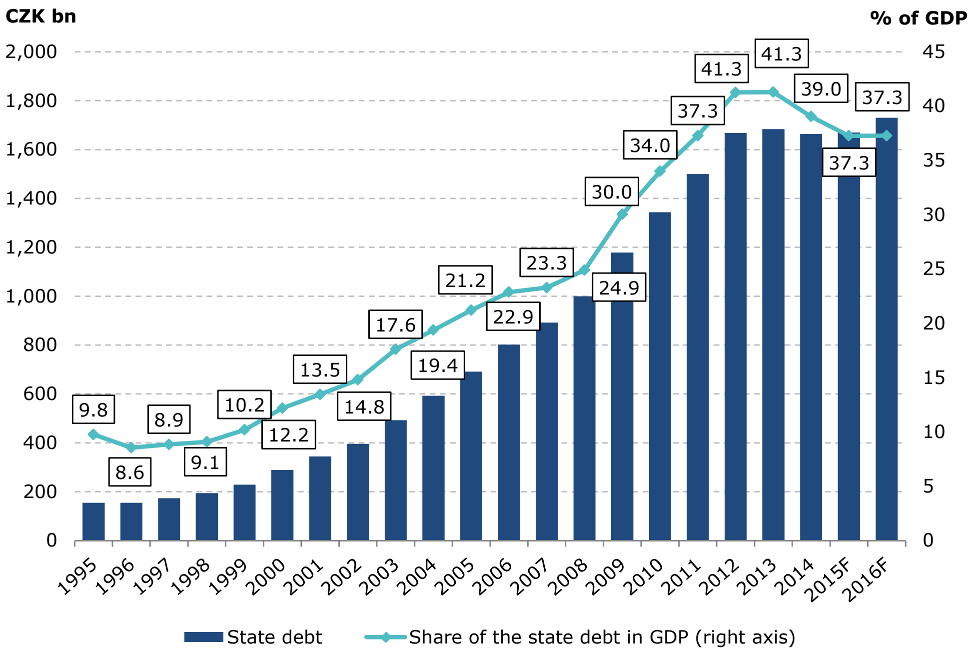
Table 2: Financing Needs (CZK billion)

Financing needs	2013	2014	2015F	2016F	2017F	2018F
State budget deficit[1]	81.3	77.8	70.0	70.0	60.0	50.0
T-Bonds redemptions[2]	107.9	143.7	123.9	155.8	210.4	201.2
Redemptions and early redemptions on savings government bonds	7.7	11.9	11.8	30.0	16.9	16.6
T-Bills and other money market instruments redemptions excl. roll-over [3]	189.1	120.9	110.2	84.4	60.0	60.0
Repayments on credits and loans	2.8	11.1	2.5	1.7	1.7	4.8
Total financing needs[4]	**388.8**	**365.3**	**318.3**	**342.0**	**348.9**	**332.6**
Total financing needs (% of GDP)[5]	**9.5%**	**8.6%**	**7.1%**	**7.4%**	**7.2%**	**6.6%**

[1] For 2013 and 2014 actual budget deficit, for 2015 expected state budget deficit, for 2016 budgeted state budget deficit and for 2017 and 2018 medium-term outlook for state budget deficit.
[2] Incl. hedging operations and the effect of already executed buy-backs and exchanges in previous years.
[3] Excl. T-Bills issued and redeemed within respective year, and roll-over of other money market instruments.
[4] Excl. planned future buy-backs and exchanges of T-Bonds.
[5] Source for GDP in ESA 2010 methodology for 2013 and 2014 is the CZSO, for 2015 to 2018 the MoF Macroeconomic Forecast – October 2015.
Source: MoF, CZSO

The resulting gross borrowing requirement, which is derived from the financing needs and represents the part of financing needs, which must be covered through borrowing operations on financial markets, especially government bond markets, is dependent on the involvement of financial assets into covering the financial needs, i.e. in particular the available state treasury resources. In case of involvement of these liquid assets into covering the financing needs, the resulting gross borrowing requirement is lower than total financing needs in respective period, which occurred in 2013, 2014 and 2015. In the opposite case, when there is an accumulation of financial assets, the gross borrowing requirement is higher than the financing needs, which occurred e.g. in 2011 and 2012. Also in 2015, the active use of refinancing mechanism of state treasury and more effective financial planning allowed the decrease in the extent of borrowing operations of the state and thereby further savings on interest expenditure of state budget and relatively stabilized development of state debt were achieved.

