



Ministry
of Finance

Republic
of Poland

The Public Finance Sector Debt Management Strategy in the years 2014-17

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Ministry of Finance
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The Public Finance Sector Debt Management Strategy in the years 2014-2017

Macroeconomic assumptions

| Item | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|--------------------------------|---------|---------|---------|---------|---------|---------|
| Real GDP growth (%) | 1.9 | 1.5 | 2.5 | 3.8 | 4.3 | 4.3 |
| GDP in current prices (PLN bn) | 1 595.3 | 1 642.9 | 1 721.5 | 1 829.8 | 1 955.6 | 2 089.6 |
| CPI annual average (%) | 3.7 | 1.6 | 2.4 | 2.5 | 2.5 | 2.5 |
| USD/PLN (end of year) | 3.10 | 3.14 | 3.02 | 2.95 | 2.92 | 2.92 |
| EUR/PLN (end of year) | 4.09 | 4.07 | 3.92 | 3.84 | 3.80 | 3.80 |

The Public Finance Sector Debt Management Strategy in the years 2014-2017

Objective of the Strategy

▪ **Objective of the Strategy**

minimisation of the long term debt servicing costs subject to constraints on the level of:

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

▪ **Two aspects of the Strategy's objective:**

- Choice of instruments
- Efficiency of the TS market

The Public Finance Sector Debt Management Strategy in the years 2014-2017

Flexible approach to financing structure

DOMESTIC FINANCING

- main source of financing the borrowing requirements of the budget

FOREIGN FINANCING

- ensuring diversification of sources by Poland's access to the investor base in major financial markets
- taking into account the foreign currency borrowing requirements, including principal and interest payments on foreign debt
- maintaining Poland's position in the euro market and strengthening the position in the US dollar market
- utilizing an access to attractive financing in international financial institutions
- stabilising the domestic market by:
 - ensuring safety of financing the State budget borrowing requirements in case of temporary disruptions on the domestic market
 - absorbing foreign investors' demand for Polish treasury securities
- possible sale of foreign currencies on the financial market or in the NBP as an available instrument of managing foreign and domestic currency borrowing requirements, while taking into account considerations of monetary policy and financial rationale

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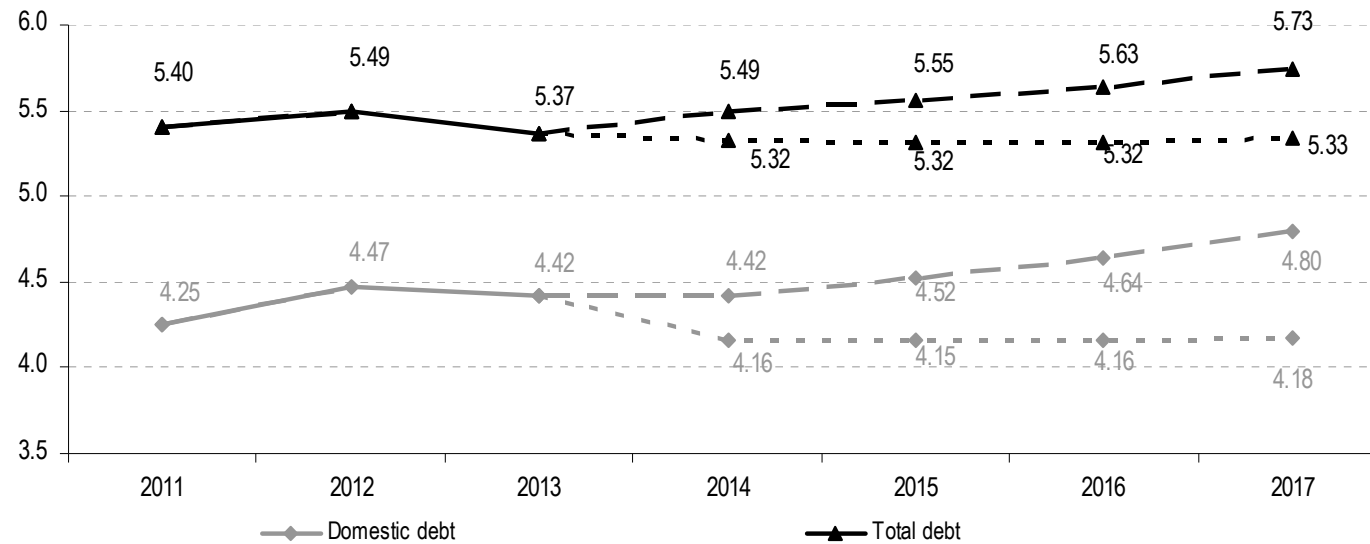
Risk constraints of the Strategy's objective: refinancing risk (1)

- aiming at increasing the role of medium- and long-term instruments in financing the State budget borrowing requirements on domestic market – at a pace dependent on investors' demand
- aiming at even distribution of redemptions and interest payments of domestic and foreign debt
- reaching and maintaining the average term to maturity (ATM) of domestic debt at about 4.5 years if the demand and the term structure of interest rates make it possible
- maintaining the ATM of State Treasury debt ≥ 5.0 years

