

THE PUBLIC FINANCE SECTOR DEBT MANAGEMENT STRATEGY

in the years 2015-2018

Ministry of Finance

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I. INTRODUCTION

Pursuant to Article 75 of the Public Finance Act of 27 August 2009, the Minister of Finance is obliged to develop annually a 4-year strategy on managing the State Treasury (ST) debt and influencing the public finance sector debt. This document is presented by the Minister of Finance to the Council of Ministers for approval, and then it is submitted by the Council of Ministers to the Sejm, together with the justification to the draft Budget Act.

Public debt management is conducted at two levels:

- in a broader sense, debt management is a part of the fiscal policy and covers decisions on what portion of State expenditures is to be financed through debt, accordingly, what the level of public debt should be (this aspect is discussed in documents updated on an annual basis, dedicated to the government economic programme, especially in the justification to the draft Budget Act and the Convergence Programme Update);
- in a narrower sense, debt management means determining the way of financing the State budget borrowing requirements and designing the debt structure by selecting markets, instruments and dates of issuance.

The *Strategy*, including forecasts of public debt contained herein, has been developed on the basis of the assumptions of the draft Budget Act for 2015. The forecasts of the *general government* sector (EU definition) have been prepared in accordance with the ESA2010 rules, taking into account current knowledge on the scope of the *general government* sector.

Table 1. Public debt and debt servicing costs – the Strategy’s key forecasts

Item	2013 (execution)	2014	2015*	2016	2017	2018
1. Public debt						
a) PLN bn	882.3	807.5	850.0	880.1	915.2	943.1
b) in relation to GDP	53.9%	47.7%	48.0%	46.9%	46.0%	44.5%
2. The amount specified in article 38a point 3 of the Public Finance Act**						
a) PLN bn	864.8	788.1	840.2	873.2	901.9	929.2
b) in relation to GDP	52.9%	46.5%	47.4%	46.5%	45.4%	43.9%
3. General government debt						
a) PLN bn	934.6	848.5	899.3	940.5	985.3	1 028.6
b) in relation to GDP	57.1%	50.1%	50.8%	50.1%	49.5%	48.5%
4. Debt servicing costs (cash basis)						
a) PLN bn	42.5	36.2	32.3	31.7 - 33.1	32.5 - 33.8	33.6 – 35.0
b) in relation to GDP	2.60%	2.14%	1.82%	1.69% - 1.76%	1.63% - 1.70%	1.58% - 1.65%

*Forecast for the year 2015 is based on the assumption that the execution of the budget deficit in this year will be equal to the limit from the Budget Act. It is expected that lower actual execution will lead to the lower increase in public debt.

**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.

**Forecasts of the debt servicing costs for the years 2016-2018 account for the exchange rate risk provisions

In 2014, the decrease in the public debt is expected, both in nominal terms and in relation to GDP, which results from the changes implemented in the pension system, including the cancellation of Treasury bonds with the nominal value amounting to PLN 130.2 billion. In accordance with the adopted assumptions, the public debt-to-GDP ratio at the end of 2014 shall fall to 47.7% from 53.9% at the end of 2013.

In 2015, the stabilisation of the debt-to-GDP ratio is expected, at a level similar to 2014, or slightly higher, whereas in the subsequent years this ratio will decrease to reach the level of 44.5% in 2018. Both in 2014 and in the timeframe of the Strategy, the amount determined by recalculating public debt using the average yearly NBP rates and reducing it by the value of the liquid funds of the Ministry of Finance (MoF), shall amount between GDP 43% and GDP 48%, i.e. the thresholds specified in the stabilizing expenditure rule. No threat is expected that

the sanctions set out in the Public Finance Act for exceeding the 55% threshold will come into force.

The *general government* debt-to-GDP ratio in the time frame of the *Strategy* will reach the level of 48.5%. According to the *Strategy*, this ratio is not expected to exceed the 60% threshold set out in the Maastricht Treaty.

In the *Strategy* a decrease in ST debt servicing costs-to-GDP ratio in 2014 to 2.1% from 2.6% is forecasted, resulting to a great extent from the cancellation of Treasury securities acquired by the Minister of Finance from the Social Security Institution (ZUS) as well as from the decline of the interest rates in the domestic and foreign markets. The decrease in the debt servicing costs was also affected by the increased share of floating rate debt. In 2015, the decrease in ST debt servicing costs-to-GDP ratio to the level of 1.8% is expected. In subsequent years, the continuation of the downward trend is assumed, to 1.6-1.7% in 2018.

This *Strategy* is a continuation of the strategy developed last year. The objective of minimisation of the long-term debt servicing costs subject to the adopted risk constraints remained unchanged. The tasks aimed at implementation of the *Strategy* objective, associated with the development of the financial market in qualitative terms have been maintained, whereas their names have been changed into: ensuring liquidity, efficiency and transparency of the Treasury securities (TS) market. The task related to the broadening of the scope of the public finance sector liquidity management consolidation has been also maintained.

The following has been assumed for the accomplishment of the *Strategy's* objective for 2015-2018:

- the flexible approach towards shaping the financing structure in terms of selecting the market, currency and instruments shall be maintained, to the extent that cost minimisation is achieved, subject to the assumed risk level limitations and avoiding distortions of monetary policy;
- the domestic market shall remain the main source of financing the State budget borrowing requirements;
- the share of foreign currency debt in the ST debt will be decreasing, ultimately to less than 30%, at a rate depending on market conditions;
- building large and liquid fixed rate issues, both in the domestic, as well as the Euro and US dollar markets, shall be a priority of the issuance policy;
- the average maturity of domestic debt shall be increased to about 4.5 years, if the demand and the level of yields in particular segments of the yield curve makes it possible, and the average maturity of the State Treasury debt shall be maintained at no less than five years.

The *Strategy* comprises six annexes supplementing the main text, with a glossary of terms included.

II. CHANGES IN THE VOLUME AND STRUCTURE OF PUBLIC DEBT

Subsequent subchapters present recent changes in the volume of public debt, the structure and servicing costs of the ST debt, as well as the volume of contingent liabilities resulting from guarantees and sureties. A separate issue significantly affecting public finance, including both the volume and the structure of public debt, refers to the changes in the pension system introduced in 2014.

II.1. Impact of changes in the pension system on public finance

Based on the review of pension system performance, conducted in 2013, the government decided to introduce changes in the pension system. The changes have been introduced by *the Act of 6 December 2013 on the amendment of certain acts of law, that are setting principles of pension benefits' payments from contributions gathered in Open Pension Funds (OFE)*, covering, among others:

- **transfer of assets and cancellation of Treasury securities** – 51.5% of accounting units recorded on the settlement account of each open pension fund (OFE) member was cancelled, and the corresponding assets: Treasury securities (TS), bonds guaranteed by the State Treasury and cash, have been transferred to ZUS. After being acquired by the State Treasury from ZUS, the TS were cancelled;
- **records on sub-accounts in ZUS** of the values of the assets transferred, however, in case the clean price of assets transferred as at September 3, 2013 was higher than the clean price of such assets as at January 31, 2014, the funds on the subaccount of the insured in ZUS are recorded according to the higher of these prices, increased by the accrued interest;
- **introduction of so-called "safety zipper"**– assets of the insured in OFE, with 10 years or less left to their retirement, shall be subject to transfer to ZUS on a pro rata basis;
- **choice as regards contribution transferred to OFE** – the insured have a possibility to choose periodically whether a part of their future contribution should be transferred to OFE, or to the subaccount in ZUS. The level of the premium which can be transferred to OFE, was set at 2.92%;
- **ban on investing by OFE in TS and bonds guaranteed by the ST.**

Pursuant to the Act of February 3, 2014, OFE transferred assets with the market value amounting to PLN 153.2 billion to ZUS, including:

- TS with the market value of PLN 134.1bn (PLN 130.2bn in nominal value),
- TS of the National Road Fund with the market value of PLN 16.9bn (PLN 15.6bn in nominal value),
- other securities guaranteed by ST with the market value of PLN 0.3bn (PLN 0.3bn in nominal value),
- cash with the value of PLN 1.9bn.

The TS were acquired by the State Treasury and then cancelled. Other assets were transferred to the Demographic Reserve Fund.

The cancellation of TS and consolidation (within the general government sector) of the National Road Fund (KFD) bonds acquired by ZUS, resulted in a one-off reduction of the State Treasury debt by ca. GDP 7.7%, and the general government debt by ca. GDP 8.6% of the GDP. Debt servicing costs in 2014 decreased by PLN 4.6bn as a result of the TS cancellation. The State budget borrowing requirements will also decrease in the following years due to the improvement of Social Security Fund (FUS) balance and the reduction of the public debt servicing costs, related to the cancellation of the Treasury bonds and lower borrowing requirements. The improvement of the FUS balance will mainly arise from reducing the contribution transferred to OFE (in connection with the lower rate and introduction of

voluntary transfer of contribution to OFE¹⁾), a gradual transfer of assets of the insured at 10 years before retirement and due to the revenues from assets other than T-bonds, transferred by OFE to ZUS. Lower borrowing requirements will bring about the reduction of the level of debt in the consecutive years.

In connection with the debt reduction as a result of the pension system reform, the public debt-to-GDP ratio thresholds set in the new stabilizing expenditure rule were decreased respectively (from the original 50% and 55% to 43% and 48%, cf. Chapter VII.1).

II.2. Volume of public debt and debt servicing costs

Changes in the volume of public debt in 2003-2012 resulted mainly from changes in the ST debt. Change in the nominal debt was primarily an outcome of financing borrowing requirements and changes in exchange rate of Polish zloty, and since 2011, also the public finance sector liquidity management consolidation. At the end of 2013, the debt-to-GDP ratio (national definition) amounted to 53.9%, and the general government debt-to-GDP ratio (EU definition) reached 57.1%. In the first half of 2014 a significant decrease was recorded (according to both the national and the EU definition), mainly as a result of the cancellation of the TS transferred by OFE to ZUS.

Chart 1. Public debt level in years 2003-2014²

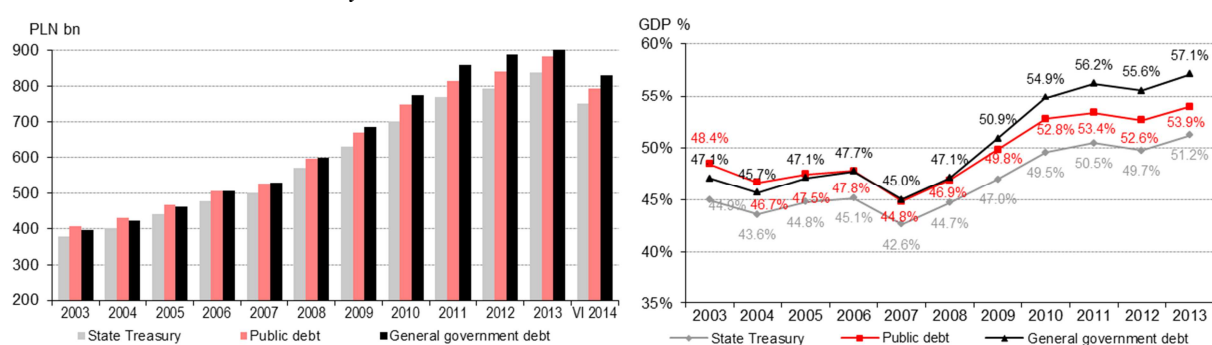
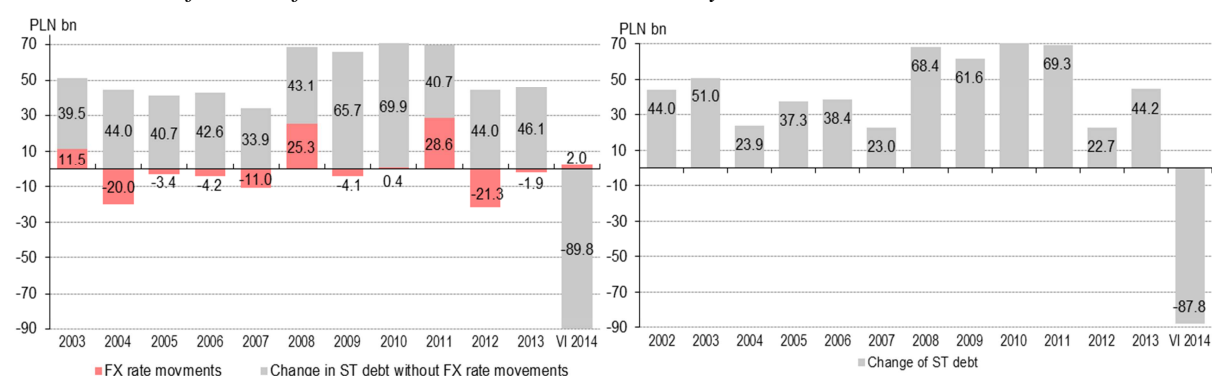


Chart 2. The influence of FX rate movements on ST debt in years 2003-2014



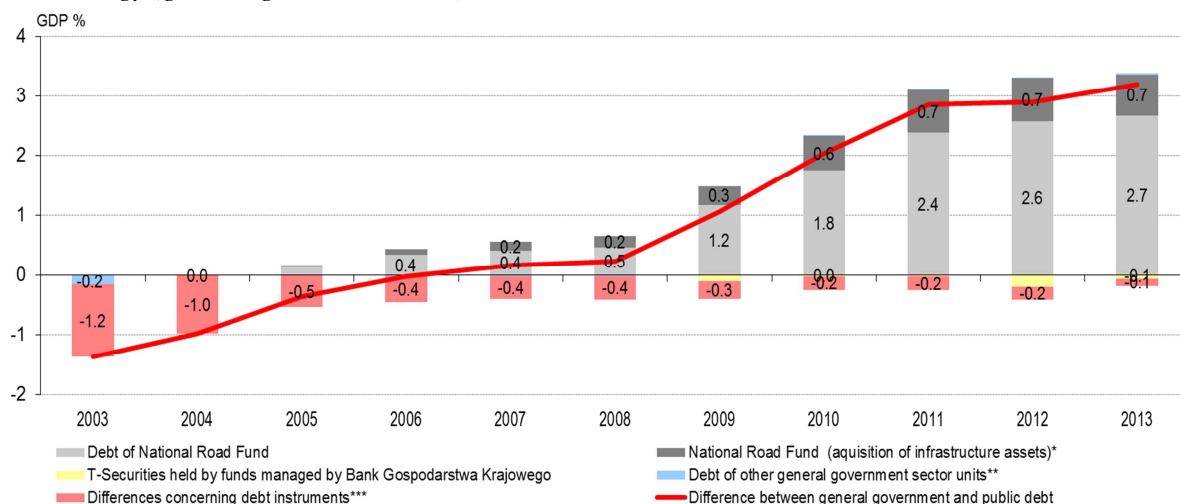
The debt-to-GDP ratio according to the EU definition, which amounted to 57.1% at the end of 2013, is higher than in case of public debt (the difference results primarily from the debt of the National Road Fund (KFD), which is included in general government sector according to the EU definition) and, simultaneously, significantly lower as compared to the level of this ratio for the whole EU (87.1%) and for the Euro zone (92.7%)³⁾.

¹⁾ In accordance with the information provided by ZUS to PAP on August 18, 2014, 2.56 million individuals decided to transfer their contribution to OPF.

²⁾ Detailed information regarding the level of public debt is presented in Annex 6.

³⁾ The differences between the Polish and the EU definition are presented in Annex 2, whereas the comparison of the deficit and debt of the EU Member States is included in Annex 4.

Chart 3. Differences in the level of debt according to national methodology (public debt) and EU methodology (general government debt)

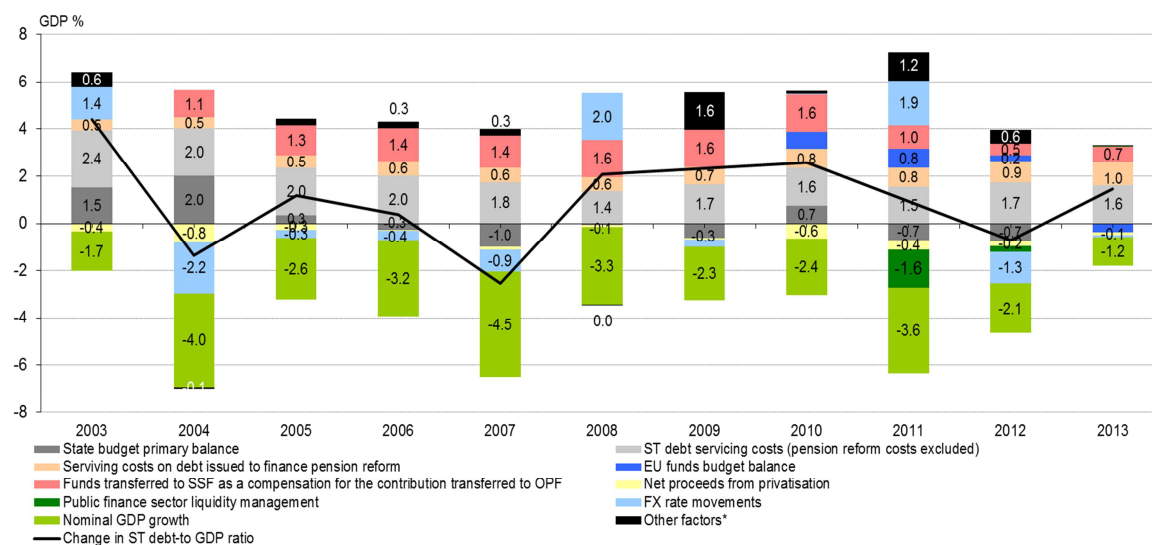


* In compliance with Eurostat guidelines on sector classification of some motorway projects, general government debt figures include capital expenditures of the projects in question

** Due to changes in sources of financing The Agricultural Market Agency was incorporated in general government sector in 2004. Other differences concerning the scope of the sector are negligible

*** Matured payables, debt assumption – activation of guarantees, up-front payments on off-market swaps, restructured/refinanced trade credits

Chart 4. Factors influencing changes in debt-to-GDP ratio

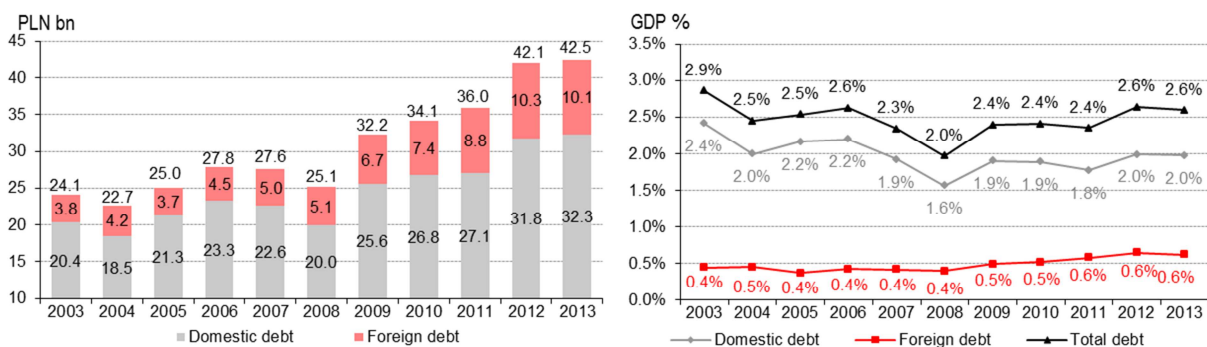


* Other factors include: other borrowing requirements (including: the balance of granted loans, and prefinancing), changes not resulting from borrowing requirements (changes of debt resulting from: changes of budget account balance, TS discount, TS capitalization and indexation, off-budget drawings, conversion of FUS debt to OFE securities) and changes in other ST debt (among others: matured payables and funds deposited with Minister of Finance under the public finance sector liquidity management).

Changes in the level of ST debt servicing costs resulted from increasing debt volume and changes in interest and exchange rates. To mitigate the destabilising effect of variable debt servicing costs on the State budget, measures aimed at smoothing the distribution of debt servicing costs over time were undertaken. These included:

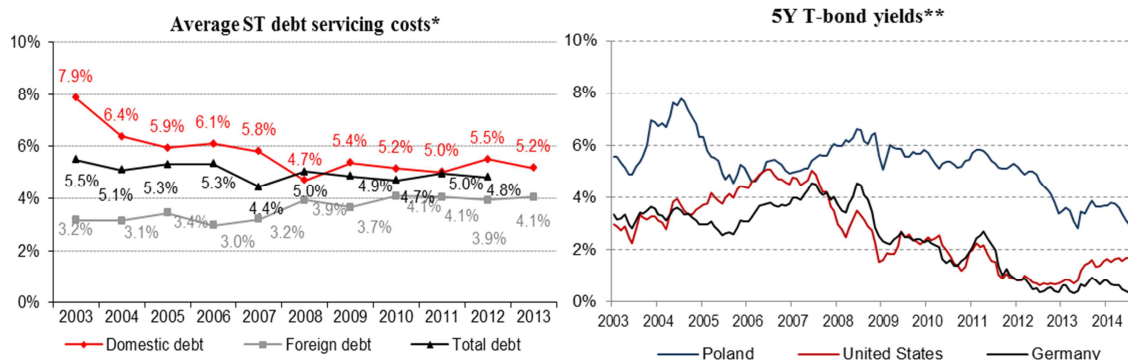
- derivatives - in use since the end of 2006,
- setting coupons of newly issued bonds at levels close to their yields to reduce the accumulation of discount costs at maturity,
- switching auctions, in use since 2001, and buy-back auctions aimed primarily at reducing refinancing risk, but allowing also for the redistribution of debt servicing costs over time.

Chart 5. State Treasury debt servicing costs in years 2003-2013



Foreign debt servicing costs were much lower than those of domestic debt, due to the lower share of foreign debt in ST debt, and the difference in interest rates on domestic and major foreign markets. An increase in foreign debt servicing costs since 2009 resulted from an increased importance of foreign financing and depreciation of the Polish zloty. The significant increase in domestic debt servicing costs in 2012 resulted from higher discount expenses from redeemed securities, which was the effect of the structure of debt issued in previous years. On the other hand, the decrease of yields in the years 2012-2013 and the increased share of floating rate debt, had an impact on stabilisation of debt servicing costs and the decline in average debt servicing costs in relation to the debt volume in 2013.

Chart 6. Market interest rates and average servicing costs of foreign and domestic debt



* Average ST debt servicing costs were calculated as a ratio of the difference between debt servicing costs and revenues in a particular year to the average debt volume in this year

** In domestic currency

II.3. Structure of the State Treasury debt

Changes in the ST debt structure resulted from implementation of the *Strategy* objective, i.e. long-term cost minimisation subject to risk constraints. The flexible issuance policy and operations on debt kept the risk connected with the ST debt structure on a safe level. The ST debt structure in 2014 was affected by the pension system reform and the associated cancellation of the TS transferred by OFE to ZUS.

Refinancing risk

The domestic debt refinancing risk has been gradually reduced since 2004, and it has been relatively stabilised since 2007. The risk reduction was a result of:

- the growing importance of medium and long-term bonds in financing the borrowing requirements, and at the same time, the decreasing role of T-bills;
- large scale of switching auctions;
- prefinancing of the following year State borrowing requirements in the 4th quarter of the preceding year;
- maintaining the liquidity reserve of the State budget.