Figure 1: Czech Republic's State Debt Development



Source: MoF, CZSO

In 2015, an increase in the absolute value of state debt equalling approximately the level of budgeted state deficit for 2016 was declared within the proposal of state budget for 2016. However, this does not represent any target value of state debt for 2016, the eventual change will fully depend not only of final state budget deficit in 2016 but also on the result of currently ongoing legislative processes which will allow involvement of resources of additional accounts of public sector organisations into central system of state treasury and thereby further strengthening liquid reserves of state debt financing, which could result into the lower increase in the absolute value of state debt.

On the other hand, the Ministry must also take into account very favourable conditions on government bonds market, when negative yields are achieved in auctions, and in case of their further continuance in 2016, it is ready to flexibly increase the issuance correspondingly and thereby partly cover the state budget deficit for 2016 and possibly pre-finance the financing needs for 2017 under conditions, which may not be achievable to such an extent in the coming future. Anyway, these operative decisions will be transparently communicated with the public, particularly with the primary dealers in government bonds, through regular updates of issuance calendars or alternatively through quarterly updates of issuance strategy for 2016. In 2016, the stabilization of the state debt in GDP is expected after there was a decrease of it by four percentage points compared to 2013.

Funding Programme and Issuance Activity in 2016

Medium-Term and Long-Term Government Bonds

The Ministry plans to carry out gross issue of T-Bonds on domestic market in total nominal value of CZK 150.0 billion minimum in 2016.

The Ministry plans to further utilize favourable market conditions, as yields of government bonds with residual maturity up do 6 years reach negative values, and plans to carry out the bigger part of the issuance on shorter end of yield curve with positive impact on state budget deficit and, in the end, on the absolute value of state debt. In dependence on the demand from primary dealers and the development on financial markets, the Ministry plans to issue new issues of T-Bonds with maturity from 2018 to 2017. In case of favourable market conditions, the Ministry will consider issuing new zero-coupon T-Bonds along the whole yield curve including the option of issuance of some issues in a single tranche. When choosing particular maturities and type of instrument, the Ministry will flexibly react on development of market conditions and the demand from the primary dealers. The issuance including the inclusion of variable-rate T-Bonds will be carried out with the respect to the riskiness of the debt portfolio and maintaining strategic targets and limits for risk parameters.

The issuance in 2016 will be focused primarily on residual maturity segment of up to 10 years.

Table 3: Framework Issuance Plan of T-Bonds on the Domestic Primary Market in 2016 (CZK billion)

	Framework scope of sale
Fixed-rate T-Bonds	
Maturity segment of up to 5 years	Max. 150
Maturity segment of 5 to 10 years	Max. 120
Maturity segment of over 10 years	Max. 70
Variable-rate T-Bonds	Max. 70

Source: MoF

If there is an unexpected change of the Czech Republic's government bond market conditions, the Ministry reserves the option of not issuing these new bonds or only some of them. The Ministry will also consider the option of supplementing the issuance of CZK-denominated T-Bonds on the primary market in the course of 2016 with tap sales of T-Bonds from its own asset account on the secondary market, if the primary dealers interest in using these government bonds within T-Bonds lending facilities drops. Furthermore, tap sales of T-Bonds with a long time to maturity may be used to manage the average time to maturity of the debt portfolio.

The execution of the issue of T-Bonds on foreign markets in 2016 will depend mainly on current market conditions on the domestic and foreign markets, which the Ministry will monitor and evaluate intensively throughout the year in the cooperation with the contractual primary dealers. The condition for executing foreign issues is lower costs related to the issue on foreign markets compared to the comparable issue on the domestic market after taking into account the costs of hedging of the currency risk.

Money Market Instruments

In case of favourable market conditions, there may be another substitution of T-Bills issues for T-Bonds bearing an interest on the short end of the yield curve with positive impact on risk parameters of state debt portfolio. T-Bills will be offered by the Ministry in all available maturities up to one year with the aim of maximally utilizing the actual market condition with the respect to actual borrowing requirement and effective state treasury liquidity management. The Ministry plants to further offer T-Bills with relatively short time to maturity in 2016 if there is no deterioration of market conditions with consequent increase in yields on short end of the yield curve to the positive values.

During 2016, the Ministry will also use the T-Bonds lending facilities intensively, but in greater extent in the form of collateralized loans of T-Bonds, under which the Ministry provides government bonds of Czech Republic from own asset account against another government bond or CNB bill for a short period of time. These facilities may be used by the primary dealers for the period up to 90 days. The aim of these operations is to increase the liquidity of government bonds on secondary market particularly in case of short-term excess of demand over supply at the particular government bond. The scope of realized T-Bonds lending facilities in 2016 will primarily depend of the demand for particular government bonds from the investors with the fact, that the Ministry will be ready to flexibly satisfy this demand accordingly to the availability of government bonds on its asset account.

