



The Czech Republic (A1/AA-/A+)

Funding and Debt Management Strategy 2013

12 December 2012



Representatives of the Ministry of Finance of the Czech Republic

| | |
|----------------------|--------------------------------------------------------------------|
| Jan Gregor | Deputy Minister of Finance |
| Petr Pavelek | Director of Debt and Financial Assets Management Department |
| Jan Thorovský | Head of Funding and Liquidity Management |



Agenda

1. Fiscal Framework
2. Debt Management Strategy
3. Secondary Market Development





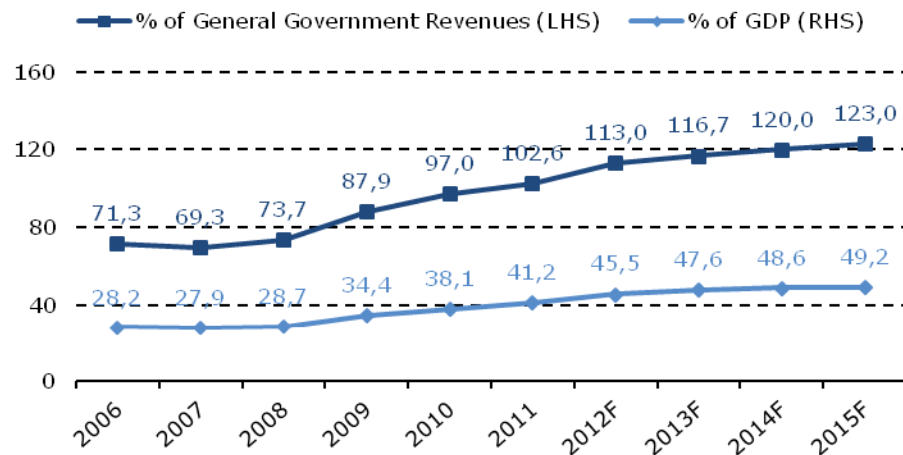
Fiscal Framework

Sound Medium-Term Fiscal Position Supported by Structural Reforms

- Low general government debt compared to EU average
 - 2012 general government debt estimated at 45.5% of GDP, 41.5 p.p. below EU average
 - 2013 general government debt estimated at 47.6% of GDP
 - Reduction of deficit mainly driven by expenditure cuts and lower interest burden
- Key figures for 2013:
 - Real GDP growth: 0.7%
 - General government deficit target: 2.9% of GDP

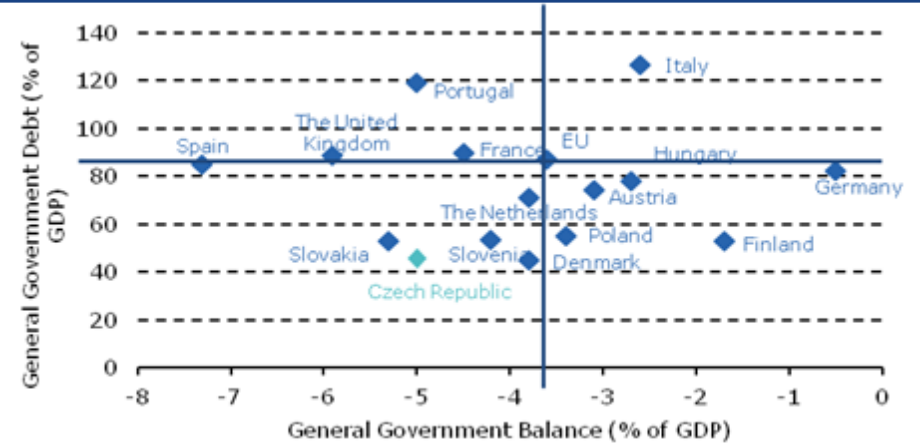
Source: Ministry of Finance

General Government Debt Development (ESA95)



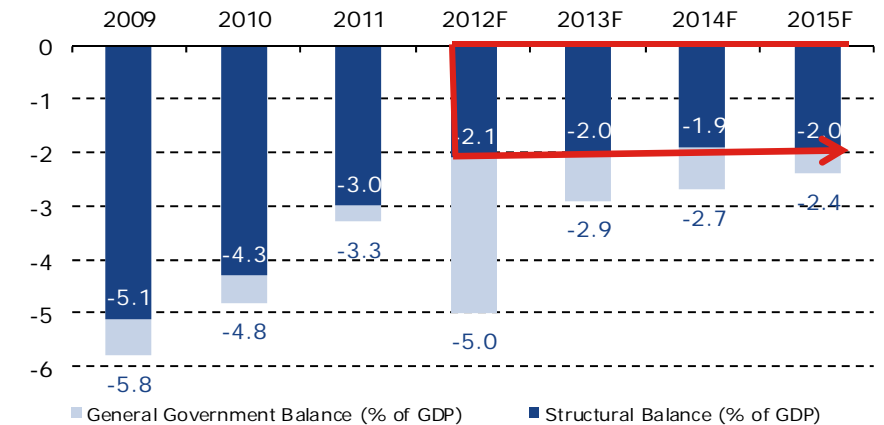
Source: Czech Statistical Office and Ministry of Finance

General Government Balance v. Real GDP Growth



Source: Eurostat, for 2012

General Government Balance (% of GDP)



Source: Czech Statistical Office, data for 2009-2011; Ministry of Finance, forecast for 2012-2015



Fiscal Framework

Low Level of Indebtedness and Sound Fiscal Position

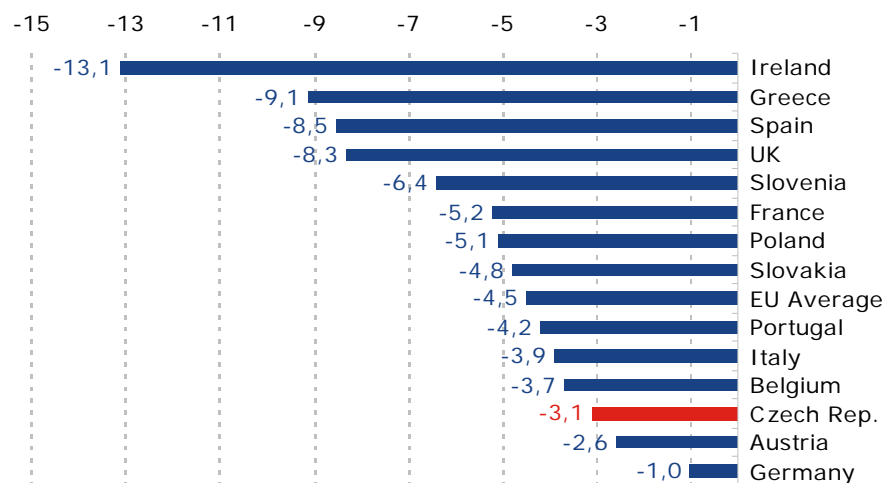
| | CZK bn | EUR bn | % of GDP |
|------------------------------------------------|--------|--------|----------|
| State debt forecast for 2012 ⁽²⁾ | 1,668 | 66.7 | 43.4 |
| State debt forecast for 2013 ⁽²⁾ | 1,769 | 71.0 | 45.6 |
| Planned budget deficit for 2012 ⁽³⁾ | 105 | 4.2 | 2.7 |
| Planned budget deficit for 2013 ⁽³⁾ | 100 | 4.0 | 2.6 |