Chart 7. Residual maturity of ST debt in years 2003-2014

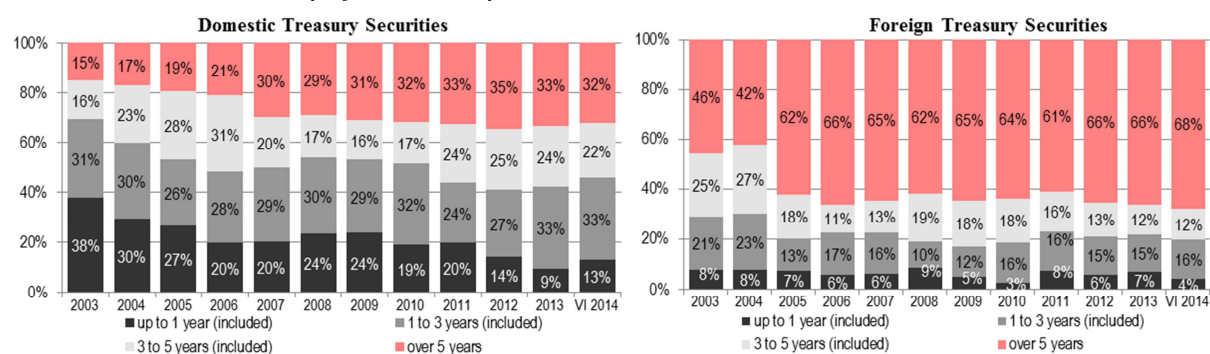
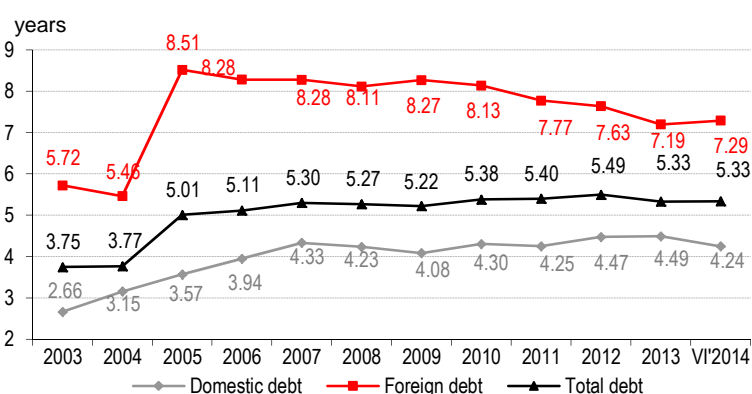


Chart 8. ATM of ST debt in years 2003-2014

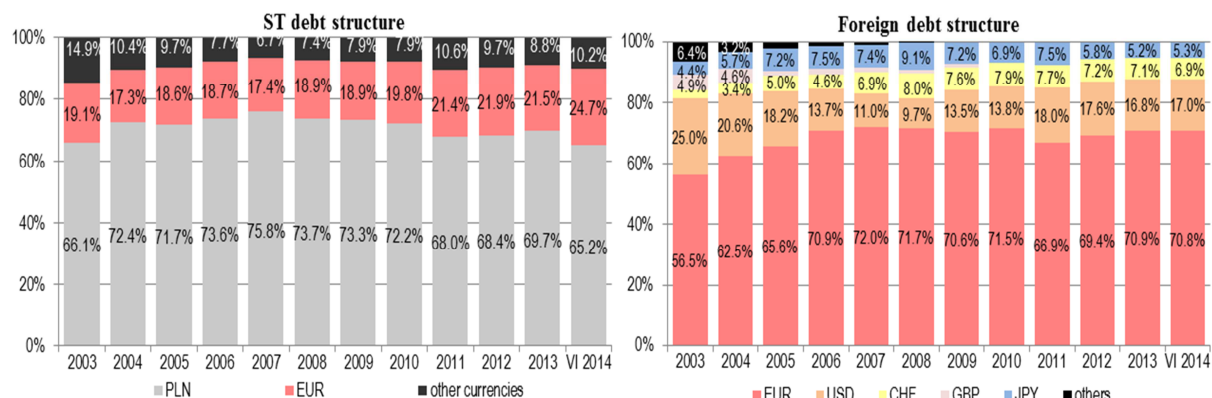


At the end of 2013 the average maturity of the domestic debt reached the level of 4.49 years. The decrease in the average maturity of the domestic debt in the first half of 2014 resulted from the cancellation of a part of the domestic TS as a consequence of the pension system reform. The refinancing risk of foreign debt is significantly lower as compared with that of domestic debt. The sudden reduction of this risk in 2005 resulted from the early redemption of a part of the Paris Club debt which was refinanced by issuing bonds with a significantly longer maturity. In recent years, the average time to maturity of the overall ST debt has remained at a stable level above five years.

Foreign exchange risk

The increase of the role of foreign currency debt since 2008 has been, on the one hand, the result of volatility of the Polish zloty exchange rate and, and a flexible approach to implementing the objective of minimising the debt servicing costs arising from foreign exchange risk constraints on the other hand. Temporary increase in foreign financing was allowed, if justified by striving towards domestic market stabilisation, diversification of sources of capital and taking advantage of the possibility of issuing bonds with a yield lower than that prevailing in the domestic market and incurring low interest loans in international financial institutions (IFI). The share of debt denominated in foreign currency in the ST debt in the years 2011-2013 slightly exceeded 30%. As a result of the cancellation of the part of TS (affecting the decrease in the domestic debt volume, with unchanged level of the foreign debt) due to the pension system reform, the increase in foreign currency debt in the total debt occurred – at the end of June 2014 this share amounted to 34.8%.

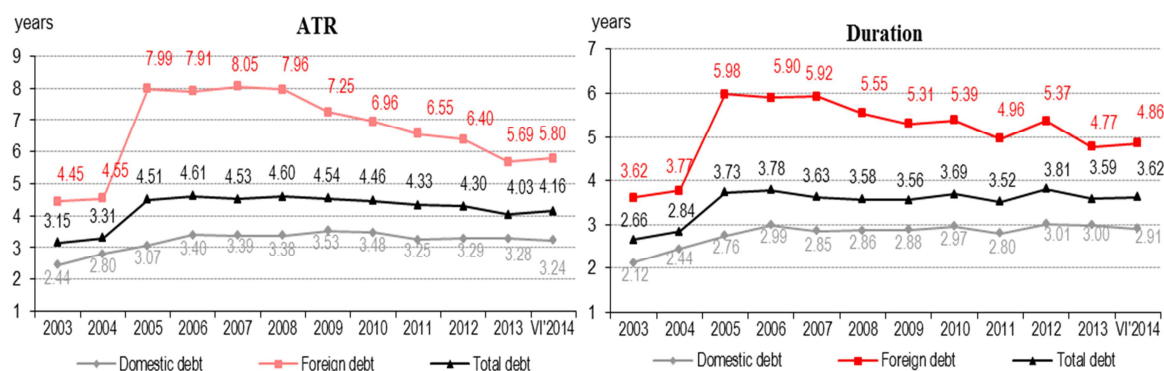
Chart 9. Currency structure of ST debt in years 2003-2014



Interest rate risk

Interest rate risk for the domestic and foreign debt was subject to similar trends as the refinancing risk. In the recent years the increase in the share of floating rate debt, both domestic (from 12.0% at the end of 2009 to 22.3% in mid-2014), and foreign (from 9.6% to 16.7%, respectively), contributed to the decline in ST debt servicing costs.

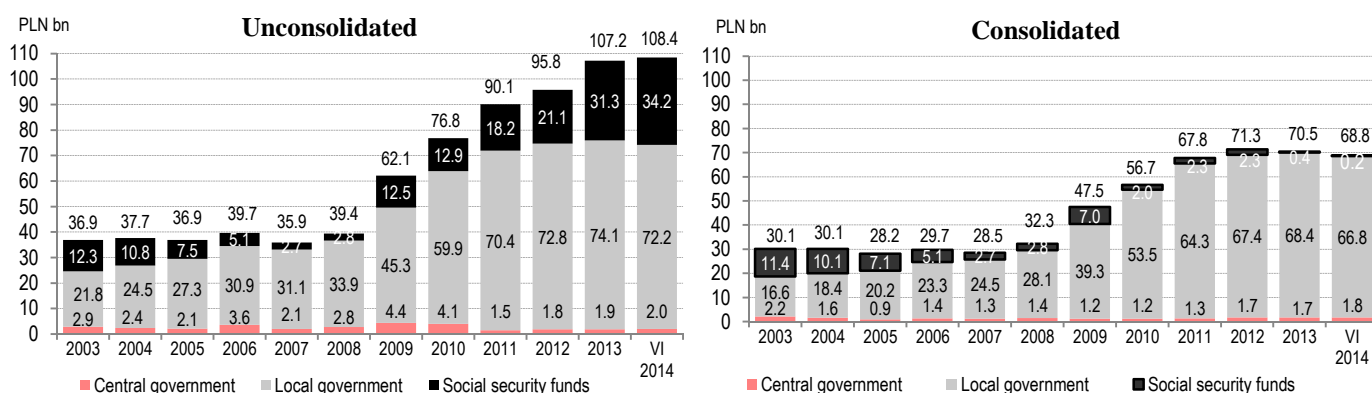
Chart 10. ATR and duration of ST debt in years 2003-2014



II.4. Volume and structure of other public finance sector debt

At the end of 2013, the unconsolidated debt of units other than ST amounted to 11.3% of public debt (the ratio for consolidated debt was 8.0%), compared to 10.8% for unconsolidated debt (8.5% for consolidated debt) at the end of 2012. After the first half of 2014 these ratios reached the level of 12.6% and 8.7%, respectively.

Chart 11. Debt of public finance sector units other than ST by sectors.



The local government sector debt, in particular that of local government units (LGU), had the highest share in this part of the debt. The social security sector unconsolidated debt had been steadily decreasing until 2008, only to increase to 4.0% since 2009. The growing since

2009 difference between the social security sector unconsolidated and consolidated debt is a consequence of the fact that FUS deficits were financed with loans from the State budget.

Chart 12. Share of debt of public finance sector units other than ST in public finance sector debt and as a GDP ratio.

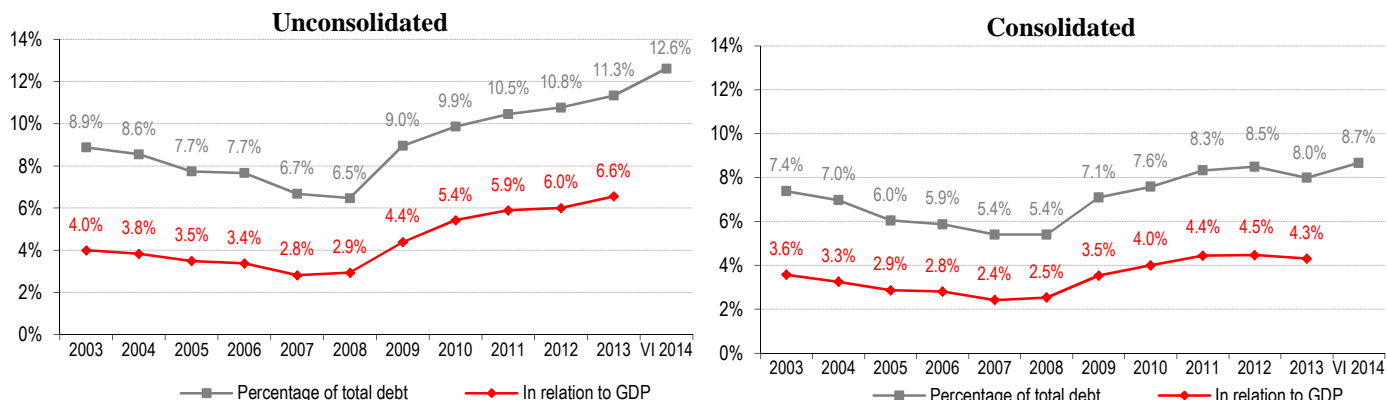
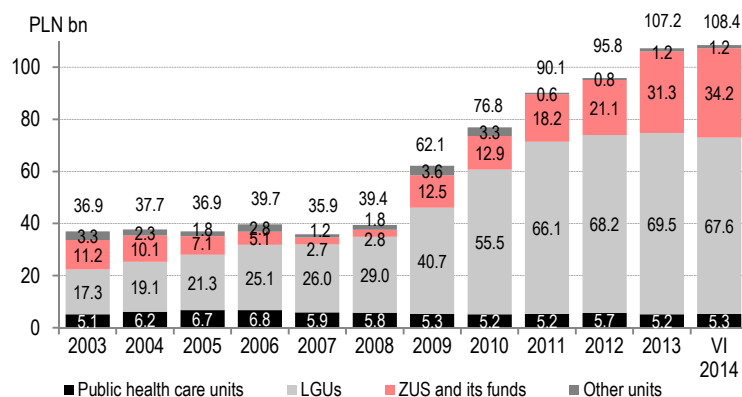


Chart 13. Unconsolidated debt of public finance sector units other than State Treasury

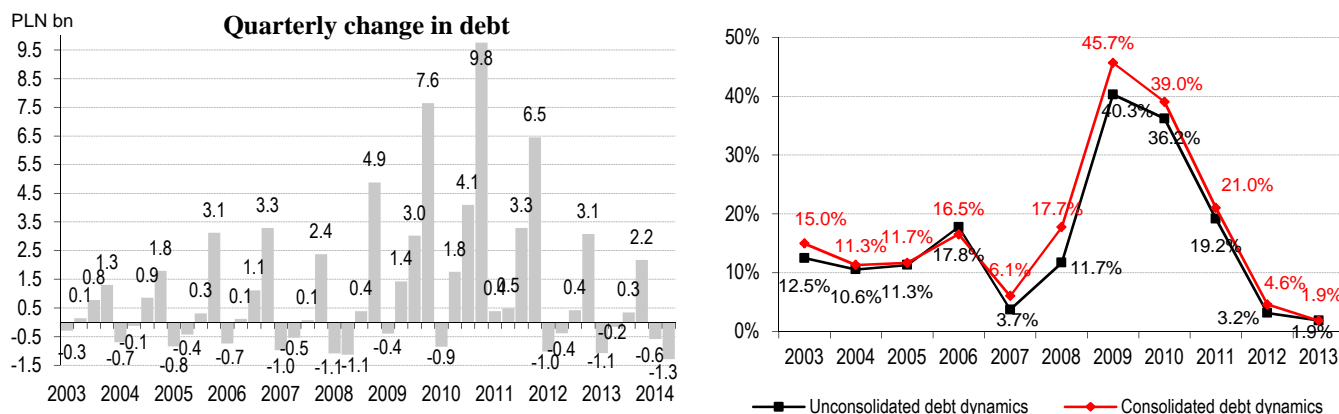


The following part of the subchapter focuses on the analysis of unconsolidated debt of public finance sector entities other than ST.

II.4.1. Debt of local government units

The debt of local government units (LGUs) and their associations has been gradually increasing, reaching PLN 69.5bn at the end of 2013, compared to PLN 68.2bn at the end of 2012. After the first half of 2014, the debt declined to PLN 67.6bn. In 2009, significant increase of the annual debt dynamics was recorded (growth by 40.3% for unconsolidated debt and 45.7% for consolidated debt). In the subsequent years, the growth rate was gradually reduced, and in 2013 it amounted to 1.9% for both unconsolidated and consolidated debt.

Chart 14. Debt of local government units and their associations: quarterly changes and yearly dynamics

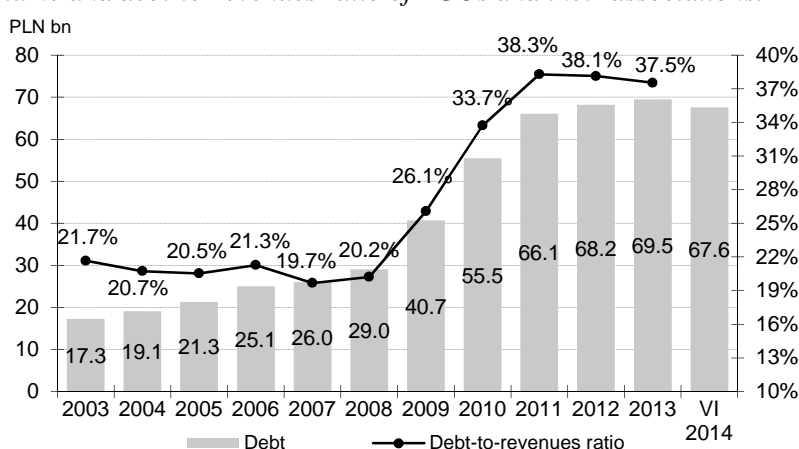


In 2013, LGUs and their associations recorded a budget deficit of PLN 0.3bn. This result is significantly better than that of 2012, i.e. - PLN 3.0bn. Debt of LGUs and their associations in 2013 increased by PLN 1,3bn.

LGUs incurred liabilities primarily in the last quarter of the year, which is associated with highly seasonal nature of their results, although in 2009-2011, a significant increase in debt was also recorded in the second and third quarter of the year. In the first half of 2014 a decline in the debt of LGUs by a total of PLN 1.8 billion was recorded (with a budget surplus of PLN 9.6bn). A similar situation occurred in 2013. In the first half of 2013, the debt decreased by PLN 1.2bn (with a budgetary surplus in the amount of PLN 8.1bn), to increase in the second half of the year by PLN 2.5bn.

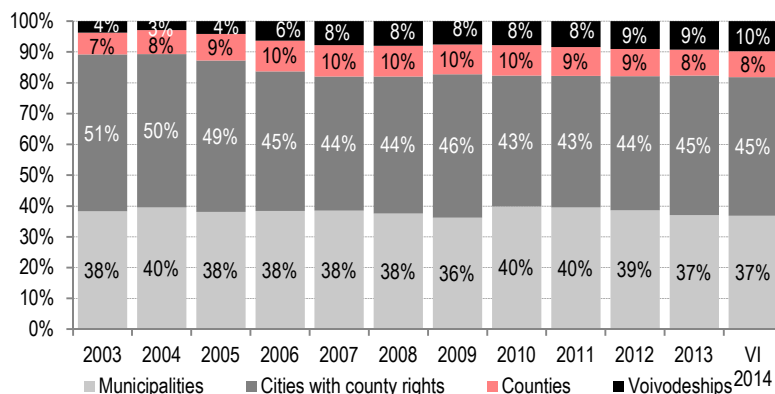
The ratio of the total debt of LGUs to their revenues in 2013 was well below the statutory limit of 60% (applicable until 31 December 2013) and stood at 37.5%, which means a decrease of 0.6 percentage point compared to 2012. In 2013, the highest average debt ratio was recorded in cities with county rights (48.1%) and the lowest ratio was recorded in counties (25.5%).

Chart 15. Debt volume and debt-to-revenues ratio of LGUs and their associations.



The liabilities of cities with county rights made up the largest part of total liabilities incurred by all LGUs, i.e. 45.3% in 2013 and 44.9% in the first half of 2014. The share of liabilities of municipalities in 2003-2014 remained at a relatively stable level of ca. 36-40% (at the end of 2013, the share reached 37.0% and remained at the same level at the end of June 2014), whereas the share of voivodeships and counties after several years of growth stabilised at a level of ca. 8-10% (at the end of the second quarter of 2014, it amounted to 9.7% and 8.5%, respectively).

Chart 16. The debt structure of LGUs and their associations according to the levels of local government.

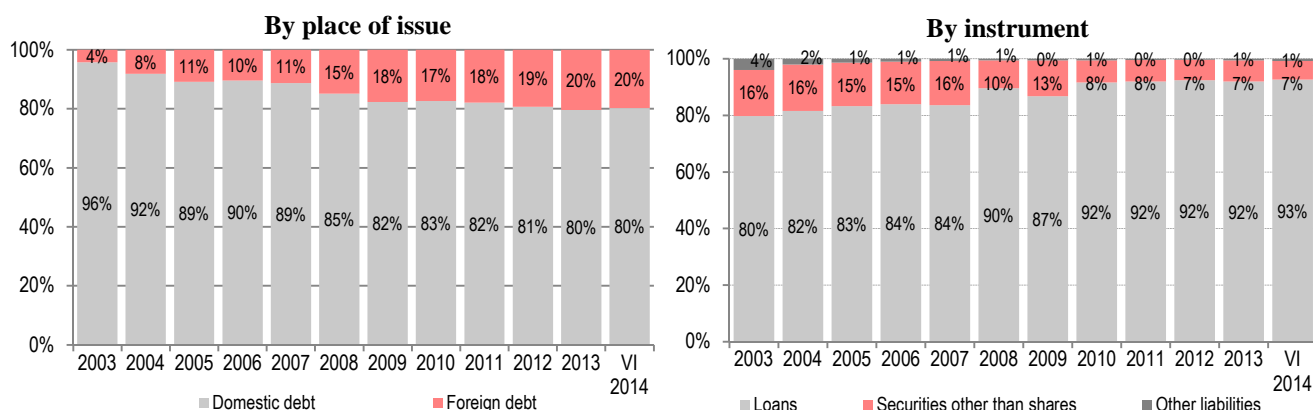


In 2013, the total amount of debt, excluding liabilities incurred on EU co-financed programmes and projects exceeded 60% of revenues in the 37 LGUs (compared to 30 in 2012). The vast majority of units exceeding the ratio which is the limit specified in the Public Finance

Act, are the municipalities. In 2013, only four counties, one city with county rights and one voivodship exceeded the permissible value of the ratio.

The structure of local government liabilities was dominated by domestic debt, although the share of foreign debt has been increasing steadily, reaching 20% at the end of June 2014. Loans prevailed in the structure of liabilities of LGUs and their associations.

Chart 17. Structure of debt of LGUs and their associations.



II.4.2. Debt of independent public health care units

At the end of 2013, the debt of independent public health care units (SPZOZ) amounted to PLN 5.2bn and to PLN 5.3bn at the end of June 2014, compared to PLN 5.7bn in 2012. Since 2007, loans have been the dominant component of the debt. Matured payables which have arisen as a result of untimely settlement of liabilities continue to be a significant component of debt. Changes in the debt structure in 2005-2008 resulted from a reduction of the growth rate of matured payables while pursuing remedial procedures at the same time.

Chart 18. Debt volume and structure of independent public health care units.

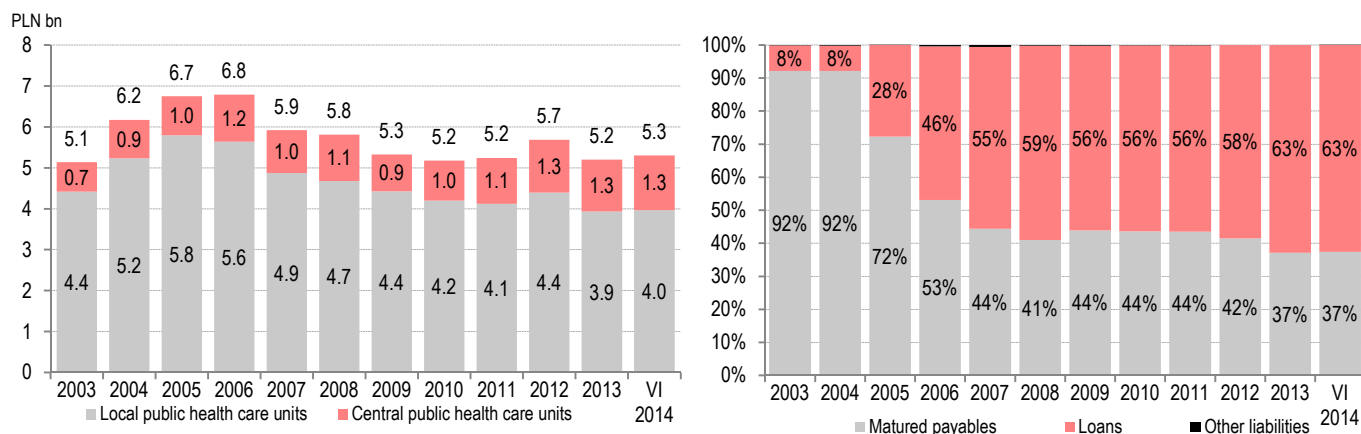
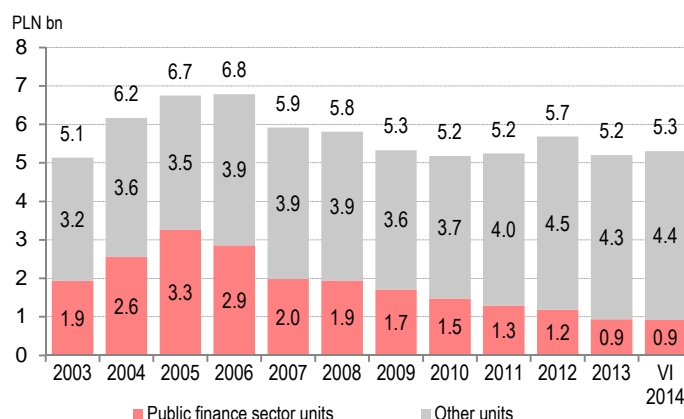


Chart 19. Debt of independent public health care units owed to public finance sector and other units.



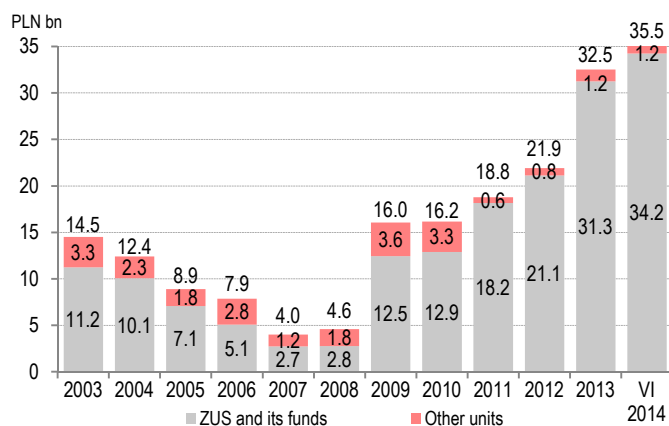
In 2006-2013, the debt of independent public health care units (SPZOZ) owed to the public finance sector decreased; at the end of 2013 it amounted to ca. PLN 0.9bn, and remained at that level at the end of June 2014. The level of debt of all SPZOZ was influenced by the commercialisation of independent public health care units conducted pursuant to the *Act on therapeutic activity*. In accordance with the provisions of the Act, the entity founding the SPZOZ is obliged to cover its deficit within three months since the expiry of the deadline for approval of the financial statement. Otherwise, the founding entity shall be bound to change the organisational and legal form of the SPZOZ or to perform its liquidation. In addition, entities which decided to perform the restructuring of hospitals into companies until December 31, 2013 had the opportunity to take advantage of cancellation of the public-law liabilities assumed from the restructured SPZOZ.

