



Debt Portfolio Management Quarterly Review

DECEMBER 2009

The Ministry of Finance submits the twentieth *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 2009, these targets were quantified by the *Financing and Debt Management Strategy for 2009* released on 3 December 2008 and based on the Finance Minister's decision. The Strategy specifies operating space of the asset and liability management through issuance activity, financial investment and active operations of MoF on secondary market of government bonds and financial derivatives.

I. Review of Strategic Targets for 2009

The 2009 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.

The initially declared financial programme targets were broken due to financial crisis and resulting higher government requirements than initially supposed.

Financing programme and strategic targets in 2009

Criterion	Guidelines for 2009	December 31, 2009
International issues	Max. 50% of the total annual gross borrowing requirement	73,7%
	CZK 0.0 to 74.2 bn	54,7 mld. Kč
Gross government bonds issues	CZK 40.0 to 125.0 bn	203,0 mld. Kč
Net money market issues	CZK 0.0 to 5.0 bn	9,4 mld. Kč
Loans from EIB	CZK 15.8 bn	11,9 mld. Kč
Short-term state debt	20% and less	14,7%
Average time to maturity	5.5 to 7.0 years	6,5 let
Interest Rate Re-fixing	30 to 40%	30,5%

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

As regards **international funding**, on April 29th the Czech Republic has issued the fourth public benchmark Eurobond in the amount of **EUR 1.5 bn.**, i.e. **CZK 39.5 billion**. Further, the Czech Republic has issued first ever floating rate note denominated in EUR through Czech National Bank auction in the amount of **EUR 262.5 million.**, i.e. **CZK 6.7 billion**, in the fourth quarter. Further, the Czech Republic has issued bond denominated in CHF in the amount of **EUR 500.0 million.**, i.e. **CZK 8.5 billion**, in the fourth quarter. The total international issuance reached approximately **CZK 54.7 bn.** during 2009 which is 73.7% of maximal international issuance activity according to initially declared financial programme for year 2009. Further, the Czech Republic has drawn four tranches of loans from the European Investment Bank in the amount of **CZK 5.0 billion** during the fourth quarter. During year of 2009, loans were drawn in total amount of CZK 11.9 billion, which represents 75.3% of the limit in the State Budget Act for 2009.

Regarding **domestic issuance activity**, the total gross issuance of government bonds reached **CZK 25.8 billion**, including tap sales in the amount of CZK 2.6 billion via Reuters Dealing system used by the Debt and Financial Assets Management Department in the fourth quarter. The total annual gross issuance reached CZK 203.0 billion, which is about 162.4 % of the maximal supply initially announced on 3 December 2009. The total annual amount of tap sales reached CZK 36.0 billion. Buy-backs of government bonds were not executed during fourth quarter. The total annual amount of Buy-backs reached CZK 13.5 billion. The net issuance of government bonds was **CZK 103.0 billion** during 2009.

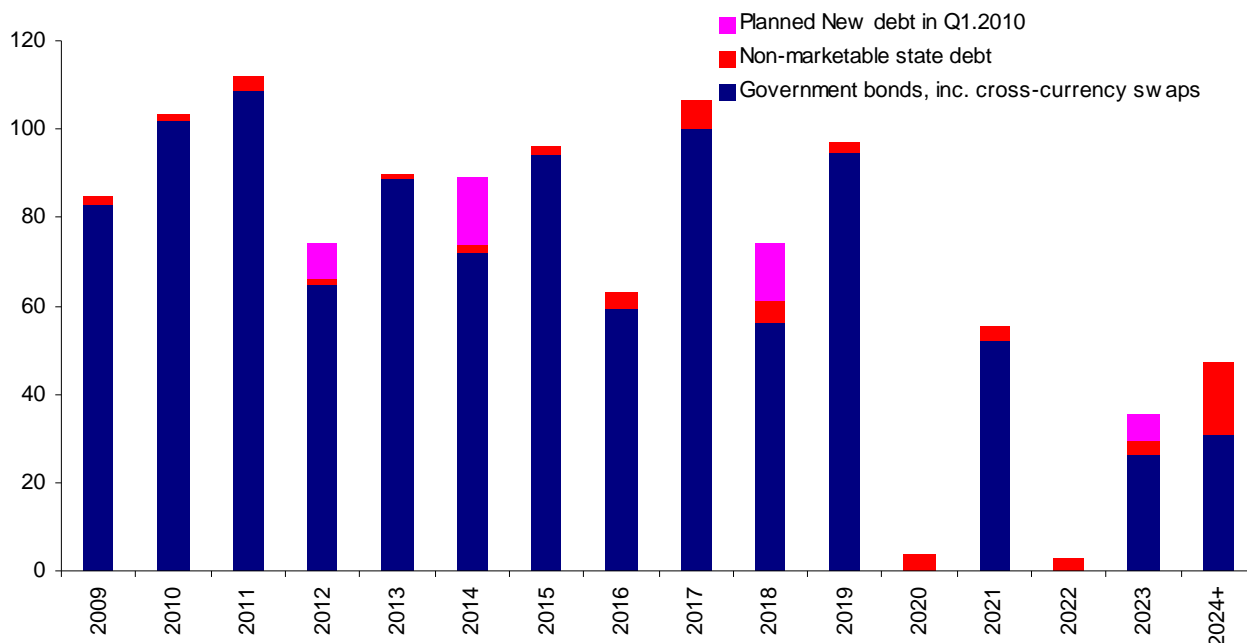
The volume in issue of money market instruments increased by **CZK 8.7 billion** during fourth quarter (CZK 9.4 bn. during 2009).

