



**Ministry
of Finance**

**Debt and Financial Assets
Management Department**

The Czech Republic Funding and Debt Management Strategy

2017

Second Half Update

30 June 2017

Ministry of Finance

The Czech Republic Funding and Debt Management Strategy for 2017 Second Half Update

**The Czech Republic Funding and Debt
Management Strategy for 2017
Second Half Update**

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The Minister of Finance decided on 29 June 2017 about the structure and method of covering the financing needs in the second half of 2017 and approved the basic absolute and relative limits for issuance activity on the domestic and foreign markets and for active management of the debt portfolio, financial assets and liquidity of the treasury single account in the individual currencies (Ref. No. MF-18505/2017/2002). This decision updates the decision of the Minister of Finance from 21 December 2016 (Ref. No. MF-44392/2016/2002) published in the form of The Czech Republic Funding and Debt Management Strategy for 2017.

This defined operational framework in the form of the submitted The Czech Republic Funding and Debt Management Strategy for 2017 - Second Half Update 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 2017 - Second Half Update is consistent with the approved State Budget Act of the Czech Republic for 2017, proposed budget for 2018 approved by the government including the medium-term outlook to 2020, the Fiscal Outlook of the Czech Republic from November 2016 and the Macroeconomic Forecast of the Czech Republic from April 2017.

The Czech Republic Funding and Debt Management Strategy for 2017 - Second Half Update 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 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

bn	billion
CNB	Czech National Bank
CZK	currency code of Czech Koruna
CZSO	Czech Statistical Office
EIB	European Investment Bank
ESA 2010	European System of Accounts 2010
FIX	fixed-rate
GDP	gross domestic product
JCR	Japan Credit Rating Agency
MoF	Ministry of Finance
MTS	Mercato Telematico Secondario
p.p.	percentage point
R&I	Rating and Investment Information, Inc.
T-Bills	state treasury bills
T-Bonds	medium-term and long-term government bonds
VAR	variable-rate

Published aggregate data in the tables and in the text may not correspond in the last decimal place to the sum of respective indicators due to rounding in some cases.

Introduction

The Ministry of Finance (hereinafter the Ministry or MoF) presents to the public The Czech Republic Funding and Debt Management Strategy for 2017 – Second Half Update (hereinafter the Updated Strategy) in accordance with the calendar of published information. The Ministry reserved the possibility to update the funding programme plan and strategy targets in the second half of 2017 in order to respond flexibly to the actual development of financing needs and state treasury liquidity in the course of 2017 and to the situation on domestic and foreign financial markets in terms of minimizing the

state debt service expenditure and financial risk management.

The Updated Strategy includes an updated funding programme of the Czech Republic in 2017, particularly the funding programme for the second half of the year. The limits and targets for each monitored risk indicator of the state debt portfolio defined in The Czech Republic Funding and Debt Management Strategy for 2017 (hereinafter the Strategy) remain valid in the second half of 2017.

Key Events in the Second Half of 2017

Financing needs of CZK 290.9 billion

- expected financing needs in 2017 at the level of CZK 290.9 billion dependent on the actual amount of carried out buy-backs and exchange operations of medium-term and long-term government bonds and actual state budget performance
- redemption of Czech Republic Treasury Bond, 2012-2017, VAR % in total nominal value of CZK 46.8 billion
- redemption of Government Bond of the Czech Republic, 2015-2017, 0.00 % in total nominal value of CZK 70.0 billion
- redemption of Coupon savings government bond of the Czech Republic, 2012-2017 II, FIX % in total nominal value of CZK 1.8 billion
- redemption of Reinvestment savings government bond of the Czech Republic, 2012-2017 II, FIX % in total nominal value of CZK 8.1 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

Primary market of government bonds

- issuance of medium-term and long-term government bonds on domestic market in total minimum nominal value of CZK 50.0 billion
- possibility of issuance of new benchmark issues of CZK-denominated fixed-rate government bonds with maturity along the whole yield curve

- possibility of issuance of new CZK-denominated zero-coupon government bonds with maturity along the whole yield curve, as a possible alternative particularly to state treasury bills
- re-opening of already issued fixed-rate and variable-rate CZK-denominated government bonds with maturity from 2019
- benchmark foreign issue of government bonds in case of cost-favourable conditions
- state treasury bills may be issued in all available maturities up to 1 year

Secondary Market of Government Bonds

- continuation of tap sales and exchanges of CZK-denominated government bonds on secondary market second half of 2017 in dependence on market conditions, demand from primary dealers, and availability of government bonds on Ministry's asset account
- possible launch of government bonds buy-backs programme in dependence on the demand from the primary dealers and in case of cost-favourable conditions mainly for the purpose of the state debt maturity profile management
- continuation of active support of lending facilities of medium-term and long-term government bonds in the form of repo operations and also in the form of collateralized loans

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 or positive 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.