Other Debt Instruments

During 2016, the Ministry will continue to analyse the option to implement new concept of direct sale of government bonds to citizens, which will allow their more regular availability during the calendar year and will bring them closer to the conditions of issuance of other government bonds in the term of the costs. Within this concept, the test operations may be carried out mainly through the electronic distribution platform operating from November 2013. For 2016, no quantitative target plan regarding the issuance of savings government bonds was set, and as well as in 2015, no issuance may be realized.

In 2016, the Ministry does not plan any drawing of EIB loan tranches or receiving any loans from other international financial institutions.

Programme for Buy-backs and Exchanges Operations on Secondary Market

The Ministry plans the inclusion of government bonds into buy-backs and exchanges transactions in dependence on market condition in particular segment of the yield curve and their execution will primarily depend on the demand from primary dealers. The exchange transactions will be technically available to primary dealers through the MTS Czech Republic from January 2016. The impacts of these operations will affect the financing needs and borrowing requirement accordingly and will have positive impact on refinancing risk of state debt management.

Adjustment of the Rules for the Primary Sale of Government Securities

With the effect from 1 January 2016, the Ministry agreed with the CNB to adjust the Rules for the Primary Sale of Government Securities Organized by the Czech National Bank. Due to the development on the financial markets, no auction limits on individual primary dealers' orders will be set regarding the T-Bills auctions.

Further, the formula for calculation of limits for non-competitive part of T-Bonds auctions will be specified in case that the offered total nominal value of T-Bonds is given as a maximum, i.e. not by a range. In this case this maximum of offered total nominal value will be used in the calculation instead of the range centre. Furthermore, there will be an adjustment of the part of non-competitive limit, which takes into account the success of the primary dealers in competitive parts of auctions, when the half of total nominal value of T-Bonds offered in non-competitive part of the T-Bonds auctions, i.e. 10% of total nominal value of T-Bonds offered in competitive part of the T-Bonds auctions, may be purchased by the particular primary dealer based on their success in all competitive parts of the T-Bonds auctions in previous three auction days regardless the number of executed auctions in each particular auction day. In the context of taking into account the results of discussions with primary dealers regarding the T-Bills auctions, the orders of T-Bills will be submitted with yield to the three decimal places from 2016.

At the same time, with the effect from 1 January 2016, there will be a formal revision of General MTS Domestic Market Rules and relevant Annex for MTS Czech Republic, meaning primarily an adjustment of the structure of these rules without any major changes that would have an impact on trading.

Funding Programme and Issuance Activity in the First Half of 2016

Medium-Term and Long-Term Government Bonds

The primary auctions of CZK-denominated T-Bonds in the course of the first half of 2016 will be held on the traditional auction day of Wednesday with the settlement on Friday according to the T+2 standard for settling operations on the primary market which was implemented at the beginning of 2015 within the harmonisation process of market standards of European Union member states.

The issuance calendars of T-Bonds together with indicative maximum total nominal value of T-Bonds sold in auctions for respective quarter of the year will be published monthly usually the third working Monday of the month preceding the respective month unless announced otherwise by the Ministry. The Ministry reserves the option of update according to the actual development of market conditions and the demand from the primary dealers.

The Ministry also reserves the right to specify one or more alternative T-Bonds to be included in the relevant T-Bonds auction, as it was done in September 2015 and thus keeping more room for flexible reaction on actual development of market conditions and demand from primary dealers. The selection of particular T-Bonds for the relevant auction will be announced at least one working day before the date of the competitive part of the auction. The nominal value of T-Bonds offered in the competitive part of the auction will be published in indicative maximum amount or in indicative range within the issuance calendars.

In the first half of 2016, the Ministry plans to issue T-Bonds on domestic markets with maturity from 2018 to 2027. In case of favourable market conditions, the Ministry will consider issuing new zero-coupon T-Bonds along the whole yield curve, including the option of issuance of some issues in a single tranche. When choosing particular maturities and instrument type, the Ministry will flexibly react on the development of market conditions and demand from primary dealers. Issuance in 2016 including the inclusion of variable-rate T-Bonds will be executed with the respect to the riskiness of debt portfolio and maintaining strategic targets and limits for risk parameters.

The planned maximum range of the gross issue of CZK-denominated T-Bonds in the first half of 2016 amounts to CZK 150.0 billion.