The short-term state debt increased by 1.8 percentage point and reached the share of **14.7%** at the end of 2009. It means that the Ministry of Finance maintains the planned long-term target.

Average time to maturity reached the level of **6.5 years**, i.e. remains within the announced target band 5.5–7.0 years for 2009.

Redemption profile of state debt (CZK billion)

(end of Q4. 2009; updated on 31 December 2009)

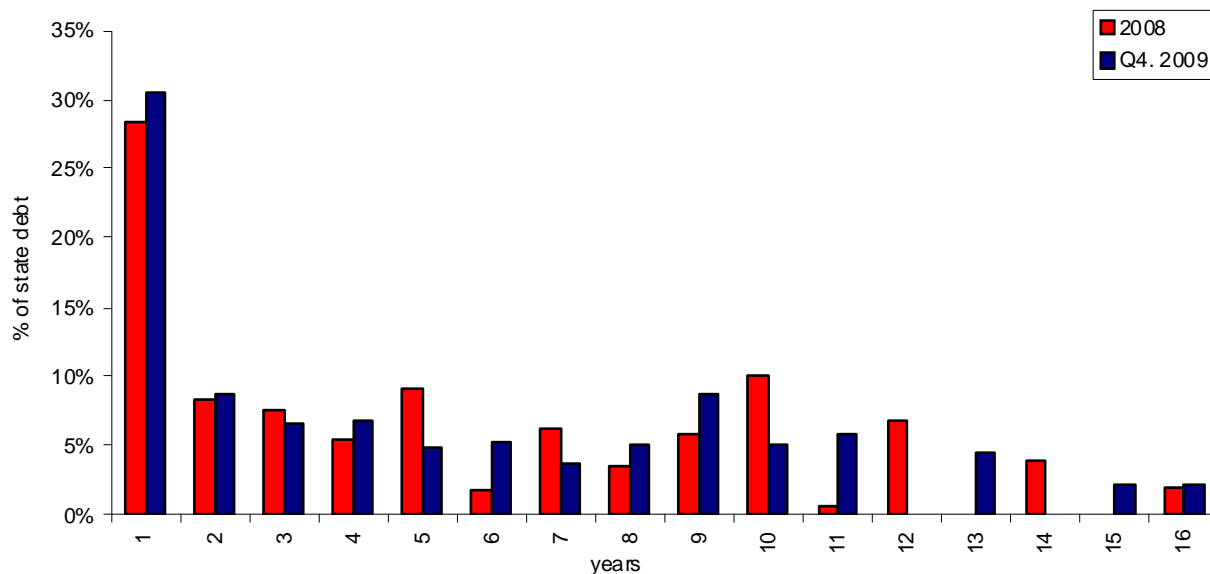


Note: Excluding money market instruments
Source: MF CR.

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 2009* sets the average yearly range between 30% and 40%. This risk measure increased to 30.5% at the end of the fourth quarter 2009 and crossed the lower barrier.