(1) Source: Ministry of Finance, as of 12 December 2012

(2) Source: Ministry of Finance, forecast as of 12 December 2012

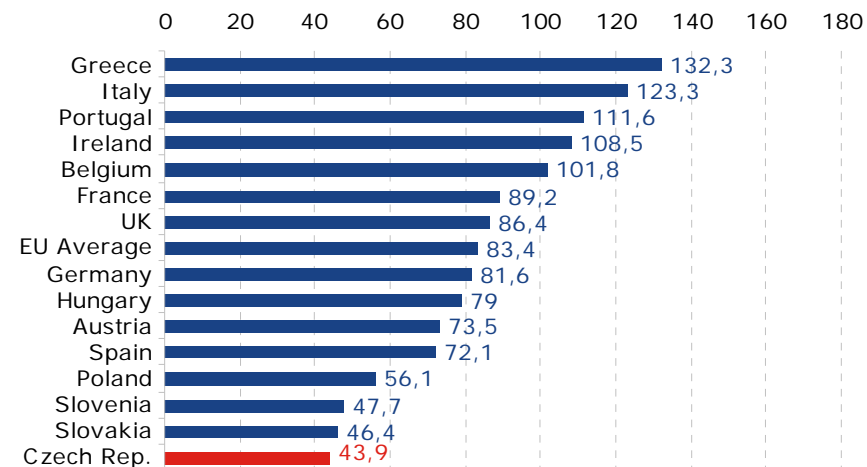
(3) Source: Ministry of Finance, plan as of 12 December 2012

General Government Balance (% of GDP)



Source: Eurostat, for 2011

General Government Debt (% of GDP)



Source: Eurostat, as of 31 March 2012



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- 2. Debt Management Strategy**
3. Secondary Market Development





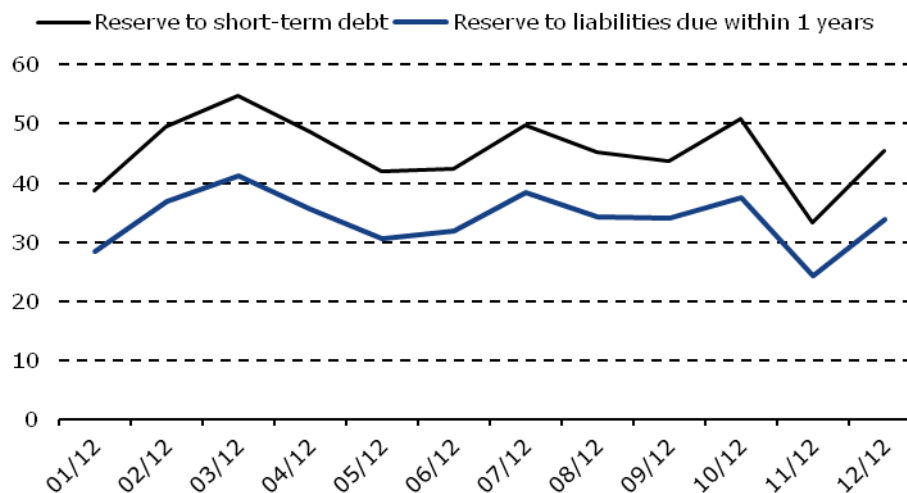
Debt Management Strategy

Gross Borrowing Requirement 2012

- **Gross borrowing requirement (GBR⁽¹⁾) CZK 309.3bn (EUR 12.4bn) in 2012**
 - up from the plan of 243.3bn due to higher cash reserve increase in the amount of CZK 65.1bn
 - excl. cash reserve increase, GBR up by CZK 0.6bn
- Major part of the funding covered on **domestic market** via primary auctions and tap sales with 53.2% share on GBR
- Bond issuance in **foreign markets** covered 22.3% of GBR
- **Savings bonds** programme fully implemented and covered 14.7% of GBR in 2012 after successful pilot issuance in November 2011

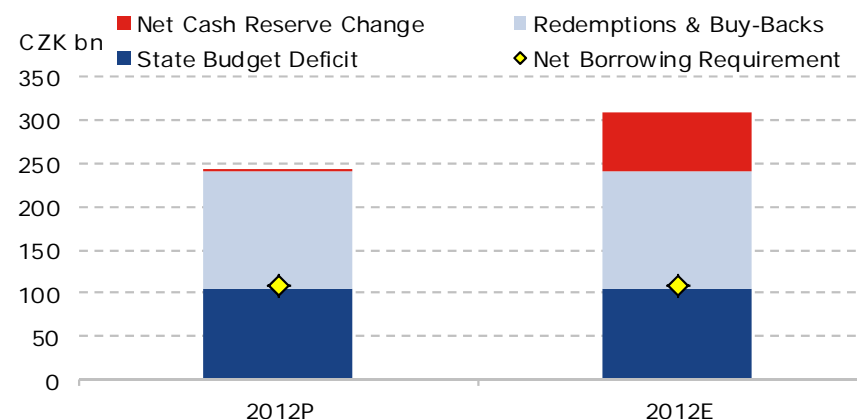
⁽¹⁾ Excluding money market instruments outstanding

Cash Reserve Development throughout the year 2012



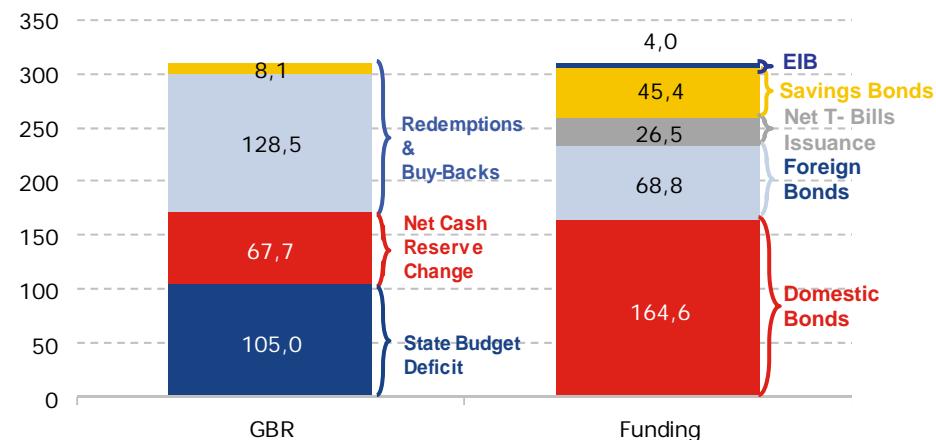
Source: Ministry of Finance, as of 12 December 2012

Gross Borrowing Requirement 2012 (Plan vs Estimate)



