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Debt and Financial Assets
Management Department

The Czech Republic

Government Debt Management

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Ministry of Finance

The Czech Republic Government Debt Management Annual Report 2014

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List of Abbreviations

APEI	Aggregate Performance Evaluation Index
bn	Billion
CaR	Cost-at-Risk
CDCP	Central Securities Depository Prague
CDS	Credit default swap
CNB	Czech National Bank
CZGB	Czech government bond
CZK	Czech koruna currency code
CZSO	Czech Statistical Office
DETS	Designated Electronic Trading System
EA12	Euro area (12 countries)
ECB	European Central Bank
EIB	European Investment Bank
ESA2010	European Systém of Accounts 2010
ESRB	European Systemic Risk Board
EU	European Union
EUR	Euro currency code
EURIBOR	Euro Interbank Offered Rate
FIX	Fixed-rate
FX	Foreign-currency
GDP	Gross domestic product
ISIN	International Securities Identification Number
JCR	Japan Credit Rating Agency
LTE	Long-Term Evolution, wireless comunication standard
MoF	Ministry of Finance
MoM	Month-to-month
MTS	Mercato Telematico Secondario
OECD	Organisation for Economic Co-operation and Development
p.a.	Per annum
p.p.	Percentage point
PIIGS	Abbreviation of Portugal, Ireland, Italy, Greece, Spain
PRIBOR	Prague Interbank Offered Rate
QoQ	Quarter-on-quarter
R&I	Rating agency Rating and Investment Information, Inc.
RfQ	Request for quote
T-Bonds	Medium-term and long-term government bond
T-Bills	Treasury bill
USA	United States of America
VAR	Variable-rate
VAT	Value added tax
YoY	Year-on-year

Summary

The Ministry of Finance (hereinafter the „Ministry" or „MoF") presents to the public The Czech Republic Government Debt Management Annual Report 2014 (hereinafter the „Report"), which involves a detailed summary of events related to the state debt management and the management of the treasury single accounts liquidity, evaluation of the issuance activity of the state and the situation on financial markets in the context of Czech Republic's financing, analysis of the development of state debt and related state budget expenditure on debt service, and last but not least, evaluation of meeting the targets set for the risk management of net debt portfolio and liquidity position of the central government.

In accordance with the Funding and Debt Management Strategy for 2015 published on 17 December 2014, the Debt Portfolio Management Quarterly Review for December 2014, which in previous years was published during the first two weeks of January, and the Performance Evaluation of Primary Dealers in Czech Government Securities for December 2014, which in previous years was published on the last working day of January. The change in communication with the public concerning the state debt management arises from the current prevailing practice in the countries of European Union and it is in accord with the aim to maintain the highest transparency and predictability of the Ministry's operations on the financial markets in order to ensure the financing needs of the central government most efficiently after considering the related long-term risks.

The financing of the Czech Republic was carried out in the environment of gradual economic recovery based solely on the domestic demand. Year-on-year GDP growth for 2014 is expected to reach 2.4%, which means that the Czech Republic restored the faster growth dynamics than the expected average of the countries of the European Union and the euro area. The dominant demand factors of the development were household consumption and restored investment activity, while the impact of foreign trade balance was rather neutral. The environment of highly stable banking sector, external balance and low inflation remained in 2014 despite the weakening domestic currency in the face of the foreign exchange interventions of the Czech National Bank and the impact of external rate-fixing factors.

The stable macroeconomic environment was supported by the general conservative management of government institutions and the gradual shift of fiscal policy of the new government towards the support of economic growth. The decision of the European Council of 20 June 2014 closing the Excessive Deficit Procedure was a significant positive international event. The Czech Republic started the process of deficit decrease in 2009. The government deficit is expected to be 1.3% of GDP in 2014, safely below the 3% threshold. The total general government debt in 2014 should decrease by 2.5 percentage points in comparison to 2013 and reach 43.2% of GDP. It places the Czech Republic among the least indebted countries of the European Union.

The increase in effectiveness of state debt and state treasury liquidity management contributed to the positive development of public finances. Thanks to the inclusion of central government institutions' available resources under the single treasury accounts administered by the Czech National Bank it was possible for the first time since 1995 to achieve the year-on-year decrease in CZK-denominated value of state debt by CZK 19.7 billion. The state debt, which represents approximately 90% of the total gross indebtedness of the general government, decreased to CZK 1,663.7 billion, i.e. 38.8% of GDP, in comparison to the CZK 1,683.3 billion and 41.2% of GDP in 2013.

The introduction of a stricter regime, which entails better planning of cash flow on the accounts under the Ministry's direct management, led to more effective investment operations within the state treasury liquidity. Thanks to this the yields from the investment of available state treasury liquidity increased by CZK 130.5 million in comparison with 2013 and totalled CZK 238.8 million in 2014.

The concurrence of positive perception of the Czech Republic on the domestic and foreign markets, which was again confirmed by the outstanding rating with stable outlook by all the main rating agencies, and the continuing easing of the monetary policy of the Czech National Bank and European Central Bank reflected in the gradual drop in yields of government bonds in all maturity segments and in the flattening of the domestic benchmark yield curve. Based on the right timing of issuance activity the Ministry was able to reduce the net expenditure on state debt service by CZK 2.4 billion. Average weighted yield of CZK-denominated medium-term and long-term government bonds sold in primary auctions was 1.7%, while the average weighted maturity of these bonds extended by 0.9 year in comparison to 2013 and reached 9.1 years.

The financing needs of central government in 2014 amounted to CZK 365.3 billion, i.e. they were lower

by CZK 23.5 billion than in 2013 and at the same time CZK 33.2 billion lower than the originally planned financing needs according to the Funding and Debt Management Strategy for 2014. This is based on the significantly lower cash deficit of the state budget; by CZK 34.2 billion lower than the budgeted deficit of CZK 112 billion. The increase in the financing needs by CZK 1.0 billion was based on the early repayments of the EIB loans and the savings government bonds totalling CZK 9.7 billion together with the lower amount of buy-backs of medium-term and long-term government bonds of CZK 8.7 billion in contrast to the original plan.

The gross borrowing requirement decreased year-on-year by CZK 44.3 billion to CZK 265.6 billion. The financing of the gross borrowing requirement in 2014 was carried out solely on the domestic market by the issuance of government bonds. The gross issue of medium-term and long-term government bonds amounted to CZK 153.3 billion, i.e. it was higher by CZK 7.7 billion than in previous year. With regards to two repayments of EUR-denominated foreign issues of medium-term and long-term government bonds in the total nominal value of EUR 3.0 billion and the continuing absence of the Czech Republic on the foreign markets the net issue of CZK-denominated medium-term and long-term government bonds reached CZK 96.0 billion, which is the highest amount since 2009. The Ministry enabled the investors, in particular the domestic ones, to participate on the increase in market prices of Czech government bonds. On the contrary, a potential foreign issue was postponed to the period of more favourable cost-related conditions. Most of the issuance activity was carried out in the maturity segment of more than 10 years to maturity, more precisely 43% of all issues of medium-term and long-term government bonds, by 23.6 percentage points more than in previous year.

Fixed-rate and variable-rate bonds were issued on the domestic market in 2014, particularly via 26 primary auctions amounting to CZK 144.3 billion, 23.5% was comprised by the variable-rate bonds. In accordance with the original plan two new benchmark issues of fixed-rate bonds CZGB 0.85/18 and CZGB 2.40/25 were issued, as well as two issues of variable-rate bonds due in 2020 a 2027 with the interest linked to 6M PRIBOR interbank rate. Tap sales of medium-term and long-term government bonds amounting to CZK 9.0 billion were carried out via the MTS Czech Republic electronic trading platform in November and December as a complement to the issuance activity when no primary auctions took place. Buy-backs of bonds due in 2015 and 2016 in the total amount of CZK 11.3 billion were carried out in the last two months of the year.

In accord with the intention to support the domestic money market the gross issue of treasury bills totalling CZK 114.9 billion was carried out in 2014, the amount outstanding of treasury bills decreased by CZK 13.3 billion in comparison to 2013 to CZK 107.6 billion. The cash resources received through the lending facilities of medium-term and long-term government bonds totalled CZK 2.5 billion while the balance at the end of 2013 was zero. The interest of primary dealers in this instrument rose significantly in 2014, when the annual turnover of the nominal amount of collateral provided in the lending facilities was by CZK 61.5 billion higher than in 2013 and amounted to CZK 84.6 billion. It confirmed the attractiveness of Czech Government bonds in the environment of limited offer connected to the available liquidity in the banking sector, as well as the favourable conditions for the financing of the Czech Republic in 2015.

1 – Macroeconomic Framework and Financial Markets

Economic Development

Since the second half of 2011, the Czech economy has been going through a shallow recession, where the YoY real GDP decrease amounted to 0.8% in 2012 and moderated to 0.7% in 2013. Since the start of 2014, economic activity has been renewed, with the real GDP in Q1 2014 reporting a QoQ growth of 0.6%, followed by a QoQ growth of 0.2% in Q2, 0.4% in Q3, and in Q4, the expected QoQ growth amounts to 1.0%. The development of the Czech Republic's economy in previous year confirms that the period of economic recession has been overcome, although the dynamics of real GDP recovery remain somewhat fragile. In 2014, the negative production gap started closing, which is also confirmed by the YoY growth of GDP in Q4, adjusted for price effects and seasonality, which was 2.2%.

In terms of dynamics, the most important component in GDP recovery was the gross fixed capital formation. The key qualitative GDP change in 2014 is the positive turnaround in the development of domestic absorption, which is also confirmed by the higher YoY tempo of real growth of import of goods and services compared to exports. This reflects the slower growth of economic performance of the EU in contrast to the Czech Republic. The currency commitment of the CNB operated positively on the development of exports and acted against the slow growth of primary trading partners' demand.

Table 1: Main Macroeconomic Indicators of the Czech Republic

	2008	2009	2010	2011	2012	2013	2014P
Real GDP growth (%)	2.7	-4.8	2.3	2.0	-0.8	-0.7	2.4
Household consumption growth (%)	2.9	-0.7	1.0	0.2	-1.8	0.4	1.5
Government consumption growth (%)	1.1	3.0	0.4	-2.9	-1.0	2.3	1.9
Growth of gross fixed capital formation (%)	2.5	-10.1	1.3	1.1	-2.9	-4.4	4.5
Contribution of foreign trade to GDP growth (p.p.)	0.8	0.5	0.5	1.9	1.3	0.0	-0.2
Average inflation rate (%)	6.3	1.0	1.5	1.9	3.3	1.4	0.4
Unemployment rate (%)[1]	4.4	6.7	7.3	6.7	7.0	7.0	6.1
Nominal wage and salary growth (%)	7.5	-2.0	0.6	2.2	2.1	-0.4	3.0
Current account balance on GDP (%)	-1.9	-2.3	-3.6	-2.1	-1.6	-1.4	-0.2
CZK/EUR exchange rate	25.0	26.4	25.3	24.6	25.1	26.0	27.5
Real Eurozone GDP growth (%)[2]	0.3	-4.4	2.0	1.6	-0.7	-0.5	0.8

[1] Unemployment rate based on the method of Labour Force Survey.
[2] EA12
Source: CZSO and MoF

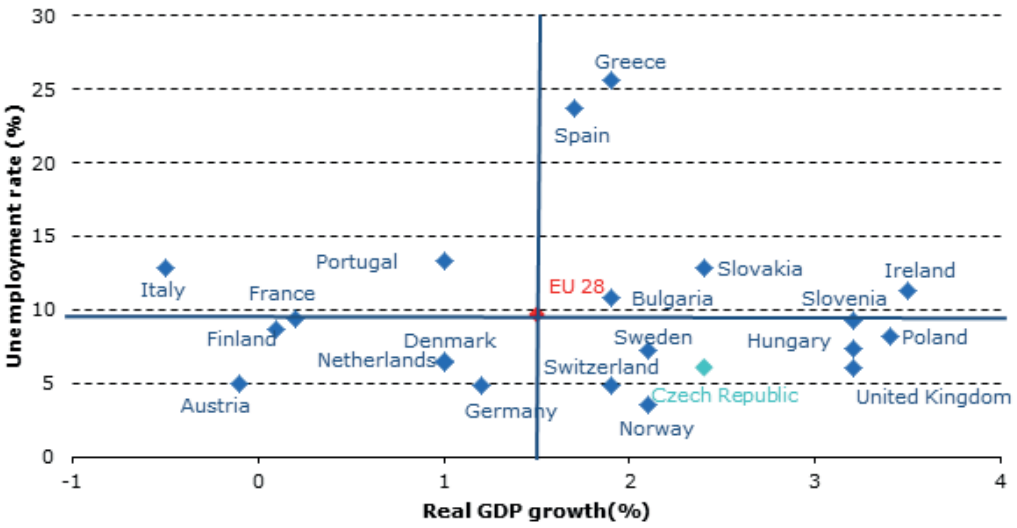
For 2014 a real GDP growth of 2.4% is expected, while the similar dynamics are expected also in medium-term horizon with the fact, that the real GDP growth should be driven by domestic demand. With the exception of net exports, positive contributions are expected for all GDP components. The contribution of net exports to real GDP growth depends largely on the uncertain economic development of primary trading partners. Recovery of economic activity in the Czech Republic was positively affected by improving terms of trade, which contributed to the growth of real gross domestic product, which moved at about 4.0 %. In 2014, the practically even balance of current account of balance of payments was achieved, which confirms problem-free sustainability of external macroeconomic equilibrium.

On 7 November 2013, the Czech National Bank announced the launch of FX interventions with the aim of easing the currency policy through an alternative instrument in the form of an exchange rate, for the purpose of maintaining inflation close to the inflation target of 2%. Real FX intervention occurred only in November 2013. Nevertheless, inflation in 2014 remained well below the inflation target, but avoided to deflation band. In December 2014, the inflation rate expressed as the increment in the consumer price index compared to the same month of the previous year was around 0.1%, which means significant slowdown of price dynamics compared to the YoY increase of 0.6% in November 2014. The development of consumer prices as of the end of 2014 was affected by the slump in oil prices, which creates external offer pressure on their

decrease. The MoM decrease of consumer prices in December amounted to 0.1% and the average inflation rate for 2014 amounted to 0.4%, which is the lowest value since 2003.

The Czech Republic is among the countries with one of the lowest unemployment rates in the long term. The unemployment rate (according to Labour Force Survey) in Q3 2014 was around 5.9%, which meant a year-on-year decrease of 1.0 percentage point. In accordance with the change in the aggregate demand structure, no significant growth of unemployment is expected, even if the Eurozone's recovery is slower. The currency commitment of the CNB should also have a positive impact on employment among Czech exporters. Should there be a slight recovery in Western Europe, to which most Czech exporters export their goods and services, it is possible to expect the following of this trend and further decrease of unemployment rate.

Figure 1: Real GDP growth and Unemployment Rate in Selected EU Countries in 2014



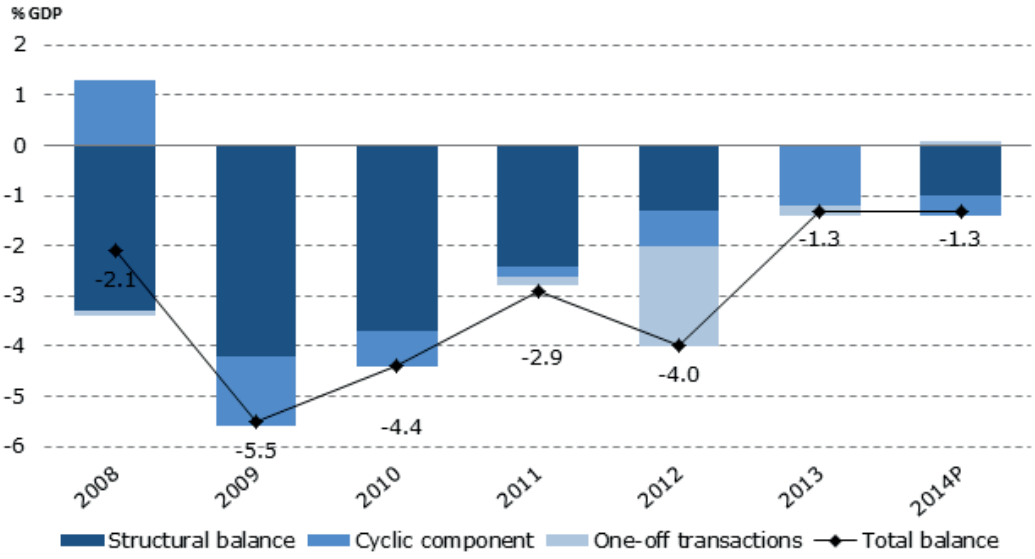
Source: Eurostat and MoF

An advantage of the Czech Republic is the stable financial sector and reliable fiscal policy. There is adequate liquidity in the banking system and the profitability of banks has a positive impact on capital adequacy. Household indebtedness remains relatively low on an international comparison due to the moderate tempo of taking on debt and the share of non-performing loans is also stable, which amounted to 4.8% for households and for 7.0% for non-financial enterprises as of the end of Q3 2014. The loans-to-deposits ratio also shows long-term stability and its value is among the lowest in an international comparison. The high volume of deposits by residents and sufficient liquidity in the banking system mean that the domestic banking sector is independent from foreign sources of funding in the long term. Capital adequacy measured as Capital Adequacy Ratio Tier I reached 17.5% at the end of Q3 2014, which is a value well above the eight-percent limit, which means that the banking sector is sufficiently prepared for the new capital regulations.

General Government Sector Finances

After four years of fiscal consolidation, the Czech Republic managed to reduce the government sector funding deficit from 5.5% of GDP in 2009 to 1.3% of GDP in 2013. The fiscal efforts were a contributing factor to the fact that on 20 June 2014, the Council of Europe decided to terminate the excessive deficit procedure. Starting in 2014, the new government has realized gradual limiting of fiscal restrictions with unambiguous aim to support the revival of domestic aggregate demand, The draft state budget and state fund budgets for 2015 are focused primarily on pro-growth investment with a positive long-term impact on development of potential product. Particularly accented are investments into education, science and research, and transport infrastructure. Despite GDP support, the long-term objective is to maintain the government sector deficit safely below the level of 3% of GDP.

Figure 2: The Czech Republic Government Sector Balance (ESA2010)



Note: Structural balance based on the European Commission method.
Source: MoF

In 2013, the government sector balance ended with a deficit of 1.3% of GDP, which represents an improvement in comparison to the previous year. The measures on the revenue side in the area of VAT (increase of the rate of 1.0 p.p) and personal income tax (e.g. solidarity surcharge of 7%, lump-sum expenses limitations) and significant decrease of gross capital formation by approx. 0.4% of GDP contributed to the decrease of the deficit in 2013 (adjusted for one-off operation in the form of financial compensations with the churches). Since 2010, the investments have continuously decreased. In 2014, a total deficit of 1.3% of GDP is expected.

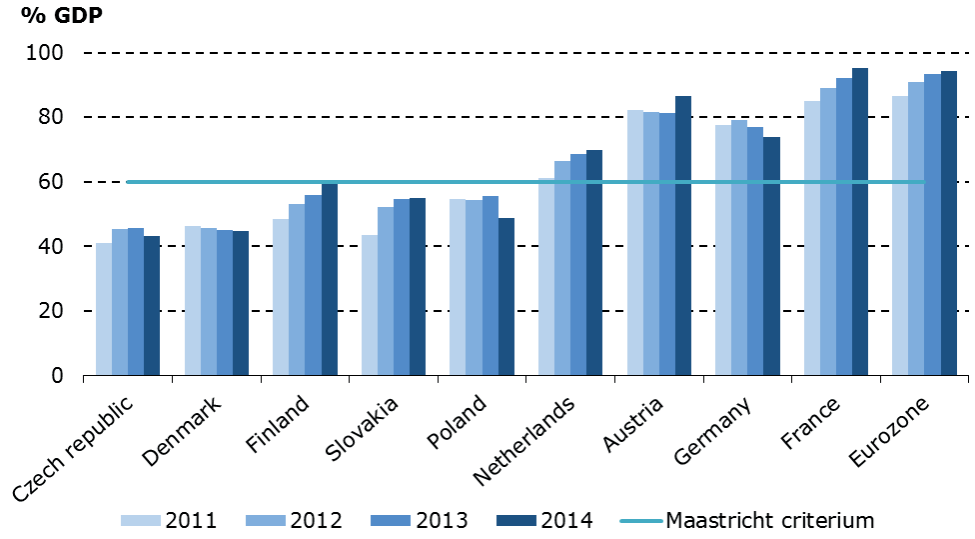
At the end of 2014, the state budget reported a cash deficit of CZK 77.8 billion, which is a result better by CZK 3.5 billion compared to 2013, and better by CZK 34.2 billion compared to the budgeted value. The lower-than-planned deficit was due on the revenue side to VAT and corporate income tax collection. On the spending side, savings were achieved particularly in non-investment purchases and related expenditure (CZK 8.4 billion), social allowances (CZK 7.6 billion), and potential binding of costs in the chapter of General Treasury Management (CZK 5 billion).

Total revenue reached CZK 1,133.8 billion and was CZK 5.4 billion higher compared to the budget after changes. Fulfilment and YoY growth of CZK 42.0 billion were largely due to tax revenue, of which VAT collection had a particularly positive impact (exceeding the budget by CZK 11.5 billion with a YoY growth of CZK 10.3 CZK billion), as did corporate income tax collection (exceeding the budget by CZK 7.0 billion, growth of CZK 7.9 billion) and social security premiums with a growth of CZK 10.6 billion. Of non-tax and other revenues, the year-on-year growth was affected particularly by February's extraordinary revenue to the chapter of the Czech Telecommunication Office from frequency auctions for high-speed mobile LTE networks (CZK 8.5 billion) and revenue from the EU (growth of CZK 6.6 billion).

Total expenditure in 2014 reached the amount of CZK 1,211.6 billion, which represented a YoY increase of CZK 38.5 billion, i.e. 3.3%. The budget after changes was used to a level of 97.7%, which represents savings in the amount of CZK 28.8 billion. The YoY growth was affected (apart from other items) in particular by higher spending designated for co-financing the joint programs of the Czech Republic and EU by about CZK 20 billion.

According to the October notification, general government sector debt in 2014 reached 45.7% of GDP. Due to the methodical transition to ESA2010, there was reduction by 0.3 p.p. compared to the April notifications. According to the Ministry, the debt should decrease to 43.2% of GDP in 2014. In terms of meeting the Maastricht criteria, the indicator is safely below the limit of 60%.

Figure 3: Government Sector Debt in Selected EU Countries (ESA2010)



Note: The Maastricht criterion is a part of the condition for EU members to join the single currency union. The value of the share of government sector debt to GDP should not exceed 60%.
Source: Eurostat and MoF

Financial Markets

After the stagnation of Czech Republic government bond yield in first two months of 2014, there has been a continual decrease since March 2014, which built on similar development during the second quarter of previous year. The 10-year government bonds yield dropped from January to December 2014 by 187.5 basis points. Government bond yields across the entire yield curve were at their historical minimums at the end of 2014. The drop in government bonds yields in 2014 was positively impacted by a number of factors, which were strongly reflected in the declining trend and had a major effect on savings on the interest costs of the state debt. Hence, in 2015 the Ministry may conduct issuance activity under better conditions than in 2014. In 2014, the average fixed-rate CZK-denominated medium-term and long-term government bonds yield in domestic auctions was 1.7%.

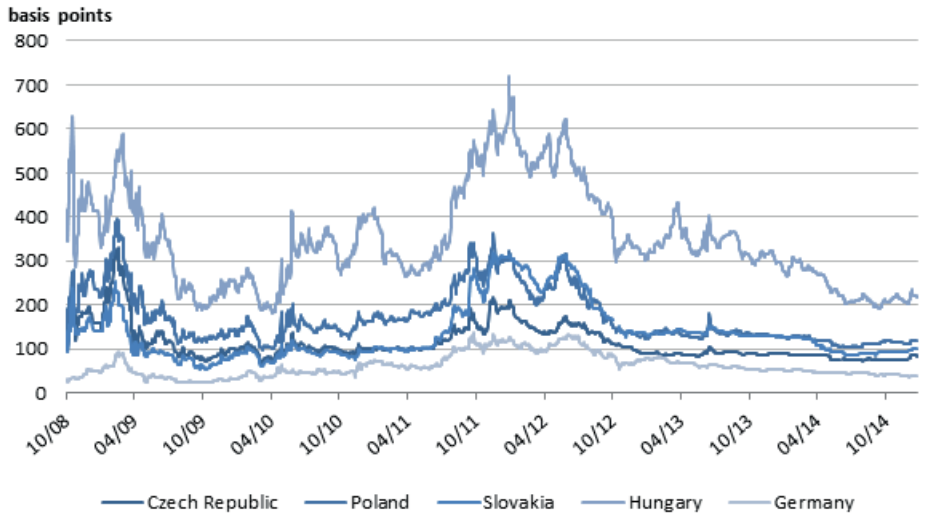
Figure 4: Development of Czech Government Bonds Yields

Source: Thomson Reuters

The important factor in the decrease of government bonds yields is conservative debt management and the credible fiscal policy of the government, with a positive impact on investor trust, which is reflected in a higher demand from investors for medium-term and long-term government bonds in primary auctions. The wide offer of both fixed-rate and variable-rate debt instruments created a sufficient range for investors to diversify the debt portfolio without the necessity to use interest swaps to optimize their positions. The declining trend of government bonds yields, especially among government bonds with a longer time to maturity, was largely the result of a limited offer of medium-term and long-term government bonds in primary auctions in the second half of 2014 and deferring their issue and sale to the first half of 2015.

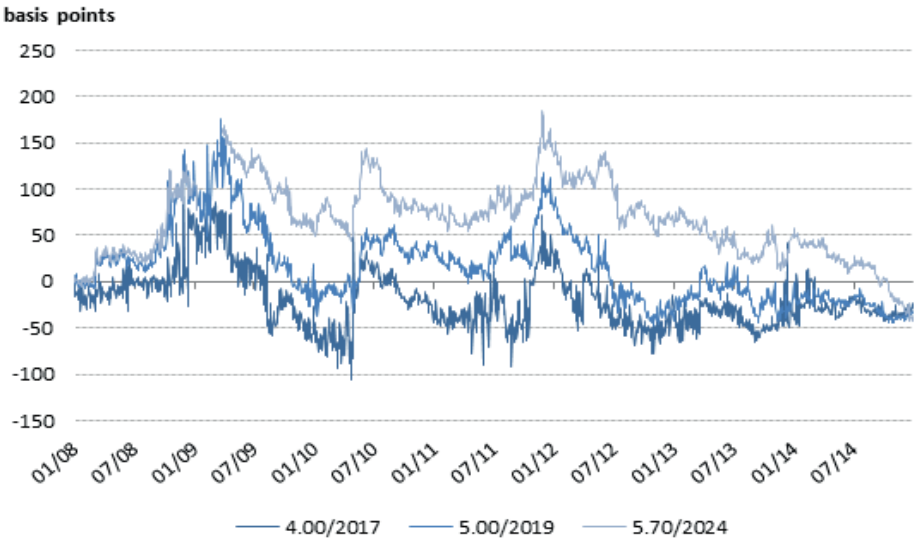
The perception of the Czech Republic on the international market as a reliable issuer of government bonds is illustrated by the situation on the credit default swaps (CDS) markets, where the Czech Republic has a position comparable to Germany and within the region of comparable neighbouring countries, market participants pay the lowest risk premium compared to Poland, Hungary and Slovakia.

Figure 5: Premiums on Credit Default Swaps – Central Europe (10-year)



Source: Thomson Reuters

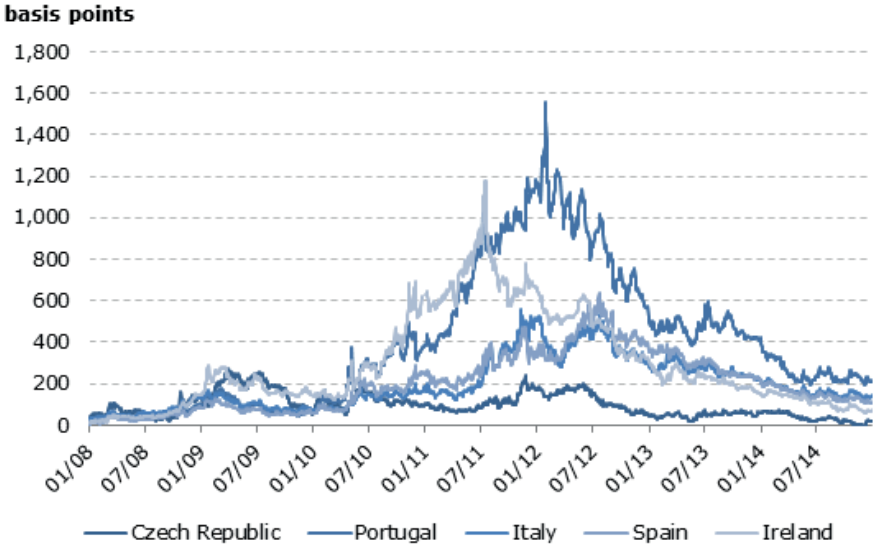
Figure 6: "Asset Swap Spread" Risk Premium on Czech Government Bonds



Source: Thomson Reuters

Likewise, the development of the risk premium measured using the spread to comparable swap rates ("asset swap spread") indicates a significant decrease of the risk premium on Czech government bonds since the start of 2014. This reduce in aversion to risk is related to the gradual calming down of the situation in the Eurozone in terms of the debt crisis, also illustrated by the decrease of yield spreads of the problematic countries of Portugal, Ireland, Italy, Greece and Spain ("PIIGS") compared to German government bonds. The main uncertainty in terms of the debt crisis remains the development of the Greek economy, although an issue of 5-year government bonds was successfully subscribed on the primary market in April 2014. The relaxed refinancing conditions and reduction of basic interest rates by the ECB, as well as the gradual fiscal consolidation and restructuring of PIIGS economies, contributed to a significant easing of tension on the debt market in Eurozone. This is also confirmed by the development of the yield spreads of PIIGS countries compared to German government bonds, which returned to the values before the debt crisis broke out. The effect of spill-over between national debt markets was also reflected in the decrease of Czech government bond yields.

Figure 7: Yield Spreads Compared to German Government Bonds (10-year)



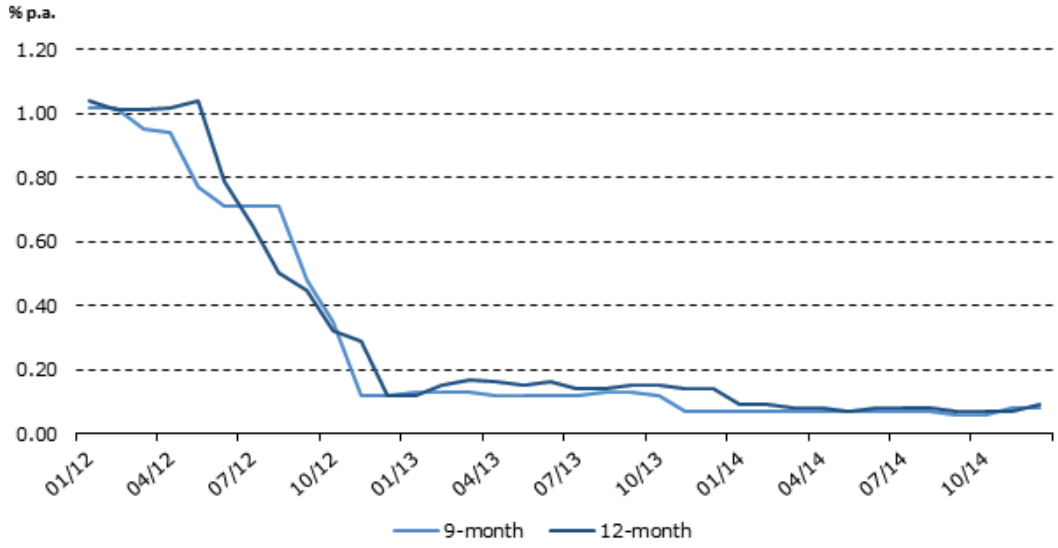
Source: Thomson Reuters

The slight increase of the risk premium on the European bond market occurred at the end of 2014 due to political uncertainty in Greece only, which was also reflected in the development of the spread compared to German bonds.