Re-fixing profil of state debt

(end of Q4. 2009 compared with end of 2008; updated on 31 December 2009)



Note: Including derivatives
Source: MF CR.

II. State debt costs and Cost-at-Risk in 2009

Planned and actual budgetary expenditures and revenues in 2009 are captured in following table:

Planned and actual budgetary expenditures and revenues on state debt in 2009

Measure (CZK mil)	Actual Q1-Q4. 2008	Budget 2009		Actual Q1-Q4. 2009	% Execution	Index 2009/2008 (%)
		<i>Approved</i>	<i>After changes</i>			
1	2	3	4	5	5:4	5:2
Total balance	44 751	71 043	56 356	53 073	94,2	118,6
	(-) 7 087	(-) 6 676	(-) 6 676	(-) 8 601	128,8	121,4
1. Total interest costs	44 600	53 810	53 810	51 999	96,6	116,6
	(-) 7 024	(-) 6 666	(-) 6 666	(-) 7 639	114,6	108,8
Domestic debt	37 726	42 148	42 148	41 808	99,2	110,8
	(-) 6 044	(-) 5 916	(-) 5 916	(-) 6 465	109,3	107,0
<i>Of which:</i>						
Money market instruments	2 209	2 262	2 262	1 722	76,1	78,0
	(-)3 683	(-)3 000	(-)3 000	(-) 1 784	59,5	48,4
Government bonds	35 517	39 886	39 886	40 086	100,5	112,9
	(-)2 361	(-)2 916	(-)2 916	(-) 4 681	160,6	198,3
Foreign debt	6 874	11 662	11 662	10 191	87,4	148,3
	(-) 980	(-)750	(-)750	(-) 1 174	156,3	119,8
<i>Of which:</i>						
International issues	5 255	9 173	9 173	8 785	95,8	167,2
	(-) 980	(-)750	(-)750	(-) 1 172	156,3	119,6
EIB loans	1 619	2 489	2 489	1 406	56,5	86,8
Short-term loans	-	-	-	(-) 2	-	-
2. Total fees	132	400	393	341	86,7	257,7
3. Redemption	18	10	10	9	85,5	46,4
4. Transfers for project	-	15 823	2 143	-	-	-
5. FX gain (-)/loss (+)	0	1 000	1 000	725	72,5	-
	(-)63	(-)10	(-)10	(-)963	9 625,2	1 527,5

Note: (-) means revenues (gains).

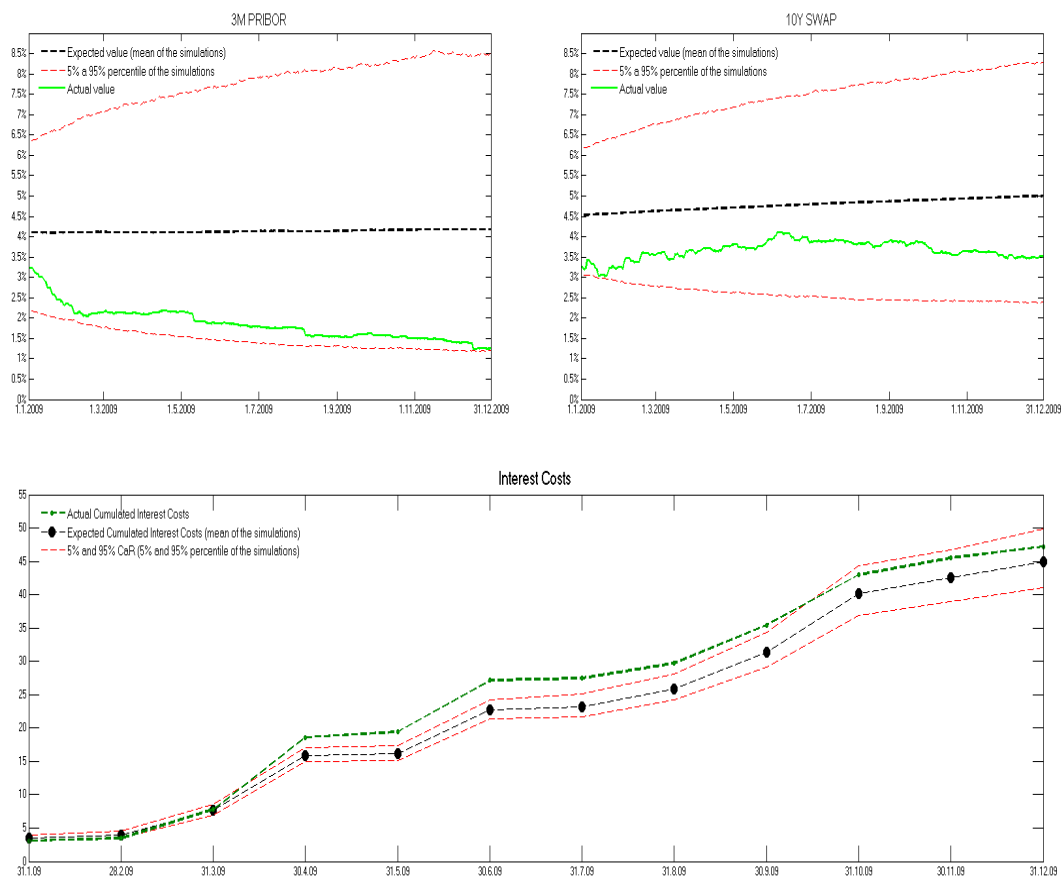
Source: MF CR.

