



Debt Portfolio Management Quarterly Review

SEPTEMBER 2007

The Ministry of Finance submits the eleventh 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	September 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 118.8 bn	
Net T-Bills issues	CZK 0.0 to – 30.0 bn	CZK - 34.9 bn	
Loans from EIB	CZK 4.6 bn	CZK 3.8 bn	
Short-term state debt	20% and less	State debt	17.8%
		inc. Guarantees	17.4%
Average time to maturity	6.0 to 7.0 years	State debt	6.5 years
		Inc. Guarantees	6.4 years
Interest Rate Re-fixing	30 to 40%	State debt	25.5%
		Inc. Guarantees	25.8%

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 2.1 bn in the third quarter. The total amount of new EIB loans reached CZK 3.8 bn which represents 83% of the approved limit in the State Budget Act for 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 -2.0 bn in the third quarter. The total gross issuance of T-Bonds reached CZK **118.8 bn**; it is about 77.7% of the maximal supply announced on 1 December 2006.

The volume in issue of T-Bills decreased by CZK **34.9 bn** during the first three quarters, i.e. more than 16% above the annual plan in the financing programme.

The short-term state debt increased by two percentage points and reached the share of **17.8%**. 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 **6.5 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 increased slightly to 25.5% at the end of the third quarter and is stabilised below the lower limit.

II. Budgetary expenditures and Cost-at-Risk in the first three quarters of 2007

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

Measure (CZK mil)	Actual Q1-Q3. 2006	Budget 2007		Actual Q1-Q3. 2007	% Execution	Index 2007/2006 (%)
		Approved	After changes			
1	2	3	4	5	5:4	5:2
Total expenditures	23 291	38 102	38 102	25 084	65.8	107.7
1. Total interest costs	23 243	37 802	37 802	25 003	66.1	107.6
Domestic debt	20 482	32 777	32 777	21 775	66.4	106.3
<i>Of which:</i>						
T-Bills	1 544	3 185	3 185	1 281	40.2	83.0
T-Bonds	18 938	29 592	29 592	20 494	69.3	108.2
Foreign debt	2 762	5 025	5 025	3 228	64.2	116.9
<i>Of which:</i>						
International issues	2 274	3 924	3 924	2 444	62.3	107.5
EIB loans	488	1 101	1 101	784	71.2	160.7
2. Total fees	48	300	300	81	27.0	169.9

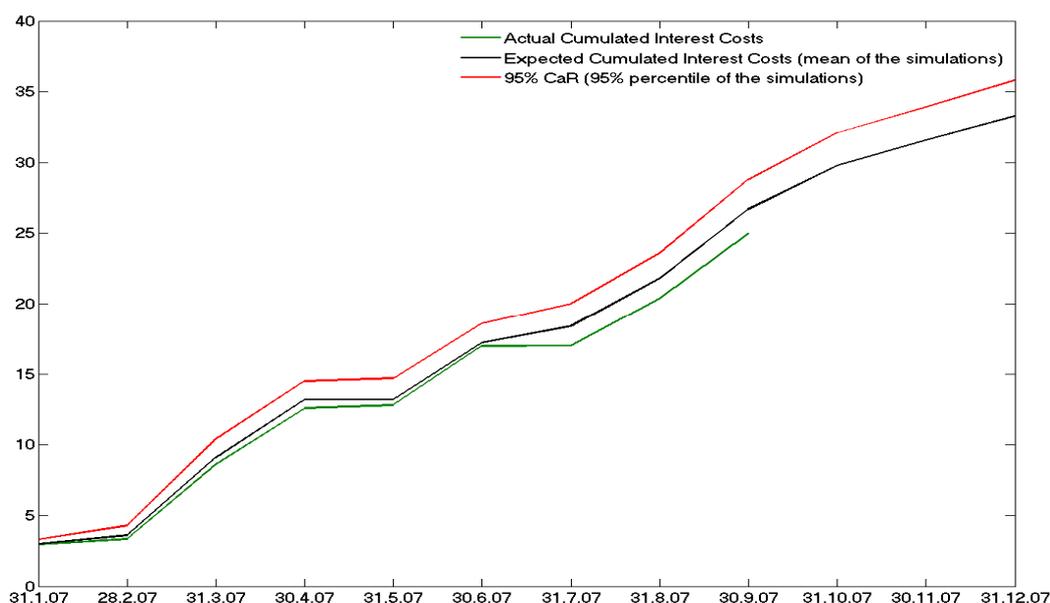
Source: MF CR.

Interest costs in the first three quarters of 2007 increased by 7.6% in comparison with the same period of the year 2006. Total budgetary expenditures related to state debt represent 65.8% of planned annual expenditures in 2007 and are 9.2 percentage points below the respective share for the first three quarters of 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 the Czech conditions in the *Financing and Debt Management Strategy for the year 2006* released on December 1, 2005.

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

Actual versus Expected Cumulated Monthly Interest Costs in 2007 (CZK bn)



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 three quarters of 2007 is summarized in the following table.

CaR Deviation from the actual interest costs in the first three quarters of 2006 and 2007

	Q1.- Q3. 2006	Q1.- Q3. 2007
Actual interest costs (CZK bn)	23.2	25.0
Expected (simulated) costs (CZK bn)	25.2	26.7
Cost-at-Risk 95% (CZK bn)	28.1	28.8
Expectation bias (%)	8.6	6.8

Source: MF CR.

The simulation model framework delivers moderate and acceptable overestimate of the expected costs that is slightly lower in the first three quarters of 2007 compared with the same period of 2006.