II.4.3. Debt of the Social Security Fund and other entities

Among other entities, the debt of the Social Security Institution (ZUS) and funds managed by it constituted the biggest share in 2002-2014. The debt of ZUS and its funds consisted almost exclusively of liabilities incurred by the Social Security Fund (FUS). In 2003-2008, the debt of the FUS was gradually decreasing as a result of repayment of loans at commercial banks and conversion of matured payables to T-bonds. In 2009 and subsequent years, there was a significant increase of the FUS debt, up to PLN 31.3bn at the end of 2013 and PLN 34.2bn at the end of June 2014. The increase in the FUS debt was a result of a considerable imbalance of the fund resulting from slow increase of revenues due to the reduction of the disability pension premium in 2007- 2008, the economic slowdown and the significant increase in expenditures related to disability pension and retirement benefits. As of 2009, the loan from the State budget was used as an instrument for financing FUS deficit. In mid-2014, it accounted for 99.5% of the total debt of the fund, while the debt in commercial banks has been repaid in full.

The debt of other entities constituted an insignificant share of public debt (0.1% of the unconsolidated public finance sector debt, both at the end of 2013 and in mid-2014).

Chart 20. Debt of Social Security Fund other public finance sector entities.



II.5. Guarantees and sureties granted by public finance sector entities

Contingent (undue) liabilities arising from guarantees and sureties owed by public sector entities at the end of the first half of 2014 amounted to PLN 108.7bn, compared to PLN 108.9bn, i.e. 6.7% of the GDP in 2013 and PLN 101.1bn, i.e. 6.3% of GDP in 2012.

Liabilities due to guarantees and sureties granted by the ST had a dominant share in the potential liabilities. At the end of the first half of 2014 they amounted to PLN 104.8bn, as compared to PLN 104.8bn, i.e. 6.4% of the GDP in 2013 and PLN 97.5bn, i.e. 6.1% of the GDP in 2012.

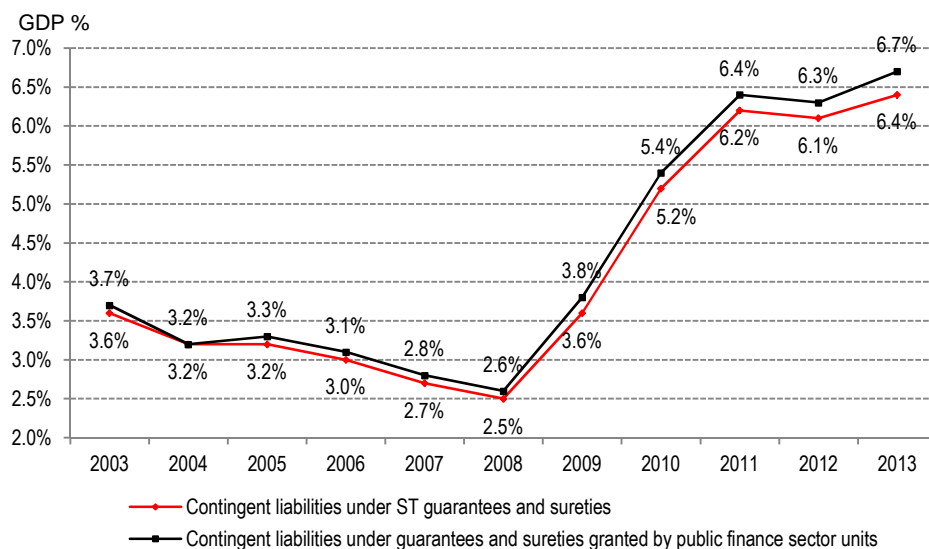
The hitherto ST operations related to sureties and guarantees do not pose significant risks to public finance. At the end of 2013, about 85% of contingent ST liabilities belonged to the low-risk group. The increase in contingent liabilities resulted mainly from a large volume of guarantees granted to support the development of road infrastructure. At the same time,

forecasted payments due to guarantees and sureties amounted to ca. PLN 6.1bn in nominal terms, reaching 0.37% in relation to the GDP at the end of 2013, as compared to PLN 5.4bn and 0.34% of GDP at the end of 2012. At the end of 2013, the long-term risk factor for the entire portfolio of guarantees and sureties stood at less than 6%.

The biggest amounts of ST contingent liabilities at the end of June 2014 resulted from:

- guarantees granted for Bank Gospodarstwa Krajowego (BGK), including support for the National Road Fund (KFD) PLN 74.3bn
- guarantees of payments from the KFD for Gdańsk Transport Company S.A. PLN 72.3bn
- guarantees granted for for PKP Polskie Linie Kolejowe S.A. PLN 8.5bn
- guarantees granted for for PKP Polskie Linie Kolejowe S.A. PLN 7.3bn
- guarantees of payments granted for Autostrada Wielkopolska II S.A. PLN 7.0bn
- guarantees of payments granted for Autostrada Wielkopolska S.A. PLN 3.3bn
- guarantees granted for Polskie Koleje Państwowe S.A. PLN 1.4bn

Chart 21. Contingent liabilities under guaranties and sureties granted by the ST and the public finance sector.



III. EVALUATION OF IMPLEMENTATION OF THE STRATEGY OBJECTIVE

In 2013 and the first half of 2014, debt management was conducted in accordance with *The Public Finance Sector Debt Management Strategy in the years 2013-2016*, adopted by the Council of Ministers in September 2012 and *the Public Finance Sector Debt Management Strategy in the years 2014-2017* adopted in September 2013. Table 2 presents the evaluation of the progress in implementing the *Strategy* objective, including the risk constraints in 2013 and the first half of 2014.

Table 2. Evaluation of implementing the *Strategy's* objective in 2013 and the first half of 2014.

I. Strategy objective – minimisation of debt servicing costs	
Level of implementation*	Implementation method
High	<p>1. Selection of instruments</p> <p>The domestic market was the basic source of financing borrowing requirements. In 2013, the face value of TS issuance amounted to PLN 131.2 billion in the domestic market (including PLN 17.4bn with floating interest rate), while funds with the face value amounting to PLN 21.7bn were raised in foreign markets (including PLN 11.6bn from IFIs, almost only with floating interest rate); in the first half of 2014, this amount reached, respectively PLN 73.9bn (including PLN 21.9bn with floating interest rate), and PLN 18.1bn (including PLN 2.5bn from IFIs). Main factors taken into account when deciding about the financing structure in 2013 and first half of 2014 included:</p> <ul style="list-style-type: none"> • external factors, in particular: <ul style="list-style-type: none"> ○ the gradual stabilisation and improvement of the economic situation in the developed countries (USA, Japan, EU Member States) and the slowdown in the emerging economies; ○ the monetary policy carried out by the main central banks: <ul style="list-style-type: none"> in the USA: the policy of low interest rates conducted by the Fed and the announcement of maintaining their low level following the termination of the QE3 programme as well as initial concerns of investors followed by the beginning in December 2013 of the quantitative easing tapering by the Fed, resulting in capital outflows from risky assets, including the government bonds in the emerging markets in the 2nd half of 2013. Further gradual tapering of QE3 in 2014 was anticipated by investors and did not significantly affect the market; in the Euro zone: reduction of interest rates by the ECB by 50 basis points in 2013 and by 10 basis points in both June and September 2014 (including the deposit rate, to -0.20%), announcement of the package of measures stimulating the economy (in June 2014) as well as the announcement of initiation of purchase programmes for ABSs and covered bonds starting from October 2014; in Japan: stimulating the economy and increasing the inflation through the asset purchases; ○ the budgetary crisis in the USA and concerns related to the possible announcement of the technical insolvency of the country, concluded with the provisional agreement between the Republicans and the Democrats (October 2013) – the effect of this situation was the considerable volatility in the bond and PLN markets; ○ escalation of the geopolitical conflict in Ukraine (since February 2014), engagement of Russia in the conflict and the response of the Western countries (imposing the economic sanctions) resulting in risk aversion and the temporary weakening of the domestic bonds and the Polish zloty; ○ volatility of the EUR/USD exchange rate (within the range of 1.28-1.39). • local factors, in particular: <ul style="list-style-type: none"> ○ continuation of the monetary policy easing by the Monetary Policy Council (RPP) - from December 2012 to July 2013 RPP cut interest rates by 1.75 percentage points to the historically low level of 2.5% for the reference rate) and the announcement of the next monetary policy easing cycle in autumn 2014 significant weakening of the economic growth rate in Poland in the first half of 2013 and the gradual improvement of the economic trends in the subsequent periods, under a very low inflation pressure (in July 2014 the decline in prices in YoY terms occurred in Poland – by 0.2%); ○ amendment to the Budget Act for 2013; ○ introducing changes in the pension system, resulting, among others, in the cancellation of Treasury bonds with the face value of PLN 130.2 billion (cf. Chapter II.1 and Chapter IV.2);

- the positive perception of Poland both by foreign investors and by rating agencies, as a regional "safe haven" (maintaining the long-term rating by the major agencies at unchanged level and upgrading the rating from A- to A by Japan Rating Agency in March 2013 with a stable perspective);
- the continuing interest of foreign investors in the TS market (inflow of foreign capital in the amount of PLN 2.7bn in 2013 and PLN 6.7bn in the first half of 2014);
- significant fluctuations in the exchange rate of Polish zloty: in 2013, the EUR/PLN exchange rate was fluctuating in the range of 4.07-4.34, and USD/PLN - 3.0-3.38, and in the first half of 2014 in the range of 4.09-4.25 and 3.0-3.15, respectively;
- continued decrease in yields of domestic Treasury bonds in the first half of 2013 (all-time lows), reversal of this trend in the 2nd half of the year, followed by recovery of the downward trend since mid-March 2014 (following the temporary yield increase in the first quarter of 2014, mainly as a result of the geopolitical risk) and reaching another record lows in September 2014;
- favourable budgetary situation in 2014 and the fast pace of financing the borrowing requirements;
- distribution over time of the State borrowing requirements, including those connected with the redemption of large series of bonds in January, April, July and October;
- flexible approach to the choice of instruments and timing of issuance in order to adjust the size and structure of the offer to current and expected market conditions;
- maintaining a safe level of state budget liquidity, as reflected in pre-financing of a significant part of gross borrowing requirements of the next year (respectively, 29% of the requirements of 2013, and 28% of the requirements planned for 2014) at the end of the preceding years.

As far as foreign debt is concerned, the most important operations included:

- regular issuance in the Euro market (in 2013, the total value of debt incurred in the Euro market was EUR 2.0bn, while in the first half of 2014, it amounted to EUR 2.3bn) and for the US dollar market - the issue of bonds with the face value of USD 2.0bn in January 2014);
- maintaining the Polish presence in other major markets. In 2013, bonds issued on the Japanese yen market amounted to JPY 60.0bn;
- drawing credits from IFIs (in 2013 and in the first half of 2014, the total of EUR 4.4bn, including EUR 2.2bn from the EIB and EUR 2.0bn from the World Bank).

2. Efficiency of the TS market

The main measures aimed at cost minimisation included:

- the policy providing liquid benchmark bond issues in the domestic market. In mid-2014, 11 issues of bonds exceeded the equivalent of EUR 5bn (17 in the first half of 2013). At the end of June 2014, benchmark issues accounted for 64.5% of the face value of fixed rate medium-term and long-term bonds outstanding (as compared to 84% at the end of June 2013). The decrease in the share of benchmark issues resulted from the cancellation of bonds as a result of the pension system reform. The average liquidity ratio⁴⁾ having decreased to 111.2% in 2009, increased to 172.4% in 2013, reaching 194.8% in the first half of 2014;
- issuance of liquid bonds series (regular issues with face value ensuring the liquidity of a given issue) in the Euro and US dollar markets (in mid-2014, 3 series of bonds in Euro had the value of at least EUR 3bn, including one exceeding EUR 5bn, and 2 bonds in US dollars had the value of at least USD 3bn);
- adjusting the level and structure of the TS supply to the current market situation and influencing this situation through information policy;
- introduction in February 2014, following the entry into force of the ban on OFE investment in the TS, of the mechanism supporting the clearing under the circumstances of temporary and limited availability constraints of bonds of a given series in the secondary market, through the possibility of concluding the Sell-Buy-Back transactions with Bank Gospodarstwa Krajowego (BGK) by authorised entities (Primary Dealers – PDs and PD candidates) under special terms;
- extending the single price auction formula for switching auctions, introducing a possibility to submit non-competitive bids and the cash purchase option following the switching auction;
- one-off issues of KOS saving bonds in November 2013 (13-month bonds, sale PLN 874.3 million) and in February 2014 (7-month bonds, sale PLN 282.2 million) in order to raise funds for financing in periods of increased state borrowing requirements.

⁴⁾ Liquidity ratio –the quotient of the monthly value of transactions involving bonds to the debt month-end.

II. Constraints of the objective						
Constraint	Level of implementation*	Implementation method	Measure	Value		
				2012	2013	June 2014
Refinancing risk	Satisfactory	<ul style="list-style-type: none"> • Total discharge of debt in Treasury bills as of August 2013; • High sale of medium and long-term bonds in 2013 and in the first half of 2014 (respectively, 63% and 80% of all TS sold at outright and switching auctions) under favourable market conditions; • High importance of switching auctions (in the period from January 2013 to June 2014 25% of the initial bonds outstanding was bought back at switching auctions); • Temporary decrease in the average maturity of domestic debt arising from the portfolio of the TS cancelled in February 2014, under the stabilisation of the average ST debt maturity. 	ATM (in years)			
			- domestic	4.47	4.49	4.24
			- foreign	7.63	7.19	7.29
			- total	5.49	5.33	5.33
		Share in domestic TS:				
		- TS up to 1 year	14.2%	8.1%	11.1%	
		- T-bills	1.1%	0.0%	0.0%	
Foreign exchange risk	Satisfactory	<ul style="list-style-type: none"> • Share of foreign debt remained slightly above the level of 30% assumed in the <i>Strategy</i>, which resulted from cancellation of bonds transferred from OFE (resulting in the decrease of domestic debt); • Share of Euro denominated debt in the foreign debt remained at a level slightly above the minimum level assumed in the <i>Strategy</i> (70%); • Continuation of long-term non-marketable financing from IFIs. 	Share of foreign debt in ST debt	31.6%	30.3%	34.8%
			Share of Euro denominated debt in foreign debt	69.4%	70.9%	70.8%
Interest rate risk	High	<ul style="list-style-type: none"> • ATR of domestic debt remained in the range of 2.8-4.0 years set in the <i>Strategy</i>; • <i>Duration</i> of the domestic debt remained at a stable level, within the range adopted in the <i>Strategy</i>, i.e. 2.7-3.0 years; • Risk of foreign debt remained at a safe level and was not a threat to the costs minimisation objective; • The stabilisation of risk parameters resulted from the high sale of medium and long-term bonds and the increased exposure to instruments with floating interest rate, which enabled faster adjustment of debt servicing costs to the lowering interest rates in the financial market. 	ATR (in years)			
			- domestic	3.29	3.28	3.24
			- foreign	6.40	5.69	5.80
			- total	4.30	4.03	4.16
		<i>Duration</i> (in years)				
		- domestic	3.01	3.00	2.91	
		- foreign	5.37	4.77	4.86	
		- total	3.81	3.59	3.62	

III. Constraints of the objective - cont.		
Constraint	Level of implementation*	Implementation method
Liquidity risk	High	<p>The main instruments used in liquidity risk management included:</p> <ul style="list-style-type: none"> • switching auctions (in 2013, bonds of the face value of PLN 23.8bn were bought back, while in the first half of 2014, the value reached PLN 10.7bn); • interest-bearing PLN-denominated deposits at the NBP - deposits of the total value of PLN 99.2bn were made in 2013, while those made in the first half of 2014 amounted to PLN 43.5bn; • PLN-denominated deposits where BGK acted as an intermediary. In 2013, transactions of the total value of PLN 1,146.1bn were concluded, whereas those concluded in the first half of 2014 amounted to PLN 516.2bn; • FX swap transactions enabling temporary utilization of currencies held, in order to raise funds denominated in PLN. In 2013, transactions amounting to the equivalent of EUR 0.8bn were performed; • market FX swap transactions, CIRS type, enabling usage of held currency resources for the service of liabilities denominated in the currency with of a lower interest rate. In the first half of 2014, transactions with the value of USD 0.7bn were concluded; • interest-bearing foreign currency deposits – in 2013, the deposits amounting to EUR 172.3bn were made and in the first half of 2014 – amounting to EUR 85.6bn; • sale of a part of foreign currency resources from the EU funds and those associated with the debt servicing directly in the foreign exchange market (in 2013, foreign currencies equivalent of EUR 13.1bn were sold, in 2014 the sale continued); • deposits of liquid funds of public finance sector entities in the accounts of the Ministry of Finance in BGK as part of the public finance sector liquidity management consolidation. At the end of June 2014, the accumulated funds amounted to PLN 29.7bn. <p>The level of State liquid assets in 2013 and in the first half of 2014 provided for smooth execution of budgetary flows.</p>
Credit risk	High	<ul style="list-style-type: none"> • Deposits in BGK, secured with TS, did not generate credit risk; • For unsecured deposits a system of credit limits is in place; • Credit risk connected with derivatives is limited by selection of counterparties with high credit rating; • A collateral system related to transactions on derivatives in the form of blocking TS in the National Depository Securities (KDPW) is in force. Secured transactions do not generate credit risk; • The credit risk generated by unsecured transactions is diversified through limits imposed on the total value of transactions made with individual partners. Creditworthiness of potential partners is monitored on an on-going basis;
Operational risks	High	<ul style="list-style-type: none"> • Debt management conducted in one department in the Ministry of Finance; • Technical infrastructure adequate to the requirements of conducting market transactions; • Security of information related to debt management; • Integrated database of the ST debt.
Distribution of debt servicing costs over time	High	<ul style="list-style-type: none"> • The level of servicing costs in 2013 was affected by swap transactions concluded in 2012 (increase in costs by PLN 0.49 billion in 2012 and reduction of costs by PLN 0.50 billion in 2013) within the management of the Budget Act limit and the distribution of costs between years; • Coupons of new issues were set close to their yields; • Switching auctions of T-bonds on domestic market and EUR and USD denominated bond buy-back auctions contributed to smooth distribution of costs.

*) In accordance with the following scale: high, satisfactory, moderate and low.

IV. ASSUMPTIONS OF THE STRATEGY

The following subchapters present the main macroeconomic assumptions of the *Strategy* and the market conditions that affect debt management. The issues discussed included the impact of the changes in the pension system on the domestic TS market, the role of both domestic and foreign investors and the development of the situation in the international markets, including markets in which ST borrowing requirements are financed.

IV.1. Macroeconomic assumptions of the Strategy

The assessment of the macroeconomic situation and directions of the fiscal policy is presented in the justification to the draft Budget Act for 2015. Table 3 presents the macroeconomic assumptions of the *Strategy*.

Table 3. Macroeconomic assumptions of the strategy

Item	2013	2014	2015	2016	2017	2018
Real GDP growth (%)	1.6	3.3	3.4	3.7	3.9	4.0
GDP at current prices (PLN bn)	1 635.7	1 693.6	1 771.2	1 876.3	1 988.6	2 119.0
Average CPI (%)	0.9	0.1	1.2	2.3	2.1	2.5
USD/PLN - end of period	3.01	3.01	2.87	2.68	2.60	2.59
EUR/PLN - end of period	4.15	4.08	3.90	3.65	3.54	3.52

IV.2. Impact of changes in the pension system on the TS market

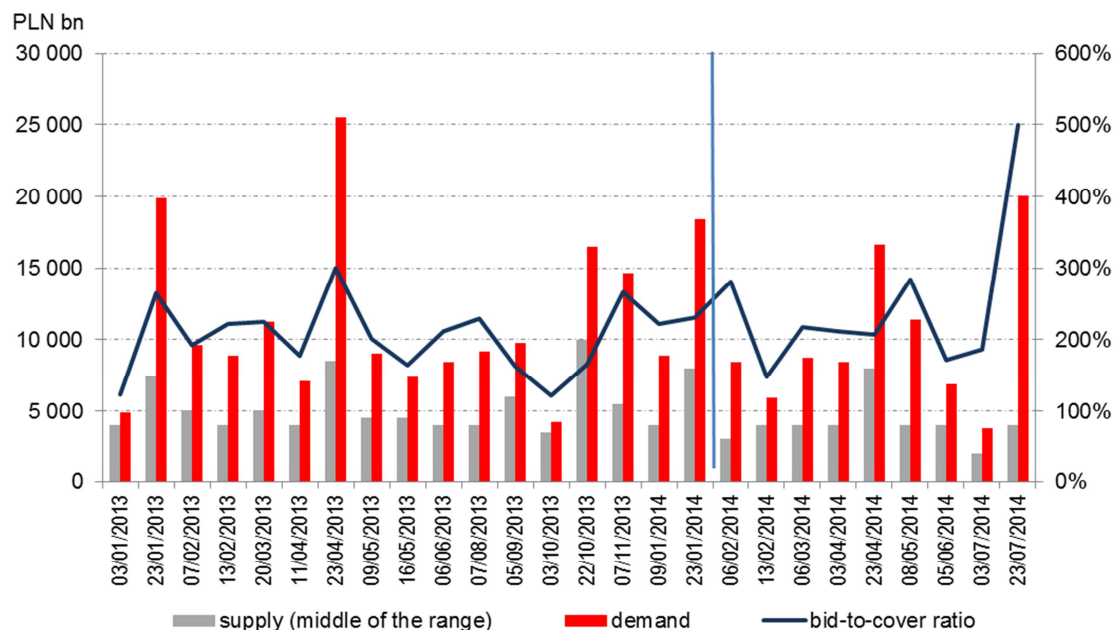
The changes in the pension system affected the holder's structure of domestic TS. In a one-off operation, as a result of transfer of a part of OFE assets to ZUS, the share of the non-banking sector in the domestic ST debt decreased from 46.9% at the end of January 2014 to 31.1% at the end of February 2014, and the share of domestic banking sector and non-residents increased to 27.7% (from 20.9%) and 41.2% (from 32.2%), respectively. The cancellation of the part of the domestic debt resulting from the acquisition of TS by the Minister of Finance has also influenced the increase in the share of foreign currency denominated debt – from 31.8% at the end of January 2014, to 36.1% at the end of February 2014. Ultimately, lower borrowing requirements and the resulting lower need for foreign financing shall lead to gradual increase of domestic investors' share in the TS market and to the decrease of the foreign debt share in total debt.

The cancellation of the TS acquired by the Minister of Finance, resulting from the pension system changes, caused the decrease of the average time to maturity (ATM) of the domestic debt from 4.6 years at the end of January 2014 to 4.3 years as at the redemption day. The reduction of ATM resulted from the cancellation of the domestic TS, rather than from the issue of short-term debt, accordingly, the refinancing risk has not increased. In the long term, reduced borrowing requirements will limit the supply of TS, including those with shorter maturities. This should lead to a gradual increase in ATM of the domestic debt to the level assumed in the *Strategy*.

Changes in the pension system were neutral for the interest rate risk. The cancellation of the TS acquired by the Minister of Finance did not affect the change in the ATR which, as of February 3, 2014, was at a level similar to that prior to the cancellation, amounting to 3.4 years.

The pension reform had no adverse effects on the performance of the TS market. Following the introduction of changes in the OFE, the demand in the primary TS market has not decreased. In the period from February 2014 to July 2014 the average demand to supply ratio at TS sale auctions amounted to 245%, and was considerably higher than the average demand to supply ratio at auctions conducted in 2013 that amounted to 202%. Chart 22 presents the demand to supply ratio at bond auctions before and after the introduction of changes in the OFE functioning.

