Public Debt Management Strategy in the years 2011-2014

(summary)

Ministry of Finance

September 2010

Macroeconomic assumptions

Item	2009	2010	2011	2012	2013	2014
Real GDP growth (%)	101.7	103.0	103.5	104.8	104.1	104.0
GDP in current prices (PLN bn)	1 343.7	1 412.1	1 496.3	1 608.9	1 716.8	1 829.5
CPI annual average (%)	103.5	102.0	102.3	102.5	102.5	102.5
PLN/USD - annual average	3.1	2.9	2.9	2.8	2.7	2.7
PLN/EUR - annual average	4.3	3.9	3.7	3.6	3.5	3.5

Objective of the Strategy

- ***Objective of the Strategy maintained***

<u>**minimisation of the long term debt servicing costs subject to constraints on the level of**</u>**:**

- refinancing risk
- exchange rate risk
- interest rate risk
- State budget liquidity risk
- other risks, in particular credit risk and operational risk
- distribution of debt servicing costs over time

- ***Two aspects of the Strategy's objective:***
  - Choice of instruments
  - Efficiency of the TS market

Flexible approach to the financing structure

DOMESTIC FINANCING

– main source of financing the borrowing requirements of the budget

FOREIGN FINANCING

– ensuring diversification of sources by Poland's access to the investor base in major financial markets

– taking into account the foreign currency borrowing requirements, including principal and interest payments on foreign debt

– strengthening Poland's position in the euro market – deemed strategic due to the perspective of full integration under the EMU

– utilising an access to attractive financing in international financial institutions

– stabilising the domestic market by ensuring safety of financing the State budget borrowing requirements in case of temporary disruptions on the domestic market

– possible buy and sale of foreign currencies in the NBP as an available instrument of managing foreign currency borrowing requirements and utilising foreign currencies to finance borrowing requirements in PLN, while taking into account considerations of monetary policy and financial rationale

Risk constraints of the Strategy's objective: refinancing risk (1)

DOMESTIC DEBT

– aiming at increasing the role of medium- and long-term instruments in financing the State budget borrowing requirements – at a pace dependent on investors' demand

– aiming at even distribution of redemptions and interest payments of domestic and foreign debt

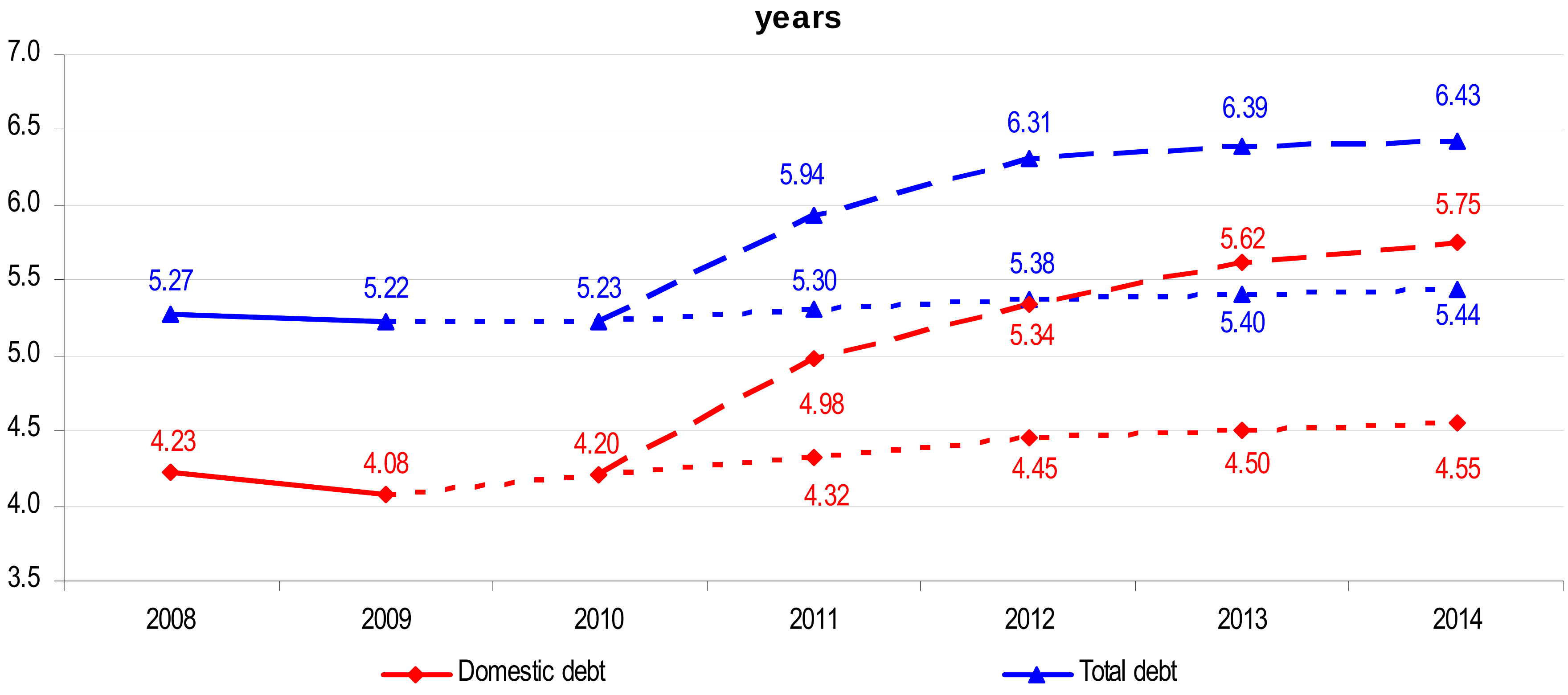
– average term to maturity (ATM) reaching ≥ 4.5 years