The decrease of government bonds yields was also positively impacted by a reduction of the illiquidity premium, which is confirmed by the declining competitive spread particularly among bonds subject to quoting on the electronic trading platform MTS Czech Republic. Investors thus require a lower illiquidity premium, if they can sell the government bonds without problems on the functional secondary market. This is subsequently reflected in the overall decrease of government bonds yields with a positive impact on the reduced interest costs on state debt service.

In times of global surpluses of liquidity on the interbank market, investors seek ways to valorise available liquidity. Liquidity provided on a long-term basis is illustrated in the flattening out of the risk-free yield curve. Government bonds provide an investment alternative at zero or negative interbank interest rates. State treasury bills can be considered an almost perfect substitute for liquidity provided on a short-term basis. In maturity segments of up to 1 year, the state treasury bill auction yields in 2014 were below the level of 0.1%. In the course of 2014, there were situations in which the state treasury bill yield with a longer period to maturity was lower than from state treasury bills with a shorter period to maturity. This was probably due to investor expectations of a further decrease of interest rates on money market instruments with a longer period to maturity. The average state treasury bill auction yield in 2014 was 0.07%.

Figure 8: Development of State Treasury Bill Auctions Yields



Source: CNB and MoF

The decrease of Czech government bond yields may also have been positively affected by the alternative monetary policy instrument in the form of the CNB currency commitment. This eased the currency risk and foreign investors could raise their investments into Czech medium-term and long-term government bonds without requiring a higher yield to cover significant fluctuations in the FX rate. Unsterilized currency interventions also contributed to raising the liquidity of the banking system in the Czech Republic, where financial institutions can subsequently place available liquidity into Czech government bonds.

Czech Republic's Sovereign Credit Rating

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. In fact, in March 2014 the Japan Credit Rating Agency improved the Czech Republic's credit rating to AA- with a stable outlook for long-term debt in foreign currencies, and to A+ with a stable outlook for long-term debt in the domestic currency. 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 countries average for several years.

Table 2: Czech Republic's Sovereign Credit Rating in 2014

Rating agency	Domestic long-term liabilities	Outlook	Foreign long-term liabilities	Outlook	Granted/ affirmed
Moody's	A1	Stable	A1	Stable	19/07/2013
Standard & Poor's	AA	Stable	AA-	Stable	25/07/2014
Fitch Ratings	AA-	Stable	A+	Stable	14/11/2014
JCR	AA-	Stable	A+	Stable	24/03/2014
R&I	AA-	Stable	A+	Stable	11/09/2013

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

2 - Borrowing Requirement and Development of State Debt

The quantification of borrowing requirement is a key parameter in government funding management, which definitely determines the value of financial sources that the central government needs to acquire over the course of the respective calendar year through borrowing operations primarily on financial markets, in order to ensure coverage of the total planned annual government financing needs. Apart from borrowing operations, the funding requirement may also be covered by operations with state financial assets, or management of other state assets within extra-budgetary balance operations, or the involvement of available cash resources of the state treasury through the re-financing mechanism of treasury single accounts.

Financing Needs and Sources of the Central Government

The financing needs of the central government are determined by standard components, which must be financed in the given year using monetary resources, i.e. the budgeted state budget deficit and all redemptions, early redemptions and buybacks and exchanges of nominal value (principals) of state debt, including the related derivatives. Financing operations on the side of sate financial assets and liquidity management operations take place on the side of funding sources, which may be involved in covering financing needs in parallel with the state's lending operations on financial markets.

Table 3: Funding Needs and Sources (CZK billion)

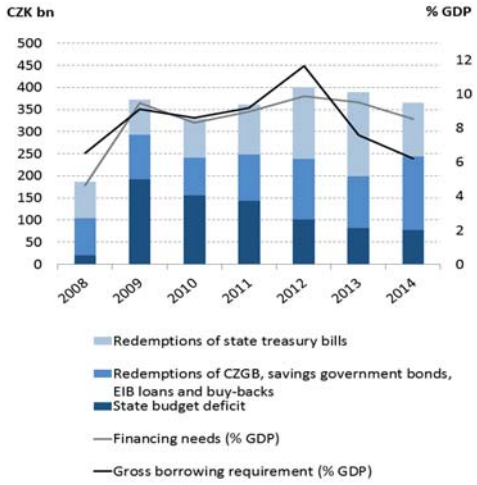
Financing needs	2008	2009	2010	2011	2012	2013	2014
Primary balance of state budget	-17.7	147.9	120.6	97.6	59.6	30.4	29.3
Net expenditure on state debt	37.7	44.5	35.8	45.1	41.4	50.9	48.5
Extra-budgetary financing needs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Redemption on government bonds in the respective year[1]	90.1	98.2	83.0	102.1	115.6	108.6	136.4
Buy-backs and exchanges of government bonds from prior years	-10.0	-0.2	0.0	0.0	-2.0	-8.1	-4.0
Buy-backs and exchanges of government bonds due in coming years[2]	0.2	2.0	0.0	2.0	8.1	7.5	11.3
Redemption and early redemptions on savings government bonds in given year	0.0	0.0	0.0	0.0	9.6	7.7	11.9
Redemption on state treasury bills excl. roll-over[3]	82.2	78.7	88.2	113.3	162.6	189.1	120.9
Redemptions on other money market instruments excl. roll-over[3]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments on EIB loans	4.5	0.8	1.1	1.1	5.3	2.8	11.1
Total financing needs	**186.9**	**372.0**	**328.7**	**361.3**	**400.2**	**388.8**	**365.3**
Gross state treasury bill issue excl. roll-over[3]	78.7	88.2	113.3	162.6	189.1	120.9	107.6
Other money market instruments excl. roll-over[3]	0.0	0.0	0.0	0.0	0.0	0.0	2.5
Gross issue of government bonds on the domestic market	123.6	203.0	167.4	180.3	164.6	145.6	153.3
Gross issue of government bonds on foreign markets[1]	48.2	54.7	49.7	0.9	69.0	0.0	0.0
Gross issue of savings government bonds	0.0	0.0	0.0	20.4	45.4	39.1	2.1
EIB loans	12.6	11.9	10.4	5.3	4.0	4.3	0.0
Financial asset and liquidity management operations	-76.2	14.2	-12.0	-8.2	-71.8	78.9	99.7
Total financing sources	**186.9**	**372.0**	**328.7**	**361.3**	**400.2**	**388.8**	**365.3**
Gross borrowing requirement	**263.1**	**357.8**	**340.7**	**369.5**	**472.0**	**309.9**	**265.6**

[1] Incl. hedging operations.
[2] Excl. operations with medium-term and long-term government bonds during the current budgetary year.
[3] Within the respective period.
Source: MoF

The total financing needs are adjusted according to the recommended international OECD methodology for roll-over operations with state treasury bills, and by re-financing operations with other cash and money market instruments, which take place in the calendar year and thus do not affect the net change of these items in the course of the year. The total annual financing needs in the given year thus only take into account the balances of these short-term instruments at the end of the previous year.

The following figure depicts the share of the financing needs and their components in GDP, including the balance of state treasury bills outstanding at the end of the previous period, which must also be re-financed in the current year, and the share of the gross borrowing requirement in GDP.

Figure 9: Financing Needs of the Central Government



Source: MoF

Financing of the Gross Borrowing Requirement

The gross borrowing requirement determines the part of the sources for the government's financing needs secured through borrowing operations, i.e. it stipulates the value of cash resources that the government must obtain primarily by issuing and selling government bonds and drawing credits and loans. The gross borrowing requirement may be lower than the annual financing needs, if state financial assets or liquidity management operations are involved as a source of financing; on the contrary, it may be higher if assets are accumulated through borrowing operations.

Table 4: Financing of the Gross Borrowing Requirement (CZK billion)

	2008	2009	2010	2011	2012	2013	2014
Gross borrowing requirement	**263.1**	**357.8**	**340.8**	**369.5**	**472.0**	**309.9**	**265.6**
Gross issue of state treasury bills excl. roll-over[1]	78.7	88.2	113.3	162.6	189.1	120.9	107.6
Other money market instruments excl. roll-over[1]	0.0	0.0	0.0	0.0	0.0	0.0	2.5
Received collateral in cash	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross issue of government bonds on the domestic market up to 5 years[2]	50.4	81.4	63.4	45.3	31.4	37.8	37.3
Gross issue of government bonds on the domestic market from 5 to 10 years[2]	51.9	62.3	61.2	73.6	93.3	79.6	50.0
Gross issue of government bonds on the domestic market over 10 years[2]	21.2	59.3	42.8	61.4	39.9	28.3	65.9
Gross issue of government bonds on foreign markets[2; 3]	48.2	54.7	49.7	0.9	69.0	0.0	0.0
Gross issue of savings government bonds[4]	0.0	0.0	0.0	20.4	45.4	39.1	2.1
EIB loans	12.6	11.9	10.4	5.3	4.0	4.3	0.0
Other financing sources	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total financing of gross borrowing requirement	**263.1**	**357.8**	**340.7**	**369.5**	**472.0**	**309.9**	**265.6**

[1] Within the respective period.
[2] Nominal value; premiums and discounts are included in net costs on state debt service, i.e. they are included in the net borrowing requirement.
[3] Incl. hedging operations.
[4] Including reinvestment of yields.
Source: MoF

Net Borrowing Requirement, Change and Structure of State Debt

The net borrowing requirement of the central government is a key factor in the change in the nominal CZK-denominated value of the gross state debt, and is determined by the difference between the gross borrowing requirement and total redemption on the nominal values (principal) of state debt, including the related derivatives. In the case of a zero net change in state financial assets, including the cash reserve, the net borrowing requirement corresponds to the sum of the state budget deficit and potential extra-budgetary financing needs. Hence, the net borrowing requirement represents the value of cash resources that the central government must borrow in the current year beyond the resources already borrowed in previous years.

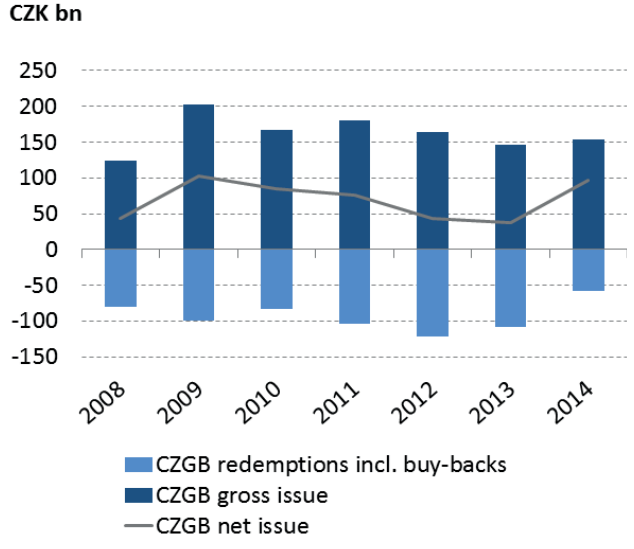
Table 5: Net Borrowing Requirement of the Central Government (CZK billion)

	2008	2009	2010	2011	2012	2013	2014
Gross borrowing requirement	**263.1**	**357.8**	**340.7**	**369.5**	**472.0**	**309.9**	**265.6**
Redemption on government bonds in the given year[1]	90.1	98.2	83.0	102.1	115.6	108.6	136.4
Buy-backs and exchanges of government bonds from previous years	-10.0	-0.2	0.0	0.0	-2.0	-8.1	-4.0
Buy-backs and exchanges of government bonds due in coming years[2]	0.2	2.0	0.0	2.0	8.1	7.5	11.3
Redemptions and early redemptions on savings government bonds in the given year	0.0	0.0	0.0	0.0	9.6	7.7	11.9
Redemptions on state treasury bills excl. roll-over[3]	82.2	78.7	88.2	113.3	162.6	189.1	120.9
Other money market instruments redemptions excl. roll-over[3]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments of EIB loans	4.5	0.8	1.1	1.1	5.3	2.8	11.1
Net borrowing requirement	**96.2**	**178.2**	**168.5**	**151.0**	**172.8**	**2.3**	**-21.9**

[1] Incl. hedging operations.
[2] Excl. operations with medium-term and long-term government bonds due in the respective budgetary year.
[3] Within the respective period.
Source: MoF

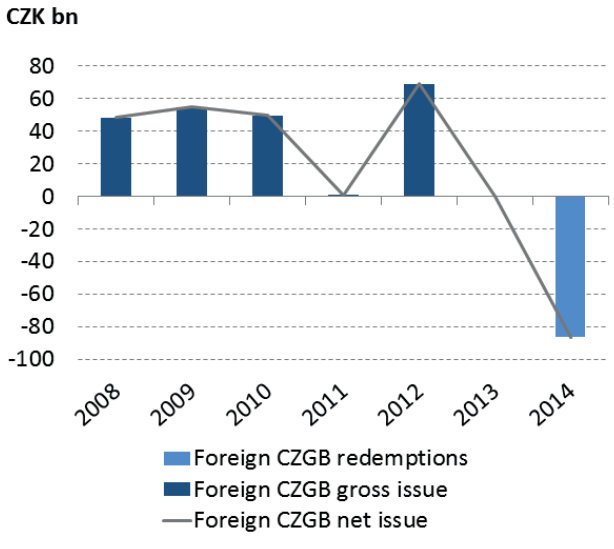
The net borrowing requirement is financed using the same instruments as the gross borrowing requirement. In financing the net borrowing requirement, however, it is necessary to take into account the value of total redemption on the nominal values (principal) of the given debt portfolio instruments, including the impact of derivatives.

Figure 10: Net Issue of CZGB on the Domestic Market



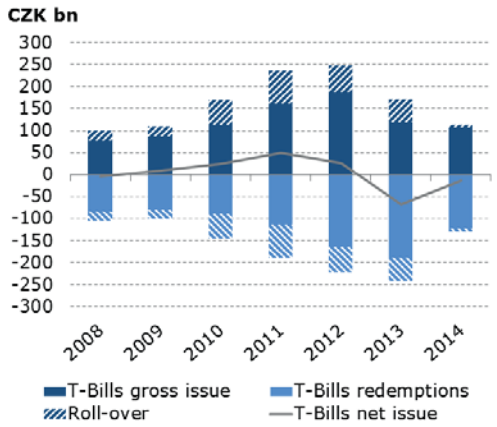
Note: Redemptions on medium-term and long-term government bonds include realized buy-backs.
Source: MoF

Figure 11: Net Issue of Foreign Bonds



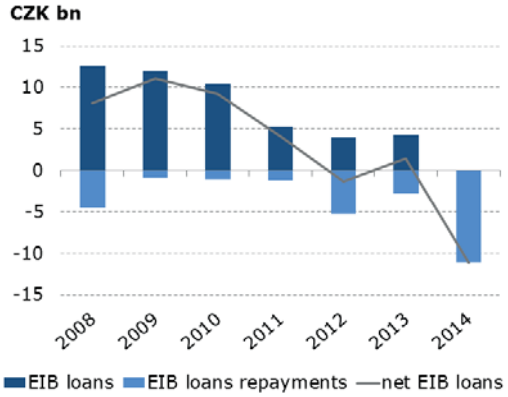
Source: MoF

Figure 12: Net Issue of State Treasury Bills



Source: MoF

Figure 13: Net Change in the Balance of Loans and Credits



Source: MoF

Table 6: Net Borrowing Requirement of the Central Government and Change in State Debt (CZK billion, % of GDP)

	2008	2009	2010	2011	2012	2013	2014
Gross state debt as at 1 January	**897.6**	**999.8**	**1,178.2**	**1,344.1**	**1,499.4**	**1,667.6**	**1,683.3**
Primary state budget balance	-17.7	147.9	120.6	97.6	59.6	30.4	29.3
Net expenditure on state debt service[1]	37.7	44.5	35.8	45.1	41.4	50.9	48.5
Extra-budgetary financing needs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial asset and liquidity management operations	76.2	-14.2	12.0	8.2	71.8	-78.9	-99.7
Net borrowing requirement	**96.2**	**178.2**	**168.5**	**151.0**	**172.8**	**2.3**	**-21.9**
Net issue of state treasury bills	-3.4	9.4	25.1	49.3	26.5	-68.2	-13.3
Net change in the balance of other money market instruments	0.0	0.0	0.0	0.0	0.0	0.0	2.5
Net issue of government bonds on the domestic market	43.4	103.0	84.4	76.2	42.9	37.7	96.0
Net issue of government bonds on the foreign market[2]	48.2	54.7	49.7	0.9	69.0	0.0	-86.4
Net issue of savings government bonds	0.0	0.0	0.0	20.4	35.8	31.4	-9.7
Net change in balance of provided loans and credits	8.1	11.1	9.3	4.1	-1.3	1.5	-11.1
Financing of net borrowing requirement	**96.2**	**178.2**	**168.5**	**151.0**	**172.8**	**2.3**	**-21.9**
Revaluation of state debt[3]	6.0	0.5	-2.4	4.5	-4.4	13.4	2.3
Promissory note repayments[4]	0.0	-0.2	-0.3	-0.2	-0.1	0.0	0.0
Gross state debt change	**102.2**	**178.4**	**165.8**	**155.3**	**168.3**	**15.7**	**-19.7**
Gross state debt as at 31 December	**999.8**	**1,178.2**	**1,344.1**	**1,499.4**	**1,667.6**	**1,683.3**	**1,663.7**
Share of GDP (%)[5]	**24.9**	**30.0**	**34.0**	**37.3**	**41.2**	**41.2**	**38.8**

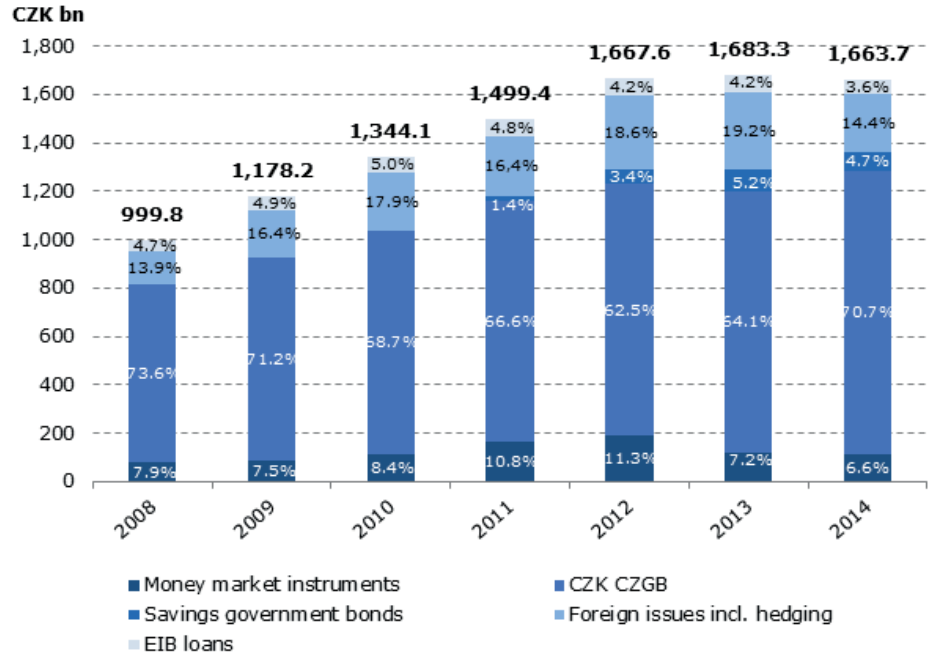
[1] Balance of budgetary chapter 396 – State debt.
[2] Incl. hedging operations.
[3] Exchange rate changes due to revaluation of debt denominated in foreign currencies.
[4] Promissory notes covering parts of the Czech Republic's ownership interests in international financial institutions.
[5] GDP in the ESA2010 method. The source of data for 2008 – 2013 is CZSO, for 2014 the Macroeconomic Forecast of the MoF – January 2015.
Source: MoF, CZSO

Table 7: Balance and Structure of the Net Debt Portfolio (CZK billion)

	2008	2009	2010	2011	2012	2013	2014
Gross state debt	**999.8**	**1,178.2**	**1,344.1**	**1,499.4**	**1,667.6**	**1,683.3**	**1,663.7**
State treasury bills	78.7	88.2	113.3	162.6	189.1	120.9	107.6
Other money market instruments	0.0	0.0	0.0	0.0	0.0	0.0	2.5
Received collateral in cash	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government bonds issued on the domestic market	735.6	838.6	923.0	999.1	1,042.0	1,079.7	1,175.7
Government bonds issued on foreign markets[1]	137.9	193.0	240.3	245.7	310.3	323.7	239.6
Savings government bonds	0.0	0.0	0.0	20.4	56.2	87.6	77.8
EIB loans	46.8	57.9	67.2	71.3	70.0	71.5	60.4
Promissory notes[2]	0.8	0.6	0.3	0.1	0.0	0.0	0.0
Liquid state financial assets	**116.6**	**102.2**	**112.3**	**119.7**	**191.5**	**116.7**	**67.8**
Nuclear investment portfolio	11.6	13.5	15.1	16.6	18.5	20.7	22.7
Pension investment portfolio	17.5	21.2	21.6	22.0	22.4	22.6	22.7
Special-purpose state financial assets accounts	9.5	9.2	10.2	10.5	10.6	10.7	10.9
On-lending over 1 year[3]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash reserve[4]	78.0	58.3	65.4	70.6	139.9	62.7	11.5
State budget surplus	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State financial assets	**116.6**	**102.2**	**114.0**	**121.4**	**193.2**	**116.7**	**67.8**
Liquid state financial assets	116.6	102.2	112.3	119.7	191.5	116.7	67.8
On-lending[5]	0.0	0.0	1.7	1.7	1.7	0.0	0.0
Net debt portfolio	**883.2**	**1076.0**	**1,230.1**	**1,378.0**	**1,474.4**	**1,566.7**	**1,595.8**

[1] Incl. hedging operations.
[2] Promissory notes covering parts of the Czech Republic's ownership interests in international financial institutions.
[3] Extra-budgetary loans with maturity of over 1 year granted to other countries and domestic legal entities.
[4] Available cash resources created according to Section 35(4) of Act No. 218/2000 Coll. incl. the impact of exchange rate difference of the CZK value of the part of the cash reserve in foreign currencies.
[5] Extra-budgetary loans with original maturity over 1 year granted to other countries and domestic legal entities whose expected residual maturity is greater than 12 months.
Source: MoF

Figure 14: Structure of the Debt Portfolio



Source: MoF

State Treasury Liquidity Management

In the environment of extremely low and negative interest rates and in case of the Czech Republic also under the regime of the foreign exchange interventions of the Czech National Bank, that increased the liquidity in the domestic banking sector, the Ministry focused on the significant rationalization of the available state treasury liquidity in 2014. Since a substantial increase in interest rates on the financial market cannot be expected, the liquidity became involved more intensively as a short-term source of cash resources for the covering of financing needs of the central government in accordance with the most recent principles of management of government finances. The cash reserve generated in previous years by the issuance activity with correlative increase in the gross state debt is being progressively replaced by the available cash resources of the central system of treasury state accounts.

Table 8: State and Structure of Resources and Investment Position of State Treasury (CZK/ EUR billion)

	2012		2013		2014	
	CZK	EUR	CZK	EUR	CZK	EUR
Liquid state financial assets	**162.3**	**1.2**	**94.0**	**0.8**	**56.3**	**0.4**
Mandatory clients of state treasury [1]	36.4	0.0	96.1	2.2	99.3	1.8
Optional clients of state treasury	0.0	0.0	4.4	0.0	5.6	0.0
Liabilities to the state treasury (-)	0.0	0.0	0.0	0.0	-50.7	0.0
Total liquidity position of the state treasury[2]	**198.7**	**1.2**	**194.5**	**3.0**	**110.5**	**2.2**
Reverse repo operations (T-bills collateral)	5.2	0.0	18.0	0.0	0.0	0.0
Reverse repo operations (T-bonds collateral)	0.0	0.0	0.0	1.4	0.0	0.8
Reverse repo operations (CNB bills collateral)	158.5	0.0	141.5	0.0	71.3	0.5
Reverse repo operations (foreign securities collateral)	0.0	0.0	0.0	0.0	0.0	0.0
Provided deposits and short-term borrowings and loans	13.1	0.0	14.0	1.0	22.1	0.8
On-lending [3]	1.7	0.0	0.0	0.0	0.0	0.0
Investment in T-bills and T-bonds	18.5	0.0	19.2	0.0	15.5	0.0
Investment in foreign securities	0.0	0.0	0.0	0.0	0.0	0.0
Provided collateral (in cash)	0.0	0.0	0.0	0.0	0.0	0.0
Cash resources in treasury single account [4]	1.6	1.2	1.8	0.7	1.7	0.0
Ministry's cash resources in commercial banks accounts	0.0	0.0	0.0	0.0	0.0	0.0
Total investment position of the state treasury	**198.7**	**1.2**	**194.5**	**3.0**	**110.5**	**2.2**

[1] Excl. quasi-clients of the state treasury (state debt and state financial assets budgetary chapters).
[2] Available liquidity of the state treasury incl. investments outside state treasury liquidity management accounts.
[3] Extra-budgetary lending to other states and on-lending to institutions with state-backed guarantees for their core business with original maturity longer than 1 year and expected residual maturity less than 12 months.
[4] Until 31/3/2013 it is a part of the cash reserve denominated in EUR, as the CNB established the treasury single account in EUR for the Ministry of Finance on 2/4/2013.
Source: MoF

Despite the reduction in interest rates, the yields from the investment operations on the money market within the state treasury liquidity management in 2014 were by CZK 130.5 million higher than in 2013.

Within the CZK state treasury liquidity management and the state financial assets investment operations in the nuclear portfolio, short-term investments with the use of the CNB bills and state treasury bills as collateral in total nominal value of CZK 4,569.6 billion were carried out in 2014. The average interest rate achieved when investing with the use of this collateral was 0.04% p.a. Short-term investments in form of deposit operations in total nominal value of CZK 1,735.3 billion were carried out as well. The average interest rate achieved when investing in form of deposit operations was 0.04% p.a. The Ministry did trade with 11 counterparts in 2014, mainly domestic but also foreign banks. CZK 87.1 million of yields from operations with the CZK state treasury liquidity were transferred to the state budget.

Within the EUR state treasury liquidity management, short-term investments with the use of the medium-term and long-term government bonds or CNB bills and state treasury bills as collateral in total nominal value of EUR 11.4 billion were carried out in 2014. The average interest rate achieved when investing with the use of medium-term and long-term government bonds as collateral was 0.18% p.a. Short-term investments in form of deposit operations in total nominal value of EUR 13.8 billion were carried out as well. The average interest rate achieved when investing in form of deposit operations was 0.16% p.a. The Ministry did trade with 13 counterparts in 2014, domestic and foreign banks. CZK 151.7 million of yields from operations with the EUR state treasury liquidity were transferred to the state budget. The situation on the European deposit market is characterized by the gradually reduced interest rates, particularly due to the monetary policy of the European Central Bank.

Table 9: Yields from Investment Operations in 2013 and 2014 (CZK million)

Yields	2013	2014	2014/2013
REPO CZK	81.8	73.1	0.9
DEPO CZK	11.2	14.0	1.3
REPO EUR	5.9	65.2	11.0
DEPO EUR	9.4	86.5	9.2
Total	108.3	238.8	2.2

Source: MoF

3 – Funding Program and Issuance Activity in 2014

The funding program for the given year defines the space for borrowing operations and quantifies the value of cash resources acquired via borrowing operations on the financial market or from the international financial institutions in order to cover the financing needs of the central government. Its structure consists of debt sources of the financing needs of the central government, which are used for financing of the gross borrowing requirement of the central government, i.e. issuance and sale of government bonds on domestic and foreign markets and acceptance of loans and credit from international financial institutions.

Implementation of the Funding Program

The regular quarterly evaluation of the real structure of the debt portfolio in relation the declared strategic objectives and limits that constitute the key parameters of the publicly define strategic benchmark portfolio, communicated primarily through the Strategy, and the quarterly update of the gross borrowing requirement and funding program, are the Ministry's main instruments to support the credibility and transparency of the entire process of state debt management and related state financial assets and the execution of borrowing operations on financial markets in accordance with best international practice and recommended standards. The overview of this evaluation for 2014 confirms that the Ministry has not diverged from any of the declared objectives and limits, and that borrowing operations performed in accordance with the alternative funding program scenario declared in the Strategy correspond in their scope to the declared issue activity plans, with the exception of retail bonds issues, where the parameters were rationalised and the planned issues reduced.

Table 10: Funding Program for 2014 (CZK billion)

INDICATOR	Declared plan for 2014	2014
Foreign issuance activity	CZK 0.0 to 80.0 billion[1]	CZK 0.0 billion
Gross issue of medium-term and long-term government bonds[2]	CZK 119.2 to 230.1 billion	CZK 153.3 billion
Gross issue of retail bonds	CZK 20.0 to 50.0 billion	CZK 2.1 billion[3]
Net issue of money market instruments[4]	CZK -20.9 to 0.0 billion	CZK -10.7 billion
Gross issue of state treasury bills[5]	CZK 100.0 to 120.9 billion	CZK 107.6 billion
Loans from the European Investment Bank	CZK 0.0 to 10.0 billion	CZK 0.0 billion

[1] The share of funding on the foreign market will not exceed 25% of the gross borrowing requirement in the method valid for 2014.
[2] Incl. direct sales from the Ministry's own portfolio on the secondary market and purchase of investment portfolios.
[3] Incl. reinvestment of yields at a total nominal value of CZK 699.3 million.
[4] Incl. state treasury bills, medium-term and long-term government bond lending facility and other money market instruments.
[5] Excl. issuances of state treasury bills issued and redeemed within the respective period.
Source: MoF

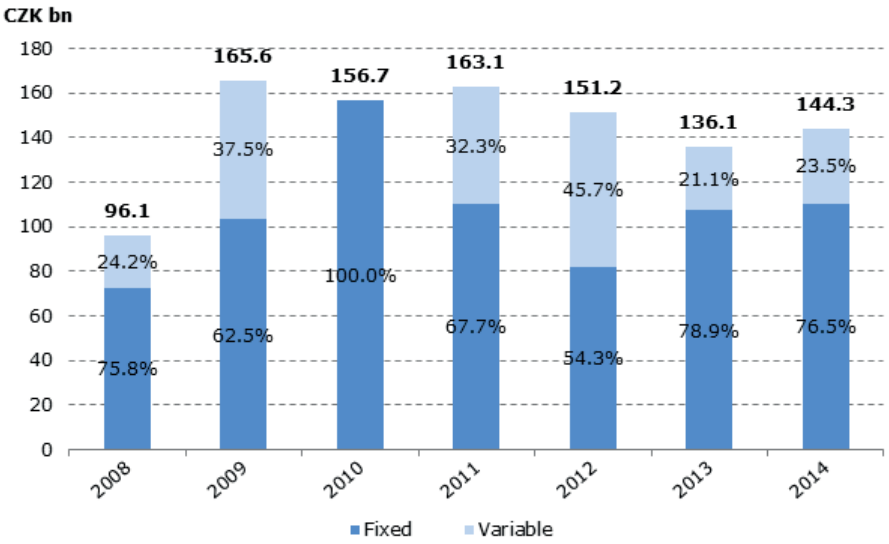
Medium-Term and Long-Term Government Bonds

In the area of domestic issuance activity, the total nominal value of the gross issue of CZK-denominated medium-term and long-term government bonds amounted to CZK 153.3 billion, resulting in the use of 66.6% of the annual maximum issuance limit for this type of financing, thus financing 43.8% of the planed gross borrowing requirement of the central government within the alternative scenario of 2014 funding programme.