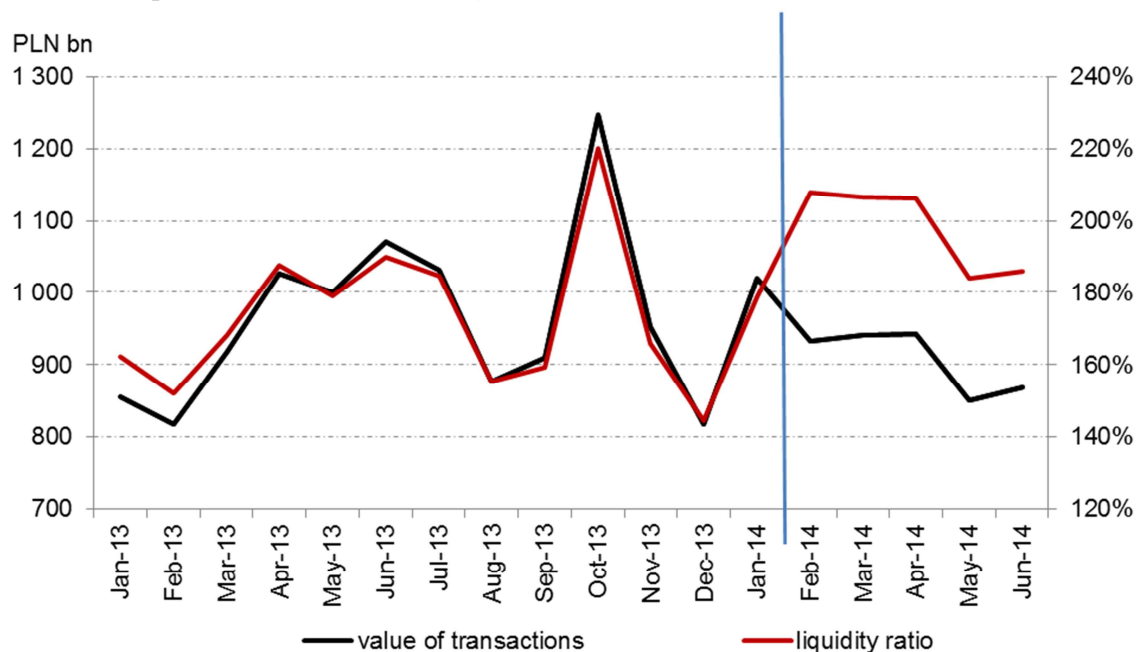
Chart 22. Bid to cover ratio at T-bonds auctions in years 2013-2014.



As a result of the cancellation of the TS acquired by the Minister of Finance, 9 of the previous 17 benchmarks series maintained the benchmark status. In order to ensure the adequate liquidity level and considering the investors' demand on, "old" T-bonds issues may be reopened.

Cancellation of the TS transferred by OFE to ZUS and the ban on OFE investment in the TS had no adverse impact on the liquidity of the secondary TS market, which results from the fact that the OFEs were not liquidity providers in this market. The average monthly liquidity ratio of the TS secondary market in the first half of 2014 amounted to 195% as compared to 172% for the entire 2013. On the other hand, the average monthly value of transactions in the TS market decreased slightly, from PLN 960bn in 2013 to PLN 926bn (i.e. by 3.6%) in the first half of 2014. Chart 23 presents the liquidity ratio and the value of transactions in the TS secondary market before and after introduction of the changes in OFE.

Chart 23. Liquidity ratio and the value of transactions on domestic TS market in years 2013-2014.



In response to the concerns of market participants indicating that after the ban on OFE investment in the TS has been introduced, an investor fulfilling the role of a short-term TS

lender would disappear from the market, the Ministry of Finance introduced a possibility for the BGK to conclude Sell-Buy-Back transactions with banks acting as PDs or candidates to the PDs. This instrument offers a possibility to support, if necessary, the clearing mechanism of T-bond transaction under the circumstances of transitional and significantly limited availability of bonds of a given issue in the secondary market as a result of dominance of demand over supply. The SBB transactions concluded by BGK neither replace nor supplement the SBB transaction market, providing only the support in situations of tensions which cannot be overcome by the market itself. Thus, BGK should represent the last resort institution addressed by market participants as the last alternative, in situations of problems related to bond clearing.

Until June 30, 2014, 7 transactions in with the face value of PLN 253 million were concluded. The limited scale of the operations confirms appropriate functioning of the secondary TS market following the changes in the OFE. On the other hand, the sole possibility to conclude such transactions has a stabilising effect on the market.

IV.3. The domestic TS market

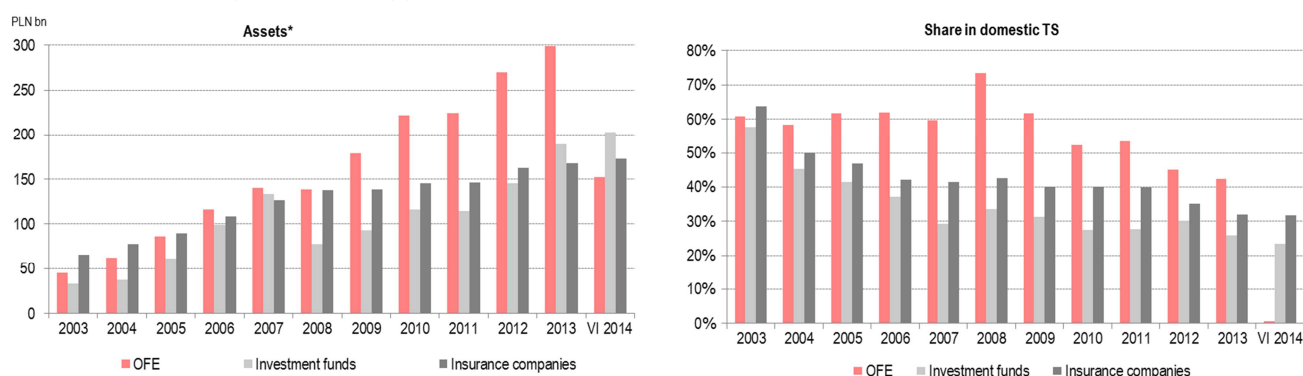
The level of development of the domestic financial market, including the domestic investor base, as well as the role of foreign investors in the domestic market are the important determinants of debt management. Under conditions of free capital flow, a well-developed and deep domestic market allows for absorption of external shocks and outflow of foreign capital.

IV.3.1. Domestic investor base

Since the introduction of the changes in the pension system and exclusion of the OFE from the TS market investors, insurance companies and investment funds have remained in the group of stable non-banking long-term investors. The total share of those entities in the domestic TS amounted to 20.5% at the end of June 2014. TS constitute ca. 1/3 of insurance companies assets and ca. 1/4 of investment funds assets.

In the recent years, assets under management of insurance companies have been increasing steadily – from the end of 2007 to the end of June 2014, they increased by PLN 46.2bn (by 36%). In the group of investment funds, following the decline in the value of assets as a result of the crisis in financial markets, and subsequently, the period of stabilisation in 2009, assets returned to upwards tendency in the following years, reaching the level higher by PLN 68.9bn (by 52%) at the end of June 2014, as compared to end of 2007.

Chart 24. Assets of non-banking financial institutions and TS share in their assets*



*) For OFE and investment funds net assets are presented (assets reduced by liabilities)

The main factors to determine the value of the assets under management of non-banking financial institutions in the forthcoming years include:

- changes in the level of domestic savings;
- further development of the insurance and investment funds market ;
- situation in the stock market, which is one of the factors determining the decisions on savings allocation by households.

The well-developed domestic non-banking sector contributes to growing stability of TS demand and, due to the long-term nature of the investments of substantial part of non-banking institutions increases the demand for long-term instruments. The exclusion of OFE from non-banking investors should be approximately neutral for the domestic TS market, since the decline in the demand of OFE shall be accompanied by a lower supply of new debt, due to lower borrowing requirements in the subsequent years.

The banking sector demand for the TS can be treated as a residual factor since the role of banks usually declines in the periods of dynamic economic growth. In the periods of slowdown, banks increase their TS portfolios, whereas under the outflow of foreign investors, they may periodically absorb the TS supply (what happened on a large scale in 2008, and was also recorded to a lesser extent in the second half of 2013 and at the beginning of 2014). This tendency is supported by structural over-liquidity of the banking sector⁵⁾.

IV.3.2. Role of foreign investors

Foreign investors play a significant role in financing the state budget borrowing requirements on the domestic market. Their demand is highly volatile and strongly depends on the international situation.

In the period from the beginning of 2009 to April 2013 the uninterrupted inflow of foreign investors to the domestic TS market continued. As a result, the involvement of this group of investors increased over 3.5-fold, reaching an all-time high of PLN 207.3bn at the end of April 2013 (increase in the share from 13% to 36%). In the following months, as a result of the changes in monetary policy announced by Fed, the outflow of investors from the emerging markets, including the Polish market, occurred, and consequently, at the end of 2013, the involvement of non-residents in domestic ST debt amounted to PLN 193.2bn, i.e. 33.1%, compared to end 2012, however, it was higher by PLN 2.7bn. In the first half of 2014, slight net growth in involvement of foreign investors occurred, to the level of PLN 199.8 billion, constituting 40.9% of debt in the domestic TS. Such a high percentage share resulted mainly from the significant decrease in debt held by domestic entities due to the cancellation of Treasury bonds transferred from OFE to ZUS.

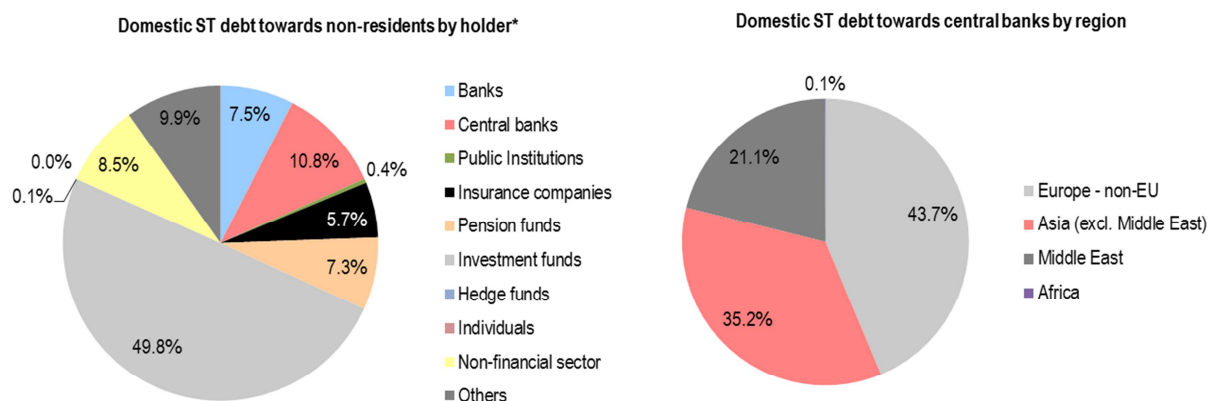
The foreign investors holding structure (cf. Chart 25.) of the domestic TS is well-diversified⁶⁾. Investment funds had the highest share in the debt structure (49.8%). Central banks and public institutions, i.e. target investors, also had a significant share in the domestic debt. At the end of June 2014, these entities held bonds with the value of PLN 18.8bn, representing 11.2% of debt in the domestic TS towards non-residents. Central banks investing in PLN-denominated bonds originated mainly from the non-EU European countries (43.7%), Asia (35.2%) and the Middle East (21.1%). The share of commercial banks was lower than the share of central banks and amounted to 7.5% at the end of June 2014. A part of the non-resident debt in the domestic TS was recorded on the so-called omnibus accounts⁷⁾.

⁵⁾ According to the assessment of the Monetary Policy Council, presented in the "Assumptions of the monetary policy for 2014" (Warsaw, September 2013), year 2014 will be the next year of over-liquidity in the domestic banking sector. The inflow of the EU funds will be the major factor to increase the liquidity of the sector. In 2013 and in the first half of 2014, the average scale of the open market operations amounted to ca. PLN 122 billion.

⁶⁾ Since April 2014, much more detailed information on the structure of foreign investors holding the domestic TS is available. The reporting according to the type of institution has been extended, moreover, data on the geographical structure in terms of countries and regions are available.

⁷⁾ Omnibus accounts - accounts run by direct participants of the National Depository (KDPW) who are not holders of securities registered on these accounts. Introduction of omnibus accounts facilitated foreign investors access to Polish Treasury securities market. Due to the previous regulations holding separate account dedicated for operations on Polish market was required which formed cost and organizational barrier.

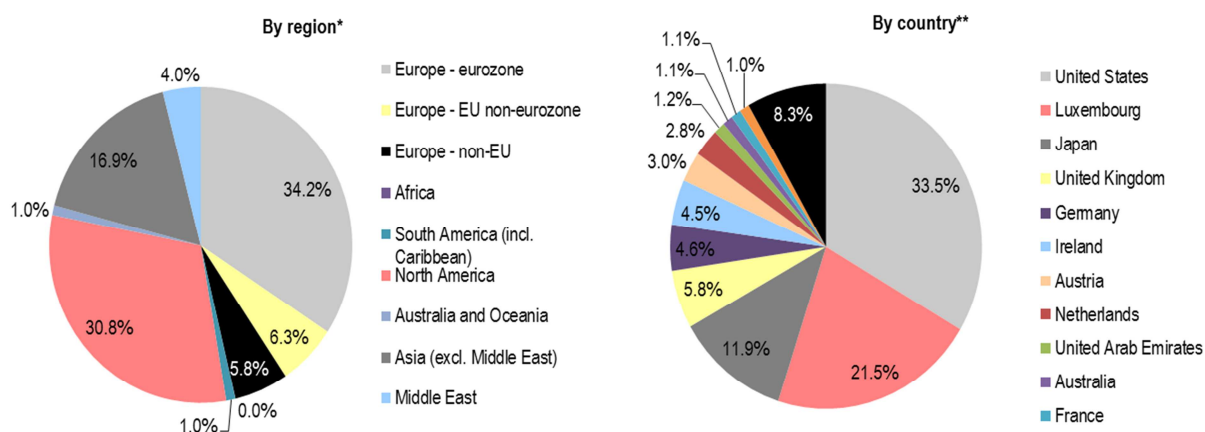
Chart 25. Domestic ST debt towards non-residents by holder and domestic ST debt towards central banks by region (state on June 30, 2014)



^{*)} Excluding omnibus accounts

The geographical structure of foreign investors is well-diversified and includes at least 60 countries. Among purchasers (excluding central banks), entities from the USA (33.5%), Luxembourg (21.5%), Japan (11.9%) and Great Britain (5.8%) dominate. The high share of Luxembourg results from the role of this country as a centre of financial services; investors from Luxembourg represent mostly institutions from outside Europe, mainly from the USA, running investment activities in Europe through companies registered in Luxembourg.

Chart 26. Domestic ST debt towards non-residents by region and by country (state on June 30, 2014)



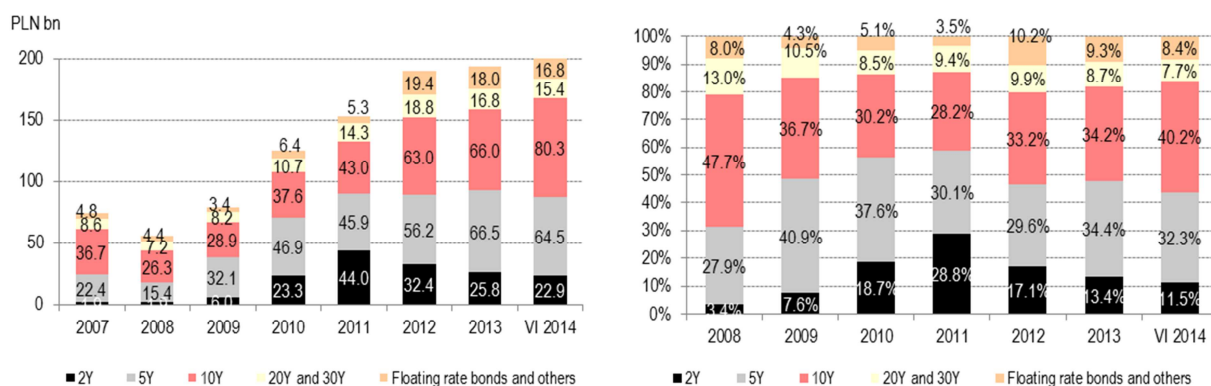
^{*)} Excluding omnibus accounts

^{**)} Excluding omnibus accounts and central banks

The considerable diversification, both in terms of holder and in geographical terms, of the structure of foreign investors holding the domestic TS means that the risk of single-track actions of these investors is insignificant. This risk is inversely related to the diversification level of foreign investors - the higher the diversification, the lower the risk.

In the portfolio structure of TS held by non-residents, the positive trend of the dynamic growth of 10-year bond portfolio has been continued, reaching the dominant share of 40.2% at the end of June 2014, compared to 34.2% at the end of 2013. On the other hand, as in the previous several years, the involvement of foreign investors in TS with the shortest maturities was decreasing (for 2-year bonds - the decline to 1.5% at the end of June 2014, from 3.4% at the end of 2013 and 7.1% at the end of 2012).

Chart 27. Structure of non-residents T-bonds portfolio



The perception of Poland by foreign investors will have significant influence on the terms and conditions of financing State budget borrowing requirements in the timeframe of the *Strategy*. The influx of foreign investors had an impact on the TS yields decline along the whole yield curve, close to all-time low, both in the domestic and foreign markets.

The inflow of foreign capital into Poland should continue, however, most probably, its share in the domestic TS market, after an increase related to the cancellation of the bonds acquired by the Minister of Finance from ZUS, will decline, due to the lower borrowing requirements.

The risk of sudden outflow from the TS market should remain constrained, provided that the main factors fostering decisions of foreign entities to invest in Polish TS are maintained:

- there is a disparity in interest rates;
- the investment risk assessment for Poland is maintained or improved
- maintained perception of Poland by the financial markets as a country that stands out in the group of emerging markets, among others, owing to the strong economic foundations and the improving fiscal situation (considerable decrease in public debt and lower borrowing requirements in the subsequent years resulting from progressing consolidation of public finance and changes in the pension system);
- there is a big and liquid financial market, particularly the TS market and its adequate infrastructure;
- the structure of foreign investors is well-diversified;
- access to the flexible IMF credit line stabilising the investment risk perception in relation to Polish TS.

Stronger short-term foreign capital flows unrelated to the above factors may occur as a result of turmoil on international financial markets. In the medium term, on one hand, the effects of the asset purchase programmes closure, scheduled in autumn this year by Fed may be expected, and on the other hand, a possible further easing of the monetary policy by the ECB is foreseen. The effects of such capital flows should be cushioned by the market itself (over-liquidity in the interbank market and a limited supply of short-term TS make the market capable of absorbing significant pools of such securities), or by the introduced market affecting instruments.

Due to free flow of foreign capital, non-residents investment in domestic TS, as well as raising funds in international markets, pose exchange rate risk for ST debt, considering the impact on the level of Polish zloty rate. Therefore, this factor determines a flexible approach to shaping the financing structure in terms of selection of the market and currency.

IV.4. International situation

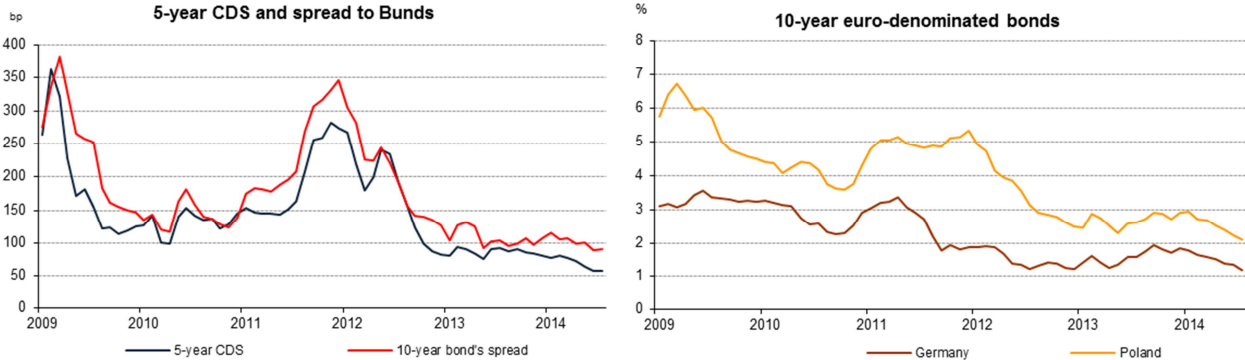
In the second half of 2013 the beginnings of a modest economic recovery were observed in the EU and the GDP over the entire year increased by 0.1%. According to the European

Commission forecasts published in May 2014, the recovery trend shall continue in 2014, and the European economy will record the GDP growth at a level of 1.6% (1.2% in the Eurozone). According to the estimates of the EC, the growth rate of the biggest EU economy - Germany, will increase to 1.8% in 2014, compared to 0.4% recorded in 2013. For the Polish economy the situation in export markets, mainly in the German market, will be the key factor determining external demand. The development of the events in Ukraine and their impact on the Polish export to Russia and also to Ukraine, will be also significant.

The most important international conditions from the perspective of ST debt management include:

- the situation on the interest rate markets for the currencies in which liabilities will be incurred, predominantly in the EUR and USD markets, and actions undertaken by central banks:
 - since September 2014 the ECB has been maintaining the main interest rate at 0.05%, the record low level, it has also announced the launch of the asset purchase programme in October 2014, simultaneously declaring that in case the low inflation continues and worse data on the economic growth in the Eurozone are recorded, the bank is ready to take further measures in order to stimulate the economy;
 - since December 2008, the FED has been maintaining the basic federal funds rate in the range from 0.00 to 0.25%, declaring its keeping within the same range over a considerable period of time following the termination of the asset purchase programme scheduled in autumn 2014;
 - in April 2013 the Bank of Japan made the revolutionary decision in its monetary policy, to switch from interest rates control to money supply control and declared to conduct its operations so that the monetary base grows at an annual rate of JPY 60-70 trillion;
 - since September 2011, the Swiss National Bank (SNB) has been striving to maintain the EUR/CHF exchange rate at a minimum level of 1.20;
- the perception of Poland credit risk and liquidity preferences of buyers of Polish bonds operating in global markets, which affect the level of the premium in relation to core markets. The spread between the yields of Polish and German 10-year Euro government bond tightened to about 90 basis points at the end of July 2014. Taking into account the decline of interest rates on the core markets, it should be stated that the cost of market financing in Euro fell sharply compared to pre-crisis levels. Since the end of 2012, a moderate downward trend of credit risk pricing in the majority of the EU countries, including Poland, is observed. At the end of July 2014, the credit rating of Poland measured by CDS quotations was on the level similar to the level recorded in Slovakia and the Czech Republic although these countries have a higher credit rating than Poland.

Chart 28. 5-year Polish CDS and 10-year Euro-denominated T-bonds yields in Poland and Germany



V. OBJECTIVE OF THE STRATEGY

The objective of the *Strategy* will remain **the minimisation of the long-term debt servicing costs subject to the constraints on the level of:**

1. refinancing risk,
2. exchange rate risk,
3. interest rate risk,
4. State budget liquidity risk,
5. other risks, in particular credit risk and operational risk,
6. distribution of debt servicing costs over time

This objective, determining the debt management, is applied in two aspects:

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

The approach to accomplishment of the objective of minimisation of debt servicing costs has not changed in relation to the previous year *Strategy*. This means the possibility of a flexible financing structure in terms of selection of the market, currency and type of instruments. The choice of the financing structure should result from an assessment of market conditions (level of demand, interest rates and the shape of the yield curve in individual markets, as well as the expected levels of exchange rates), and it should arise from the comparison of costs of raising funds in the long term, taking into consideration constraints resulting from acceptable risk levels.

Experience in debt management indicates the importance of flexibility and diversification of sources of financing borrowing requirements. In the period of financial markets turmoil it is advisable to use instruments adequate to the market situation. At the same time, the possibility to choose the currency and the market allows for appropriate distribution of incurred liabilities over time and the accumulation of reserves in case of periodic market disturbances and, consequently, enables to lower the overall cost of raising capital.

The domestic market shall remain the main source of financing the State budget borrowing requirements. The supply of instruments in the domestic market will be developed in a flexible manner, adapted to the current market situation, i.e. the reported structure and level of demand, so that the TS supply impact on the yield level can be minimised. Funds raised in the international markets will be an important supplementary source of domestic financing. Financing in foreign currencies should:

- take into account foreign currency borrowing requirements;
- ensure diversification of funding sources through the access of Poland to the investor base in major financial markets;
- maintain the position of Poland in the Euro and US dollar market,
- utilize the access to attractive financing in international financial institutions;
- stabilise the domestic market through ensuring the security of financing the State budget borrowing requirements in case of temporary disturbances in the domestic market;
- allow for selling currencies on the financial market or in the NBP as a financing instrument of foreign currency borrowing requirements and managing the foreign currency funds,

taking into account the conditions arising from the monetary policy and the economic rationale.

