

THE PUBLIC FINANCE SECTOR DEBT MANAGEMENT STRATEGY in the years 2017-2020

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 public 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 issuance, 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 macroeconomic and fiscal assumptions adopted in the Strategy are compliant with the assumptions of the draft Budget Act for 2017.

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

Item	2015 (execution)	2016	2017	2018	2019	2020
1. Public debt						
in relation to GDP	49.0%	51.4%	52.3%	51.7%	51.1%	49.5%
2. The amount specified in the article 38a of the Public Finance Act*						
in relation to GDP	47.3%	49.8%	51.1%	50.6%	50.0%	48.4%
3. General government debt						
in relation to GDP	51.4%	53.7%	55.0%	55.0%	54.6%	53.0%
4. State Treasury debt servicing costs**						
a) PLN bn	29.2	31.8	30.4	31.0 - 32.1	30.8 – 31.8	32.4 - 33.4
b) in relation to GDP	1.63%	1.71%	1.56%	1.50% - 1.55%	1.40% - 1.45%	1.38% - 1.43%

*) 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 2018-2020 account for the exchange rate risk provisions.

Under the adopted assumptions, in 2016-2017 the public debt-to-GDP ratio shall increase to 52.3%, and then it will decrease gradually to reach 49.5% in 2020. The ratio of the amount specified in the article 38a of the Public Finance Act shall reach the level of 49.8% in 2016 and 51.1% in 2017, to decrease gradually to 48.4% in 2020.

The general government debt-to-GDP ratio will increase to 55.0% in 2017 and stabilise at this level in 2018, to be followed by its subsequent gradual decrease to reach the level of 53.0% in the timeframe of the *Strategy*.

The limit of debt servicing costs assumed in the draft Budget Act for 2017 will be lower than the limit for 2016, both in nominal terms and in relation to GDP, and it will reach PLN 30.4bn (from PLN 31.8bn) and 1.56% of GDP (from 1.71% of GDP), respectively. It was assumed that in the timeframe of the *Strategy*, the debt servicing cost-to-GDP ratio will decrease to the level of 1.38% - 1.43%.

This *Strategy* is a continuation of the strategy developed last year, however it focuses on the diagnosis of the current situation and activities planned in the timeframe of the *Strategy*. As a consequence, parts of the *Strategy* related to the past have been shortened and re-drafted. Moreover,

a chapter concerning guarantees and sureties was separated and the arrangement of annexes has been modified. 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 have been maintained, i.e. ensuring liquidity, efficiency and transparency of the Treasury Securities (TS) market.

The following has been assumed for the accomplishment of the *Strategy's* objective for 2017-2020:

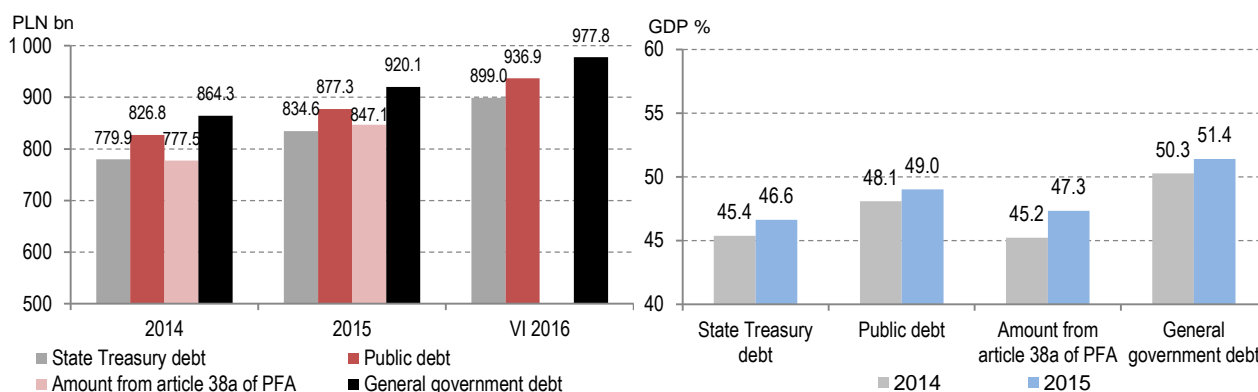
- the flexible approach towards shaping the financing structure in terms of selecting the market, currency and instruments shall be maintained, to the extent that cost minimisation is achieved, subject to the assumed risk level limitations and avoiding distortions of monetary policy;
- the domestic market shall remain the main source of financing the State budget borrowing requirements;
- the share of foreign currency debt will be reduced to the level below 30%, at a rate depending on market and budgetary conditions,
- building large and liquid fixed rate issues, both in the domestic, as well as the Euro market, shall be a priority of the issuance policy,
- the average maturity of domestic debt shall be maintained at a level of no less than 4 years, striving to achieve the ultimate level of 4.5 years,
- the average maturity of ST debt shall be maintained at a level close to 5 years.

The Strategy comprises four annexes, including the glossary of terms.