The **net debt service costs** on the state debt in 2009 amounts **CZK 44.5 billion**. Accrued interest income and government bonds premiums achieve CZK 4.8 billion and financial investments on the money market gain CZK 1.8 billion. The gross debt service costs reached CZK 53.1 billion.

The state debt interest costs model **Cost-at-Risk (CaR)** for the year 2009 was published in the *Financing and Debt Management Strategy for the year 2009*. Calculations of the CaR values are based on future interest rates simulations.

The actual versus simulated development of the PRIBOR 3M and 10Y swap from January 2009 till December 2009 are in the upper part of the figure. The actual versus simulated interest costs for the year 2009 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 at the end of 2009 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 at the end of 2008 and 2009

	2008	2009
Actual interest costs (CZK billion)	42,2	47,2
Expected (simulated) costs (CZK billion)	41,7	44,9
Cost-at-Risk 95% (CZK billion)	50,2	49,9
Expectation bias (%)	-1,2	-4,9

Source: MF CR.

III. State Debt Parameters (end of quarter)

Debt Parameter	Dec 2008	Mar 2009	Jun 2009	Sep 2009	Dec 2009
Total state debt (CZK billion)	999,5	1 000,5	1 137,3	1 167,7	1 178,2
Market value, inc. derivatives (CZK billion)	1000,3	994,4	1 139,0	1 191,8	1 225,6
Short-term state debt (%)	17,7	11,2	13,4	12,9	14,7
Share of money market instruments (%)	7,9	6,1	7,0	6,8	7,5
Average time to maturity (years)	6,6	6,8	6,6	6,4	6,5
Interest rate refixing up to one year, inc. derivatives (%)	28,4	23,8	26,8	27,5	30,5
Variable-rate state debt (%)	7,3	9,3	10,5	11,7	13,1
Modified duration (years)	4,3	4,3	4,3	4,2	4,2
Modified duration, exc. CZK IRS (years)	4,2	4,1	4,1	4,1	4,1
Foreign currency state debt (%)	4,6	4,7	6,2	7,0	8,6
Foreign currency debt, exc. cross-currency swaps (%)	12,8	13,0	14,2	13,4	15,4
Nonmarketable state debt (%)	4,7	4,8	4,6	4,6	5,0
Marketable state debt (CZK billion)	952,2	952,2	1 085,5	1 114,0	1 119,8
Market value (CZK billion)	952,5	945,9	1 087,0	1 137,6	1 166,5
Short-term marketable debt (%)	18,5	11,5	13,9	13,4	15,3
Share of money market instruments (%)	8,3	6,4	7,4	7,1	8,0
Average time to maturity (years)	6,4	6,6	6,3	6,1	6,2
Interest rate refixing up to one year, inc. derivatives (%)	25,0	20,1	23,6	24,3	27,2
Variable-rate marketable debt (%)	2,9	5,1	6,6	7,8	9,0
Modified duration (years)	4,5	4,5	4,4	4,4	4,4
Modified duration, exc. CZK IRS (years)	4,4	4,3	4,2	4,2	4,2
Foreign currency marketable debt (%)	4,8	4,9	6,5	7,3	9,0
Foreign currency debt, exc. cross-currency swaps (%)	13,4	13,6	14,8	14,1	16,1

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.

