

**The Public Finance Sector  
DEBT MANAGEMENT STRATEGY  
in the years 2008-2010**

**Ministry of Finance  
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I. INTRODUCTION	4
II. CHANGES IN VOLUME AND STRUCTURE OF PUBLIC DEBT	5
II.2. Structure of the State Treasury debt	7
II.3. Guarantees and sureties granted by public finance sector entities	9
II.4. Evaluation of implementing the Strategy's objective in 2006 and first half of 2007	10
III. ASSUMPTIONS OF THE STRATEGY	14
III.1. Macroeconomic situation in Poland	14
III.2. International situation	17
IV. DEBT MANAGEMENT STRATEGY OBJECTIVE IN THE YEARS 2008-2010	18
V. STRATEGY TASKS IN A THREE-YEAR HORIZON	20
VI. INFLUENCING THE PUBLIC FINANCE SECTOR DEBT	23
VI.1. Changes in legal regulations	23
VI.2. Assumptions of the Strategy of granting sureties and guarantees	23
VI.3. Debt of public finance sector units other than State Treasury	24
VII. EXPECTED EFFECTS OF IMPLEMENTING THE STRATEGY	29
VII.1. Volume of debt and its servicing costs	29
VII.2. State Treasury debt structure	31
VII.3. Threats to the implementation of the Strategy	32
Annex 1. Glossary	33
Annex 2. Institutional framework for public debt management in the EU Member States	37
Annex 3. General government deficit and debt and yields on 10-year bonds in the EU Member States	39
Annex 4. Government debt rating of the EU Member States	40
Annex 5. ATM and duration of public debt of the EU Member States in 2006	41
Annex 6. Legal regulations applied to public debt in Poland and the EU	42
Annex 7. Basic categories of debt and their GDP ratios in the period 2001-Jun 2007	45
Annex 8. Debt of the public finance sector and debt of the State Treasury in Poland	46

## I. INTRODUCTION

According to article 70 of the Public Finance Act of June 30, 2005, the Minister of Finance is obliged each year to prepare a 3-year strategy of managing the State Treasury (ST) debt and of influencing the public debt as a whole. The Strategy is presented to the Council of Ministers for approval and then submitted to the Sejm (lower house of the Parliament) together with the justification of the draft budget act.

Public debt management is conducted at two levels:

- in a broader sense, debt management is a part of fiscal policy and covers decisions on what portion of State expenditures are to be financed by debt and hence, what the level of public debt should be;
- in a narrower sense, debt management means determining the way of financing the State borrowing requirements, by selecting markets, instruments and dates of issuance.

*The Public Finance Sector Debt Management Strategy in the years 2008-2010* contains forecasts of debt levels which are consistent with the fiscal policy assumptions of the draft Budget Act for 2008, however its objectives and tasks refer to the narrower sense of public debt management.

In 2006 the public debt reached PLN 505.0 billion (47.7% of GDP) against PLN 510.2 billion (49.2% of GDP) forecasted in the previous Strategy. The debt to GDP ratio, after declining to 47.0% (i.e. by 0.7 percentage points) in 2007, is expected to increase slightly within the Strategy time horizon. Under the adopted assumptions the public debt will reach PLN 593.6 billion (47.4% of GDP) in 2008 and PLN 694.1 billion (47.7% of GDP) in 2010, which means that the first threshold of 50% provided for the Public Finance Act will not be exceeded.

The ST debt servicing costs, at PLN 27.8 billion (2.6% of GDP) in 2006, will reach about PLN 28.1 billion (2.4% of GDP) in 2007 and about PLN 34.9 billion (2.4% of GDP) in 2010.

This Strategy is to a large extent a continuation of the strategy developed last year. The objective of the minimisation of the long term debt servicing costs subject to risk constraints remains unchanged, so do the major tasks of the Strategy, related to the development of the primary and secondary market of Treasury securities (TS).

In implementing the Strategy's objective in the years 2008-2010 the following was assumed:

- The flexible approach towards the market and currency structure of issuance will be maintained, to the extent that cost minimisation is achieved, subject to limitations resulting from the exchange rate risk and avoiding distortions of monetary policy.
- The domestic market will remain the main source of financing the State budget borrowing requirements. Because of the ongoing integration with the Economic and Monetary Union (EMU), the euro market will retain its strategic role in foreign issuance.
- Issuing large and liquid fixed rate benchmark bonds, both in the domestic and euro market, will be a priority of the issuance policy.
- The average term to maturity (ATM) of domestic debt will continue to increase, while its duration has already reached the acceptable level in terms of interest rate risk and will remain within the range of 2.5-4.0 years (in case of foreign debt the current levels of neither refinancing risk nor interest rate risk constitute limitations to the debt servicing cost minimisation). The management of refinancing risk and interest rate risk of domestic debt will be separated.

The layout of the Strategy has not changed significantly. The key measures of contingent debt resulting from sureties and guarantees granted by the public finance sector entities have been presented in more detail.

## II. CHANGES IN VOLUME AND STRUCTURE OF PUBLIC DEBT

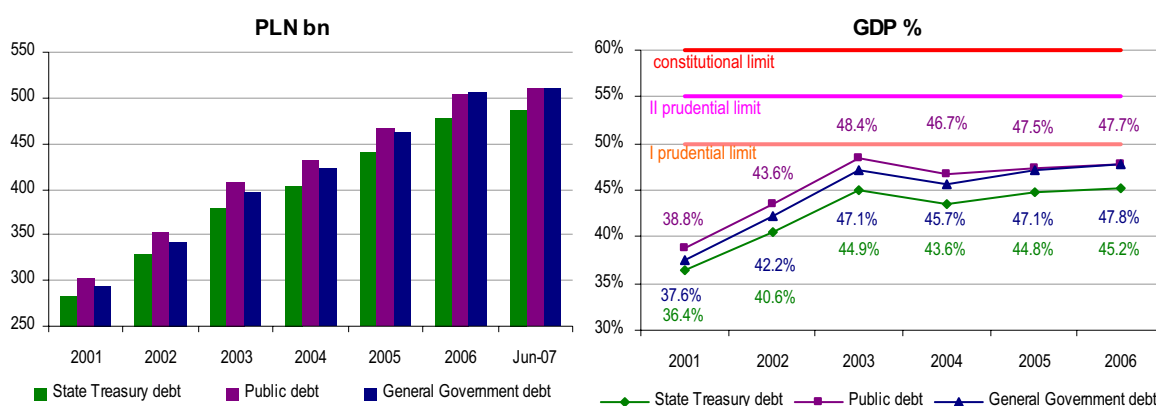
Financing the State budget borrowing requirements requires incurring public debt and bearing costs of its servicing. The essence of debt management is shaping the structure of debt to minimize servicing costs while at the same time keeping risk at an acceptable level.

Subsequent subchapters present recent changes in volume of public debt, the structure and servicing costs of the ST debt as well as volume of contingent liabilities resulting from granted guarantees and sureties.

### II.1. Volume of public debt and its servicing costs

Changes in volume of public debt in the years 2001-07 resulted mainly from changes in the ST debt. Growth of the nominal value of debt was the result of high level of State budget borrowing requirements and changes in exchange rate of the Polish zloty. However high rate of the GDP growth (since 2004) contributed to a stabilization of the debt-to-GDP ratio at levels below 50%, i.e. the first threshold set in the Public Finance Act.

Chart 1. Volume of public debt in the years 2001-2007<sup>1</sup>



In April 2007 the transition period during which Poland had the right to include Open Pension Funds (OFE) in the general government sector came to an end. Since then TS in possession of OFE do not lower the general government debt hence the volume of public debt measured in accordance with the Polish and EU methodologies is similar<sup>2</sup>.

The debt-to-GDP ratio, at the end of 2006 equal to 47.8% (EU methodology) is lower than the ratio for the EU as a whole (61.7%) and the Eurozone (69.0%)<sup>3</sup>.

Changes of the debt-to-GDP ratio in the years 2001-2006 were influenced mainly by amounts of budget deficits and other borrowing requirements (including those resulting from the pension reform) as well as by the nominal GDP growth. The importance of proceeds from privatisation was diminishing. FX rates fluctuations influencing PLN value of foreign currency denominated debt were an important factor causing discrepancies between the amount of borrowing requirements and the growth of debt.

There was also a systematic decrease of other ST debt, not originating from financing the State budget borrowing requirements (from PLN 9.0 billion in 2001 to PLN 0.2 billion in mid 2007). This decrease was primarily caused by the repayment of liabilities resulting from lack of salaries increase in the public sector and repayment of the Labour Fund debt.

<sup>1</sup> Detailed data on public debt volume are presented in Annex 7.

<sup>2</sup> Differences between Polish and EU methodology are presented in Annex 6.

<sup>3</sup> See Annex 3.

Table 1. Factors influencing changes of the ST debt-to-GDP ratio in the years 2001-2006 (%)

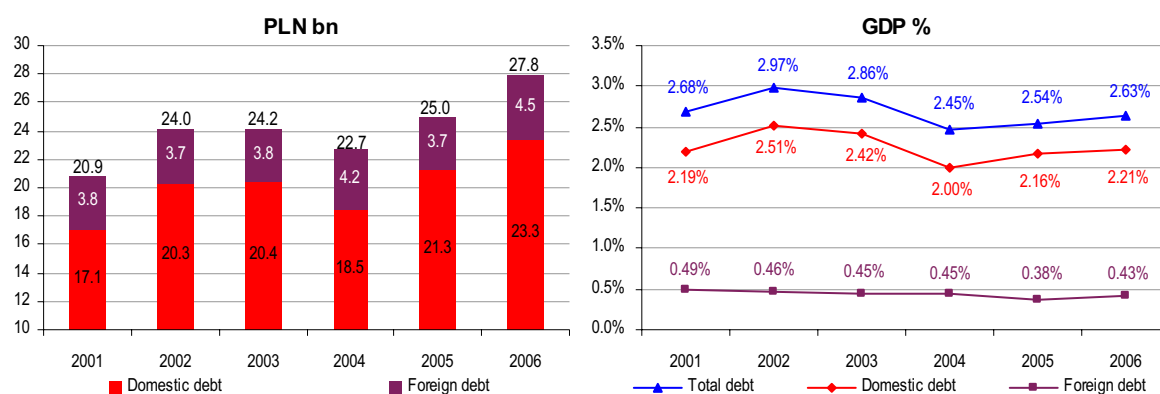
Description	2001	2002	2003	2004	2005	2006
<b>Debt-to-GDP ratio</b>	<b>36.4</b>	<b>40.6</b>	<b>44.9</b>	<b>43.6</b>	<b>44.8</b>	<b>45.2</b>
Change of the ST debt-to-GDP ratio	0.6	4.2	4.3	-1.3	1.2	0.4
1. State budget borrowing requirements, including:	3.3	4.6	4.5	4.9	4.3	4.2
1.1. State budget primary balance	1.5	1.9	1.5	2.0	0.4	-0.3
1.2. ST debt servicing costs	2.7	3.0	2.9	2.4	2.5	2.6
1.3. Pension reform costs*	0.0	0.0	0.0	1.1	1.3	1.4
1.4. Net proceeds from privatisation	-0.8	-0.2	-0.4	-0.8	-0.3	0.0
1.5. Other borrowing requirements**	-0.1	-0.1	0.5	-0.2	0.4	0.5
2. Changes not resulting from State budget borrowing requirements	-0.6	1.1	1.7	-2.2	-0.4	-0.5
2.1 FX rates movements	-1.0	0.8	1.4	-2.2	-0.3	-0.4
2.2 other factors***	0.4	0.3	0.4	0.0	-0.1	-0.1
3. Changes in other ST debt	-0.5	-0.2	-0.2	0.0	-0.1	-0.1
4. Nominal GDP growth	-1.6	-1.3	-1.7	-4.0	-2.6	-3.2

\*) Funds transferred to Social Security Fund (FUS) as compensation for contributions transferred to OFE.

\*\*) Mainly: changes of budget account balance, balance of granted loans, prefinancing.

\*\*\*) Changes of debt caused by TS discount, TS capitalisation and indexation, off-budget drawings, written off debt, conversion of FUS to OFE debt for securities.

Chart 2. ST debt servicing costs in the years 2001-2006



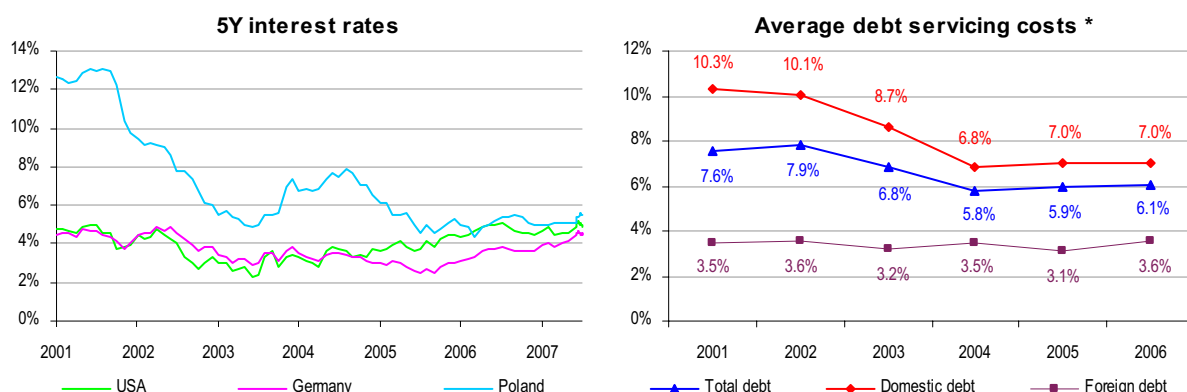
Changes in the debt servicing costs level were the result of growth of the ST debt and changes in interest rates levels (decreasing till mid 2003, increasing till mid 2004, lowering again till July 2005 and since then relatively stable). Distribution of the debt servicing costs over time was influenced by the State budget accounting system (cash based), where discount constitutes cost at maturity. To eliminate the destabilizing effect of variable debt servicing costs on the State budget, activities aimed at smoothing the distribution of debt servicing costs over time were undertaken. These were:

- Coupons of Treasury bonds offered in the wholesale market set at the level close to their yields to lower the burden of discount cost cumulating at maturity. 10-year bonds reopened as 5-year benchmarks were the exception (their coupons were set in a different market situation).
- Switching and buy-back auctions, in use since 2001, with the primary goal to reduce refinancing risk, but also allowing for the redistribution of costs over time.
- Derivatives – in use since the end of 2006.

Debt servicing cost of foreign debt were much lower than those of domestic debt. This was caused by positive yet diminishing spreads between interest rates on domestic and major foreign markets, and, more importantly, by the lowering share of foreign debt in total ST debt.

The ST debt servicing costs-to-GDP ratio, after significant fall in the years 2003-2004, grew slightly in 2005-2006.

Chart 3. Market interest rates and average servicing costs of domestic and foreign ST.



\*) Average servicing costs of the ST debt were calculated as a ratio of debt servicing costs in a given year to the arithmetic average of debt volume at the end of given and previous year.

## II.2. Structure of the State Treasury debt

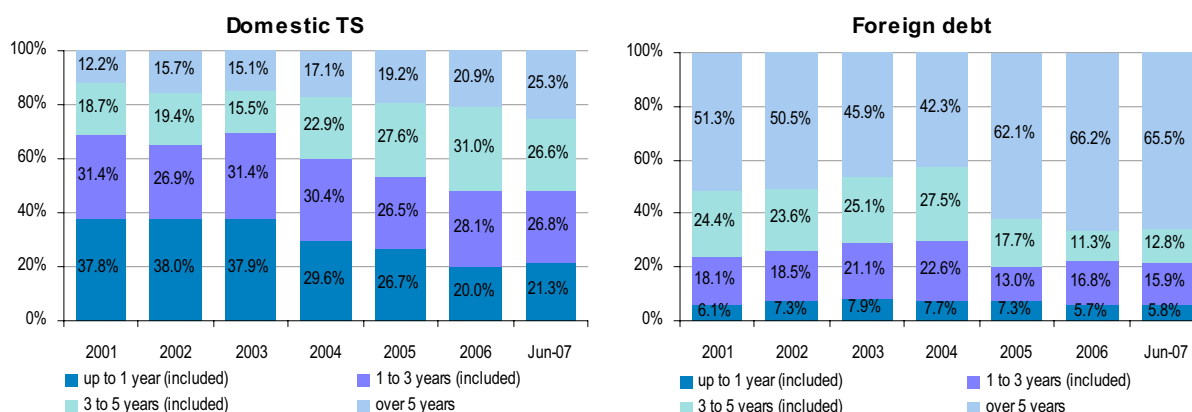
Changes in the ST debt structure were the result of implementing the Strategy's objective i.e. minimisation of debt servicing costs over a longer time horizon subject to risk constraints. The issuance policy and other operations on debt significantly reduced the risk connected with the debt structure.

### a) Refinancing risk

The domestic debt refinancing risk, relatively high in the years 2001-2003, was systematically reduced in the following years. The reduction of the refinancing risk was a result of:

- growing importance of medium- and long-term bonds in financing the borrowing requirements; the share of bonds with maturity of 5 years or more in total sales of bonds on regular auctions amounted to 58.9% in 2001, 70.9% in 2006 and 90.4% in the first half of 2007<sup>4</sup> respectively,
- a significant drop in the outstanding amount of Treasury bills (from PLN 35 billion in 2001 to PLN 20 billion in the first half of 2007, which constituted 20% and 5.6% of debt in TS respectively); since 2004 Treasury bills are not used for deficit financing,

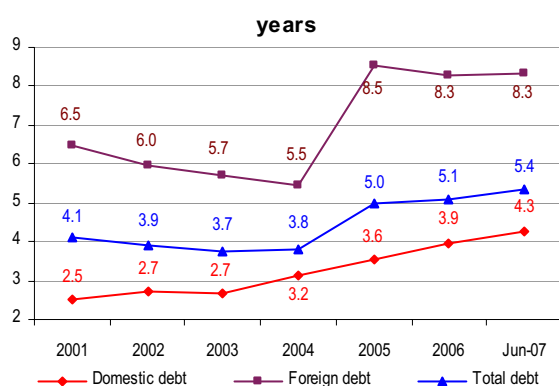
Chart 4. Residual maturity of the ST debt in the years 2001-2007.



- Growing significance of switching auctions. In 2002 bonds with short residual maturities in the face value of PLN 9.6 billion were bought back. For 2006 and first half of 2007 the numbers were PLN 27.6 billion and PLN 13.1 billion respectively.

<sup>4</sup> Including switching auctions.