On the domestic market of medium-term and long-term government bonds, a total of 26 primary auctions were carried out in 2014. Generally, two different instruments were offered on one auction day; in the auctions held on 23 April and 14 May 2014, three different instruments were offered on one auction day.

Medium-term and long-term government bonds for a total nominal value of CZK 144.3 billion were sold through primary auctions. According to the Strategy, fixed-rate and variable-rate medium-term and long-term government bonds were issued in primary auctions. The share of both types of instruments sold through primary auctions for the entire year 2014 amounted to 76.5% for fixed-rate government bonds and 23.5% for variable-rate government bonds.

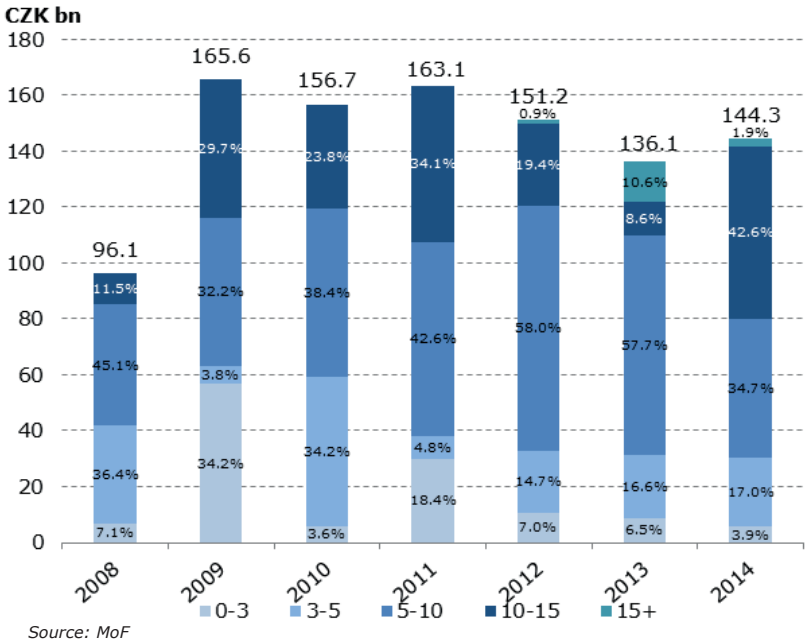
Figure 15: Interest Structure of Government Bonds Sold in Auctions



Source: MoF

Government bonds in various segments of time to maturity were issued in primary auctions of medium-term and long-term government bonds in accordance with the declared limits for refinancing risk, whereas according to the issuance plan, two new benchmark issues of fixed-rate of government bonds with maturity in 2018 and 2025 and two new issues of variable-rate government bonds due in 2020 and 2027 were opened. The share of the total nominal value of sold government bonds in the segment of time to maturity of 10 to 15 years in the total nominal value of all government bonds sold in primary auctions is 42.6%, which is the highest share in the monitored segments of remaining time to maturity. Compared to the end of 2013, there was an increase of this share by 33.9 p.p., when this share was 8.6%. However, compared to the end of 2013 there was a significant decrease of the share of the total nominal value of sold government bonds in the segment of remaining time to maturity of 5 to 10 years, to the total nominal value of all government bonds issued in primary auctions by 23.0 p.p. In the segment of remaining time to maturity of over 15 years, this decrease was 8.7 p.p.

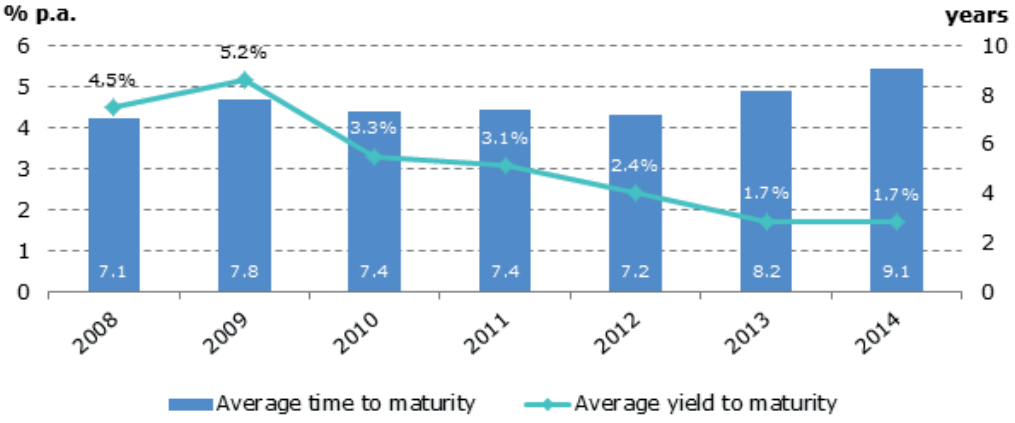
Figure 16: Maturity Structure of Government Bonds Sold in Auctions



Source: MoF

The average yield of fixed-rate medium-term and long-term government bonds sold in primary auctions in 2014 is 1.7%. The declining trend of yields in primary auctions of medium-term and long-term government bonds continued. On the contrary, the average time to maturity of medium-term and long-term government bonds (relative to the issue date) sold in primary auctions in 2014 increased by 0.9 year to 9.1 years.

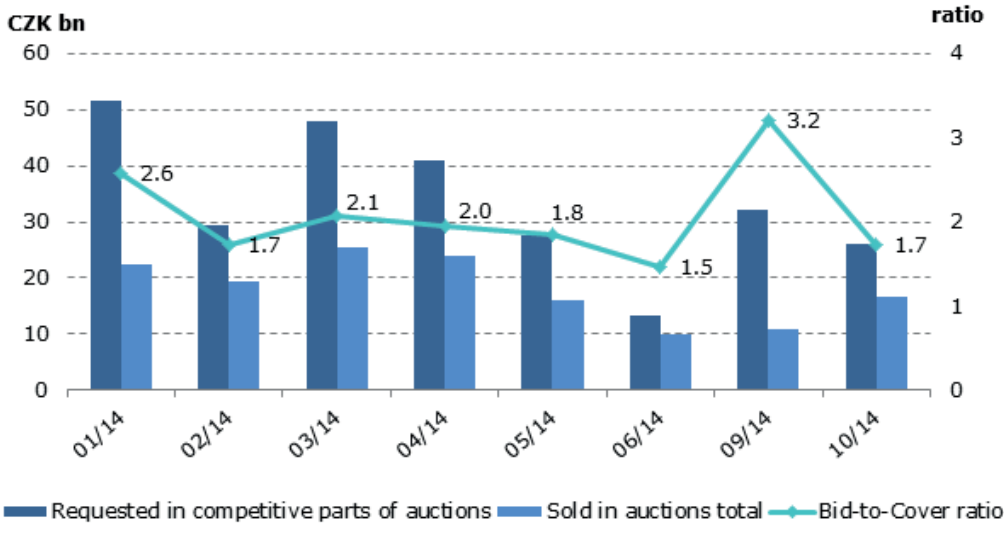
Figure 17: Average Yield and Time to Maturity of Government Bonds in Primary Auctions



Note: Average yield to maturity includes fixed-rate medium-term and long-term government bonds.
Source: MoF

The stable demand for CZK-denominated medium-term and long-term government bonds persisted in 2014, which is illustrated by the total Bid-to-Cover Ratio. The average Bid-to-Cover Ratio at a value of 2.1 signalises a very high demand in auctions for medium-term and long-term government bonds on the domestic market.

Figure 18: Primary Auctions of Government Bonds in 2014



Source: CNB a MoF

Medium-term and long-term government bonds for a total nominal value of CZK 9.0 billion were sold in tap sales on the secondary market via the MTS Czech Republic electronic trading platform.

In 2014, a regular redemption of CZK-denominated Czech Republic Treasury Bond, 2011-2014, 2.75 % at a total nominal value of CZK 46.0 billion was carried out. Furthermore, buy-backs of medium-term and long-term government bonds before their maturity at a total nominal value of CZK 11.3 CZK billion were carried out, namely buy-backs of the Czech Republic Treasury Bond, 2005 - 2015, 3.80 % at a total nominal value of CZK 2.5 billion, the Czech Republic Treasury Bond, 2010-2015, 3.40 % at a total nominal value of CZK 8.3 billion and the Czech Republic Treasury Bond, 2001-2016, 6.95 % at a total nominal value of CZK 0.4 billion.

The total nominal value of the net issue of medium-term and long-term government bonds on the domestic market amounted to CZK 96.0 billion.

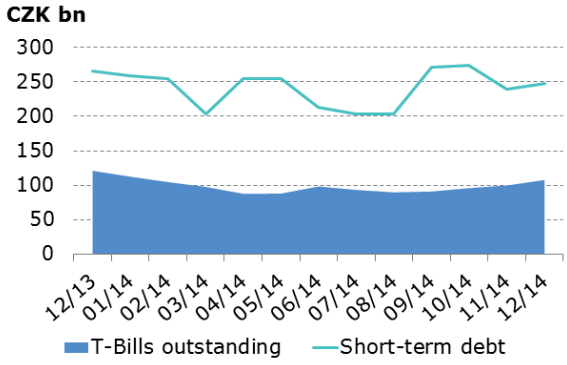
In the area of foreign issuance activity, the Ministry did not execute any borrowing operations in 2014. In June 2014, the historically first redemption on a foreign issue of Czech Republic government bonds denominated in the single European currency was executed at a total nominal value of EUR 1.5 billion. In November 2014 another foreign issues of the Czech Republic government bond denominated in the single European currency took place at a total nominal value of EUR 1.5 billion.

Money Market Instruments

In 2014, the total nominal value of the gross issue of money market instruments excl. roll-over was CZK 110.2 billion, of which CZK 107.6 billion were issued state treasury bills and CZK 2.5 billion were received cash resources within the medium-term and long-term government bonds lending facility. The gross issue of money market instruments resulted in the use of 91.1% of the annual maximum issuance limit for this type of financing, thus financing 31.5% of the planned gross borrowing requirement of the central government within the alternative scenario of 2014 funding programme. The total nominal value of net issue of money market instruments was CZK -10.7 billion.

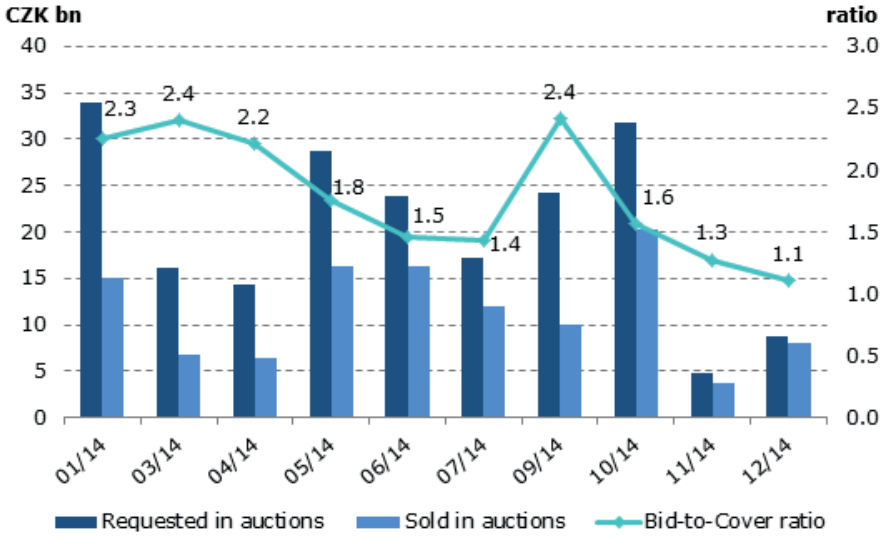
In 2014, the gross issue of state treasury bills incl. roll-over was CZK 114.9 billion. The average state treasury bills auction yield in 2014 was 0.07%. Even in 2014, a relatively stable demand for these instruments can be observed on the part of primary dealers of Czech government bonds, where the average share of demanded and sold state treasury bills in auctions in 2014 is 1.8.

Figure 19: State Treasury Bills Outstanding in 2014



Source: MoF

Figure 20: State Treasury Bill Auctions in 2014



Source: CNB a MoF

IIn 2014, the primary dealers of Czech government bonds continued to use the medium-term and long-term government bonds, the aim of which is to increase the liquidity of government bonds on the secondary market. In 2014, medium-term and long-term government bonds in a total nominal value of CZK 84.6 were provided from the Ministry's own portfolio and the nuclear investment portfolio through the lending facility, compared to received cash resources of CZK 99.3 billion, which were invested on the money market within the state treasury liquidity management and within the framework of investment operations of financial asset management in the nuclear portfolio.

Other Debt Instruments

In 2014, no tranche of the loans from the European Investment Bank were drawn. In the course of the year, planned repayments of EIB loans tranches in a total amount of CZK 1.7 billion were carried out, and early repayments of EIB loan tranches totalling CZK 9.4 billion were carried out. Overall, EIB loan tranches totalling CZK 11.1 billion were repaid in 2014.

In the area of savings government bonds, the total nominal value of the gross issue of savings government bonds amounted to CZK 2.1 billion (including CZK 0.7 billion in tranches of savings government bonds issued in the form of reinvestment of yields). The sixth series of issues in total nominal value of CZK 1.4 billion was carried out in June 2014, which was the only series of savings government bonds issues carried out in the course of 2014. Reduction of the gross issue of savings government bonds compared to past series was due to parametric adjustments in the issuance terms and conditions related to a reduction of the state's total borrowing requirement on financial markets.

In 2014, regular redemptions were carried out on the Czech Republic Discounted Savings Government Bond, 2012 – 2014 in a total nominal value of CZK 8.4 billion and Czech Republic Discounted Savings Government Bond, 2013 – 2014 in a total nominal value of CZK 3.1 billion. The issuance terms and conditions of savings government bonds allow the owners to request their redemption before the the maturity date. The actual development of early redemption in 2014, however, indicates that the share of early redemptions is not significant and the owners of savings government bonds request this service only exceptionally. In 2014 within eight periods for submitting requests for early redemption, such early redemption was requested for a total nominal value of CZK 338.3 million, which is 0.4% of the total nominal value of savings government bonds outstanding as at the end of 2014. The total nominal value of regular and early redemptions of savings government bonds in 2014 was CZK 11.9 billion.

As at the end of 2014, the total nominal value of savings government bonds outstanding amounted to CZK 77.8 billion, which is 4.7% of the total state debt and 6.2% of CZK-denominated government bonds excluding state treasury bills.

Table 11: Issues and Redemptions on Savings Government Bonds

	2011	2012	2013	2014
Total nominal value of savings government bonds issued (CZK bn)	20.4	45.3	38.8	1.4
Reinvestment of yields (CZK bn)	0.0	0.1	0.3	0.7
Early redemptions (CZK bn)	-	0.1	0.2	0.3
Early redemptions (% savings government bonds outstanding as at the end of the respective year)	0.0	0.2	0.2	0.4
Regular redemptions (CZK bn)	0.0	9.5	7.5	11.6
Total redemptions (CZK bn)	0.0	9.6	7.7	11.9
Savings government bonds outstanding (CZK bn)	20.4	56.2	87.6	77.8

Source: MoF

4 - Risk Management and Portfolio Strategy

Public definition of the strategy benchmark debt portfolio through the declaration of strategic goals is the main tool for increasing the transparency of the Ministry's debt policy in line with the best international practice. The objectives have been set up based on the requirements stemming from the cautious approach to the management of financial and credit risks while minimizing economic costs over the long term. The main risks to which the debt portfolio is subjected over the long term are refinancing, interest and currency risks. All of the objectives and limits defined below are being applied to the portfolio of the state debt as a whole, including derivative operations.

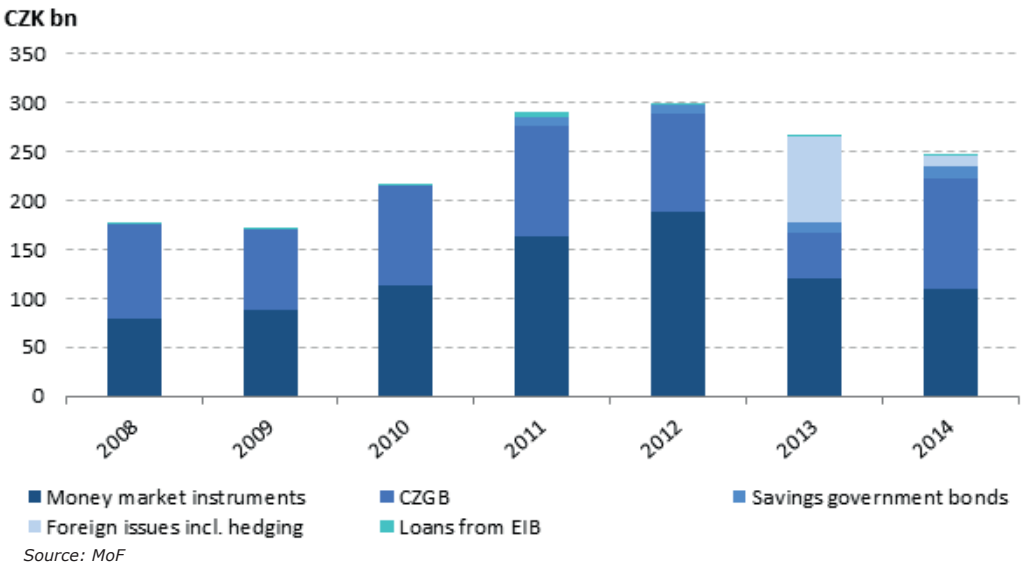
Refinancing Risk

Refinancing risk is managed by a system of four indicators: share of short-term state debt, share of medium-term state debt, average time to maturity and the maturity profile. These four indicators must be considered as a self-contained system, whereas focussing on only one of them may pose a risk.

The share of short-term state debt (i.e. the share of debt due within one year of out the total state debt) is a key indicator of refinancing risk in the short-term horizon. Within the management of short-term refinancing risk management, the Ministry has applied limits to this indicator since 2006, which have not been exceeded in any year of their existence. In 2006 to 2012, the limit for this indicator was set at 20.0%. For 2012 and 2013, the limit was increased by 5 p.p. to 25.0% in relation to introducing a limit on the share of medium-term state debt. For 2014 the limit was reduced by 5 p.p. back to 20.0%, primarily due to the more effective available state treasury liquidity management. The system of limits on the share of short-term and medium-term state debt allows the distribution of the refinancing risk of the debt portfolio over the short-term and long-term horizon.

The share of short-term state debt as at the end of 2014 amounted to 14.9% of the total state debt, which represents a decrease of 0.9 p.p. compared to the end of 2013.

Figure 21: Structure of Short-Term State Debt



Source: MoF

Even at the end of 2014, it applies that the balance of medium-term and long-term government bonds issued on the domestic and foreign markets, including savings government bonds due within one year, exceeds the balance of money market instruments outstanding. The share of money market instruments in short-term state debt as at the end of 2014 amounted to 44.5%, having decreased by 0.9 p.p. compared to the end of 2013. The share of money market instruments in total state debt as at the end of 2014 amounted to 6.6% and decreased by 0.6 p.p. compared to the end of 2013.

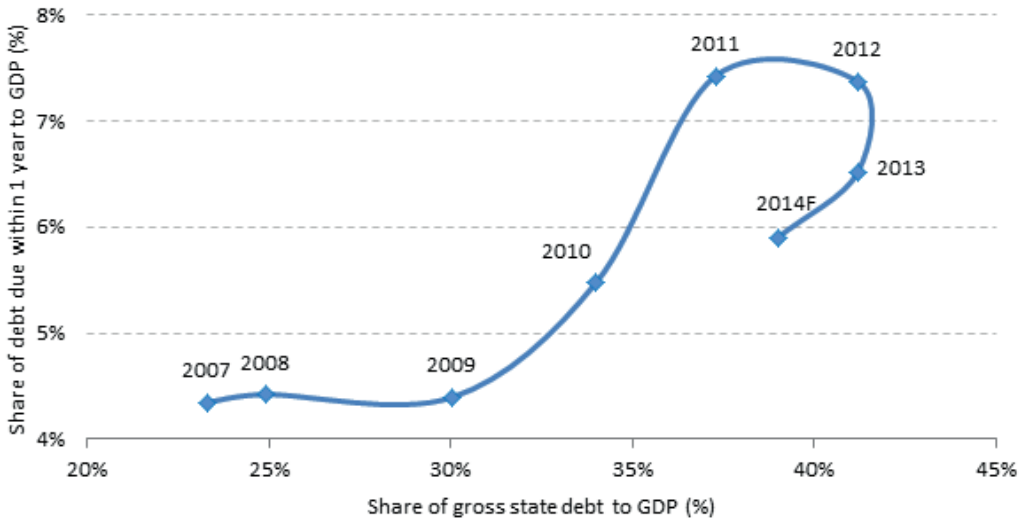
Table 12: Structure of Short-Term State Debt (%)

	2008	2009	2010	2011	2012	2013	2014
CZK CZGB	55.2	48.1	47.1	39.0	33.7	17.3	45.7
Savings government bonds	-	-	-	3.3	2.5	4.3	4.7
Foreign issues incl. hedging	0.0	0.0	0.0	0.0	0.0	32.4	4.3
Bonds total	**55.2**	**48.1**	**47.1**	**42.3**	**36.2**	**54.0**	**54.6**
Money market instruments	44.3	51.3	52.4	55.9	63.4	45.4	44.5
EIB loans	0.5	0.6	0.5	1.8	0.4	0.6	0.8
Short-term debt to GDP	**4.4**	**4.4**	**5.5**	**7.2**	**7.4**	**6.5**	**5.8**

Note: As at the end of each year. The GDP data for 2007 to 2013 is from the CZSO, for 2014 from the Macroeconomic Forecast of the MoF – January 2015.
Source: CZSO, MoF

In the course of 2014, there was a decrease of the absolute value of short-term state debt by CZK 19.1 billion; expressed as the share in GDP a decrease of 0.7 p.p. compared to the end of 2013 is expected. This marks a continuation of the decreasing trend of the share of state debt in GDP and the share of short-term state debt in GDP, which began in 2012. Compared to the end of 2013, there was a change in the structure of short-term debt, particularly as concerns domestic and foreign medium-term and long-term government bonds, whereas at the end of 2013 the redemptions of foreign issues exceeded the redemptions of domestic issues due to the historically fist two redemptions of foreign issues of medium-term and long-term government bonds of the Czech Republic denominated in the single European currency in a total nominal value of EUR 3.0 billion.

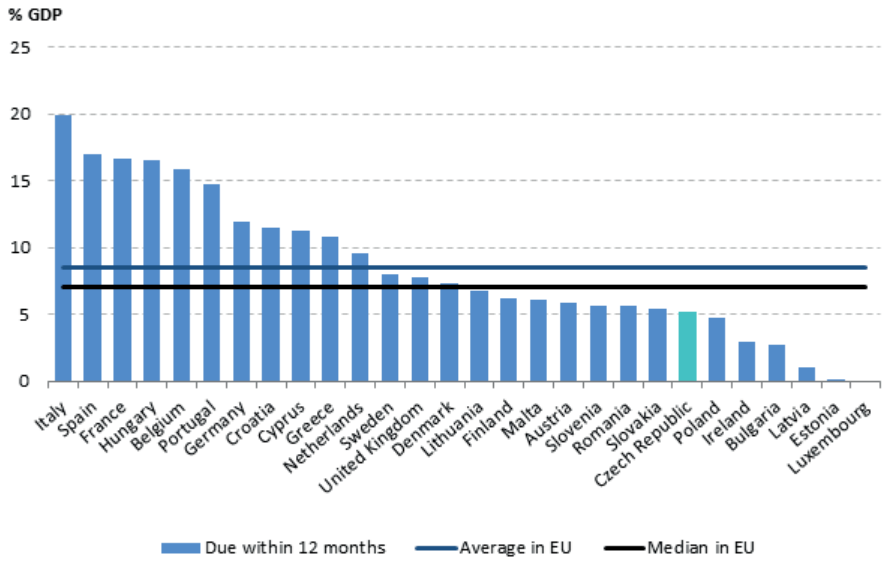
Figure 22: Gross State Debt and State Debt Due within 1 Year



Note: As at the end of each year. The source of GDP data for 2007 to 2013 is the CZSO, for 2014 the Macroeconomic Forecast of the MoF – January 2015.
Source: CZSO, MoF

The size of short-term state debt of the Czech Republic is relatively low compared to EU countries, with the share of short-term state debt to GDP far below the EU average and as well as below the EU median. However, this is also due to the relatively low debt exposure of the Czech Republic compared to other EU countries.

Figure 23: Short-Term State Debt in EU Countries



Note: As at the end of December 2014. Excludes non-marketable state debt, includes retail state debt. The predictions of the gross domestic product of individual economies are based on the predictions of the European Commission.
Source: ESRB Risk Dashboard

In connection with refinancing risk, it is also necessary to mention the early redemption of savings government bonds, the value of which is not yet significant in 2014, given that the total nominal value of early redeemed savings government bonds in 2014 is CZK 0.3 billion. Since the pilot series of issues in 2011 until the end of 2014, the redemption of savings government bonds before maturity has amounted to CZK 0.6 CZK billion, which is 0.6% of all issued savings government bonds in this period, including reinvestment of yields. The Ministry is monitoring the situation, but at present does not expect any significant rise in the redemption of savings government bonds before maturity, among other because of the high yields from these bonds compared to the current situation bond markets.

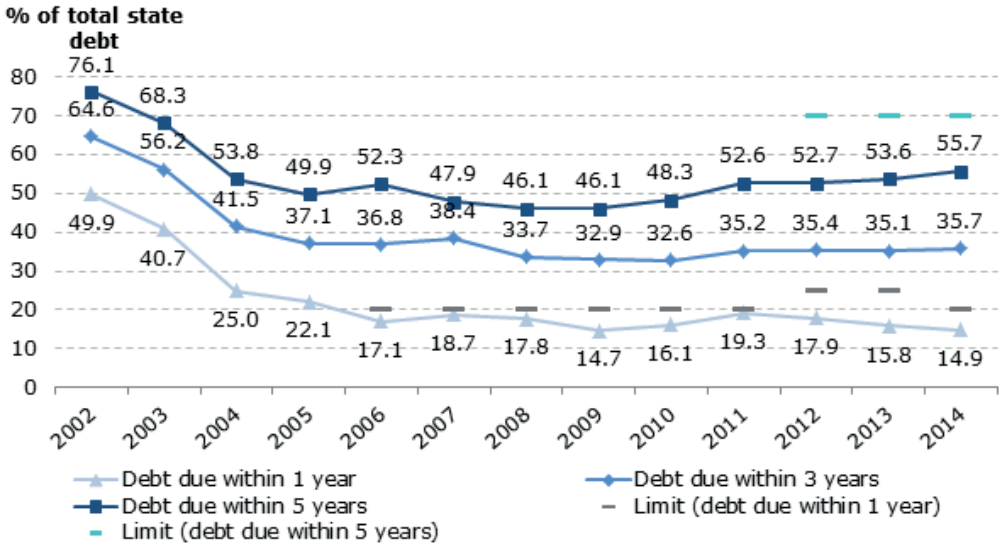
In the second half of 2014, the Ministry proceeded to execute buy-backs of CZK-denominated medium-term and long-term government bonds. These operations on the secondary market reduce the refinancing risk of the debt portfolio by reducing the share of short-term debt and extending the average maturity of the debt portfolio. These operations are also used to manage state budget expenditure management in the current and forthcoming fiscal years, where the future coupon payments representing the expenditure of the State Debt budget chapter in forthcoming fiscal years are paid in the current fiscal year as a result of executing buy-backs. Buy-backs can also be seen as an alternative to investing available liquidity in the CZK state treasury, in the event that the yield from executing buy-backs exceeds the expected yield from investing available liquidity of CZK state treasury through repo and depo operations. The total nominal value of government bonds maturing in 2015 and later that was bought back in 2014 amounted to CZK 11.3 billion.

In 2014, the Ministry also used a lending facility for providing loans of medium-term and long-term government bonds in the form of repo operations, in which the collateral consists of medium-term and long-term government bonds provided from the Ministry's own portfolio or from the nuclear investment portfolio. Although the primary goal of these operations is to increase the liquidity of government bonds on secondary market, especially in case of the short-term excess of demand over the supply of the particular bond, due to the very low repo rates, the Ministry considers these operations as a preferred source in the segment of short-term financing. These operations thereby also contribute to savings on net interest costs on the state debt – but at the same time they increase refinancing risk and interest rate risk. Given the relatively low share of state treasury bills in total state debt and relatively low refinancing and interest risk of state debt, the loaning facilities do not pose a significant risk for the state debt portfolio, despite a substantial increase of their use in 2014. The total value of repo operations carried out over the course of 2014 is CZK 99.3 billion compared to CZK 27.5 billion in 2013. Within the framework of loaning facilities, collateral for a total nominal value of CZK 84.6 billion was provided in 2014. As at the end of 2014, the total value of all received financial resources from unrepaid lending facilities amounted to CZK 2.5 billion.

In terms of medium-term refinancing risk, the Ministry monitors and manages the share of debt due within three and five years. The debt due within

five years is managed using the share of medium-term debt to total state debt indicator, for which the Ministry has been setting explicit limits, the value of which starting in 2012 was 70.0% of total state debt. The value of the share of medium-term debt in total state debt as at the end of 2014 amounted to 55.7% and compared to the end of 2013 this represents an increase by 2.1 p.p. The share of state debt due within three years as at the end of 2014 amounted to 35.7%, which represents a growth of this indicator value by 0.6 p.p. compared to the end of 2013.

Figure 24: State Debt by Maturity Baskets



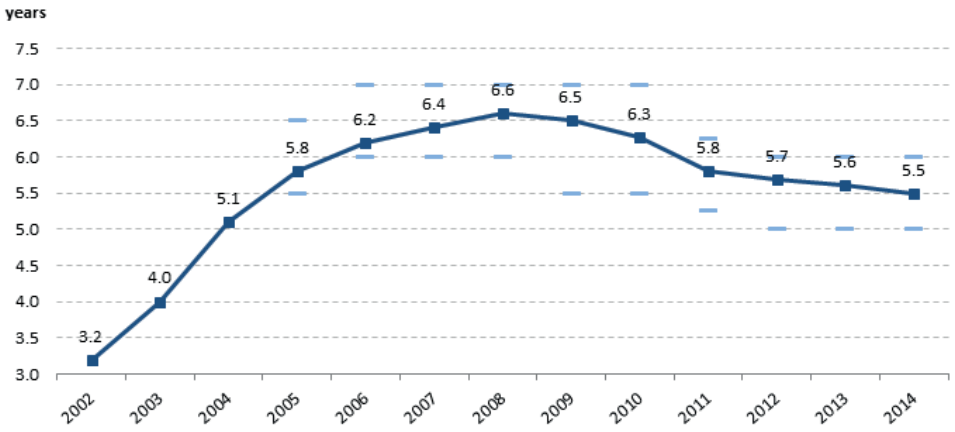
Note: As at the end of each year.
Source: MoF

Another indicator used in managing of the refinancing risk is the average time to maturity of state debt. The goal for this indicator was first explicitly declared for 2005 in the form of an interval. Starting in 2012, the target for the average time to maturity is 5.0 to 6.0 years. The declared targets were fulfilled in all years of their validity. Maintaining the average time to maturity within the target band and a smooth maturity profile of the debt portfolio are among the fundamental indicators that determine the time and volume structure of government bond issues on the domestic and foreign market, and the setting of repayment schedules for drawn EIB loans.