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The next issue of Quarterly Review will be published on April 8, 2010, at 2.00 p.m.

Further information:

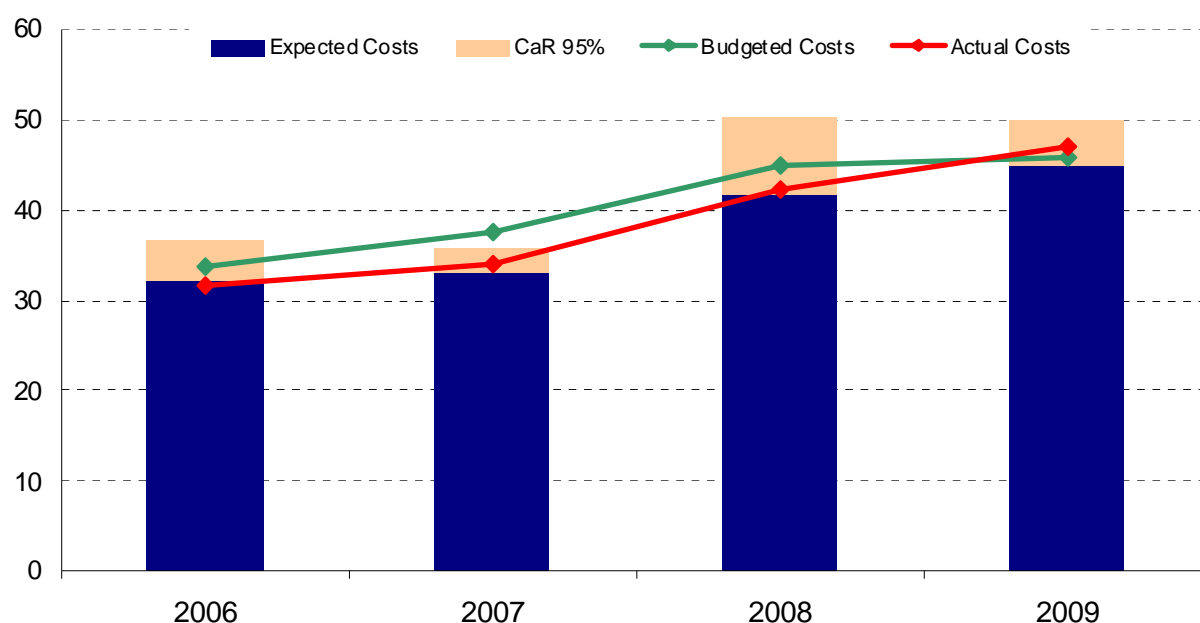
Martin Cícha, Funding & Portfolio Management
 Debt and Financial Assets Management Department MF CR
 Letenská 15, 118 10 Praha 1
 Tel.: +420 257 043 032, E-mail: martin.cicha@mfcr.cz, Reuters <MFCR>

Appendix

Since 2005, the Ministry has applied a more sophisticated model framework when measuring and managing interest rate risk, namely Cost-at-Risk (CaR), which is based on the VaR methodology and simulates future expected and maximum interest costs at a given risk level that is derived from the volatility of the time structure of interest rates. The yield curve is thus the stochastic element in the CaR model. In the CaR model, the development of the national debt portfolio is regarded as deterministic and is based on the basic scenario of the financing of the government's borrowing requirement, which ensures that the funding programme and strategic targets of risk management are achieved.

In the years 2006 to 2008 the utilised model framework for simulating interest costs displayed relatively reliable values of the CaR indicator that were consistent with the enacted state budgets and described the actual development of the servicing costs of the national debt. In 2006, the expected costs were overvalued by 2.9% compared to the actual state. In 2007, the actual costs were undervalued by 2.1% and in 2008 by 1.2%. In 2009, the actual costs were undervalued by 4.9% due to the higher than planned issuance activity. In all years, the realisation of costs was always below the maximum value determined by an absolute CaR 95%.

Interest costs and Cost-at-Risk in 2006 to 2009 (CZK billions)



NB: Interest costs are simulated without revenues from the investments of idle funds of the state treasury account on the money market, which are income of the national debt chapter of the state budget.

Source: Ministry of Finance of the Czech Republic