Chart 5. ATM of the ST debt in the years 2001-2007.



In comparison with the domestic debt the refinancing risk of foreign debt is relatively low. It was reduced significantly in 2005 when the Paris Club debt was partly repaid before maturity and refinanced by long term bonds. In subsequent years ATM of foreign debt was lowering slowly, as a natural effect of aging of debt and limited value of new issuance.

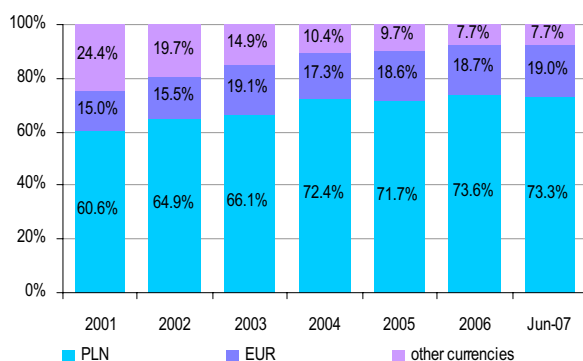
A regular, since 2003, increase of ATM of the ST debt originated from stable increase of ATM of domestic debt, which has a dominant share in total debt, and a significant increase in 2005 followed by stabilisation at a high level of ATM of foreign debt.

Progress in the reduction of the domestic debt refinancing risk brings its level close to values in other EU countries, where ATM of domestic debt on average amounts to 5.8 years and of total debt to 6.2 years<sup>5</sup>.

#### b) FX risk

Share of the foreign currency debt in total ST debt had been decreasing regularly till 2004 and later stabilised in the range of 26-29%. The share of currencies other than the euro was reduced. This tendency was the result of:

Chart 6. Currency composition of the ST debt.

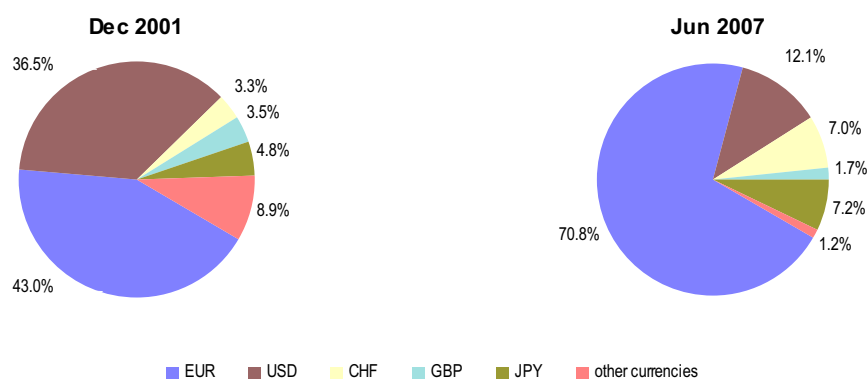


- the adoption (in basic scenario) of foreign financing in the amount close to the value of State budget borrowing requirements in foreign currencies resulting from the servicing and repayment of foreign debt (from the end of 2001 till mid 2007 the face value of foreign debt increased merely by PLN 30.8 billion in comparison to PLN 171.8 billion increase of domestic debt),
- flexible approach to the implementation of the cost minimisation objective in the area of FX risk constraint, allowing for temporary divergences from the basic scenario (in use since 2004),
- strategic importance of the euro as a prospective domestic currency (adopting the euro will result in immediate drop of FX risk).

<sup>5</sup> See Annex 5 for detailed data.



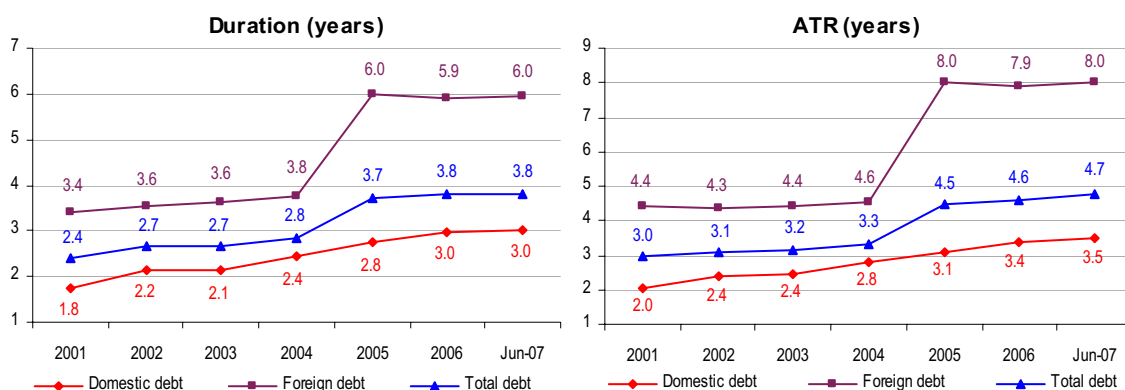
Chart 7. Currency composition of the ST foreign debt



### c) Interest rate risk

Due to the dominant role of fixed-rate instruments in new issuance, changes in the interest rate risk of both domestic and foreign debt were in recent years similar to changes in the refinancing risk. As a consequence interest rate risk measures (duration and ATR) remained closely related to ATM. In the domestic market falling interest rates, especially in 2002 and 2005, contributed to higher duration, while rising interest rates in 2003 lowered duration. In 2007 the rise of both duration and ATR of the domestic debt was slower than rise of ATM due to a temporary rise in sales of floating-rate instruments and higher interest rates.

Chart 8. Duration and ATR of the ST debt in the years 2001-2007



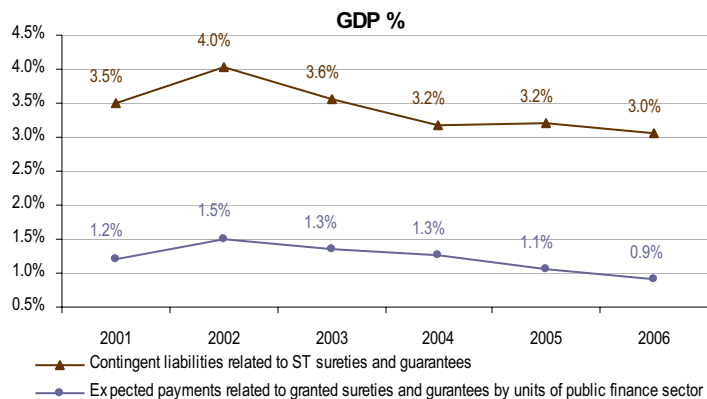
Duration of the domestic debt is higher than in the EU countries with the lowest values of this measure, while duration of the total debt is close to EU average<sup>6</sup>. As in case of the refinancing risk, the interest rate risk of foreign debt remains at an acceptable level.

### **II.3. Guarantees and sureties granted by public finance sector entities**

Activity of the ST in granting guarantees and sureties has not created any serious threats to the public finance so far. At the end of 2006 almost 70% of contingent liabilities belonged to the low-risk group. As in 2005, the long term risk for the whole portfolio decreased. Domestic guarantees and sureties were more risky than foreign ones. The ratio of risk-weighted payments under guarantees and sureties to GDP decreased from 1.06% in 2005 to 0.9% in 2006.

<sup>6</sup> At the end of 2006 duration in the EU countries (on average) amounted to 3.9 years in case of domestic debt (2.6 in Finland and Hungary) and 4.1 in case of total debt. See annex 5 for detailed data.

Chart 9. Contingent liabilities and expected payments under guarantees and sureties granted by the ST



#### II.4. Evaluation of implementing the Strategy's objective in 2006 and first half of 2007

In 2006 and in the first three quarters of 2007 debt management was conducted in accordance with *The public finance sector debt management strategy in the years 2006-08*, approved by the Council of Ministers in September 2005 and with *The public finance sector debt management strategy in the years 2007-09*, approved in September 2006.

Table 2 presents the evaluation of implementing the Strategy's objective (minimisation of servicing costs subject to risk constraints).

Table 2. Evaluation of implementing the Strategy's objective in 2006 and first half of 2007

<b>I. Strategy's objective</b>		
	Evaluation	Implementation
<b>Debt servicing costs minimisation</b>	High	<p><b>1. Selection of instruments</b></p> <p>The domestic market was core to financing the borrowing requirements (in 2006 the face value of TS issuance amounted to PLN 131.4 billion in the domestic market and PLN 13.5 billion in foreign markets, in the first half of 2007 - PLN 47.7 billion and PLN 9.3 billion respectively). Main factors taken into account when deciding about the financing structure were:</p> <ul style="list-style-type: none"> <li>• narrowing spreads between interest rates in Poland and main foreign markets (USD, EUR),</li> <li>• limited State budget borrowing requirements in foreign currencies,</li> <li>• attempts to avoid negative effects of exchanging foreign currencies for the zloty,</li> <li>• high demand for medium- and long-term fixed-rate bonds in the domestic market (in 2006 bonds with value of PLN 32.2 billion were sold and demand amounted to PLN 93.1 billion, the numbers for the first half of 2007 were PLN 16.6 billion and PLN 57.1 billion respectively).</li> </ul> <p>The most important activities connected with foreign debt included:</p> <ul style="list-style-type: none"> <li>• early redemption of Brady bonds (value of about USD 0.6 billion),</li> <li>• benchmark issues on the euro market (10-year bonds with face value of EUR 3 billion in February 2006 and 15-year bond with face value of EUR 1.5 billion in January 2007),</li> <li>• maintaining Poland's presence on other foreign markets, especially those with low interest rates like the Japanese yen (in November 2006 10-year bonds with face value of JPY 25 billion and 20-year bonds with face value of JPY 60 billion were issued) and the Swiss franc (in May 2007 5-year bonds with face value of CHF 500 million and 12-year bonds with face value of CHF 1 billion were issued).</li> </ul> <p><b>2. Efficiency of the TS market</b></p> <p>Main activities aimed at cost minimisation included:</p> <ul style="list-style-type: none"> <li>• Issuance policy aimed at creation of large and liquid benchmark issues in the domestic market was continued. EUR 5 billion threshold was crossed by 8 domestic issues (including 7 fixed-rate bonds). Concentration of issuance constituted an important factor facilitating the rise of liquidity in the secondary market. Liquidity ratio of the bond market rose from 134.5% in 2005 to 176.2% in 2006 and 175.9% in the first half of 2007.</li> <li>• Policy of issuing liquid benchmarks in the euro market. Face value and liquidity of Polish bonds is the largest among bonds listed on the NewEuroMTS electronic platform.</li> <li>• Opening of the Primary Dealers (PD) system to foreign institutions. In 2006 two foreign institutions gained the PD status, which, among other things, attracted new foreign investors to the domestic market. In 2007 3 foreign banks gained the PD status.</li> <li>• In April 2006 time between auction and its settlement was shortened (T+2 introduced). As a consequence risk for investors (resulting from restricted trading ability before auction settlement) was reduced.</li> <li>• Adopted selection criteria contributed to the reduction of issuance costs connected with commissions and fees for banks organising foreign issuance.</li> </ul>

II. Constraints – quantitative						
Constraint	Evaluation	Implementation	Measure	Value		
				2005	2006	Jun 2007
<b>Refinancing risk</b>	High	<ul style="list-style-type: none"> <li>• Dominant position of 5-year and 10-year bonds in total sales.</li> <li>• High importance of switching auctions.</li> <li>• New long term instruments (30-year fixed rate bond issued in June 2007).</li> <li>• ATM of domestic debt exceeded the level of 4 years assumed in the previous Strategy.</li> </ul>	ATM:			
			- domestic debt	3.57	3.94	4.27
			- foreign debt	8.51	8.28	8.33
			- total debt	5.01	5.11	5.37
Share in domestic TS of:			- securities maturing within 1 year	26.7%	20.0%	21.3%
			- Treasury bills	7.8%	7.4%	5.6%
<b>FX risk</b>	High	<ul style="list-style-type: none"> <li>• Limited significance of foreign financing.</li> <li>• High influence of appreciation of the zloty on the share of foreign debt in total debt.</li> <li>• Share of foreign debt in total debt maintained in the range set in the Strategy (25-27%).</li> </ul>	Share of foreign debt in total ST	28.3%	26.4%	26.7%
			Share of EUR-denominated debt in foreign debt	65.6%	70.9%	71.2%
<b>Interest rate risk</b>	High	<ul style="list-style-type: none"> <li>• Duration of domestic debt remained in the middle of 2.5-3.5 range set in the Strategy.</li> <li>• Risk connected with foreign debt remained at a safe level.</li> </ul>	Duration:			
			- domestic debt	2.76	2.99	3.01
			- foreign debt	5.98	5.90	5.97
			- total debt	3.73	3.78	3.81
ATR			- domestic debt	3.07	3.40	3.51
			- foreign debt	7.99	7.91	8.04
			- total debt	4.51	4.61	4.74

<b>III. Constraints – non-quantitative</b>		
<b>Constraint</b>	<b>Evaluation</b>	<b>Implementation</b>
<b>Liquidity risk</b>	Satisfactory	<p>Main instruments used in liquidity management included:</p> <ul style="list-style-type: none"> <li>switching auctions (their main purpose was to reduce refinancing risk connected with redemptions of large issues),</li> <li>interest-bearing zloty deposits in the National Bank of Poland (NBP),</li> <li>deposits, where Bank Gospodarstwa Krajowego (BGK) acts as an intermediary. These were buy-sell-back transactions and interbank deposits. In 2006 1570 transactions with face value of PLN 352 billion were concluded, in the first half of 2007 – 715 transactions and PLN 237 billion respectively.</li> <li>interest-bearing foreign currency deposits with the NBP.</li> </ul> <p>Liquid assets of the State budget (on average: PLN 8.9 billion in 2006 and PLN 9.4 billion in the first half of 2007 of zloty deposits as well as EUR 1.8 billion equivalent in 2006 and EUR 0.9 billion equivalent in the first half of 2007 of foreign currency deposits) allowed for undisturbed execution of budgetary expenditures and smooth distribution of TS supply.</p>
<b>Credit risk</b>	Satisfactory	<ul style="list-style-type: none"> <li>Buy-sell-back transactions did not generate credit risk.</li> <li>For interbank deposits credit the system of limits was in place.</li> <li>Credit risk connected with derivatives is limited by selection of counterparties with high credit rating (it is necessary to have ISDA Master Agreement or an equivalent Polish law agreement signed with MF to make deals).</li> </ul>
<b>Operational risk</b>	High	<ul style="list-style-type: none"> <li>Management of a vast majority of debt conducted in one department in the Ministry of Finance.</li> <li>Integrated database of the ST debt.</li> <li>Work on development of a comprehensive risk management system is carried out.</li> <li>Additional measures improving safety of debt management data were introduced. Infrastructure enabling market activity was created.</li> </ul>
<b>Distribution of debt servicing cost over time</b>	Satisfactory	<p>Smooth distribution of servicing costs was taken into account when deciding about new issues of TS. Coupons of new bonds were set close to their yields. Even distribution of debt servicing costs was enhanced by:</p> <ul style="list-style-type: none"> <li>switching auctions for bonds maturing in a following year,</li> <li>derivatives.</li> </ul>

### **III. ASSUMPTIONS OF THE STRATEGY**

#### ***III.1. Macroeconomic situation in Poland***

Major economic factors influencing changes of the nominal value of public debt include: the borrowing requirements (including the deficit of the public finance sector) and exchange rate of the zloty. Changes in the debt-to-GDP ratio are also influenced by the real GDP growth and changes in prices. The main factors which have a direct impact on debt servicing costs include interest rates, exchange rate and, to a lesser extent, inflation.

##### **1. GDP growth**

Real GDP growth in 2006 amounted to 6.1% (as compared to 3.6% in 2005), the highest since 1997.

Data for the first half of 2007 (real GDP growth of 7.1%) show that currently Poland is in the phase of fast economic growth. It is expected that real GDP growth in 2007 will amount to 6.5%. Main factors contributing to growth, in the forecast's horizon, will include, as in 2006, domestic consumption and investment. According to current forecast, GDP growth rate will decrease to 5.5% in 2008, 5.2% in 2009 and 5.0% in 2010.

##### **2. Fiscal deficit**

Under the adopted assumptions, the public finance sector cash deficit-to-GDP ratio will amount to 2.0% in 2007, 2.0% in 2008, 2.0% in 2009 and 1.6% in 2010.

Due to the general government deficit being higher than 3% of GDP, since 2004 Poland has been under the excessive deficit procedure and has been obliged to reduce the deficit below the reference level by 2007. Once the excessive deficit procedure is lifted, the EU countries are obliged to reach the medium term budgetary objective measured by their structural balance. For Poland this objective was set at a level of -1.0% of GDP.

General government deficit in 2007 is estimated at 3.0% of GDP. In subsequent years deficit is expected to decline. It is forecasted that in 2010 the deficit will reach 2.5%.

##### **3. Inflation**

In spite of high GDP growth and improving situation in the labour market, inflation remains under control, yet it shows an upward trend. In 2006 the average CPI growth amounted to 1.0%, and 2.2% is forecasted for 2007. In subsequent years it is expected that inflation will return to the 2.5% target, which will be connected with still a high growth pace of consumption and the situation in the labour market. It is forecasted that the average CPI inflation will reach 2.3% in 2008 and 2.5% in the years 2009-2010. The path of inflation indicates that the Maastricht convergence criterion concerning inflation will still be met.

##### **4. Exchange rate of the zloty**

In 2006 the zloty appreciated by 3.2% against the euro and 4.1% against the US dollar. In the period of January-August 2007 the zloty further appreciated by 1.8% against the euro and 8.9% against the US dollar. It is expected that in the third quarter of 2007 the exchange rate of the zloty will be influenced by the uncertainty resulting from the domestic politics and the situation in the international financial markets. Further appreciation of the zloty is expected in 2007 and in subsequent years. The appreciation should be gradual, however deviations from the trend connected with changes in the market situation are possible.

The main factors influencing the exchange rate include:

- continuation of the price convergence in the EU member states (influencing appreciation of the zloty as the currency of a country with relatively low price level),
- solid macroeconomic foundations of Polish economy,
- increasing attractiveness of PLN-denominated assets resulting from tightened monetary policy,
- inflow of capital from increasing foreign direct investments, EU funds and foreign currency savings transferred by people working in the "old" EU countries.