The average time to maturity of state debt as at the end of 2014 amounted to 5.5 years, which represents a decrease of the indicator by 0.1 years compared to the end of 2013.

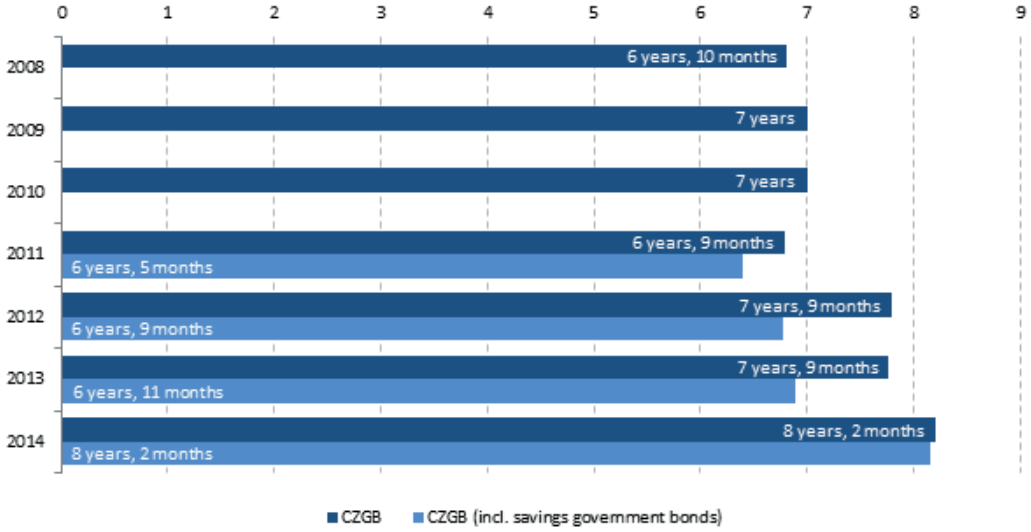
Despite the rise in the average maturity of the gross issue of medium-term and long-term government bonds in 2014 by 5 months compared to 2013 (relative to the end of the year), there has been a decrease of the average maturity of state debt. This fact is due mainly to the structure and size of the debt portfolio and the relatively low gross issue of medium-term and long-term government bonds, where the average maturity of the part of the state debt that was not due in 2014, totalling approximately CZK 1.4 billion, decreased by 1 year and is compensated by the gross issue of medium-term and long-term government bonds in the total nominal value of approximately CZK 160 billion, i.e. about one ninth of the lasting debt portfolio, with an average maturity of 8 years and 2 months.

Figure 25: Average Maturity of State Debt and Declared Goals



Note: As at the end of each year.
Source: MoF

Figure 26: Average Time to Maturity of CZGB and Savings Government Bonds on the Domestic Market



Note: Average time to maturity of sold CZK-denominated medium-term and long-term government bonds and savings government bonds during the respective calendar year calculated relative to the end of the year.
Source: MoF

The Ministry monitors not only the average time to maturity of the total state debt portfolio, but also the average time to maturity of its individual components. The average time to maturity of money market instruments stabilized at 0.4 years since 2009. The average time to maturity of foreign issues as at the end of 2014 increased by 0.7 year compared to the end of 2013 to 5.8 years, due to the redemption of two issues of government bonds denominated in EUR in a total nominal value of EUR 3.0 billion. The average time to maturity of CZK-denominated medium-term and long-term government bonds as at the end of 2014 decreased compared to the end of 2013 by 0.4 year to a value of 5.8 years, despite the relatively high time to maturity of bond sold in the course of the year. The reason is in particular the discrepancy described above between the total nominal value of the existing portfolio of CZK-denominated medium-term and long-term government bonds and the total nominal value of newly sold CZK-denominated medium-term and long-term government bonds. The average time to maturity of savings government bonds as at the end of 2014 decreased by 0.6 year compared to the end of 2013 to a value of 2.5 years. The average maturity of non-marketable state debt decreased by 1.0 year due to the fact that no new EIB loan tranches were drawn in 2014.

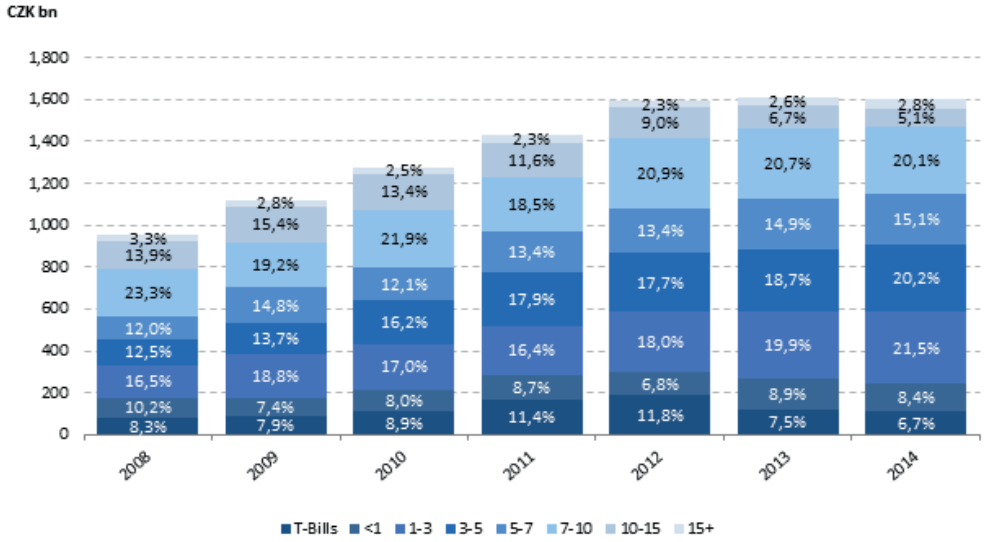
Table 13: Average Time to Maturity of Individual Components of the State Debt (years)

Indicator	2008	2009	2010	2011	2012	2013	2014
CZK-denominated CZGB	6.5	6.6	6.3	6.2	6.3	6.2	5.8
Savings government bonds	-	-	-	3.0	3.3	3.1	2.5
Foreign issues incl. hedging	9.2	7.3	7.1	6.2	6.1	5.1	5.8
Money market instruments	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Non-marketable state debt	12.0	12.2	12.5	11.5	11.8	11.4	10.4

Note: As at the end of each year. Foreign issues incl. FX hedging of the foreign-currency principal.
Source: MoF

In 2014, the declining trend in the average time to maturity of government bonds lasting since 2009 is partly caused by the decrease of the total nominal value of government bonds in the segment with a remaining maturity of 10 to 15 years lasting since 2009. Its share in the total nominal value of all government bonds outstanding as at the end of 2014 is 5.1%, having decreased by another 1.6 p.p. compared to the end of 2013 and also due to a decrease in the segment of 7 to 10 years by 0.6 p.p. to a value of 20.1% of all government bonds outstanding. On the contrary, compared to the end of 2013 the share of bonds in the issue segments with a remaining time to maturity of 1 to 3 and 3 to 5 years increased. Other segments are relatively stable compared to 2013.

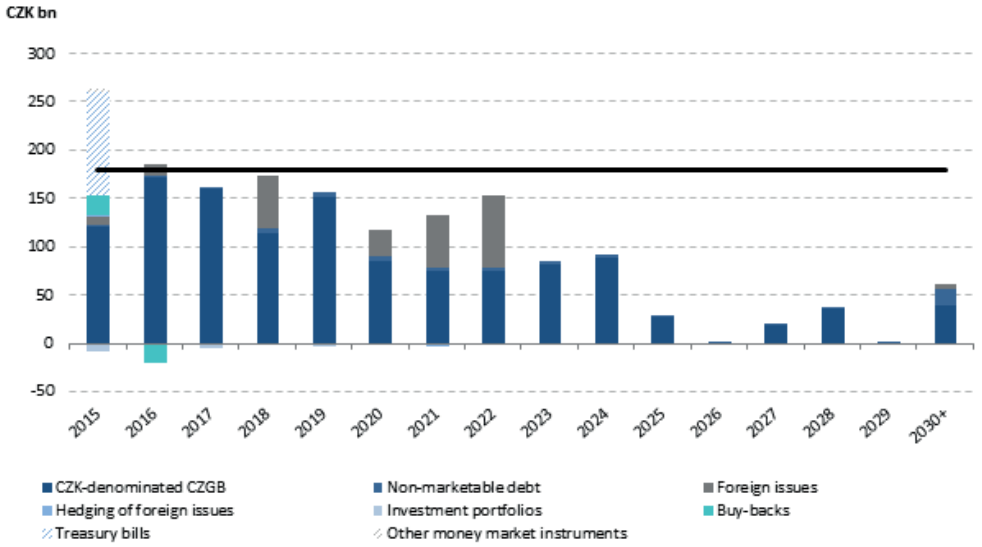
Figure 27: Structure of Government Bonds by Time to Maturity



Note: As at the end of each year. Includes CZK-denominated medium-term and long-term government bonds, foreign issues, savings government bonds and state treasury bills.
Source: MoF

Issuance calendars of government bonds, sales of government bonds on the secondary market, possible foreign issues and drawing of long-term loans from EIB will continue to be managed in accordance with the fulfilment of another key goal, namely the stabilisation and smoothing of the maturity profile of the state debt over time. The medium-term outlook shows the maximum annual redemption on the current debt portfolio, taking into account the impact of buy-backs and not considering redemptions of money market instruments, at a level of CZK 180 billion.

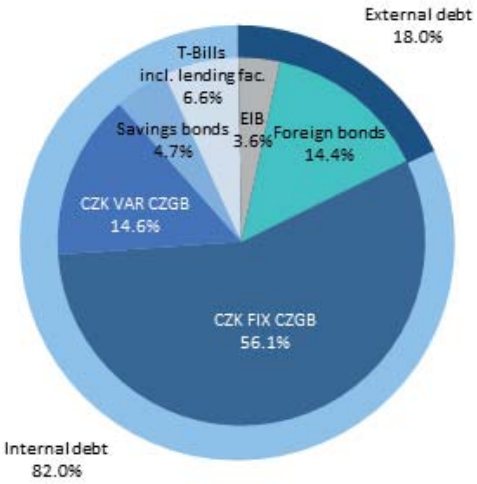
Figure 28: Maturity Profile of State Debt and Financial Asset as at the End of 2014



Note: The positive axis shows liabilities and planned buy-backs on bonds due in 2016 and following years, the negative vertical axis shows state financial assets and planned buy-backs of bonds carried out in 2015. Domestic government bonds include savings government bonds. Money market instruments do not include roll-over within the year.
Source: MoF

With regard to refinancing risk, the Ministry monitors the structure of the debt portfolio according to the individual instruments. Over the long term, fixed-rate CZK-denominated medium-term and long-term government bonds account for the greatest share, with a share of 56.1% of total state debt as at the end of 2014, which represents an increase of 4.0 p.p. compared to the end of 2013. The share of variable-rate CZK-denominated medium-term and long-term government bonds in state debt as at the end of 2014 is 14.6%, which represents a growth of 2.5 p.p. compared to the end of 2013. The total nominal value of foreign issues including hedging of principal in total state debt as at the end of 2014 equals 14.4%, which represents a decrease of 4.8 p.p. compared to the end of 2013. This decrease was caused by the redemption of two foreign issues of medium-term and long-term government bonds denominated in the single European currency and no foreign issues in 2014. The share of money market instruments in the total state debt as at the end of 2014 is 6.6% of the total state debt, which represents a decrease of 0.6 p.p. compared to the end of 2013. The share of savings government bonds in total debt as at the end of 2014 is 4.7%, which represents a decrease of 0.5 p.p. compared to the end of 2013.

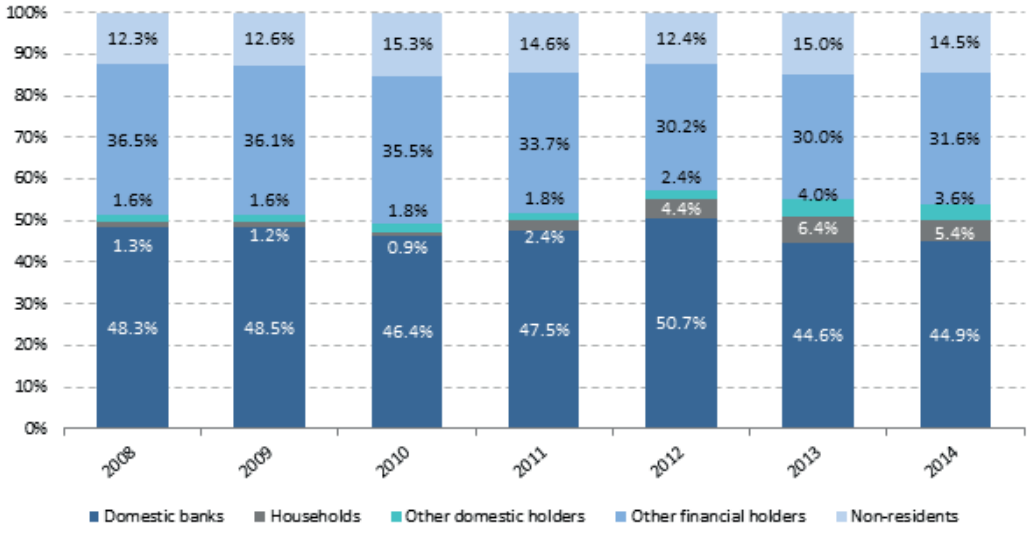
Figure 29: Structure of State Debt by Instrument at the End of 2014



Source: MoF

The structure of holders of CZK-denominated government bonds has been relatively stable in recent years. In the course of 2014, the rising trend of the share of households in holding government bonds stopped, declining by 1.0 p.p., due mainly to the lower gross issue of savings government bonds compared to their redemption. In the medium term, the Ministry does not expect any major changes in the structure of domestic bond holders. The share of non-residents holding domestic government bonds is relatively low on an international comparison and shows high stability, ranging between 12.3% (end of 2008) to 15.3% (end of 2010) since 2008. At the end of 2014, this share amounted to 14.5%. The share of domestic banks in holding domestic government bonds stabilised in the range of 44.6% (end of 2012) to 50.7% (end of 2012). At the end of 2014, the share of domestic banks in holding domestic government bonds reached 44.9%.

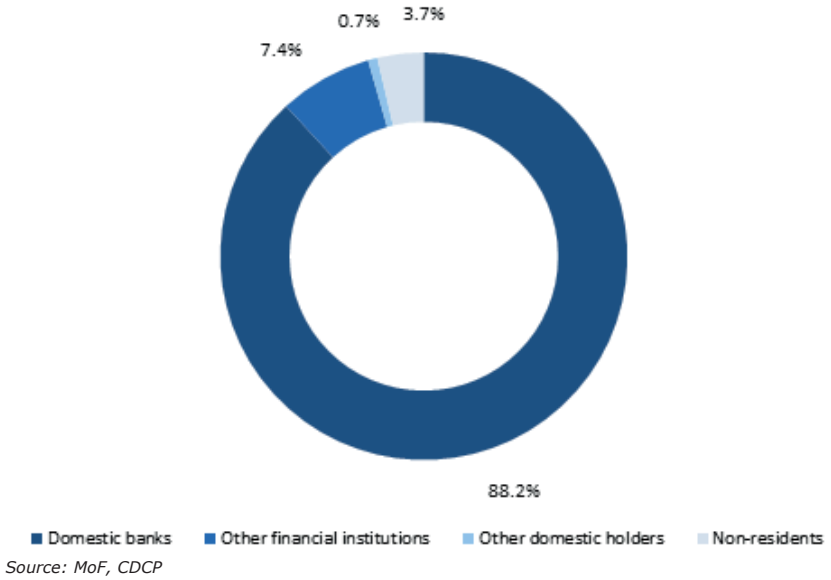
Figure 30: Structure of Domestic Bonds by Holder Type



Note: As at the end of each year.
Source: MoF, CDCP

The majority of state treasury bills holders are domestic banks, which held 88.2% of state treasury bills outstanding as at the end of 2014. In other sectors, the nominal value of held state treasury bills is in the order of CZK billions.

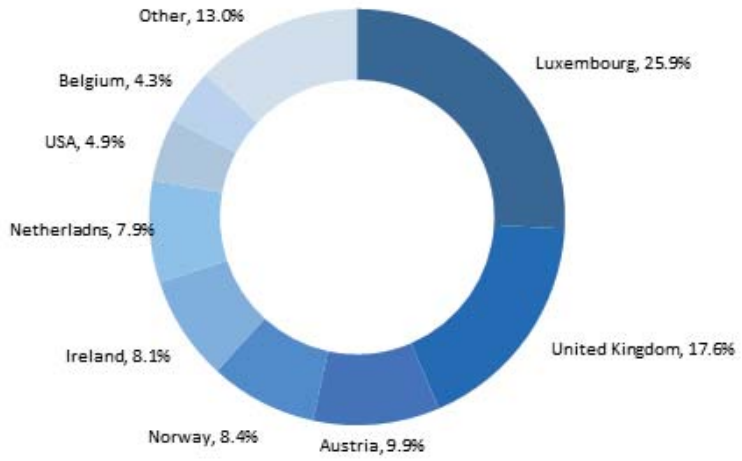
Figure 31: Structure of State Treasury Bill Holders



Source: MoF, CDCP

In terms of geographical structure of non-residents holding domestic government bonds, non-residents from Luxembourg and United Kingdom dominate, accounting for more than 40% of all non-resident holders of domestic government bonds as at the end of 2014. As at the end of 2014, 84.3% of domestic government bonds were held by non-residents from European Union countries, with 15.7% of domestic government bonds held by non-residents from other countries.

Figure 32: Structure of Non-Resident Holders of Domestic CZGB



Source: MoF, CDCP

Interest Rate Risk

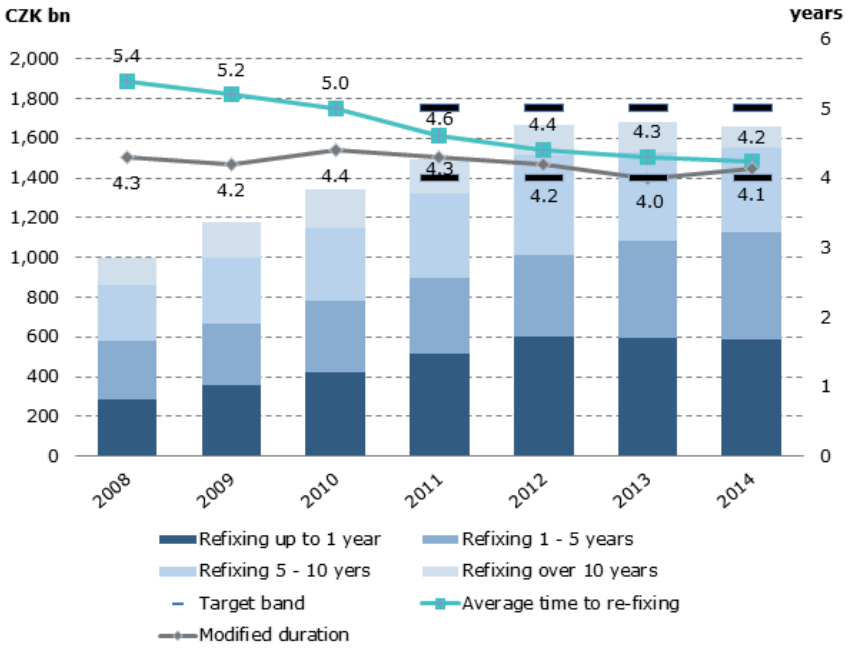
Interest rate risk remains the most important market risk affecting the management of state debt. The Ministry manages interest rate risk using the strategic indicator - average time to re-fixing of state debt. Starting in 2011, the Ministry has set an explicit target band for this indicator to interval of 4.0 to 5.0 years.

The average time to re-fixing of state debt as at the end of 2014 amounted to 4.2 years, and is thus within the target interval. Compared to the end of 2013, there was a decrease of this indicator by 0.1 year. The decrease of the average time to re-fixing corresponds to the decrease of the average time to maturity of the debt portfolio in the course of 2014. Since 2008, there the average time to re-fixing has decreased while the modified duration has stayed relative stable, which corresponds with the decrease of yields during the reference period. In the segment of instruments bearing an interest at the short end of the yield curve, variable-rate medium-term and long-term government bonds were issued on the primary and secondary market in 2014 in a total nominal value of 39.0 CZK billion, which represents 25.4% of the total gross issue of CZK-denominated medium-term and long-term government bonds in 2014. The share of newly issued variable-rate medium-term and long-term government bonds in the total gross issue in 2014 increased by 4.5 p.p. compared to 2013, when this share was 20.9%. The share of state treasury bills outstanding in the total state debt as at the end of 2014 amounted to 6.5%, having decreased by 0.7 p.p. from 7.2% compared to the end of 2013. The share of money market instruments in the total state debt as at the end of 2014 amounted to 6.6%.

The decrease of average time to re-fixing of state debt causes the interest costs of state debt to be generated on average on the shorter end of the yield curve, which should result in savings in interest costs in medium term. The price of this possibility to generate these savings is a higher risk of interest rates increase which could lead to achieving negative savings in coming years. In case of issuance of variable-rate medium-term and long-term government bonds in 2008 to 2014, the accrual savings in interest costs of CZK 13 billion were achieved. To express realized savings, it is necessary to know the coupon payments, i.e. expressing the realized savings by issuing particular variable-rate note government bond is possible after the last coupon payment has been fixed. Total realized savings in state budget expenditure connected with the issue of Czech Republic Treasury Bond, 2009-2012, VAR %, i.e. already redeemed government bond, amounted to CZK 1.0 billion in comparison to the situation, when fixed-rate government bond with equal maturity was issued instead of this government bond.

The Ministry's benchmark model compares accrued interest costs generated by the government bonds sold in auctions of medium-term and long-term government bonds with the benchmark portfolio containing only fixed-rate government bonds issued on the same day the auction is carried out and in the same nominal value as the real government bond and with the time to maturity ensuring achieving the average time to maturity of synthetic benchmark and debt portfolio corresponding to the average time to maturity of real debt portfolio as of the end of 2014. The benchmark model shows that regarding issuance activity on primary market of medium-term and long-term government bonds, due to the shape of the yield curve, the average annual savings expressed on accrual basis amounted to CZK 0.2 billion. Detailed information can be found in the chapter Benchmark Portfolio.

Figure 33: Interest Re-fixing of State Debt



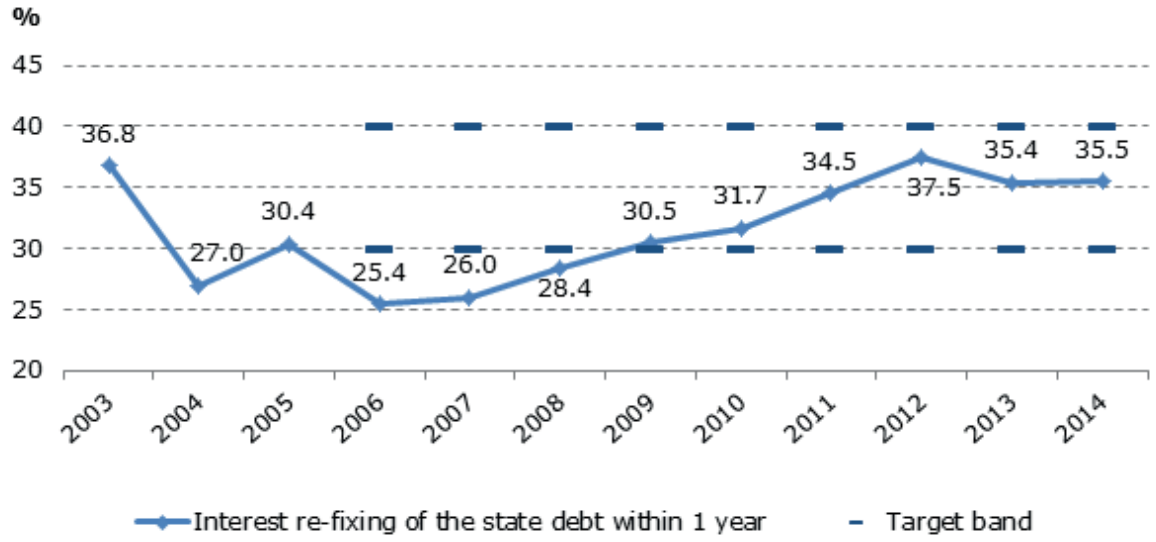
Note: As at the end of each year.
Source: MoF

Another indicator monitored by the Ministry in connection with interest rate risk management, for which the Ministry also sets a strategic goal for each year, is the interest re-fixing of the debt portfolio within one year, this being the share of debt that is sensitive to fluctuations in interest rates on the financial market in the following year. Since 2006, this indicator has been set at the level of 30.0 to 40.0% of the total state debt. This goal is in line with the average time to re-fixing in the target band of 4.0 to 5.0 years. Starting in 2009, the interest re-fixing of the debt portfolio within one year has remained within the target band. As at the end of 2014, the growth of this indicator amounted to 0.1 p.p. compared to the end of 2013, when the share of interest re-fixing within one year to the total state debt amounted to 35.5%, thus remaining in the middle of the target band valid for 2014. The development of interest re-fixing within one year is thus developing oppositely than the average time to re-fixing.

The structure of interest re-fixing of the debt portfolio within 1 year is important not only for the expression of short-term interest rate risk, but also affects long-term interest rate risk expressed by the indicator average time to re-fixing. The debt portfolio sensitive to interest rate fluctuation in the financial market in 2015 consists mainly of CZK-denominated variable-rate medium-term and long-term government bonds (41.1%), state treasury bills and other money market instruments (18.7%), and CZK-denominated fixed-rate medium-term and long-term government bonds (19.2%). Loans from the EIB account for 9.7% of this portfolio, and government bonds issued on foreign markets including hedging account or 8.6%, while retail bonds account for 2.7%. Compared to 2013 there was a change in the structure of interest re-fixing of state debt, particularly in foreign bonds, where the share decreased by 15.4 p.p. due to the redemption of the 1st and 4th issue of Eurobonds in 2014 in a total nominal value of CZK 86.4 billion. Regarding the CZK-denominated fixed-

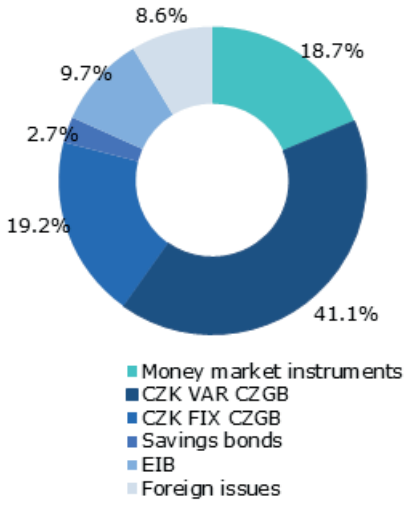
rate medium-term and long-term government bonds, there was an increase of 11.5 p.p. due to the redemption of one CZK-denominated fixed-interest issue in 2014 in the nominal value of CZK 46.0 billion compared to the redemptions of two fixed-rate issues for a total nominal value of CZK 113.0 billion in 2015. The gross issue of variable-rate medium-term and long-term government bonds on the primary and secondary market in a total nominal value of CZK 39.0 billion also caused a increase of the share of variable-rate government bonds in the interest re-fixing of state debt within one year by 7.0 p.p. compared to the end of 2013. The decrease of the share of money market instruments in the interest re-fixing of state debt within one year is consistent with the decrease of their nominal value outstanding at the end of 2014, and is equal to 1.6 p.p. compared to the end of 2013. Due to planned and early repayments of EIB loans carried out 2014, there was also a decrease of the share of this instrument in interest re-fixing within one year by 1.6 p.p.

Figure 34: Interest Re-fixing of State Debt within 1 Year



Note: As at the end of each year.
Source: MoF

Figure 35: Structure of Interest Re-fixing of State Debt within 1 Year (% of Total State Debt)



Note: Balance as at the end of 2014.
Source: MoF

The Ministry also monitors the structure of CZK-denominated medium-term and long-term government bonds based on the current time to maturity, the original time to maturity and coupon rate. Thus constructed structure of bonds allows a detailed breakdown of interest costs on state debt service generated by CZK-denominated medium-term and long-term government bonds. As at the end of 2014, these bonds have an average coupon rate of 3.28%. Bonds maturing in 2015 have an average coupon rate of 3.96%, whereas the Czech Republic Premium Savings Government Bond of the, 2012 – 2015, has a coupon rate of 7.5%. In the segment of 2- to 4-year original maturity the bonds have an average coupon rate of 1.58%, in the 8- to 10-year original maturity segment the bonds have an average coupon rate of 2.70%, and in the 10- to 15- year original maturity segment the bonds have an average coupon rate of 4.03%. The discount on state treasury bills and discounted savings bonds is a cost for the state budget at the moment of the sale of the bond, and therefore does not affect interest costs on state debt service in future years. In 2014 the Ministry opened two new benchmark issues of

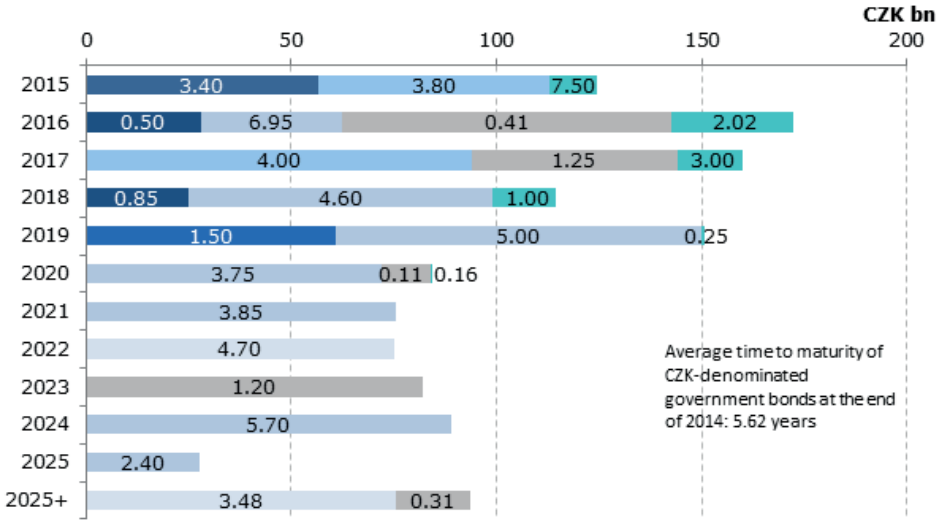
fixed-rate medium-term and long-term government bonds maturing in 2018 and 2025, and two new benchmark issues of CZK-denominated variable-rate medium-term and long-term government bonds maturing in 2020 and 2027, the gross issue of which accounted for approximately 54% of the total gross issue of CZK-denominated medium-term and long-term government bonds on the primary and secondary market in 2014. Given the relatively low coupon rates of new bond issues, the indicator of average coupon rate for maturity in 2018 decreased by 0.60 p.p. and in 2020 by 0.52 p.p. compared to the end of 2013. There were no bonds with maturity in 2025 and 2027 as at the end of 2013.