Table 4: Potential Auction Days of T-Bonds in the First Half of 2016

1st quarter	2nd quarter
13/1/2016	6/4/2016
20/1/2016	13/4/2016
27/1/2016	20/4/2016
3/2/2016	27/4/2016
10/2/2016	4/5/2016
17/2/2016	11/5/2016
24/2/2016	18/5/2016
2/3/2016	25/5/2016
9/3/2016	1/6/2016
16/3/2016	8/6/2016
23/3/2016	15/6/2016
30/3/2016	22/6/2016

Source: MoF

Money Market Instruments

T-Bills will be issued on traditional auction day of Thursday with the settlement on Friday during the first half of 2016.

The issuance calendars of T-Bills with particular maturities offered in individual auctions will be published monthly usually on third working Monday of the month preceding the respective month unless announced otherwise by the Ministry. The nominal value of T-Bills offered in auction will be published in predetermined indicative range or an indicative maximum value will be announced. However, the Ministry reserves the right to change the range or maximum value according to the actual development of market conditions or the demand from primary dealers. Together with the issuance calendars, the Ministry will publish also the indicative maximum total nominal value of T-Bills issues for respective quarter excluding the T-Bills issued and redeemed within 2016.

In case of the demand from primary dealers, the Ministry plans the gross issue of T-Bills in maximum of CZK 70.0 billion in the first half of 2016.

Table 5: Potential Auction Days of T-Bills in the First Half of 2016

1st quarter	2nd quarter
7/1/2016	7/4/2016
14/1/2016	14/4/2016
21/1/2016	21/4/2016
28/1/2016	28/4/2016
4/2/2016	5/5/2016
11/2/2016	12/5/2016
18/2/2016	19/5/2016
25/2/2016	26/5/2016
3/3/2016	2/6/2016
10/3/2016	9/6/2016
17/3/2016	16/6/2016
31/3/2016	23/6/2016

Source: MoF

Strategic Targets, Limits and Risk Parameters of the Debt Portfolio in 2016

In connection with the sufficient liquidity of single treasury accounts and relatively stable balances of the accounts owners mandatorily included into single treasury accounts, improvement of the efficiency and modernization of state treasury liquidity management, the Ministry approaches new concept of risk management starting from 2016, as strategic targets and limits of refinancing and interest risk will be published in medium-term horizon. This concept allows the Ministry to flexibly react on short-term market conditions and interest of investors for instruments in particular segment of time to maturity or re-fixing.

Short-term deviation from established strategic medium-term limits and targets for risk parameters of debt portfolio for refinancing and interest risk is possible. However, the issuance in medium-term horizon will be planned so that the targets and limits defined in this Strategy will be fulfilled in medium-term 2018 horizon. The additional effect of this step may be the decrease in total net expenditure on state debt service with positive impact on state budget deficit and, in the end, the level of state debt.

Starting from 2016, the Ministry also changes the concept of refinancing risk management through the average time to maturity of state debt indicator and interest risk management through the average time to re-fixing of the state debt indicator, as it abandons the target band and establishes a medium-term target value of this indicator with a possibility of a short-term deviation from this value instead. The reason is the actual market condition, when the Ministry achieves extraordinary savings on state debt service by issuing on short end of the yield curve and thus it is desirable to use this situation at maximally acceptable level. Maintaining a fixed target band would run counter to this intention. The actual financial market condition is also related among other things to the expansionary monetary policy of central banks and it is probable that it will persist even during 2016. The Ministry will monitor and evaluate the financial market conditions intensively.

Medium-term targets and limits in the area of refinancing and interest risks will be evaluated against a 12-month moving average of the particular indicator starting from 2016. For the purpose of determining these averages, the values of these risk parameters as of the end of each calendar month will be recorded. Indicators constructed in this way will smooth out the fluctuations of the values of these indicators caused for example by the short-term fluctuations of markets or large redemption of T-Bonds in particular month.

The currency risk is managed by the Ministry through the net foreign-currency exposure of state debt indicator taking into account also the foreign-currency exposure of state financial assets. In this context, the Ministry distinguishes between net foreign-currency exposure of state debt with the impact on state debt level and net foreign-currency exposure with the impact of the level of interest expenditure on state debt service. The limit stipulated by the Ministry is valid for both indicators and is valid for each year of medium-term horizon without the possibility to exceed it. However, its value is subjected to the condition that there will be no more pronounced depreciation of Czech Koruna exchange rate. Compared to the refinancing and interest risk, the currency risk is relatively small, which is demonstrated by low sensitivity of interest expenditure on state debt service to the change in exchange rate, which in case of depreciation of Czech Koruna against currencies included in the current state debt portfolio by 10% in the course of 2015 would increase by approx. 1.9%.