In the first half of 2017 the rating was affirmed by Standard & Poor's, Fitch Ratings and Rating and Investment Information, Inc.

Table 1: The Czech Republic's Credit Rating in 2017

Rating agency	Local currency liabilities	Outlook	Foreign currency liabilities	Outlook	Affirmed
Moody's	A1	Stable	A1	Stable	14/10/2016
Standard & Poor's	AA	Stable	AA-	Stable	20/1/2017
Fitch Ratings	A+	Stable	A+	Stable	7/4/2017
JCR	AA-	Positive	A+	Positive	27/9/2016
R&I	AA-	Stable	A+	Stable	2/6/2017

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, 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.

Table 2: Financing Needs

CZK bn	2017F	2018F	2019F
State budget deficit ¹	60.0	50.0	50.0
T-Bonds redemptions ²	208.1	238.8	242.1
Redemptions and early redemptions on savings government bonds	16.9	16.4	2.7
T-Bills and other money market instruments redemptions ³	4.2	5.0	5.0
Repayments on credits and loans	1.7	4.8	4.7
Total financing needs	290.9	315.0	304.5
Total financing needs (% of GDP)⁴	5.9%	6.2%	5.7%

¹ For 2017 budgeted state budget deficit, for 2018 proposed deficit approved by the government, and for 2019 proposed medium-term outlook approved by the government.

² Incl. the effect of already executed buy-backs and exchanges in previous years. Excl. planned future buy-backs and exchanges.

³ Excl. T-Bills issued and redeemed within respective year, and roll-over of other money market instruments.

⁴ Source for GDP in ESA 2010 methodology for 2017 to 2019 Macroeconomic Forecast of the Czech Republic – April 2017.

Source: MoF

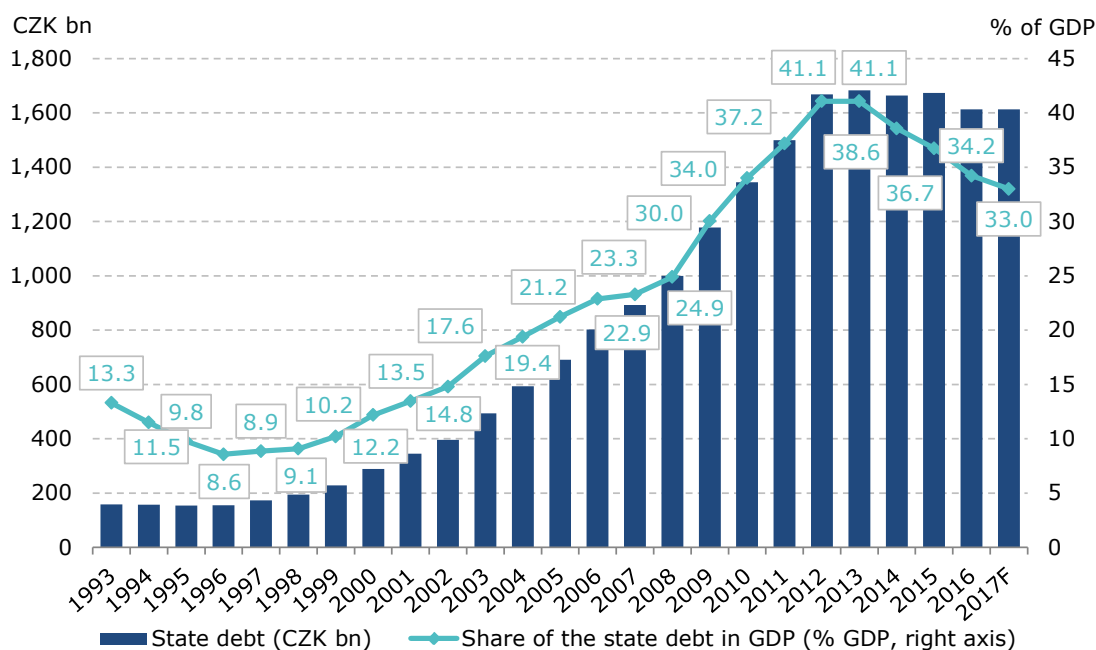
For 2017, the updated planned financing needs amount to CZK 290.9 billion but its actual value will primarily depend on the actual state budget performance and on the actual amount of carried out buy-backs and exchange operations of government bonds in this year. In case of better state budget performance compared to the approved one or to its medium-term outlook, the decrease of financing needs in absolute and relative terms may be expected with the possibility of staying below

6% of GDP in 2017 and also in the medium-term outlook. The financing needs in 2018 increased by CZK 3.8 billion compared to the Strategy primarily due to the increase of medium-term and long-term government bonds redemptions. The increase of financing needs in 2019 compared to the Strategy is given mainly due to the higher proposed medium-term outlook for budget deficit approved by the government.