FOREIGN DEBT

– current level of foreign debt refinancing risk does not restrain cost minimisation objective, ATM at 8.3 in mid 2010

Risk constraints of the Strategy's objective: refinancing risk (2)

ATM of the State Treasury debt



Risk constraints of the Strategy’s objective: exchange rate risk (1)

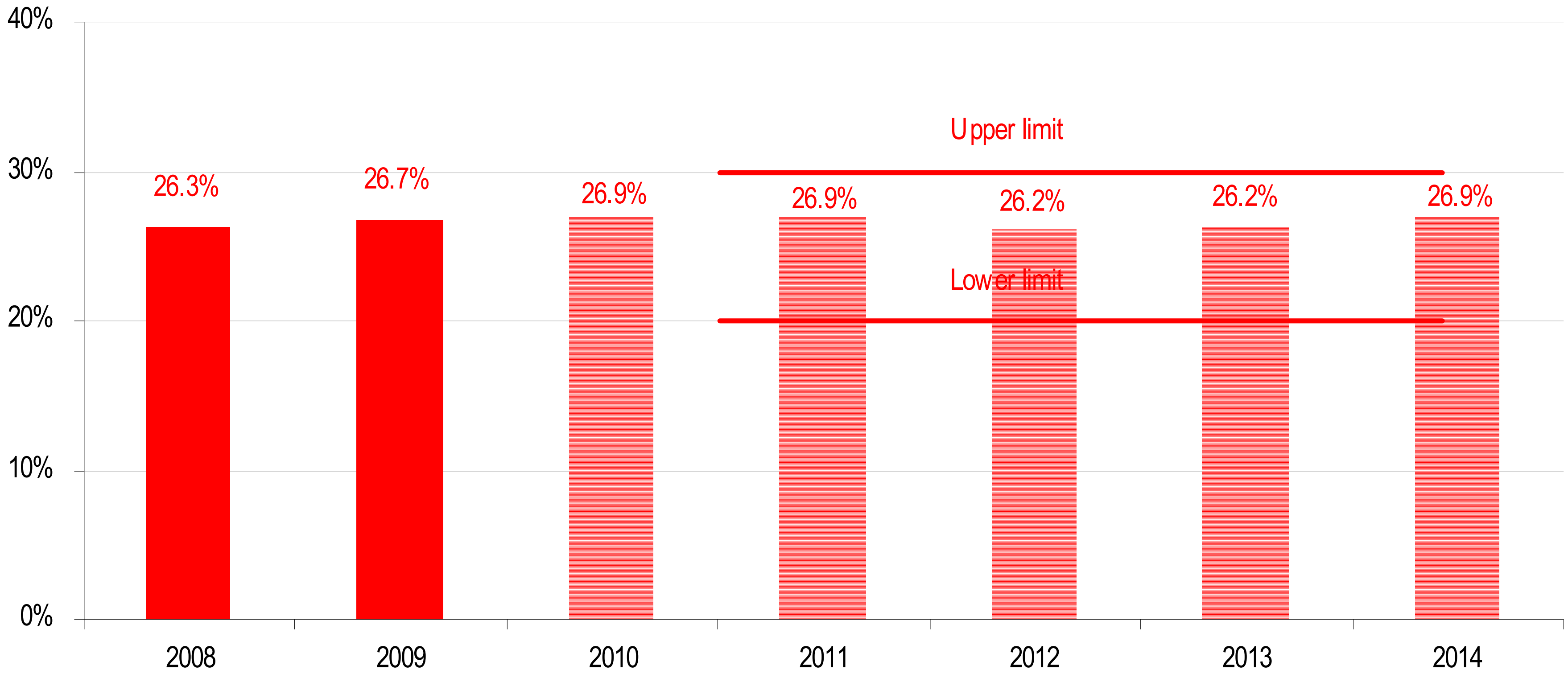
– maintaining the acceptable share of foreign currency debt in total debt to the range of 20-30%, in connection with high volatility of exchange rates and flexible approach to choosing markets