Note: Net cash reserve change incl. state financial assets
 Note: Net Borrowing Requirement excl. net cash reserves change
 Source: Ministry of Finance, as of 12 December 2012

Uses and Sources of Funding in 2012 (CZK bn)



Note: Net cash reserve change incl. state financial assets
 Source: Ministry of Finance, as of 12 December 2012



Debt Management Strategy

Diversified Funding Sources in 2012

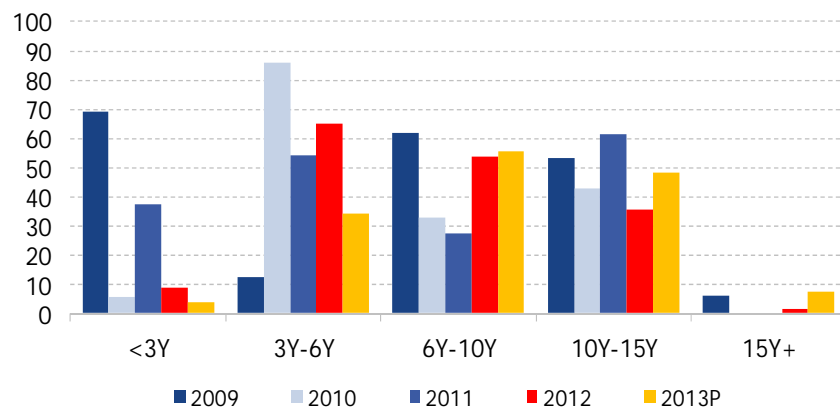
- Smooth funding on **domestic primary market** in 2012
- The Ministry successfully entered secondary market with **tap sales via MTS Czech Republic** in 2012
- Average primary auction yield dropped to **2.34%**, down by 75 basis points since 2011
- Average bid-to-cover ratio **2.24** in primary auctions
- Government Bond Issuance **well diversified** (fixed and floating rate) and spread across the yield curve

Domestic Issuance 2012 (Primary Auctions & Taps)

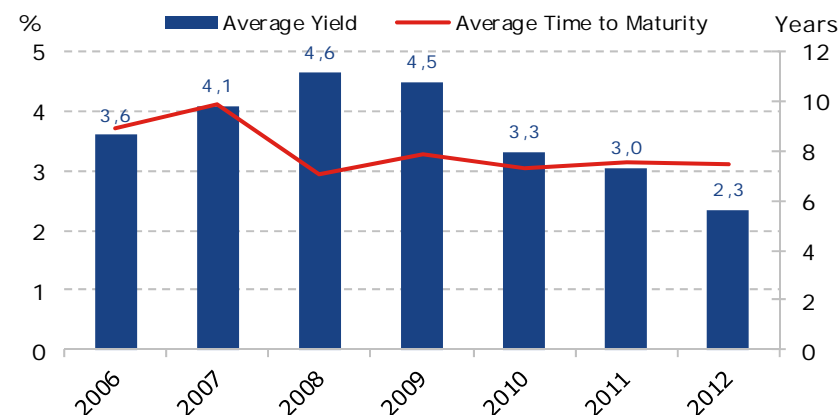
| Government Bond | CZK bn | Share (%) |
|-----------------|--------------|--------------|
| 2.75/14 | 9.0 | 5.6 |
| 3.40/15 | 12.4 | 7.7 |
| 4.00/17 | 1.8 | 1.1 |
| VAR/17 | 39.7 | 24.7 |
| 4.60/18 | 25.9 | 16.1 |
| 3.85/21 | 33.7 | 21.0 |
| VAR/23 | 29.4 | 18.3 |
| 5.70/24 | 2.9 | 1.8 |
| 4.20/36 | 1.3 | 0.8 |
| 4.85/57 | 4.5 | 2.8 |
| Total | 160.4 | 100.0 |

Note: Direct Sales to EIB (3.3. bn) and purchases into MoF asset funds (0.9 bn) not included

Domestic Government Bonds Issuance (CZK bn)



Average Yield and Time to Maturity of Primary Auctions

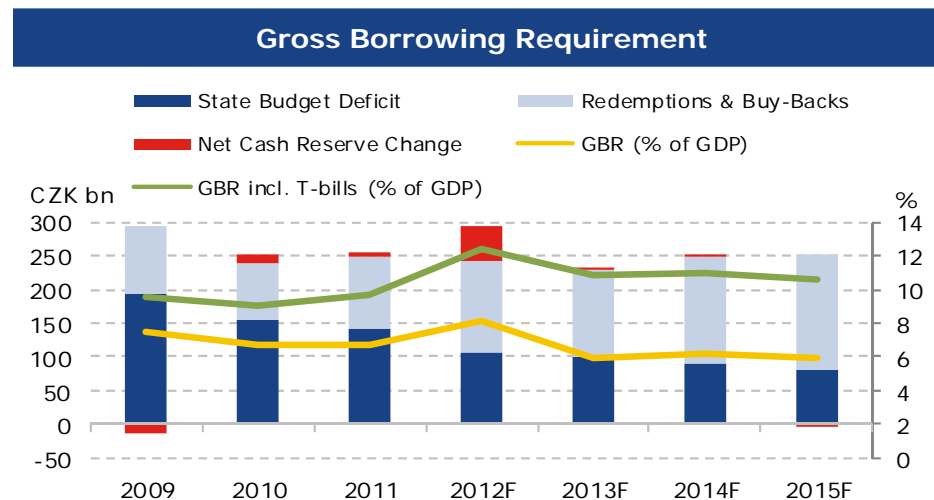




Debt Management Strategy

Gross Borrowing Requirement 2013-2015

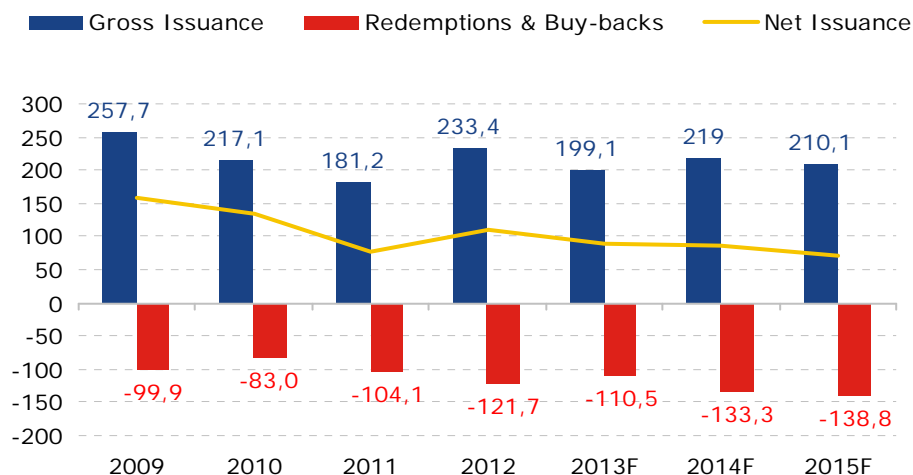
- **Gross borrowing requirement** (GBR⁽¹⁾) planned at the level of **CZK 230.7bn** (EUR 9.3bn) for 2013
- Major part of the funding to be covered on **domestic market** in a range of **CZK 87.1bn to 219.1bn**
- Bond issuance in **foreign markets** may add up to **CZK 92.0bn**
- **Net T-bills issuance** down to **CZK -10.0bn to 10.0bn**
- **Savings bonds** depending on demand of eligible investors in a range of **CZK 20.0bn to CZK 40.0bn**
- **EIB loans** complete the funding programme with **1.6bn**