Table 14: Average Coupon Rates and Costs of CZK-denominated CZGB by Year of Maturity (% p.a.)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2025+	Average
Average coupon rate[1]	3.96	2.01	3.04	3.29	3.56	3.23	3.85	4.70	1.20	5.70	2.40	2.87	3.28
Average costs[2]	3.11	3.33	4.01	3.11	3.50	3.93	3.08	4.34	-	4.48	1.93	3.51	3.56

[1] Incl. medium-term and long-term government bonds and savings government bonds, does not include inflation-linked savings government bonds.
[2] Incl. only fixed-rate medium-term and long-term government bonds.
Note: Balance as at the end of 2014.
Source: MoF

Figure 36: Maturity Profile of CZK-Denominated CZGB by Time to Maturity and Coupon Rate (% p.a.)

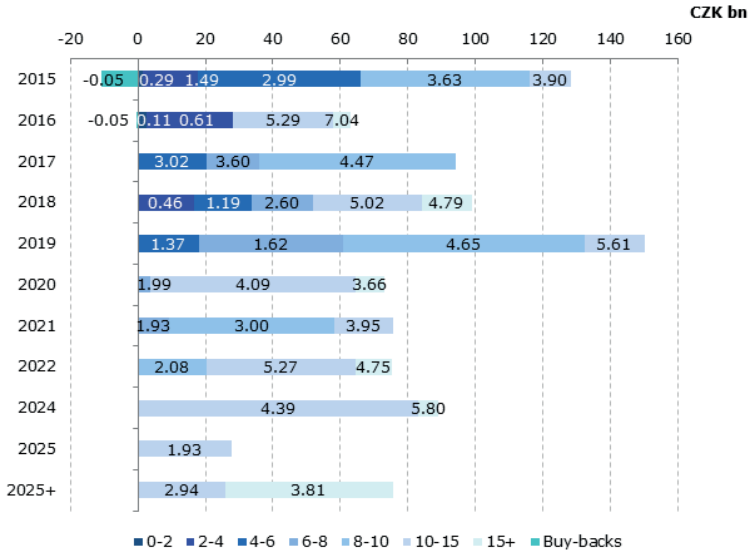


Note: Maturity profile as at the end of 2014. Segments represent original maturity. Data in individual segments represents the average coupon rate in %. Excl. inflation-linked savings government bonds.
Source: MoF

The Ministry also monitors the structure of CZK-denominated fixed-rate medium-term and long-term government bonds based on the current time to maturity, time to maturity at the moment of the sale of the bonds and achieved yield to maturity at the moment of sale. Thus constructed structure of bonds indicates the average annual costs of these bonds in the individual segments of the current time to maturity and time to maturity at the moment of the bond sale. As at the end of 2014 the average annual costs of the CZK-denominated fixed-rate medium-term and long-term government bonds amount to 3.56%. The buy-backs of bonds due in 2015 and 2016 carried out in 2014 have reached an average yield to maturity of 0.05%. In 2015, government bonds with average annual costs of 3.11% will mature in the following structure: bonds issued as 0- to 2-year bonds with average annual costs of 0.29%, bonds issued as 2- to 4-year bonds with average annual costs of 1.49%, bonds issued as 4- to 6-year bonds with average annual costs of 2.99%, bonds issued as 8- to 10-year bonds with average annual costs of 3.63%, and bonds issued as 10- to 15-year bonds with average annual costs of 3.90%. The decreasing yields achieved in auctions of medium-term and long-term government bonds in 2014 across the maturity profile caused the decrease of the average annual costs in all maturities in comparison to the average annual costs as at the end of 2013. The average annual costs decreased the most for medium-term and long-term government bonds maturing in 2016 (decrease of 0.44 p.p.) and 2018 (decrease of 0.85 p.p.), due to the relatively low

yields to maturity during the sale of Czech Republic Government Bond, 2013–2016, 0.50 % and Czech Republic Government Bond, 2014–2018, 0.85 %. Due to the new benchmark issue (2014 – 2025), the average annual costs of medium-term and long-term government bonds maturing in 2025 amounts to 1.93%, whereas there were no bonds maturing in 2025 and 2027 as at the end of 2013.

Figure 37: Maturity Profile of CZK-Denominated Fixed-Rate CZGB and Achieved Yield to Maturity (% p.a.)



Note: Maturity profile by time to maturity at the moment of sale as of the end of 2014. Maturity profile of CZK-denominated fixed rate CZGB by time to maturity at the moment of sale. Data in the individual segments represents the average yield to maturity at the moment of the sale of the medium-term and long-term government bonds in %. Excluding savings government bonds.
Source: MoF

Currency Risk

Currency risk is another market risk to which the state debt portfolio is exposed. In connection to currency risk, the Ministry monitors the development of the net foreign-currency exposure that measures the market risk to which the foreign-currency state debt is exposed in term of foreign-currency exchange rate movement after being adjusted for the foreign-currency exposure of state financial assets, where the foreign-currency debt represents the total nominal value of the debt portfolio denominated in the foreign currency. The value of net foreign-currency exposure of the state debt is affected primarily by derivative operations, which hedge a part of the foreign-currency debt against the negative development of currency exchange rates. The key indicator implemented in connection to managing currency risk is the share of net foreign-currency exposure of state debt to the total state debt, for which a strategic limit of 15% + 2 p.p. was introduced at the start of 2012, whereas it applies that the long-term exceeding of the 15% limit is not possible; overstepping by 2 p.p. serves only for the short-term overcoming of unexpected deprecation of the domestic currency.

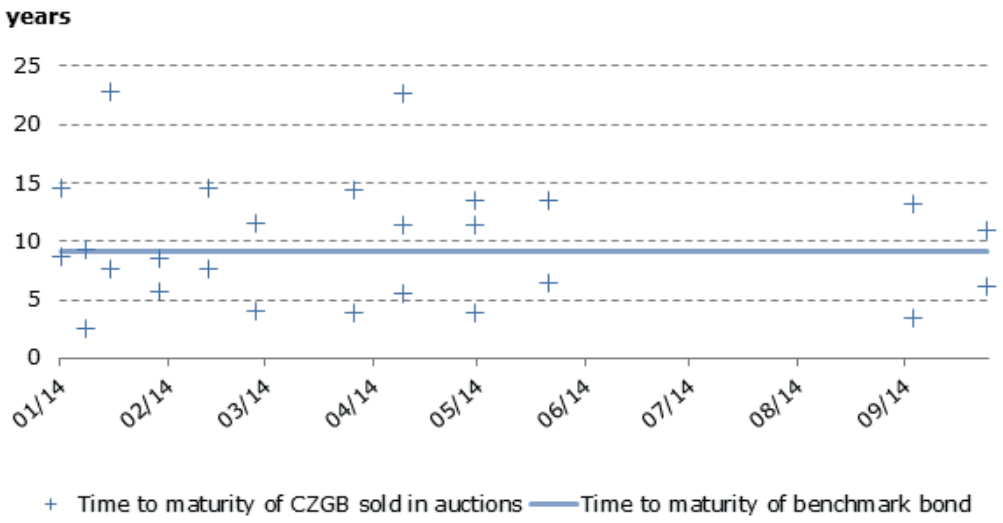
At the end of 2014, the value of the share of net foreign-currency exposure to state debt amounted to 10.4% and is therefore safely below the limit. Compared to the end of 2013, there was an increase of the indicator by 1.0 p.p. The dominant part of net foreign-currency exposure is comprised of EUR currency in the long term. The share of foreign-currency state debt in total state debt as at the end of 2014 is 14.5%, where compared to the end of 2013 there was a decrease of the indicator by 4.5 p.p. due to the redemption of two foreign issues of middle-term and long-term government bonds of the Czech Republic denominated in the single European currency, with a total nominal value of EUR 3.0 billion.

In 2014, the Ministry did not carry out any foreign issues on foreign financial markets due to the relatively low gross borrowing requirement and also higher costs related to issuing government bonds on the foreign market, as compared to a similar issue of government bonds on the domestic market after taking into account the costs of hedging against currency risk

Benchmark Portfolio

In order to assess the structure of issuance calendars and the ability to profit from the development of government bond yields during the year and the shape of the yield curve, the Ministry created the synthetic benchmark portfolio consisting of the fixed-rate CZK-denominated bonds only. The bonds contained in the benchmark portfolio are always issued on the auction day at the same nominal value as the real issued bonds. All bonds within the benchmark portfolio are issued with the same time to maturity, whereas this time to maturity guarantees the same average time to maturity of the synthetic portfolio of state debt containing the benchmark portfolio as the average time to maturity of the real portfolio as of at the end of the year. The average time to maturity of the state debt as of at the end of 2014 is 5.5 years. Provided the real issuance of CZK-denominated medium-term and long-term government bonds is substituted by the fixed-rate benchmark portfolio bonds with maturity of 9.1 years at the time of auction, the required average maturity of the synthetic portfolio of state debt will be 5.5 years as at the end of 2014.

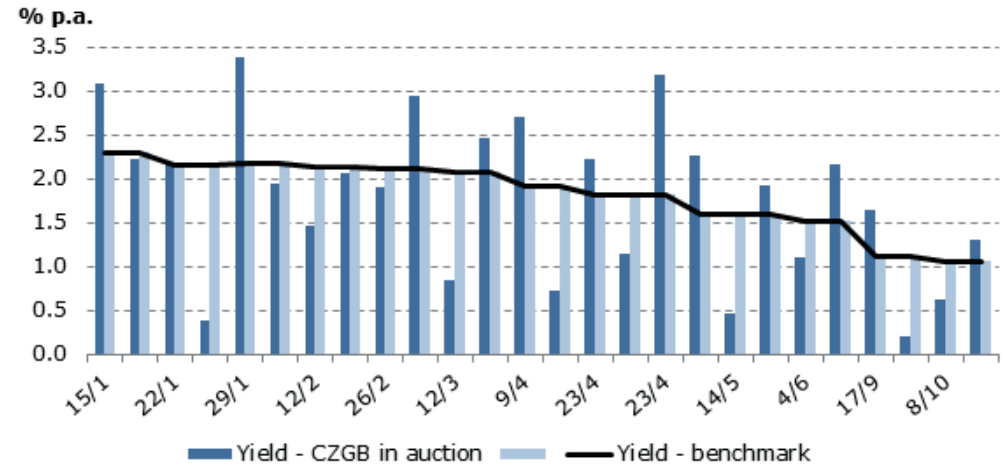
Figure 38: Time to Maturity of CZGB Sold in Auctions in 2014 and Benchmark Bond



Source: MoF

The average weighted yield of the portfolio of CZK-denominated medium-term and long-term government bonds sold at auctions during 2014 using the average auction yield to maturity in case of fixed-rate government bonds and average spread to reference interest rate achieved in auctions and respective forward values of PRIBOR reference interest rate in case of variable-rate government bonds amounted to 1.68% p.a. The average weighted yield to maturity of benchmark portfolio achieved in 2014 amounted to 1.80% p.a., i.e. is 12 basis points higher, then the yield of the real portfolio. To assess the actual savings achieved in 2014, it is essential to express accrued interest costs of each issued bonds in the real and benchmark portfolio and then compare these two total accrued costs. Total annual accrued costs on all actually sold CZK-denominated medium-term and long-term government bonds in auctions during 2014 amounted to CZK 2.4 billion. Total annual accrued costs generated in benchmark portfolio amounted to CZK 2.6 billion.

Figure 39: Yields of CZK-Denominated CZGB Achieved in 2014 and Yields of Benchmark Bonds



Source: MoF

It must be noted that the achieved savings of CZK 0.2 billion on accrual basis is generated solely by the adjustment of issuance calendar and is given by the shape of the yield curve. It is also necessary to note, that the savings are expressed based on PRIBOR reference interest rate forward values, the actual achieved savings can be calculated based on the actual future values of PRIBOR reference interest rate.

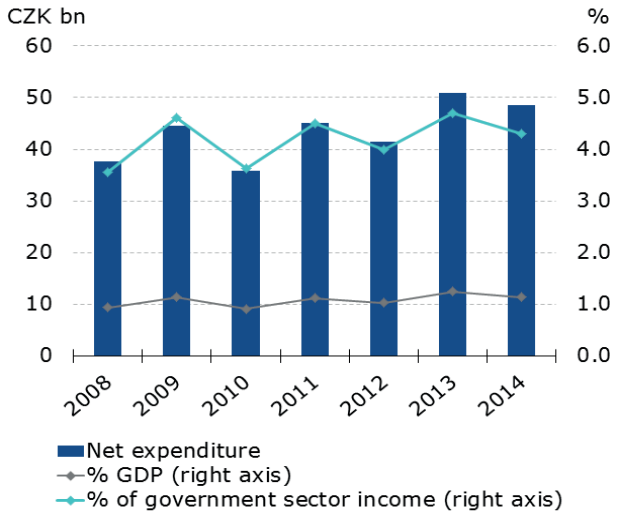
Over the course of 2014, 20 auctions of fixed-rate CZK-denominated medium-term and long-term government bonds at the total nominal value of CZK 110.5 billion and 6 auctions with variable-rate CZK-denominated medium-term and long-term government bonds at the total nominal value of CZK 33.9 billion were held on the primary market. The average weighted time to maturity of all CZK-denominated medium-term and long-term government bonds sold at auctions on the primary market in 2014 reached a value of 9.1 years as at the end of 2014.

5 – State Debt Service Expenditure

Cash and Accrued Expression

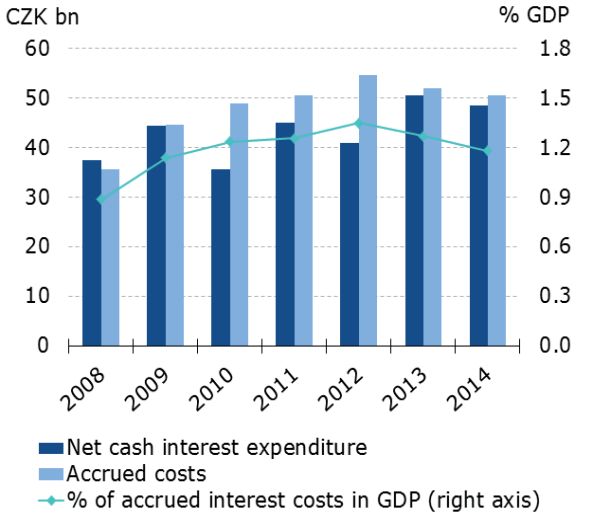
Since 2008, the net expenditure on state debt service are represented by the difference of gross expenditure on state debt service and revenue, which is cash-based (like the entire state budget); hence, it is not accrued according to the ESA2010 methodology, which takes place while preparing data for the notification. The share of net expenditure on state debt service in revenue of state budget and also in the GDP has been relatively stable over the past years.

Figure 40: Net Expenditure on State Debt Service



Note: Net expenditure for 2008 to 2014 represent actual data, and data in 2015 for expectated value of expenditure given by the model. The revenue of state budget is adjusted of the revenue of chapter 396 – State Debt. The source for GDP in the ESA 2010 methodology for 2008 to 2013 is the CZSO, for 2014 and 2015 the Macroeconomic Forecast of the MoF – January 2015. The source for state budget revenue for 2015 is the State Budget Act of the Czech Republic for 2015.
Source: MoF, CZSO

Figure 41: Net Cash Expenditure and Accrued Costs on State Debt Service



Note: The source of GDP in the ESA 2010 methodology in 2008 through 2013 is the CZSO, for 2014 the Macroeconomic Forecast of the MoF – January 2015.
Source: MoF, CZSO

Monitoring the development of revenue and expenditure, or net expenditure on state debt service, does not always provide accurate information on which costs are really associated with state debt in the given period. For these purposes, the accrued-based expression of costs, based on the accumulation of interest costs on a daily basis, is more appropriate. The development of accrued interest costs has a tendency to show much lower volatility than the development of interest on a cash basis, because it is not influenced by time disproportions between the time of creation of given interest costs and the date of realization of related expenditure or revenue. Until 2012, accrued costs grew continuously and their share in GDP developed similarly. The decrease of accrued costs in 2013 and 2014 is due to the concurrence of very moderate growth, respectively stagnation of the balance of state debt and a decrease of yields of government bonds to a historical minimum.

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 accrued 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 outweighs 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.

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 decline.

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 accrued costs starts being continually accounted from the issue or acceptance date, which may not be reflected in cash interest at all in the given period.

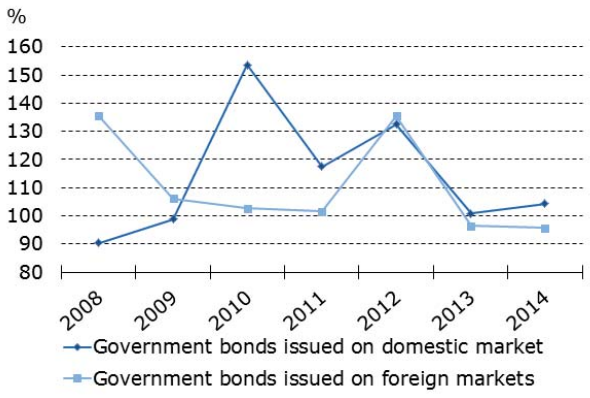
Table 15: Difference Between Cash Discounts and Premiums and Cash and Accrued Interest of CZGB

CZK billion	2008	2009	2010	2011	2012	2013	2014
CZGB cash premiums	0.0	2.0	9.4	7.4	11.8	5.8	6.0
CZGB cash discounts	4.3	6.3	0.0	0.7	0.8	1.4	1.3
Difference between CZGB cash discounts and premiums	4.3	4.3	-9.3	-6.8	-11.0	-4.4	-4.7
Difference between CZGB cash and accrued interest	3.2	0.4	-13.1	-5.7	-9.7	-0.3	-1.5

Note: Government bonds issued on the domestic market
Source: MoF

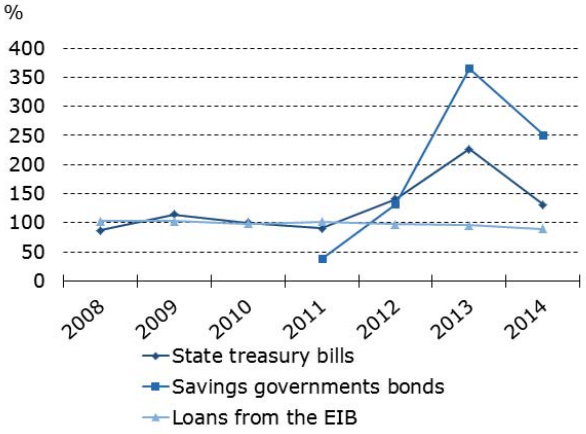
The basic development trends of cash expenditure and accrued costs is largely based on the development of these indicators for medium-term and long-term government bonds issued on the domestic market, which constitute a dominant part of the state debt, and in 2014 accounted for more than two thirds of the total accrued costs on the state debt. The ratio between accrued costs and cash expenditure on medium-term and long-term government bonds issued on the domestic market is relatively balanced in 2014. In the case of medium-term and long-term government bonds issued on the foreign market, which accounted for almost one quarter of total accrued costs in 2014, cash expenditure was prevalent, which is due to two redemptions of Eurobond issues in this period. In the case of state treasury bills, there was a strong prevalence of accrued costs over cash expenditure. In the case of medium-term and long-term government bonds, there is a strong prevalence of accrued costs. With regard to the short maturity period of most provided loans in a form of lending facilities, the difference between cash and accrued interest is not very significant. The same applies to short-term loans received, and with regard to the usually short period of re-fixing, in most cases also loans received from the European Investment Bank, given that in 2014 there was a prevalence of cash expenditure over accrued costs due to the concurrent decrease of interest rates and prepaid loans received from the EIB.

Figure 42: Percentage Share of Accrued Costs and Net Cash Expenditure of Government Bonds



Source: MoF

Figure 43: Percentage Share of Accrued Costs and Net Cash Expenditure of Other Components of State Debt



Source: MoF

Budget for the Chapter 396 – State Debt in 2014

The budget for the Chapter 396 – State debt is composed annually based on Cost-at-Risk analysis, and for 2014 was based on a 96% percentile of division of net interest expenditure, which means that these expenditure will not be exceeded with 96% probability.

The expected net expenditure amounted to CZK 51.5 billion. The actual net expenditure on the Chapter in 2014 amounted to CZK 48.5 billion, i.e. about 1.1% of GDP and 4.3% to total state budget revenue excluding the revenue of the Chapter. The difference between real expenditure compared to the originally approved budget of CZK 58.4 billion was CZK 9.9 billion, which partially contributed to the better-than-expected government sector financial management in 2014. The difference between the real and budgeted net expenditure is due to the lower gross expenditure, while revenue achieved approximately the level of the approved budget. Compared to 2013, there was a decrease of net interest expenditure of about 4.7%.

In the course of 2014, a total of CZK 5.1 billion was transferred to other budget chapters from the State debt chapter via budgetary transfers. Due to the approval of an amendment to the State Budget Act for 2014, the expenditure of the Chapter was reduced by CZK 0.9 billion. The resulting difference in real net expenditure compared to the final budget and after including the impact of the approved amendment to the State Budget Act, was CZK 3.9 billion.

The relatively significant difference between real and budgeted expenditure is due to several factors. The main factor is mainly the character of the construction of budgeted expenditure for the Chapter. Budgeted expenditure represents the limit that will be exceeded with a certain degree of probability. The probability of it being exceeded is generally in the range of 1% to 5%. Due to higher budget expenditure compared to expected expenditure, part of the state debt may be held in the form of variable-rate instruments, which on average accrue lower interest than fixed-rate bonds, thus achieving savings on state budget expenditure.

The total state budget savings from the sale of CZK-denominated variable-rate bonds compared to fixed-rate bonds of the same time to maturity, i.e. whilst preserving the same refinancing risk, amounts to more than CZK 13 billion in 2008 through 2014. Another factor is the substantial decrease of government bonds yields to new historical minimums due to the expansive monetary policy of the CNB and ECB, which was not foreseen in the first half of 2013 during preparation of the state budget for 2014.

Table 16: Budget Expenditure and Revenue of the State Debt Chapter in 2014

Indicator (CZK million)	Actual 2013	Budget 2014		Actual 2014	% Execution	Index 2014/2013 (%)
		Approved	After changer			
1. Total interest expenditure and revenue	57 516	64 427	59 312	55 694	93.9	96.8
	(-) 6 952	(-) 7 400	(-) 7 400	(-) 7 402	100.0	106.5
Domestic debt	43 758	51 072	45 957	42 537	92.6	97.2
	(-) 6 716	(-) 6 952	(-) 6 952	(-) 7 207	103.7	107.3
Money market instruments	209	1 409	1 409	77	5.5	36.9
	(-) 166	(-) 64	(-) 64	(-) 241	376.1	145.0
Of which: derivative operations	36	-	-	-	-	-
Savings government bonds	487	949	949	909	95.8	186.8
	(-) 1	-	-	0	-	-
Government bonds	43 062	48 714	43 599	41 551	95.3	96.5
	(-) 6 550	(-) 6 888	(-) 6 888	(-) 6 966	101.1	106.4
Foreign debt	13 754	13 350	13 350	13 156	98.5	95.6
	(-) 228	(-) 448	(-) 448	(-) 195	43.5	85.7
Foreign bond issues	13 054	12 599	12 599	12 596	100.0	96.5
	(-) 228	(-) 448	(-) 448	(-) 195	43.5	85.7
Of which: derivative operations	3 915	2 987	2 987	2 984	99.9	76.2
	(-) 228	(-) 448	(-) 448	(-) 195	43.5	85.7
EIB loans	700	751	751	560	74.6	80.0
Bank accounts	3	5	5	1	14.2	20.9
	(-) 8	-	-	0	-	-
Revenue (-) and expenditure (+) from account deposits	3	5	5	1	14.2	20.9
	(-) 8	-	-	0	-	-
2. Fees	**327**	**450**	**450**	**201**	**44.6**	**61.4**
	-	-	-	0	-	-
Total balance	**57 843**	**64 877**	**59 762**	**55 895**	**93.5**	**96.6**
	(-) 6 952	**(-) 7 400**	**(-) 7 400**	**(-) 7 402**	**100.0**	**106.5**

Note: (-) means revenue (gains). Approved budget indicates the budget after approval of the amendment to the Czech Republic State Budget Act for 2014.
Source: MoF

The interest costs on state debt service in 2014 in accrued expression reached CZK 50.6 billion, of which net interest costs for state debt issued in 2014 account for approximately CZK 1.6 billion. The total nominal value of state debt issued in 2014 is CZK 269.6 billion including T-bills roll-over. Due to the time heterogeneity of individual borrowing operations in 2014, the accrued costs on this debt will increase to CZK 2.2 billion in 2015, which is maximum value of accrued costs on state debt issued in 2014. After 2015, the accrued costs on this debt will only decrease as the individual instruments, which are parts of this debt issued in 2014, will be redeemed. The decrease in 2015 and 2016 will be gradual and accrued interest will be on a level of approximately CZK 2.1 billion.

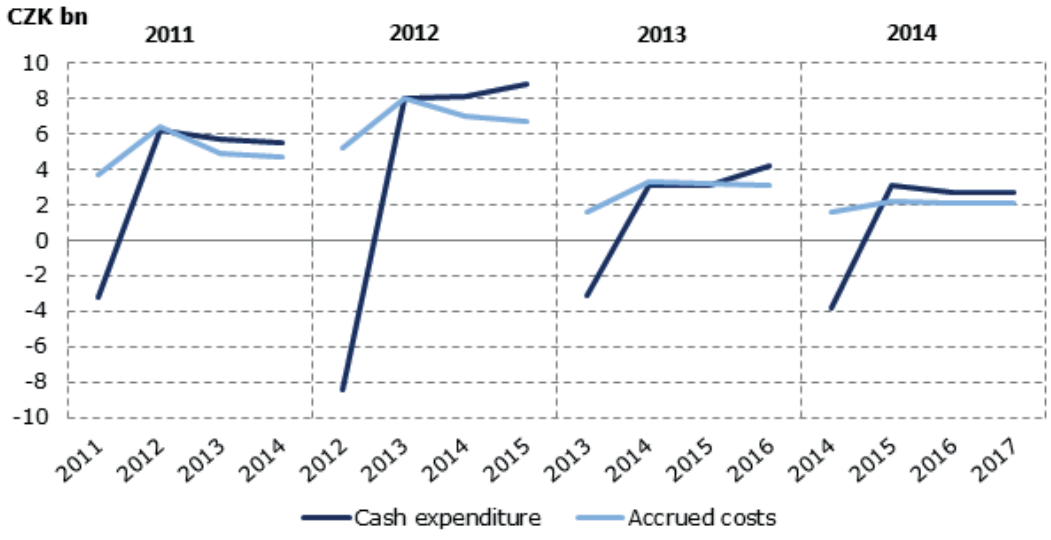
Table 17: Interest Costs of the Newly Issued State Debt (CZK billion)

	Nominal value	Net interest costs			
		2014P	2015P	2016P	2017P
Cash basis expression	269.6	-3.9	3.1	2.7	2.7
Accrued basis expression	269.6	1.6	2.2	2.1	2.1
Gross issuance of CZGB	153.3	1.6	2.1	2.1	2.1
Gross issuance of state treasury bills	114.9	0.0	0.0	-	-
Foreign issues	-	-	-	-	-
Gross issuance of savings government bonds	1.4	0.0	0.0	0.0	0.0
Drawing of EIB loans	-	-	-	-	-

Source: MoF

The completely different development of net expenditure on the same debt can be seen when expressed in cash basis, where the value of these expenditure in 2014 is CZK -3.9 billion. In 2015 the net interest expenditure on state debt issued in 2014 will increase to CZK 3.1 billion. In 2016 and 2017, net interest expenditure on new state debt are expected on a level of CZK 2.7 billion. Newly generated state debt in 2014 brought state budget cash revenue in total amount of CZK 3.9 billion due to the re-openings of issues with high coupon rate, which together with low market yields generated auction premiums. State budget revenue from state debt issued in 2014 will be compensated in the following years by higher cash expenditure compared to accrued expenditure. It is true, that the net cash expenditure and accrued costs on the new state debt are equal for the existence of this debt. The following figure shows that in 2011 to 2014 the debt issued in each of those years generated cash revenue in the year of issue, which was mainly caused by the consistent decline of market yields. If only new issues of government bonds with market coupon rates were issued in each year and the coupon payments were made at the end of the year, the accrued costs and cash expenditure would be identical in the year of issue. For this reason, the accrued expression of costs on state debt is more accurate and revealing, since it is not affected by the reopening of issues with other than market coupon rate, which, however, cannot be avoided in the real world, because small volumes of government bond issues cause illiquidity of these bonds and ultimately may cause an increase in costs due to the illiquidity premium. The figure below shows the further decrease of current accrued interest costs for newly issued state debt, which is related firstly to the reduction of the total issue of debt instruments and secondly to the lasting decrease of yields from government bonds.

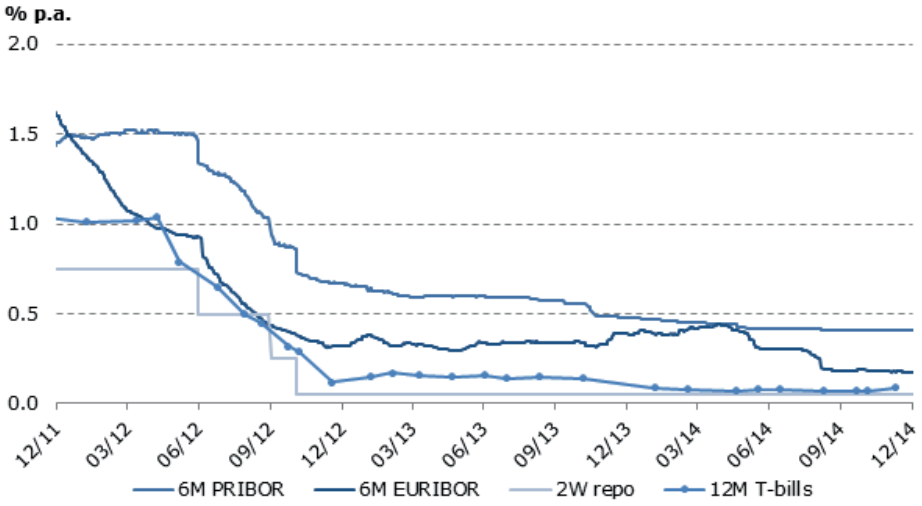
Figure 44: Net Cash Interest Expenditure and Accrued Interest Costs of Newly Issued Debt



Source: MoF

After the substantial decrease of yield curves on the CZK and EUR money market in 2012, the 6-month PRIBOR rate continued to decrease in 2014 with very low volatility. On contrary, 6-month EURIBOR rate has showed significantly higher volatility in 2014. The Czech National Bank kept the basic interest rate (2-week repo rate) at a historical minimum at 0.05% during the whole of 2014.