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

ATM of the State Treasury debt



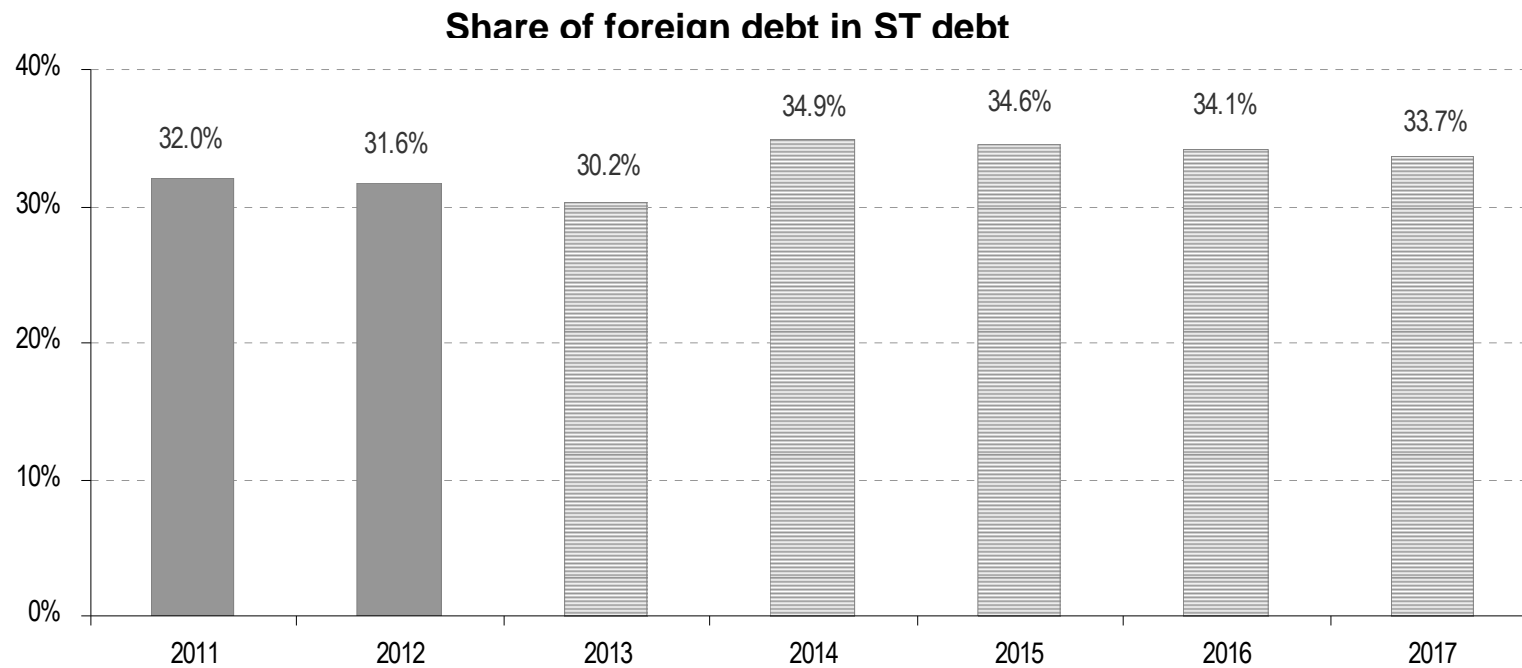
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Risk constraints of the Strategy's objective: exchange rate risk (1)

- temporary increase of the share of foreign currency denominated debt in State Treasury debt to 35%-37% at the end of 2014 as a result of changes in pension system, and its gradual decrease (depending on the market conditions) to the target share of 30%
- possible use of derivatives in exchange rate risk management
- maintaining an effective share of the euro in foreign currency debt at $\geq 70\%$, with possible temporary deviations in case of limited access to euro market, its ineffectiveness or unfavorable situation in the derivatives market