Note: Net cash reserve change incl. state financial assets
Source: Ministry of Finance, as of 12 December 2012

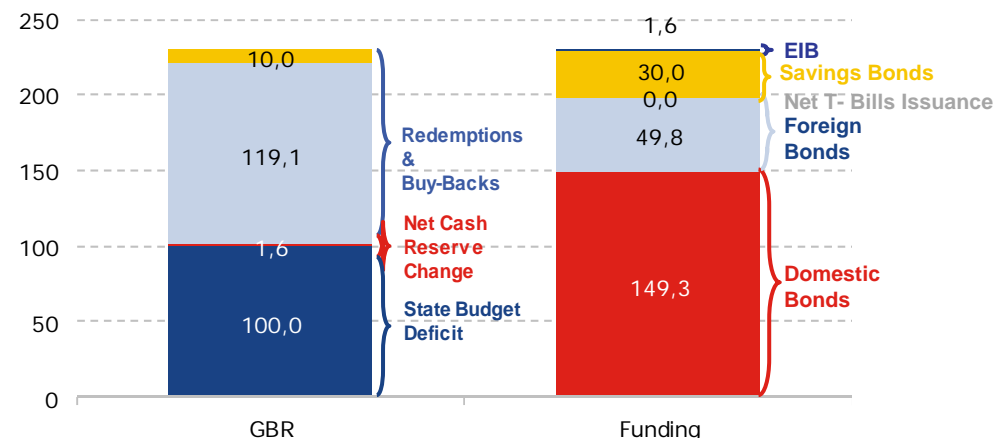
(1) Excluding money market instruments outstanding

Government Bond Issuance Dynamics (CZK bn)



Note: Excluding government savings bonds
Source: Ministry of Finance, as of 12 December 2012

Uses and Sources of Funding in 2013 (CZK bn)



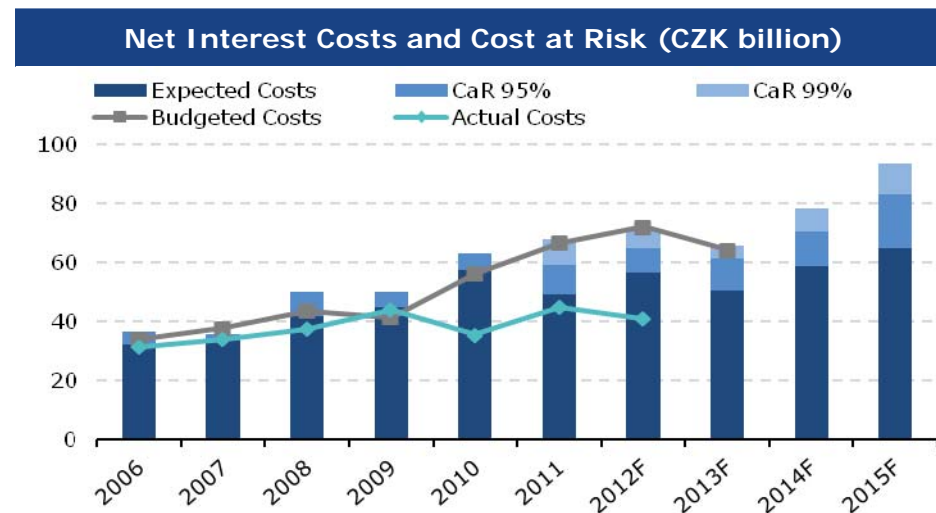
Note: Net cash reserve change incl. state financial assets
Source: Ministry of Finance, as of 12 December 2012