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 to 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 2017, the active use of refinancing mechanism of state treasury and more effective financial planning allows the decrease in the extent of borrowing operations of the state and thereby further savings on interest expenditure of state budget. Another decrease in ratio of state debt to GDP is expected in 2017 after the decrease of its value by 6.9 percentage points from 2013 to the end of 2016.

Figure 1: Czech Republic's State Debt Development



Note: Source for GDP in ESA 2010 methodology for 1993 to 2016 is CZSO, for 2017 Macroeconomic Forecast of the Czech Republic – April 2017
Source: MoF, CZSO

Funding Programme and Issuance Activity in the Second Half of 2017

Medium-Term and Long-Term Government Bonds

The total planned range of medium-term and long-term government bonds gross issue nominal value on domestic market in 2017 has been increased to minimum amount of CZK 180.0 billion. The planned minimum range of nominal value of medium-term and long-term government bonds gross issue in the second half of 2017 is CZK 50.0 billion.

The Ministry will further consider the possibility to carry out a part of the issuance on shorter end of yield curve with positive impact on state budget performance and, in the end, on the absolute value of state debt, thus utilizing favourable market conditions, as yields of government bonds with residual maturity up to 5 years reach negative values.

In accordance with the Strategy, the Ministry will consider issuing new issues of medium-term and long-term government bonds with

maturity from 2021 in the second half of 2017 with the aim of aligning the coupon rates of newly issued government bonds with the actual market conditions. 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. If there is an unexpected change of the Czech Republic's government bond market conditions during the second half of 2017, the Ministry reserves the option of not issuing new bonds.

The issuance including the inclusion of variable-rate medium-term and long-term government bonds will be carried out with the respect to the riskiness of the debt portfolio and maintaining strategic targets and limits for risk parameters.

Table 3: Framework Issuance Plan of T-Bonds on the Domestic Primary Market in 2017 and Its Fulfilment in the First Half of 2017

CZK bn	Framework scope of sale	Gross issue in the first half of 2017
Fixed-rate T-Bonds		
Maturity segment of up to 5 years	Max. 150	74.5
Maturity segment of 5 to 10 years	Max. 120	29.0
Maturity segment of over 10 years	Max. 70	23.1
Variable-rate T-Bonds	Max. 70	1.0

Source: MoF

The Ministry will also consider the possibility of continuation of tap sales of medium-term and long-term government bonds from its own asset account on the secondary market through electronic trading platform MTS Czech Republic during the second half of 2017 supplementing the issuance on primary market due to the significantly higher flexibility of these operation, as they may be carried out more often and in the limited scope of total nominal value compared to the auctions on primary market. The tap sales may be carried out in situation, where the primary dealers' interest in using these government bonds within medium-term and long-term government bonds lending facilities drops. Furthermore, tap sales of government bonds with a long time to maturity may be used to manage the average time to maturity of the debt portfolio.

The execution of benchmark issue of medium-term and long-term government bonds on foreign markets in the second half of 2017 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.

The competitive part of primary auction of CZK-denominated medium-term and long-term government bonds will be held on the traditional auction day of Wednesday while the non-competitive part of primary auctions will be held on Thursday in the course of the second half of 2017 as well. The settlement will take place according to the T+2 standards for settling operations on the primary market, usually on Friday.

The issuance calendars of medium-term and long-term government bonds together with indicative maximum total nominal value of these 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, with the exception of issuance calendar for January 2018, which will be published together with The Czech Republic Funding and Debt Management Strategy for 2018. However, the Ministry reserves the option to update the issuance calendar according to the actual development of market conditions and the demand from the primary dealers.

The Ministry also reserves the right to replace the offered government bond with government bond

having similar time to maturity. The selection of particular government bond 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 medium-term and long-term government bonds offered in the competitive part of the auction will be published in indicative maximum amount or in indicative range within the issuance calendars. When choosing particular maturities and instrument type, the Ministry will flexibly react on the development of market conditions and demand from primary dealers.