The Public Finance Sector Debt Management Strategy in the years 2014-2017

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



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

DOMESTIC DEBT

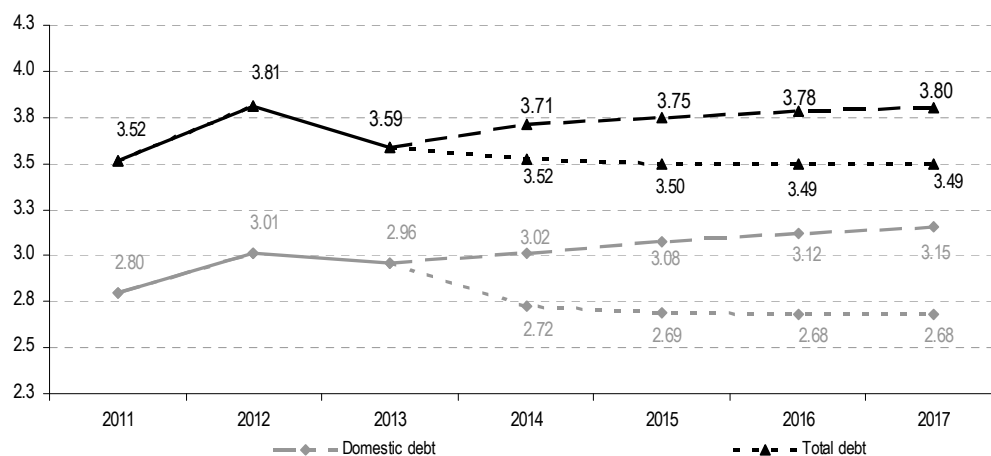
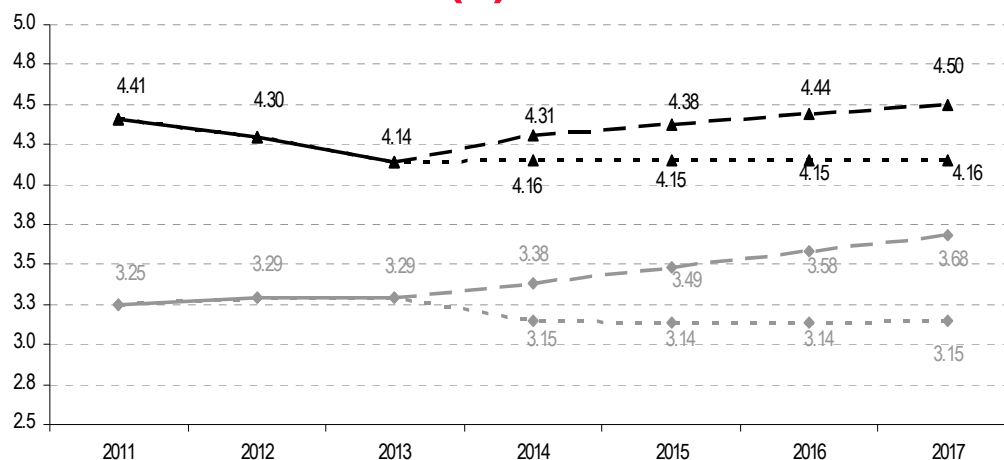
- maintaining average time to refixing (ATR) in the range of 2.8-4.0 years
- possible separation of interest rate and refinancing risks management by using floating rate bonds, inflation-linked bonds and derivatives

FOREIGN DEBT

- current level of risk does pose a threat to the cost minimization objective: in mid 2012 ATR amounted to 6.3 years

The Public Finance Sector Debt Management Strategy in the years 2014-2017

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



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Strategy tasks (1)

1. Increasing liquidity of the TS market

- continuation of issuing medium and long term fixed rate benchmark bonds (at least EUR 5 bn equivalent) in the domestic market
- neutralizing possible inadequacies in liquidity of certain bond issues by reopening those which outstanding value significantly decreased as a result of changes in pension system (depending on market and budgetary conditions)
- large liquid issues in the euro and US dollar markets
- expanding uniform price auction formula to switch auctions
- adapting issuance policy to market circumstances

2. Increasing efficiency of the TS market, including:

- issuance schedule adjusted to market and budgetary circumstances
- increasing the role of the participants of the Primary Dealers system
- removing technical and legal obstacles
- direct meetings with investors and consultations with market participants
- broadening the investor base, including non-deal roadshows in the key foreign markets
- broadening electronic communication channels with both foreign and domestic investors

The Public Finance Sector Debt Management Strategy in the years 2014-2017

Strategy tasks (2)

3. Increasing transparency of the TS market

- transparent issuance policy, including TS issuance calendars, supply plans of TS and supply offers for individual auctions
- promoting the electronic market

4. Broadening the scope of public finance sector liquidity management consolidation

- adding new groups of entities to the public finance sector units subject to the liquidity management consolidation
- utilisation of court deposits by placing them with the account of Minister of Finance instead of commercial banks
- temporary use of funds accumulated on the MoF guarantee provisions account to finance State budget borrowing requirements
- consolidation of foreign currency funds managed by the Minister of Finance

The Public Finance Sector Debt Management Strategy in the years 2014-2017

Debt forecasts

| Item | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|--|-------------|-------|-------|---------------|---------------|---------------|
| | (execution) | | | | | |
| 1. Public debt | | | | | | |
| a) bn PLN | 840.5 | 899.5 | 810.9 | 875.5 | 920.9 | 964.9 |
| b) GDP % | 52.7% | 54.8% | 47.1% | 47.8% | 47.1% | 46.2% |
| 2. The amount specified in article 38a of Public Finance Act* | | | | | | |
| a) bn PLN | 818,7 | 887,5 | 803,7 | 864,0 | 909,6 | 950,3 |
| b) GDP % | 51,3% | 54,0% | 46,7% | 47,2% | 46,5% | 45,5% |
| 3. General Government debt | | | | | | |
| a) bn PLN | 886.9 | 952.1 | 859.5 | 934.9 | 993.9 | 1 046.6 |
| b) GDP % | 55.6% | 58.0% | 49.9% | 51.1% | 50.8% | 50.1% |
| 4. State Treasury debt servicing costs | | | | | | |
| a) bn PLN | 42.1 | 42.7 | 36.2 | 35.4 – 37.0 | 37.9 – 39.5 | 41.2 – 43.0 |
| b) GDP % | 2.64% | 2.60% | 2.10% | 1.94% - 2.02% | 1.94% - 2.02% | 1.97% - 2.06% |