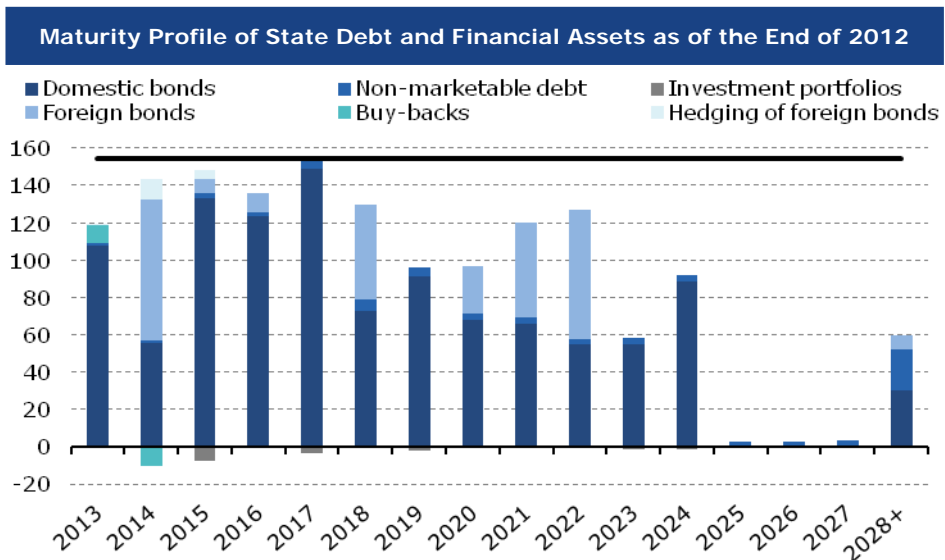
Conservative Debt Management Strategy

Low Costs and Substantial Cash Buffer during Periods of Market Volatility

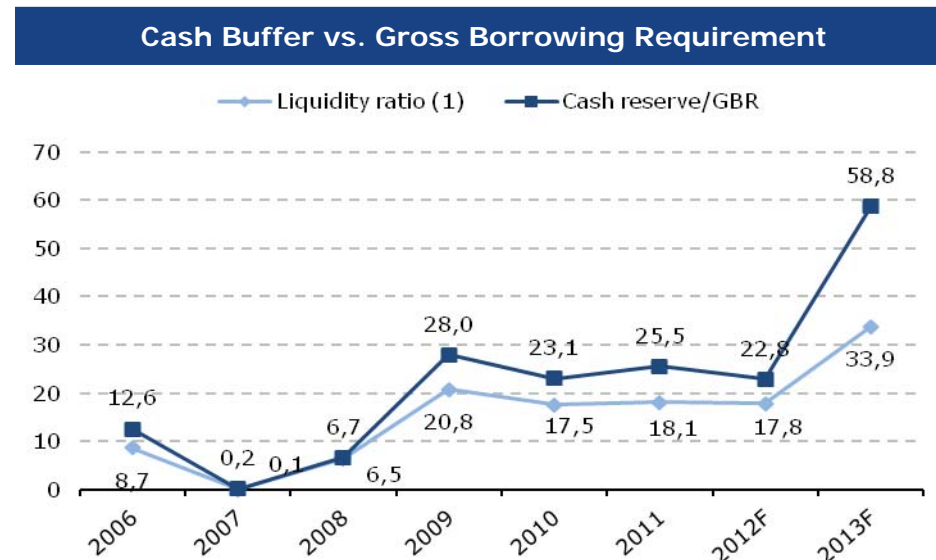
- Historically, average net interest costs were ranging between 3.5% and 4.0% of net debt portfolio
- However in 2010, net interest cost went sharply down to 2.9%, the evidence of Czech Republic's solid reputation as debtor at turbulent times
- Savings on actual interest costs versus budget amounted to CZK 21 bn in 2010, CZK 22 bn in 2011 and CZK 31 bn in 2012
- Less conservative approach to risk premium modeling for the 2013–2015
- New issuance of government bonds is determined in accordance with smooth maturity profile
- In 2008, cash reserves were created to absorb euro area debt crisis impact on domestic liquidity in the short-term horizon
- Cash Buffer above 5% of GDP** at the end of 2012



Source: Ministry of Finance forecast for 2012, as of 10 December 2012



Source: Ministry of Finance



Source: Ministry of Finance, as of 10 December 2012
 (1) Liquidity Ratio is defined as cash reserves divided by the sum of short-term state debt, budget balance and operations of state financial assets



Conservative Debt Management Strategy

Key Portfolio Limits for 2013 within Conservative Strategy

| | Limit in 2012 | Forecast as of 31 December 2012 | Limit in 2013 |
|----------------------------------------------|-------------------|---------------------------------|-------------------|
| Short-term debt (<1 year) | ≤ 25.0% | 17.9% | ≤ 25.0% |
| Medium-term debt (<5 years) | ≤ 70.0% | 52.7% | ≤ 70.0% |
| Average time to maturity | 5.0 to 6.0 years | 5.7 years | 5.0 to 6.0 years |
| Floating rate exposure (incl. IRS) | 30.0 to 40.0% | 36.0% | 30.0 to 40.0% |
| Average time to re-fixing | 4.0 to 5.0 years | 4.4 years | 4.0 to 5.0 years |
| FX exposure (incl. CCS) | 15.0% (+2.0 p.p.) | 10.0% | 15.0% (+2.0 p.p.) |
| Foreign currency debt | x | 17.7% | x |
| Foreign holders of CZK Gov't bonds | x | 12.7% | x |
| Foreign holders of state debt ⁽¹⁾ | x | 32.8% | x |

⁽¹⁾ This figure represents maximum possible share, because Ministry of Finance has no information about breakdown of foreign currency bonds holders
Source: Ministry of Finance

- No change in key portfolio limits and targets for 2013 in line with medium term strategy
- Maintaining acceptable refinancing, IR and FX rate risk in line with core euro area countries
- Short-term debt has been successfully reduced below 20% from 70% since 2000
- Interest rate exposure is balanced in line with cost/risk optimization simulation framework
- Foreign currency exposure around or below 10% of total debt in the long term (incl. hedging)
- Non-resident holders don't put funding stability at risk



Debt Management Strategy

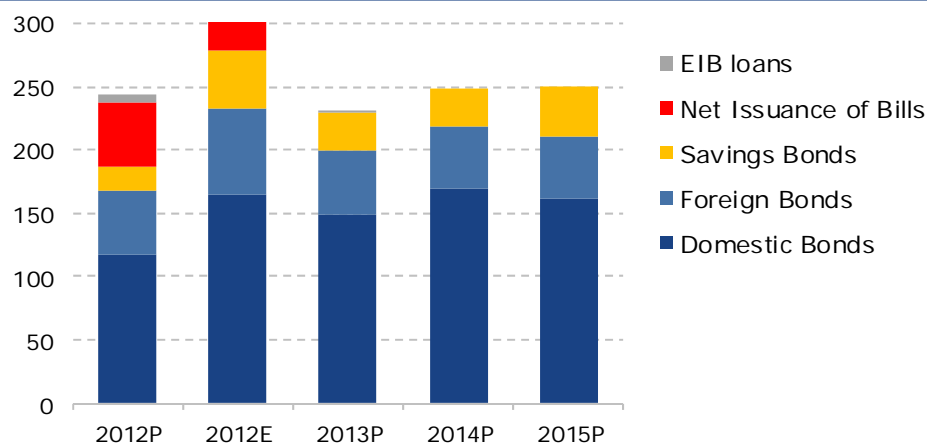
Funding Outlook 2013-2015

- Three new **fixed-rate benchmark bond** issues to be opened in 2013
 - 3Y/2016
 - 6Y/2019
 - 15Y/2028
- **No new floating-rate note issue will be offered in 2013**
- **Re-openings** across the yield curve in 2013
- The Ministry will continue with its operations on secondary market with **tap sales** via MTS Czech Republic
- The Ministry plans to re-enter **foreign markets** with at least one public issue in 2013
- Net **T-bills** issuance planned at zero level in 2013

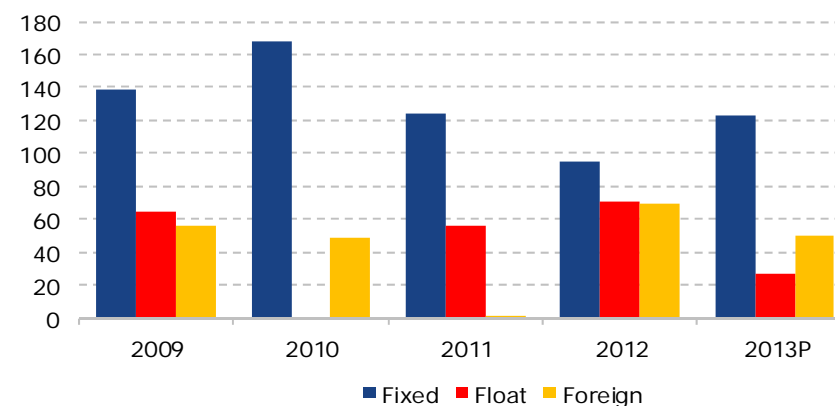
Domestic Issuance 2013 (Primary Auctions & Taps)

| Government Bond | Primary Auctions (CZK bn) | Tap Sales (CZK bn) |
|-----------------|---------------------------|--------------------|
| 3.40/15 | Up to 3 | 0 - 1 |
| new/16 | 25 - 35 | - |
| VAR/16 | - | 0 - 2 |
| VAR/17 | Up to 3 | 0 - 2 |
| 4.60/18 | - | 0 - 1 |
| new/19 | 25 - 35 | - |
| 3.75/20 | Up to 3 | 0 - 2 |
| 4.70/22 | 20 - 30 | - |
| VAR/23 | 15 - 25 | - |
| new/28 | 25 - 35 | - |
| 4.20/36 | 0 - 5 | 0 - 10 |
| 4.85/57 | - | 0 - 9 |