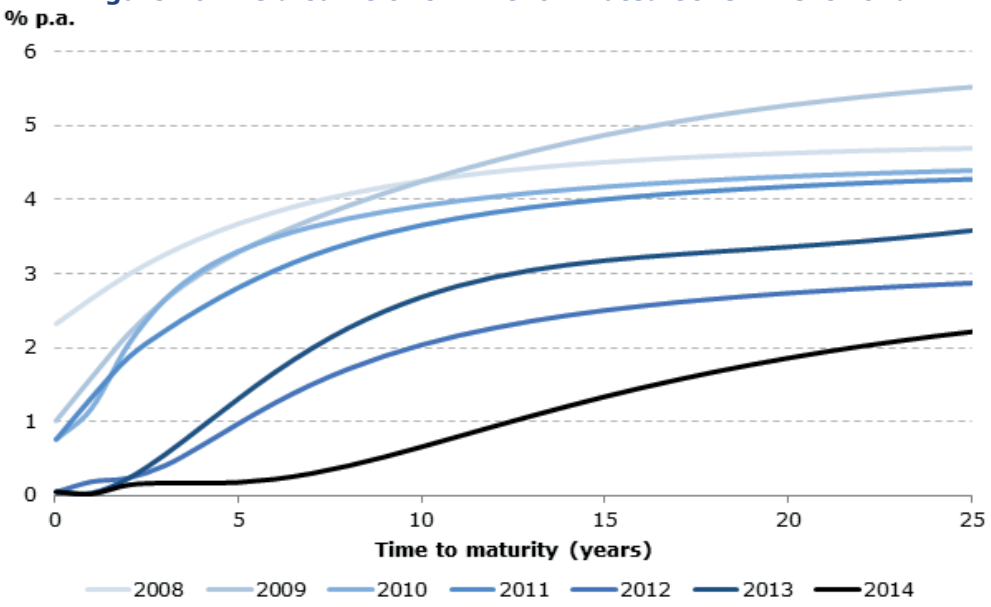
Figure 45: Development of Rates: 6M PRIBOR, 6M EURIBOR and 2W Repo and 12M T-Bills Yields



Note: As at 31 December 2014
Source: Bloomberg

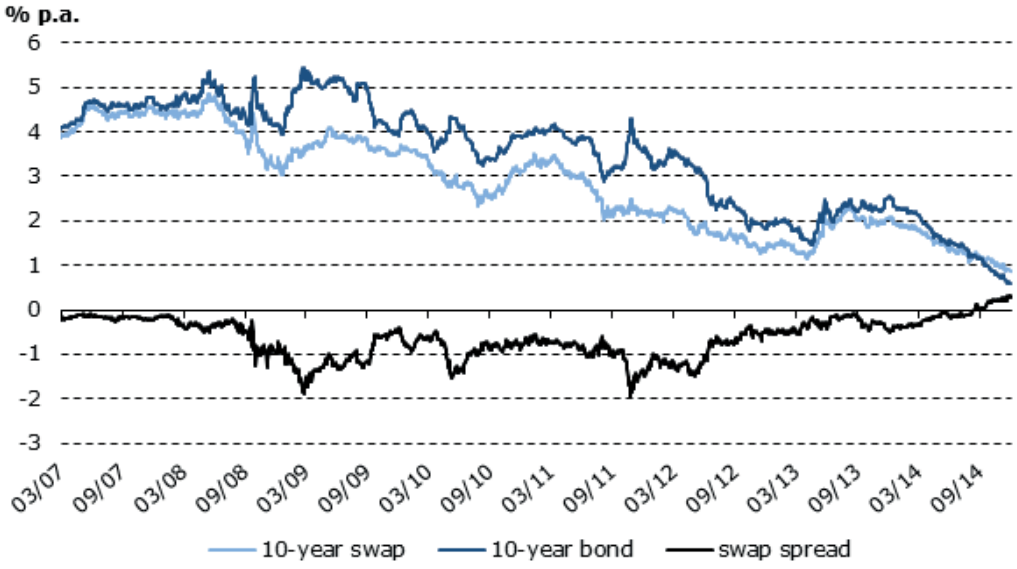
Following a slight increase at the end of 2013, the yields of government bonds continued to decline, and this trend continued practically throughout 2014. At present, they are at their historically lowest values. The difference between swap rate and government bond yield, i.e. the swap spread was increasing through the whole year and at the end of the year amounted positive values up to time to maturity of approximately 12 years. The positive value of swap spread confirms the attractiveness of the Czech Republic as a sovereign debt issuer among investors and at the same time confirms the decision of the Ministry of the end of 2012 to use less conservative model for the risk premium of government bonds. The value of swap spread in the case of ten-year maturity was at the beginning of 2014 at about - 50 basis points towards the end of December 2014 stands at 30 basis points. The average value of swap spread on ten-year swap achieved during the 2014 value of about -10 basis points.

Figure 46: Yield Curve of CZK-Denominated Government Bond



Note: Yield curve of CZK-denominated government bonds always at the end of the year. "Par" yield curve of CZK-denominated government bonds is constructed on the basis the extended Nelson-Siegel model, called Svensson model.
Source: MoF, MTS, Bloomberg

Figure 47: Swap Rate, Yield to Maturity of CZK and Swap Spread



Source: MoF, MTS, Bloomberg

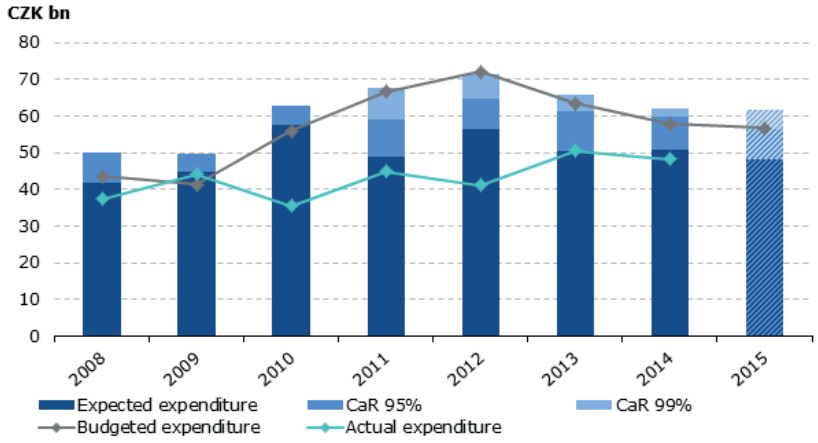
Cost-at-Risk of State Debt

In measuring and managing interest rate risk, the Ministry applies a sophisticated model framework known as Cost-at-risk (CaR) for measuring and managing interest risk, which is based on 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 state debt portfolio, which is based on the basic scenario of the funding program while respecting the set strategic goals for managing financial risks.

The primary goal of the model is to determine the maximum 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. Compared to gross expenditure on state debt service, gross interest expenditure do not include fees related to state debt service, which are of a deterministic nature.

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

Figure 48: Net Interest Expenditure and Cost-at-Risk



Note: Original budgeted net interest expenditure in all years.
Source: MoF

Table 18: Net Interest Expenditure and Cost-at-Risk (CZK billion)

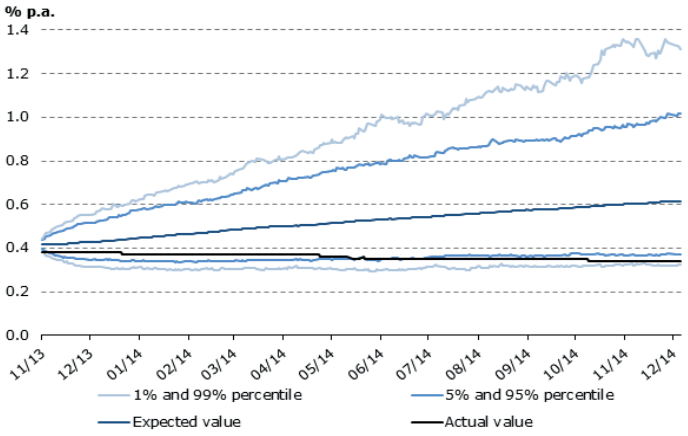
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Budgeted expenditure[1]	43.7	41.3	56.1	66.7	72.1	63.6	57.8	56.8	63.3	72.9
Actual expenditure	37.5	44.1	35.6	45.0	41.1	50.6	48.3	-	-	-
Expected expenditure	41.7	44.9	57.5	49.1	56.4	50.6	50.9	48.2	49.0	52.0
CaR 95%	50.2	49.9	62.9	59.2	64.9	61.3	60.0	56.6	62.4	67.4
CaR 99%	-	-	-	67.8	71.5	65.9	62.3	61.7	67.8	75.9

[1] *In 2008 through 2014, the original budgeted net interest expenditure. In 2016 and 2017, the medium-term forecast.*
Source: MoF

In the Czech Republic Funding and Debt Management Strategy for 2014, the Cost-at-Risk of state debt for 2014 was published. Calculation of the CaR indicator is based on simulations of the time structure of interest rates as at 27 November 2013.

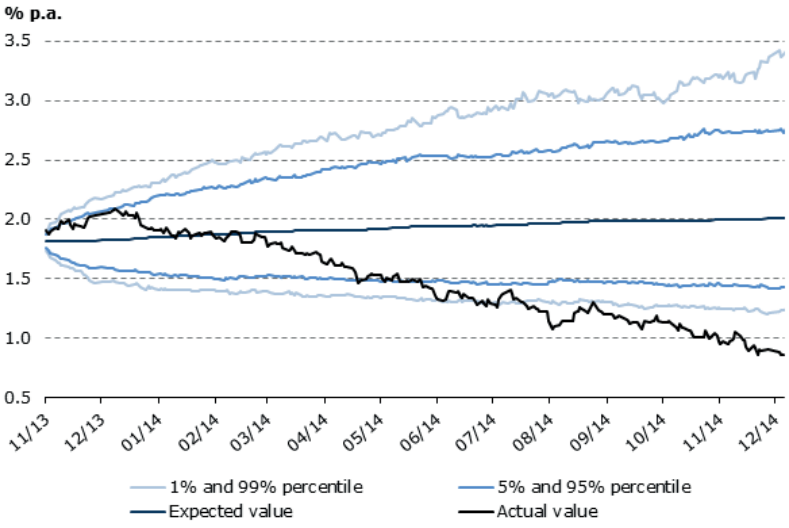
A comparison of the real development of the three-month PRIBOR and ten-year swap interest rates with their simulations for the period from 27 November 2013 to 31 December 2014 is shown in the following figures.

Figure 49: Actual vs. Simulated 3M PRIBOR Rates in 2014



Source: MoF

Figure 50: Actual vs. Simulated 10-year CZK swap rates in 2014



Source: MoF

A comparison of the actual net interest expenditure on state debt service with the simulated values of expected expenditure (simulation average) and interest expenditure in CaR (95% and 99% percentile of simulations) in 2013 and 2014 is shown in the following table.

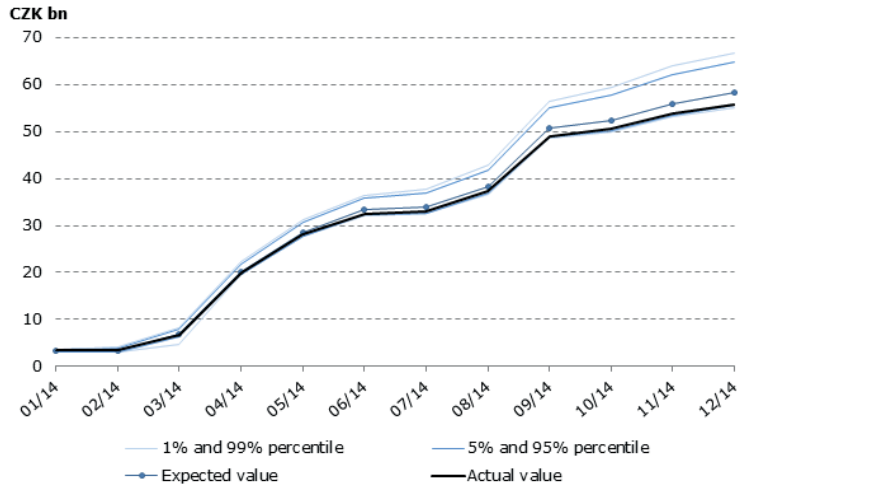
Table 19: Expected vs. Actual Net Interest Expenditure in 2013 and 2014 (CZK billion)

	2013	2014
Actual expenditure	50.6	48.3
Expected expenditure	50.6	50.9
CaR 95%	61.3	60.0
CaR 99%	65.9	62.3
Difference between expectation and reality	0.0	2.6

Source: MoF

In 2014, the gross interest expenditure amounted to CZK 55.7 billion, while the expected gross interest expenditure in 2014 predicted by the model were at CZK 58.3 CZK billion. The actual interest revenue of state debt in 2014 amounted to CZK 7.4 billion and thus corresponds to the expected revenue predicted by the model. The net interest expenditure on state debt in 2014 were CZK 48.3 billion, while the net interest expenditure predicted by the model were CZK 50.9 CZK billion.

Figure 51: Actual vs. Simulated Gross Interest Expenditure in 2014



Note: Interest expenditure are calculated using the cash principle according to the current state budget methodology.
Source: MoF

The net interest expenditure in 2014 remained below the CaR 95% and CaR 99% level, having been fixed at CZK 60.0 billion and CZK 62.3 billion, respectively. The primary goal of the model was thus achieved, as the actual interest expenditure on the state debt remained below the CaR 99% level and the fulfilment of the state budget balance for 2014 approved by the Chamber of Deputies from the title of State debt chapter budget was not jeopardized. The expected gross interest expenditure predicted by the model are CZK 2.6 billion higher compared to the expectation, which is fully reflected in the difference in the prediction of expected interest expenditure.

The difference in expected gross interest expenditure is given primarily by the decrease of yields of CZK-denominated government bond, which latest practically throughout 2014 when government bonds yields reached their historically minimal values. The difference from this title is CZK 2.0 billion and is mainly due to change in the structure of the bond issuance calendar and lower-than-expected discounts. Another important factor was the lower level of the PRIBOR reference interest rate, which continued its slight decrease in 2014. Due to the lower-than-expected values of the reference rate, the difference of expectations is about CZK 0.4 billion. The difference of about CZK 0.2 billion is caused by the impact of lower-than-expected yields from state treasury bills.

Due to the relative stabilisation of the financial and economic situation in the Eurozone and EU, the government's rational fiscal policy and the CNB's zero interest rate policy, it was possible to reduce the expenditure on state debt in the state budget for 2015 by CZK 1.3 billion compared to the approved budget for 2014, and by CZK 7.5 billion compared to the medium-term outlook for the state budget for 2015 and 2016, which the Strategy operated with. The current forecast of expenditure on state debt service for 2016 was reduced by CZK 7.1 billion compared to the previous outlook.

The interest rate model used to construe the CaR indicator for the period of 2015 to 2017 is based on the modelling of the entire yield curve. Another very important feature of the model is the non-undervalued estimate of the volatility of the long curve end. The model was defined for the first time ever and applied in *Yacine-Ait Sahalia: Testing Continuous Time Models of the Spot Interest Rate, The Review of Financial Studies, 9, 2, 385-426, 1996*. The model is characteristic for its "mean reversion" feature, i.e. convergence of expected rates to its balanced value and has been modified by the Ministry so as to comply with Czech market specifics. The model parameters are estimated based on historical daily observations of the Czech yield curve starting on 25 August 2000. 10 000 simulations of interest rates are conducted daily for each of the required maturities for the horizon from 24 November 2014 to 31 December 2017. Due to the fact that the applied model contains the feature of the interest rate return to its long-term mean value, the model expects the rates to increase in the medium-term horizon. The model outcome includes simulations of money market yield curves, according to which, however, only a small portion of the state debt bears interest. Therefore, it is important to model the risk premium of government bonds, defined as a difference between the government bonds yield curve and money market yield curve. Given the consistent decrease of yields across the entire yield curve of government bonds, the Ministry continues to apply a less conservative approach to modelling the risk premium. This approach currently best illustrates the present situation on markets. Since 2012, the Ministry has switched from the CaR 95% indicator to the CaR 99% indicator when evaluating the risk of interest expenditure on state debt. It was first used to estimate expenditure on state debt in 2011. One of the reasons for this transition is compliance with the risk management practices in developed financial institutions. The CaR 95% indicator is still constructed along with the whole probability distribution of future interest expenditure.

The gross interest expenditure in 2015 predicted by the model amount to CZK 55.4 billion. Gross interest expenditure at risk, i.e. CaR 99% amount to CZK 64.0 billion (CaR 95% CZK 59.5 billion). The actual gross interest expenditure in 2015 will not be more than CZK 8.7 billion higher compared to expected expenditure with 99% probability. The budgeted gross interest expenditure of the Chapter in 2014 are CZK 64.0 billion and are thus at 99% percentile of gross interest expenditure distribution in this year.

The following table shows in detail the development of cumulative gross interest expenditure on state debt in 2015 predicted by the model always at the end of the month. It also contains the respective critical values of CaR 95% and CaR 99%.

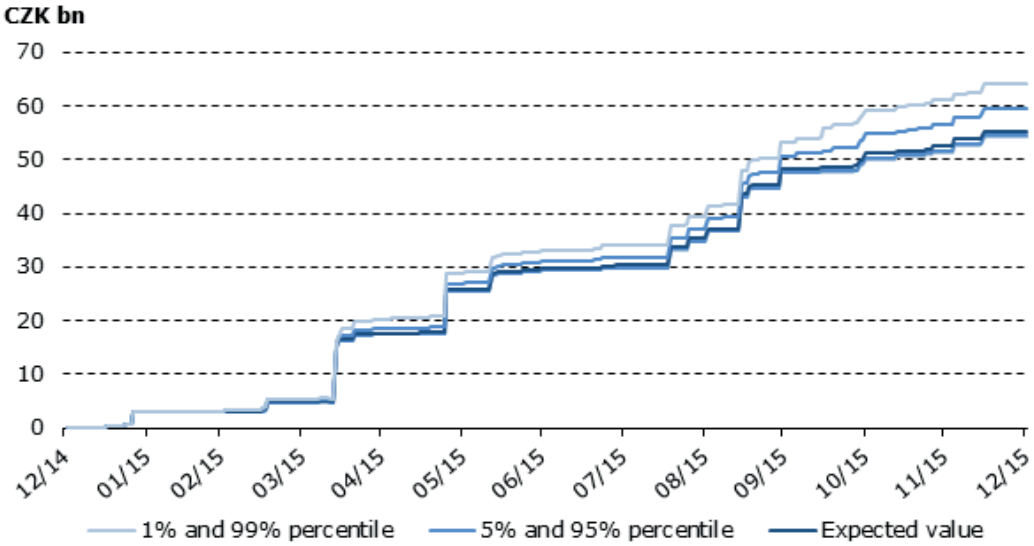
Table 20: Development of Cumulative Gross Interest Expenditure in 2015 (CZK billion)

Months	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.
Expected expenditure	3.1	3.1	4.9	17.7	25.8	29.8	30.3	35.2	48.2	51.1	52.5	55.4
CaR 95%	3.1	3.1	5.3	18.4	26.8	31.1	31.8	37.0	50.5	54.8	56.6	59.5
CaR 99%	3.1	3.1	5.5	20.1	28.8	33.1	34.1	39.4	53.2	59.2	61.1	64.0

Source: MoF

The graphic presentation of simulations of cumulative gross interest expenditure on state debt in 2015 calculated on a daily basis is shown in the following figure. The figure also shows the expected values of expenditure and the respective 5% and 95%, 1% and 99% percentiles of simulated values.

Figure 52: Simulation of Gross Interest Expenditure of State Debt during 2015



Note: Development of gross interest expenditure on a daily basis
Source: MoF

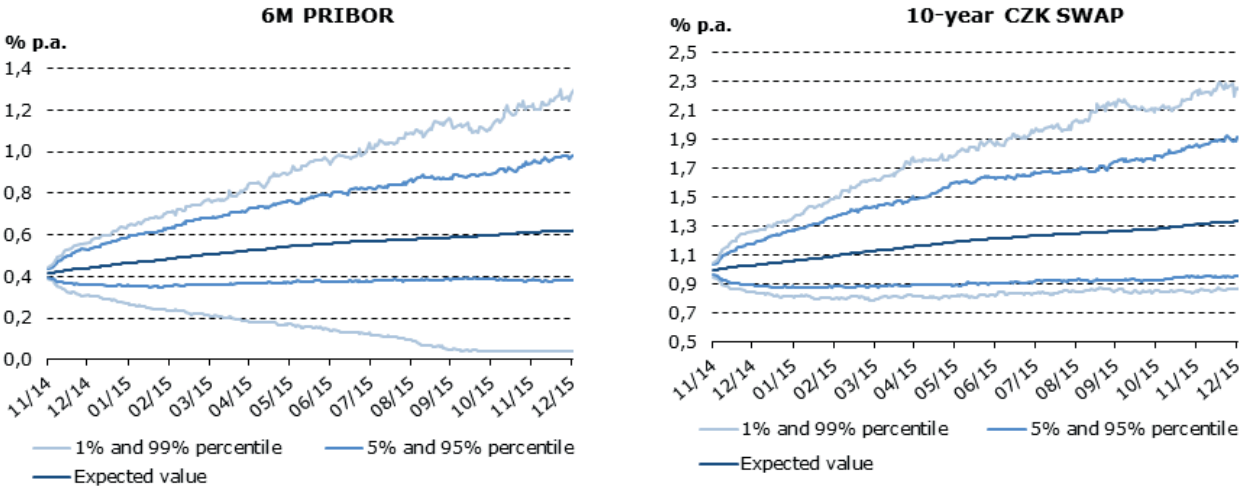
The budgeted net interest expenditure on state debt in 2015 are in the 95% percentile of the CaR indicator, meaning they will not be exceeded with 95% probability. The gross interest expenditure are budgeted in the 99% percentile of gross interest expenditure simulations. In the case of budgeting the Chapter's revenue, the Ministry continues to apply the model of expected revenue.

Table 21: Development of cumulative net interest expenditure in 2015 (CZK billion)

Months	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.
Expected expenditure	3.1	2.1	1.6	13.4	20.1	24.1	23.6	28.5	41.1	44.0	45.4	48.2
CaR 95%	3.1	2.6	3.6	16.3	24.4	28.6	29.1	34.4	47.8	52.0	53.8	56.6
CaR 99%	3.1	2.7	4.1	18.4	26.9	31.1	32.0	37.3	51.0	56.9	58.8	61.7

Source: MoF

Figure 53: Simulation of CZK-Denominated Interest Rates in 2015



Source: MoF

The Ministry is also concerned with the problem of interest rates hikes, which could occur e.g. via a sharp increase in the Czech National Bank basic rate, sudden deterioration of the economic situation in the Eurozone, a sharp increase of the risk premium for the Czech Republic, etc. The Ministry strives to quantify the impact of these circumstances on interest expenditure and revenue of the Chapter. Each economic event has an effect on a certain part of the yield curve, which is why it is important for the Ministry to observe the shift in the individual parts of the yield curves separately. The following table quantifies the consequences of a potential increase in interest rates at the short end of the yield curve, at the long end of the yield curve and along the entire curve evenly, all over the course of 2015. This analysis also enables the uneven shifting of the short and long end of the yield curve and arbitrary selection of the date of this shift.

Table 22: Development of Net Interest Expenditure in Case of Sudden Interest Hikes (CZK billion)

	Current model	Shift of rates at the short end of the yield curve		Shift of rates at the long end of the yield curve		Shift of the whole yield curve	
		by 1 p.p.	by 5 p.p.	by 1 p.p.	by 5 p.p.	by 1 p.p.	by 5 p.p.
Expected expenditure	48.2	50.9	61.7	53.2	68.7	55.9	82.2
CaR 95%	56.6	59.3	69.8	61.1	75.0	63.8	88.2
CaR 99%	61.7	64.4	74.8	66.1	79.6	68.7	92.7

Note: The shock in the form of a one-time shift in the yield curve will occur at the start of 2015.
Source: MoF

The shift of the yield curve for CZK-denominated government bonds at the short end by 1 p.p. upwards in 2015 would bring an increase in the expected net interest expenditure by CZK 2.7 billion. If the rates increased at the long end of the yield curve by 1 p.p., the expected net interest expenditure would increase by CZK 5.0 billion. The shift of the entire yield curve of CZK-denominated government bonds by 1 p.p. upwards would result in an increase in expected net interest expenditure by approximately CZK 7.7 billion.

The Ministry also quantifies the impact of an unplanned increase of the state budget deficit on the interest expenditure of the Chapter. If the state budget deficit of the Czech Republic were to increase by CZK 10.0 billion in 2015, and assuming the financing of this increase by means of the equal increase of nominal values of medium-term and long-term government bonds sold in auctions according to the current issue calendar, this change would result in an increase of expected gross interest expenditure of the Chapter by CZK 0.1 billion. The impact on the state budget on a cash basis is very sensitive to selected methods of financing the deficit increase. If a bond with a premium is issued, the increased gross issue may not be reflected in a growth of net expenditure with regard to the cash principle, and will cause a reduction of net interest expenditure, the expense will be apparent only in later years in the form of increased coupon payments. If the accrued

approach is applied, the increase of the gross issue would be apparent immediately.

Within three-year simulation horizon, the Ministry also constructs CaR indicators for 2016 and 2017. The expected value of net interest expenditure is CZK 49.0 billion in 2016 and CZK 52.0 billion in 2017, which is due primarily to the use of a less conservative model for the risk premium of government bonds and the current historically lowest yields of government bonds.

In the medium-term forecast of the Czech Republic's budget for 2016 and 2017, the expenditure frameworks for the Chapter are consistent with the CaR 99% and CaR 95% indicators. For 2016, the expenditure framework is CZK 63.3 billion, corresponding to the 96% percentile of interest expenditure. For 2017, the expenditure framework is CZK 72.9 CZK billion corresponding to approximately the 98% percentile of interest expenditure. The rising trend of budgeted interest expenditure is due mainly to the volatility of interest rates, which increases with the rising scope of the prediction. Given that the state budget is always compiled only for the following year, the prediction horizon of interest rates when compiling the budget for the following year will be shorter, and assuming that market conditions remain unchanged, it may be expected that the value of CaR 95% and CaR 99% indicators will decline due to the lower volatility of the interest rate prediction.

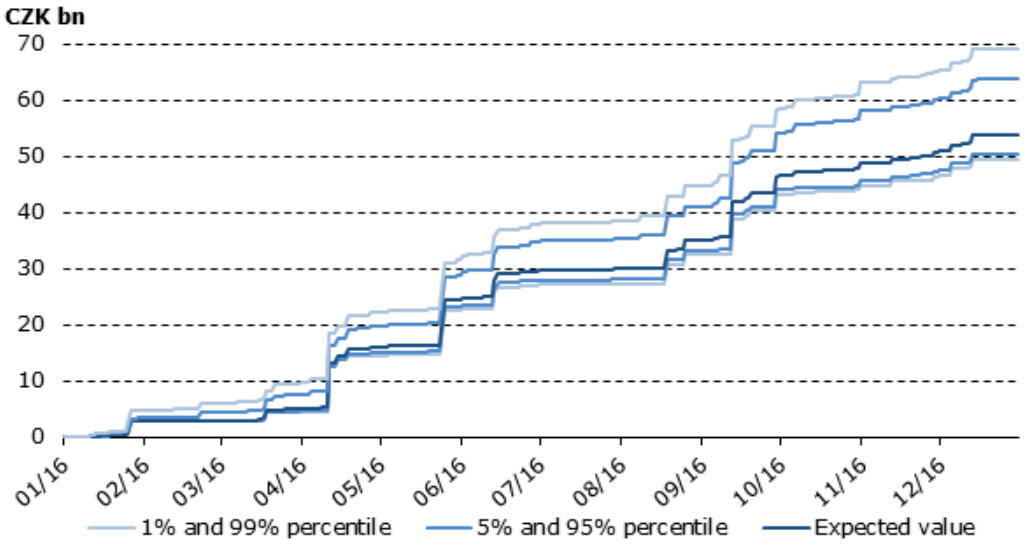
Expected gross interest expenditure on state debt in 2016 predicted by the model amount to CZK 53.9 billion. The following table shows in detail the development of cumulative gross interest expenditure on state debt in 2016 predicted by the model always at the end of the month. It also contains the respective critical values of CaR 95% and CaR 99%. The difference between the CaR 99% indicator and expected costs in 2016 is higher than the same difference in 2015. The reason for this difference is higher uncertainty with longer yield curve prediction horizon, which increases the volatility of rates.

Table 23: Development of Cumulative Gross Interest Expenditure in 2016 (CZK billion)

Months	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.
Expected expenditure	2.8	2.9	5.1	15.8	24.4	29.6	29.9	35.2	46.6	48.8	50.8	53.9
CaR 95%	3.4	4.3	7.6	19.6	28.7	34.9	35.2	41.1	54.2	58.1	60.2	63.7
CaR 99%	4.8	5.9	9.6	22.1	31.5	38.0	38.4	44.7	58.4	63.1	65.4	69.2

Source: MoF

Figure 54: Simulation of Gross Interest Expenditure on State Debt during 2016



Note: Development of gross interest costs on a daily basis
Source: MoF

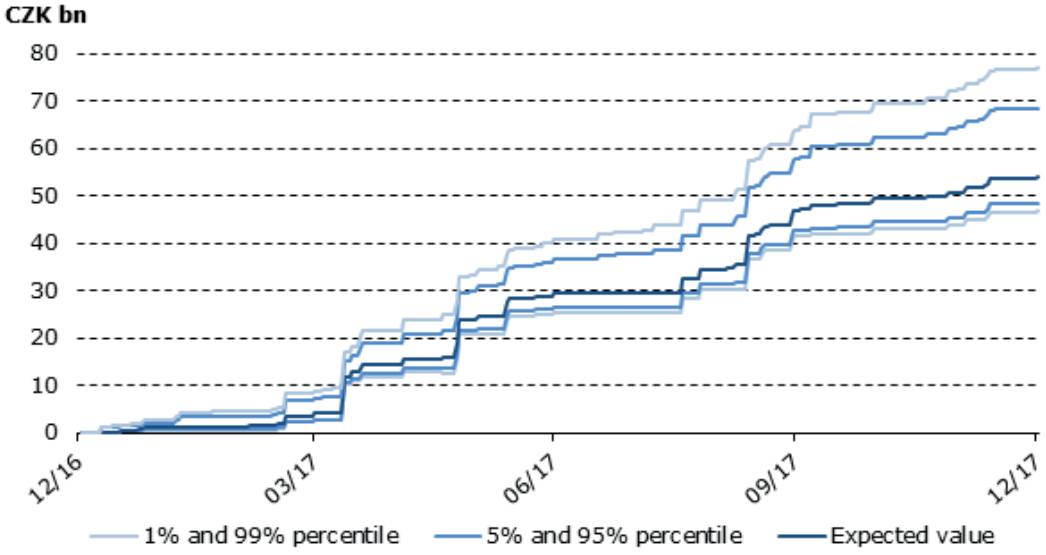
Expected gross interest expenditure on state debt in 2017 predicted by the model amount to CZK 54.0 billion. The following table shows in detail the development of cumulative gross interest expenditure on state debt in 2017 predicted by the model always at the end of the month. It also contains the respective critical values of CaR 95% and CaR 99%. The difference between the CaR 99% indicator and expected expenditure in 2017 is higher than the same difference in 2015 and 2016. The reason for this difference is higher uncertainty with longer yield curve prediction horizon, which increases the volatility of rates.

Table 24: Development of Cumulative Gross Interest Expenditure in 2017 (CZK billion)

Months	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.
Expected expenditure	1.1	1.3	4.1	14.3	24.0	29.4	29.6	34.6	47.0	49.6	50.5	54.0
CaR 95%	2.1	3.6	7.3	19.1	30.0	36.6	37.8	43.7	57.9	62.4	64.4	68.5
CaR 99%	2.7	4.5	8.9	21.7	33.4	40.7	42.5	49.1	63.9	69.4	72.3	77.1

Source: MoF

Figure 55: Simulation of Gross Interest Expenditure on State Debt during 2017



Note: Development of gross interest expenditure on a daily basis
Source: MoF

Efficient Frontier and Alternative Debt Portfolios

The Ministry's primary goal is always the problem-free financing of the central government's gross borrowing requirement at minimal costs related to the specific level of risk. Due to the fact that the gross borrowing requirement in 2015 consists solely of government bonds, it is crucial to issue bonds with parameters that will satisfy investors' demand. Another important factor that the Ministry must monitor is the liquidity of the secondary bond market. To maintain a certain level of liquidity of the secondary government bond market, it is necessary to ensure a relatively high total nominal value outstanding for every bond issue. According to the portfolio theory, situations may occur where the issuance of bonds according to the issuance calendar so as to satisfy investor demands and guarantee the liquidity of the secondary government bond market may create certain inefficiency in the management of the debt portfolio. This inefficiency may theoretically be eliminated by concluding swap operations, but this involves additional costs and the need to manage credit risk.