– maintaining an effective share of the euro in foreign currency debt at ≥ 70%

– possible use of derivatives

Risk constraints of the Strategy's objective: exchange rate risk (2)

Share of foreign debt in the State Treasury debt



Risk constraints of the Strategy's objective: interest rate risk (1)

DOMESTIC DEBT

– maintaining duration in the range of 2.5 – 4.0 years

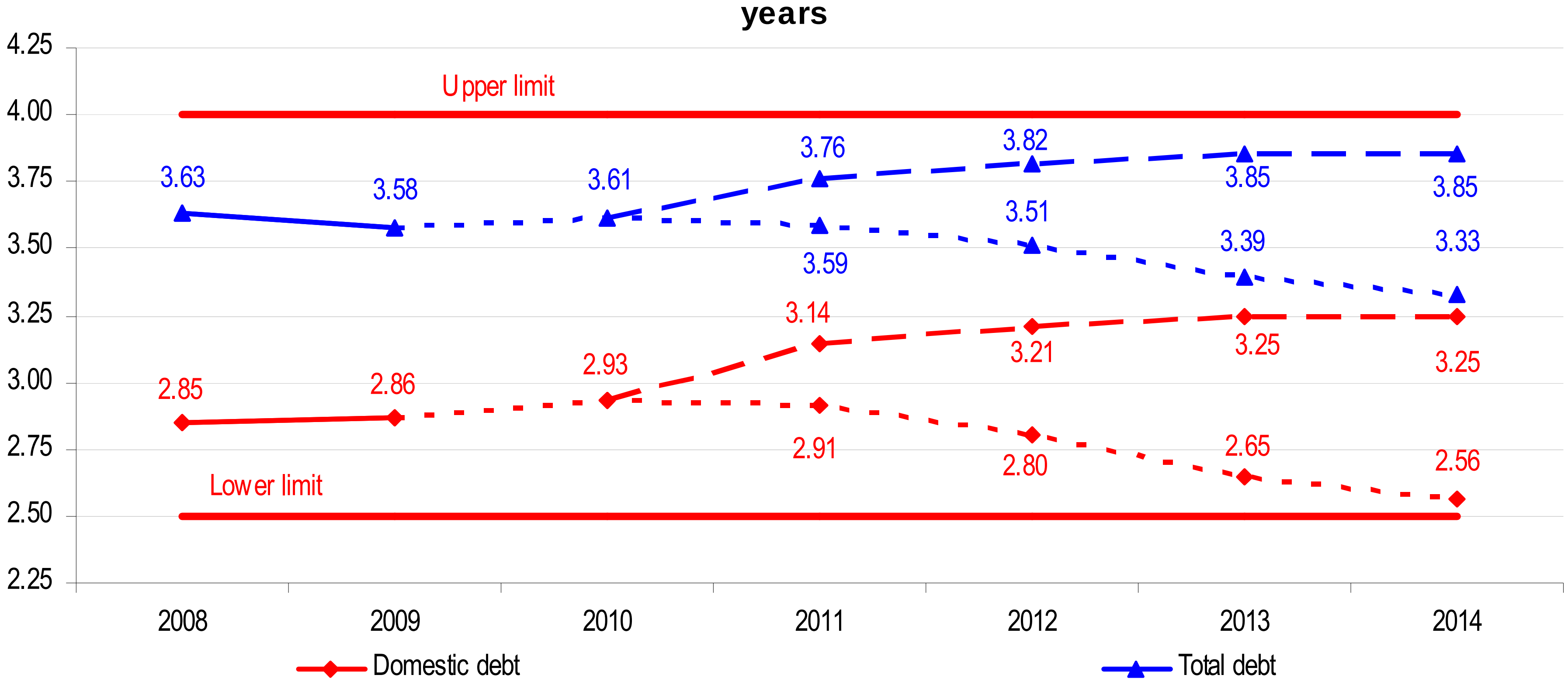
– possible separating the management of the interest rate and refinancing risks by using floating rate bonds, inflation-linked bonds and derivatives