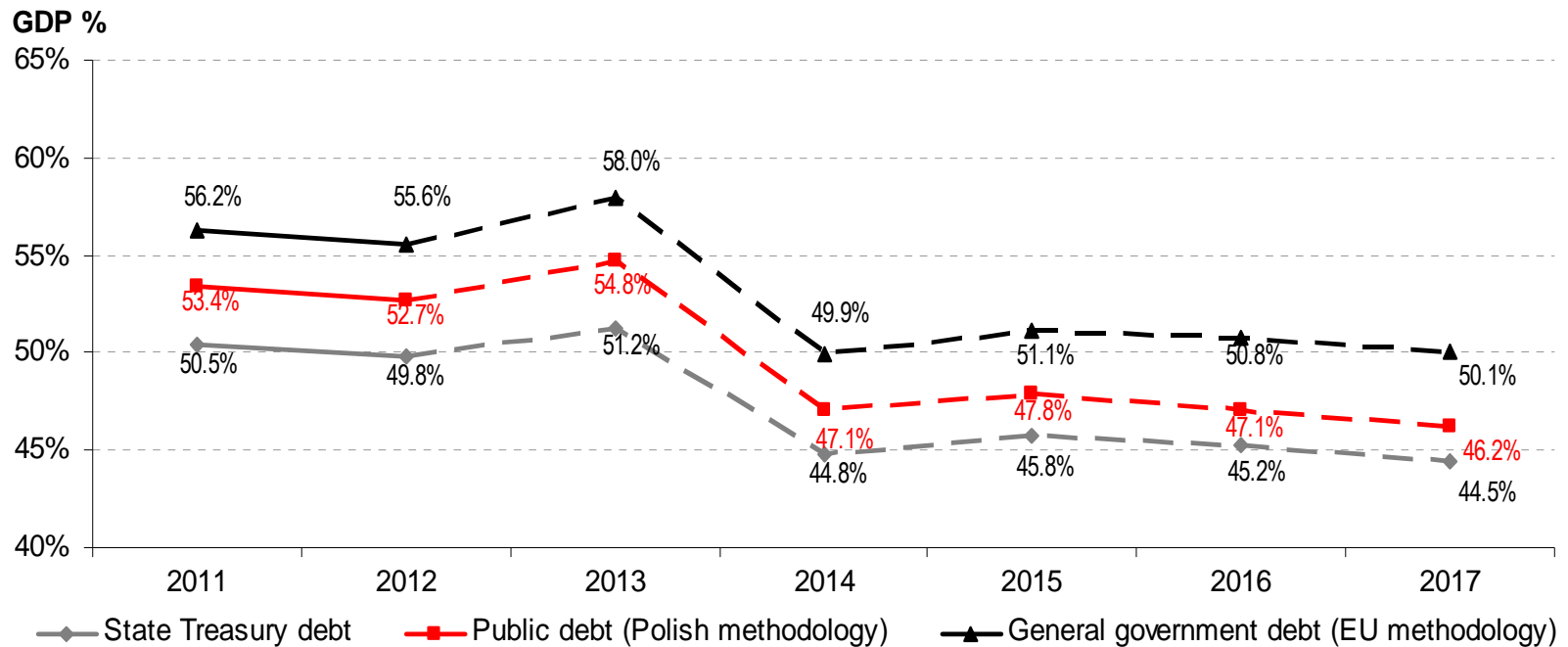
* The amount of public debt recalculated using the yearly average of foreign currency exchange rates for the year concerned and reduced by the value of State budget liquid funds raised to finance the borrowing requirements for the following budget year.

The Public Finance Sector Debt Management Strategy in the years 2014-2017

Public debt volume

Under the adopted assumptions in the *Strategy* timeframe the debt-to-GDP ratio will decrease:

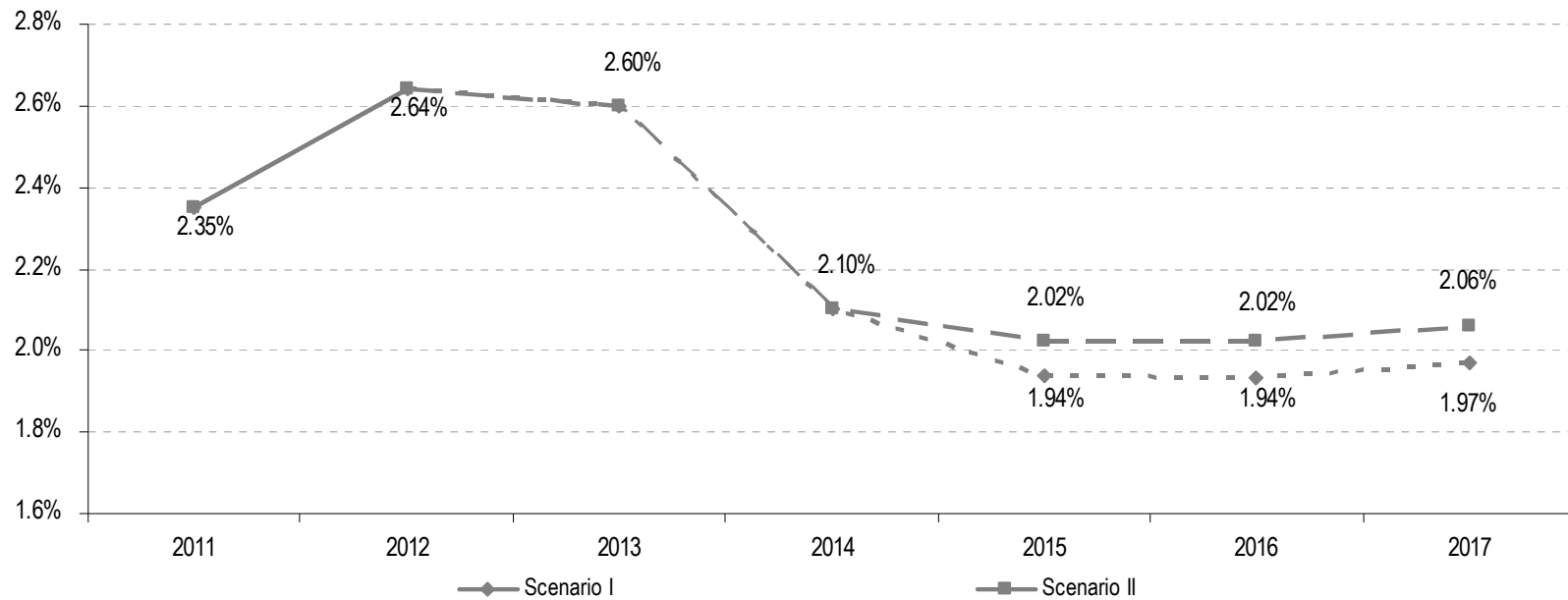
- to 46.2% according to Polish methodology
- to 50.1% according to EU methodology



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Debt servicing costs

From 2014 on, the debt servicing costs-to-GDP ratio will decrease to 2.0-2.1%, depending on the exchange rate.



The Public Finance Sector Debt Management Strategy in the years 2014-2017

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

| Item | 2014 | 2015 | 2016 | 2017 |
|---|-------|-------|-------|-------|
| GDP and borrowing requirements (GDP %) | | | | |
| - growth path of GDP lower by 1 p.p. | 0.45% | 0.92% | 1.36% | 1.78% |
| - borrowing requirements higher by PLN 1bn a year | 0.06% | 0.12% | 0.17% | 0.21% |
| Exchange rates (GDP %) | | | | |
| - PLN depreciation by 10% towards all currencies | 1.59% | 1.61% | 1.56% | 1.52% |

Sensitivity of the debt servicing costs to changes in assumptions

| Item | 2014 | 2015 | 2016 | 2017 |
|---|--------|-------|-------|-------|
| Interest rates - increase by 1 p.p. | | | | |
| | PLN bn | | | |
| - domestic debt | 1.0 | 2.3 | 3.9 | 5.0 |
| - foreign debt | 0.2 | 0.6 | 1.0 | 1.3 |
| - total debt | 1.2 | 2.9 | 4.9 | 6.3 |
| Exchange rates | | | | |
| | PLN m | | | |
| - PLN depreciation by 1% towards all currencies | 102.6 | 103.0 | 110.2 | 118.9 |

The Public Finance Sector Debt Management Strategy in the years 2014-2017

Planned changes in pension system: overview

1. **Transfer of assets** – Treasury Securities (TS), State-guaranteed bonds and potentially other non-equity assets will be transferred from Open Pension Funds (OPF) to the public pension system (ZUS). The value of transferred assets will amount to 51.5% of total assets of each OPF.
2. Simultaneously to transfer of assets from OPF to ZUS, individual account in ZUS will be increased by at least the same value.
3. **Gradual transfer of funds before retirement** – the funds of those who are 10 years before retirement will be gradually transferred to ZUS. Transfers in a form of cash only.
4. **Membership in OPF on a voluntary basis** – the insured will make a choice on whether they future contributions are transferred to OPF or to ZUS. Contributions to the OPFs for those who will choose to stay in OPF will amount to 2.92% of wage fund.
5. OPFs will not be allowed to invest in TS or State-guaranteed bonds.
6. OPF will be required to keep the share of TS and State-guaranteed bonds at the level not lower than the one specified by law (the level from a period proceeding announcement of the changes).