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

1. refinancing risk:

- striving for increasing the role of medium and long-term instruments in the State budget borrowing requirements financing in the domestic market at a pace dependent on investors' demand;
- striving for even distribution of interest payments and redemptions of domestic and foreign debt in the subsequent years;
- reaching the ATM of domestic debt at the level of ca. 4.5 years, provided that is possible from the perspective of the demand and yield level in individual segments of the yield curve,
- maintaining the ATM of ST debt at the level of at least 5 years;

2. exchange rate risk:

- reducing the share of foreign currency denominated debt below 30% after its temporary increase resulting from the cancellation of a part of domestic T-bonds in 2014 , at a rate depending on market conditions;
- possible use of derivatives in order to create the adequate currency structure of debt and financing State budget borrowing requirements;
- aiming, within the time frame of the *Strategy*, at maintaining the effective (i.e. taking into account derivative transactions) share of Euro in foreign currency debt of at least 70%, with the possibility of temporary deviations from this level in case of limited access to the Euro market, its inefficiency or adverse conditions in derivatives market;

3. interest rate risk:

- keeping ATR of the domestic debt in the range of 2.8-3.8 years;
- possibility of separating the interest rate risk management from the refinancing risk management by using floating-rate bonds, inflation-linked bonds and derivatives;
- the current level interest rate risk of foreign debt interest rate risk does not restrain cost minimisation;

4. State budget liquidity risk:

- keeping the safe level of State budget liquidity while managing liquid assets in an effective way;
- utilisation of free funds of selected public finance sector entities in managing the State budget liquidity, including the broadening of the group of units and the scope of available funds subject to consolidation;
- the level of liquid assets will be determined by the State budget demand for funds, the current and expected market situation, taking into account seasonal conditions as well as striving for the even distribution of TS supply within a year;
- using foreign currency funds and derivative transactions in managing the currency structure of liquid State budget funds;

5. other risks, in particular credit risk and operational risk:

- concluding transactions involving derivatives with domestic and foreign entities with high creditworthiness;
- using instruments limiting credit risk and allowing for its diversification when concluding transactions involving derivatives;

- diversification of credit risk generated by uncollateralised transactions;
6. distribution of debt servicing costs over time:
- striving for smooth distribution of debt servicing costs in individual years, in particular, through the use of derivatives;
 - setting bond coupons at the levels that shall be close to their yields over the sales period.

VI. TASKS OF THE STRATEGY

The following tasks have been recognised as essential for implementing the objective of the *Strategy*:

1. Ensuring liquidity of the TS market,
2. Ensuring efficiency of the TS market,
3. Ensuring transparency of the TS market,
4. To continue broadening of the public finance sector liquidity management consolidation.

The tasks assumed in the *Strategy* are long-term and cover measures implemented on a continuous basis. These tasks are to a large extent interdependent, i.e. individual measures may contribute to the implementation of more than one task at a time. The change of wording of these tasks in relation to the previous *Strategy* by replacing the increasing with ensuring the liquidity, effectiveness and transparency of the TS market arises from the fact that, at the current development stage, this market already fulfils these conditions. Accordingly, the measures undertaken should be mainly aimed at maintaining the proper functioning of the market or its further improvement, in order to contribute to the better implementation of the *Strategy* objective. The task related to the public finance sector liquidity management consolidation is intended to increase the efficiency of the assets and liabilities management of the public finance sector. Within the timeframe of the *Strategy* there it is planned to expand the liquidity management consolidation to new sector entities and instruments.

VI.1. Ensuring liquidity of the TS market

Ensuring adequate liquidity of the TS market and of the individual issues contributes to elimination of the premium expected by investors in case of TS with insufficient liquidity, i.e. those with high costs of disinvestment, as well as to increase the demand from investors interested in holding liquid issues. Both these factors contribute to decreasing TS yields and, accordingly, to the minimisation of ST debt servicing costs. The following measures are planned in the time frame of the *Strategy*:

- Continuation of issuing large series of benchmark bonds in the domestic market ensuring their sufficient liquidity in the secondary market. The policy of issuing medium and long-term fixed-rate bond series until their value reaches at least PLN 20 billion equivalent, adopted in 2003 remains in force;
- Neutralisation of consequences for the liquidity of some bond issues which resulted from the cancellation of a part of domestic TS, by re-opening the issues for which the outstanding amount was significantly reduced, taking into account investors' demand and the budgetary and market conditions;
- Large liquid bond issues in the Euro and the US dollar market;
- Adapting the issuance policy, including sale, switching and buy-back auctions to market circumstances, including the demand in different segments of the TS market.

VI.2. Ensuring efficiency of the TS market

Ensuring efficiency of the TS market covers measures aimed at minimising debt servicing costs under the second out of two aspects of implementation of this objective, discussed in Chapter V. It applies to both the primary and secondary market. The following measures are planned:

- Adjusting the issuance timing in the domestic and foreign market to the market and budgetary conditions, while taking into account measures arising from the task of increasing the transparency of the TS market;
- Increasing the role of participants of the PD system in the development of the TS market and in debt management operations - in the areas where participants of the PD system are at least as competitive as other financial market participants, conclusion of transactions and

selection of partners will be carried out taking into account preferences resulting from their participation in the system; signing an agreement with the Ministry of Treasury under which Ministry of Treasury shall prefer PDs while concluding the transactions associated with the sale of financial instruments. At the same time, the Ministry of Finance, while selecting banks for the issuance of T-bonds in foreign markets, will take into consideration the assessment of entities acting on Polish capital market prepared by the Ministry of Treasury;

- Removing technical and legal obstacles in the domestic and foreign TS market;
- Direct meetings with investors in the domestic and foreign market along with consultations with TS market participants, aimed at effective exchange of information, and taking into account investors' requirements in the implementation process of the *Strategy*, including:
 - regular meetings with banks participating in the PD system,
 - meetings with non-banking sector entities,
 - meetings with foreign investors and foreign banks,
 - ad hoc meetings and phone consultations with investors;
- Extension of the investor base, including, by regular meetings with foreign investors in the form of non-deal roadshows in key foreign markets aimed at:
 - building and maintaining relations with key foreign investors,
 - promotion of Polish TS issued both in the domestic and foreign markets;
- Active participation in conferences and seminars for investors;
- Expanding the channels of electronic communication with domestic and foreign investors.

VI.3. Ensuring transparency of the TS market

Ensuring transparency of the TS market is aimed at limiting the uncertainty connected with its functioning and enables its participants to receive reliable information on current market prices and to formulate expectations concerning the future market prices. Both predictability of the issuance policy and transparent functioning of the secondary market contribute to transparency of the market as a whole. The following measures are planned to be carried out in the time frame of the *Strategy*:

- Transparent issuance policy with regard to the information concerning TS issuance plans (comprising the annual issuance calendar, annual, quarterly, and monthly plans of TS supply);
- Promoting the electronic market through the appropriate PD system regulations, in accordance with the competitiveness and transparency rules, in particular, related to the obligations imposed on participants of the system concerning quoting benchmark bonds, maintaining specific spreads and participation in the fixings of TS.

VI.4. To continue broadening of the public finance sector liquidity management consolidation

Continuation of the second stage of liquidity management consolidation aimed at implementing the *Strategy* objective, understood in terms of the first aspect, i.e. as a selection of debt management instruments. The first stage of the consolidation was introduced in May 2011 and obliged selected public finance sector entities to deposit liquid funds with the account of the Ministry of Finance. In September 2013 within the second stage, foreign currency funds at the disposal of the Minister of Finance were consolidated, and in February 2014 the Minister of Finance was granted the right to temporary use funds deposited in the surety and guarantee reserves account to finance State budget borrowing requirements.

The amendment to the Public Finance Act is currently subject to the Parliamentary procedure. It assumes broadening of a group of public finance units covered by the funds consolidation obligation by:

- institutions of budgetary management,
- state institutions of culture,
- Polish Academy of Sciences (PAN) and the organisational units founded by it,
- governmental independent public health care units (SPZOZ),
- Regional Funds of Environmental Protection and Water Management,

and consolidation of court deposits by placing them with the account of the Minister of Finance. According to the estimates, the implementation of the proposed changes will reduce the public debt by ca. PLN 3.1bn, and the State budget borrowing requirements by ca. PLN 5.5bn.

VII. IMPACT ON THE PUBLIC FINANCE SECTOR DEBT

Pursuant to Article 74 of the Public Finance Act of August 27, 2009, the Minister of Finance is in charge of the public finance sector as regards the rule which states that the public debt must not exceed 60% of the annual GDP.

In the case of public debt, including the debt of entities other than the State Treasury, which are autonomous in incurring liabilities, the influence on the level of debt is indirect and is derived from the regulations of the Public Finance Act. Above all, they include constraints imposed on the manner of incurring liabilities by LGUs, as well as the prudential and remedial procedures, which apply to the public finance sector entities when both the public debt-to-GDP ratio and at the same time the ratio to GDP of the amount of public debt recalculated using for the foreign currency denominated debt the yearly average of the NBP foreign currency exchange rates for the year concerned and reduced by the value of the State budget liquid funds, exceed 55%.

VII.1. Changes in legal regulations

Since the last update of the *Strategy*, the regulatory changes have been introduced in the following areas:

Broadening the public finance sector liquidity management consolidation

The consecutive stages of liquidity management consolidation of public finance sector are discussed in Chapter VI.4. In order to broaden the liquidity management consolidation, a legislative process aimed at amending Public Finance Act is conducted.

Introduction of new fiscal rules

Pursuant to the Act of November 8, 2013 on the amendment to the Public Finance Act and certain other acts, the stabilizing expenditure rule (SER) was introduced which replaced the temporary disciplinary expenditure rule. Legal sanctions triggered by the 50% debt-to-GDP threshold have been replaced with sanctions resulting from the SER mechanism. The introduction of the stabilising expenditure rule was an element of implementation of the Council Directive 2011/85/EU of November 8, 2011 in the scope of numerical fiscal rules. Poland was bound to implement the aforementioned directive by the end of 2013.

The goal of the rule is to reduce the increase in the expenditure of the general government sector, excluding expenditures fully financed from the EU and EFTA funds and the expenditures of those units which do not have the ability to generate high deficits. The introduction of the SER shall ensure the sustainability of public finance in Poland and adjust its possible excessive imbalance.

The rule has been designed so that it contributes to the compliance with both Polish and the EU requirements concerning the fiscal policy. The SER contains the correction mechanism for automatic adjustment of public finance imbalance, in case if:

- the deficit of the general government sector exceeds the reference value of 3% of the GDP;
- the level of public debt exceeds the value of 43% or 48% of the GDP;
- the sum of the differences between the general government nominal balance and the medium-term budgetary objective (the so-called MTO) exceeds +/- 6% of the GDP.

The SER is based on expenditure, i.e. it imposes constraints on the level of public expenditure and allows for calculating, based on the formula specified in Article 112aa item 1 of the Public Finance Act, the legally binding and definitive limit of expenses for a given budgetary year. The level of expenditure covers two groups of the general government sector institutions. The first group includes: State budget, Social Security Fund, Labour Fund, Pension and Retirement Fund, Bridging Allowance Fund and the funds established, entrusted or assigned to BGK. The second group comprises of National Health Fund, local government units and their associations, entities referred to in art. 139 item 2 of the Public Finance Act. In

order to obtain the aforementioned expenditure limit, the forecasted expenditure of units listed in group 2 are deducted from the amount of expenditure.

The current level of prudential thresholds set out in the adjustment mechanism (43% and 48% of the GDP) results from the reduction by 7 percentage points of the primary thresholds of 50% and 55% defined in Article 112aa of the Public Finance Act of August 27, 2009, in its wording binding since July 10, 2014.

This amendment was introduced in connection with pension system reform, as a result of which the level of public debt has been reduced. The reduction of the aforementioned thresholds is aimed at providing the relevant restrictiveness of the fiscal policy despite the lower level of public debt, stabilising public debt at a lower level as well as ensuring the reliability of fiscal policy in Poland.

Changes in the regulations relating to local government units

Since January 1, 2014, the system of setting individual limits on incurring debt by LGUs, as defined in Article 243 of the Public Finance Act, has come into force, making the potential amount of debt of each LGU dependent on their ability to repay the debt. The new solution is aimed at customizing an indicator defining the safe level of debt and to reflect the creditworthiness of units and their financial standing.

Moreover, pursuant to the Act of November 8, 2013 on the amendment to the Public Finance Act and certain other acts new rules were introduced to put more emphasis on the self-improvement of financial condition in the particular LGU based on its own resources. These changes regulate the issues of remedy procedures for LGU to be introduced in case of the risk of failure of the unit to the implement of public tasks and to comply with the ratios defined in Articles 242-244 of the Public Finance Act. They also regulate the issue of a replacement budget of a LGU by the regional clearing house (Article 240a of the Act).

This solution - assuming certain financial requirements concerning the financial management of the unit conducting the remedy procedure - enables to concentrate resources and efforts of the LGU required in terms of effective financial recovery. These requirements include, inter alia, the provisions on limiting new investments to those which do not generate debt growth and reducing the expenditure related to remuneration of the management board and daily allowances of the councillors.

At the same time, in order to increase the absorption of EU funds by LGUs, the constraints arising from the Public Finance Act have been alleviated. The provisions, inter alia, pertain to the exclusion of interest on the liabilities incurred to finance projects co-financed with EU funds from the debt limit and liabilities incurred to co-finance expenditure under the EU programme, project or task, where the EU co-financing level exceeds 60%.

VII.2. Assumptions of the strategy of granting sureties and guarantees

In order to reduce the risk associated with granting ST sureties and guarantees while preserving the advantages of using them as an instrument of the State economic policy, the following principles shall be maintained:

- concentration of granting sureties and guarantees on supporting development-oriented projects concerning infrastructure investments, environmental protection, creating new jobs and regional development, in particular, based on the EU funds (loans and bonds guaranteed by the ST should help to acquire the EU funds), but also on subsidising other investment tasks which may arise from potential new support programmes for granting sureties and guarantees in compliance with the EU rules;
- using sureties and guarantees to support possible measures undertaken in case of potential deterioration in the Polish financial system as an effect of the global financial and economic crisis;
- 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.

The amount of new sureties and guarantees granted in a given year is limited through the Budget Act. Pursuant to Article 31 of the Act of May 8, 1997 on sureties and guarantees granted by the State Treasury and certain other legal persons, each year the Budget Act stipulates the total amount to which guarantees and securities can be granted by the State Treasury. The limit for 2015 in the draft budget act was determined at a level of PLN 200 billion.

The extent of use of the ST sureties and guarantees will result mainly from the continuation of infrastructural investments, as well as possible measures which can be undertaken in the event of potential deterioration of the Polish financial system resulting from a global financial and economic crisis. An increase in contingent liabilities resulting from sureties and guarantees granted by the ST will be affected to a large extent by sureties and guarantees granted to the following entities:

- BGK for bonds issuance and repayment of loans incurred for the National Road Fund (KFD) in order to co-finance the construction of a road infrastructure;
- PKP Polskie Linie Kolejowe S.A. for the repayment of loans incurred in order to co-finance the investment in railway infrastructure.

VII.3. Debt of public finance sector entities other than the State Treasury

Under the adopted assumptions, the nominal debt of public finance sector entities other than the State Treasury will increase slightly, within the time frame of the *Strategy*, from PLN 118.0bn to PLN 126.6bn before consolidation, and from PLN 72.4bn to PLN 75.2bn after consolidation. The increase will be the result of the relatively insignificant increase in the LGUs debt and the stabilisation of debt of other units of central and local government sector.

Within the time frame of the *Strategy*, the before consolidation debt of other public finance sector units in relation to the GDP will amount to ca. 7.8%, whereas the debt after consolidation will amount to approximately 4.0% of the GDP. The share of this group of entities in the total debt of the public finance sector before consolidation will amount to ca. 13.0%, and to ca. 6.7% after consolidation.

Chart 29. Debt of public finance sector entities other than State Treasury by sectors, before and after consolidation

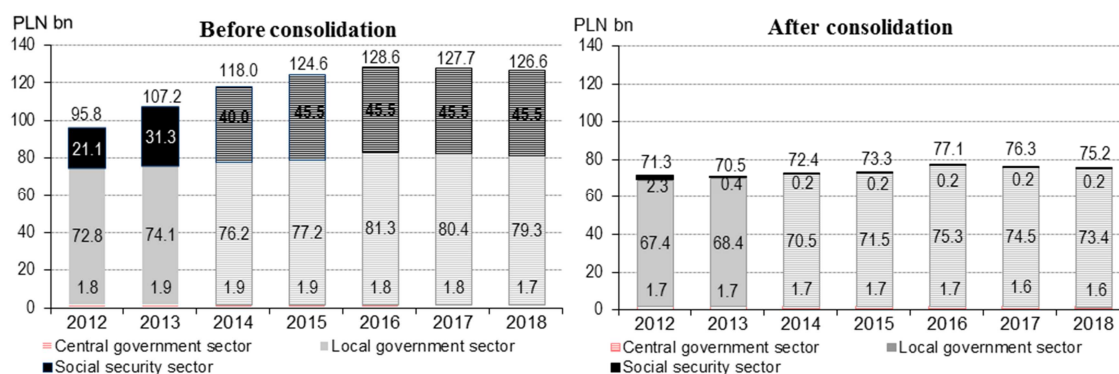
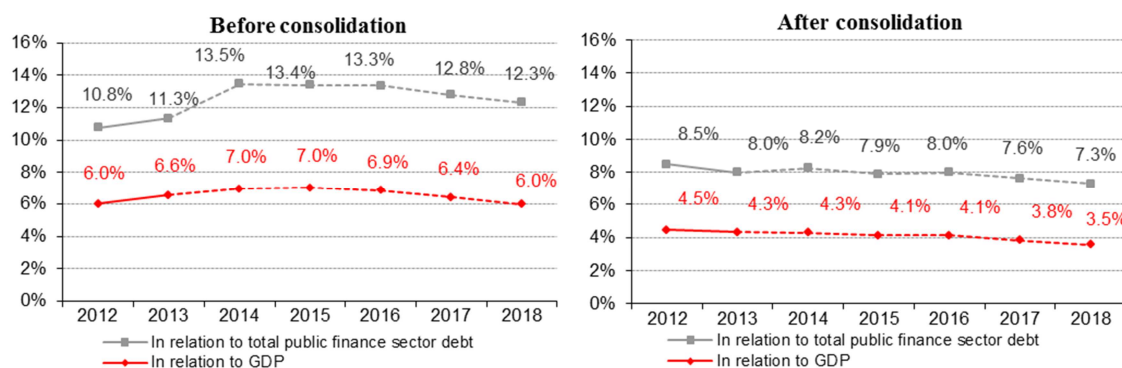


Chart 30. Debt of public finance sector units other than ST in relation to GDP and total public finance sector debt



VII.3.1. Debt of local government units

The *Strategy* assumes that the debt of the LGUs and their associations will continue to increase until 2016, as a result of budgetary deficits of this group of units. From 2017 on, a slight decrease of the debt of the LGUs is expected, resulting from the total surplus of the LGU budgets.

The borrowing requirements of the LGUs will be determined by their investment expenditures, in particular, by expenditures allocated for the implementation of infrastructural projects, including those co-financed with the EU funds.

Loans incurred in the domestic market from commercial banks will remain the main source of financing of the borrowing requirements of LGUs. The foreign debt, from both bonds issued in international markets and loans incurred at international financial institutions, will constitute the supplementary source of financing the borrowing requirements of those units.

The level of debt of the LGUs will be affected by the new rules regarding incurring liabilities by such units, which came into force as of January 1, 2014.

VII.3.2. Debt of other entities

Credits and loans will dominate element in the debt structure of other public finance sector entities.

It is assumed that within the timeframe of the *Strategy* the debt of SPZOZ will stabilise. The debt of local government units will continue to have a dominant share in the total liabilities of SPZOZ.

It is expected that the debt of FUS after consolidation will be significantly lower than before consolidation due to utilisation of loans from the State budget as a source of financing.

VIII. EXPECTED EFFECTS OF IMPLEMENTING THE STRATEGY

The expected effects of the *Strategy* implementation include forecasts of:

- the volume of public debt and the debt servicing costs;
- contingent liabilities due to guarantees and sureties;
- changes in risk related to public debt.

These are the expected results of the implementation of the *Strategy* objectives under the adopted macroeconomic, budgetary and market assumptions. The most important threats to the implementation of the *Strategy* objectives are also presented in this chapter.

VIII.1. Debt volume and its servicing costs

In 2014, the decrease in the public debt is expected, both in nominal terms and in relation to GDP, which results from the changes implemented in the pension system, including the cancellation of T-bonds with the nominal value amounting to PLN 130.2 bn. In accordance with the adopted assumptions the public debt-to-GDP ratio at the end of 2014 shall fall to 47.7% from 53.9% at the end of 2013.

In 2015, the stabilisation of the debt-to-GDP ratio is expected, at a level similar to 2014, or slightly higher, whereas in the subsequent years this ratio will decrease to reach the level of 44.5% in 2018. Both in 2014 and in the timeframe of the *Strategy*, the amount determined by recalculating public debt using the average yearly NBP rates and reducing it by the value of liquid funds of the MoF, shall be above GDP 43%, but below GDP 48%, i.e. the thresholds specified in the stabilizing expenditure rule. No threat is expected that the sanctions specified in the Public Finance act for exceeding the 55% threshold will come into force.

Table 4. Forecasts of the public debt volume and the ST debt servicing costs

Item	2013	2014	2015*	2016	2017	2018
1. State Treasury debt						
a) PLN bn	838.0	759.5	804.8	832.1	869.1	899.3
- domestic	584.3	501.3	548.4	576.8	606.8	629.4
- foreign	253.8	258.2	256.5	255.4	262.3	269.9
b) in relation to GDP	51.2%	44.8%	45.4%	44.3%	43.7%	42.4%
2. Public debt						
a) PLN bn	882.3	807.5	850.0	880.1	915.2	943.1
b) in relation to GDP	53.9%	47.7%	48.0%	46.9%	46.0%	44.5%
3. The amount specified in article 38a point 3 of the Public Finance Act**						
a) PLN bn	864.8	788.1	840.2	873.2	901.9	929.2
b) in relation to GDP	52.9%	46.5%	47.4%	46.5%	45.4%	43.9%
4. General government debt						
a) PLN bn	934.6	848.5	899.3	940.5	985.3	1 028.6
b) in relation to GDP	57.1%	50.1%	50.8%	50.1%	49.5%	48.5%
5. Debt servicing costs (cash basis)						
a) PLN bn	42.5	36.2	32.3	31.7 - 33.1	32.5 - 33.8	33.6 - 35.0
- domestic debt	32.3	24.4	22.1	22.9	23.8	24.1
- foreign debt	10.1	11.8	10.2	8.8 - 10.1	8.7 - 10.0	9.5 - 10.9
b) in relation to GDP	2.60%	2.14%	1.82%	1.69% - 1.76%	1.63% - 1.70%	1.58% - 1.65%

*Forecast for the year 2015 is based on the assumption that the execution of the budget deficit in this year will be equal to the limit from the Budget Act. It is expected that lower actual execution will lead to the lower increase in public debt.

**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.

**Forecasts of the debt servicing costs for the years 2016-2018 account for the exchange rate risk provisions

The *general government* debt-to-GDP ratio in the timeframe of the *Strategy* will reach the level of 48.5%. According to the *Strategy*, this ratio is not expected to exceed the 60% threshold set out in the Maastricht Treaty. In the *Strategy* a decrease in ST debt servicing costs-to-GDP ratio in 2014 to 2.1% from 2.6% is forecasted, resulting to a great extent from the

cancellation of TS acquired by the Minister of Finance from ZUS, as well as from the decline of the interest rates in the domestic and foreign markets. The decrease in the debt servicing costs was also affected by the increased share of floating rate debt. In 2015, the decrease in ST debt servicing costs-to-GDP ratio to the level of 1.8% is expected. In subsequent years, the continuation of the downward trend is assumed, to 1.6-1.7% in 2018.