FOREIGN DEBT

– current level of risk is not a constraint for cost minimisation objective, in mid 2010 duration amounted to 5.7 years

Risk constraints of the Strategy's objective: interest rate risk (2)

Duration of the State Treasury debt

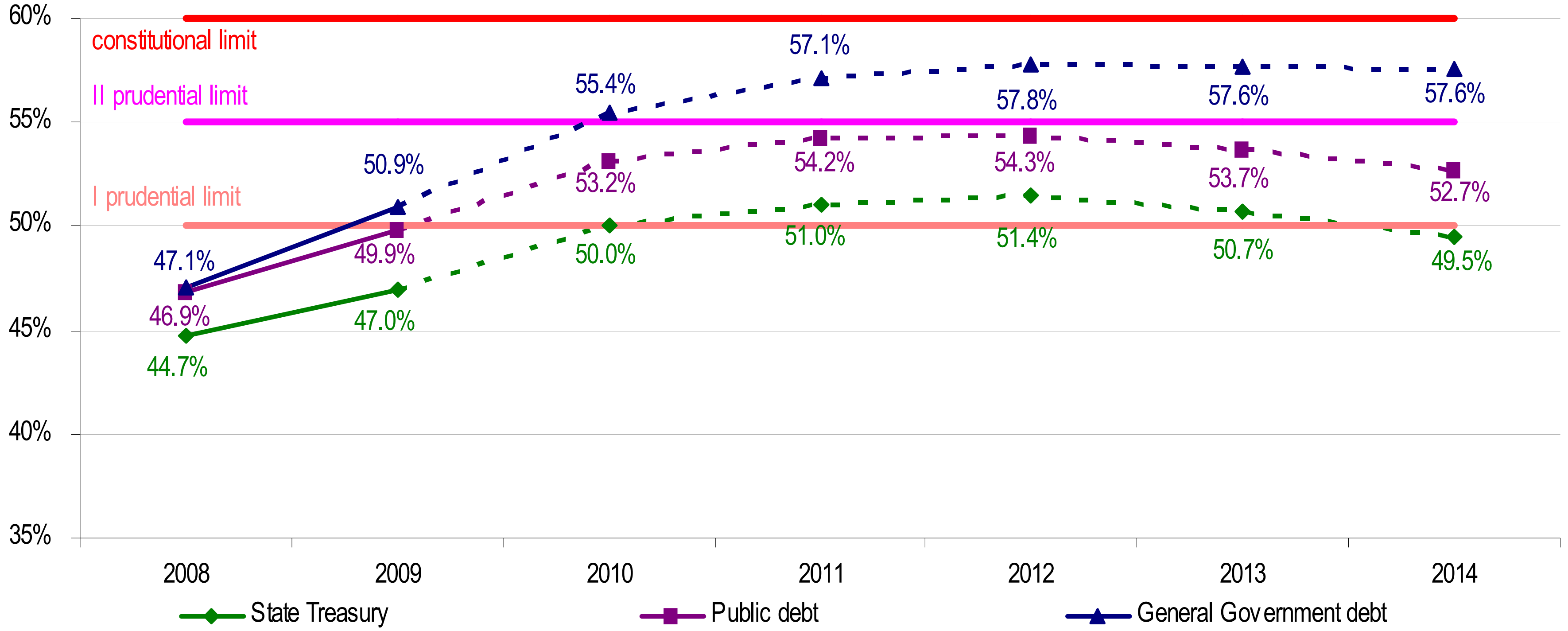


Strategy tasks

1. **Increasing liquidity of the TS market**
   - Continuation of issuing medium and long term fixed rate benchmark bonds (at least EUR 5 bn) in the domestic market
   - Large liquid issues in the euro market
   - Adapting issuance policy to market circumstances, including demand in different segments of the TS market
2. **Increasing efficiency of the TS market,** including:
   - Issuance schedule adjusted to market and budgetary circumstances
   - Increasing the role of the participants of the Primary Dealers system
   - Removing technical and legal obstacles
   - Direct meetings with investors and consultations with market participants
   - Broadening the investor base, including non-deal roadshows in the key foreign markets
3. **Increasing transparency of the TS market**
   - Transparent issuance policy, including TS issuance calendars, supply plans of TS and supply offers for individual auctions
   - Promoting the electronic market