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

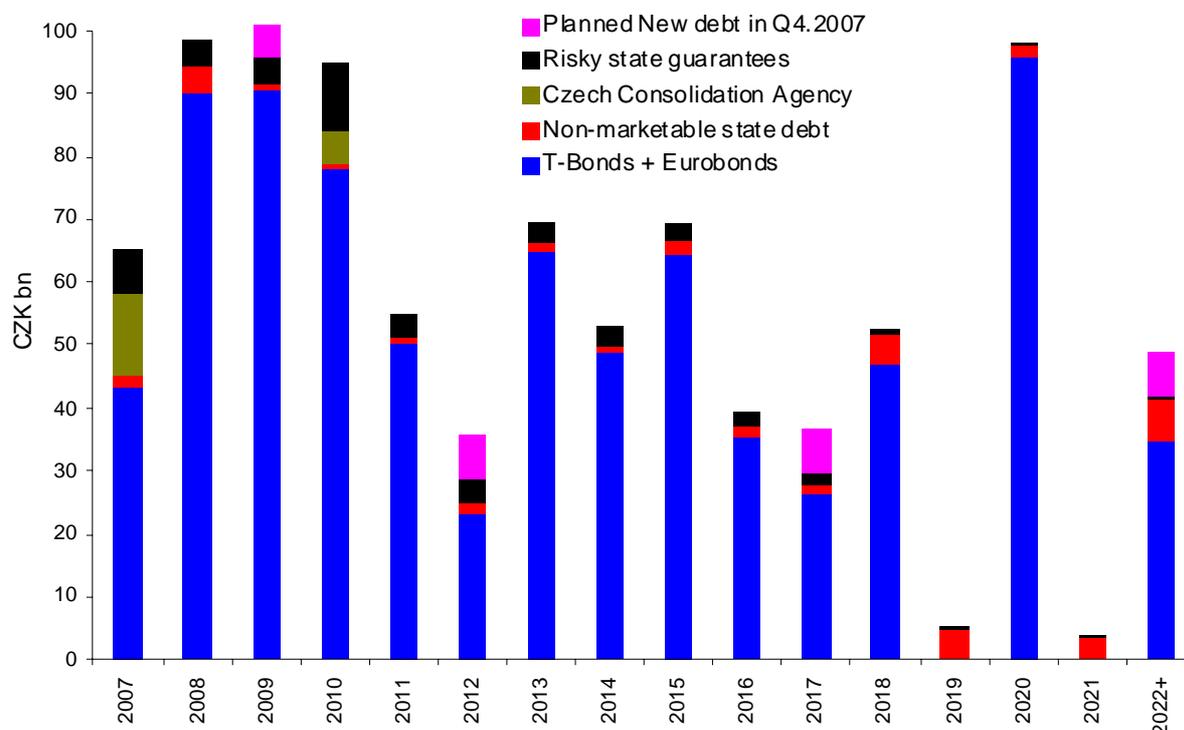
Measures of the integrated portfolio of state debt and risky state guarantees

	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	842.7	859.9	0.6	4.3	17.7	25.5	6.5	3.9
Risky state guarantees	52.9	53.8	41.4	27.2	12.7	28.5	4.6	3.1
Portfolio total	895.7	913.7	3.1	5.7	17.4	25.8	6.4	3.9

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 8 October 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	Sep 2006	Dec 2006	Mar 2007	Jun 2007	Sep 2007
Total state debt (CZK bn)	746.3	802.5	811.7	856.1	842.7
Market value, inc. derivatives (CZK bn))	778.7	844.2	846.5	870.1	859.9
Short-term state debt (%)	19.5	17.1	18.3	16.0	17.8
Share of T-Bills (%)	9.6	11.5	9.6	7.7	6.5
Average time to maturity (years)	5.9	6.2	6.5	6.4	6.5
Interest rate refixing up to one year, inc. derivatives (%)	28.2	25.4	26.0	23.4	25.5
Variable-rate state debt (%)	4.4	4.3	4.2	4.2	4.3
Modified duration (years)	3.6	3.8	4.0	3.8	3.9
Modified duration, exc. IRS (years)	3.3	3.5	3.6	3.5	3.6
Foreign currency state debt (%)	0.8	0.7	0.7	0.6	0.6
Foreign currency debt, exc. cross-currency swaps (%)	10.4	9.3	9.4	9.1	8.9
Nonmarketable state debt (%)	4.7	4.7	4.6	4.6	4.7
Marketable state debt (CZK bn)	711.3	765.0	774.4	817.0	803.3
Market value (CZK bn)	743.5	806.7	809.1	830.9	820.5
Short-term marketable debt (%)	20.1	17.6	18.4	15.9	18.0
Share of T-Bills (%)	10.1	12.0	10.1	8.1	6.8
Average time to maturity (years)	5.7	6.1	6.4	6.3	6.4
Interest rate refixing up to one year, inc. derivatives (%)	24.8	22.0	22.7	20.0	22.1
Variable-rate marketable debt (%)	0.0	0.0	0.0	0.0	0.0
Modified duration (years)	3.8	4.0	4.1	4.0	4.1
Modified duration, exc. IRS (years)	3.4	3.6	3.8	3.7	3.8
Foreign currency marketable deb (%)	0.9	0.7	0.7	0.7	0.7
Foreign currency debt, exc. cross-currency swaps (%)	10.9	9.8	9.8	9.5	9.3

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.

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

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

Further information:

Petr Pavelek, Ph.D., Head of Funding & Portfolio Management
 Debt and Financial Assets Management Department MF CR
 Letenská 15, 118 10 Praha 1
 Tel.: +420 257 042 678, E-mail: petr.pavelek@mfcr.cz