## 5. Interest rates

In the first quarter of 2006 interest rates in the domestic market reached their historic lows (on February 28, 2006 yields of bonds reached 3.9% for 2-year bonds, 4.3% for 5-year bonds and 4.6% for 10-year bonds respectively). After the rise in TS yields in the second quarter of 2006 resulting from the situation in global markets, interest rates fell in the second half of 2006 and remained stable till mid 2007. At the end of the first half of 2007 a dynamic upward trend in yields began. It has been connected with strong expectations that NBP reference rate will be increased and in the third quarter of 2007 supported by the situation in the base markets.

High GDP growth accompanied by the risk of rising inflationary pressure persuaded the Monetary Policy Council (RPP) to decide about three increases of the NBP reference rate in the period of January-August 2007 (the reference rate reached 4.75%).

It is expected that in the rest of 2007 and in 2008 the RPP will be deciding about levels of interest rates in the situation where there is still a risk of rising inflationary pressure due to high rise of domestic demand and deteriorating relationship between increases in the productivity and in wages. Taking into account the above mentioned factors it is expected that the reference rate will reach on average 4.4% in 2007 and 5.2% in 2008.

It should be expected that bond markets in Poland and in the Eurozone will remain highly correlated, while spreads in yields will be the effect of:

- level of fulfilment of Maastricht criteria and prospects of Poland' entry to the monetary union,
- development of situation in the base markets, including global investors risk aversion. Rise in risk aversion can result in rises of credit spreads for bonds issued by sovereigns with lower credibility,
- development of the TS market in Poland.

Table 3. Macroeconomics assumptions adopted in the Strategy

Description	2006	2007	2008	2009	2010
Real GDP growth (%)	6.1	6.5	5.5	5.2	5.0
GDP in current prices (PLN billion)	1057.9	1156.9	1252.5	1352.2	1456.4
Public finance sector deficit (% of GDP)	2.1	2.0	2.0	2.0	1.6
Public finance sector deficit (PLN billion)	22.6	23.5	25.2	26.4	23.2
Average CPI (%)	1.0	2.2	2.3	2.5	2.5
Reference interest rate (%) – on average	4.10	4.40	5.20	5.30	5.30
PLN/USD – on average	3.1025	2.8508	2.7711	2.7587	2.7464
PLN/EUR – on average	3.8951	3.8258	3.7410	3.7243	3.7076

## 6. Credit rating

Prospects of a balanced GDP growth, strong fundamentals of the economy and its increasing efficiency resulted in changes of ratings of Poland:

- in January 2007 Poland's long-term rating was increased by Fitch (from BBB+ to A-),
- in March 2007 Poland's credit rating was increased by Standard&Poor's (long-term rating from BBB+ to A-).

Increases of credit ratings influence the way investors perceive the risk of investing in Polish TS. Higher grades issued by two rating institutions should be a strong signal indicating the growing safety of investing in Polish TS, which should increase the demand and lower their yields.

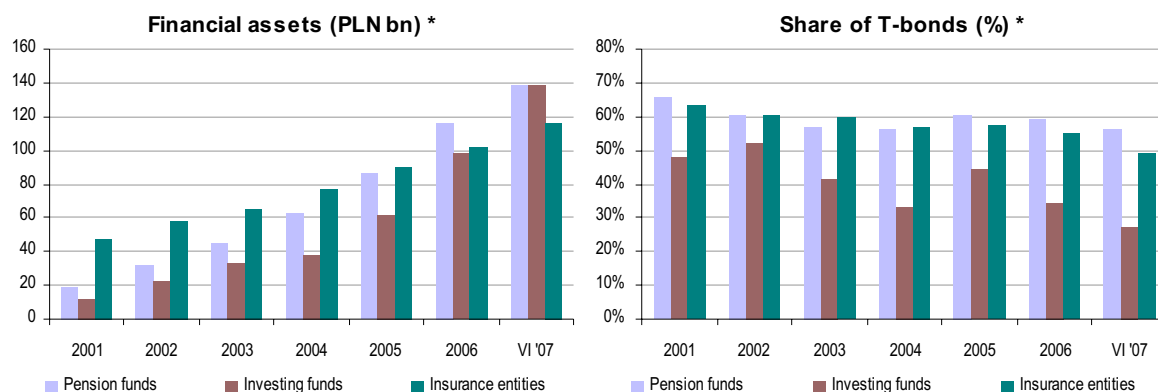
## 7. Investor base development

The level of development of the domestic financial market, investor base in particular, is an important factor influencing debt management. In the environment of free capital flows, a well-developed and deep domestic market enables an absorption of external shocks and neutralizes outflows of foreign capital. A few recent years brought dynamic growth in assets

of domestic institutional investors. Main factors influencing this growth include:

- the pension reform introduced in 1999, accompanied by creation of Open Pension Funds (OFE). Assets of these funds are growing quickly due to inflow of prospective pensioners' contributions and lack of outflows (first outflows will occur in 2009);
- changes in investment preferences of households. Due to low yields bank deposits are losing popularity in favour of investment funds, which offer potentially higher profits;
- less dynamic than in case of OFE and investment funds, however still significant growth of insurance companies assets;
- boom in the Polish stock market in place since 2003.

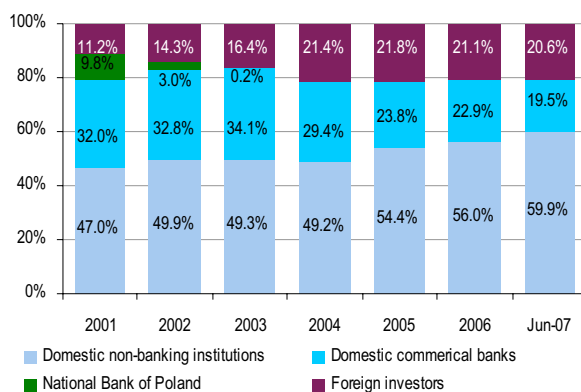
Chart 10. Non-banking financial institutions assets and share of TS



\*) in case of insurance companies data as of the end of March 2007

The above mentioned trends influence positive changes in the structure of TS holders: importance of stable investors (i.e. domestic non-banking financial institutions) is growing, while importance of the banking sector is diminishing.

Chart 11. Domestic ST debt by holder





### **III.2. International situation**

In 2006 the GDP growth rate in the world economy amounted to 5.4%, the fastest pace in almost 35 years. It is estimated that in 2007 the global growth will be slightly slower, mainly due to slowing of the US economy. The Eurozone economy growth should remain high. 2008 will bring further slowdown of world's GDP growth to less than 5%. This will be a result of a slower growth in the Eurozone and of the US economy regaining some of its momentum. In spite of high growth, factors which may influence a scenario worse than described above taking place gained more importance.

The most important aspects of the international situation, from the public debt management point of view, include:

- situation in the interest rate markets for currencies in which liabilities will be contracted. As a result of the adopted issuance policy, the development of the situation in the euro, yen and US dollar markets are the most important for Poland (Swiss franc market is highly correlated with euro market);
- risk aversion of investors acting in the global market influencing the level of the risk premium expected by the purchasers of Polish bonds (yield spread between Polish and "base" instruments).

#### **1. Euro market (EUR)**

The European Central Bank continues to tighten monetary policy. After a series of increases (the last one in June 2007) reference rate amounts to 4.0%. Analysts forecast that rates in the Eurozone will rise only slightly (to 4.25%) and remain at this level in the years 2008-09.

#### **2. American market (USD)**

The period of monetary policy tightening in the USA has probably come to an end. Due to signs of weakening of the economy and worries about possible escalation of the crisis in the sub-prime mortgages sector in September 2007 FED decided to cut the base interest rate by 50 basis points to 4.75%.

#### **3. Japanese market (JPY)**

As a result of an improving situation in the Japanese economy, in mid 2006 the Japanese central bank abandoned the "zero interest rate" policy. Currently the base interest rate amounts to 0.5%. In spite of hawkish accents present in some of the Bank of Japan president's statements, ambiguous signs from economy indicate that there are only slight expectations that interest rates will rise in the near future.

#### **4. Credit spreads**

Rise of risk aversion among investors, associated with problems in the mortgage market in the USA and worries about possible harmful effects of this situation for global financial markets caused a rise of credit spreads. Quick response of central banks reduced fears of a crisis but investors are not sure whether the situation is entirely under control. Deterioration of situation in the USA may harmfully influence international financial markets, which will be particularly damaging for borrowers with lower creditworthiness. As a result, risk premium can further increase (spread between yields of Polish TS and TS characterized by the highest creditworthiness), but due to relatively high credit rating and strong fundamentals of the economy, it is highly improbable that Poland has any difficulties accessing foreign markets. In the basic scenario it is assumed that a severe crisis will not occur but the situation in the markets will not be as favourable as in recent years, characterised by low risk premium.

#### IV. DEBT MANAGEMENT STRATEGY OBJECTIVE IN THE YEARS 2008-2010

The objective of the Strategy, superior to all debt management activities, will remain to be the **minimisation of the long term debt servicing costs subject to constraints on the level of:**

- a) refinancing risk,
- b) exchange rate risk,
- c) interest rate risk,
- d) State budget liquidity risk,
- e) other risks, in particular credit risk and operational risk,
- f) distribution of debt servicing costs over time.

There are two levels on which the cost minimisation objective is applied:

- **the choice of instruments**, i.e. cost minimisation within the timeframe of longest maturities of debt instruments with significant share in debt volume, through the optimal choice of markets, debt management instruments, structure of financing the borrowing requirements and issuance dates;
- **increasing efficiency of the TS market**, contributing to lowering of TS yields. It means aiming at spreads between TS issued by Poland and EU countries with highest credit ratings to reflect only differences in creditworthiness and not barriers and limitations in the organisation and infrastructure of the TS market.

The scope of implementing the cost minimisation objective remains unchanged as compared to the previous year's Strategy. This provides for a possible flexibility in choosing the market, currency and instrument type in financing the borrowing requirements. The choice of the financing structure should take into account the assessment of the market situation (levels of interest rates and shapes of yield curves on respective markets as well as expected exchange rates) and result from comparing the long term funding costs, subject to risk constraints.

The domestic market will remain the main source of financing the State budget borrowing requirements. The supply of domestic TS will be designed in a way that excessive increase in yields in respective segments of the curve does not occur.

Taking the aforementioned policy rules into account, foreign markets issuance should:

- take foreign currency borrowing requirements of the State budget into account, including principal and interest payments, both scheduled and resulting from early repayments,
- strengthen Poland's position in the euro market, which is of strategic importance due to the perspective of full integration under the EMU,
- ensure that Poland has access to the investor base in other major financial markets,
- stabilise the domestic market in the sense that security of financing the State budget borrowing requirements is ensured, should temporary disturbances in the domestic market occur,
- affect the domestic financial market, especially the exchange rates, as little as possible,
- allow buying or selling foreign currencies in the NBP, as an available instrument of managing the foreign currency borrowing requirements of the budget, while taking into account its economic rationale and the monetary policy considerations.

Minimisation of long term debt servicing costs will be subject to constraints related to the debt structure. Therefore, the following was assumed:

- a) refinancing risk
  - further increase in the role of medium and long term instruments in financing the State budget borrowing requirements in the domestic market at the pace dependent on the investors' demand,

- aiming at even distribution of redemptions and interest payments of domestic and foreign debt in subsequent years,
  - ATM of domestic debt reaching at least 5 years,
  - the current level of foreign debt refinancing risk does not restrain cost minimisation;
- b) exchange rate risk
- decrease in exchange rate risk measured by the share of foreign currency debt in the ST debt in the period preceding the entry to the euro zone to 20-25%,
  - possibility of using derivatives in managing the exchange rate risk in order to target the currency structure of debt,
  - reaching and keeping within the Strategy's timeframe an effective (after swaps) share of the euro, as a future domestic currency, of at least 70%;
- c) interest rate risk
- keeping duration of the domestic debt in the range of 2.5-4.0 years,
  - separating the management of the interest rate and refinancing risks by using floating rate bonds, inflation-linked bonds and derivatives,
  - the current level of foreign debt interest rate risk does not restrain cost minimisation;
- d) State budget liquidity risk
- keeping a safe level of State budget liquid funds while managing them efficiently,
  - the level of liquid funds will be the result of the State budget's demand for liquidity and of smoothening of TS supply within a year, taking into account seasonal considerations as well as current and expected market situation;
- e) other risks, in particular credit risk and operational risk
- concluding derivatives transactions with domestic and foreign entities with high creditworthiness,
  - use of instruments limiting the credit risk and solutions allowing for its diversification when concluding derivatives transactions,
  - diversification of credit risk generated by uncollateralized transaction in the State budget liquidity management;
- f) distribution of debt servicing costs over time
- aiming at smooth distribution of yearly debt servicing costs, with the use of available instruments, especially switching auctions and derivatives,
  - setting the bond coupons at levels close to their yields over the sales period.

## V. STRATEGY TASKS IN A THREE-YEAR HORIZON

The major tasks for implementing the Strategy's objective are:

1. Increasing liquidity and efficiency of the TS market,
2. Development of the Primary Dealers (PD) System and of the electronic market for TS,
3. Development of the system for managing State budget liquidity,
4. Broadening the investor base and efficient communication with participants of financial markets.

As the financial market develops constantly, the tasks of the Strategy are continuous in nature. Additionally, tasks 1, 2 and 4 are strongly interrelated, which means that activities aiming at carrying out one task influence the extent to which the remaining tasks are performed.

### **Ad 1. Increasing liquidity and efficiency of the TS market**

Increasing liquidity and efficiency of the TS market is a continuous task, contributing to cost minimisation at the second level of applying the objective (see Chapter IV), both in the primary and the secondary market. In the period covered by the Strategy steps will be made to further integrate the domestic TS market with the European market.

Increasing liquidity of the TS market will be achieved by:

- Continuation of issuing large benchmark bonds in the domestic market, ensuring sufficient liquidity in the secondary market. The policy of issuing medium and long term bond series at least until their value reaches EUR 5 billion equivalent, adopted in 2003, remains in force. The reference value of EUR 5 billion is considered sufficient to provide liquidity at the current stage of development of the domestic TS market. Bond issues will be granted sufficient liquidity by using such instruments as properly suited issuance calendar, switching auctions and supplementary auctions.
- Reduction of the number of series of 2-year bonds and T-bills, as a result of a diminishing role of short term instruments in financing the State borrowing requirements.
- Large liquid issues in the euro market, contributing to the development of the Polish yield curve in the euro.

Increasing efficiency of the TS market will be achieved by:

- Conducting the issuance policy in a way that takes the efficiency level of cost minimisation into account by the means of:
  - stable and transparent TS issuance calendar in the domestic market (see task 4),
  - regular benchmark issues in the euro market,
  - suiting the issuance schedule of non-euro foreign bonds to the market situation and investor demand,
- Removing technical and legal obstacles on the domestic and foreign TS markets, in particular:
  - actions aiming at enabling the settlement of transactions on TS issued on the domestic market by internationally recognized clearing houses (in particular Clearstream and Euroclear),
  - comprehensive regulation of tax exemptions of non-residents from the income tax on interest of bonds offered in the foreign markets,
  - actions aiming at harmonizing a tax rate for non-residents on interest of bonds issued on the domestic market (withholding tax) so that the country of origin is neutral to the profitability of investment.

## **Ad 2. Development of the Primary Dealers (PD) System and of the electronic market for TS**

The development of the PD system and the electronic market is in fact an activity contributing to carrying out the task of increasing the liquidity and efficiency of the market. However, because of the importance of the PD system in the development of the TS market, these activities are singled out as a separate task. In 2007 the PD system consists of 15 banks (including 3 non-residents). Efficiency of the system contributes to the increase in transparency of the TS primary and secondary market and to the safety of financing the State borrowing requirements, hence it helps to achieve the objective of the Strategy.

The development of the PD system should involve increasing the role of its participants in the development of the TS market and in debt management operations. The following elements will affect the efficiency and competitiveness of the PD system and its attractiveness to domestic and foreign banks:

- regulations defining the PD system in the area of rights and obligations of its participants;
- the MoF's policy of choosing partners for debt management transactions – in the areas where primary dealers are at least as competitive as other market participants, the choice of partner should be made with the preference for primary dealers over other market participants.

Further development of the electronic market of TS has a role in increasing the transparency of the market. Actions taken in this area will include:

- promoting the electronic market in the PD system regulations (mainly the obligations imposed on dealers and candidates concerning quoting benchmark bonds, the bid and offer spreads and participation in the fixings of TS),
- possible opening of the electronic market for the non-bank institutional investors. An institutional segment of the current platform with the bank-to-client access for non-banking investors is planned to be created.

## **Ad 3. Development of the system for managing State budget liquidity**

The system of liquidity management should ensure both safe level of liquidity of the State budget and efficient use of liquid assets. As liquidity management is strongly related to debt management, they should be closely coordinated. In setting the level of liquid funds the uneven distribution of borrowing requirements over time (including large bond redemptions) and issuance policy (including issuance calendar and seasonal fluctuations in demand for TS) should be taken into account.

Actions aimed at developing the system of liquidity management will include:

- budgetary planning – improvements in forecasting the budgetary flows,
- development of the technical infrastructure, mainly implementation of the single account of the State budget,
- further improvements in coordination of debt and liquidity management,
- developing new instruments and procedures.

## **Ad 4. Broadening the investor base and efficient communication with participants of financial markets**

An access to the broadest possible investor base, both in the domestic and foreign markets, is key to meeting the objective of the Strategy. Broad investor base contributes to an additional demand for TS issued on the domestic and foreign markets, it can also create demand for new instruments, which means that it contributes both to cost minimisation and risk diversification.

Broadening the investor base and communication with market participants will be carried out by the means of:

- transparent issuance policy, including announcing TS issuance calendars, yearly, quarterly and monthly supply plans of TS in the domestic and foreign markets and supply offers for individual auctions;

- broadening the channels of electronic communication, in particular with foreign investors,
- direct meetings with investors and consultations with the participants of the TS market, including:
  - regular meetings with primary dealers,
  - regular meetings with non-banking sector investors,
  - meetings with foreign banks and other foreign investors,
  - ad hoc meetings and phone consultations with investors;
- regular meetings with foreign investors in the form of non-deal roadshows in the key foreign markets, aiming at:
  - building and maintaining relations with key foreign investors,
  - separating issuance of foreign bonds from promotional activities (roadshows), enabling issuance at best possible timing, regardless of the marketing readiness,
  - promotion of Polish TS issued both in the domestic and foreign markets;
- active participation in conferences and seminars for investors.

## **VI. INFLUENCING THE PUBLIC FINANCE SECTOR DEBT**

According to Article 69 of the Public Finance Act, the Minister of Finance holds control over the public finance sector in respect to the rule which states that the public debt must not exceed the 60% of the annual GDP.