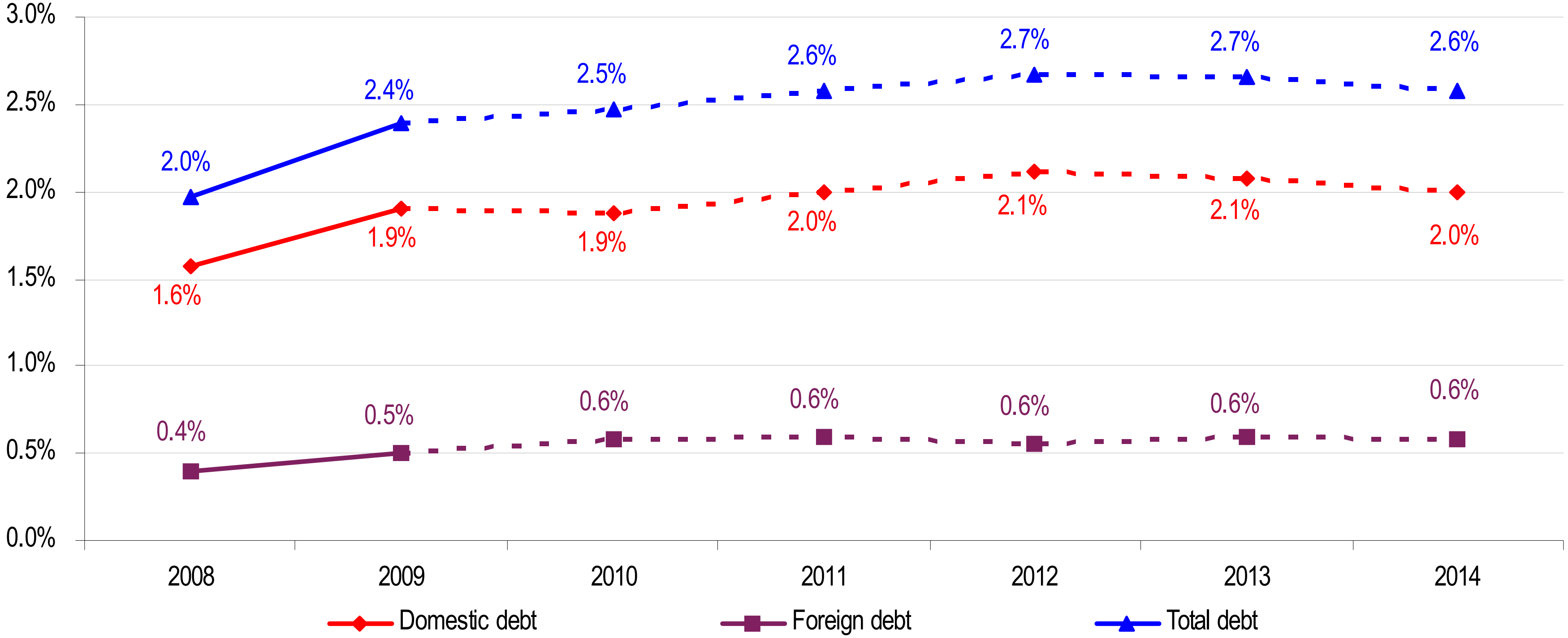
Public debt volume

- In the years 2010-2012 the debt to GDP ratio close to the 55% threshold – risk of triggering the procedures envisaged in the Public Finance Act
- General government (EU methodology) debt safely below 60%



State Treasury debt servicing costs

- **Increase in the costs to GDP ratio to 2.7% in 2012 and decrease to 2.6% in 2014**



Sensitivity of the public debt to GDP ratio to changes in assumptions

Item	2011	2012	2013	2014
GDP and borrowing requirements (GDP %)				
- growth path of GDP lower by 1 percentage point	0.52	1.03	1.54	2.02
- borrowing requirements higher by PLN 1 bn a year	0.07	0.13	0.19	0.23
Exchange rate (GDP %)				
- PLN depreciation by 10% towards all currencies	1.42	1.40	1.39	1.39

Sensitivity of the debt servicing costs to changes in assumptions

Item	2011	2012	2013	2014
Interest rates – 1 percentage point increase (PLN bn)				
- total debt	0.8	2.2	3.9	5.1
- domestic debt	0.7	1.9	3.3	4.2
- foreign debt	0.1	0.3	0.6	0.9
Exchange rate - PLN depreciation by 1% towards all currencies (PLN million)				
	81.0	89.6	101.4	105.8