Chart 31. Debt-to-GDP ratio

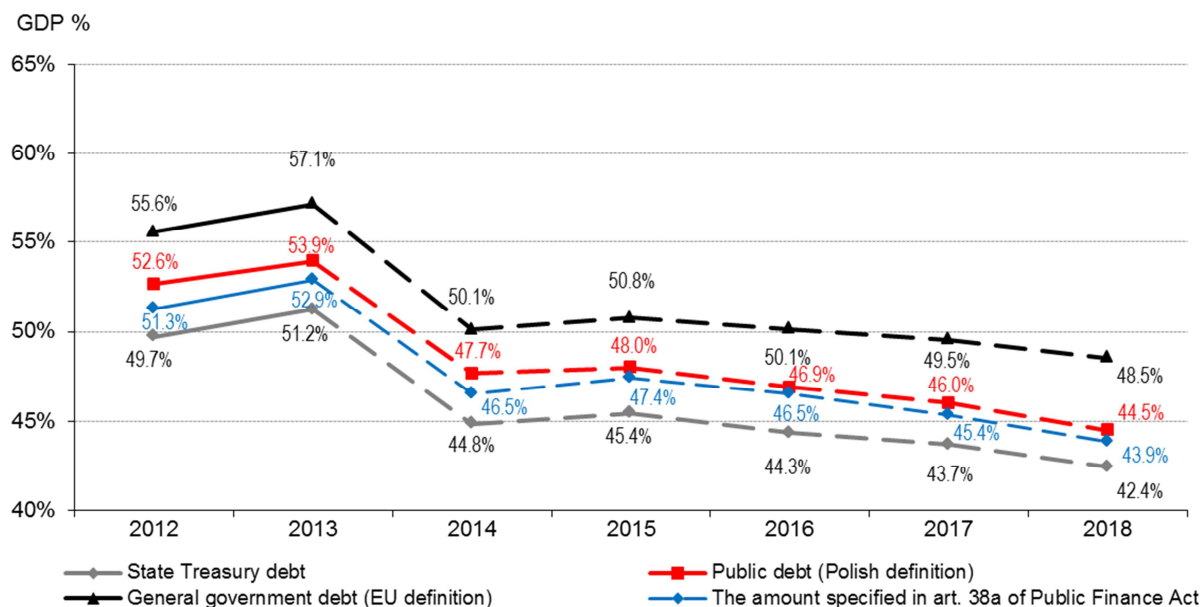


Chart 32. ST debt servicing costs-to-GDP ratio

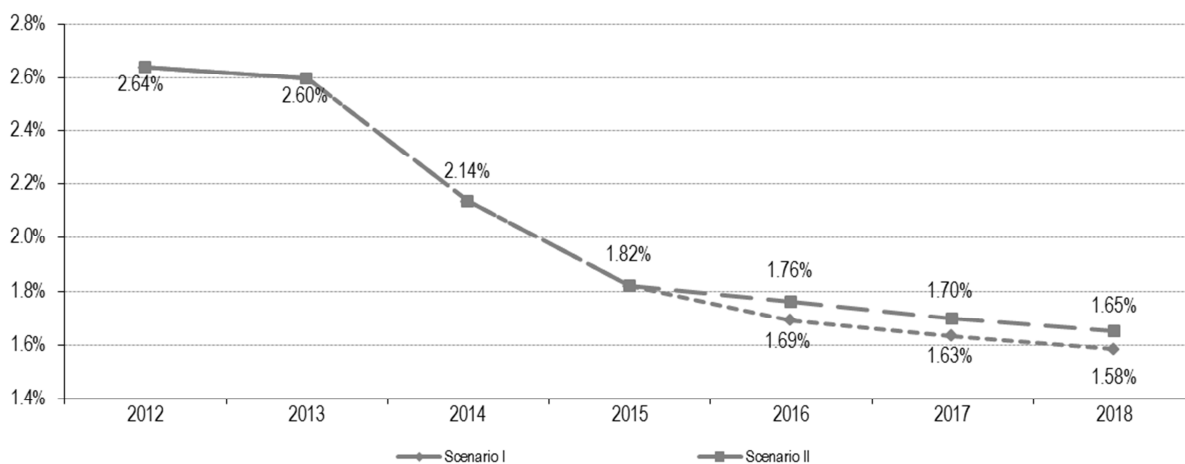
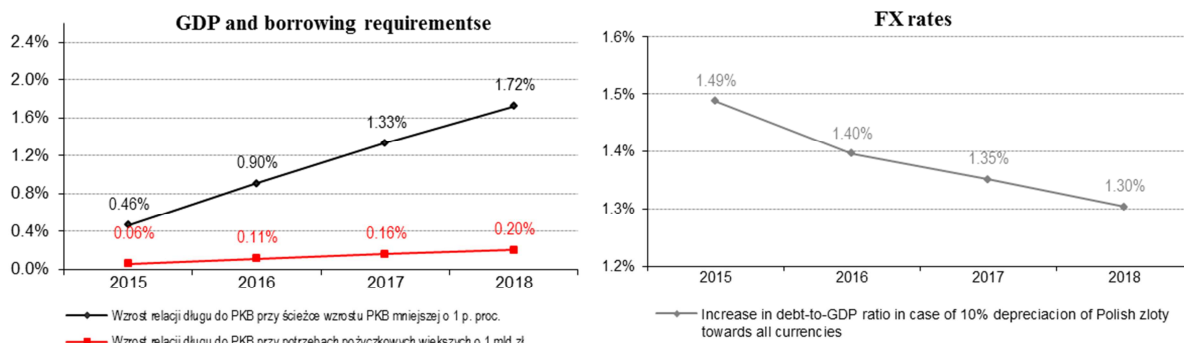
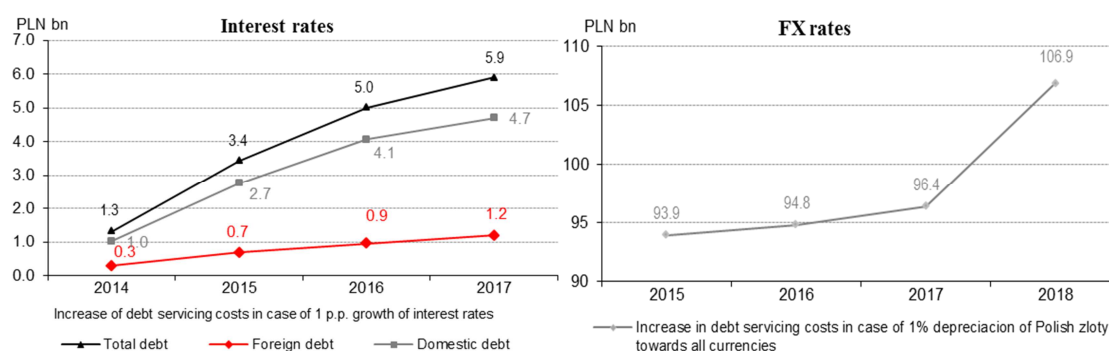


Chart 33. Sensitivity of public debt-to-GDP ratio to changes in assumptions*



* assuming the change of paths since 2014.

Chart 34. Sensitivity of ST debt servicing costs-to- GDP ratio to changes in assumptions



Contingent liabilities (guaranties and sureties)

It is expected that in 2014 the ratio of ST contingent liabilities resulting from sureties and guarantees to GDP will amount to ca. 7.3% and it will continue to grow in the consecutive years, to reach its maximum of 8.0% in 2016 and 2017. In 2018, the decline of this ratio to the level of GDP 7.7% is foreseen. At the same time, the amount of expected payments on this account will remain at a safe level, i.e. they will not exceed the threshold of GDP 1.4%.

Table 5. Forecast of contingent liabilities under guaranties and sureties granted by the ST and the public finance sector units

	2014	2015	2016	2017	2018
Forecasted payments under guaranties and sureties granted by:					
- Public finance sector					
PLN bn	8.5	8.3	8.7	8.9	9.7
GDP %	0.5%	0.5%	0.5%	0.4%	0.5%
- State Treasury					
PLN bn	8.4	8.3	8.7	8.9	9.7
GDP %	0.5%	0.5%	0.5%	0.4%	0.5%
Contingent liabilities under guaranties and sureties granted by:					
- Public finance sector					
PLN bn	128.0	145.0	156.0	165.8	171.1
GDP %	7.6%	8.2%	8.3%	8.3%	8.1%
- State Treasury					
PLN bn	123.4	139.9	150.3	159.3	163.8
GDP %	7.3%	7.9%	8.0%	8.0%	7.7%

VIII.2. Structure of the State Treasury debt

In the time frame of the *Strategy* the following is expected:

- regarding the refinancing risk – the ATM of the ST domestic marketable debt, following the temporary decline in 2014, from 4.6 to 4.2 years due to the cancellation of the TS in connection with the pension system reform, will increase, at a pace dependant on the market conditions, to ca. 4.3-4.7 years in 2018, ATM of the total ST debt will remain in range of ca. 5.2-5.5 years;
- the interest rate risk will remain within the range set in the *Strategy*, depending on the adopted financing structure, the ATR of the domestic marketable debt will remain within the range of ca. 3.1-3.6 years compared to 3.1 at the end of 2014, while the ATR of the total debt will be in the range of ca. 4.0-4.2 years; the duration of the domestic marketable debt will stay within the range of ca. 2.9-3.2 years compared to ca. 2.9 at the end of 2014, while that of the total debt will be in range of ca. 3.5-3.8 years;

- the average share of foreign currency debt will be gradually reduced and in the timeframe of the *Strategy*, it may reach ca. 30%.

Chart 35. ATM of the ST debt

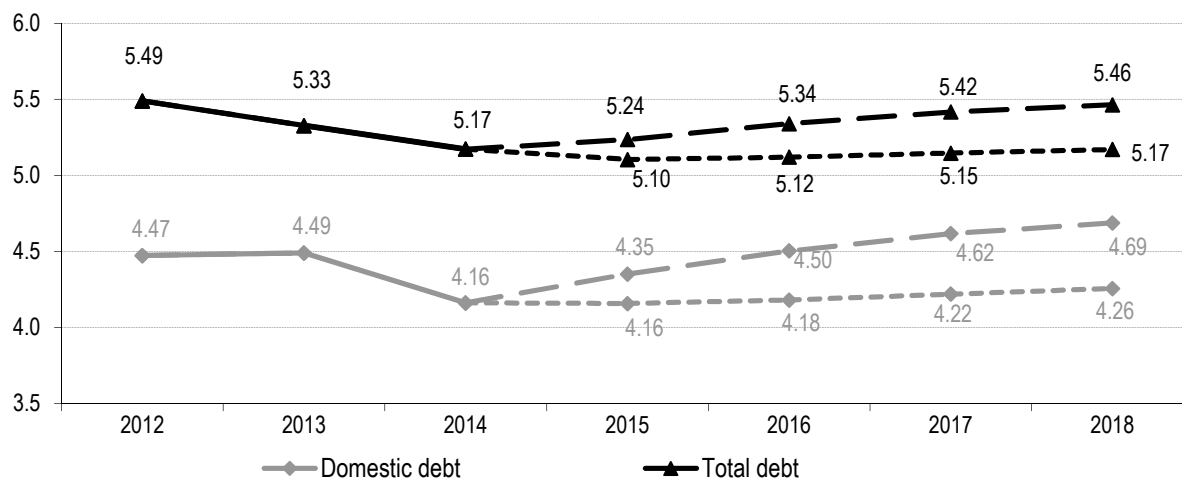


Chart 36. ATR of ST debt

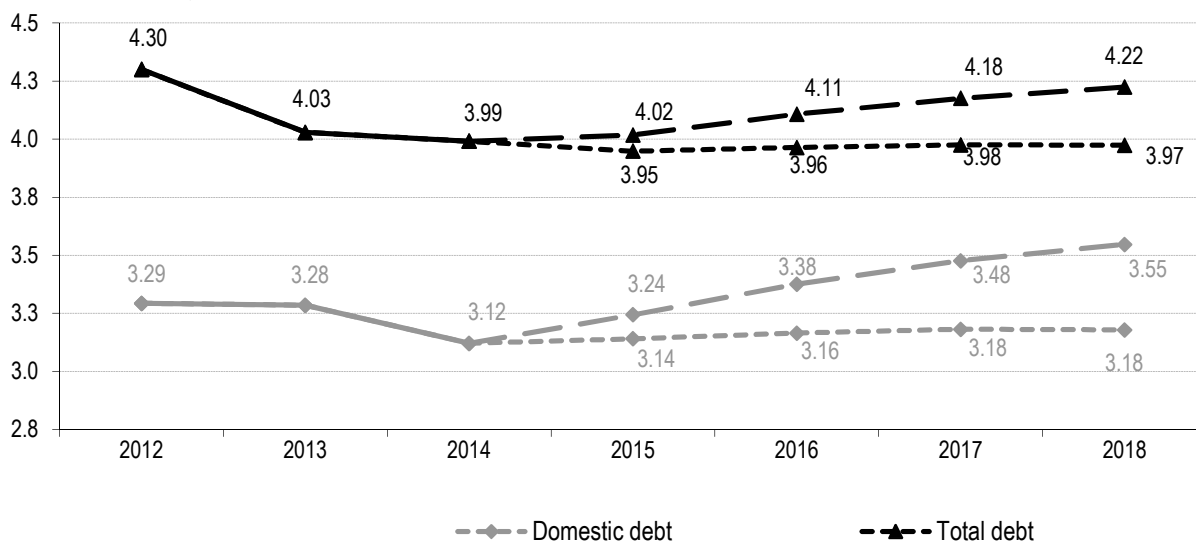


Chart 37. Duration of the ST debt

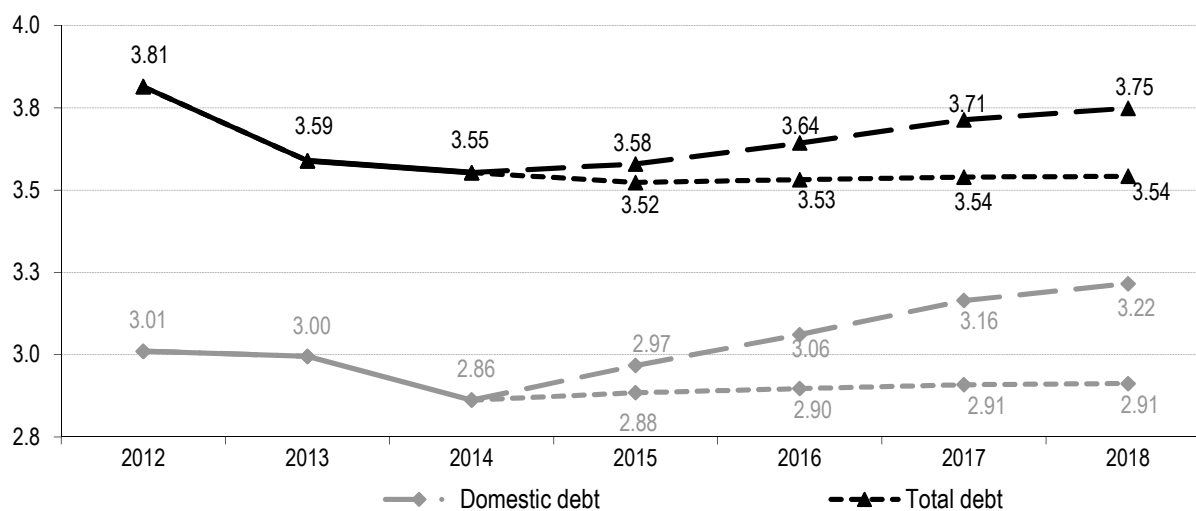
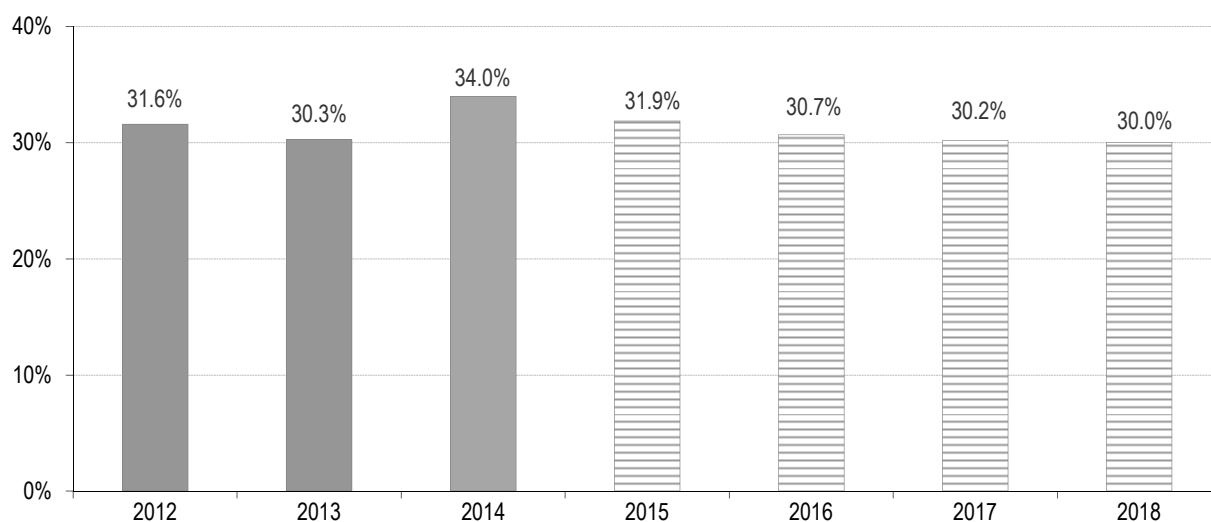


Chart 38. Share of foreign debt in the ST debt



VIII.3. Threats to the Strategy implementation

The main threats to the implementation of the presented *Strategy* are mainly associated with:

1. a macroeconomic situation in Poland varying from the assumed scenario, in particular, a slower GDP growth, higher interest rates, as well as volatility in foreign exchange rates;
2. conditions in the international market, including:
 - slower than expected economic growth rate in Europe and in the USA,
 - lending capital withdrawal towards investments in core markets or other markets, resulting from tapering monetary policy in the USA;
 - the consequences of the conflict in Ukraine;
3. the risk of excessive growth of public debt and general government debt-to-GDP ratio, resulting from:
 - higher State budget borrowing requirements depending, among others, on the trends in the Polish economy,
 - lower exchange rate of the Polish Zloty as compared to the assumptions of the *Strategy*,
 - considerable increase in debt of public finance sector entities other than ST, in particular, the LGUs,
 - the necessity to execute sureties or guarantees granted by public finance sector entities.

Annex 1. Abbreviations and glossary

A. Abbreviations used in the Strategy

ATM – average time to maturity
ATR – average time to refixing
BGK – Bank Gospodarstwa Krajowego
CDS – Credit Default Swap
CPI – consumer price index
ECB – European Central Bank
EDP – Excessive Deficit Procedure
EFSF – the European Financial Stability Facility
EU – European Union
FED – the Federal Reserve System
FUS – Social Security Fund
GDP – Gross Domestic Product
GG – general government sector
IFI – International Financial Institutions
KDPW – National Depository Securities
KFD – National Road Fund
LGUs – local government units
NBP – National Bank of Poland
OFE – Open Pension Funds
SPZOZ – independent public health care units
ST – State Treasury
TS – Treasury securities
PD – Primary Dealers
VAT – value added tax
ZUS – Social Security Institution

B. Glossary

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:

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

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 $I_0 = 1$).

ATR (*average time to refixing*) – 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.

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.
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.

Buy-sell-back – transaction which consists of two agreements: spot purchase and forward sale of securities at a price set upfront at the day of the transaction.

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*.

$$Duration = \frac{\sum_{r \in R} \left[r \sum_{s \in S_r} \frac{CFZ_s}{(1+i_s)^s} \right] + \sum_{s \in S} \frac{sCFS_s}{(1+i_s)^s}}{\sum_{s \in S} \frac{CFZ_s}{(1+i_s)^s} + \sum_{s \in S} \frac{CFS_s}{(1+i_s)^s}}$$

where:

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

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

r – 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,
 S_r - set of all payment dates for these floating-rate securities, which the nearest fixed maturity is r ,
 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 State Treasury 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 State Treasury 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.

Potential debt – 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 potential debt. 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.

Primary Dealers – a group of institutions (banks) 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.

Public Debt – debt of State Treasury and public finance sector units after consolidation. Public finance sector includes:

- bodies of public authority, including bodies of government administration, bodies of state control and legal protection, courts and tribunals;
- local government units and their associations;
- budgetary units;
- local government budgetary entities;
- executive agencies;
- institutions of budgetary management;
- state special-purpose funds;
- Social Security Institution and funds under management of it;
- Agricultural Social Insurance Fund (KRUS) and funds under management of the President of KRUS;
- National Health Fund;
- independent public health care units;
- public universities;
- Polish Academy of Sciences and organizational units founded by it;
- state and local government cultural institutions and state film institutions;
- other state or local government legal persons founded under separated acts in order to execute public tasks, excluding enterprises, research institutes, banks and commercial companies.

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.

Residency 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 *financial derivatives*. *Swap* may be a separate financial instrument or it may accompany other instruments.

Annex 2. Legal regulations applied to public debt in Poland and the EU

Table 1. Public debt – basic legal regulations

Polish regulations	EU regulations
1. Constitution of the Republic of Poland ban on incurring loans and granting guaranties and sureties resulting in the public debt exceeding 3/5 of GDP (Article 216(5));	1. Treaty on the functioning of the European Union ➤ 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 126) – specifies the Excessive Deficit Procedure (EDP);
2. Public Finance Act ➤ regulations on public debt: definitions, basic principles of issuing public debt and debt management, prudential and remedial procedures applied to public debt levels; ➤ definition of the scope of the public finance sector.	2. Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community and the Treaty on the functioning of the European Union ➤ definition of general government debt and reference value of debt to GDP ratio at 60%;
	3. Council Regulation on the application of the Protocol on the Excessive Deficit Procedure annexed to the Treaty establishing the European Community ➤ definition of general government debt with specification of categories of liabilities which constitute it;
	4. The European System of Accounts (ESA 2010) ➤ definition of categories of financial liabilities; ➤ definition of general government sector.

Table 2. Limits on the public debt to GDP ratio in Public Finance Act

Public Finance Act
I. Legal procedures regarding limits on public debt to GDP ratio
1) the ratio in year x is greater than 55% and lower than 60%:
<p>a) it is assumed the lack of deficit or the difference between state budget revenues and expenditures in draft budget act adopted by the Council of Ministers for the year $x+2$ must ensure the decrease in State Treasury debt to GDP ratio as compared to the ratio announced for the year x;</p> <p>b) budget deficit of local government unit diminished by cumulated budgetary surplus from previous years and liquid funds in budget resolution for the year $x+2$ can only derive from expenditures for current tasks co-financed from EU funds or non-returnable financial aid provided by EFTA member countries;</p> <p>c) in draft budget act adopted by the Council of Ministers for the year $x+2$:</p> <ul style="list-style-type: none"> ➤ no increase in salaries of public sector employees is assumed, ➤ revaluation of pensions must not exceed the CPI level in the budgetary year $x+1$, ➤ ban on granting new loans and credits from the State budget is introduced, ➤ the increase in expenditures of the Sejm (lower house of Polish Parliament), the Senate (upper house of Polish Parliament), Presidential Chamber of the Republic of Poland, Constitutional Tribunal, Supreme Chamber of Control (NIK), Supreme Court, Primary Administration Court, common courts of law and provincial administration courts, Spokesman of Citizen Rights, Spokesman of Child Rights, National Board of Radio and Television, General Inspector for the Security of Personal Data, The Institute of National Remembrance – Commission for the Prosecution of Crimes against the Polish Nation, National Electoral Office, National Labour Inspection must not be higher than expenditures in the government administration; <p>d) the Council of Ministers make a review of:</p> <ul style="list-style-type: none"> ➤ State budget expenditures financed by foreign credits, ➤ long- term programs; <p>e) the Council of Ministers presents a remedial program ensuring the fall in public debt to GDP ratio;</p> <p>f) the Council of the Ministers make a review of regulations in force to propose possible legal solutions which influence state budget revenues, including VAT rates,</p> <p>g) State Fund for the Rehabilitation of Disabled Persons receives earmarked subsidies from the state budget for co-financing of disabled workers salaries at the level of 30% of planned funds for that year,</p>
h) new liabilities can be incurred by government administration if the investments are co-financed from EU funds or non-returnable financial aid provided by EFTA member countries at the maximum level, set in the rules or procedures for

Public Finance Act
particular type of investment, not lower than 50% of the total costs, however these restrictions do not apply to state road rebuilding or repairs required for road traffic hazard removal, anti-flood infrastructure investments, electronic toll service and compensations for properties taken over for public roads investments;
2) the ratio in year x is equal to or greater than 60%:
a) procedures provided in point 1, letters a, c, d, f, g and h in case of the ratio greater than 55%, and lower than 60% are in force;
b) budgets of local government units for the year x+2 must at least be balanced;
c) a ban on granting new sureties and guarantees by public finance sector entities is introduced;
d) 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%;
Procedures provided in point 1 are not applicable if the amount of debt determined by recalculating public debt using for the foreign currency denominated debt yearly average of NBP exchange rates and reducing it by the value of State budget liquid funds raised to finance borrowing requirements of the following year does not exceed the threshold of 55%.
II. Principles and limits on incurring liabilities by local government units
a) planned and executed current expenditures must not exceed planned and executed current revenues including liquid funds and budgetary surpluses from previous years;
b) executed current expenditures can be higher than executed current revenues including liquid funds and budgetary surpluses from previous years only by amounts linked with the current tasks co-financed from EU funds or non-returnable financial aid provided by EFTA member;
c) Local government units can incur loans and issue securities for: <ul style="list-style-type: none"> ➤ repayment of earlier incurred liabilities resulting from securities and loans, ➤ covering transitional budget deficit of local government within the fiscal year, ➤ financing of planned budget deficits; ➤ preceding financing tasks co-financed from UE funds;
d) 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;
e) Local government can only incur liabilities of which servicing costs are borne at least once a year, while: <ul style="list-style-type: none"> ➤ discount of securities issued by local government cannot exceed 5% of their face value, ➤ capitalization of interest is inadmissible;
f) For a local government unit, the total ratio of: <ul style="list-style-type: none"> ➤ instalments of loans and interest payable in this fiscal year, ➤ redemption of securities and interest (including discount) payable on them, ➤ potential payments resulting from sureties and guarantees granted, to planned revenues cannot exceed in the budgetary year and any other year following the budgetary year the arithmetical average for last three years of current revenues including proceeds from privatisation minus current expenditures to total revenues ratio;
g) Limitations on debt repayments of local government do not apply to: <ul style="list-style-type: none"> ➤ instalments of loans and interest payable on them drawn in connection with a programme, project or task co-financed with the EU funds; ➤ redemption of securities and interest (including discount) payable on them issued in connection with a programme, project or task co-financed with the EU funds; - but no later than 90 days after the end of the programme, project or task and receiving a refund; this cut-off date doesn't apply to liabilities incurred for national contribution; <ul style="list-style-type: none"> ➤ instalment of loans and redemption of securities and interest (including discount) payable on them incurred or issued to finance national contribution of a programme, project or task with the EU co-financing level exceeding 60%.