Refinancing Risk

The limit for the share of the short-term debt (debt due within 1 year) is stipulated at 20.0% of the total state debt for the 2018 medium-term horizon. The expected share of the short-term state debt in the total state debt as of the end of 2015 amounts to 16.2% and is thus below the limit valid for this year.

The limit for the share of the medium-term debt (debt due within 5 year) is stipulated at 70.0% of the total state debt for the 2018 medium-term horizon. The expected share of the medium-term state debt in the total state debt as of the end of 2015 amounts to 59.4% and is thus below the limit valid for this year.

For average time to maturity of the state debt, the target value of 6.0 years is stipulated for the 2018 medium-term horizon with the possibility of deviation of 0.25 years. The Ministry will consider achieving this medium-term target if favourable market conditions remain. The expected average time to maturity of the state debt as of the end of 2015 amounts to 5.1 years and is thus in the lower half of the target band valid for this year.

Interest Risk

For interest re-fixing of the debt portfolio within 1 year, the target band of 30.0 to 40.0% of total state debt is stipulated for the 2018 medium-term horizon. The expected interest re-fixing of the debt portfolio within 1 year as of the end of 2015 amounts to 34.1% and is thus in the middle of the target band valid for this year.

Starting from 2016, the Ministry establish a medium-term target value of average time to re-fixing of 4.0 years in line with the new concept of interest risk management. The expected average time to re-fixing of the state debt as of the end of 2015 amounts to 4.0 years and is thus on the lower bound of the target band of 4.0 to 5.0 years valid for this year.

Currency Risk

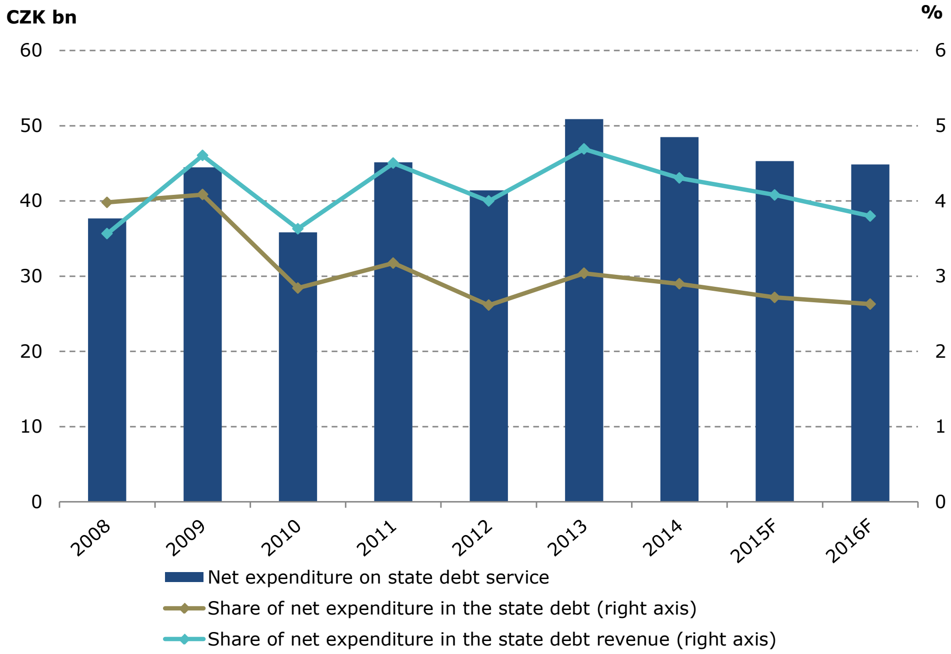
For 2016, the Ministry retains the limit for both net foreign-currency exposure of the state debt indicators, i.e. net foreign-currency exposure of state debt with the impact on state debt level and net foreign-currency exposure with the impact of the level of interest expenditure on state debt service, at the level of 15.0% (up to 17.0% in the short-term) of total state debt. The level of stipulated limit is conditioned by the persistent situation on foreign exchange market in case there will be no significant depreciation of Czech Koruna against Euro compared to the current CNB's commitment of keeping the exchange rate close to the 27 CZK/EUR level against the average development since November 2013. The expected net foreign-currency exposure of state debt with the impact on state debt as of the end of 2015 amounts to 10.9%, and expected net foreign-currency exposure of state debt with the impact of the level of interest expenditure on state debt service as of the end of 2015 amounts to 10.2%.