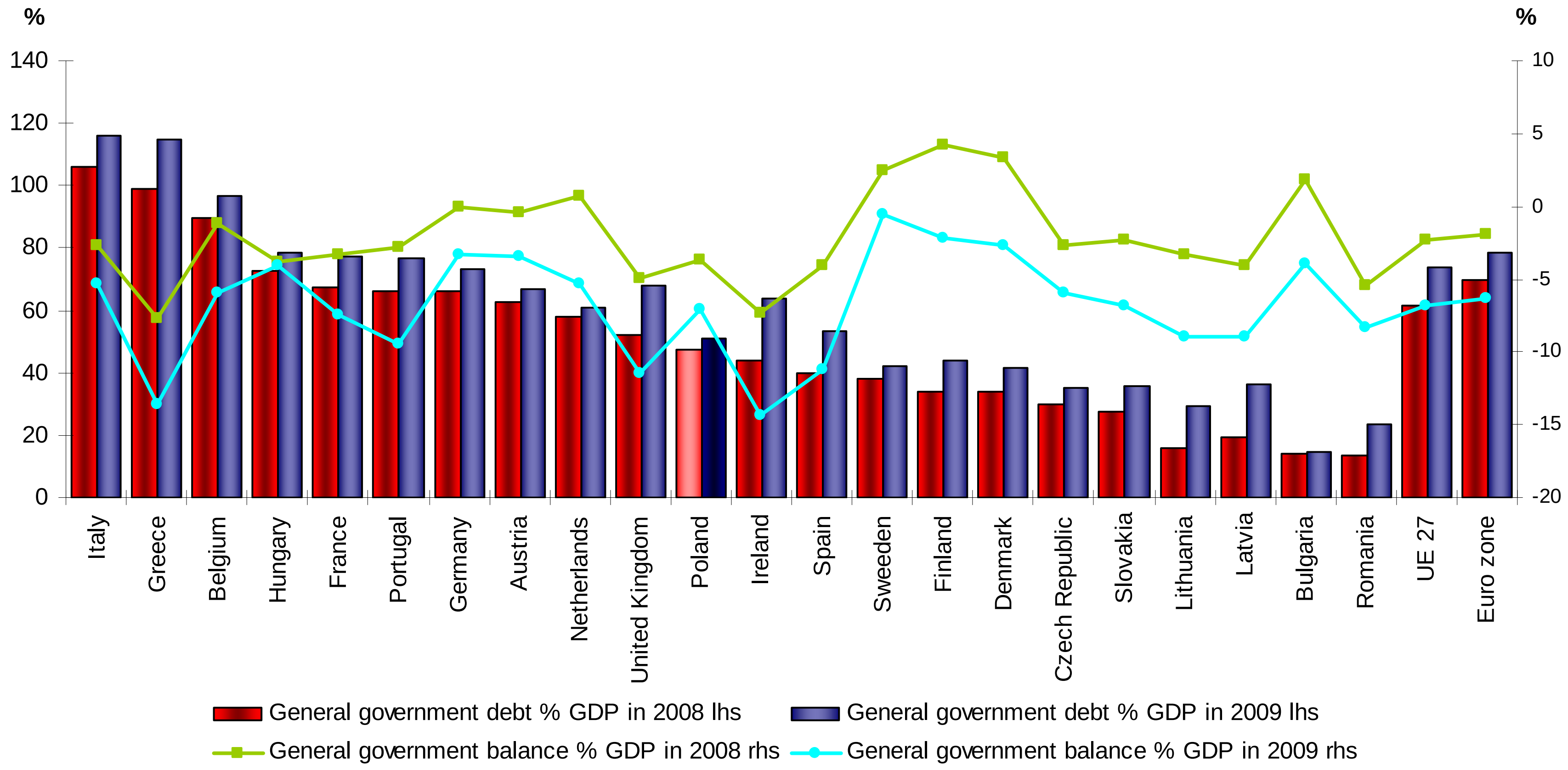
Changes in legal regulations in the scope and organization of public debt

- **Inclusion of The State Forests National Forest Holding into the public finance sector**
- **Strenghtening the liquidity managment of the State budget, which involves:**

  - obligation of public finance sector entities on the central level, such as state agencies and funds, to place their liquid funds on a deposit account with the Minister of Finance

  - possibility of local government units and other public sector entities to place their liquid funds on a deposit account with the Minister of Finance
- **Implementation of expenditure rule in order to reach durable public finance stability**
- **Strengthening the prudential procedures triggered if public debt to GDP ratio exceeds 55%**