Table 3. Correction mechanism of the stabilising expenditure rule.

Public Finance Act
The correction amounts of the stabilizing expenditure rule pursuant to Article 112aa:
1) – 2 percentage points: <ul style="list-style-type: none"> ➤ the general government deficit in year x-2 exceeds GDP 3% (including costs of pension system reform) or ➤ the amount specified in article 38a point 3 of the Public Finance Act (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) exceeds in year x

Public Finance Act	
-2 GDP 48%.	
2) - 1.5 percentage points:	<ul style="list-style-type: none"> ➤ the general government deficit in year x-2 does not exceed GDP 3% (including costs of pension system reform) and the amount specified in article 38a point 3 of the Public Finance Act exceeds in year x-2 GDP 43% but is lower or equal to GDP 48% and ➤ the forecasted dynamics of the real GDP for year x (assumed in the draft budget act for the year x) is not lower than the medium term average by over 2 percentage points;
	<ul style="list-style-type: none"> ➤ the general government deficit in year x-2 does not exceed GDP 3% (including costs of pension system reform) and ➤ the amount specified in article 38a point 3 of the Public Finance Act in year x-2 is lower or equal to GDP 43% and ➤ the sum of the differences between the general government nominal balance and the medium-term budgetary objective (MTO) exceeds in year x-2 - 6% of the GDP and ➤ the forecasted dynamics of the real GDP for year xn (assumed in the draft budget act for the year x) is not lower than the medium term average by over 2 percentage points;
3) + 1.5 percentage points:	<ul style="list-style-type: none"> ➤ the general government deficit in year x-2 does not exceed GDP 3% (including costs of pension system reform) and ➤ the amount specified in article 38a point 3 of the Public Finance Act in year x-2 is lower or equal to GDP 43% and ➤ the sum of the differences between the general government nominal balance and the MTO exceeds in year x-2 6% of the GDP and ➤ the forecasted dynamics of the real GDP for year x (assumed in the draft budget act for the year x) is not higher than the medium term average by over 2 percentage points
4) in other cases there is no correction element	

Table 4. Main differences in general government debt – Polish (current act and new project on act) and EU definition

Polish regulations	EU regulations
public debt	general government debt
1) scope of the public finance sector	
➤ Public Finance Act defines limited catalogue of units included in the public finance sector;	➤ scope of <i>general government</i> ¹⁾ sector is defined in ESA2010 ²⁾ ; no limited catalogue of units is defined;
<i>differences in the scope of sector depending on regulations</i>	
a) funds formed within Bank Gospodarstwa Krajowego (BGK), f. ex. : the National Road Fund (KFD), the Railway Fund (FK)	
➤ are excluded from the public finance sector;	➤ are included in the general government sector ³⁾ ;
b) public corporations that are deemed non-marketable (f. ex. PKPPR sp. z o.o., Port Lotniczy Łódź, health care institutions)	
➤ are excluded from the public finance sector;	➤ are included in the general government sector;
2) liabilities which constitute public debt	
<ul style="list-style-type: none"> ➤ securities (excluding shares); ➤ loans (including securities whose disposal is limited); ➤ deposits; ➤ matured payables (i.e. liabilities due but not settled, which have not been lagged nor cancelled); 	<ul style="list-style-type: none"> ➤ securities; ➤ loans; ➤ cash and deposits;
<i>differences in liabilities depending on regulations</i>	
➤ matured payables;	<ul style="list-style-type: none"> ➤ ⁴⁾ ➤ restructured or refinanced trade credits (including those with original maturity of one year or less) are included in loan category⁵⁾
3) valuation of liabilities denominated in foreign currencies	
➤ liabilities denominated in a foreign currency shall be converted into the national currency on the basis of the middle exchange rate applicable on the last working day of each period.	➤ liabilities denominated in a foreign currency, or exchanged from one foreign currency through contractual agreements to one or more other foreign currencies shall be converted into the other foreign currencies at the rate

Polish regulations	EU regulations
public debt	general government debt
	agreed on in those contracts and shall be converted into the national currency on the basis of the representative market exchange rate prevailing on the last working day of each year.
4) contingent liabilities	
<i>differences in treatment of contingent liabilities in debt-to-GDP ratio</i>	
<ul style="list-style-type: none"> ➤ is not included; 	<ul style="list-style-type: none"> ➤ EU limitations do not take directly into account contingent liabilities generated by issued sureties and guarantees; ➤ 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;

- 1) Polish Central Statistical Office (GUS) is responsible for the scope of general government sector (in line with EU regulations).
- 2) ESA2010 (Regulation (EU) No 549/2013 of the European Parliament and of the Council of May 21, 2013 on the European system of national and regional accounts in the European Union) states that an entity is classified to the general government sector if it is not a separate institutional unit from government or is a separate institutional unit controlled by general government and it is non-market. The ability to undertake market activity will be checked notably through the usual quantitative criterion, i.e. if the ratio of sales to production costs is above 50% , the unit is in principle market. However, in order to decide whether a producer that operates under the control of government is a market unit some qualitative criteria must also be taken into account. According to Eurostat's guidelines in relation to classification of infrastructure enterprises, apart from liabilities of special purpose funds other investment expenditures incurred by units outside the sector which implement such investments could be included, when certain criteria regarding general government debt are met (imputed loan).
- 3) 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.
- 4) Pursuant to decision of Eurostat of 31 July 2012 on *The statistical recording of some operations related to trade credits incurred by government units*

Annex 3. Institutional framework for public debt management in the EU member states

There is 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 the tasks imposed on the central bank is not optimal. Furthermore, even if the tasks of monetary policy and debt management are assigned to separate divisions and the so-called “Chinese Wall” is applied, suspicions can arise that some information on interest rate levels unknown to the market may be used in debt management, thus reducing confidence to the issuer and resulting in requesting an additional risk premium for TS by investors.

An argument used by supporters of **the bank model** is their conviction belief that the central bank is better prepared to operate on the financial market than unit remaining within the structure of a ministry.

The government model is used successfully in conditions typical for emerging economies or subject to political transformations where development of the domestic financial market is low, though the model is used also in some developed economies. This is due to the large impact on the power 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 run,
- lack of sufficient flexibility and ability to react quickly to changing market conditions (which is especially important if derivatives are used in debt management) arising from the significant bureaucracy of administrative entities,
- difficulties in recruiting and retaining appropriately highly qualified 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 generalization (it does not mean a government agency as defined by Polish law) as specialized institutions involved in debt management in different countries vary considerably within the scope of their tasks and the level of their institutional independence. As an agency can be also

consider organisationally and budgetary part of the ministry. The common feature of all agencies 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:

- 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 in debt management operations through the use of better control and reporting mechanisms, thus increasing investor confidence and lowering costs of financing of borrowing requirements,
- 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 compete with 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 28 member states of the enlarged EU the agency model is applied (in 11 out of 17 member states in the Eurozone).

Table 5. Institutions responsible for debt management in the EU member states

	Country	Model	Institution name
Eurozone	Austria	agency	Österreichische Bundesfinanzierungsagentur
	Belgium		Agence de la Dette (Agentschap van de Schuld)
	Finland		Valtiokonttori
	France		Agence France Trésor
	Netherlands		Agentschap van het ministerie van Financiën
	Greece		Οργανισμός Διαχείρισης Δημοσίου Χρέους
	Ireland		National Treasury Management Agency
	Latvia		Valsts Kase
	Germany		Finanzagentur GmbH
	Portugal		Instituto de Gestão do Crédito Público
	Slovakia		Agentúra pre riadenie dlhu a likvidity
	Cyprus	government	Υπουργείο Οικονομικών
	Estonia		Rahandusministeerium
	Spain		Ministerio de Economía y Hacienda
Luxemburg	Ministère des Finances		
Slovenia	Ministrstvo za finance		
Malta	Treasury Department		
Italy	Ministero dell'Economia e delle Finanze		
Other EU countries	Sweden	agency	Riksgälden
	Hungary		Allamadósság Kezelő Központ Zrt.
	United Kingdom		Debt Management Office
	Denmark	bank	Danmarks Nationalbank
	Bulgaria	government	Министерство на финансите
	Croatia		Ministarstvo Financija
	Czech Republic		Ministerstvo financí
	Lithuania		Finansų Ministeria
	Poland		Ministerstwo Finansów
Romania	Ministerul Economiei și Finanțelor		

Annex 4. General government deficit and debt, yields on 10-year bonds in the EU member states and TS issuance structure in selected countries

Table 6. General government deficit, debt and yields on 10-year bonds in the EU countries in 2012-2013

	2012			2013		
	GG balance	GG debt	10Y interest rate	GG balance	GG debt	10Y interest rate
	% PKB	% PKB	%	% PKB	% PKB	%
Greece	-8.9	157.2	22.50	-12.7	175.1	10.05
Italy	-3.0	127.0	5.49	-3.0	132.6	4.32
Portugal	-6.4	124.1	10.55	-4.9	129.0	6.29
Ireland	-8.2	117.4	6.17	-7.2	123.7	3.79
Cyprus	-6.4	86.6	7.00	-5.4	111.7	6.50
Belgium	-4.1	101.1	3.00	-2.6	101.5	2.41
Spain	-10.6	86.0	5.85	-7.1	93.9	4.56
France	-4.9	90.6	2.54	-4.3	93.5	2.20
Euro area³⁾	-3.7	90.8	3.88	-3.1	92.7	3.00
United Kingdom	-6.1	89.1	1.74	-5.8	90.6	2.03
European Union⁴⁾	-3.9	85.5	3.65	-3.3	87.1	2.96
Hungary	-2.1	79.8	7.89	-2.2	79.2	5.92
Germany	0.1	81.0	1.50	0.0	78.4	1.57
Austria	-2.6	74.4	2.37	-1.5	74.5	2.01
Netherlands	-4.1	71.3	1.93	-2.5	73.5	1.96
Malta	-3.3	70.8	4.13	-2.8	73.0	3.36
Slovenia	-4.0	54.4	5.81	-14.7	71.7	5.81
Croatia	-5.0	55.9	6.13	-4.9	67.1	4.68
Poland	-3.9	55.6	5.00	-4.3	57.1	4.03
Finland	-1.8	53.6	1.89	-2.1	57.0	1.86
Slovakia	-4.5	52.7	4.55	-2.8	55.4	3.19
Czech Republic	-4.2	46.2	2.78	-1.5	46.0	2.11
Denmark	-3.8	45.4	1.40	-0.8	44.5	1.75
Sweden	-0.6	38.3	1.59	-1.1	40.6	2.12
Lithuania	-3.2	40.5	4.83	-2.2	39.4	3.83
Romania	-3.0	38.0	6.68	-2.3	38.4	5.41
Latvia	-1.3	40.8	4.57	-1.0	38.1	3.34
Luxembourg	0.0	21.7	1.82	0.1	23.1	1.85
Bulgaria	-0.8	18.4	4.50	-1.5	18.9	3.47
Estonia	-0.2	9.8	:	-0.2	10.0	:

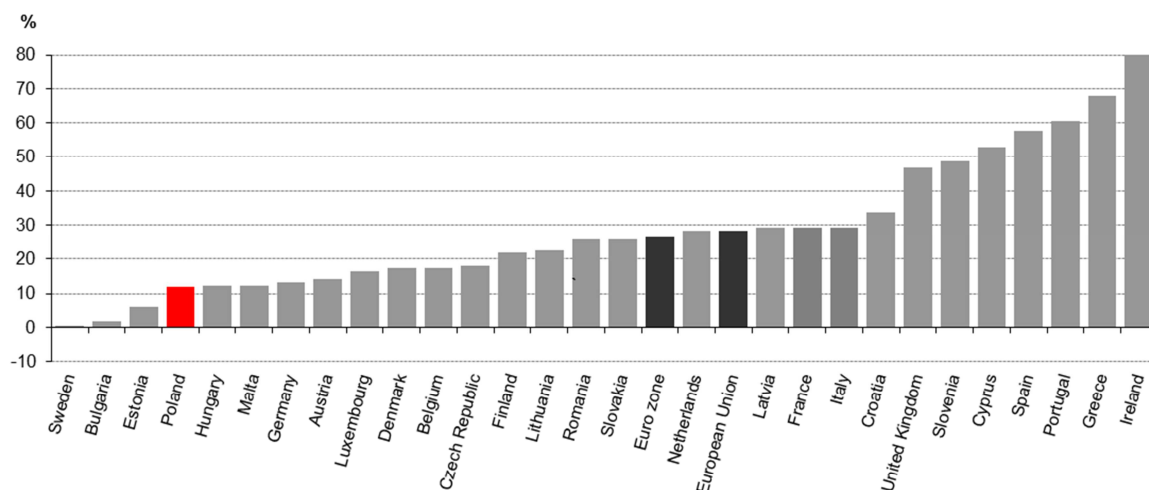
¹⁾ Data on general government balance and debt – Eurostat. Data on Poland – MF.

²⁾ 10-year interest rate – average of average monthly 10-year T-bond yields from last twelve months, average in December, Eurostat.

³⁾ Data on 2012 and 2013 for 17 countries.

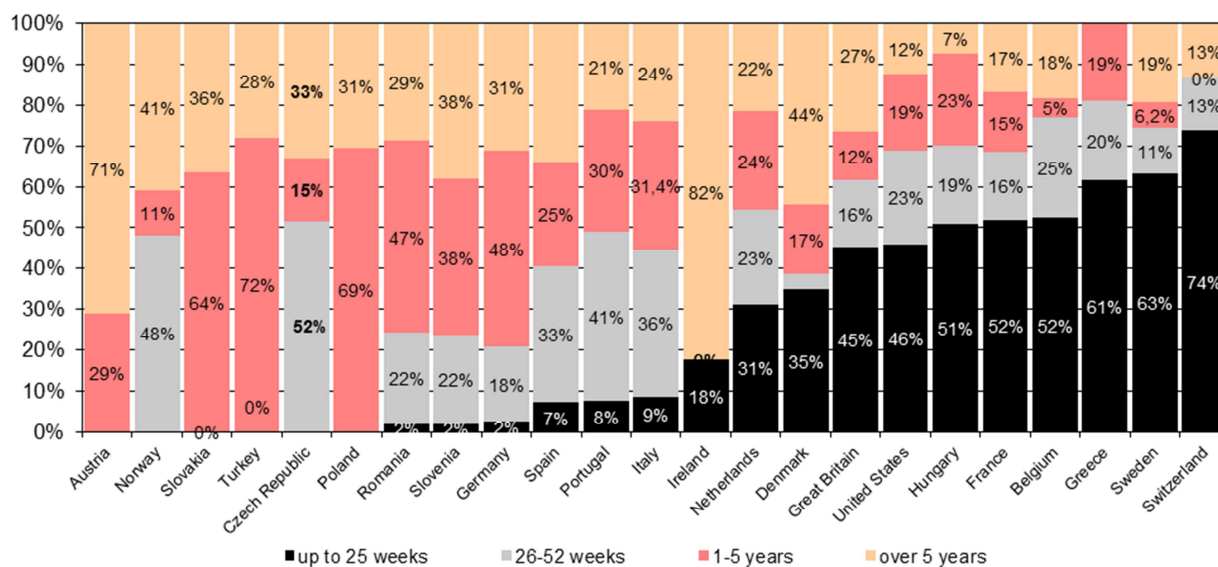
⁴⁾ Data on 2012 for 27 countries, on 2013 for 28 countries.

Chart 1. Cumulative growth of general government debt to GDP ratio in years 2008-2013*



*) Difference between general government debt to GDP ratio at the end of the years 2013 and 2007.

Chart 2. T-bonds issuance in Poland and selected countries in terms of maturity in 2014 r.*



*) Auctions and syndicates from January 1, to September 18, 2014.

Annex 5. Government debt rating of EU Member States

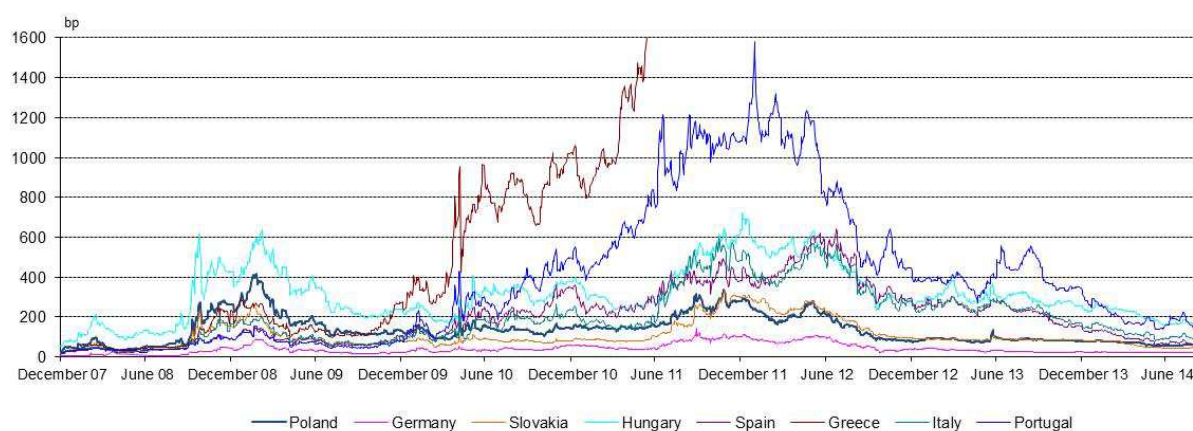
Table 7. Long-term government debt rating in foreign currency of EU Member States as of September 22, 2014

	Standard&Poor's	Fitch	Moody's
Austria	AA+	AAA	Aaa
Belgium	AA	AA	Aa3
Bulgaria	BBB-↓	BBB-	Baa2
Chroatia	BB+	BBB-	Ba1
Cyprus	B ↑↑	B-	Caa3
Czech Republic	AA-	A+	A1
Denmark	AAA	AAA	Aaa
Estonia	AA-	A+	A1
Finland	AAA	AAA	Aaa
France	AA ↓	AA+ ↓	Aa1
Greece	B ↑	B ↑	Caa1 ↑↑↑↑
Spain	BBB ↑	BBB+ ↑	Baa2 ↑
Netherlands	AA+ ↓	AAA	Aaa
Ireland	A- ↑	A- ↑	Baa1 ↑↑↑
Lithuania	A- ↑↑	A- ↑	Baa1
Luxemburg	AAA	AAA	Aaa
Latvia	A- ↑	A- ↑	Baa1 ↑↑
Malta	BBB+	A	A3
Germany	AAA	AAA	Aaa
Poland	A-	A-	A2
Portugal	BB	BB+	Ba1 ↑↑
Romania	BBB- ↑	BBB-	Baa3
Slovakia	A	A+	A2
Slovenia	A-	BBB+	Ba1
Sweeden	AAA	AAA	Aaa
Hungary	BB	BB+	Ba1
United Kingdom	AAA	AA+ ↓	Aa1
Italy	BBB	BBB+	Baa2

Source: Reuters.

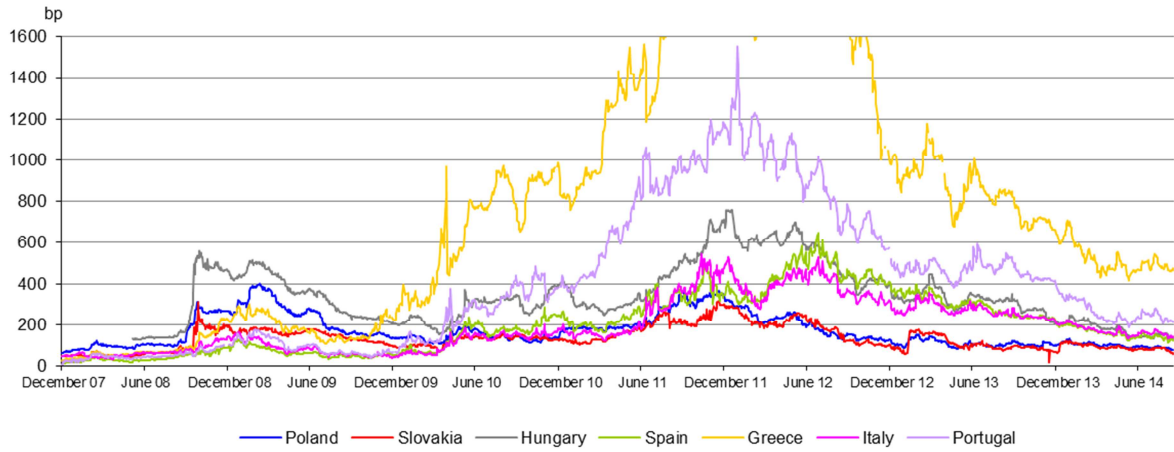
↓ ↑ - downgrade or upgrade of rating in comparison to previous Strategy

Chart 3. 5-years CDS for Poland and other EU Member States*



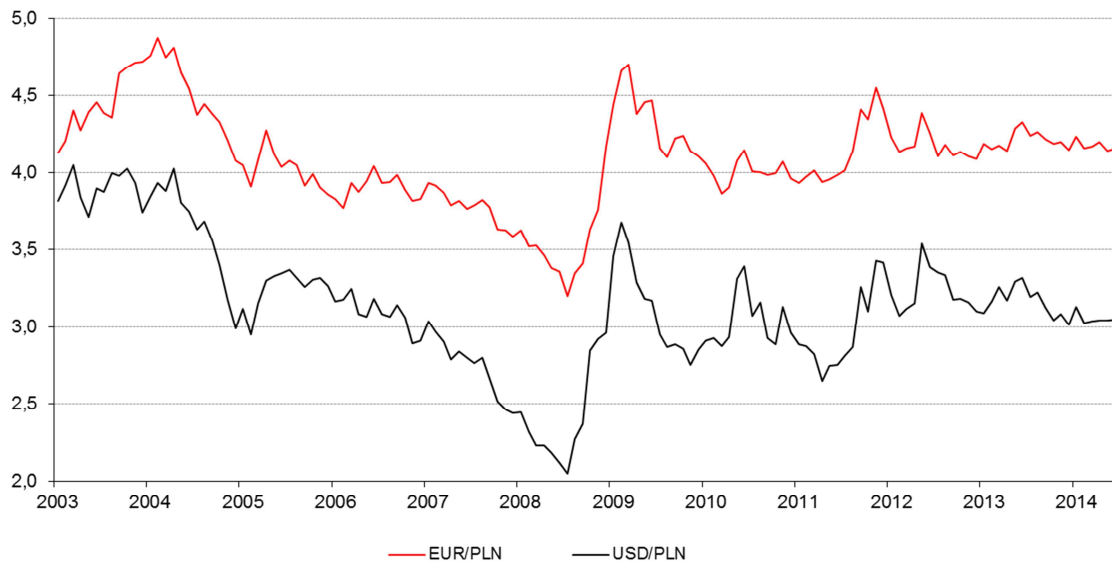
*) Since mid-June 2011 Greek CDS are quoted above 1 600 bp.

Chart 4. Selected 10Y euro-denominated bond spread towards German bunds*



*) Since September 2011 10Y Greek bonds spread towards German bunds is quoted well above 1500 bp.