State Debt Service Expenditure

Cash and Accrued Expression

The net expenditure on state debt service is represented by the difference of gross expenditure on state debt service and revenue, which is cash-based (like the entire state budget); hence, it is not accrued according to the ESA 2010 methodology, which takes place while preparing data for the notification. The share of net expenditure on state debt service in revenue of state budget, in state debt and also in GDP has been relatively stable over the past years.

Figure 2: Net Expenditure on State Debt Service

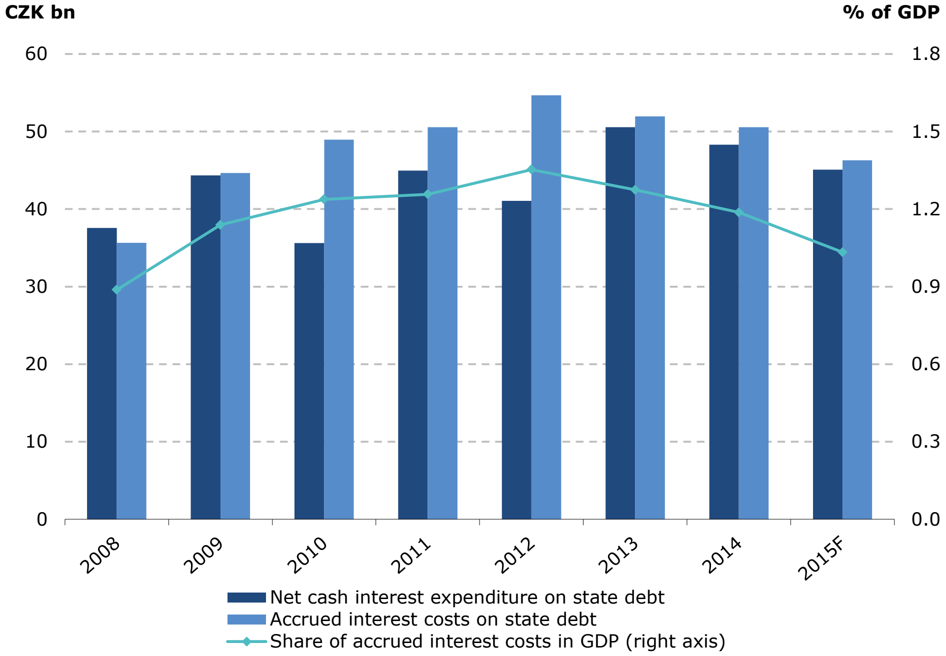


Note: Net expenditure for 2008 to 2014 represent actual data, data for 2015 the expected actual data and data for 2016 expected value of expenditure given by the model. The revenue of state budget is adjusted for the revenue of budget chapter 396 – State Debt. The Source for the revenue of state budget for 2015 and 2016 is the State Budget Act of the Czech Republic for respective years.
Source: MoF

Monitoring of the development of revenue and expenditure, or net expenditure on state debt service, does not always provide entirely accurate information on which costs are really linked to state debt in the given period. This purpose is better served by the accrued-based expression of costs, which is based on the gradual accumulation of interest costs on a daily basis. The development of accrued interest costs has a tendency to show much lower volatility than development of interest on the cash basis because it is not affected by time disproportions between the time of creation of given interest cost and the date of realization of related expenditure or revenue. Until 2012, accrued costs grew steadily and the share of accrued costs in GDP developed accordingly. The decline in accrued costs in 2013 to 2015 is due to the concurrence of a very slight increase/stagnation in state debt and a decrease in yields of government bonds to a historic low.

Among the factors affecting the relation between cash expenditure and accrued costs is the development of the balance of individual debt instruments. When the balance increases, interest payments paid at the end of calculation period (i.e. mainly coupon of domestic T-Bonds, EIB loans interest and swap interest) have an impact on costs on accrual basis at first and then on cash basis at the end of this period. When the state debt increases, the accrued costs in the given period outweigh cash expenditure for this reason. On the contrary, for discounted instruments (T-Bills), interest is settled with the state budget on the issue date, i.e. discounts have an impact on expenditure on cash basis at first and then have gradual impact on costs on accrued basis throughout the duration of the instrument. A similar principle applies to discounts and premiums on T-Bonds.

Figure 3: Net Cash Expenditure and Accrued Costs on State Debt Service



Note: Source for GDP in ESA 2010 methodology for 2008 to 2014 is the CZSO, for 2015 the MoF Macroeconomic Forecast – October 2015. Figures in 2015 are expected values.
Source: MoF, CZSO

A key role in the proportion between cash expenditure and accrued costs is also played by the development of interest rates. In case of their growth, there is a prevalence of accrued costs over cash expenditure for payments made at the end of the calculation period, and in the case of interest expenditure at the beginning of the instrument's duration, cash expenditure prevails over accrued costs. The similar principles apply in opposite sense in case of the interest rates decrease.