Funding Sources (CZK bn)



Funding Structure (CZK bn)



Source: Ministry of Finance, as of 12 December 2012

Source: Ministry of Finance, as of 12 December 2012



Debt Management Strategy

Issuance Calendars for January 2013

Government Bonds

| Auction Date | Issue Date | Government Bond | Total Volume Offered (competitive part) |
|--------------|------------|-----------------|-----------------------------------------|
| 9 January | 14 January | new/19 | CZK 3-5 bn |
| 9 January | 14 January | VAR/17 | CZK 2-4 bn |
| 23 January | 28 January | new/16 | CZK 3-5 bn |
| 23 January | 28 January | 4.70/22* | CZK 2-4 bn |

* Instead of originally proposed 3.75/20

Note: Total Volume Offered (competitive part) in Q1 should not exceed CZK 50 bn

Treasury Bills

| Auction Date | Issue Date | Treasury Bill | Total Volume Offered |
|--------------|------------|---------------|----------------------|
| 10 January | 11 January | 9 month | CZK 8 bn |
| 17 January | 18 January | 3 month | CZK 10 bn |
| 24 January | 25 January | 6 month | CZK 8 bn |



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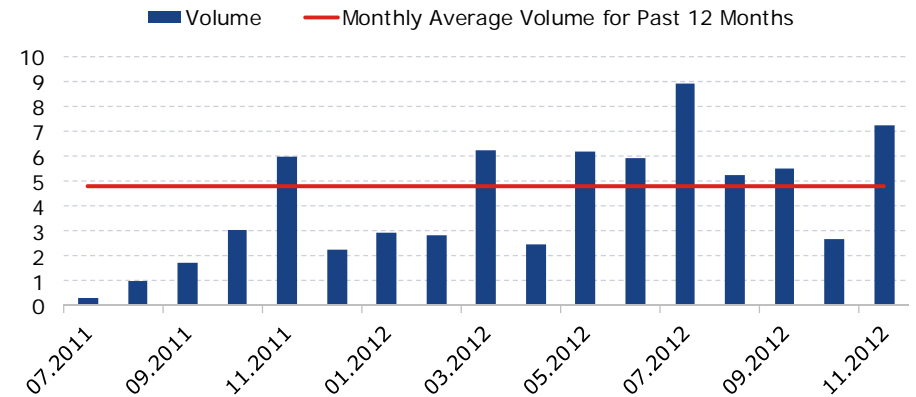


Secondary Market Development

MTS Czech Republic Trading Performs Well

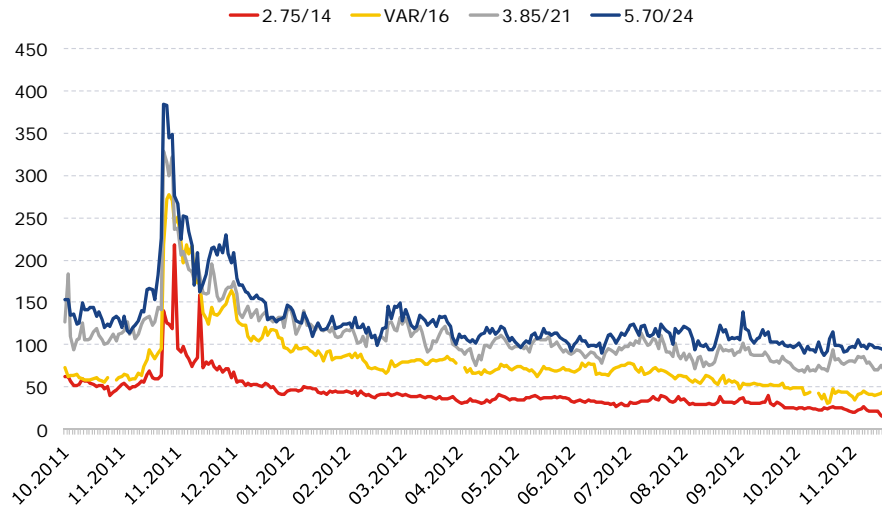
- **Liquidity** has improved
- **Monthly turnover** on an increasing path
- **Bid-Offer** spreads have tightened
- **Compliance** with quoting obligations above 90% level most of the time

Trading Volumes on MTS CR (CZK bn)



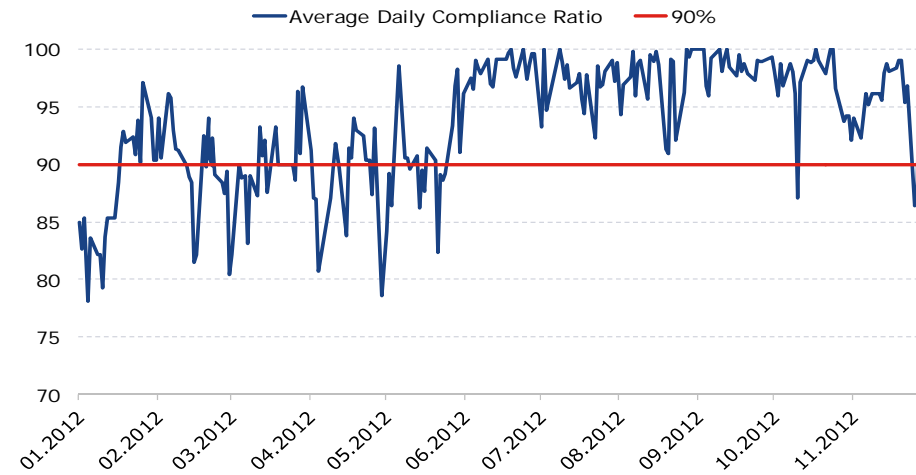
Source: Ministry of Finance, EuroMTS, as of 10 December 2012

Secondary Market Bid-Offer Spreads (bps) on MTS CR



Source: Ministry of Finance, EuroMTS, as of 10 December 2012

Performance on MTS CR – Quoting Obligations (%)



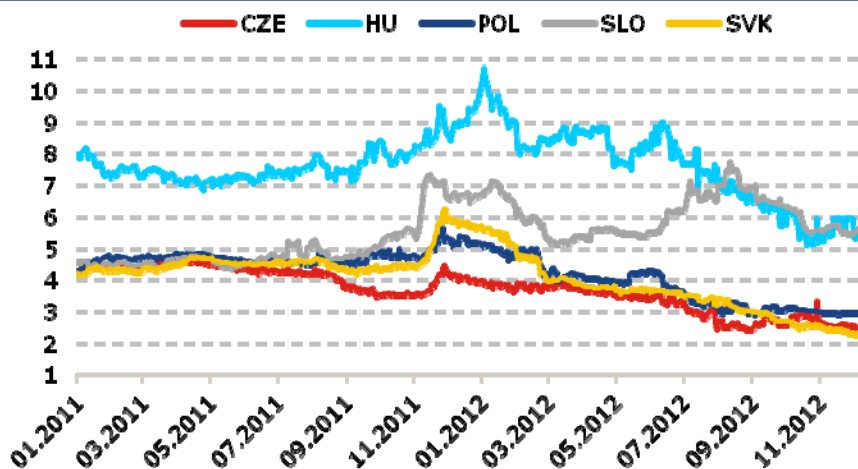
Source: Ministry of Finance, EuroMTS, as of 10 December 2012