Chart 5. Polish zloty exchange rate against euro and dollar in years 2003-2014



Annex 6. Public debt In Poland – statistical annex

Table 8. Public debt in Poland in period 2001 – VI 2014

Item	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	VI 2014
1. State Treasury debt														
a) PLN bn	283.9	327.9	378.9	402.9	440.2	478.5	501.5	569.9	631.5	701.9	771.1	793.9	838.0	750.2
domestic *	185.0	219.3	251.2	291.7	315.5	352.3	380.4	420.2	462.7	507.0	524.7	543.0	584.3	488.8
foreign *	98.9	108.6	127.8	111.2	124.7	126.2	121.1	149.7	168.8	194.8	246.4	250.9	253.8	261.4
b) GDP %	36.4%	40.6%	44.9%	43.6%	44.8%	45.1%	42.6%	44.7%	47.0%	49.5%	50.5%	49.7%	51.2%	-
2. Public debt														
a) PLN bn	302.1	352.4	408.3	431.4	466.6	506.3	527.4	597.8	669.9	747.9	815.3	840.5	882.3	793.6
b) GDP %	38.8%	43.6%	48.4%	46.7%	47.5%	47.8%	44.8%	46.9%	49.8%	52.8%	53.4%	52.6%	53.9%	-
3. General government debt (EU methodology)														
a) PLN bn	292.8	340.9	396.7	422.4	463.0	506.0	529.3	600.8	684.4	777.4	859.2	886.9	934.6	830.2
b) GDP %	37.6%	42.2%	47.1%	45.7%	47.1%	47.7%	45.0%	47.1%	50.9%	54.9%	56.2%	55.6%	57.1%	-

*) place of issue criterion

Table 9. GDP and exchange rates in period 2001 – VI 2014

Item	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	VI 2014
1. Gross Domestic Product														
PLN bn	779.6	808.6	843.2	924.5	983.3	1 060.2	1 176.7	1 275.5	1 344.5	1 416.6	1 528.1	1 596.4	1 635.7	-
2. Exchange rate (end of period)														
a) EUR	3.5219	4.0202	4.7170	4.0790	3.8598	3.8312	3.5820	4.1724	4.1082	3.9603	4.4168	4.0882	4.1472	4.1609
b) USD	3.9863	3.8388	3.7405	2.9904	3.2613	2.9105	2.4350	2.9618	2.8503	2.9641	3.4174	3.0996	3.0120	3.0473

Table 10. Public finance sector debt before consolidation *

Public finance sector debt		2012		2013				2014			
		XII	Structure	Change XII 2012 - XII 2013		XII	Structure	Change XII 2013 - VI 2014		VI	Structure
				PLN mn	%			PLN mn	%		
BEFORE CONSOLIDATION		889 652.1	100.0%	55 568.6	6.2%	945 220.7	100.0%	-86 598.2	-9.2%	858 622.5	100.0%
1.	Central government sector debt	795 702.9	89.4%	44 204.1	5.6%	839 907.1	88.9%	-87 727.4	-10.4%	752 179.6	87.6%
1.1.	State Treasury	793 853.7	89.2%	44 171.7	5.6%	838 025.4	88.7%	-87 821.4	-10.5%	750 204.0	87.4%
1.2.	Earmarked State Funds	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-	0.0	0.0%
1.3.	State institutions of higher education	519.1	0.1%	60.6	11.7%	579.8	0.1%	-27.3	-4.7%	552.5	0.1%
1.4.	Independent public health care units	1 293.5	0.1%	-32.1	-2.5%	1 261.4	0.1%	79.5	6.3%	1 340.9	0.2%
1.5.	State institutions of culture	16.8	0.0%	-3.4	-20.4%	13.4	0.0%	-7.1	-53.4%	6.2	0.0%
1.6.	Polish Academy of Science (PAN) and units established by it	8.0	0.0%	-4.1	-52.1%	3.8	0.0%	-1.0	-25.2%	2.9	0.0%
1.7.	Other central government legal entities established under separate acts for public tasks execution with the exception of enterprises banks and companies organized under commercial law	11.8	0.0%	11.5	97.4%	23.3	0.0%	49.8	213.7%	73.1	0.0%
2.	Local government sector debt	72 812.6	8.2%	1 243.5	1.7%	74 056.0	7.8%	-1 857.6	-2.5%	72 198.4	8.4%
2.1.	Local government units and their associations	68 206.6	7.7%	1 286.1	1.9%	69 492.7	7.4%	-1 848.5	-2.7%	67 644.2	7.9%
2.2.	Local earmarked funds	4 392.9	0.5%	-455.3	-10.4%	3 937.6	0.4%	26.1	0.7%	3 963.7	0.5%
2.3.	Independent public health care units	99.5	0.0%	-18.4	-18.5%	81.1	0.0%	-4.0	-5.0%	77.0	0.0%
2.4.	Other local government legal entities established under separate acts for public tasks execution with the exception of enterprises banks and companies organized under commercial law	113.6	0.0%	431.1	379.4%	544.7	0.1%	-31.2	-5.7%	513.5	0.1%
3.	Social security sector debt	21 136.6	2.4%	10 121.0	47.9%	31 257.6	3.3%	2 986.9	9.6%	34 244.5	4.0%
3.1.	Social Insurance Institution (ZUS)	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-98.2%	0.0	0.0%
3.2.	Funds managed by Social Insurance Institution	21 136.6	2.4%	10 121.0	47.9%	31 257.6	3.3%	2 986.9	9.6%	34 244.5	4.0%
3.3.	Agricultural Social Insurance Fund (KRUS)	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-	0.0	0.0%
3.4.	National Health Fund	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-	0.0	0.0%

*) data as of September 18, 2014

Table 11. Public finance sector debt after consolidation *

Public finance sector debt		2012		2013				2014			
		XII		Change XII 2012 - XII 2013		XII		Change XII 2012 - XII 2013		XII	
		PLN mn	%	PLN mn	%	PLN mn	%	PLN mn	%	PLN mn	%
AFTER CONSOLIDATION		840 476.8	100.0%	41 816.2	5.0%	882 293.0	100.0%	-88 727.5	-10.1%	793 565.5	100.0%
1.	Central government sector debt	770 819.5	91.7%	42 695.8	5.5%	813 515.3	92.2%	-86 976.6	-10.7%	726 538.7	91.6%
1.1.	State Treasury	769 128.8	91.5%	42 698.4	5.6%	811 827.1	92.0%	-87 081.9	-10.7%	724 745.2	91.3%
1.2.	Earmarked State Funds	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-	0.0	0.0%
1.3.	State institutions of higher education	486.4	0.1%	45.5	9.4%	531.9	0.1%	-32.9	-6.2%	498.9	0.1%
1.4.	Independent public health care units	1 188.6	0.1%	-55.1	-4.6%	1 133.5	0.1%	92.4	8.1%	1 225.9	0.2%
1.5.	State institutions of culture	3.1	0.0%	5.1	164.5%	8.3	0.0%	-7.4	-89.6%	0.9	0.0%
1.6.	Polish Academy of Science (PAN) and units established by it	4.7	0.0%	-2.6	-55.7%	2.1	0.0%	-0.2	-11.2%	1.9	0.0%
1.7.	Other central government legal entities established under separate acts for public tasks execution with the exception of enterprises banks and companies organized under commercial law	7.9	0.0%	4.5	57.6%	12.4	0.0%	53.5	429.7%	65.9	0.0%
2.	Local government sector debt	67 398.2	8.0%	999.3	1.5%	68 397.6	7.8%	-1 537.7	-2.2%	66 859.8	8.4%
2.1.	Local government units and their associations	64 020.2	7.6%	1 189.9	1.9%	65 210.1	7.4%	-1 563.8	-2.4%	63 646.3	8.0%
2.2.	Local earmarked funds	3 314.1	0.4%	-184.9	-5.6%	3 129.1	0.4%	30.3	1.0%	3 159.5	0.4%
2.3.	Independent public health care units	58.1	0.0%	-3.6	-6.2%	54.5	0.0%	-3.5	-6.4%	51.0	0.0%
2.4.	Other local government legal entities established under separate acts for public tasks execution with the exception of enterprises banks and companies organized under commercial law	5.9	0.0%	-2.1	-35.0%	3.8	0.0%	-0.8	-19.8%	3.1	0.0%
3.	Social security sector debt	2 259.1	0.3%	-1 879.0	-83.2%	380.1	0.0%	-213.1	-56.1%	167.0	0.0%
3.1.	Social Insurance Institution (ZUS)	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-98.2%	0.0	0.0%
3.2.	Funds managed by Social Insurance Institution	2 259.1	0.3%	-1 879.0	-83.2%	380.1	0.0%	-213.1	-56.1%	167.0	0.0%
3.3.	Agricultural Social Insurance Fund (KRUS)	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-	0.0	0.0%
3.4.	National Health Fund	0.0	0.0%	0.0	-	0.0	0.0%	0.0	-	0.0	0.0%

*) data as of September 18, 2014

Table 12. State Treasury debt by instrument according to the place of issue criterion (PLN million)

	XII 2011	XIII 2013	VI 2014	structure VI 2014 %	change		change	
					XII 2013 – XII 2012		VI 2014 - XII 2013	
					PLN mn	%	PLN mn	%
State Treasury Debt	793 853.7	838 025.4	750 204.0	100.0	44 171.7	5.6	-87 821.4	-10.5
I. Domestic debt	542 969.9	584 273.0	488 822.7	65.2	41 303.1	7.6	-95 450.3	-16.3
1. Treasury Securities issued in domestic market	533 477.5	574 338.0	477 012.9	63.6	40 860.5	7.7	-97 325.1	-16.9
1.1. Marketable securities	526 109.5	565 703.8	467 797.8	62.4	39 594.2	7.5	-97 906.0	-17.3
fixed rate	404 025.7	421 166.5	357 277.3	47.6	17 140.8	4.2	-63 889.1	-15.2
Treasury bills	6 110.4	-	-	0.0	-6 110.4	-100.0	0.0	-
OK bonds	55 489.4	61 527.1	52 807.4	7.0	6 037.8	10.9	-8 719.8	-14.2
PS bonds	151 290.3	172 794.2	142 103.0	18.9	21 503.9	14.2	-30 691.2	-17.8
DS bonds	154 636.1	148 565.1	129 764.1	17.3	-6 071.0	-3.9	-18 801.0	-12.7
WS bonds	36 499.5	38 280.0	32 602.9	4.3	1 780.5	4.9	-5 677.2	-14.8
fixed rate - inflation-linked	23 100.0	30 050.3	7 801.5	1.0	6 950.2	30.1	-22 248.7	-74.0
IZ bonds	23 100.0	30 050.3	7 801.5	1.0	6 950.2	30.1	-22 248.7	-74.0
floating rate	98 983.8	114 487.0	102 718.9	13.7	15 503.2	15.7	-11 768.1	-10.3
TZ bonds	494.6	360.5	244.9	0.0	-134.1	-27.1	-115.6	-32.1
WZ bonds	97 739.2	114 126.5	102 474.0	13.7	16 387.3	16.8	-11 652.5	-10.2
PP bonds	750.0	-	-	0.0	-750.0	-100.0	0.0	-
1.2. Savings bonds	7 367.9	8 634.2	9 215.1	1.2	1 266.2	17.2	580.9	6.7
fixed rate	1 784.0	2 685.5	3 130.7	0.4	901.6	50.5	445.2	16.6
KOS bonds	-	873.1	1 139.1	0.2	873.1	-	265.9	30.5
DOS bonds	1 784.0	1 812.4	1 991.7	0.3	28.4	1.6	179.3	9.9
floating rate	5 584.0	5 948.7	6 084.4	0.8	364.7	6.5	135.7	2.3
TOZ bonds	80.5	258.6	363.7	0.0	178.1	221.1	105.1	40.6
COI bonds	1 831.9	1 848.3	1 817.1	0.2	16.4	0.9	-31.2	-1.7
EDO bonds	3 671.5	3 841.7	3 903.6	0.5	170.2	4.6	61.9	1.6
2. Other domestic debt	9 492.4	9 935.1	11 809.8	1.6	442.6	4.7	1 874.7	18.9
deposits of public finance sector entities	9 438.1	9 918.5	11 804.2	1.6	480.4	5.1	1 885.7	19.0
matured payables	50.8	13.1	2.1	0.0	-37.8	-74.3	-10.9	-83.7
other	3.6	3.6	3.5	0.0	0.0	-0.6	0.0	-0.4
II. Foreign debt	250 883.8	253 752.3	261 381.3	34.8	2 868.6	1.1	7 628.9	3.0
1. Treasury securities issued in international	199 955.1	193 781.9	200 883.6	26.8	-6 173.2	-3.1	7 101.6	3.7
1.1. Marketable securities	199 955.1	193 781.9	200 883.6	26.8	-6 173.2	-3.1	7 101.6	3.7
fixed rate	198 431.5	192 267.4	199 350.0	26.6	-6 164.1	-3.1	7 082.6	3.7
EUR	123 367.6	120 069.7	124 502.4	16.6	-3 297.8	-2.7	4 432.7	3.7
USD	44 014.3	42 372.2	46 319.0	6.2	-1 642.2	-3.7	3 946.8	9.3
CHF	16 680.0	16 654.4	14 725.8	2.0	-25.6	-0.2	-1 928.6	-11.6
JPY	14 369.6	13 171.1	13 802.8	1.8	-1 198.5	-8.3	631.7	4.8
floating rate	1 523.6	1 514.5	1 533.5	0.2	-9.1	-0.6	19.0	1.3
USD	253.6	246.4	249.3	0.0	-7.2	-2.8	2.9	1.2
CHF	1 270.1	1 268.1	1 284.2	0.2	-2.0	-0.2	16.1	1.3
2. Loans	50 928.6	59 970.4	60 497.7	8.1	9 041.8	17.8	527.3	0.9
fixed rate	21 496.0	19 078.6	18 433.1	2.5	-2 417.4	-11.2	-645.4	-3.4
EUR	21 251.6	18 991.9	18 398.4	2.5	-2 259.7	-10.6	-593.6	-3.1
USD	3.9	-	-	0.0	-3.9	-100.0	0.0	-
JPY	240.5	86.6	34.8	0.0	-153.8	-64.0	-51.8	-59.9
floating rate	29 432.6	40 891.8	42 064.5	5.6	11 459.2	38.9	1 172.7	2.9
EUR	29 428.2	40 891.8	42 064.5	5.6	11 463.6	39.0	1 172.7	2.9
USD	4.4	-	-	0.0	-4.4	-100.0	0.0	-
3. Other foreign debt	0.1	0.0	0.0	0.0	-0.1	-95.7	0.0	-89.8

Table 13. State Treasury debt by holder (PLN million)

	XII 2012	XII 2013	VI 2014	structure VI 2014 %	change XII 2013 – XII 2012		change VI 2014 - XII 2013	
					PLN mn	%	PLN mn	%
State Treasury debt	793 853.7	838 025.4	750 204.0	100.0	44 171.7	5.6	-87 821.4	-10.5
I. State Treasury debt towards residents	361 478.4	403 314.7	303 157.7	40.4	41 836.3	11.6	-100 157.0	-24.8
Domestic banking sector	98 564.1	125 813.6	148 928.4	19.9	27 249.5	27.6	23 114.8	18.4
1. TS issued in domestic market	91 526.3	114 686.2	135 379.2	18.0	23 159.9	25.3	20 692.9	18.0
1.1. Marketable TS	91 526.3	114 686.2	135 379.2	18.0	23 159.9	25.3	20 692.9	18.0
Treasury bills	3 769.8	0.0	0.0	0.0	-3 769.8	-100.0	0.0	-
OK bonds	7 115.5	15 349.5	12 355.8	1.6	8 234.0	115.7	-2 993.7	-19.5
PS bonds	24 411.6	31 870.3	41 578.6	5.5	7 458.7	30.6	9 708.3	30.5
DS bonds	19 844.9	18 180.2	16 037.7	2.1	-1 664.7	-8.4	-2 142.5	-11.8
WS bonds	1 389.7	2 223.9	2 311.5	0.3	834.3	60.0	87.6	3.9
IZ bonds	581.2	677.0	987.4	0.1	95.8	16.5	310.4	45.8
TZ bonds	0.5	0.0	0.0	0.0	-0.5	-100.0	0.0	-
WZ bonds	34 398.3	46 385.4	62 108.2	8.3	11 987.1	34.8	15 722.8	33.9
PP bonds	15.0	0.0	0.0	0.0	-15.0	-100.0	0.0	-
1.2. Savings bonds	0.0	0.0	0.0	0.0	0.0	-	0.0	-
KOS bonds	0.0	0.0	0.0	0.0	0.0	-	0.0	-
DOS bonds	0.0	0.0	0.0	0.0	0.0	-	0.0	-
TOZ bonds	0.0	0.0	0.0	0.0	0.0	-	0.0	-
COI bonds	0.0	0.0	0.0	0.0	0.0	-	0.0	-
EDO bonds	0.0	0.0	0.0	0.0	0.0	-	0.0	-
2. Other ST debt	0.0	0.0	0.0	0.0	0.0	-	0.0	-
deposits of public finance sector entities	0.0	0.0	0.0	0.0	0.0	-	0.0	-
matured payables	0.0	0.0	0.0	0.0	0.0	-	0.0	-
other	0.0	0.0	0.0	0.0	0.0	-	0.0	-
3. TS issued in foreign markets	7 037.8	11 127.4	13 549.2	1.8	4 089.6	58.1	2 421.9	21.8
Domestic non-banking sector	262 914.4	277 501.1	154 229.3	20.6	14 586.8	5.5	-123 271.8	-44.4
1. TS issued in domestic market	251 472.4	266 493.4	141 812.3	18.9	15 020.9	6.0	-124 681.0	-46.8
1.1. Marketable TS	244 122.0	257 874.8	132 612.6	17.7	13 752.7	5.6	-125 262.1	-48.6
Treasury bills	1 750.9	0.0	0.0	0.0	-1 750.9	-100.0	0.0	-
OK bonds	15 930.9	20 335.7	17 553.2	2.3	4 404.7	27.6	-2 782.4	-13.7
PS bonds	70 630.9	74 388.2	36 012.2	4.8	3 757.3	5.3	-38 376.0	-51.6
DS bonds	71 812.2	64 414.5	33 450.6	4.5	-7 397.7	-10.3	-30 963.9	-48.1
WS bonds	16 278.6	19 200.7	14 884.5	2.0	2 922.1	18.0	-4 316.2	-22.5
IZ bonds	12 960.5	22 528.8	2 521.1	0.3	9 568.3	73.8	-20 007.7	-88.8
TZ bonds	492.2	359.8	244.6	0.0	-132.4	-26.9	-115.2	-32.0
WZ bonds	53 530.8	56 647.1	27 946.4	3.7	3 116.3	5.8	-28 700.7	-50.7
PP bonds	735.0	0.0	0.0	0.0	-735.0	-100.0	0.0	-
1.2. Savings bonds	7 350.4	8 618.6	9 199.7	1.2	1 268.2	17.3	581.1	6.7
KOS bonds	0.0	873.0	1 138.8	0.2	873.0	-	265.8	30.4
DOS bonds	1 782.4	1 810.8	1 989.8	0.3	28.4	1.6	179.0	9.9
TOZ bonds	80.3	258.3	363.3	0.0	178.0	221.5	105.0	40.7
COI bonds	1 820.8	1 839.9	1 811.5	0.2	19.1	1.0	-28.3	-1.5
EDO bonds	3 666.9	3 836.6	3 896.2	0.5	169.8	4.6	59.5	1.6
2. Other ST debt	9 492.4	9 935.1	11 809.8	1.6	442.6	4.7	1 874.7	18.9
deposits of public finance sector entities	9 438.1	9 918.5	11 804.2	1.6	480.4	5.1	1 885.7	19.0
matured payables	50.8	13.1	2.1	0.0	-37.8	-74.3	-10.9	-83.7
other	3.6	3.6	3.5	0.0	0.0	-0.6	0.0	-0.4
3. TS issued in foreign markets	1 949.5	1 072.6	607.1	0.1	-876.8	-45.0	-465.5	-43.4
II. State Treasury debt towards non-residents	432 375.3	434 710.7	447 046.3	59.6	2 335.4	0.5	12 335.6	2.8
1. TS issued in domestic market	190 478.7	193 158.3	199 821.3	26.6	2 679.6	1.4	6 663.0	3.4
1.1. Marketable TS	190 461.2	193 142.8	199 806.0	26.6	2 681.6	1.4	6 663.2	3.4
Treasury bills	589.7	0.0	0.0	0.0	-589.7	-100.0	0.0	-
OK bonds	32 442.9	25 842.0	22 898.3	3.1	-6 600.9	-20.3	-2 943.7	-11.4
PS bonds	56 247.8	66 535.8	64 512.2	8.6	10 287.9	18.3	-2 023.5	-3.0
DS bonds	62 979.1	65 970.4	80 275.7	10.7	2 991.3	4.7	14 305.3	21.7
WS bonds	18 831.2	16 855.4	15 406.8	2.1	-1 975.8	-10.0	-1 448.6	-8.6
IZ bonds	9 558.4	6 844.5	4 293.1	0.6	-2 713.9	-28.4	-2 551.4	-37.3
TZ bonds	1.9	0.7	0.3	0.0	-1.2	-63.0	-0.4	-59.2
WZ bonds	9 810.1	11 094.0	12 419.5	1.7	1 283.9	13.1	1 325.4	11.9
PP bonds	0.0	0.0	0.0	0.0	0.0	-	0.0	-
1.2. Savings bonds	17.5	15.5	15.4	0.0	-2.0	-11.3	-0.2	-1.2
KOS bonds	0.0	0.1	0.2	0.0	0.1	-	0.1	111.4
DOS bonds	1.5	1.6	1.8	0.0	0.1	3.4	0.2	14.8
TOZ bonds	0.2	0.3	0.3	0.0	0.1	64.0	0.0	0.9
COI bonds	11.1	8.5	5.6	0.0	-2.7	-23.8	-2.9	-33.9
EDO bonds	4.7	5.1	7.4	0.0	0.4	8.5	2.3	46.3
2. TS issued in foreign markets	190 967.9	181 581.9	186 727.2	24.9	-9 385.9	-4.9	5 145.3	2.8
3. Foreign loans	50 928.6	59 970.4	60 497.7	8.1	9 041.8	17.8	527.3	0.9
European Investment Bank	29 130.2	34 024.6	35 667.8	4.8	4 894.4	16.8	1 643.2	4.8
The World Bank	20 855.6	25 112.8	23 941.7	3.2	4 257.2	20.4	-1 171.1	-4.7
Council of Europe Development Bank	702.4	746.4	853.5	0.1	44.0	6.3	107.0	14.3
Paris Club	0.0	0.0	0.0	0.0	0.0	-	0.0	-
other loans	136.4	36.9	0.0	0.0	-99.5	-73.0	-36.9	-100.0
4. Other ST debt	104.1	49.8	34.8	0.0	-54.3	-52.2	-15.0	-30.1

Table 14. Factors influencing change in the debt-to-GDP ratio

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Change in ST debt-to GDP ratio	4.4	-1.4	1.2	0.4	-2.5	2.1	2.3	2.6	0.9	-0.7	1.5
State budget primary balance	1.5	2.0	0.3	-0.3	-1.0	-0.1	-0.6	0.7	-0.7	-0.7	0.0
ST debt servicing costs (pension reform costs excluded)	2.4	2.0	2.0	2.0	1.8	1.4	1.7	1.6	1.5	1.7	1.6
Servicing costs on debt issued to finance pension reform	0.5	0.5	0.5	0.6	0.6	0.6	0.7	0.8	0.8	0.9	1.0
EU funds budget balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.7	0.8	0.2	-0.4
Funds transferred to FUS as a compensation for the contribution transferred to OPF	0.0	1.1	1.3	1.4	1.4	1.6	1.6	1.6	1.0	0.5	0.7
Net proceeds from privatisation	-0.4	-0.8	-0.3	0.0	-0.1	-0.1	0.0	-0.6	-0.4	-0.2	-0.1
Public finance sector liquidity management	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-1.6	-0.2	0.0
FX rate movements	1.4	-2.2	-0.3	-0.4	-0.9	2.0	-0.3	0.0	1.9	-1.3	-0.1
Nominal GDP growth	-1.7	-4.0	-2.6	-3.2	-4.5	-3.3	-2.3	-2.4	-3.6	-2.1	-1.2
Other factors*	0.6	-0.1	0.3	0.3	0.3	0.0	1.6	0.1	1.2	0.6	0.0

*) Other factors include: other borrowing requirements (including: the balance of granted loans, and prefinancing), changes not resulting from borrowing requirements (changes of debt resulting from: changes of budget account balance, TS discount, TS capitalization and indexation, off-budget drawings, conversion of FUS debt to OFE securities) and changes in other ST debt (among others: matured payables and funds deposited with Minister of Finance under the public finance sector liquidity management).

Table 15. Local government units and their debt-to-revenues ratio in 2012 – 2013

	Group of units	Total no. of units	Number of indebted units					
			Debt-to-revenues ratio					
			Total	i<10%	10%<i<30%	30%<i<50%	50%<i<60%	i>60%
XII 2012	Municipalities	2 414	2 300	297	923	858	196	26
	Cities with county rights	65	64	2	14	35	13	0
	Counties	314	310	48	155	86	18	3
	Voivodeships	16	16	1	4	6	4	1
	Total	2 809	2 690	348	1 096	985	231	30
XII 2013	Municipalities	2 413	2 307	317	972	839	148	31
	Cities with county rights	66	66	3	26	24	12	1
	Counties	314	308	50	156	80	18	4
	Voivodeships	16	16	2	2	10	1	1
	Total	2 809	2 697	372	1 156	953	179	37