To compare the real funding strategy with other alternative strategies in terms of costs and risks, the Ministry has conducted an analysis based on the CaR method as of 2012, the aim of which is the construction of an efficient frontier.

In classic portfolio management, the yields and risks of individual potential investments within the given portfolio are compared directly among each other. On the contrary, the main factor influencing the portfolio structure in debt portfolio management

is the time to maturity of the individual instruments. Fluctuations in yield curves and the need for refinancing (re-fixing) cause every refinancing (re-fixing) to bear the risk of increased costs. Portfolios with a higher share of instruments that accrue interest at the short end of the yield curve are exposed to the risk of higher costs compared to portfolios with a higher share of instruments that accrue interest at the long end of the yield curve.

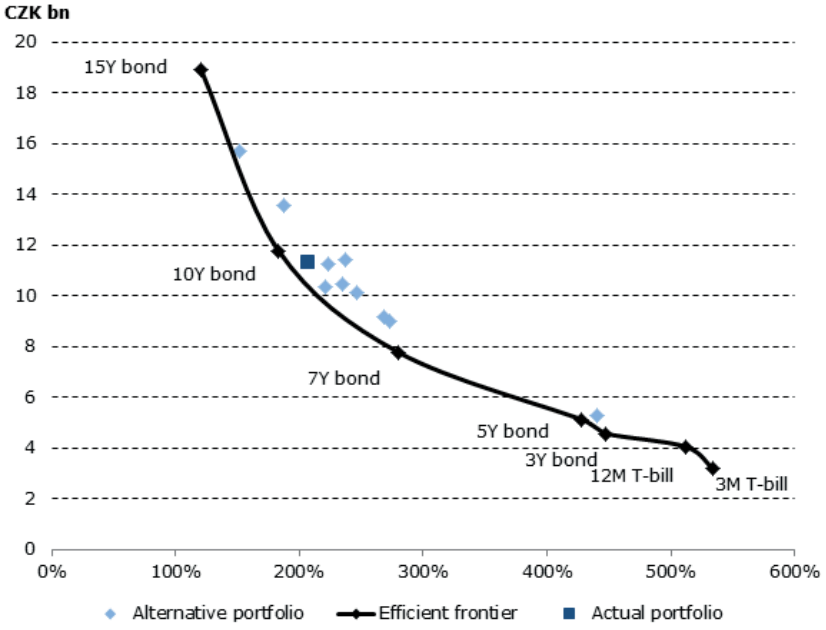
The efficient frontier depicts a curve that combines the risk and expected costs of alternative debt portfolios, which contain only bonds with one specific constant time to maturity. The bonds in this portfolio are issued always with a constant time to maturity, i.e. re-openings are not considered, and on its maturity date it is replaced with a bond with the same constant time to maturity. The efficient frontier represents a frontier of risk and expected costs combinations, which cannot be exceeded by any alternative debt portfolio. Hence, there is no debt portfolio that would enable the reduction of risk and simultaneously expected costs below the risk and expected costs of the portfolios containing only bonds with a constant time to maturity.

For all alternative debt portfolios in the conducted analysis, all financing of government's gross borrowing requirement in following years is carried out on the dates of actually planned auctions using only the bonds according to the definition of alternative portfolio (without considered reopening of the issue). The efficient frontier consists of seven alternative debt portfolios containing only newly issued bonds with a constant time until maturity. These bonds are: 3-month and 12-month state treasury bills and 3-year, 5-year, 7-year, 10-year and 15-year medium-term and long-term government bonds. Compared to the efficient frontier constructed in the previous year, there is an evident decrease of yields of government bonds, which is reflected in the reduction of expected costs in coming years. Furthermore, very low yields at the short end of the yield curve are apparent, where the expected costs in the case of the issue of 5-year and 3-year government bonds do not differ significantly from the expected costs in the case of state treasury bills.

In addition to the seven alternative portfolios lying on the efficient frontier, the Ministry also analysed ten more alternative portfolios with instruments, which correspond more to the real demand of investors. These ten alternative portfolios are created analogically as portfolios lying on the efficient frontier, a mix of government bonds with various maturities, through which the central government's gross borrowing requirement in forthcoming years is funded.

Two alternative portfolios consider zero net issue of state treasury bills in all years, whereas in the first portfolio government bonds with a maturity of 3, 5, 7, 10 and 15 years are equally issued. In the second portfolio, bonds with various times to maturity are also issued, whereas the average time to maturity of the entire debt portfolio at the end of each year is secured at 6.0 years. A third to sixth alternative portfolios finance the gross borrowing requirement evenly always with two instruments; these are 15-year government bonds and 3-month state treasury bills; 10-year government bonds and 12-month state treasury bills; 10-year government bonds and 3-month treasury bills; 5-year government bonds and 12-month state treasury bills. The seventh and eighth alternative portfolios are consider evenly issuing state treasury bills with a maturity of 3 and 12 months and government bonds with a maturity of 10 and 15 years, whereas the chosen instruments are issued equally in case of the former alternative portfolio and the time to maturity of 5.5 year of the whole newly issued debt is maintained at the end of each year in the latter alternative portfolio. The ninth and tenth alternative portfolios consider issuing 3-, 5-, 7-, 10- and 15-year government bonds and 3- and 12-month state treasury bills, whereas the debt instruments are issued equally in on strategy and in the other, one half consists of issuing state treasury bills and the other half of issuing medium-term and long-term government bonds, whereas the proportion of maturities within the individual groups is equal.

Figure 56: Efficient Frontier and Alternative Debt Portfolios



Source: MoF

The expected costs of the individual debt portfolios are represented by the cumulated expected costs of state debt service in 2015 to 2017. In all cases, the costs are expressed on an accrued basis. Thereby the comparable position of each alternative portfolio is achieved. In the case of the real portfolio, this results in the clearing of impacts of reopened issues, which in the short-term simulation scope lead to over-valuation of the risk and expected cost. To determine the degree of risk of the individual debt portfolios, the cumulative CaR 99% indicator is used in 2015 to 2017; specifically, the horizontal axis shows the maximum possible percentage change of expected costs, at which the cumulative CaR 99% indicator is achieved.

The figure shows that no alternative or actual debt portfolio, which includes the mix of government bonds with various times to maturity, lies on the efficient frontier. The actual debt portfolio containing the current actual gross borrowing requirement funding strategy is very close to the efficient frontier. The current debt portfolio lies near a cluster of alternative portfolios, which consist of the mix of government bonds with similar average time to maturity. The cumulative expected costs of newly issued debt according to the actual issue calendars amount to CZK 11.3 billion with a risk of approximately 207.0%. There is therefore a risk that the actual realized costs for next 3 years will exceed the expected costs by 207.0%, or in absolute terms CZK 23.4 billion. Compared to the previous year, expected costs declined significantly and the risk increased, which is related to the current record-breaking low yields of government bonds. If the average time to maturity of the newly issued actual debt decreased, the position of the real portfolio would be closer to the x-axis, i.e. the expected interest costs would decrease and the risk that they would be exceeded, would increase.

In the context of the efficient frontier analysis, it should be noted that there is no optimal portfolio that can be obtained by quantitative optimization. In the real world, where it's not possible to issue only new issues of government bonds in each auction and not take into account the needs of investors, only the portfolios approaching the efficient frontier can be chosen. The choice of the part of the efficient frontier, where this approach of the portfolio to the efficient frontier occurs, primarily depends on the risk preference or aversion of the management.

6 - Primary and Secondary Market for Government Bonds

Primary Dealers of Czech Government Bonds

The status of a Primary Dealer in Czech government bonds was contractually formalised as of 1 October 2011, when the Primary Dealer Agreement for Czech Republic Government Bonds, renamed Agreement on Execution of the Rights and Obligations of a Primary Dealer of Czech Government Bonds as of 1 January 2014 (hereinafter the Agreement) became valid. According to best international practice, the Agreement specifies the rights and obligations of individual members of the group of Primary Dealers, and provides an institutional framework for cooperation between the Ministry and financial institutions in funding and state debt management. Only a primary dealer who has entered into this Agreement with the Ministry will have the right as of 1 January 2012 to participate in auctions according to the Rules for Primary Sale of Government Bonds organised by the Czech National Bank.

A Primary Dealer is granted exclusive access to primary auctions of government bonds and the Ministry's operations on the secondary market, such as buy-backs and exchanges of government bonds, tap sales, lending facilities or reverse repo operations. Primary dealers are also the Ministry's counter-parties to foreign issues, private placements and other financial operations by the state. Primary dealers also have an exclusive right to participate at regular meetings with the representatives of the Ministry, at least once per quarter, and to be involved among others in the preparation of issuance calendars for government bonds as well as to propose alternative instruments for financing the borrowing requirement, including follow-up operations for risk management.

A Primary Dealer's obligation is to purchase at least 3% of the total nominal value of medium-term and long-term government bonds sold at primary auctions (including non-competitive parts) during four consecutive quarters. Another important obligation is for the participant to fulfil the quoting obligations on a secondary market through the Designated Electronic Trading System (DETS) with the aim of achieving a highly liquid secondary market for government bonds. For 2014 and 2015, MTS Czech Republic (which launched operation on 1 July 2011) was chosen as this platform once again based on a decision taken by the Primary Dealers Committee on 6 September 2013. The system of notifications in the case of failure to meet one of the two basic obligations has proven useful and the Ministry will continue to apply this practice.

The group of primary dealers of Czech government bonds is confirmed by the Ministry for every calendar year. For 2015, the Czech Republic will have a total of 13 primary dealers, the number and composition of which is identical to 2014, whereas the new primary dealer in 2014 was Morgan Stanley & Co International PLC.

Table 25: List of Primary Dealers of Czech Government Bonds in 2014 and 2015

2014 a 2015	
Barclays Bank PLC	ING Bank N. V.
Citibank Europe plc	J. P. Morgan Securities plc
Česká spořitelna, a.s.	Komerční banka, a.s.
Československá obchodní banka, a. s.	PPF banka, a.s.
Deutsche Bank AG	Morgan Stanley & Co International PLC
Goldman Sachs International	UniCredit Bank Czech Republic and Slovakia, a.s.
HSBC Bank plc	

Source: MoF

Evaluation Results of Primary Dealers for 2014

The new version of the Agreement, which came into force on 1 January 2014, maintains the three primary evaluation criteria and their weighting. The importance of a functional and liquid secondary market is demonstrated by the allocation of high weight to this criterion, which allows the appraisal of active market-makers in relation to their performance in government bond auctions on the primary market. The maximum evaluation of each Primary Dealer is 100 points, calculated on a relative basis. The activity of Primary Dealers is thus evaluated on a quarterly basis always for the last four consecutive quarters of the year. The method of evaluating primary dealers is described in detail in the appendix to this document. The maximum evaluation that can be achieved by any primary dealer is 100 points, whereas this score is counted on a relative basis. The activity of primary dealers is thus evaluated every quarter based on the Aggregate Performance Evaluation Index (APEI) defined in Annex I to the Agreement, always for four consecutive evaluation periods. The evaluation period according to Article 1 of the Agreement is every calendar quarter.

Table 26: Overall Evaluation in 2014

Ranking	Primary Dealer	Points
1st	**Citibank Europe plc**	**82.3**
2nd	KBC Bank NV / Československá obchodní banka, a.s.	61.3
3rd	Erste Group Bank AG / Česká spořitelna, a.s.	56.5
4th	PPF banka a.s.	51.4
5th	Société Générale / Komerční banka, a.s.	46.0
6th	UniCredit Bank Czech Republic and Slovakia, a.s.	36.8
7th	J.P.Morgan Securities Ltd.	34.0

Note: Maximum possible number of points in overall evaluation is 100
Source: MoF

Table 27: Primary Market in 2014

Ranking	Primary Dealer	Points
1st	**Citibank Europe plc**	**38.2**
2nd	Erste Group Bank AG / Česká spořitelna, a.s.	24.9
3rd	KBC Bank NV / Československá obchodní banka, a.s.	21.1
4th	PPF banka a.s.	19.0
5th	Société Générale / Komerční banka, a.s.	16.7
6th	UniCredit Bank Czech Republic and Slovakia, a.s.	14.9
7th	J.P.Morgan Securities Ltd.	10.3

Note: Maximum possible number of points in this criterion is 45
Source: MoF

Table 28: Secondary Market in 2014

Ranking	Primary Dealer	Points
1st	**Citibank Europe plc**	**32.3**
2nd	KBC Bank NV / Československá obchodní banka, a.s.	27.6
3rd	PPF banka a.s.	21.7
4th	Société Générale / Komerční banka, a.s.	18.5
5th	Erste Group Bank AG / Česká spořitelna, a.s.	17.7
6th	J.P.Morgan Securities Ltd.	13.2
7th	UniCredit Bank Czech Republic and Slovakia, a.s.	13.1

Note: Maximum possible number of points in this criterion is 40
Source: MoF

Secondary Government Bond Market and MTS Czech Republic

One of the long-term objectives for state debt management is to support the maximum possible liquidity of issues of Czech government bonds on the secondary market, which the Czech Republic aimed to fulfil through the implementation of the MTS Czech Republic platform for the secondary market of CZK-denominated government bonds. Pilot operation was launched on 11 July 2011, continuing with live operation after three months. The MTS Czech Republic platform enables clear monitoring of the behaviour of market participants and compliance with the set rules in real time as a basis for the subsequent evaluation of their performance and point awarding. Implementation of this platform also enabled expansion of the group of Primary Dealers by new foreign market-makers of the domestic market.

An effective secondary market in terms of minimising transaction costs and maintaining market depth and price stability is a necessary condition for the issuing activity of the state and smooth and cost-effective funding over the long term. In order to meet this task, the Ministry gradually expanded the list of benchmark issues from 1 June 2014, based on a decision of the of the MTS Czech Republic

committee (composed of the representatives of the Ministry and Primary Dealers), to include newly issued government bonds in 2014 with maturity in 2018 and 2025, whose nominal value outstanding was sufficient to allow the fulfilment of quoting obligations. An issue of government bonds due in 2036 was also added to the list, which eases the Ministry's construction of the long end of the yield curve of Czech Republic government bonds. From 1 June 2014, Czech Republic Treasury Bond, 2010-2015, 3.40 % was removed from the list of benchmark issues due to a time to maturity of less than 1.25 years.

Table 29: Benchmark Issues of Government Bonds as at 31 December 2014

Issue No.	Issue	ISIN	Coupon	Maturity Date	Maturity Basket
77th issue	ČR, 0,50 %,16	CZ0001003842	0.50%	28/07/2016	A
55th issue	ČR, VAR %,16	CZ0001002331	PRIBOR 6M	27/10/2016	A
51st issue	ČR, 4,00 %,17	CZ0001001903	4.00%	11/04/2017	B
88th issue[1]	**ČR, 0,85 %, 18**	**CZ0001004246**	**0.85%**	**17/03/2018**	**B**
41st issue	ČR, 4,60 %,18	CZ0001000822	4.60%	18/08/2018	B
56th issue	ČR, 5,00 %,19	CZ0001002471	5.00%	11/04/2019	B
76th issue	ČR, 1,50 %,19	CZ0001003834	1.50%	29/10/2019	B
61st issue	ČR, 3,85 %,21	CZ0001002851	3.75%	29/09/2021	C
52nd issue	ČR, 4,70 %,22	CZ0001001945	4.70%	12/09/2022	C
58th issue	ČR, 5,70 %,24	CZ0001002547	5.70%	25/05/2024	C
89th issue[1]	**ČR, 2,40 %,25**	**CZ0001004253**	**2.40%**	**17/09/2025**	**C**
78th issue	ČR, 2,50 %,28	CZ0001003859	2.50%	25/02/2014	D
49th issue[1]	**ČR, 4,20 %, 36**	**CZ0001001796**	**4.20%**	**04/12/2036**	**D**

[1] Issue was included among benchmark issues from 1/6/2014
Source: MoF

In 2014, the Ministry continued in executing of the tap sales of those issues of government bonds, which were not already included into primary auctions and also actively provided lending facilities to cover short positions of Primary Dealers.

The Primary Dealer who fulfils the role of market maker on the secondary market quotes the bid and offer prices for all bonds subject to quoting obligations in the minimum quoted total nominal value, which varies depending on the time to maturity, and at least 5 hours during a single trading day.

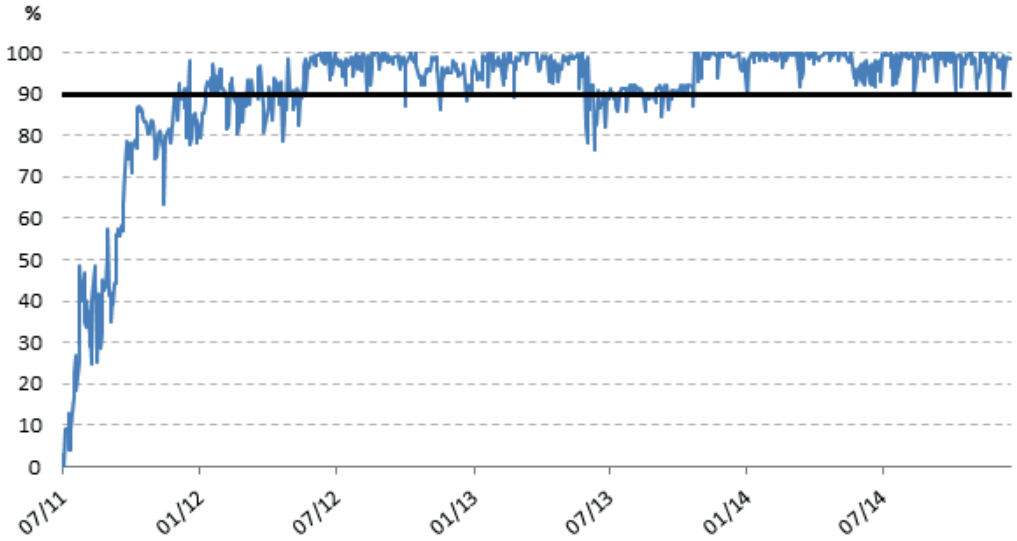
Table 30: Maturity Baskets Based on the Minimum Traded Volume on the MTS Czech Republic

A	**Bonds maturing within 1.25 to 3.5 years**	CZK 50 million
B	**Bonds maturing within 3.5 to 6.5 years**	CZK 50 million
C	**Bonds maturing within 6.5 to 13.5 years**	CZK 40 million
D	**Bonds maturing within 13.5 years and more**	CZK 30 million[1]

[1] In case of ČR, 4,20 %, 36 issue, the minimum quoted nominal value was reduced to CZK 10 million.
Source: MoF

However, the quoted prices must be within the competitive spread, which is set on a daily basis for each government bond subject to quoting obligations as the weighted average of the quoted spreads of all primary dealers multiplied by the coefficient of k = 1.5. This method and the quantitative criteria were set up following mutual discussion in the MTS Czech Republic Committee, and the respective calculations are available to all participants in the system. The evaluation of the performance and activity of participants takes place on a monthly basis.

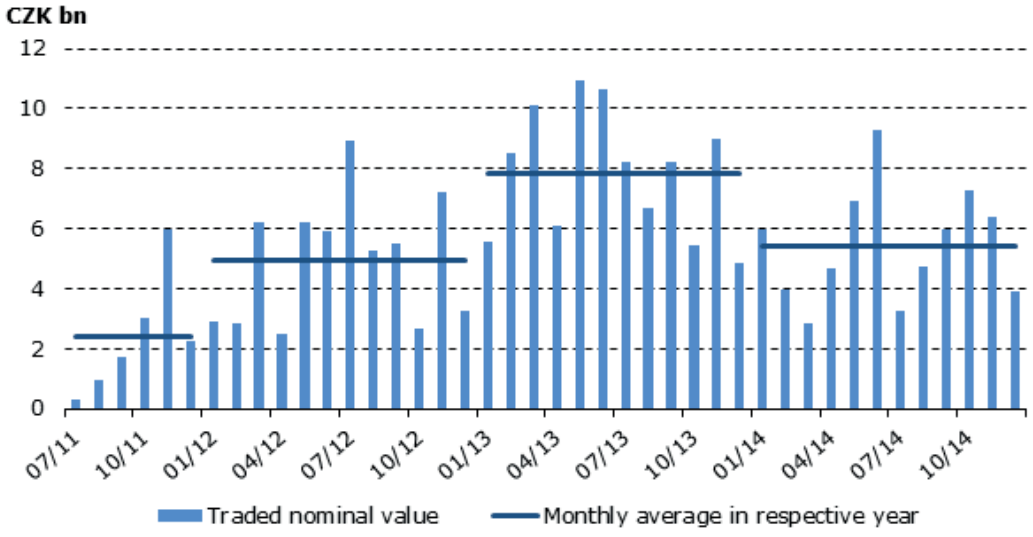
Figure 57: Average Daily Compliance Ratio on MTS Czech Republic



Source: EuroMTS and MoF

Following a growth of the traded volume of CZK-denominated government bonds in 2013 on the domestic secondary market carried out through the MTS Czech Republic electronic trading platform, there was an overall decrease of the traded nominal value from November 2013 to March 2014. From March 2014, the traded nominal value began to rise substantially, reaching its peak in June at CZK 9.275 billion. In 2014, the traded nominal value stabilised at an average monthly value of CZK 5.5 billion, which is a higher level than in 2012, but on average about CZK 2.4 billion lower than in 2013.

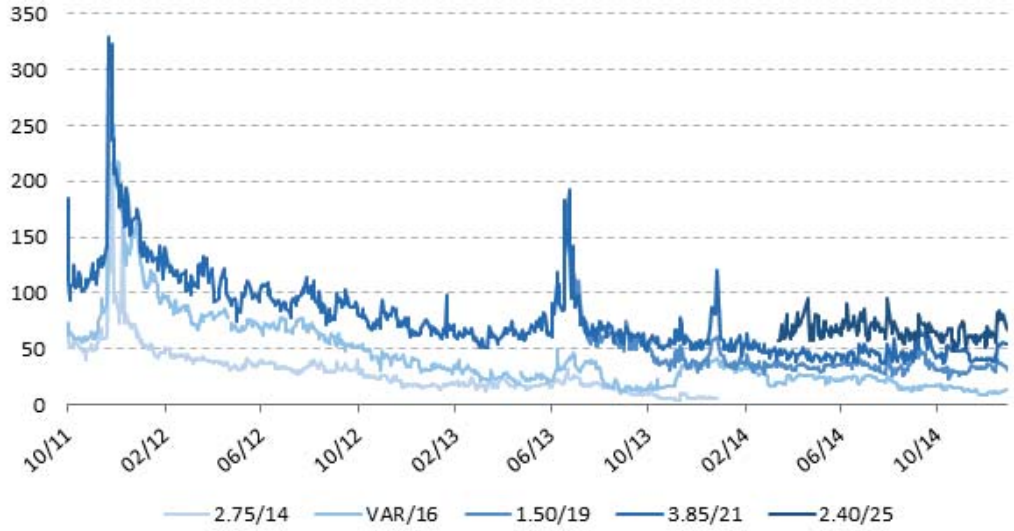
Figure 58: Traded Nominal Value on MTS Czech Republic



Note: The above-mentioned trades do not include trades of the Ministry on the secondary market.
Source: EuroMTS and MoF

The spread of the bid and offer prices went through an unstable period since May 2013, particularly as concerns higher maturity terms due to external influences. With decreasing uncertainty on financial markets, the prior stable trend was also restored in the quotation spread. Market stabilization and the gradual narrowing of price spreads were also supported by the fact that the mandatory bid-offer spread is built on a relative basis compared to the market average of all Primary Dealers. This enabled significant flexibility and adaptation to the continually changing and poorly predictable market environment as opposed to the fixed spreads.

Figure 59: Bid-Offer Spreads of Selected Bonds Quoted on MTS Czech Republic



Source: EuroMTS a MoF

The strategy in relation to the development of the secondary market via MTS Czech Republic primarily focuses on the flexible use of all available MTS Czech Republic electronic platform instruments and smooth running of the system. The Ministry views as very promising the developments related to the fulfilment of quoting obligations, particularly with regard to the significant expansion of the range of benchmark issues in 2013. Lending facilities, buy-backs and tap sales will continue to be the tools actively used by the Ministry for its direct participation on the secondary market in 2015.

Ministry's Operations on the Secondary Market

Since December 2011, the Ministry has been operating actively on the secondary market, primarily through the MTS Czech Republic platform. Buy-backs of government bonds before their maturity date and tap sales of government bonds from the Ministry's portfolio became an integral part of the planned issuance activity, contributing to the effective management of liquidity and refinancing risk and supporting the liquidity of the domestic bond market.

Tap sales and buy-backs will be performed flexibly based on the Ministry's needs. The Ministry selects the government bonds designated for tap sales based on consultation with the Primary Dealers from the government bonds held in the Ministry's own portfolio, with the exception of government bonds which are being sold in auction during that week, or in the week before or after this auction.

In order to ensure maximum transparency, the Ministry informs all Primary Dealers about the intention to conduct a buy-back or a tap sale on the secondary market at least one business day prior to the date on which the transaction is to occur. The Ministry will publish the result of the transactions (total nominal value of the transactions carried out within one buy-back or tap sale, number of transactions and weighted average price) on its website by the settlement date of the transactions.

As concerns the tactic for buy-backs, the Ministry will continue to use the method based on receiving the quoted offers from the side of Primary Dealers, so as to react flexibly to current market conditions particularly in relation to effective liquidity management. The algorithm for obtaining offers to sell bonds designated for buy-back is analogical with the current practice of tap sales, meaning using requests for quotes (RfQ), where the Primary Dealers are unaware of their respective bids. The Ministry sets a time limit during which the Primary Dealers send their bids for sale or purchase in case of tap sales. At the end of this period, the Ministry evaluates the received requests and either rejects them, responds with adjustments (both in terms of volume and price), or accepts them.

Table 31: Nominal Value of Ministry's Operations on the Secondary Market in 2014 (CZK billion)

	1Q	2Q	3Q	4Q	2014
Buy-backs	**0**	**0**	**2.22**	**9.06**	**11.28**
ČR 3,40 %, 15	0	0	1.56	6.79	8.35
ČR 3,80 %, 15	0	0	0.45	2.05	2.5
ČR 6,95 %, 16	0	0	0.21	0.22	0.43
Tap sales	**0**	**0**	**0.20**	**8.75**	**8.95**
ČR VAR %, 16	0	0	0.20	0.80	1.00
ČR 0,50 %, 16	0	0	0	2.40	2.40
ČR VAR %, 17	0	0	0	2.35	2.35
ČR 0,85 %, 18	0	0	0	0.45	0.45
ČR 1,50 %, 19	0	0	0	1.00	1.00
ČR VAR %, 27	0	0	0	1.75	1.75
Lending facilities	**11.81**	**22.03**	**28.18**	**22.55**	**84.57**
ČR 0,50 %, 16	0.27	0.57	3.01	0.80	4.65
ČR VAR %, 16	0.08	0.15	0.34	0.00	0.56
ČR VAR %, 17	0.00	0.35	0.45	0.00	0.79
ČR 4,00 %, 17	0.46	0.00	0.03	0.00	0.49
ČR 0,85 %, 18	0.00	0.93	0.46	0.56	1.95
ČR 4,60 %, 18	0.61	1.58	2.69	1.77	6.64
ČR 1,50 %, 19	0.00	0.11	0.20	4.07	4.38
ČR 5,00 %, 19	2.15	0.83	0.25	0.82	4.06
ČR 3,75 %, 20	0.00	0.00	0.20	0.00	0.20
ČR 3,85 %, 21	0.48	0.96	3.52	2.31	7.27
ČR 4,70 %, 22	0.00	0.18	0.31	0.32	0.80
ČR VAR %, 23	3.80	6.49	8.07	6.87	25.23
ČR 5,70 %, 24	3.97	6.75	4.00	4.18	18.90
ČR 2,40 %, 25	0.00	0.05	1.10	0.86	2.01
ČR VAR %, 27	0.00	0.74	1.52	0.00	2.26
ČR 2,50 %, 28	0.00	0.00	2.02	0.00	2.02
ČR 4,85 %, 57	0.00	2.35	0.03	0.00	2.38
Total	**11.82**	**22.03**	**30.60**	**40.36**	**104.81**

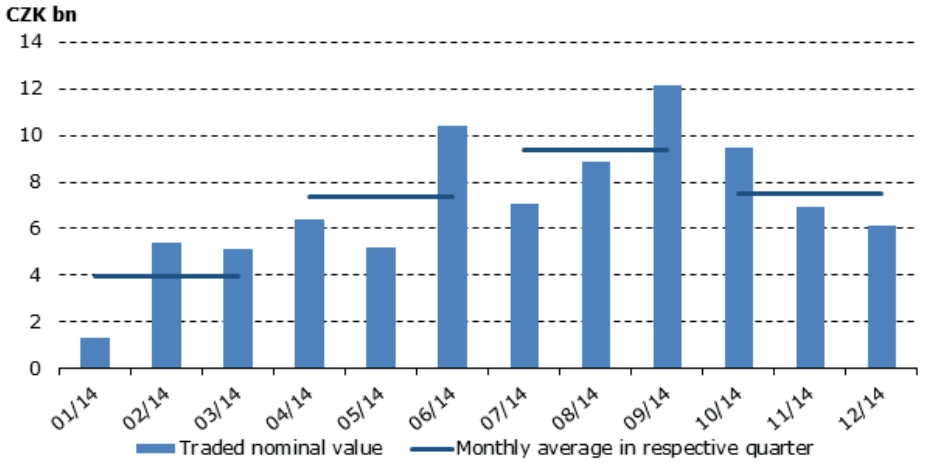
Note: Tap sales and buy-backs of medium-term and long-term government bonds include only operations carried out on the MTS Czech Republic platform and via Thomson Reuters Dealing 3000. Medium-term and long-term government bonds lending facilities are presented in the nominal value of collateral from the Ministry's own and investment portfolio.
Source: MoF

In the course of 2014, the Ministry based on an agreement with Primary Dealers commenced the buy-backs of Czech Republic Treasury Bond, 2005 - 2015, 3.80 % and Czech Republic Treasury Bond, 2010-2015, 3.40 %, the time to maturity of which is less than 1 year, and the buy-back of Czech Republic Treasury Bond, 2001-2016, 6.95 % which does not have benchmark status and is not mandatorily quoted by the Primary Dealers on the DETS. During the buy-back period, these medium-term and long-term government bonds which were bought back can be replaced with the tap sales of medium-term and long-term government bonds from the Ministry's own portfolio with benchmark status and with the same or longer time to maturity, so that these operations simultaneously contribute to achieving the stipulated objectives for the management of refinancing risk of the debt portfolio. In 2014, the Ministry also continued the extensive realisation of the short-term lending facility of medium- and long-term government bonds for Primary Dealers. In September, the total volume of the lending facility expressed as the nominal value of provided collateral reached CZK

12.2 billion. Lending facilities are available in the form of repo operations, where the primary dealer may borrow a government bond for up to 90 days while providing the Ministry with CZK liquidity. The average repo rate within operations in 2014 was around -0.03% p.a.