Similarly, there may be a significant disproportion between cash expenditure and accrued costs in the given period, if an instrument with a high interest rate is due in the period, which is fully projected in cash interest but only partly in accrued interest, and is replaced with an instrument with a low interest rate, whose accrual cost starts being continually accounted from the issue or acceptance date, which may not be reflected in cash interest at all in the given period.

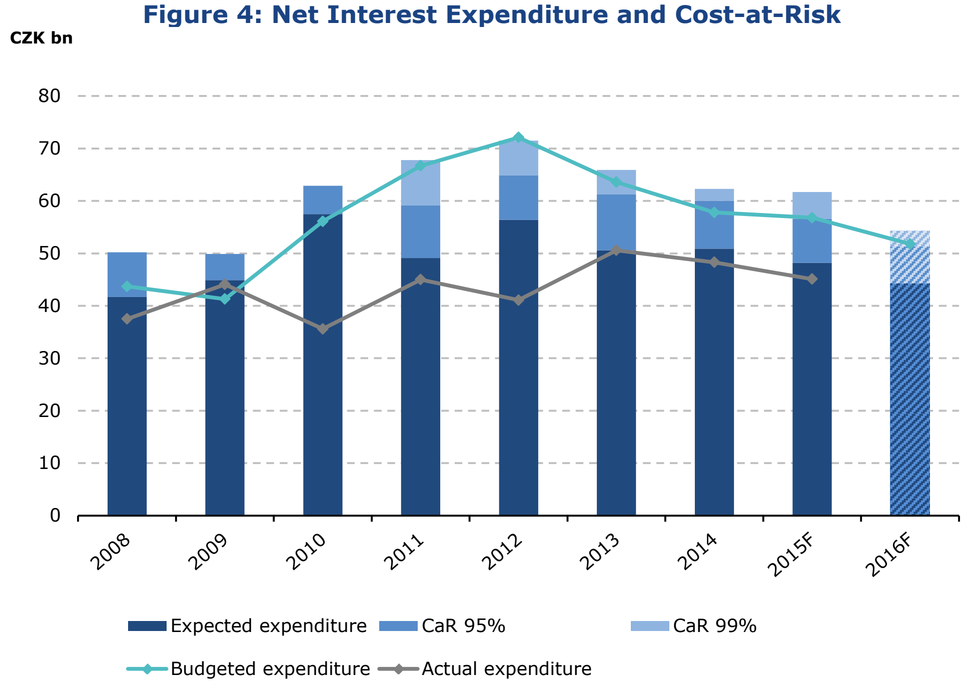
Cost-at-Risk of State Debt

The Ministry applies a sophisticated model framework known as Cost-at-Risk (CaR) for measuring and managing interest rate risk since 2005, which is based on the Value-at-Risk methodology and simulates future expected and maximum interest expenditure for a particular degree of risk, which is derived from the volatility of the time structure of interest rates. The stochastic element of the CaR model is the yield curve, and the deterministic element is the dynamic structure of the portfolio of state debt, which is based on the base case scenario of the funding programme while respecting the set strategic goals for managing financial risks.

The primary goal of the model is to determine the maximum interest expenditure on state debt, which with 95% or 99% probability will not be exceeded (CaR 95% and CaR 99%). The secondary goal of the model is to estimate the actual interest expenditure on state debt. The simulation framework operates separately with the interest expenditure and interest revenue. The outcome of aggregation of interest expenditure and interest revenue is the net interest expenditure on state debt. Interest expenditure on state debt service does not include fees related to state debt service, which are of a deterministic nature.

Over all the years the CaR methodology being applied, the model has fulfilled the primary goal, since the predicted maximum interest expenditures were not exceeded in any of those years.

Figure 4: Net Interest Expenditure and Cost-at-Risk



Note: In 2008 to 2015, the figures represent the originally approved budget, in 2016 budgeted net interest expenditure in State Budget Act of the Czech Republic for 2016. Figure in 2015 is expected value.
Source: MoF

Table 6: Net Interest Expenditure and Cost-at-Risk (CZK billion)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Budgeted expenditure[1]	43.7	41.3	56.1	66.7	72.1	63.6	57.8	56.8	51.8	53.2	58.1
Actual expenditure[2]	37.5	44.1	35.6	45.0	41.1	50.6	48.3	45.1	-	-	-
Expected expenditure	41.7	44.9	57.5	49.1	56.4	50.6	50.9	48.2	44.3	45.9	48.0
CaR 95%	50.2	49.9	62.9	59.2	64.9	61.3	60.0	56.6	51.4	56.0	59.6
CaR 99%	-	-	-	67.8	71.5	65.9	62.3	61.7	54.3	60.3	66.4