The Public Finance Sector Debt Management Strategy in the years 2014-2017

Planned changes in pension system: expected impact on public finance

- At the end of 2012 the estimated amount of public debt issued to finance contributions to OPF was 17.5% of GDP (more than 30% of public debt)
- Decrease in public debt-to-GDP ratio in 2014 by ca. 7 pp (national definition) and by 8 pp (EU definition)
- Decrease in State budget net borrowing requirements in 2014 by PLN 16.5bn
- Gradual decrease in State budget borrowing requirements and public debt levels in subsequent years due to:
 - the mechanism of the gradual transfer (beginning at 10 years before retirement) of the assets of future pensioners from OPFs to ZUS, responsible for providing pension benefits
 - lower contributions to OPF as the insured will be granted a choice between OPFs and ZUS regarding the 2.92% portion of their future contributions

The Public Finance Sector Debt Management Strategy in the years 2014-2017

Planned changes in pension system: structure of the State Treasury debt

Short-term implications:

- Increase of a share of foreign debt in total State Treasury debt – expected to increase from 31% at the end of June 2013 to around 35-37%
- Higher share of foreign investors in domestic debt – expected to increase from 34% at the end of June 2013 to around 42-44%

Long-term implications:

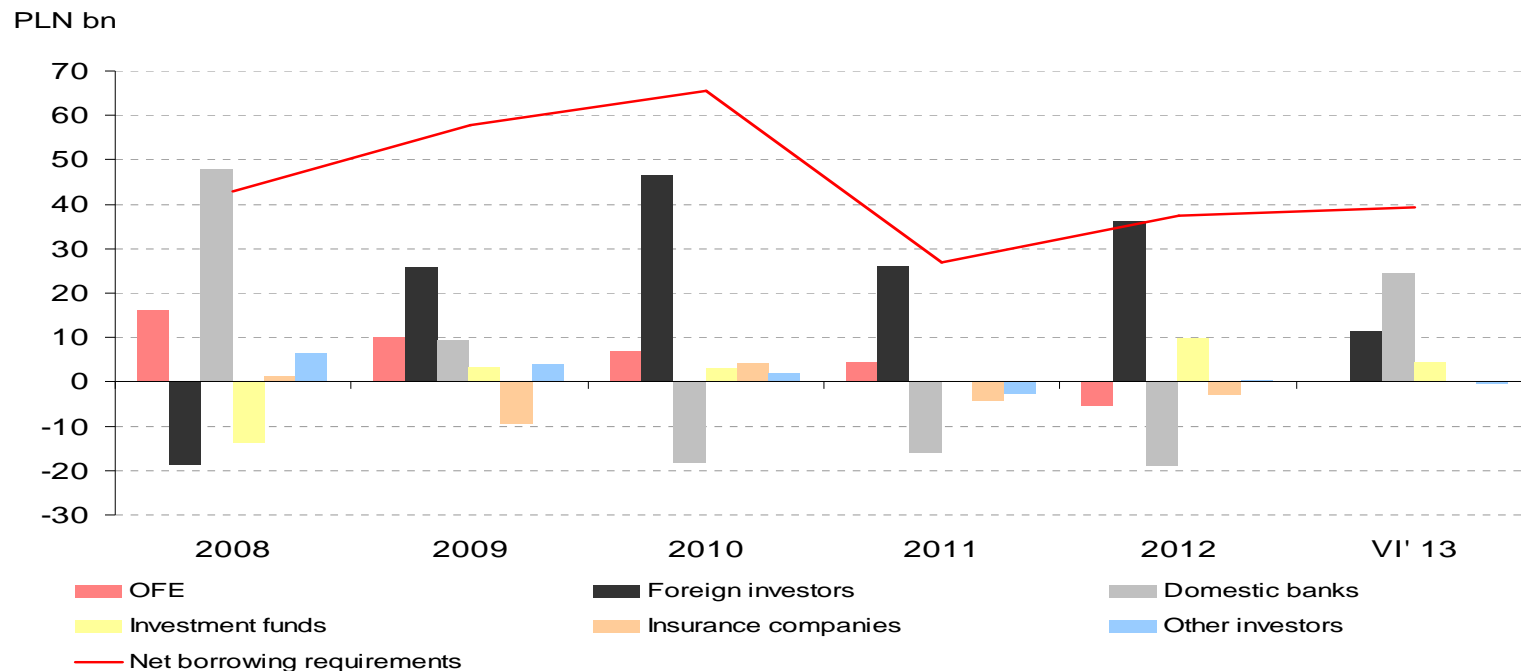
- Lower borrowing requirements – in the long term it is assumed that the share of foreign currency denominated debt in total outstanding debt should go back to 30%
- Lower debt – important from the rating point of view

The Public Finance Sector Debt Management Strategy in the years 2014-2017

Planned changes in pension system: Treasury Securities markets (1)

- Substantial role of OPFs in the development of domestic TS market in Poland
- Since 2009 declining investments of OPF in TS - the share of TS in their portfolios fell below 50%
- OPFs invest only a part of received contributions in TS, thus the rest of the additional supply of TS issued to cover transfers to OPFs has to be absorbed by other investors

Change in holder's structure of domestic TS and net borrowing requirements in years 2008-2013.