In the case of other public finance sector units, which are autonomous in incurring liabilities, the influence on their level of debt is indirect and stem from regulations in the Public Finance Act. First and foremost they include constraints imposed on the manner of incurring obligations by local government units as well as prudential and remedial procedures, which are applied to the public finance sector units when the public debt to GDP ratio exceeds thresholds of 50%, 55% and 60%.

### ***VI.1. Changes in legal regulations***

The most important legislative change that influences incurring liabilities by public finance sector units and their level of borrowing requirements is an amendment of the Social Security System Act. The act from June 15, 2007, on the change of the Social Security System Act and of some other acts decreases contributions for retirement and pension insurance from the current level of 13% of the gross income, paid in half by the insured and the employer, to the level at 6% of the gross income paid at 4.5% by the employer and at 1.5% by the insured (in two stages: from the July 1, 2007, and from January 1, 2008). The most important consequences for the public finance are:

- decrease in the revenues of the Social Insurance Fund (the ST is the guarantor of payments from social insurance, hence the loss in contributions resulting from decreased rates will be compensated by subsidies from the State budget),
- increase in the budgetary revenues from PIT and in the volume of contributions for universal health insurance, resulting from the increase of the personal income aggregate,
- rise in local units' revenues from their share in PIT.

Expected total effects of lowering contributions will be the fall in the revenues of the public finance sector in the years 2007-2010 by PLN 2.9 billion, PLN 17.5 billion, PLN 19.9 PLN billion and PLN 21.6 billion respectively.

### ***VI.2. Assumptions of the Strategy of granting sureties and guarantees***

Granting sureties and guarantees by the public finance sector units, especially by the ST, entails the risk of generating debt servicing costs when sureties or guarantees are executed. Sureties and guarantees constitute contingent liabilities, which can become public debt if they are executed.

Further decrease in the ratio of expected payments under sureties and guarantees granted by the ST to GDP is expected.

In order to reduce risk stemming from granting sureties and guarantees while preserving advantages of using them as an instrument of the State's economic policy, the following principles, also in force in last year's strategy, should be maintained:

- Concentrating on granting sureties and guarantees to support development-oriented investments in infrastructure, protection of environment, creating new jobs, regional development, residential building, railway, especially those co-financed with the EU structural funds (loans and bonds secured or guaranteed by the ST should help to utilize the EU structural funds), but also to support other investment that may arise from possible new support programs using sureties and guarantees in compliance with the EU rules, e.g. in the shipyard, defense and air sectors.
- The ratio of expected sureties and guarantees granted by the ST to GDP should not exceed 1.4%, the ratio of the ST contingent liabilities resulting from granted sureties and guarantees to GDP should not exceed 4.5%.
- Limiting the role of sureties and guarantees particularly risky for the ST, which are

granted on the basis of special-purpose, so-called “sectoral”, acts.

According to the Act on sureties and guarantees granted by the ST and by some other legal persons, the budgetary act determines each year the total amount to which sureties and guarantees can be granted by the ST. The limit on the amount of sureties and guarantees of the ST planned for a given year will be increased by the unused limit from the previous year, provided that the risk level for the public finance sector is at a similar or lower level.

### VI.3. Debt of public finance sector units other than State Treasury

Data on the debt of public finance sector units in the recent period, both before and after consolidation are presented in Annex no. 8.

Table 4. Debt of public finance sector units excluding the ST, before consolidation

Item	Dec 2005	Dec 2006	Jun 2007	Change Dec 06- Dec 05		Change Jun 07- Dec 06	
	PLN million	PLN million	PLN million	PLN million	%	PLN million	%
<b>Debt of other public finance sector units</b>	<b>36 941.3</b>	<b>38 443.8</b>	<b>36 659.5</b>	<b>1 502.5</b>	<b>4.1%</b>	<b>-2 784.3</b>	<b>-7.2%</b>
<b>1. Central government sub-sector</b>	<b>2 526.4</b>	<b>3 725.1</b>	<b>2 364.7</b>	<b>1 198.8</b>	<b>47.4%</b>	<b>-1 360.4</b>	<b>-36.5%</b>
National Health Fund	400.9	80.2	0.0	-320.7	-80.0%	-80.2	-100.0%
State earmarked funds with legal personality	0.0	0.0	0.0	0.0	-	0.0	-
State higher schools	185.1	319.1	229.7	134.0	72.4%	-89.4	-28.0%
Reserch and development units	275.5	295.5	279.9	20.0	7.2%	-15.6	-5.3%
Independent public health units	952.6	1 151.2	1 100.1	198.6	20.8%	-51.1	-4.4%
State cultural units	34.8	38.8	55.0	4.0	11.5%	16.2	41.7%
Polish Academy of Science and units established by it	7.7	17.5	12.7	9.8	127.9%	-4.8	-27.3%
Other State legal entities established under separate acts	669.8	1 823.0	687.3	1 153.2	172.2%	-1 135.7	-62.3%
<b>2. Local government sub-sector</b>	<b>27 320.2</b>	<b>30 933.1</b>	<b>29 615.8</b>	<b>3 612.9</b>	<b>13.2%</b>	<b>-1 317.3</b>	<b>-4.3%</b>
<b>2.1. Local government units and their associations</b>	<b>21 268.9</b>	<b>25 051.8</b>	<b>23 535.3</b>	<b>3 782.9</b>	<b>17.8%</b>	<b>-1 516.5</b>	<b>-6.1%</b>
<b>2.2. Other local government units</b>	<b>6 051.3</b>	<b>5 881.3</b>	<b>6 080.5</b>	<b>-170.0</b>	<b>-2.8%</b>	<b>199.2</b>	<b>3.4%</b>
Local government earmarked funds with legal perrsonality	186.9	161.4	187.1	-25.5	-13.6%	25.7	15.9%
Independent public health units	5 793.5	5 635.2	5 838.3	-158.2	-2.7%	203.1	3.6%
Local cultural units	33.7	74.4	43.0	40.7	120.9%	-31.4	-42.2%
Other local government legal entities established under separate acts	37.3	10.3	12.1	-27.1	-72.5%	1.8	18.0%
<b>3. Social security sub-sector</b>	<b>7 094.7</b>	<b>3 785.6</b>	<b>3 679.0</b>	<b>-3 309.1</b>	<b>-46.6%</b>	<b>-106.6</b>	<b>-2.8%</b>
Social Insurance Institution (ZUS)	0.03	0.01	0.01	0.02	-62.1%	0.01	-45.5%
Funds managed by Social Insurance Institution	7 094.7	3 785.6	3 679.0	-3 309.1	-46.6%	-106.6	-2.8%
Farmer's Social Insurance Institution and funds managed by it	0.0	0.0	0.0	0.0	-	0.0	-

At the end of June 2007 debt of other units than the ST constituted 6.9% of debt of the public finance sector before consolidation (5.4% after consolidation) as compared to 7.4% (5.6%) at the end of December 2006. The basic changes in debt of units with the highest debt level are described below in this chapter.



### 1) Debt of local government units

In 2006 local government units and their associations achieved jointly a budget deficit of PLN 3 billion. Their debt increased by PLN 3.8 billion (17.8%) to the level of PLN 25.1 billion.

The tendency to incur liabilities especially in the last quarter has been maintained, which is connected with seasonal patterns of these units' budget deficits.

Table 5. Quarterly balance and change of debt of local government units and their associations (PLN mln)

Year	Category	I quarter	II quarter	III quarter	IV quarter	Total
2004	Balance of local government units and their associations	5 181.9	165.8	785.9	-6 023.3	<b>110.3</b>
	Change of debt	-720.1	-106.3	863.1	1 805.9	<b>1 842.5</b>
2005	Balance of local government units and their associations	5 806.9	244.4	824.2	-7 786.9	<b>-911.3</b>
	Change of debt	-833.8	-429.2	309.4	3 030.6	<b>2 076.9</b>
2006	Balance of local government units and their associations	5 856.2	227.2	66.7	-9 160.7	<b>-3 010.6</b>
	Change of debt	-743.0	118.3	1 116.2	3 291.4	<b>3 782.9</b>
2007	Balance of local government units and their associations	8 118.7	3 218.8			
	Change of debt	-973.5	-543.0			

Table 6. Number of local government units and their associations with budgetary surplus and deficit (end of period)

Period	Deficit		Surplus		Balanced budget		Total	
	Number of units	PLN billion	Number of units	PLN billion	Number of units	PLN billion	Number of units	PLN billion
<b>2004</b>	1 619	-2.8	1 353	2.9	4	0.0	2 975	0.1
<b>2005</b>	1348	-3.1	1 628	2.2	3	0.0	2 979	-0.9
<b>2006</b>	1 942	-5.1	1 022	2.1	1	0.0	2 965	-3.0
<b>Jan-Jun 2007</b>	230	-0.2	2 736	11.5	2	0.0	2 968	11.3

The structure of debt of local government units and their associations is dominated by loans. At the end of June 2007 68% of debt resulting from matured payables was related to deliveries of goods and services.

Table 7. Debt of local government units and their associations (end of period)

Item	Dec 2005		Dec 2006		Jun 2007	
	PLN million	%	PLN million	%	PLN million	%
<b>Total debt of local government units</b>	<b>21 268.9</b>	<b>100%</b>	<b>25 051.8</b>	<b>100.0%</b>	<b>23 535.3</b>	<b>100.0%</b>
1) loans	17 708.8	83.3%	21 029.0	83.9%	19 496.8	82.8%
2) securities	3 282.7	15.5%	3 777.8	15.1%	3 749.7	15.9%
3) other debt, of which	277.5	1.2%	245.0	1.0%	288.8	1.2%
3.1) matured payables	277.5	1.2%	241.8	1.0%	285.0	1.2%

The share of foreign debt in total debt of local government units and their associations has slightly increased but it still remains at the low level. At the end of June 2007 it stood at 11% as compared to 10.4% at the end 2006 and 10.8% at the end 2005. Liabilities with maturity over 1 year predominate in the total debt of local government units and their associations (94% in June 2007, as compared to 94.5% at the end 2006 and 94.6% at the end of 2005).

The ratio of total debt of local government units to their proceeds is significantly under the legal constraint of 60%.

Table 8. Debt of local government units to their proceeds

Item	Dec 2005	Dec 2006	Jun 2007*
Debt to proceeds ratio	20.6%	21.3%	18.6%

\*) debt of local government units at the end of June 2007 in relation to planned proceeds in 2007.

In 2006 the ratio of debt to proceeds exceeded 60% in 12 local government units (as compared to 9 in 2005). In those cases the major causes were excessive incurrence of loans for investment projects in previous years and lower than planned revenues.

Table 9. Number of indebted local government units with respect to the debt to proceeds ratio

	Group of units	Total number of units	Number of indebted units					
			Debt to proceeds ratio					
			Total	i<10%	10%<i<30%	30%<i<50%	50%<i<60%	i>60%
Dec 2005	Municipalities	2 413	2 292	785	1 162	315	21	9
	Cities with the county status	65	65	8	37	19	1	0
	Counties	314	301	131	133	36	1	0
	Provincies	16	16	3	10	3	0	0
	Associations of units	150	46	11	8	5	3	19
	<b>Total</b>	<b>2 958</b>	<b>2 720</b>	<b>938</b>	<b>1 350</b>	<b>378</b>	<b>26</b>	<b>28</b>
Dec 2006	Municipalities	2 413	2 316	688	1 256	339	23	10
	Cities with the county status	65	65	6	36	21	2	0
	Counties	314	306	95	156	49	4	2
	Provincies	16	16	2	9	5	0	0
	Associations of units	172	44	12	8	3	1	20
	<b>Total</b>	<b>2 980</b>	<b>2 747</b>	<b>803</b>	<b>1 465</b>	<b>417</b>	<b>30</b>	<b>32</b>

At the end of 2006 the value of contingent liabilities of local government units resulting from granting guarantees increased to PLN 2 876.8 million (as compared to PLN 1 587.4 million at the end of 2005). By mid-2007 these liabilities amounted to PLN 3 123.9 million.

## 2) Debt of Social Insurance Institution (ZUS) and funds managed by it

Debt of the Social Insurance Institution and funds managed by it is exclusively the result of liabilities incurred by the Social Insurance Fund (FUS).

Table 10. Debt of Social Insurance Institution (ZUS) and funds managed by it

Item	Dec 2005	Dec 2006	Jun 2007
<b>Debt of Social Insurance Institution and funds managed by it, of which:</b>	<b>7 094.8</b>	<b>3 785.6</b>	<b>3 679.0</b>
Loans from commercial banks	4 570.2	2 610.8	3 105.4
Matured payables	2 524.5	1 174.8	573.6

The Social Insurance Institution incurs credits on behalf of the Social Insurance Fund, which are the supplementary source of financing its expenditures on social security benefits, in addition to contributions and budget subsidies.

The debt of the Social Insurance Fund has been especially influenced by the level of:

- proceeds from contributions on social insurance,
- budget subsidies and possible decision of the Minister of Finance to increase their level,
- payments for retirement and disability pensions.

As a result of the high economic growth, payments from the Social Insurance Fund remained at a stable level and proceeds from contributions increased in line with growing employment and salaries. The debt of the Social Insurance Fund in commercial banks fell

significantly in 2006, then rose slightly in I quarter 2007. Most matured payables of the Social Security Fund resulting from arrears in transfers of retirement contributions to the open pension funds in the years 1999-2002 were paid off. Since November 2003, these liabilities with accrued interests have been taken over by the ST and have been converted to Treasury bonds (10Y floating rate bonds).

Table 11. Conversion of debt of the Social Insurance Fund (FUS) towards open pension funds into TS

Item	Dec 2005	Dec 2006	Jun 2007
Face value of issued T-bonds (outstanding at the end of period)	2 545.8	3 656.6	4 116.4

### 3) Debt of independent public health care units (SPZOZ)

Predominant components of debt of independent public health care units are matured payables resulting from payment arrears. Volume of loans of SPZOZ has been increasing. The debt of independent health care units (about 98.7%) is owed almost exclusively to domestic creditors.

Table 12. Debt of independent public health care units

Item	Dec 2005		Dec 2006		Jun 2007	
	PLN million	%	PLN million	%	PLN million	%
<b>Debt of independent public health care units, of which:</b>	<b>6 746.1</b>	<b>100.0%</b>	<b>6 786.4</b>	<b>100.0%</b>	<b>6 938.4</b>	<b>100.0%</b>
1) securities	3.7	0.1%	27.3	0.4%	26.6	0.4%
2) loans	1861.7	27.4%	3 155.2	46.5%	3 287.5	47.4%
3) other debt, of which:	4880.6	72.5%	3 604.0	53.1%	3 624.3	52.2%
3.1) matured payables	4878.0	72.3%	3 603.7	53.1%	3 624.3	52.2%

Table 13. Debt of independent public health care units by sectors and maturities

Item	Dec 2005		Dec 2006		Jun 2007	
	PLN million	%	PLN million	%	PLN million	%
<b>Debt of independent public health care units, of which:</b>	<b>6 746.1</b>	<b>100.0%</b>	<b>6 786.4</b>	<b>100.0%</b>	<b>6 938.4</b>	<b>100.0%</b>
1) up to 1 year	5 130.9	76.0%	3 792.7	55.9%	3 864.4	55.7%
2) beyond 1 year	1 615.2	24.0%	2 993.7	44.1%	3 074.0	44.3%
1. Central government sub-sector	952.6	14.1%	1 151.2	17.0%	1 100.1	15.9%
1.1. up to 1 year	842.1	12.5%	941.3	13.9%	907.8	13.1%
1.2. beyond 1 year	110.5	1.6%	209.9	3.1%	192.3	2.8%
2. Local government sub-sector	5 793.5	85.9%	5 635.2	83.0%	5 838.3	84.1%
2.1. up to 1 year	4 288.8	63.5%	2 851.5	42.0%	2 956.6	42.6%
2.2. beyond 1 year	1 504.7	22.1%	2 783.7	41.0%	2 881.7	41.5%

### 4) Other units

The highest indebted units are research and development units, the Agricultural Market Agency, state higher schools and local government earmarked funds with legal personality. The debt of National Health Fund systematically decreased and paid off by the end of June 2007. The debt of research and development units consists mostly of matured payables, of which majority is owed to creditors outside the public finance sector (69.6% as of June 2007). The debt of the Agricultural Market Agency is mostly loans owed to the ST (100% as of June 2007). At the end of June 2007 there were no matured payables related to guaranteed loans, which at the end of 2006 constituted 37.3% of total liabilities.

The debt of State higher schools is mostly loans (about 84.4% as of June 2007), in majority owed towards creditors outside the public finance sector. The debt of local

government earmarked funds with legal personality is mainly loans ( about 99.9% as of June 2007). The debt of other units of the public finance sector is mostly loans as well.

Table 14. Debt of other units

Item	Dec 2005		Dec 2006		Jun 2007	
	PLN million	%	PLN million	%	PLN million	%
<b>Debt of other units:</b>	<b>1 919.6</b>	<b>100.0%</b>	<b>2 820.0</b>	<b>100.0%</b>	<b>1 506.6</b>	<b>100.0%</b>
Research and development units	275.5	14.4%	295.5	10.5%	279.9	18.6%
Agricultural Market Agency	573.5	29.9%	1 495.0	53.0%	262.8	17.4%
State higher schools	185.1	9.6%	319.1	11.3%	229.7	15.2%
Local government earmarked funds with legal personality	186.9	9.7%	161.4	5.7%	187.1	12.4%
National Health Fund	400.9	20.9%	80.2	2.8%	0.0	0.0%
Others	297.7	15.5%	468.8	16.6%	547.2	36.3%

## VII. EXPECTED EFFECTS OF IMPLEMENTING THE STRATEGY

Expected effects of implementing the Strategy cover forecasts of:

- the volume of public debt and its servicing costs,
- the volume of contingent liabilities resulting from granted guarantees and sureties,
- changes in risk related to public debt,

These are the expected results of the implementation of the Strategy's objective with adopted macroeconomic and budgetary assumptions. The most important threats to implementing the Strategy have also been presented in this chapter.

### VII.1. Volume of debt and its servicing costs

With the adopted assumptions public debt-to-GDP ratio will not exceed the first safety threshold i.e. 50%. Growth of the ST debt servicing costs will be mainly the result of debt growth cash-based budget accounting. Debt servicing costs-to-GDP ratio will be stabilized at a level of 2.4%.