[1] In 2008 to 2015, the figures represent the originally approved budget, in 2016 budgeted net interest expenditure in State Budget Act of the Czech Republic for 2016, in 2017 and 2018 medium-term outlook.
[2] Figure in 2015 is expected value.
Source: MoF

The expected value of net interest expenditure in 2016 amounts to CZK 44.3 billion. Budgeted net interest expenditure on state debt service for 2016 are between 95% and 99% percentile of the CaR indicator and therefore will not be exceeded with the probability of more than 95%. The expected value of net interest expenditure amounts to CZK 45.9 billion in 2017 and CZK 48.0 billion in 2018, which is given primarily by the use of less conservative model for risk premium on government bonds, and yields of government bonds currently on historic low. In medium-term outlook of state budget for 2017 and 2018, the expenditure frameworks of budget chapter 396 – State Debt are below CaR 95% indicator. For 2017 the expenditure framework amounts to CZK 53.2 billion and is CZK 2.8 billion lower than 95% percentile of interest expenditure. For 2018 the expenditure framework amounts to CZK 58.1 billion and is CZK 1.5 billion lower than 95% percentile of interest expenditure. The increasing trend of budgeted and predicted interest expenditure is given primarily by the volatility of interest rates, which increases with longer prediction horizon. Due to the fact that the state budget is compiled only for the following year, the prediction horizon of interest expenditure for the budget compilation for following year will be shorter, and given the market conditions remain unchanged, it is expected, that the values of CaR 95% and CaR 99% indicator will decrease due to the lower volatility of the interest rates prediction.

Primary Dealers in Czech Republic Government Bonds

CZK-denominated T-Bonds and T-Bills will be offered in auctions to the primary dealers group, who concluded the Primary Dealer Agreement for Czech Government Securities with the Ministry. The number of primary dealers for 2016 is 12.

Table 7: List of Primary Dealers in Czech Republic Government Bonds for 2016

Primary Dealers	
Citibank Europe plc	ING Bank N.V.
Erste Group Bank AG / Česká spořitelna, a.s.	J. P. Morgan Securities plc
KBC Bank NV / Československá obchodní banka, a.s.	Morgan Stanley & Co International PLC
Deutsche Bank AG	Société Générale / Komerční banka, a.s.
Goldman Sachs International	PPF banka a.s.
HSBC Bank plc	UniCredit Bank Czech Republic and Slovakia, a.s.

Source: MoF

Calendar of Information Published in the First Half of 2016

January

Mo	Tu	We	Th	Fr	Sa	Su
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

February

Mo	Tu	We	Th	Fr	Sa	Su
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29						

March

Mo	Tu	We	Th	Fr	Sa	Su
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

April

Mo	Tu	We	Th	Fr	Sa	Su
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	

May

Mo	Tu	We	Th	Fr	Sa	Su
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31					

June

Mo	Tu	We	Th	Fr	Sa	Su
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30			

Publication of the The Czech Republic Debt Management Annual Report for 2015
- on the second Friday in February

Expected publication of The Czech Republic Funding and Debt Management Strategy for 2016 - Second Half Update
- on the last Friday of the first half of 2016

Publication of The Czech Republic Debt Management Quarterly Report
- regularly every third Friday of the month following the end of respective quarter

Publication of statistics of the Central Government Debt and Fiscal Data for the Czech Republic (SDDS and SDDS+ standards)
- at predefined dates in March and June

Publication of the annual statistics on Development and Structure of the State Debt, Financing Needs and Sources of the Central Government and Interest Expenditure on the State Debt
- on the last working day in March

Publication of the Statistics on Government Bonds by Type of Instrument, Statistics on Government Bonds by Type of Holder and Statistics on Government Bonds by Maturity
- regularly on the last working day of the month

Publication of the issuance calendars of T-Bills and T-Bonds for following month
- usually the third Monday in the month prior to the month of the respective auctions

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The publication was prepared based on the information and data available on 18 December 2015. The Ministry reserves the right to promptly respond to the actual development of financing needs using its tools over the course of the first half of 2016. The fulfilment of the funding programme and announced strategic goals in the first half of 2016 will depend of the development of the situation on domestic and foreign financial markets in terms of the minimization of expenditure on state debt service and financial risk management.

This publication is also available on the following website:

www.mfcr.cz/statedebt

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