Interest in the short-term lending facility in 2014 was high despite the long-term declines in yields from government bonds and the volatility on financial markets. The total size of received financial sources from short-term lending facilities in 2014 compared to 2013 increased by CZK 71.9 billion. From the side of primary dealers, the short-term lending facility allows the Ministry to cover their short positions and thus contribute to the smooth fulfilment of quoting obligations and liquidity of government bonds even at times of fluctuations on financial markets. The difference between the nominal value of trades on the MTS Czech Republic electronic trading platform and demand of primary dealers for government bonds may thus be filled through short-term lending facilities. Lending facilities thus form an important alternative for obtaining government bonds in the case of worsened conditions on the secondary market, thus enabling stabilisation of the market spread of quoted bonds, which is directly reflected in a reduction of the illiquidity premium.

Figure 60: Nominal Value of Realised Lending Facilities in 2014



Note: The medium-term and long-term government bonds lending facilities are stated in the nominal value of collateral from the Ministry's own portfolio and investment portfolio
Source: MoF

Although the primary goal of these operations is to increase the liquidity of government bonds on secondary market, especially in case of the short-term excess of demand over the supply of the particular bond, due to the very low repo rates, the Ministry considers these operations as a preferred source in the segment of short-term financing, which has presently become an integral part of the short-term financing. These operations thereby also contribute to savings on net interest costs on the state debt. The obtained financial resources are invested for higher yields on the money market within state treasury liquidity management, which leads to an increase in yields from the Ministry's investment activity. In 2014, the contribution to the total investment revenue amounted CZK 2.2 million.

Regarding the providing of lending facilities, the Ministry actively manages the balance of government bonds in its own portfolio with respect to the demand of Primary Dealers. In 2014, the largest part of lending facilities was comprised of Czech Republic Treasury Bond, 2011-2023, VAR %, Czech Republic Treasury Bond, 2009-2024, 5.70 %, Czech Republic Treasury Bond, 2010-2021, 3.85 % and Czech Republic Treasury Bond, 2003 - 2018, 4.60 %. For other bonds, the demand was evenly distributed along the entire yield curve.

Appendix I

Evaluation Methodology for Primary Dealers

As part of criterion A Evaluation of activities on the primary market, the share of the particular primary dealer in the primary market of government bonds, meaning the share of accepted bids at auctions of government bonds for the evaluated period, is monitored. Using the ratio of the accepted bids to the total nominal value of the submitted bids, the Ministry monitors the willingness of investors to hold medium-term and long-term government bonds. The important aspects of evaluating participation on the primary market include the auction pricing strategy, in which the Ministry evaluates the willingness of primary dealers to pay the highest price weighted by the nominal value of a government bond auction. In another sub-category, a Primary Dealer is evaluated with more points should that dealer be a regular participant at auctions, regardless of the evaluation period. The maximum number of points in the final sub-category is received by the Primary Dealer who subscribes the largest share of state treasury bills sold by the Ministry during the particular period.

The quantitative evaluation within criterion B Secondary market and liquidity operations, which is primarily based on available statistics and the monitoring tools of the MTS Czech Republic platform, focuses on quotation activity, its quality, traded volumes and transactions with the Ministry. The evaluation of the fulfilment of the quoting obligations also forms the subject of the first sub-criterion. The quality of quotation activity is understood as an evaluation of the average quoted spread weighed by time and total nominal value, which is further taken into account in the time to maturity of the given bond. Similarly also in relation to other sub-criteria, the traded volumes are weighted based on the time to maturity of the bond. For the next sub-criterion, Primary Dealer is evaluated based on the ratio of the total nominal value of the transactions carried out (type of repo operation, buy/sell back operation, depo operation, MLB lending facilities, tap sale of government bonds on the secondary market or buy-backs and exchanges of government bonds before their maturity date) to the total nominal value of transactions carried out for the evaluated period.

The fifth sub-criterion, added in 2013, evaluates the willingness of a Primary Dealer to pay the highest price or obtain the lowest price weighted by the nominal value and duration within tap sales, buy-backs of government bonds or exchanges of government bonds on the secondary market.

The qualitative evaluation under criterion C focuses on derivative operations, marketing, consulting and credibility. The Primary Dealers are evaluated in ascending order depending on the prices they provide for various derivative instruments. The Ministry further evaluates the quality of consulting activities, cooperation and sharing of information, human and technical resources related to risk management and optimization of the debt portfolio. Sub-criterion C.2 also includes an evaluation of analytical output and economic analyses, which primary dealers may send to a specially created e-mail box of the Ministry.

Table 32: Criteria for Evaluation of Primary Dealers valid as of 1 January 2015

A. Primary market	45 p	B. Secondary market and market operations	40 p	C. Qualitative criterion	15 p
A.1. Share on the primary MLB market	25 p	B.1. Quoting obligations on DETS	9 p	C.1. Derivative operations	8 p
A.2. Dependability of auction demand	5 p	B.2. Qualitative of quoting performance on DETS	9 p	C.2. Marketing, consultancy and credibility	7 p
A.3. Auction pricing strategy	5 p	B.3. Traded Volume on DETS	9 p		
A.4. Regularity of auction participation	2,5 p	B.4. Ministry of Finance's operations on the secondary market and liquidity operations	9 p		
A.5. Share on the primary STB market	7,5 p	B.5. Pricing strategy for tap sales, buy-backs and exchanges	4 p		

Source: MoF

Appendix II

Table 33: State Debt and Liquid State Financial Assets Parameters

	31/12/2013	31/03/2014	30/06/2014	30/09/2014	31/12/2014
Total state debt(CZK billion)	**1,683.3**	**1,683.4**	**1,683.3**	**1,683.0**	**1,663.7**
Market value (CZK billion)[1]	1,863.3	1,886.1	1,903.9	1,911.1	1,925.0
Short-term state debt (%)	15.8	12.1	12.7	16.1	14.9
Medium-term state debt (%)	53.6	50.5	53.8	53.6	55.7
State treasury bills (%)	7.2	5.8	5.8	5.4	6.5
Other money market instruments (%)	0.0	0.2	0.7	0.7	0.2
Average time to maturity (years)	5.6	5.7	5.7	5.5	5.5
Interest rate re-fixing up to one year (%)	35.4	31.8	32.8	36.4	35.5
Average time to re-fixing (years)	4.3	4.5	4.5	4.3	4.2
Variable-rate state debt (%)	16.8	17.1	17.8	18.0	18.7
Modified duration (years)	4.0	4.1	4.2	4.1	4.1
Net foreign currency exposure of the state debt (%)	9.4	9.6	10.0	10.1	10.4
Foreign currency state debt (%)	19.0	19.0	16.6	16.6	14.5
Share of € on net foreign currency exposure of the state debt (%)	89.4	89.4	89.8	89.8	90.1
Non-marketable state debt (%)[2]	4.2	4.2	4.0	3.8	3.6
Retail state debt (%)	5.2	5.2	4.8	4.8	4.7
Marketable debt (CZK billion)	**1,524.2**	**1,525.6**	**1,535.7**	**1,538.4**	**1525.4**
Market value (CZK billion)[1]	1,696.2	1,720.0	1,747.4	1,757.7	1778.3
Short-term state debt (%)	16.6	12.4	13.6	17.2	15.3
Medium-term state debt (%)	52.7	49.3	52.9	52.6	54.8
State treasury bills (%)	7.9	6.4	6.4	5.9	7.1
Other money market instruments (%)	0.0	0.2	0.8	0.8	0.2
Average time to maturity (years)	5.5	5.6	5.7	5.5	5.4
Interest rate re-fixing up to one year (%)	33.7	29.7	31.4	35.4	33.9
Average time to re-fixing (years)	4.6	4.7	4.8	4.5	4.5
Variable-rate state debt (%)	13.9	14.2	15.1	15.5	16.4
Modified duration (years)	4.1	4.3	4.5	4.3	4.3
Net foreign currency exposure of the state debt (%)	10.4	10.6	11.0	11.0	11.4
Foreign currency state debt (%)	21.0	21.0	18.2	18.2	15.8
Share of € on net foreign currency exposure of the state debt (%)	89.4	89.4	89.8	89.8	90.1
Investment portfolios	**43.3**	**43.7**	**44.6**	**45.0**	**45.4**
Share of assets up to one year on total state debt (%)	1.7	1.7	2.0	2.2	2.2
Average yield (%)	1.3	1.3	1.3	1.2	1.2
Average time to maturity (years)	1.4	1.3	1.2	1.1	1.0
Modified duration (years)	1.1	0.9	0.9	0.8	0.8

[1] Incl. derivatives
[2] Excl. retail state debt.
Source: MoF

Table 34: Issued CZK–Denominated Medium-Term and Long-Term Government Bonds at the End of 2014

Bond	Issue no.	ISIN	Maturity date	Nominal value outstanding	Nominal value in own portfolio
ČR, 3,80 %, 15	44	CZ0001001143	11/4/2015	56,354,000,000	0
ČR, 3,40 %, 15	60	CZ0001002737	1/9/2015	56,659,000,000	0
ČR, 6,95 %, 16	34	CZ0001000749	26/1/2016	34,573,000,000	0
ČR, 0,50 %, 16	77	CZ0001003842	28/7/2016	28,000,000,000	0
ČR, VAR %, 16	55	CZ0001002331	27/10/2016	80,000,000,000	0
ČR, 4,00 %, 17	51	CZ0001001903	11/4/2017	94,000,000,000	0
ČR, VAR %, 17	67	CZ0001003438	23/7/2017	50,000,000,000	0
ČR, 0,85 %, 18	88	CZ0001004246	17/3/2018	24,978,890,000	550,000,000
ČR, 4,60 %, 18	41	CZ0001000822	18/8/2018	74,000,000,000	1,000,000,000
ČR, 5,00 %, 19	56	CZ0001002471	11/4/2019	89,100,000,000	0
ČR, 1,50 %, 19	76	CZ0001003834	29/10/2019	60,937,610,000	2,000,000,000
ČR, 3,75 %, 20	46	CZ0001001317	12/9/2020	71,850,000,000	3,150,000,000
ČR, VAR %, 20	91	CZ0001004113	9/12/2020	12,012,560,000	0
ČR, 3,85 %, 21	61	CZ0001002851	29/9/2021	75,635,000,000	2,000,000,000
ČR, 4,70 %, 22	52	CZ0001001945	12/9/2022	75,116,740,000	2,000,000,000
ČR, VAR %, 23	63	CZ0001003123	18/4/2023	82,107,870,000	4,892,130,000
ČR, 5,70 %, 24	58	CZ0001002547	25/5/2024	89,000,000,000	1,000,000,000
ČR, 2,40 %, 25	89	CZ0001004253	17/9/2025	27,706,400,000	0
ČR, VAR %, 27	90	CZ0001004105	19/11/2027	18,077,010,000	1,250,000,000
ČR, 2,50 %, 28	78	CZ0001003859	25/8/2028	36,097,640,000	3,000,000,000
ČR, 4,20 %, 36	49	CZ0001001796	4/12/2036	28,428,970,000	1,417,620,000
ČR, 4,85 %, 57	53	CZ0001002059	26/11/2057	11,020,000,000	6,980,000,000
		Total		**1,175,654,690,000**	**29,239,750,000**

Source: MoF

Table 35: Issues of Medium-Term and Long-Term Government Bonds in 2014

Bond	Issue/ tranche no.		Auction date	Settlement date	Maturity date	Currency	Max. nominal value offered in the competitive part of auction	Total nominal value sold
CZGB 4.70/22	52	11	15/1	20/1	12/9/2022	CZK	6,000,000,000	6,702,210,000
CZGB 2.50/28	78	8	15/1	20/1	25/8/2028	CZK	4,000,000,000	4,490,470,000
CZGB 0.50/16	77	7	22/1	27/1	28/7/2016	CZK	5,000,000,000	5,599,750,000
CZGB VAR/23	63	20	22/1	27/1	18/4/2023	CZK	5,000,000,000	5,519,830,000
CZGB 3.85/21	61	15	29/1	3/2	29/9/2021	CZK	6,000,000,000	5,695,140,000
CZGB 4.20/36	49	6	29/1	3/2	4/12/2036	CZK	4,000,000,000	1,163,110,000
CZGB 1.50/19	76	11	12/2	17/2	29/10/2019	CZK	7,000,000,000	7,914,890,000
CZGB 4.70/22	52	12	12/2	17/2	12/9/2022	CZK	7,000,000,000	4,488,430,000
CZGB 3.85/21	61	16	26/2	3/3	29/9/2021	CZK	7,000,000,000	3,599,930,000
CZGB 2.50/28	78	9	26/2	3/3	25/8/2028	CZK	6,000,000,000	7,199,920,000
CZGB 0.85/18	88	1	12/3	17/3	17/3/2018	CZK	8,000,000,000	8,177,800,000
CZGB 2.40/25	89	1	12/3	17/3	17/9/2025	CZK	8,000,000,000	6,597,980,000
CZGB 0.85/18	88	2	9/4	14/4	17/3/2018	CZK	5,000,000,000	5,586,110,000
CZGB 2.50/28	78	10	9/4	14/4	25/8/2028	CZK	5,000,000,000	5,697,610,000
CZGB 1.50/19	76	12	23/4	28/4	29/10/2019	CZK	5,000,000,000	4,098,230,000
CZGB 2.40/25	89	2	23/4	28/4	17/9/2025	CZK	6,000,000,000	6,828,390,000
CZGB 4.20/36	49	7	23/4	28/4	4/12/2036	CZK	2,000,000,000	1,582,380,000
CZGB 0.85/18	88	3	14/5	19/5	17/3/2018	CZK	5,000,000,000	5,417,290,000
CZGB 2.40/25	89	3	14/5	19/5	17/9/2025	CZK	5,000,000,000	5,302,350,000
CZGB VAR/27	90	1	14/5	19/5	19/11/2027	CZK	5,000,000,000	5,377,550,000
CZGB VAR/20	91	1	4/6	9/6	9/12/2020	CZK	5,000,000,000	4,406,650,000
CZGB VAR/27	90	2	4/6	9/6	19/11/2027	CZK	5,000,000,000	5,438,270,000
CZGB 0.85/18	88	4	17/9	22/9	17/3/2018	CZK	5,000,000,000	5,347,690,000
CZGB VAR/27	90	3	17/9	22/9	19/11/2027	CZK	8,000,000,000	5,511,190,000
CZGB 2.40/25	89	4	8/10	13/10	17/9/2025	CZK	8,000,000,000	8,977,680,000
CZGB VAR/20	91	2	8/10	13/10	9/12/2020	CZK	8,000,000,000	7,605,910,000
			Total					**144,326,760,000**

Bond	Issue/ Tranche no.		Coupon	Average net price	Average yield to maturity (% p. a.)	Bid-to-cover ratio	Sold in the competitive part of the auction/ max. nominal value offered	Sold in the non-competitive part of the auction/ max. nominal value offered
CZGB 4.70/22	52	11	4.70%	119.31	2.219	2.31	100.0	11.7
CZGB 2.50/28	78	8	2.50%	93.18	3.087	2.39	100.0	12.3
CZGB 0.50/16	77	7	0.50%	100.3	0.379	3.6	100.0	12.0
CZGB VAR/23	63	20	VAR %	104.73	13.0481[1]	2.02	100.0	10.4
CZGB 3.85/21	61	15	3.85%	113.39	1.949	1.9	83.3	11.6
CZGB 4.20/36	49	6	4.20%	112.75	3.389	1.72	26.5	2.6
CZGB 1.50/19	76	11	1.50%	100.21	1.461	1.36	100.0	13.1
CZGB 4.70/22	52	12	4.70%	120.46	2.069	2.14	56.1	8.0
CZGB 3.85/21	61	16	3.85%	113.53	1.912	4.14	42.9	8.6
CZGB 2.50/28	78	9	2.50%	94.89	2.938	2.13	100.0	20.0
CZGB 0.85/18	88	1	0.85%	100.04	0.84	1.52	100.0	2.2
CZGB 2.40/25	89	1	2.40%	99.37	2.461	1.76	75.1	7.4
CZGB 0.85/18	88	2	0.85%	100.48	0.725	2.24	100.0	11.72
CZGB 2.50/28	78	10	2.50%	97.57	2.706	2.04	100.0	13.95
CZGB 1.50/19	76	12	1.50%	101.91	1.140	2.37	71.42	10.54
CZGB 2.40/25	89	2	2.40%	101.76	2.221	1.46	100.0	13.81
CZGB 4.20/36	49	7	4.20%	116.09	3.189	1.68	69.50	9.62
CZGB 0.85/18	88	3	0.85%	101.46	0.464	1.74	100.0	8.35
CZGB 2.40/25	89	3	2.40%	104.80	1.922	1.55	100.0	6.05
CZGB VAR/27	90	1	VAR%	97.55	7.815[1]	2.24	100.0	7.55
CZGB VAR/20	91	1	VAR%	98.65	-9.294[1]	1.13	81.0	7.13
CZGB VAR/27	90	2	VAR%	97.60	8.2931	1.75	100.0	8.77
CZGB 0.85/18	88	4	0.85%	102.21	0.212	3.66	100.0	7.0
CZGB VAR/27	90	3	VAR%	99.15	-3.430[1]	2.77	62.50	6.39
CZGB 2.40/25	89	4	2.40%	111.00	1.312	2.11	100.0	12.22
CZGB VAR/20	91	2	VAR%	99.43	-20.786[1]	1.31	87.63	7.45
			Average				86.68	**9.54**

[1] Average spread to PRIBOR in basis points
Source: MoF

Table 36: Issues of State Treasury Bills in 2014

Issue no.	Maturity (months)	Auction date	Issue date	Maturity date	Offered nominal value	Placed nominal value	Yield (% p. a.)
688	9	16/1	17/1	17/10/2014	8,000,000,000	7,257,000,000	0.07
689	12	30/1	31/1	30/1/2015	8,000,000,000	7,753,000,000	0.09
690	12	13/3	14/3	13/3/2015	7,000,000,000	6,730,000,000	0.08
691	9	17/4	18/4	16/1/2015	6,000,000,000 to 8,000,000,000	6,455,000,000	0.07
692	12	15/5	16/5	15/5/2015	7,000,000,000 to 9,000,000,000	8,285,000,000	0.07
693	9	22/5	23/5	20/2/2015	7,000,000,000 to 9,000,000,000	8,028,000,000	0.07
694	12	12/6	13/6	12/6/2015	7,000,000,000 to 9,000,000,000	7,335,000,000	0.08
695	9	26/6	27/6	27/3/2015	7,000,000,000 to 9,000,000,000	9,000,000,000	0.07
696	12	10/7	11/7	10/7/2015	6,000,000,000 to 8,000,000,000	6,413,000,000	0.08
697	9	27/7	25/7	24/4/2015	6,000,000,000 to 8,000,000,000	5,583,000,000	0.07
698	12	4/9	5/9	4/9/2015	4,000,000,000 to 6,000,000,000	6,000,000,000	0.07
699	9	25/9	26/9	26/6/2015	4,000,000,000 to 6,000,000,000	4,000,000,000	0.06
700	9	2/10	3/10	3/7/2015	5,000,000,000 to 8,000,000,000	6,460,000,000	0.06
701	12	16/10	17/10	16/10/2015	5,000,000,000 to 8,000,000,000	8,000,000,000	0.07
702	12	30/10	31/10	30/10/2015	5,000,000,000 to 8,000,000,000	5,785,000,000	0.07
703	9	13/11	14/11	14/8/2015	5,000,000,000 to 8,000,000,000	3,800,000,000	0.08
704	12	4/12	5/12	4/12/2015	5,000,000,000 to 8,000,000,000	8,000,000,0000	0.09
		Total			**102,000,000,000 to 135,000,000,000**	**114,884,000,000**	**0.07[1]**

[1] Average weighted yield to maturity of state treasury bills issued in 2014.
Source: MoF

Table 37: Issues of Savings Government Bonds in 2014

Bond	Issue no.	Settlement date	Maturity date	Original maturity (years)	Nominal value
Inflation-linked savings bond	87	12/6	12/12/2020	7.0	672,777,263
Reinvestment savings bond	92	12/6	12/6/2019	5.0	745,834,604
Variable-rate savings bond	93	12/6	12/12/2020	6.5	32,566,811
Premium savings bond[1]	80	12/6	12/6/2016	3.0	32,016,053
Reinvestment savings bond[1]	69	12/6	12/6/2017	5.0	107,529,532
Reinvestment savings bond[1]	82	12/6	12/6/2018	5.0	25,206,805
Inflation-linked savings bond[1]	70	12/6	12/6/2019	7.0	11,900,630
Inflation-linked savings bond[1]	83	12/6	12/6/2020	7.0	2,817,890
Reinvestment savings bond[1]	66	11/11	11/11/2016	5.0	270,844,948
Inflation-linked savings bond[1]	70	12/12	12/6/2019	7.0	3,332,975
Reinvestment savings bond[1]	75	12/12	12/12/2017	5.0	148,164,809
Inflation-linked savings bond1	83	12/12	12/6/2020	7.0	1,379,989
Premium savings bond	84	12/12	12/12/2016	3.0	46,981,159
Reinvestment savings bond[1]	86	12/12	12/12/2018	5.0	32,245,646
Inflation-linked savings bond[1]	87	12/12	12/12/2020	7.0	11,248,784
Variable-rate savings bond[1]	93	12/12	12/12/2020	6.5	21,338
		Total			**2,144,869,236**

[1] Incl. tranches issued in the form of reinvestment of yields
Source: MoF

Table 38: Realized Lending Facilities in 2014

Bond	ISIN	Collateral amount	Financial resources received	Financial resources paid
CZGB 0.50/16	CZ0001003842	4,654,000,000	4,687,717,944.44	4,687,613,522.89
CZGB VAR/16	CZ0001002331	560,000,000	562,833,555.56	562,823,202.67
CZGB VAR/17	CZ0001003438	794,000,000	821,244,435.83	821,243,288.51
CZGB 4.00/17	CZ0001001903	485,000,000	551,288,194.44	551,281,438.02
CZGB 0.85/18	CZ0001004246	1,953,000,000	1,991,281,109.60	1,991,231,946.74
CZGB 4.60/18	CZ0001000822	6,642,000,000	7,856,467,894.44	7,856,299,685.74
CZGB 1.50/19	CZ0001003834	4,380,000,000	4,648,863,750.00	4,648,775,979.96
CZGB 5.00/19[1]	CZ0001002471	4,056,000,000	4,966,020,583.32	4,965,911,199.88
CZGB 3.75/20	CZ0001001317	200,000,000	235,408,333.33	235,402,497.25
CZGB 3.85/21	CZ0001002851	7,269,000,000	8,844,121,887.47	8,843,938,289.51
CZGB 4.70/22	CZ0001001945	800,000,000	1,045,099,833.33	1,045,073,715.61
CZGB VAR/23	CZ0001003123	25,226,380,000	26,915,247,339.98	26,914,312,744.65
CZGB 5.70/24[1]	CZ0001002547	18,896,000,000	26,422,170,508.34	26,421,674,226.15
CZGB 2.40/25	CZ0001004253	2,006,000,000	2,237,778,454.80	2,237,733,857.46
CZGB VAR/27	CZ0001004105	2,257,730,000	2,221,087,248.92	2,221,032,756.89
CZGB 2.50/28	CZ0001003859	2,017,590,000	2,204,086,984.61	2,204,086,984.61
CZGB 4.85/57	CZ0001002059	2,375,000,000	3,117,356,909.73	3,117,352,406.52
TOTAL		**84,571,700,000**	**99,328,074,968.14**	**99,325,787,743.06**

[1] Collateral used from the Ministry´s portfolio and investment nuclear portfolio.
Source: MoF

Table 39: Buy-backs in 2014

Bond	Issue no.	Transaction date	Settlement date	Maturity date	Original maturity (years)	Average price	Nominal value
CZGB 3.80/15	44	10/9/2014	15/9/2014	11/4/2015	10.0	102.146	350,000,000
CZGB 6.95/16	34	12/9/2014	17/9/2014	26/1/2016	15.0	109.37	50,000,000
CZGB 3.40/15	60	12/9/2014	17/9/2014	1/9/2015	5.0	103.203	500,000,000
CZGB 3.80/15	44	16/9/2014	19/9/2014	11/4/2015	10.0	102.105	100,000,000
CZGB 3.40/15	60	19/9/2014	24/9/2014	1/9/2015	5.0	103.139	55,000,000
CZGB 6.95/16	34	19/9/2014	24/9/2014	26/1/2016	15.0	109.23	162,000,000
CZGB 3.40/15	60	23/9/2014	26/9/2014	1/9/2015	5.0	103.119	1,000,000,000
CZGB 3.40/15	60	3/10/2014	8/10/2014	1/9/2015	5.0	103.008	1,500,000,000
CZGB 3.40/15	60	6/10/2014	8/10/2014	1/9/2015	5.0	103.007	326,000,000
CZGB 3.80/15	44	7/10/2014	9/10/2014	11/4/2015	10.0	101.897	136,000,000
CZGB 3.40/15	60	10/10/2014	14/10/2014	1/9/2015	5.0	102.952	160,000,000
CZGB 6.95/16	34	10/10/2014	14/10/2014	26/1/2016	15.0	108.855	110,000,000
CZGB 3.40/15	60	14/10/2014	16/10/2014	1/9/2015	5.0	102.933	1,000,000,000
CZGB 3.80/15	44	17/10/2014	21/10/2014	11/4/2015	10.0	101.772	950,000,000
CZGB 3.40/15	60	20/10/2014	22/10/2014	1/9/2015	5.0	102.877	1,300,000,000
CZGB 3.80/15	44	23/10/2014	27/10/2014	11/4/2015	10.0	101.709	195,000,000
CZGB 3.80/15	44	24/10/2014	29/10/2014	11/4/2015	10.0	101.688	250,000,000
CZGB 3.80/15	44	31/10/2014	4/11/2014	11/4/2015	10.0	101.636	500,000,000
CZGB 3.40/15	60	31/10/2014	4/11/2014	1/9/2015	5.0	102.766	1,000,000,000
CZGB 3.40/15	60	8/12/2014	10/12/2014	1/9/2015	5.0	102.430	1,400,000,000
CZGB 3.40/15	60	10/12/2014	12/12/2014	1/9/2015	5.0	102.412	100,000,000
CZGB 6.95/16	34	11/12/2014	15/12/2014	26/1/2016	15.0	107.686	100,000,000
CZGB 3.80/15	44	15/12/2014	17/12/2014	11/4/2015	10.0	101.188	23,000,000
CZGB 6.95/16	34	15/12/2014	17/12/2014	26/1/2016	15.0	107.648	5,000,000
			TOTAL				**11,272,000,000**

Note: Buy-Backs include only operations carried out through MTS Czech Republic and Thomson Reuters Dealing 3000.
Source: MoF

Table 40: Tap Sales of Government Bonds in 2014

Bond	Issue no.	Transaction date	Settlement date	Maturity date	Original maturity (years)	Average price	Nominal value
CZBG VAR/16	55	23/9/2014	26/9/2014	27/10/2016	8.0	100.56	100,000,000
CZBG VAR/16	55	25/9/2014	30/9/2014	27/10/2016	8.0	100.51	100,000,000
CZBG VAR/16	55	4/11/2014	6/11/2014	27/10/2016	8.0	100.55	200,000,000
CZBG VAR/16	55	5/11/2014	7/11/2014	27/10/2016	8.0	100.536	100,000,000
CZBG VAR/17	67	6/11/2014	10/11/2014	23/7/2017	5.5	103.1	100,000,000
CZBG 0.50/16	77	6/11/2014	10/11/2014	28/7/2016	3.5	100.705	200,000,000
CZBG VAR/16	55	7/11/2014	11/11/2014	27/10/2016	8.0	100.535	400,000,000
CZBG 0.50/16	77	10/11/2014	12/11/2014	28/7/2016	3.5	100.702	300,000,000
CZBG VAR/16	55	11/11/2014	13/11/2014	27/10/2016	8.0	100.509	100,000,000
CZBG VAR/27	90	14/11/2014	19/11/2014	19/11/2027	13.5	99.53	600,000,000
CZBG VAR/17	67	18/11/2014	20/11/2014	23/7/2017	5.5	103.011	400,000,000
CZBG VAR/27	90	18/11/2014	20/11/2014	19/11/2027	13.5	99.52	200,000,000
CZBG VAR/17	67	20/11/2014	24/11/2014	23/7/2017	5.5	103.005	400,000,000
CZBG 0.50/16	77	20/11/2014	24/11/2014	28/7/2016	3.5	100.641	150,000,000
CZBG 0.50/16	77	21/11/2014	25/11/2014	28/7/2016	3.5	100.64	200,000,000
CZBG VAR/17	67	21/11/2014	25/11/2014	23/7/2017	5.5	103.01	300,000,000
CZBG VAR/27	90	21/11/2014	25/11/2014	19/11/2027	13.5	99.47	400,000,000
CZBG 0.50/16	77	24/11/2014	26/11/2014	28/7/2016	3.5	100.636	150,000,000
CZBG VAR/17	67	24/11/2014	26/11/2014	23/7/2017	5.5	102.951	650,000,000
CZBG VAR/17	67	25/11/2014	27/11/2014	23/7/2017	5.5	102.965	500,000,000
CZBG VAR/27	90	26/11/2014	28/11/2014	19/11/2027	13.5	99.5	50,000,000
CZBG 0.50/16	77	26/11/2014	28/11/2014	28/7/2016	3.5	100.65	500,000,000
CZBG VAR/27	90	27/11/2014	1/12/2014	19/11/2027	13.5	99.46	300,000,000
CZBG VAR/27	90	28/11/2014	2/12/2014	19/11/2027	13.5	99.46	200,000,000
CZBG 0.50/16	77	28/11/2014	2/12/2014	28/7/2016	3.5	100.631	100,000,000
CZBG 0.50/16	77	1/12/2014	3/12/2014	28/7/2016	3.5	100.621	500,000,000
CZBG 0.50/16	77	2/12/2014	4/12/2014	28/7/2016	3.5	100.626	301,290,000
CZBG 0.85/18	88	8/12/2014	10/12/2014	17/3/2018	4.0	102.195	400,000,000
CZBG 0.85/18	88	9/12/2014	11/12/2014	17/3/2018	4.0	102.2	50,000,000
CZBG 1.50/19	76	10/12/2014	12/12/2014	29/10/2019	6.8	106.32	500,000,000
CZBG 1.50/19	76	11/12/2014	15/12/2014	29/10/2019	6.8	106.23	500,000,000
			TOTAL				**8,951,290,000**

Note: Tap sales include only operations carried out through MTS Czech Republic and Thomson Reuters Dealing 3000
Source: MoF

Key Information 2014

- YoY state debt decrease: CZK 19.7 billion
- Financing needs: CZK 365.3 billion
- Gross borrowing requirement: CZK 265.6 billion
- Gross issue of medium-term and long-term government bonds on domestic market: CZK 153.3 billion
- Gross issue of medium-term and long-term government bonds on foreign markets: CZK 0.0
- Gross issue of state treasury bills incl. roll-over: CZK 114.9 billion
- Gross issue of savings government bonds: CZK 2.1 billion
- Medium-term and long-term government bonds and savings government bonds redemptions: CZK 57.9 billion
- Foreign-currency medium-term and long-term government bonds redemptions: EUR 3.0 billion
- YoY decrease of net cash expenditure on state debt service: CZK 2.4 billion
- Average weighted time to maturity of CZK-denominated medium-term and long-term government bonds sold in primary auctions: 9.1 years
- Average time to maturity of state debt: 5.5 years
- Short-term state debt: 14.9%
- Average time to re-fixing of state debt: 4.2 years
- Interest re-fixing of the debt portfolio within 1 year: 35.5%

Contacts

Debt and Financial Assets Management Department

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www.mfcr.cz/statedebt

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