Table 15. Forecasts of the public debt volume and the ST debt servicing costs in the years 2007-2010

	2006	2007	2008	2009	2010
<b>1. State Treasury debt</b>					
a) PLN billion	478.5	515.9	564.2	612.2	659.8
domestic	352.3	384.5	424.5	464.3	504.1
foreign	126.2	131.4	139.7	147.9	155.7
b) relative to GDP	45.2%	44.6%	45.0%	45.3%	45.3%
<b>2. Public debt</b>					
a) PLN billion	505.0	543.6	593.6	644.1	694.1
b) relative to GDP	47.7%	47.0%	47.4%	47.6%	47.7%
<b>3. General government debt (EU methodology)</b>					
a) PLN billion	505.2	545.4	596.9	647.3	697.2
b) relative to GDP	47.8%	47.1%	47.7%	47.9%	47.9%
<b>4. State Treasury debt servicing costs (cash basis)</b>					
a) PLN billion	27.8	28.1	27.8	32.3	34.9
b) relative to GDP, including:	2.6%	2.4%	2.2%	2.4%	2.4%
- domestic debt	2.2%	2.0%	1.7%	1.9%	1.9%
- foreign debt	0.4%	0.4%	0.5%	0.5%	0.5%

Chart 12. Public debt-to-GDP ratio

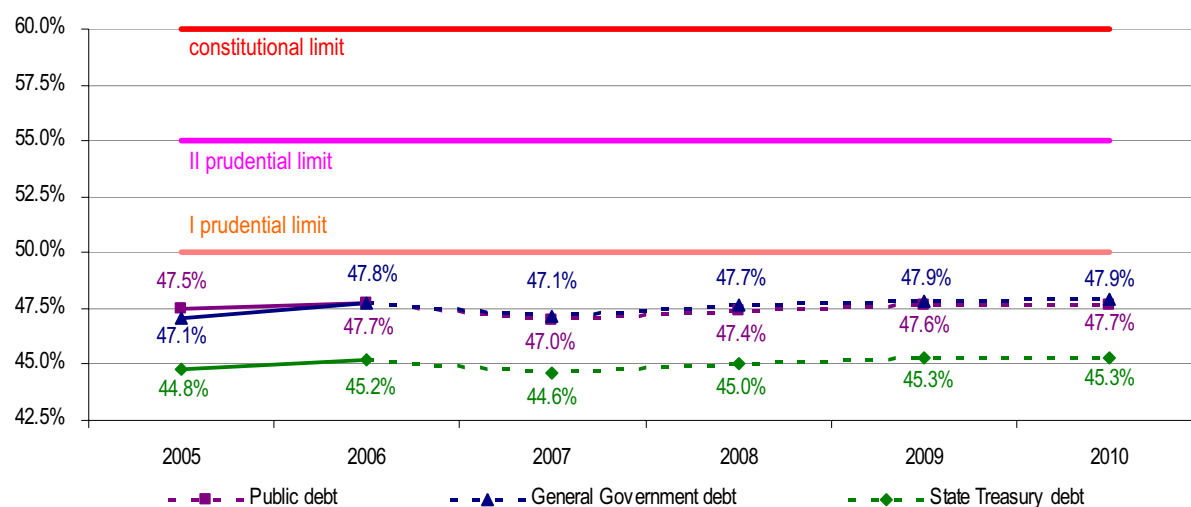


Chart 13. ST debt servicing costs-to-GDP ratio.

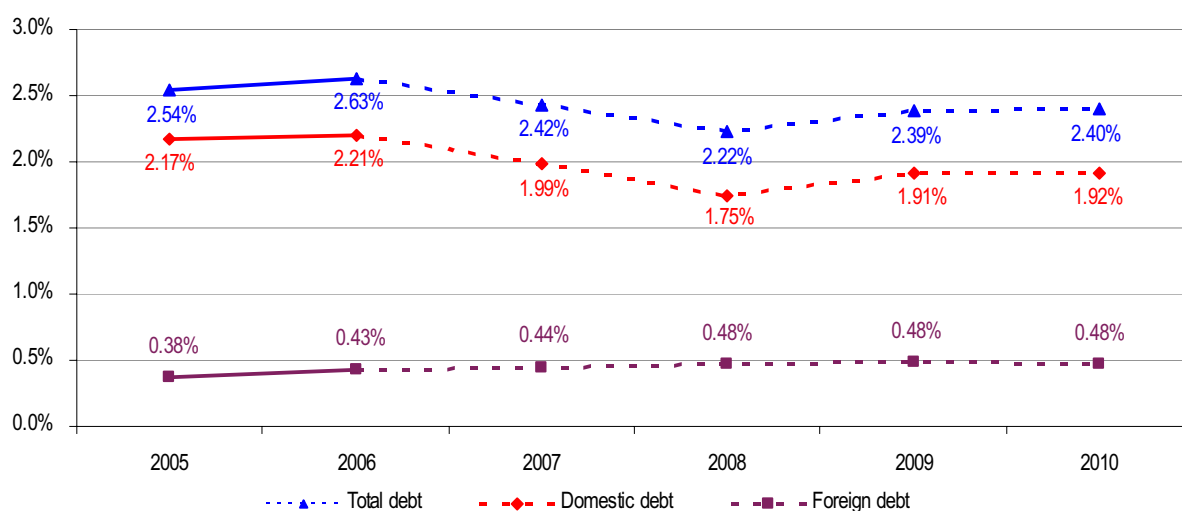


Chart 14. Sensitivity of public debt-to-GDP ratio to changes in assumptions

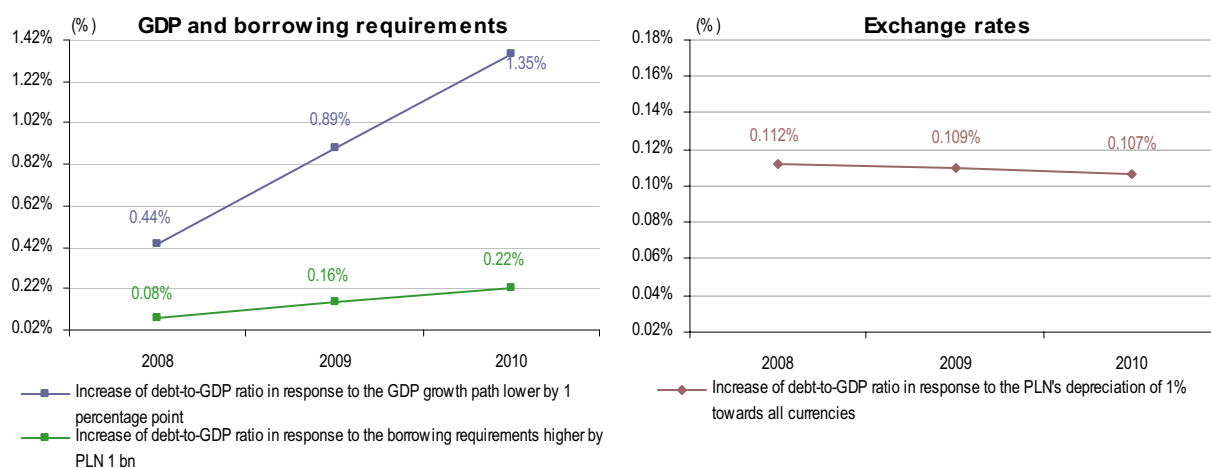
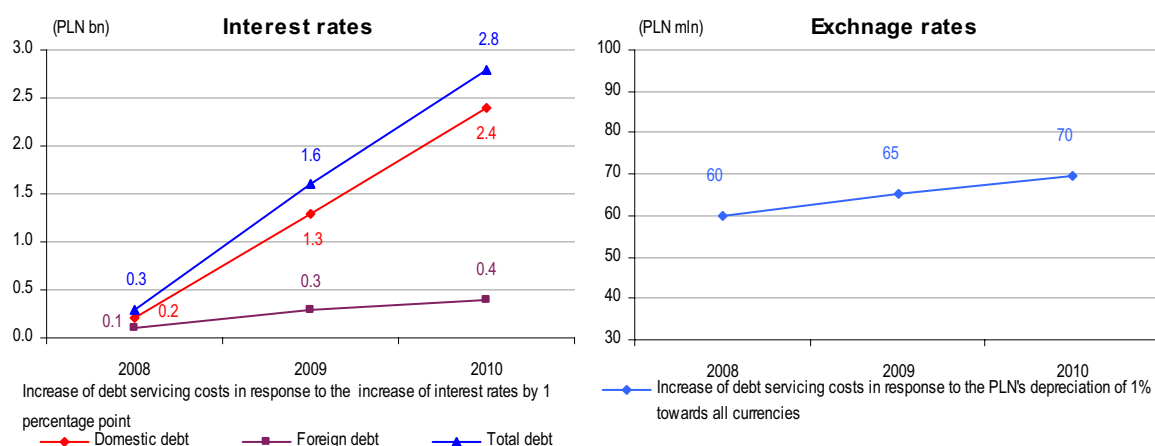


Chart 15. Sensitivity of the ST debt servicing costs to changes in assumptions



### Contingent liabilities (guarantees and sureties)

According to the adopted Strategy of granting guarantees and sureties it is expected that the ratio of the ST contingent liabilities resulting from granted guarantees and sureties to GDP will not exceed 4.5%, while the ratio of risk-weighted payments resulting from granted guarantees and sureties to GDP will not exceed 1.4%.

Table 16. Forecasts of contingent liabilities and risk-weighted payments resulting from guarantees and sureties granted by the ST in the years 2007-2010

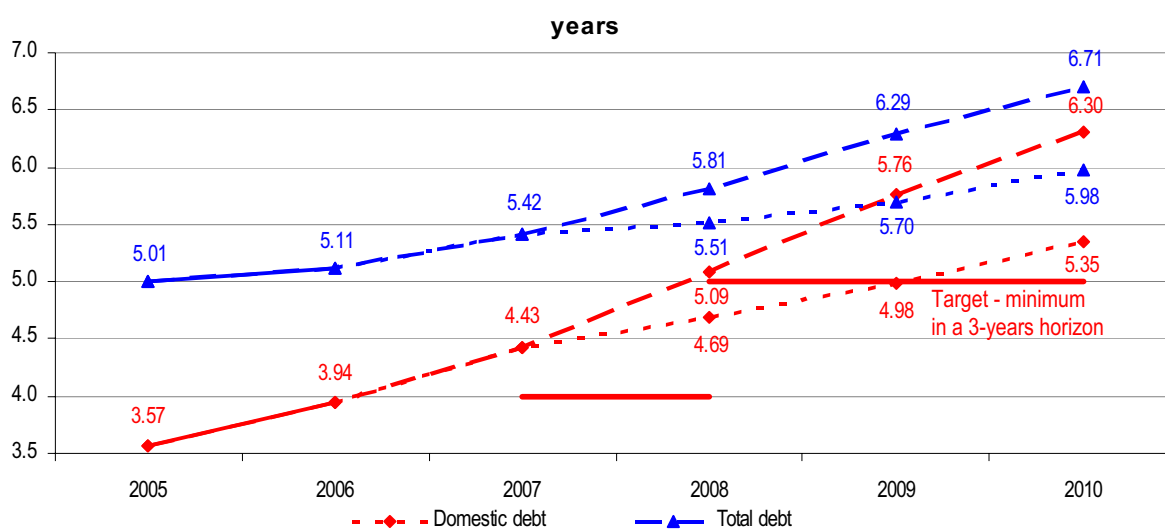
		2007	2008	2009	2010
Contingent liabilities	PLN billion	33.9	47.5	54.1	57.0
	Relative to GDP	2.9%	3.8%	4.0%	3.9%
Risk-weighted payments	PLN billion	9.0	11.6	13.0	13.7
	Relative to GDP	0.8%	0.9%	1.0%	0.9%

## VII.2. State Treasury debt structure

It is forecasted that in the horizon of the Strategy:

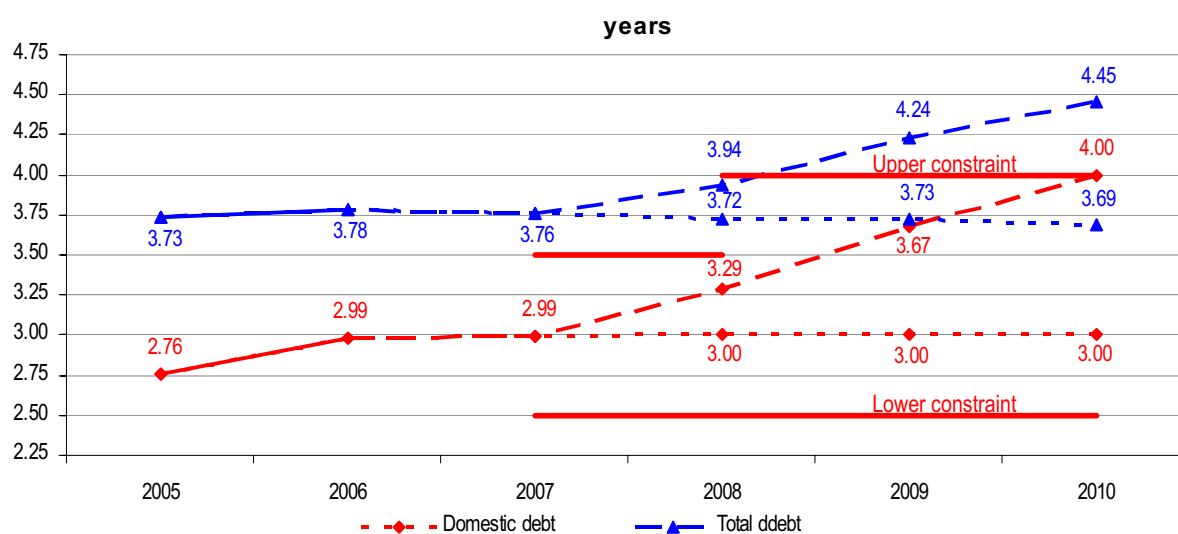
- the refinancing risk will be further reduced – ATM of the domestic marketable debt will increase, depending on adopted financing strategy, to 5.3-6.3 years, while ATM of the total ST debt will be in the range of 6.0-6.7 years,

Chart 16. ATM of the ST debt



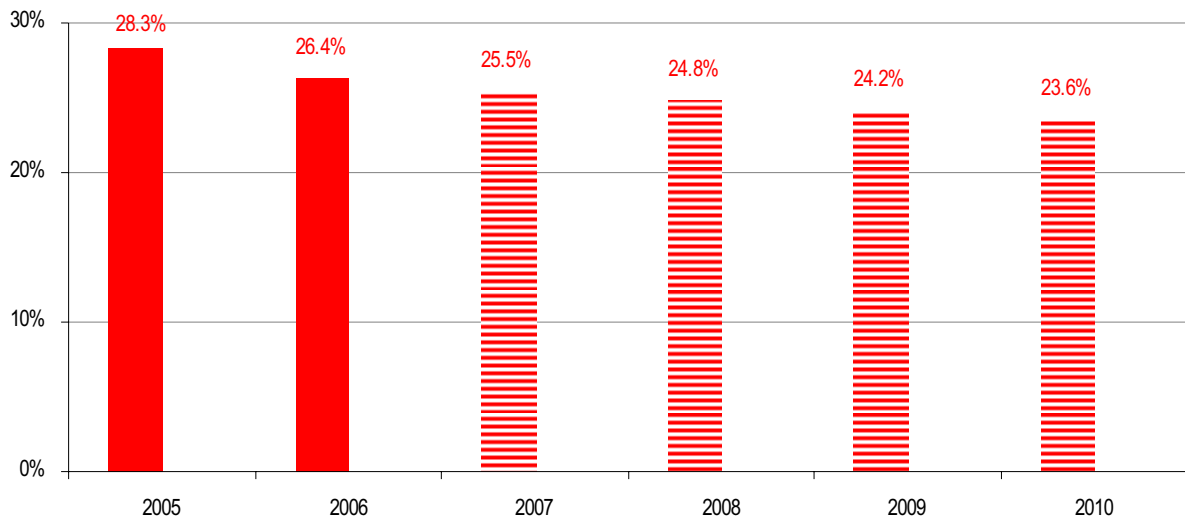
- the interest rate risk will be slightly reduced – duration of the domestic marketable debt will be in the range of 3-4 years, duration of the total debt in the range of 3.7-4.5 years,

Chart 17. Duration of the ST debt.



- the FX risk will be further reduced – share of the foreign debt in total debt will decrease from 26.7% (mid 2007) and will be in the range of 20%-25%,

Chart 18. Share of foreign debt in the ST debt.



### VII.3. Threats to the implementation of the Strategy

The main possible threats to the implementation of the Strategy are:

- 1) Risk that condition of public finances will deteriorate. This condition is influenced by:
  - the level of State budget borrowing requirements (main component of an increase in public debt),
  - growth rate of debt of public finance sector entities other than the ST,
  - guarantees and sureties granted by public finance sector entities.

Financing the infrastructure investments (co-financed from the EU funds) connected with preparations to the EURO2012 event will be particularly challenging for all three above mentioned areas.
- 2) Alternative to the assumed development of macroeconomic situation in Poland, particularly the decrease in the GDP growth rate, larger than forecasted growth of prices and increase in interest rates, as well as volatility of the FX rate.
- 3) Development of situation in the world's economy, including:
  - possible slowdown of the GDP growth,
  - outflow of funds from emerging markets caused by changes in risk aversion in the global investors community,
  - possible harmful consequences of the sub-prime mortgages crisis in the USA for other segments of the financial market;
- 4) Uncertainty related to Poland's entry to the Eurozone and its impact on the exchange rate and interest rates.



## Annex 1. Glossary

**ATR** (*average time to refinancing*) – the measure of interest rate risk related to the public debt. *ATR* is interpreted as the average period, expressed in years, for which the debt servicing costs are set. The larger the share of short-term and floating rate instruments, the higher the interest rate risk and the lower *ATR*. *ATR* was introduced in 2005 as a complementary to duration measure of the interest rate risk that covers debt both with indexed and non-indexed principal. *The ATR* of domestic marketable TS is calculated according to the following formula:

$$ATR = \frac{\sum_{r \in R} rNZ_r + \sum_{t \in T} tNS_t + \sum_{j \in J} \frac{1}{12} NI_j I_0}{\sum_{r \in R} NZ_r + \sum_{t \in T} NS_t + \sum_{j \in J} NI_j I_0}$$

where:

$r$  – payment date of the nearest fixed coupon for floating-rate instruments,

$t$  – maturity date for fixed-rate instruments,

$j$  – maturity date for inflation-linked instruments,

$R$  – set of all payment dates of the nearest fixed coupons for floating-rate instruments,

$T$  – set of all maturity dates for fixed-rate instruments,

$J$  – set of all maturity dates for inflation-linked instruments,

$NZ_r$  – face value of floating-rate instruments,

$NS_t$  – face value of fixed-rate instruments,

$NI_j$  – (non-indexed) face value of inflation-linked instruments,

$I_0$  – current indexation coefficient of inflation-linked instruments' face value.