General government debt and balance in selected EU Member States in 2008-2009



Long-term government debt rating in foreign currency of selected EU Member States

as of September 3, 2010

	Moody's	Standard&Poor's	Fitch
Austria	Aaa	AAA	AAA
Belgium	Aa1	AA+	AA+
Bulgaria	Baa3	BBB	BBB-
Czech Republic	A1	A	A+
Denmark	Aaa	AAA	AAA
Finland	Aaa	AAA	AAA
France	Aaa	AAA	AAA
Greece	Ba1↓↓↓↓↓↓	BB+ ↓↓↓↓	BBB- ↓↓↓↓
Spain	Aaa	AA ↓	AA+ ↓↓
Netherlands	Aaa	AAA	AAA
Ireland	Aa2↓	AA- ↓	AA- ↓↓
Lithuania	Baa1↓	BBB	BBB
Latvia	Baa3	BB ↓	BB+
Germany	Aaa	AAA	AAA
Poland	**A2**	**A-**	**A-**
Portugal	A1↓↓↓	A- ↓↓	AA- ↓
Romania	Baa3	BB+	BB+
Slovakia	A1	A+	A+
Sweeden	Aaa	AAA	AAA
Hungary	Baa1	BBB-	BBB
United Kingdom	Aaa	AAA	AAA
Italy	Aa2	A+	AA-

Source: International Financing Review, September 4, 2010

↓↑ - upgrde or downgrade in comparison to previous Strategy