Money Market Instruments and Other Debt Instruments

State treasury 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 plans to further offer state treasury bills with relatively short time to maturity in second half of 2017 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 the second half of 2017, the state treasury bills will be issued on traditional auction day of Thursday with a settlement T+1, usually on Friday.

The issuance calendars of state treasury 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, with the exception of issuance calendar for January 2018, which will be published together with The Czech Republic Funding and Debt Management Strategy for 2018. The nominal value of state treasury 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 state treasury bills issues for respective quarter.

Also during the second half of 2017, the Ministry plans to intensively use the medium-term and long-term government bonds lending facilities in the form of repo operations as well as in the form of collateralized loans, under which the Ministry provides government bonds of Czech Republic from own asset account against another government bond of Czech Republic 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 regarding the particular government bond. The scope of realized medium-term and long-term government bonds lending facilities in 2017 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.

In 2017, 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 which were successfully launched and carried out in 2016 and

buy-backs will be technically available to primary dealers through the MTS Czech Republic electronic trading platform. The impacts of these operations will affect the financing needs and borrowing requirement accordingly and have positive impact on refinancing risk of state debt portfolio.

Targets, Limits and Risk Parameters of the Debt Portfolio

Targets and limits for each risk indicator of state debt portfolio for medium-term horizon announced in the Strategy remain valid also in the second half of 2017. The markets risks among which belong the refinancing, interest and currency risk are managed by these medium-term targets and limits.

Within the refinancing risk, the Ministry publicly announces medium-term targets and limits for these indicators: share of short-term debt (debt due within one year) to the total state debt, share of medium-term debt (debt due within five years) to the total state debt, and average time to maturity of the state debt portfolio.

Within the interest risk, the Ministry publicly announces medium-term targets and limit for these indicators: share of interest re-fixing of the debt portfolio within one year to the total

state debt and the average time to re-fixing of the state debt.

Within the currency risk, the Ministry publicly announces limits for the share of net foreign-currency exposure of the 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.

In accordance with the Strategy, the announced medium-term targets and limits for refinancing and interest risk indicators are evaluated against their 12-month moving averages.

In case of refinancing and interest risk indicators, the Ministry allows their short-term deviation from stipulated medium-term targets and limits with the fact, that they will be met by the end of medium-term horizon.

Table 4: Targets, Limits and Risk Parameters of the Debt Portfolio

INDICATOR	Announced targets and limits for medium-term horizon
Short-term state debt	20.0% and less
Medium-term state debt	70.0% and less
Average time to maturity	6.0 years ¹
Interest re-fixing up to 1 year	30.0 to 40.0%
Average time to re-fixing	4.0 years
Net foreign-currency exposure with the impact on state debt level	15.0% ²
Net foreign-currency exposure with the impact on the level of interest expenditure on state debt service	15.0% ²

¹ With a possibility of deviation of 0.25 years.

² Possible short-term excess by 2 p.p. in case of an unexpected depreciation of domestic currency. The limit stipulated by the Ministry 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.

Source: MoF

Primary Dealers in Czech Republic Government Bonds

CZK-denominated medium-term and long-term government bonds and state treasury bills will be offered in auctions to the primary dealers, which concluded the Primary Dealer Agreement for

Czech Government Securities with the Ministry. The number of primary dealers for the second half of 2017 is 10. The following table contains the list of primary dealers.

Table 5: List of Primary Dealers in Czech Republic Government Bonds for 2017

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.	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 Second Half of 2017

July

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						

August

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			

September

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	

October






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					

November

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			

December

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

-  Publication of The Czech Republic Funding and Debt Management Strategy for 2018
- the fourth week in December
-  Publication of The Czech Republic Debt Management Quarterly Report
- the 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 Plus standards)
- the third Friday of the month following the end of respective quarter
-  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
- the last working day of the month
-  Publication of the issuance calendars of T-Bills and T-Bonds for following month
- the third Monday in the month prior to the month of the respective auctions, except December, when issuance calendar will be published together with The Czech Republic Funding and Debt Management Strategy for 2018

Ministry reserves the right to change the date of publication due to flexible response to financial markets situation. Any change will be communicated to the public in time through Ministry's website.

The publication was prepared based on the information and data available on 30 June 2017. The Ministry reserves the right to promptly respond to the actual development of financing needs using its tools over the course during 2017. The fulfilment of the funding programme and announced strategic goals 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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