**Average maturity** (also *ATM* – *average time to maturity*) – the measure of public debt refinancing risk. Average maturity is the average period, expressed in years, after which the issued debt will be redeemed. The further the maturity dates, the lower the refinancing risk and the higher the average maturity. Average maturity of domestic marketable TS is calculated according to the following formula:

$$ATM = \frac{\sum_{t \in T} tN_t I_0}{\sum_{t \in T} N_t I_0}$$

where:

$t$  – maturity date,

$T$  – set of all maturity dates,

$N_t$  – face value paid at time  $t$ ,

$I_0$  – current indexation coefficient of inflation-linked instruments' face value (for non-indexed Treasury Securities  $I_0 = 1$ ).

### Benchmark

1. (*issue*) the large amount of TS issue with a liquid secondary market. Yields of benchmark bonds are a reference point for yields in a given maturity segment. In the *Strategy* it was assumed that all new issues of fixed-rate bonds, except for two-year bonds (used for the medium-term liquidity management) should achieve a benchmark status. The minimum face value of the issue ensuring the liquidity was set at an equivalent of EUR 5 billion on the domestic market and EUR 5 billion on the Euro market. On other markets the value of the benchmark depends on issuer's preferences connected with refinancing risk and standard of market's development.
2. (*portfolio*) target characteristics of the public debt portfolio, which constitutes a *reference portfolio* for the existing portfolio and specifies the direction of public debt management.

The characteristics of the reference portfolio may include the share of particular currencies, interest rates and types of instruments, as well as the values of synthetic indicators which most often constitute the risk measures, e.g. the average maturity or duration.

**Contingent liabilities** – liabilities that are not public debt, but which can become public debt once a specific event takes place. Guaranties and sureties granted by the public finance sector units are a classical example of contingent liabilities. In the case of execution of a guaranty or surety, the liabilities became payable and increase expenditures of an entity that granted them, thus increasing its borrowing requirements and public debt.

**Credit risk** – associated with the risk that the other party of the transaction will fail to meet its obligations in whole or in part. The risk occurs as a result of transactions in assets. For the entity managing the debt such a situation occurs when financial derivatives are used, swaps in particular. Credit risk also occurs in liquid assets management, e.g. through making deposits with banks and purchase of securities.

Credit risk is managed mainly by choosing partners with high creditworthiness (measured by their ratings) and by setting limits for total transaction size for partners, dependent on their credit credibility and type of transaction.

**Duration** – the measure of vulnerability of debt servicing costs to changes of interest rates and thus the measure of interest rate risk related to public debt. *Duration* is interpreted as the average period (expressed in years) of debt servicing costs adjustment to the change of interest rate levels. The higher the level of interest rates and the larger the share of short-term and floating-rate instruments, the higher the interest rate risk and the lower *duration*. *Duration* of domestic marketable TS is calculated according to the following formula:

$$Duration = \frac{\sum_{r \in S} \frac{rCFZ_s}{(1+i_s)^s} + \sum_{s \in S} \frac{sCFS_s}{(1+i_s)^s}}{\sum_{s \in S} \frac{CFZ_s}{(1+i_s)^s} + \sum_{s \in S} \frac{CFS_s}{(1+i_s)^s}}$$

where:

$s$  – payment date (of interest or face value),

$S$  – set of all payment dates (of interest or face value),

$r=r(s)$ , ( $r \in R$ ) – payment date of the nearest fixed coupon for floating-rate instruments,

$R$  – set of all payment dates of the nearest fixed coupons for floating-rate instruments,

$CFZ_s$  - payment (of interest or face value) for floating-rate instruments,

$CFS_s$  – payment (of interest or face value) for fixed-rate instruments,

$i_s$  – zero-coupon interest rate for term  $s$ .

Duration of total debt of the ST is weighted average of appropriate duration coefficients for every currency, where weights are marketable value of debt in particular currency.

**Exchange rate risk** – stems from the existence in the ST debt instruments denominated and settled in foreign currencies. The exchange rate risk manifests itself in the vulnerability of the debt level and debt servicing costs to exchange rate fluctuations, which is a consequence of the floating exchange rate regime applied in Poland. The Zloty appreciation or depreciation against a given foreign currency results in a proportional increase or decrease (in the zloty terms) of debt volume and debt servicing costs denominated in this currency.

**Financial derivatives** – financial instruments, which depend on the value of other assets called basic instruments. They are used to change the risk profile of the parties concluding a transaction in financial derivatives, i.e. hedging against risk, change of one type of risk to

another or an conversion of the cost into the risk (a trade-off – a decrease in costs and an increase in risk). The examples of financial derivatives most often used in public debt management include swaps and options.

**Interest rate risk** - risk that payments related to the debt servicing costs will change as a consequence of a change in interest rates. It stems from the necessity to finance the debt maturing in the future at unknown rates and from volatility of coupon payments of the floating-rate debt.

**Operational risk** – risk associated with the threat that the costs related to the debt management or the level of other types of risk will increase due to an inadequate to the scope of tasks infrastructure, organization and control of the debt management. Operational risk is the type of risk most difficult to measure.

Limiting the operational risk is achieved by integration of public debt management procedures in one organizational entity, having its structure, infrastructure and procedures adjusted to efficient operations in the environments of state administration and financial markets.

**Option** – the right (but not the obligation) to buy or sell a specified asset at an agreed price, which the issuer of the option is obliged to observe with respect to the holder of the option. The options may be separate financial instruments or they may be built into other instruments, e.g. an option to present savings bonds to the State Treasury for early redemption.

**Place of issue criterion** – the criterion of the division of public debt into domestic and foreign debt, according to which the domestic debt is the debt issued on the domestic market.

**Primary Dealers** – a group of institutions selected through a competition that have specific rights and obligations related to the participation in the primary and secondary TS market. The dealers act as intermediaries between the issuer and other entities in TS trading and have the exclusive access to the primary market.

**Private placement** – an issuance addressed to a selected investor or group of investors.

**Reference portfolio** – see *benchmark (portfolio)*.

**Refinancing risk** – associated with debt issuance in order to finance the State borrowing needs resulting from the redemption of the existing debt. The risk applies to both the ability to redeem maturing debt and conditions on which it is refinanced (including in particular servicing costs generated by newly issued debt). The larger the payment related to the redemption of maturing debt and the closer the date of redemption, the larger the risk related to refinancing of this debt. The refinancing risk is influenced by the level of outstanding debt and its maturity profile. The extension of the debt maturity and the even distribution of debt redemption over time contribute to the reduction of refinancing risk.

**Resident criterion** - the criterion of the division of public debt into domestic or foreign debt, according to which the domestic debt is the debt owned by domestic investors (i.e. investors with the place of residence or registered seat in Poland).

**Spread** – the difference between yields of two securities. In narrower meaning credit *spread* (also credit margin) – the difference between yields of two securities with all the characteristics (especially maturity date) identical (or almost identical) except for issuer. Spread is often understood as a difference between yields of credit risk-burdened and credit risk free (or characterized by the lowest risk in the class) security.

**State budget liquidity risk** – risk associated with the loss of the state budget's ability to meet the current obligations and to timely execute budget expenditures. In order to reduce this risk the State budget should have an access to the adequate amount of liquid financial assets, enabling the independence from temporary events of crises which prevent or make difficult the acquisition of funds on the financial market at rational cost.

State budget liquidity risk is managed by keeping safe reserve of funds at the lowest possible level on one hand (by improving the process of state budget liquidity planning and monitoring) and on the other by the management of liquid assets in a way that they generate budget revenues which in the highest possible extent compensate for costs of keeping a given level of liquidity.

**Swap** – exchange of streams of payments with rules of calculating their value specified in advance, which takes place between the parties of the agreement. *Swap* is a financial instrument from the group of the so-called *financial derivatives*. *Swap* may be a separate financial instrument or it may accompany other instruments.

## **Annex 2. Institutional framework for public debt management in the EU Member States**

There exists no unified institutional model of State Treasury debt management in the EU Member States. Three basic types of organizational arrangements can be identified:

- the bank model - debt management in the central bank,
- the government model - debt management in a ministry (usually the Ministry of Finance or State Treasury),
- the agency model - debt management in a specialized institution (agency) whose fundamental (but sometimes not sole) task is debt management.

**The bank model** is the most strongly criticized one, as a potential conflict of interest may occur between monetary policy and public debt management. The central bank in such a situation may:

- treat debt management in an instrumental manner and concentrate on goals of monetary policy,
- be less inclined to increase interest rates in situations of inflationary risk (as this would increase costs related to debt) or it may even influence the interest rates or increase the market liquidity just prior to a TS auction in order to achieve better prices and lower financing costs.

In both cases the execution of tasks imposed on the central bank is not optimal. In addition, even if monetary policy and debt management are entrusted to different divisions and the so-called “Chinese Wall” is used, suspicions can arise that some information on interest rate levels unknown to the market may be used in debt management, thus reducing trust in the issuer and resulting in investors requesting an additional risk premium for Treasury securities.

An argument used by supporters of the solution of placing debt management within the central bank is their conviction that the central bank is better prepared for performing activities on the financial market than units remaining within the structure of a ministry.

**The government model** is used successfully in conditions typical for developing economies or economies undergoing transformations where development of the domestic financial market is low, though used also in some developed economies<sup>7</sup>. This is due to the significant ability of the government to influence the creation of appropriate legal and institutional infrastructure, necessary for the efficient functioning of the financial market. However, the disadvantages of this solution become increasingly visible in developed and stable economies:

- the threat of favouring short-term budgetary goals over long-term objectives of debt management, which may lead to an increase in both the risk associated with debt structure as well as the debt servicing costs in the long term,
- lack of sufficient flexibility as well as ability to react quickly enough to changes of market conditions (which is especially important if financial derivatives are used for debt management) arising from the significant bureaucracy of administrative entities,
- difficulties in recruiting and retaining appropriately trained specialists due to uncompetitive employment conditions for state administration employees as compared to those offered by financial sector companies (banks, investment funds, etc.).

**The agency model** dominates in the EU Member States. The term “agency” is a certain type of generalization (it does not mean a government agency as defined by Polish law) as specialized institutions involved in debt management in different countries vary significantly, both in respect to the scope of tasks entrusted to them as well as the level of their institutional independence. Their common feature though is their high level of autonomy in selecting methods used to fulfil the entrusted tasks. The advantages associated with entrusting debt management to specialized institutions include:

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<sup>7</sup> The government model is used in such countries as Spain or Italy.

- the ability to select optimal solutions as well as to carry out long-term debt management objectives by limiting the risk of impact of short-term fiscal policy goals on management decisions,
- ensuring greater transparency of management operations through the use of better control and reporting mechanisms, thus increasing investor confidence and lowering costs of financing of borrowing needs,
- the need to prepare clear and unambiguous procedures enabling prompt decision making on market transactions (a necessary condition for efficient, active debt management),
- the ability to face competition from commercial financial institutions (recruitment and retention of highly qualified specialists).

The mandate of the agency is usually to carry out guidelines specified by the Minister of Finance and its activities are audited in order to ensure the compliance with these guidelines. Therefore, in the case of the agency model, preparation of the appropriate legislative and organizational solutions is very important in order to ensure good cooperation between the Minister of Finance who specifies the objectives and the agency that carries them out.

At present in 14 out of 27 Member States of the enlarged EU the agency model is applied (in 11 out of 15 Member States before the enlargement).

Table 1. Institutions responsible for debt management the EU Member States

Country	Model	Institution name
Austria	Agency	Österreichische Bundesfinanzierungsagentur
Belgium		Agence de la Dette (Agentschap van de Schuld)
Finland		Valtiokonttori
France		Agence France Trésor
Greece		Debt Office
Germany		Finanzagentur GmbH
Hungary		Magyar Allampapír
Ireland		National Treasury Management Agency
Latvia		Valsts Kase
Malta		Debt Management Office
Netherlands		Agentschap van het ministerie van Financiën
Portugal		Instituto de Gestão do Crédito Público
Slovakia		Státna pokladnica
Sweden		Riksgäldskontoret
United Kingdom		Debt Management Office
Cyprus	Bank	Κεντρική Τραπεζα Της Κύπρου
Denmark		Dansk Nationalbanken
Bulgaria	Government	Министерство на финансите
Czech Republic		Ministerstvo financí
Estonia		Rahandusministeerium
Greece		Γενικό Λογιστήριο Τοῦ Κρατοῦς
Italy		Ministero dell'Economia e delle Finanze
Lithuania		Finansų Ministerija
Luxembourg		Ministère des Finances
Poland		Ministerstwo Finansów
Romania		Ministerul Economiei și Finanțelor
Slovenia		Ministrstvo za finance
Spain		Ministerio de Economía

### Annex 3. General government deficit and debt and yields on 10-year bonds in the EU Member States

	2005			2006		
	General government balance %GDP	General government debt %GDP	10-year rate <sup>1)</sup>	General government balance %GDP	General government debt %GDP	10-year rate <sup>1)</sup>
Greece	-5.5	107.5	3.57	-2.6	104.6	4.04
Italy	-4.2	106.2	3.55	-4.4	106.8	4.04
Belgium	0.2	93.2	3.39	-2.3	89.1	3.82
Malta	-3.1	72.4	4.39	-2.6	66.5	4.33
Cyprus	-2.3	69.2	4.09	-1.5	65.3	4.26
Germany	-3.2	67.9	3.34	-1.7	67.9	3.77
France	-3.0	66.2	3.38	-2.5	63.9	3.81
Portugal	-6.1	63.6	3.46	-3.9	64.7	3.96
Austria	-1.6	63.5	3.36	-1.1	62.2	3.80
Hungary	-7.8	61.7	6.89	-9.2	66.0	6.81
Netherlands	-0.3	52.7	3.35	0.6	48.7	3.81
Sweden	2.1	52.2	3.37	2.2	46.9	3.65
<b>Poland<sup>2)</sup></b>	<b>-4.3</b>	<b>47.1</b>	<b>5.16</b>	<b>-3.9</b>	<b>47.8</b>	<b>5.14</b>
Spain	1.1	43.2	3.57	1.8	39.9	3.82
United Kingdom	2.1	42.2	4.27	2.2	43.5	4.54
Finland	2.7	41.4	3.30	3.9	39.1	3.82
Denmark	4.7	36.3	3.35	4.2	30.2	3.78
Slovakia	-2.8	34.5	3.62	-3.4	30.7	4.15
Czech Republic	-3.5	30.4	3.61	-2.9	30.4	3.68
Bulgaria	1.9	29.2	-	3.3	22.8	4.18
Slovenia	-1.5	28.4	3.69	-1.4	27.8	3.90
Ireland	1.0	27.4	3.36	2.9	24.9	3.76
Lithuania	-0.5	18.6	3.79	-0.3	18.2	4.28
Romania	-1.4	15.8	-	-1.9	12.4	7.42
Latvia	-0.2	12.0	3.59	0.4	10.0	4.90
Luxembourg	-0.3	6.1	3.40	0.1	6.8	3.95
Estonia	2.3	4.4	3.94	3.8	4.1	4.70
<b>UE 27</b>	<b>-2.4</b>	<b>62.9</b>	<b>-</b>	<b>-1.7</b>	<b>61.7</b>	<b>-</b>
<b>Euro zone</b>	<b>-2.5</b>	<b>70.5</b>	<b>-</b>	<b>-1.6</b>	<b>69.0</b>	<b>-</b>

<sup>1)</sup> Harmonized long-term interest rates for convergence purposes, i.e. rates on the secondary market (with the exception of Cyprus and Latvia – primary market); for Luxembourg – index based on basket of long-term bonds issued by private credit institutions with an average actual maturity close to 10 years; for Estonia: an interest rate on loans for non-financial companies and households with maturity close to 10 years; Statistics Pocket Book, ECB.

<sup>2)</sup> Data for Poland – Ministry of Finance; other data – Eurostat Euro-indicators, News Release 55/2007 of April 23 2007;

#### Annex 4. Government debt rating of the EU Member States

Table 2. Long-term government debt rating in foreign currency of the EU Member States

As of August 31, 2007

	<b>Moody's</b>	<b>Standard&amp;Poor's</b>	<b>Fitch</b>
Austria	Aaa	AAA	AAA
Belgium	Aa1	AA+	AA+
Bulgaria	Baa3	BBB+	BBB
Cyprus	A1	A	AA-
Czech Republic	A1	A-	A
Denmark	Aaa	AAA	AAA
Estonia	A1	A	A
Finland	Aaa	AAA	AAA
France	Aaa	AAA	AAA
Germany	Aaa	AAA	AAA
Greece	A1	A	A
Hungary	A2	BBB+	BBB+
Ireland	Aaa	AAA	AAA
Italy	Aa2	A+	AA-
Latvia	A2	BBB+	BBB+
Lithuania	A2	A	A
Luxembourg	Aaa	AAA	AAA
Malta	A2	A	A+
Netherlands	Aaa	AAA	AAA
<b>Poland</b>	<b>A2</b>	<b>A-</b>	<b>A-</b>
Portugal	Aa2	AA-	AA
Romania	Baa3	BBB-	BBB
Slovakia	A1	A	A
Slovenia	Aa2	AA	AA
Spain	Aaa	AAA	AAA
Sweden	Aaa	AAA	AAA
United Kingdom	Aaa	AAA	AAA

Source: International Financing Review, September 1, 2007



## Annex 5. ATM and duration of public debt of the EU Member States in 2006

	ATM			Duration		
	Total	Domestic	Foreign	Total	Domestic	Foreign
Austria	8.11	8.39	3.54	5.90	6.10	3.30
Belgium	6.71	6.74	1.29	*	*	*
Bulgaria**	*	7.13	*	*	*	*
Czech Republic	6.20	*	*	*	*	*
Cyprus	*	*	*	*	*	*
Denmark	5.20	5.60	2.60	3.30	4.10	- 2.00
Estonia	*	*	*	*	*	*
Finland	4.00	4.00	0.10	2.60	2.60	0.10
France	7.10	7.10	*	*	*	*
Germany	6.30	6.30	3.42	*	*	*
Greece	7.17	*	*	*	5.00	*
Hungary	4.56	3.64	6.90	3.09	2.62	4.30
Ireland	6.04	*	*	5.16	*	*
Italy	6.57	6.77	9.48	4.37	4.40	4.79
Latvia***	*	*	*	3.07	4.13	2.31
Lithuania	*	*	*	*	*	*
Luxembourg	7.47	*	*	*	*	*
Malta	*	*	*	*	*	*
Netherlands	6.40	6.40	*	*	*	*
<b>Poland</b>	<b>5.36</b>	<b>4.27</b>	<b>8.33</b>	<b>3.81</b>	<b>3.01</b>	<b>5.97</b>
Portugal	5.80	*	*	3.03	*	*
Romania	*	*	*	*	*	*
Slovakia	5.10	4.10	9.30	4.00	3.20	8.70
Slovenia	*	*	*	*	*	*
Spain	6.70	6.70	*	5.00	5.01	*
Sweden	3.10	3.50	2.10	*	*	*
United Kingdom	*	13.90	1.50	*	8.60	1.50

\*) Not available.