Secondary Market Development

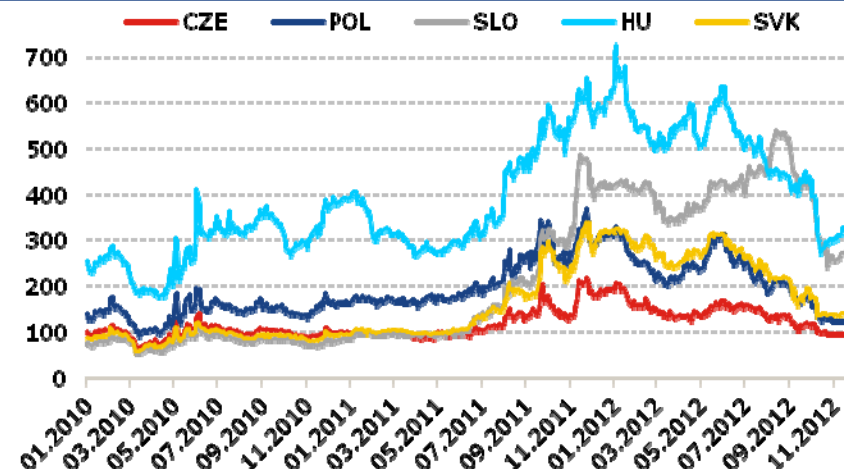
CEE Yields and Rates Performance

Yield Performance of Central European Peers (%)



Source: Thomson Reuters, as of 11 December 2012
Based on 10-year EUR bond government bond yields

10Y CDS Spread of Central European Peers (bps)



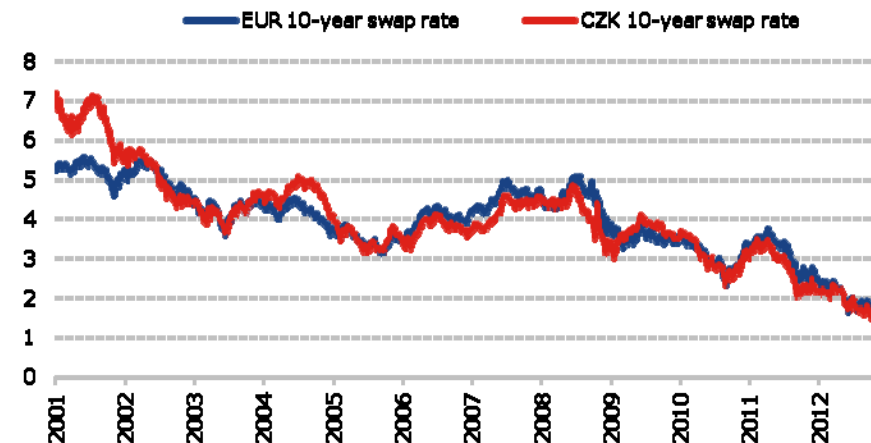
Source: Thomson Reuters, as of 11 December 2012

Current CE Peer Group EUR Bond Yields and Spreads

| Country | Czech Republic | Poland | Slovenia | Slovak Republic | Hungary |
|-----------------------|--------------------------|-------------------------|--------------------------|------------------------|----------------------------|
| Rating ⁽¹⁾ | A1/AA-/A+ sta/sta/sta | A2/A-/A- sta/sta/sta | Baa2/A/A- neg/neg/neg | A2/A/A+ neg/sta/sta | Ba1/BB+/BB+ neg/sta/neg |
| 10 year yield | 2.30% | 2.49% | 5.14% | 2.30% | 5.60% |
| 10 year spread to m/s | +76 bps | +95 bps | +360 bps | +84 bps | +446 bps |

Source: Reuters, bid levels, as of 11 December 2012
Note: Hungary 8 year yield due to unavailable data for 10 year yield
Note: Slovakia 9 year yield due to unavailable data for 10 year yield
⁽¹⁾ Ratings by Moody's, Standard & Poor's and Fitch Ratings, respectively,
second line represents rating outlook (neg – negative, sta – stable, pos – positive)

Long-Term Interest Rates (%)



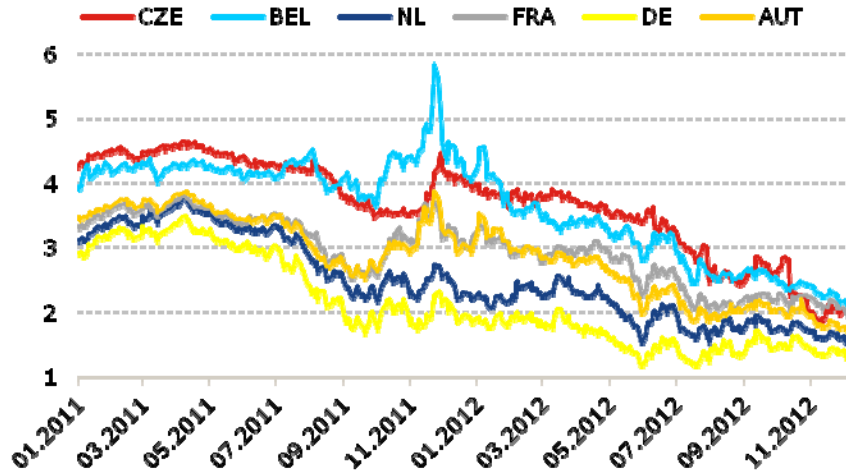
Source: Bloomberg, Reuters, as of 11 December 2012



Secondary Market Development

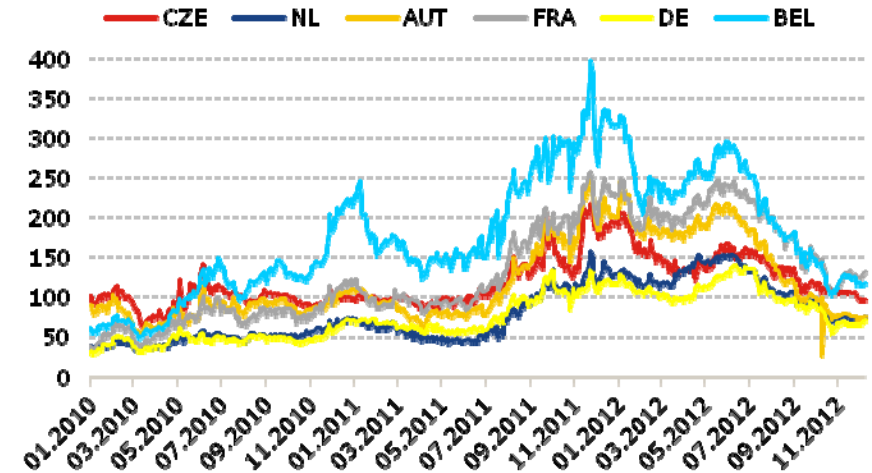
Euro-area Yields and Rates Performance

Yield Performance of Euro-Area Core Countries (%)