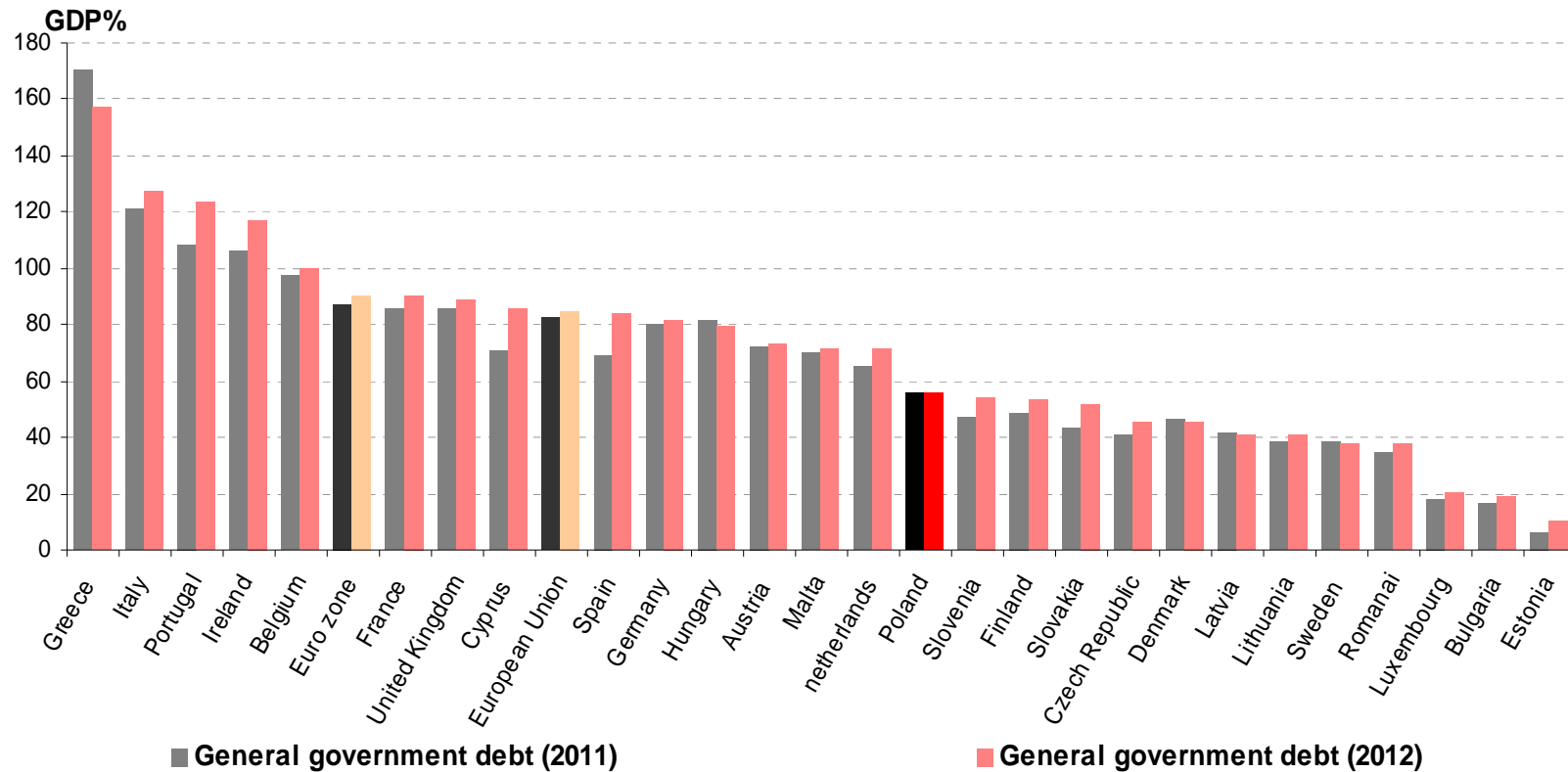
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Planned changes in pension system: Treasury Securities markets (2)

- When OPF are no longer present as an investor on the Treasury securities, liquidity of the market is not expected to be adversely affected, as they are naturally not a liquidity provider (their share in market turnover being 6% vis-à-vis their 20% share in domestic Treasury securities holdings).
- The cancellation of the TS held by OPF is expected to decrease the average maturity of debt from 4.4 years to about 4.2 years. Gradual increase of average maturity is planned in subsequent years, at a pace dependent on market conditions.
- Because of OPF's proportionally large holdings of floating-rate and inflation-linked debt, the exposure of the State Treasury to interest rate risk is expected not to be affected (ATR shall remain stable)