Source: OECD, [www.oecd.int](http://www.oecd.int).

\*\*\*) Ministry of Finance of The Republic of Bulgaria, [www.minfin.government.bg](http://www.minfin.government.bg).

\*\*\*\*) The Treasury Republic of Latvia, [www.kase.gov.lv](http://www.kase.gov.lv).

## Annex 6. Legal regulations applied to public debt in Poland and the EU

Table 3. Public debt – basic legal regulations

Polish regulations	EU regulations
<p>1. Constitution of the Republic of Poland</p> <ul style="list-style-type: none"> <li>➤ ban on contracting loans and granting guarantees and sureties resulting in the public debt exceeding 3/5 of GDP (Article 216(5));</li> </ul>	<p>1. The Maastricht Treaty</p> <ul style="list-style-type: none"> <li>➤ level of general government debt and restrictions applied to general government deficit constitute the criterion on the basis of which the Commission examines the compliance with budgetary discipline in Member States (Article 104) – specifies so called: Excessive Deficit Procedure (EDP);</li> </ul>
<p>2. Public Finance Act</p> <ul style="list-style-type: none"> <li>➤ regulations on public debt: definitions, basic principles of issuing public debt and debt management, prudential and remedial procedures applied to public debt levels (50%, 55% and 60% of GDP);</li> <li>➤ definition of the scope of the public finance sector.</li> </ul>	<p>2. Protocol on the excessive deficit procedure annexed to the Maastricht Treaty</p> <ul style="list-style-type: none"> <li>➤ definition of general government debt and reference value of debt to GDP ratio at 60%;</li> </ul>
	<p>3. Council Regulation on the application of the Protocol on the Excessive Deficit Procedure annexed to the Maastricht Treaty</p> <ul style="list-style-type: none"> <li>➤ definition of general government debt with specification of categories of liabilities which constitute it;</li> </ul>
	<p>4. The European System of Accounts (ESA'95)</p> <ul style="list-style-type: none"> <li>➤ definition of categories of financial liabilities;</li> <li>➤ definition of general government sector.</li> </ul>

Table 4. Limits of the Public Finance Act on the public debt to GDP ratio

I. Legal procedures regarding limits on public debt to GDP ratio
<p>1) the ratio in year x is greater than 50%, and not greater than 55%:</p> <ul style="list-style-type: none"> <li>a. the state budget deficit to state budget revenue ratio in the draft budget act adopted by the Council of Ministers for the year x+2 cannot be higher than in the year x+1;</li> <li>b. the state budget deficit to state budget revenue ratio adopted for the year x+2 is the upper limit on the deficit to revenue ratio in the budget act of each local government unit for the year x+2;</li> </ul>
<p>2) the ratio in year x is greater than 55%, and lower than 60%:</p> <ul style="list-style-type: none"> <li>a. the level of state deficit in adopted draft budget act by the Council of Ministers for the year x+2 must ensure a decrease in the ratio of the State Treasury debt to GDP in relation to the ratio announced for the year;</li> <li>b. the upper limit on the deficit to revenue ratio of each local government unit for the year x+2 is calculated by multiplying the state budget deficit to revenue ratio adopted for the year x+2 by coefficient "R", calculated as:  <math display="block">R = (0.6 - PD/GDP) : 0.05</math>                     where: GDP - gross domestic product, PD - public debt are amounts announced for the previous budget year (year x);</li> <li>c. the Council of Ministers presents a remedial program ensuring a fall in the ratio of public debt to GDP;</li> </ul>
<p>3) the ratio in year x is equal to or greater than 60%:</p> <ul style="list-style-type: none"> <li>a. both the state budget and budgets of local government units for the year x+2 must at least be balanced;</li> <li>b. a ban on granting new sureties and guarantees by public finance sector entities is introduced;</li> <li>c. the Council of Ministers presents to the Parliament a remedial programme with the main objective to prepare and implement actions aimed at reducing the public debt-to-GDP ratio below 60%;</li> </ul>
II. Principles and limits on incurring liabilities by local government units
<p>a) Local government units can incur loans and issue securities for:</p> <ul style="list-style-type: none"> <li>➤ repayment of earlier incurred liabilities resulting from securities and loans,</li> <li>➤ covering temporary budget deficit of local government within the fiscal year,</li> <li>➤ financing of planned budget deficits;</li> </ul>
<p>b) Loans incurred and securities issued for covering temporary budget deficit of local government have to be paid off or redeemed in the same year as they were incurred or issued;</p>
<p>c) Local government can only incur these liabilities of which servicing costs are borne at least once a year, while:</p> <ul style="list-style-type: none"> <li>➤ discount of securities issued by local government cannot exceed 5% of their face value,</li> <li>➤ capitalization of interest is inadmissible;</li> </ul>
<p>d) For a local government unit, the ratio of total debt in a fiscal year to:</p>

<ul style="list-style-type: none"> <li>➤ installments of loans and interest payable in this fiscal year,</li> <li>➤ redemption of securities and interest payable on them,</li> <li>➤ potential payments resulting from sureties and guarantees granted, to planned revenues cannot exceed 15%, in case when public debt to GDP ratio exceed 55%, it cannot exceed 12%;</li> </ul>
<p>e) The ratio of total debt at the end of a fiscal year to total revenues and of total debt at the end of quarter to planned revenues cannot exceed 60%;</p>
<p>f) Limitations on debt of local government are not applied to issuing securities and incurring loans in connection with financial means specified in an agreement with an entity that disposes the EU structural funds or the Cohesion Fund.</p>

Table 5. Main differences in general government debt – Polish and EU definition

<b>POLISH REGULATIONS</b>	<b>EU REGULATIONS</b>
<b>public debt</b>	<b>general government debt</b>
<b>1) scope of the public finance sector</b>	
<ul style="list-style-type: none"> <li>➤ Public Finance Act defines limited catalogue of units included in the public finance sector, which is divided into 3 sub-sectors : central government, local government, social security;</li> </ul>	<ul style="list-style-type: none"> <li>➤ scope of general government sector is defined in ESA'95 <sup>2)</sup>; no limited catalogue of units is defined;</li> </ul>
<i>differences in the scope of sector depending on regulations</i>	
a) State Road Fund (KFD) formed within Bank Gospodarstwa Krajowego (BGK) <ul style="list-style-type: none"> <li>➤ is excluded from the public finance sector;</li> </ul>	<ul style="list-style-type: none"> <li>➤ is included in the general government sector;</li> </ul>
b) research and development units <ul style="list-style-type: none"> <li>➤ are included in the public finance sector;</li> </ul>	<ul style="list-style-type: none"> <li>➤ are excluded from the general government units;</li> </ul>
c) Open Pensions Funds (OFE) <ul style="list-style-type: none"> <li>➤ are excluded from the public finance sector;</li> </ul>	<ul style="list-style-type: none"> <li>➤ till March 2007 a transition period was applied during which Poland could include OFE in the general government sector <sup>3)</sup>;</li> </ul>
<b>2) liabilities which constitute public debt</b>	
<ul style="list-style-type: none"> <li>➤ securities (excluding shares);</li> <li>➤ loans and credits (including securities whose disposal is limited);</li> <li>➤ deposits;</li> <li>➤ matured payables (i.e. liabilities due but not settled);</li> </ul>	<ul style="list-style-type: none"> <li>➤ securities other than shares excluding financial derivatives;</li> <li>➤ loans;</li> <li>➤ cash and deposits;</li> </ul>
<i>differences in liabilities depending on regulations</i>	
<ul style="list-style-type: none"> <li>➤ matured payables;</li> </ul>	- <sup>4)</sup>
<b>3) contingent liabilities</b>	
<i>differences in treatment of contingent liabilities in debt-to-GDP ratio</i>	
<ul style="list-style-type: none"> <li>➤ is not included; since January 2006 in line with the Act of 30 June 2005 on Public Finance the basic category of public debt to which all the limits apply is public debt without risk-weighted sureties and guarantees;</li> </ul>	<ul style="list-style-type: none"> <li>➤ EU limitations do not take directly into account contingent liabilities generated by issued sureties and guarantees;</li> <li>➤ when specific criteria are met (in line with ESA'95 rules) contingent liabilities should be treated as debt assumed by the entity which issued surety or guarantee;</li> </ul>

- 1) Polish Central Statistical Office is responsible for the scope of general government sector (in line with EU regulations).
- 2) Council Regulation No 2223/1995 on the European System of National and Regional Accounts in the Community. ESA'95 criteria apply first of all to functional activities of any entity and manner of their financing. Basic activity of a unit (i.e. redistribution of national income and wealth or being a non-market producer) is taken into account. In other cases 'the 50% rule' should apply (i.e. less than 50% of production costs is covered by sales).
- 3) Eurostat decision on classification of funded pension schemes in case of government responsibility or guarantee (Eurostat News Releases No 30/2004 from 2 March 2004 and No 117/2004 from 23 September 2004).
- 4) Matured payables are expenditure on accrual basis and thus are included in net borrowing/net lending calculated (balance of general government) in accordance with EU methodology.

## Annex 7. Basic categories of debt and their GDP ratios in the period 2001-Jun 2007

Table 6. Public debt in the period 2001-VI 2007

	2001	2002	2003	2004	2005	2006	Jun 2007
<b>1. State Treasury debt</b>							
a) PLN billion	283.9	327.9	378.9	402.9	440.2	478.5	486.3
domestic *	185.0	219.3	251.2	291.7	315.5	352.3	356.6
foreign *	98.9	108.6	127.8	111.2	124.7	126.2	129.7
b) GDP %	36.4%	40.6%	44.9%	43.6%	44.8%	45.2%	-
<b>2. Public debt</b>							
a) PLN billion	302.1	352.4	408.3	431.4	466.6	505.0	511.1
b) GDP %	38.8%	43.6%	48.4%	46.7%	47.5%	47.7%	-
<b>3. General government debt (EU methodology)</b>							
a) PLN billion	292.8	340.9	396.7	422.4	462.7	505.2	511.6
b) GDP %	37.6%	42.2%	47.1%	45.7%	47.1%	47.8%	-

\*) place of issue criterion.

Tabela 7. GDP and exchange rates in the period 2001-Jun 2007

	2001	2002	2003	2004	2005	2006	Jun 2007
<b>1. Gross Domestic Product</b>							
PLN billion	779.6	808.6	843.2	924.5	983.3	1 057.9	-
<b>2. Exchange rate</b>							
a) EUR	3.5219	4.0202	4.7170	4.0790	3.8598	3.8312	3.7658
b) USD	3.9863	3.8388	3.7405	2.9904	3.2613	2.9105	2.7989

## Annex 8. Debt of the public finance sector and debt of the State Treasury in Poland

Table 8. Debt of the public finance sector before consolidation \*

Debt of the public finance sector		2005		2006				2007			
		December	Structure	Change Dec 2005 - Dec 2006		December	Structure	Change Dec 2006 - Jun 2007		June	Structure
		PLN mln	%	PLN mln	%	PLN mln	%	PLN mln	%	PLN mln	%
<b>BEFORE CONSOLIDATION</b>		<b>477 108.7</b>	<b>100.0%</b>	<b>39 861.6</b>	<b>8.4%</b>	<b>516 970.3</b>	<b>100.0%</b>	<b>4 975.2</b>	<b>1.0%</b>	<b>521 945.5</b>	<b>100.0%</b>
1.	Debt of central government sub-sector	442 693.7	92.8%	39 557.9	8.9%	482 251.6	93.3%	6 399.1	1.3%	488 650.6	93.6%
1.1.	State Treasury	440 167.3	92.3%	38 359.1	8.7%	478 526.4	92.6%	7 759.7	1.6%	486 286.1	93.2%
1.2.	National Health Fund	400.9	0.1%	-320.7	-80.0%	80.2	0.0%	-80.2	-100.0%	0.0	0.0%
1.3.	State earmarked funds with legal personality	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-	0.0	0.0%
1.4.	State higher schools	185.1	0.0%	134.0	72.4%	319.1	0.1%	-89.4	-28.0%	229.7	0.0%
1.5.	Research and development units	275.5	0.1%	20.0	7.2%	295.5	0.1%	-15.6	-5.3%	279.9	0.1%
1.6.	Independent public health care units	952.6	0.2%	198.6	20.8%	1 151.2	0.2%	-51.1	-4.4%	1 100.1	0.2%
1.7.	State cultural units	34.8	0.0%	4.0	11.6%	38.8	0.0%	16.2	41.6%	55.0	0.0%
1.8.	Polish Academy of Science (PAN) and units established by it	7.7	0.0%	9.8	127.9%	17.5	0.0%	-4.8	-27.5%	12.7	0.0%
1.9.	Other State legal entities established under separate acts for public tasks execution, with the exception of enterprises, banks and companies organized under commercial law	669.8	0.1%	1 153.1	172.1%	1 823.0	0.4%	-1 135.7	-62.3%	687.3	0.1%
2.	Debt of local government sub-sector	27 320.3	5.7%	3 612.9	13.2%	30 933.1	6.0%	-1 317.3	-4.3%	29 615.8	5.7%
2.1.	Local government units and their associations	21 268.9	4.5%	3 782.9	17.8%	25 051.8	4.8%	-1 516.5	-6.1%	23 535.3	4.5%
2.2.	Local government earmarked funds with legal personality	186.9	0.0%	-25.5	-13.6%	161.4	0.0%	25.6	15.9%	187.1	0.0%
2.3.	Independent public health care units	5 793.5	1.2%	-158.2	-2.7%	5 635.2	1.1%	203.1	3.6%	5 838.3	1.1%
2.4.	Local cultural units	33.7	0.0%	40.7	120.9%	74.4	0.0%	-31.3	-42.1%	43.0	0.0%
2.5.	Other local legal entities established under separate acts for public tasks execution, with the exception of enterprises, banks and companies organized under commercial law	37.3	0.0%	-27.1	-72.5%	10.3	0.0%	1.8	18.0%	12.1	0.0%
3.	Debt of social security sub-sector	7 094.7	1.5%	-3 309.1	-46.6%	3 785.6	0.7%	-106.6	-2.8%	3 679.0	0.7%
3.1.	Social Insurance Institution (ZUS)	0.03	0.0%	0.02	-61.9%	0.01	0.0%	0.01	-45.5%	0.01	0.0%
3.2.	Funds managed by Social Insurance Institution	7 094.7	1.5%	-3 309.1	-46.6%	3 785.6	0.7%	-106.6	-2.8%	3 679.0	0.7%
3.3.	Farmer's Social Insurance Institution (KRUS) and funds manager by it	0.0	0.0%	0.0	0.0%	0.0	-	0.0	-	0.0	0.0%

\*) preliminary data on September 13, 2007

Table 9. Debt of the public finance sector after consolidation \*

Debt of the public finance sector		2005		2006				2007			
		December	Structure	Change Dec 2005 - Dec 2006		December	Structure	Change Dec 2006 - Jun 2007		June	Structure
				PLN mln	%			PLN mln	%		
<b>AFTER CONSOLIDATION</b>		<b>466 601.0</b>	<b>100.0%</b>	<b>38 390.4</b>	<b>8.2%</b>	<b>504 991.4</b>	<b>100.0%</b>	<b>6 128.2</b>	<b>1.0%</b>	<b>511 119.6</b>	<b>100.0%</b>
1.	Debt of central government sub-sector	439 334.1	94.2%	38 588.8	8.8%	477 922.9	94.6%	7 022.8	1.3%	484 945.6	94.9%
1.1.	State Treasury	438 416.2	94.0%	38 136.1	8.7%	476 552.4	94.4%	7 094.0	1.3%	483 646.3	94.6%
1.2.	National Health Fund	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-	0.0	0.0%
1.3.	State earmarked funds with legal personality	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-	0.0	0.0%
1.4.	State higher schools	146.6	0.0%	101.1	69.0%	247.6	0.0%	-48.0	-19.4%	199.7	0.0%
1.5.	Research and development units	152.9	0.0%	33.6	22.0%	186.4	0.0%	-5.9	-3.1%	180.6	0.0%
1.6.	Independent public health care units	525.8	0.1%	182.1	34.6%	707.9	0.1%	-9.0	-1.3%	698.9	0.1%
1.7.	State cultural units	34.5	0.0%	3.7	10.7%	38.2	0.0%	8.1	21.2%	46.2	0.0%
1.8.	Polish Academy of Science (PAN) and units established by it	3.2	0.0%	5.8	182.4%	9.0	0.0%	-4.7	-52.1%	4.3	0.0%
1.9.	Other State legal entities established under separate acts for public tasks execution, with the exception of enterprises, banks and companies organized under commercial law	54.9	0.0%	126.4	230.2%	181.3	0.0%	-11.7	-6.5%	169.6	0.0%
2.	Debt of local government sub-sector	20 172.2	4.3%	3 110.8	15.4%	23 283.0	4.6%	-787.9	-3.4%	22 495.0	4.4%
2.1.	Local government units and their associations	17 155.7	3.7%	2 835.1	16.5%	19 990.8	4.0%	-1 077.0	-5.4%	18 913.7	3.7%
2.2.	Local government earmarked funds with legal personality	1.33	0.0%	-1.32	-99.2%	0.01	0.0%	0.01	-84.5%	0.00	0.0%
2.3.	Independent public health care units	2 953.1	0.6%	273.8	9.3%	3 226.9	0.6%	311.6	9.7%	3 538.5	0.7%
2.4.	Local cultural units	25.5	0.0%	31.0	121.6%	56.5	0.0%	-24.7	-43.7%	31.8	0.0%
2.5.	Other local legal entities established under separate acts for public tasks execution, with the exception of enterprises, banks and companies organized under commercial law	36.6	0.0%	-27.8	-75.9%	8.8	0.0%	2.2	24.7%	11.0	0.0%
3.	Debt of social security sub-sector	7 094.7	1.5%	-3 309.1	-46.6%	3 785.6	0.7%	-106.6	-2.8%	3 679.0	0.7%
3.1.	Social Insurance Institution (ZUS)	0.03	0.0%	0.02	-61.9%	0.01	0.0%	0.01	-45.5%	0.01	0.0%
3.2.	Funds managed by Social Insurance Institution	7 094.7	1.5%	-3 309.1	-46.6%	3 785.6	0.7%	-106.6	-2.8%	3 679.0	0.7%
3.3.	Farmer's Social Insurance Institution (KRUS) and funds managed by it	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-	0.0	0.0%