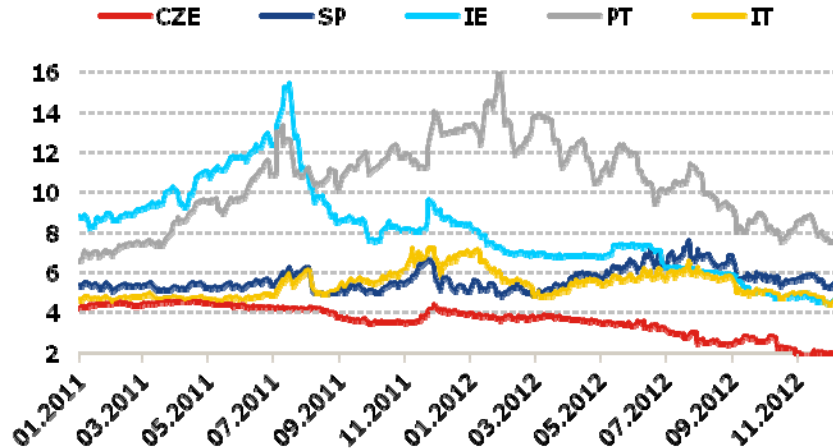
Source: Reuters, as of 11 December 2012
Based on 10-year EUR bond government bond yields

10Y CDS Spread of Euro-Area Core Countries (bps)



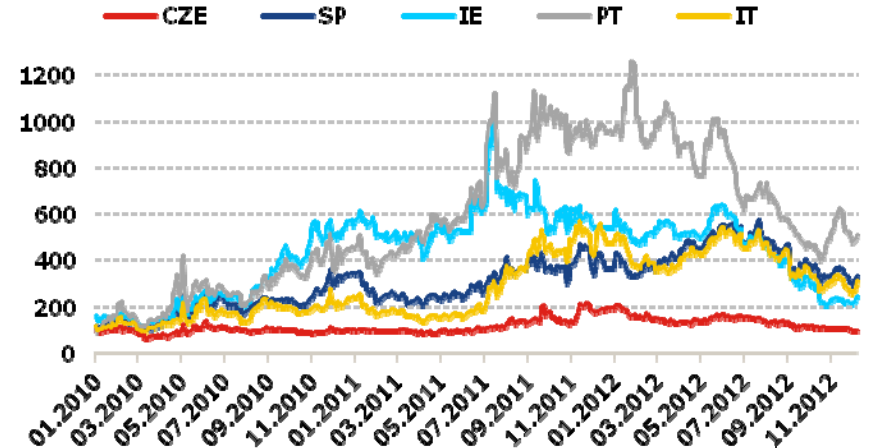
Source: Reuters, as of 11 December 2012

Yield Performance of Euro-Area Periphery Countries (%)



Source: Reuters, as of 11 December 2012
Based on 10-year EUR bond government bond yields

10Y CDS Spread of Euro-Area Periphery Countries (bps)



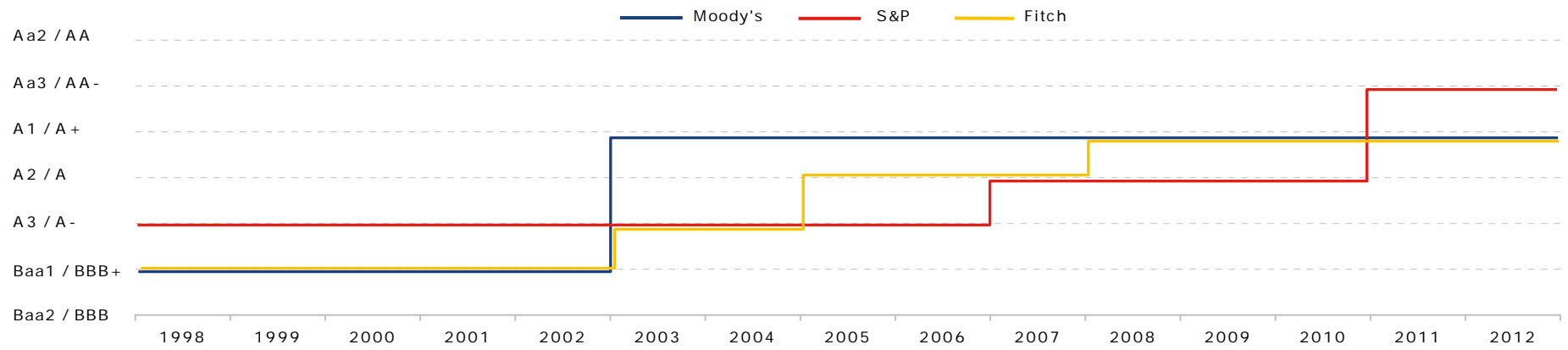
Source: Reuters, as of 11 December 2012






Debt Management Strategy

Rating Agency Views Confirm Solid Credit Quality

Evolution of Czech Republic's Sovereign Ratings



| |  Rating: A1 Outlook: stable |  Rating: AA- Outlook: stable |  Rating: A+ Outlook: stable |
|----------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Rating Support | <ul style="list-style-type: none"> “Government finances draw strength from the ability to easily tap local-currency financing through its large, though underdeveloped, domestic capital market.” | <ul style="list-style-type: none"> “...Our ratings on the Czech Republic thus reflect its prudently managed and balanced economy...” | <ul style="list-style-type: none"> “...proven macroeconomic resilience and policy flexibility and credibility support sovereign creditworthiness ...” |
| Risks to the Rating | <ul style="list-style-type: none"> “Should the government fall before the scheduled June 2014 parliamentary election, reform paralysis is likely to set in... The outcome of such a scenario would have only limited impact on the sovereign’s ,high’ institutional strength assessment” | <ul style="list-style-type: none"> “... downward pressure on the ratings could mount if the social security reform falters, the public finances deteriorate...” | <ul style="list-style-type: none"> “...deterioration of the growth outlook and heightened financial stress in the eurozone ...” |
| Outlook | <ul style="list-style-type: none"> “The stable outlook reflects Moody’s expectation that the government will: (i) continue consolidating its fiscal position; and (ii) bring a halt to negative debt dynamics in the coming years.” | <ul style="list-style-type: none"> “...The stable outlook balances our assessment of the Czech Republic’s solid medium-to-long term economic growth prospects...” | <ul style="list-style-type: none"> “...the probability of an upgrade in the next 12 months has receded and a Stable Outlook better captures the balance of risks...” |

Source: Moody's (July 2012)

Source: Standard & Poor's (August 2011)

Source: Fitch (December 2011)



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