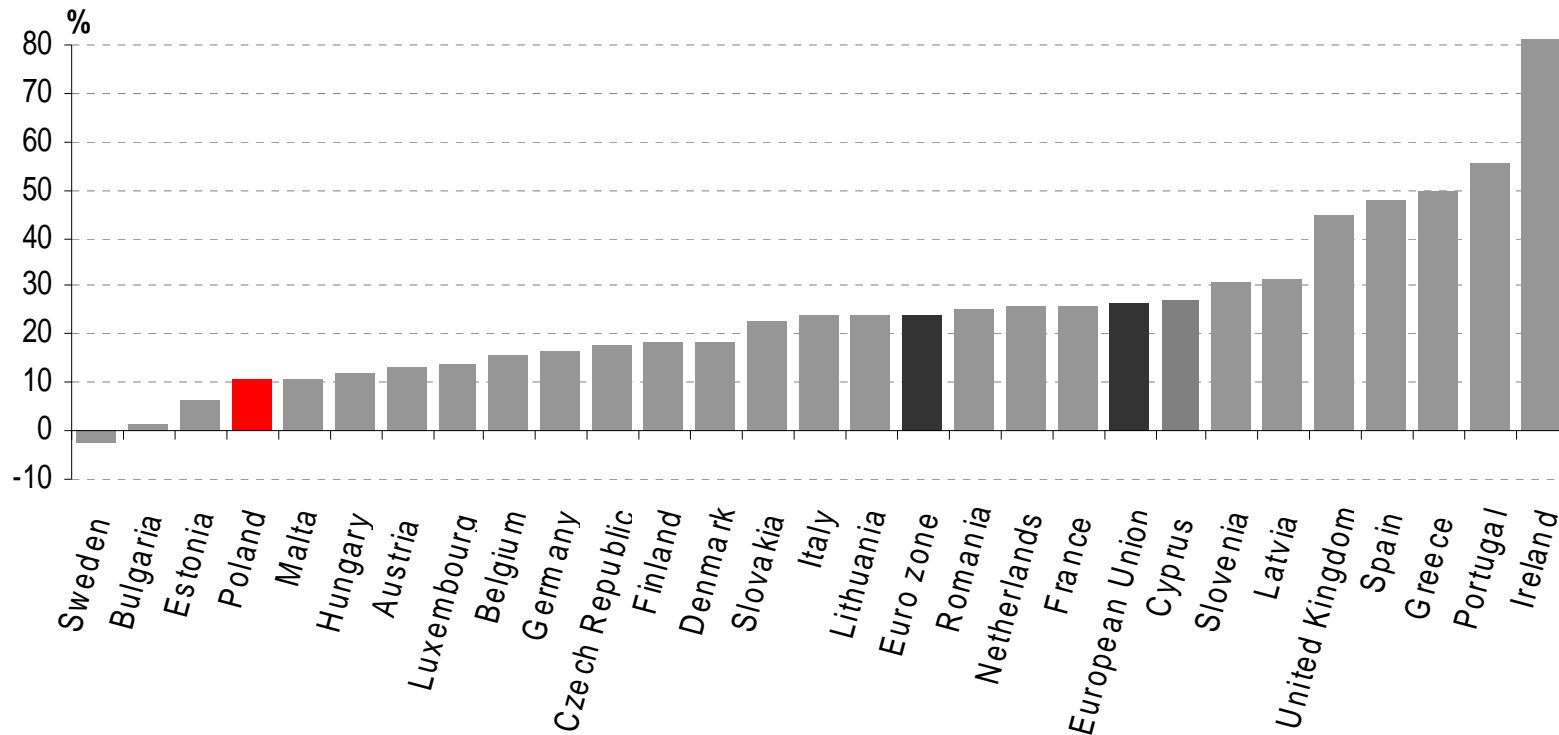
The Public Finance Sector Debt Management Strategy in the years 2014-2017

General government debt in the EU member states



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Changes in the general government debt to GDP ratios in the EU in the years 2008-2012*



* the difference between debt to GDP relation at the end of 2012 and 2007

The Public Finance Sector Debt Management Strategy in the years 2014-2017

Long-term government debt rating in foreign currency in the EU

| | Standard&Poor's | Fitch | Moody's |
|----------------|-----------------|-----------|-----------|
| Austria | AA+ | AAA | Aaa |
| Belgium | AA | AA | Aa3 |
| Bulgaria | BBB | BBB- | Baa2 |
| Croatia | BB+ | BBB- | Ba1 |
| Cyprus | CCC+↓↓↓↓↓ | B- ↓↓↓↓↓ | Caa3↓↓↓↓↓ |
| Czech Republic | AA- | A+ | A1 |
| Denmark | AAA | AAA | Aaa |
| Estonia | AA- | A+ | A1 |
| Finland | AAA | AAA | Aaa |
| France | AA+ | AAA | Aa1 ↓ |
| Germany | AAA | AAA | Aaa |
| Greece | B- ↑↑ | B- ↑ | C |
| Hungary | BB ↓ | BB+ | Ba1 |
| Ireland | BBB+ | BBB+ | Ba1 |
| Italy | BBB+ | A- | Baa2 |
| Latvia | BBB+ ↑↑ | BBB+ ↑↑ | Baa3 |
| Lithuania | BBB | BBB+ ↑ | Baa1 |
| Luxembourg | AAA | AAA | Aaa |
| Malta | BBB+ ↓ | A ↓ | A3 |
| Netherlands | AAA | AAA | Aaa |
| Poland | A- | A- | A2 |
| Portugal | BB | BB+ | Ba3 |
| Romania | BB+ | BBB- | Baa3 |
| Slovakia | A | A+ | A2 |
| Slovenia | A- ↓ | A- | Ba1 ↓↓ |
| Spain | BBB- ↓↓ | BBB | Baa3 |
| Sweedeen | AAA | AAA | Aaa |
| UK | AAA | AAA | Aa1 ↓ |

Source: Reuters. as of September 23. 2013

↑↓ - Upgrade or downgrade by one notch in comparison to previous *Strategy* (i.e. September 2012)