\*) preliminary data on September 13, 2007

STATE TREASURY DEBT according to the place of issue criterion, by instrument (PLN mln, at nominal value, eop)

	Dec 2005	Dec 2006	Jun 2007	structure Jun 2007 %%	change Dec 2006 - Dec 2005		change Jun 2007 - Dec 2006	
					PLN mln	%%	PLN mln	%%
<b>State Treasury debt</b>	<b>440 167.3</b>	<b>478 526.4</b>	<b>486 286.1</b>	<b>100.0%</b>	<b>38 359.1</b>	<b>8.7%</b>	<b>7 759.7</b>	<b>1.6%</b>
<b>I. Domestic debt</b>	<b>315 478.5</b>	<b>352 328.0</b>	<b>356 617.8</b>	<b>73.3%</b>	<b>36 849.4</b>	<b>11.7%</b>	<b>4 289.9</b>	<b>1.2%</b>
<b>1. Treasury Securities <sup>1)</sup></b>	<b>311 965.8</b>	<b>350 533.7</b>	<b>356 436.8</b>	<b>73.3%</b>	<b>38 567.9</b>	<b>12.4%</b>	<b>5 903.1</b>	<b>1.7%</b>
<b>1.1. Marketable Treasury Securities</b>	<b>302 780.8</b>	<b>342 845.7</b>	<b>349 417.0</b>	<b>71.9%</b>	<b>40 064.9</b>	<b>13.2%</b>	<b>6 571.2</b>	<b>1.9%</b>
Treasury bills	24 400.0	25 800.0	20 000.0	4.1%	1 400.0	5.7%	-5 800.0	-22.5%
marketable bonds	278 380.8	317 045.7	329 417.0	67.7%	38 664.9	13.9%	12 371.2	3.9%
marketable fixed-income bonds	241 756.3	271 773.0	279 431.0	57.5%	30 016.7	12.4%	7 657.9	2.8%
2-year zerocoupon bonds	57 148.1	52 461.4	45 719.4	9.4%	-4 686.7	-8.2%	-6 742.0	-12.9%
5-year fixed-income bonds	86 728.3	88 146.0	95 770.0	19.7%	1 417.7	1.6%	7 624.0	8.6%
5-year fixed-income retail bonds	3 199.9	2 736.0	2 049.9	0.4%	-463.8	-14.5%	-686.1	-25.1%
10-year fixed-income bonds	85 700.3	112 412.1	117 464.1	24.2%	26 711.8	31.2%	5 052.0	4.5%
20-year fixed-income bonds	6 411.5	13 449.2	14 859.2	3.1%	7 037.7	109.8%	1 410.0	10.5%
30-year fixed-income bonds	-	-	1 000.0	0.2%	-	-	1 000.0	-
10-year fixed-income bonds - debt conversion <sup>2)</sup>	2 568.3	2 568.3	2 568.3	0.5%	0.0	0.0%	0.0	0.0%
marketable floating rate notes	31 945.2	38 796.2	42 883.2	8.8%	6 851.0	21.4%	4 087.0	10.5%
3-year retail FRN	3 496.1	2 825.9	2 748.9	0.6%	-670.2	-19.2%	-77.0	-2.7%
3-year FRN	6 738.2	4 558.6	-	-	-2 179.6	-32.3%	-4 558.6	-100.0%
7-year FRN	9 063.5	19 670.4	19 670.4	4.0%	10 606.9	117.0%	0.0	0.0%
10-year FRN (WZ)	-	-	8 459.6	1.7%	-	-	8 459.6	-
10-year FRN (DZ)	11 897.5	10 991.3	11 254.4	2.3%	-906.1	-7.6%	263.0	2.4%
private placement FRN	750.0	750.0	750.0	0.2%	0.0	0.0%	0.0	0.0%
marketable index-linked bonds	4 679.2	6 476.5	7 102.8	1.5%	1 797.2	38.4%	626.3	9.7%
12-year index-linked	4 679.2	6 476.5	7 102.8	1.5%	1 797.2	38.4%	626.3	9.7%
<b>1.2. Savings bonds</b>	<b>8 619.5</b>	<b>7 205.1</b>	<b>6 580.0</b>	<b>1.4%</b>	<b>-1 414.5</b>	<b>-16.4%</b>	<b>-625.0</b>	<b>-8.7%</b>
2-year savings bonds	7 928.0	6 432.4	5 751.6	1.2%	-1 495.6	-18.9%	-680.8	-10.6%
4-year savings bonds	561.3	568.1	535.0	0.1%	6.8	1.2%	-33.0	-5.8%
10-year savings bonds	130.3	204.6	293.4	0.1%	74.3	57.0%	88.8	43.4%
<b>1.3. Non-marketable T-Bonds</b>	<b>565.5</b>	<b>482.9</b>	<b>439.8</b>	<b>0.1%</b>	<b>-82.6</b>	<b>-14.6%</b>	<b>-43.1</b>	<b>-8.9%</b>
Bonds issued for Bank BGŻ S.A.	565.5	482.9	439.8	0.1%	-82.6	-14.6%	-43.1	-8.9%
<b>2. Other domestic ST debt</b>	<b>3 512.8</b>	<b>1 794.3</b>	<b>181.1</b>	<b>0.0%</b>	<b>-1 718.5</b>	<b>-48.9%</b>	<b>-1 613.2</b>	<b>-89.9%</b>
automobile prepayments <sup>3)</sup>	3.2	3.1	3.1	0.0%	0.0	-1.5%	0.0	-0.5%
matured payables <sup>3) 4)</sup>	12.0	36.7	39.6	0.0%	24.7	204.9%	2.9	7.9%
liabilities arising from not increasing wages in the budgetary sector	197.5	154.4	138.3	0.0%	-43.1	-21.8%	-16.1	-10.4%
Employment Fund debt <sup>5)</sup>	3 300.0	1 600.0	0.0	0.0%	-1 700.0	-51.5%	-1 600.0	-100.0%
<b>II. Foreign debt</b>	<b>124 688.8</b>	<b>126 198.4</b>	<b>129 668.3</b>	<b>26.7%</b>	<b>1 509.7</b>	<b>1.2%</b>	<b>3 469.8</b>	<b>2.7%</b>
<b>1. Treasury Securities</b>	<b>83 862.0</b>	<b>90 639.0</b>	<b>97 264.5</b>	<b>20.0%</b>	<b>6 777.0</b>	<b>8.1%</b>	<b>6 625.6</b>	<b>7.3%</b>
Brady Bonds	3 891.5	1 761.1	1 693.6	0.3%	-2 130.4	-54.7%	-67.5	-3.8%
international bonds	79 970.5	88 877.9	95 571.0	19.7%	8 907.4	11.1%	6 693.1	7.5%
<b>2. Foreign Loans</b>	<b>40 826.8</b>	<b>35 559.4</b>	<b>32 403.7</b>	<b>6.7%</b>	<b>-5 267.4</b>	<b>-12.9%</b>	<b>-3 155.7</b>	<b>-8.9%</b>
Paris Club	25 153.5	17 941.3	14 517.9	3.0%	-7 212.2	-28.7%	-3 423.3	-19.1%
International Financial Institutions	15 260.7	17 377.8	17 676.2	3.6%	2 117.0	13.9%	298.5	1.7%
of which: European Investment Bank	9 340.4	11 365.3	12 021.5	2.5%	2 024.8	21.7%	656.2	5.8%
other creditors	412.6	240.4	209.5	0.0%	-172.2	-41.7%	-30.9	-12.8%

1) Treasury Securities by original maturity;

2) On September 30 and December 29, 1999, convertible bonds, USD bonds for buy-back of Brady bonds, long-term liabilities towards NBP and bonds issued to implement the agreement with the Paris Club were converted to marketable bonds;

3) quarterly data;

4) item includes matured liabilities of budgetary units, budgetary entities, ancillary entities and State earmarked funds without legal standing; debt in this item includes inter alia liabilities towards banks;

5) arising from loans drawn in commercial banks.



DOMESTIC STATE TREASURY DEBT according to the place of issue criterion by holder (PLN mln, at nominal value, eop)<sup>1)</sup>

	Dec 2005	Dec 2006	Jun 2007	structure	change		change	
				Jun 2007	Dec 2006 - Dec 2005		Jun 2007 - Dec 2006	
				%	PLN mln	%	PLN mln	%
<b>Domestic State Treasury debt</b>	<b>315 478.5</b>	<b>352 328.0</b>	<b>356 617.8</b>	<b>100.0%</b>	<b>36 849.4</b>	<b>11.7%</b>	<b>4 289.9</b>	<b>1.2%</b>
<b>DOMESTIC BANKING SECTOR</b>	<b>75 017.8</b>	<b>80 629.5</b>	<b>69 560.5</b>	<b>19.5%</b>	<b>5 611.6</b>	<b>7.5%</b>	<b>-11 069.0</b>	<b>-13.7%</b>
<b>Treasury Securities</b>	<b>71 717.8</b>	<b>79 029.5</b>	<b>69 560.5</b>	<b>19.5%</b>	<b>7 311.6</b>	<b>10.2%</b>	<b>-9 469.0</b>	<b>-12.0%</b>
Marketable Treasury Securities	71 152.4	78 546.6	69 120.7	19.4%	7 394.2	10.4%	-9 425.9	-12.0%
Treasury bills	9 756.6	10 804.9	7 239.5	2.0%	1 048.3	10.7%	-3 565.3	-33.0%
2-year zerocoupon bonds	17 048.6	12 586.4	11 686.6	3.3%	-4 462.2	-26.2%	-899.8	-7.1%
3-year retail FRN	627.2	523.6	544.7	0.2%	-103.6	-16.5%	21.0	4.0%
3-year FRN	4 107.4	2 951.1	-	-	-1 156.3	-28.2%	-2 951.1	-100.0%
5-year fixed-income bonds	21 325.8	22 063.8	19 941.5	5.6%	738.0	3.5%	-2 122.3	-9.6%
5-year fixed-income retail bonds	91.9	105.2	13.9	0.0%	13.2	14.4%	-91.3	-86.8%
7-year FRN	2 528.6	8 445.0	6 309.6	1.8%	5 916.5	234.0%	-2 135.5	-25.3%
10-year FRN (WZ)	-	-	1 518.1	0.4%	-	-	1 518.1	-
10-year FRN (DZ)	2 826.3	2 909.2	2 062.0	0.6%	83.0	2.9%	-847.2	-29.1%
10-year fixed-income bonds	12 366.3	17 615.9	19 360.9	5.4%	5 249.6	42.5%	1 745.0	9.9%
10-year fixed-income bonds - debt conversion	79.1	150.2	125.6	0.0%	71.2	90.0%	-24.6	-16.4%
private placement FRN	15.0	15.0	15.0	0.0%	0.0	0.0%	0.0	0.0%
12-year index-linked	16.3	2.1	31.5	0.0%	-14.3	-87.3%	29.4	1423.9%
20-year fixed-income bonds	363.1	374.0	201.6	0.1%	10.9	3.0%	-172.4	-46.1%
30-year fixed-income bonds	-	-	70.0	0.0%	-	-	70.0	-
Non-marketable T-bonds	565.5	482.9	439.8	0.1%	-82.6	-14.6%	-43.1	-8.9%
Bonds issued for Bank BGZ S.A.	565.5	482.9	439.8	0.1%	-82.6	-14.6%	-43.1	-8.9%
Other domestic ST debt	3 300.0	1 600.0	0.0	0.0%	-1 700.0	-51.5%	-1 600.0	-100.0%
matured payables	0.0	0.0	0.0	0.0%	0.0	-	0.0	-100.0%
Employment Fund debt	3 300.0	1 600.0	0.0	0.0%	-1 700.0	-51.5%	-1 600.0	-100.0%
<b>DOMESTIC NON-BANKING SECTOR</b>	<b>171 529.3</b>	<b>197 321.0</b>	<b>213 437.4</b>	<b>59.9%</b>	<b>25 791.7</b>	<b>15.0%</b>	<b>16 116.4</b>	<b>8.2%</b>
<b>Treasury Securities</b>	<b>171 316.5</b>	<b>197 126.7</b>	<b>213 256.3</b>	<b>59.8%</b>	<b>25 810.2</b>	<b>15.1%</b>	<b>16 129.6</b>	<b>8.2%</b>
Marketable Treasury Securities	162 703.9	189 928.8	206 681.9	58.0%	27 225.0	16.7%	16 753.1	8.8%
Treasury bills	14 369.1	14 988.7	12 708.7	3.6%	619.6	4.3%	-2 280.0	-15.2%
2-year zerocoupon bonds	33 585.9	35 740.3	30 918.0	8.7%	2 154.4	6.4%	-4 822.4	-13.5%
3-year retail FRN	2 863.4	2 298.7	2 195.3	0.6%	-564.7	-19.7%	-103.4	-4.5%
3-year FRN	2 626.8	1 605.4	-	-	-1 021.4	-38.9%	-1 605.4	-100.0%
5-year fixed-income bonds	41 574.1	44 313.5	53 633.7	15.0%	2 739.4	6.6%	9 320.2	21.0%
5-year fixed-income retail bonds	3 102.3	2 625.6	2 031.1	0.6%	-476.7	-15.4%	-594.5	-22.6%
7-year FRN	6 527.8	11 223.1	13 353.9	3.7%	4 695.3	71.9%	2 130.7	19.0%
10-year FRN (WZ)	-	-	6 933.3	1.9%	-	-	6 933.3	-
10-year FRN (DZ)	8 860.1	7 871.2	8 981.7	2.5%	-988.9	-11.2%	1 110.5	14.1%
10-year fixed-income bonds	41 761.0	57 805.5	63 328.5	17.8%	16 044.5	38.4%	5 523.0	9.6%
10-year fixed-income bonds - debt conversion	2 489.2	2 418.0	2 442.7	0.7%	-71.2	-2.9%	24.6	1.0%
private placement FRN	735.0	735.0	735.0	0.2%	0.0	0.0%	0.0	0.0%
12-year index-linked	508.4	1 274.2	2 197.6	0.6%	765.8	150.6%	923.4	72.5%
20-year fixed-income bonds	3 700.8	7 029.5	6 661.4	1.9%	3 328.8	89.9%	-368.1	-5.2%
30-year fixed income bonds	-	-	561.0	0.2%	-	-	561.0	-
Savings bonds	8 612.6	7 197.9	6 574.4	1.8%	-1 414.7	-16.4%	-623.4	-8.7%
2-year savings bonds	7 921.9	6 426.2	5 746.9	1.6%	-1 495.8	-18.9%	-679.3	-10.6%
4-year savings bonds	560.6	567.3	534.3	0.1%	6.7	1.2%	-33.0	-5.8%
10-year savings bonds	130.1	204.5	293.3	0.1%	74.3	57.1%	88.8	43.4%
Other domestic ST debt	212.8	194.3	181.1	0.1%	-18.5	-8.7%	-13.2	-6.8%
automobile prepayments	3.2	3.1	3.1	0.0%	0.0	-1.5%	0.0	-0.5%
matured payables	12.0	36.7	39.6	0.0%	24.7	204.9%	2.9	7.9%
liabilities arising from not increasing wages in the budgetary sector	197.5	154.4	138.3	0.0%	-43.1	-21.8%	-16.1	-10.4%
<b>TS's HELD BY FOREIGN INVESTORS</b>	<b>68 931.4</b>	<b>74 377.5</b>	<b>73 620.0</b>	<b>20.6%</b>	<b>5 446.1</b>	<b>7.9%</b>	<b>-757.5</b>	<b>-1.0%</b>
<b>Treasury Securities</b>	<b>68 931.4</b>	<b>74 377.5</b>	<b>73 620.0</b>	<b>20.6%</b>	<b>5 446.1</b>	<b>7.9%</b>	<b>-757.5</b>	<b>-1.0%</b>
Marketable Treasury Securities	68 924.5	74 370.3	73 614.4	20.6%	5 445.8	7.9%	-755.9	-1.0%
Treasury bills	274.3	6.5	51.8	0.0%	-267.8	-97.6%	45.3	698.9%
2-year zerocoupon bonds	6 513.5	4 134.7	3 114.9	0.9%	-2 378.9	-36.5%	-1 019.8	-24.7%
3-year retail FRN	5.4	3.6	9.0	0.0%	-1.8	-33.7%	5.4	149.6%
3-year FRN	4.0	2.2	-	-	-1.8	-45.8%	-	-
5-year fixed-income bonds	23 828.4	21 768.7	22 194.8	6.2%	-2 059.7	-8.6%	426.2	2.0%
5-year fixed-income retail bonds	5.6	5.2	5.0	0.0%	-0.4	-7.0%	-0.3	-5.2%
7-year FRN	7.1	2.2	6.9	0.0%	-4.9	-69.2%	4.7	215.6%
10-year FRN (WZ)	-	-	8.1	0.0%	-	-	8.1	-
10-year FRN (DZ)	211.0	210.9	210.6	0.1%	-0.2	-0.1%	-0.3	-0.1%
10-year fixed-income bonds	31 573.0	36 990.6	34 774.7	9.8%	5 417.6	17.2%	-2 215.9	-6.0%
private placement FRN	0.0	0.0	0.0	0.0%	0.0	-	0.0	-
12-year index-linked	4 154.5	5 200.2	4 873.7	1.4%	1 045.7	25.2%	-326.6	-6.3%
20-year fixed-income bonds	2 347.6	6 045.7	7 996.1	2.2%	3 698.0	157.5%	1 950.5	32.3%
30-year fixed income bonds	-	-	369.0	0.1%	-	-	369.0	-
Savings bonds	6.9	7.2	5.6	0.0%	0.3	4.0%	-1.6	-22.4%
2-year savings bonds	6.0	6.2	4.7	0.0%	0.2	3.7%	-1.6	-25.0%
4-year savings bonds	0.7	0.8	0.7	0.0%	0.1	7.7%	0.0	-5.3%
10-year savings bonds	0.1	0.1	0.1	0.0%	0.0	-2.5%	0.0	0.0%

1) data covers flows between sectors, bonds by original maturity.