II. VOLUME OF PUBLIC DEBT AND COSTS OF ITS SERVICING

At the end of 2015 the public debt (domestic definition) reached the level of 49.0% GDP (as compared to 48.1% GDP at the end of 2014), whereas the ratio of the amount specified article 38a of the Public Finance Act (public debt recalculated using average exchange rates and reduced by the value of State budget liquid funds raised to pre-finance borrowing requirements for the following budgetary year) reached 47.3% of GDP (as compared to 45.2% of GDP in 2014). The general government (EU definition) debt-to-GDP ratio amounted to 51.4% (as compared to 50.3% at the end of 2014) and was much lower than the ratio for the whole European Union (85.2% of GDP) and the euro area (90.7%)¹.

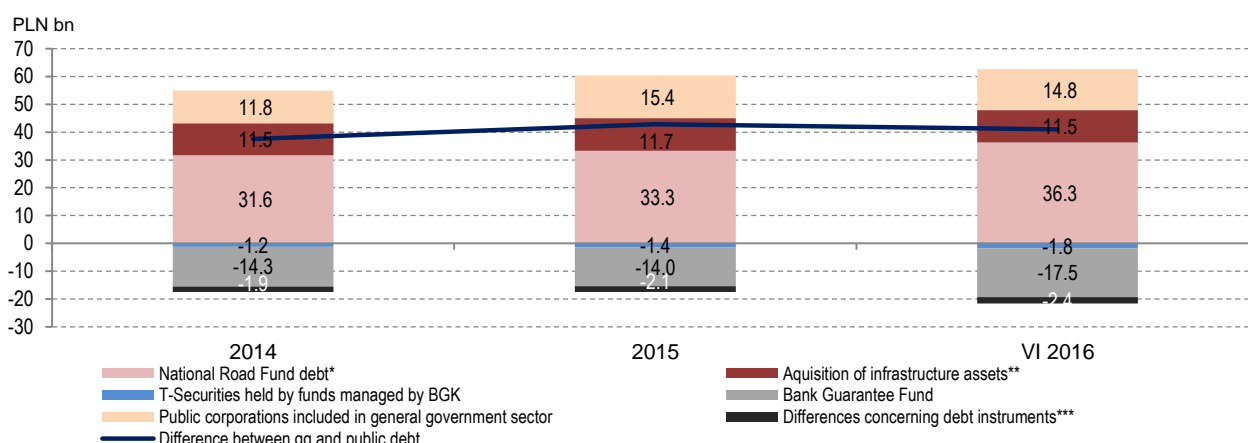
Chart 1. Volume of public debt in years 2014-2016



The differences between public debt and the general government debt arise from the following factors:

- other scope of public finance sector, including, inter alia, recognizing in the sector according to the EU definition the National Road Fund – KFD (whose indebtedness increases the debt of the sector) and the Bank Guarantee Fund (TS held by it reduce the debt of the sector),
- differences concerning debt instruments, mainly matured payables of entities, which are treated as public debt according to the domestic definition and are not included therein according to the EU definition.

Chart 2. Differences between general government debt (gg) and public debt



*) Debt consolidated within gg sector, i.e.: decreased by the nominal value of T-bonds held by Demographic Reserve Fund.

**) In compliance with Eurostat guidelines on sector classification, general government debt figures include capital expenditures of certain infrastructure projects.

***) Matured payables, debt assumption – activation of guarantee, CIRS transactions, restructured/refinanced trade credits, sale-lease-back operations.

¹ The specification of the deficit and debt for EU Member States is included in Annex 4.

The detailed description of differences related to public debt according to the Polish and EU definition is included in Annex 3.

Changes in the level of public debt in 2015 and in the first half of 2016 resulted mainly from changes in the ST debt, constituting approx. 92% of public debt and approx. 88% of the general government debt. The change in the level of the ST debt since the beginning of 2015 has resulted mainly from financing of the State borrowing requirements and weakening of Polish zloty.

Table 2. Factors affecting change in ST debt in 2015 r. and the 1st half of 2016 (PLN bn)

Item	2015	I-VI 2016
Change in ST debt	54.6	64.4
1. State budget borrowing requirements::	53.8	20.0
1.1. State budget deficit	42.6	18.7
1.2. EU funds budget deficit	3.2	7.7
1.3. Pension reform costs ¹⁾	3.1	1.7
1.4. Proceeds from privatisation	0.0	0.0
1.5. Deposits from public finance sector entities and court deposits balance	-8.5	-2.4
1.6. European funds management	9.9	-5.5
1.7. Granted loans balance	5.3	0.0
1.8. Other borrowing requirements ²⁾	-1.8	-0.2
2. Changes not resulting from State budget borrowing requirements::	-7.6	42.9
2.1. FX rates movements	8.8	12.9
2.2. Changes in budget accounts balance	-18.8	28.7
2.3. Early repayment of FMF loan ³⁾	1.8	0.0
2.4. Other factors ⁴⁾	0.6	1.2
3. Change in other State Treasury debt:	8.3	1.5
3.1. Deposits from public finance sector entities ⁵⁾	4.2	1.5
3.2. Court deposits ⁶⁾	4.1	-0.1
3.3. Other ST debt	0.0	0.1

1) Funds transferred to Social Security Fund (FUS) as compensation for contributions transferred to open pension funds (OFE).

2) Changes in pre-financing balance (of tasks co-financed with EU funds), capital payments to international financial institutions, other domestic and foreign settlements.

3) Loan associated with financing of the programme of F-16 aircraft purchase.

4) TS discount, TS indexation, sell-buy-back transactions

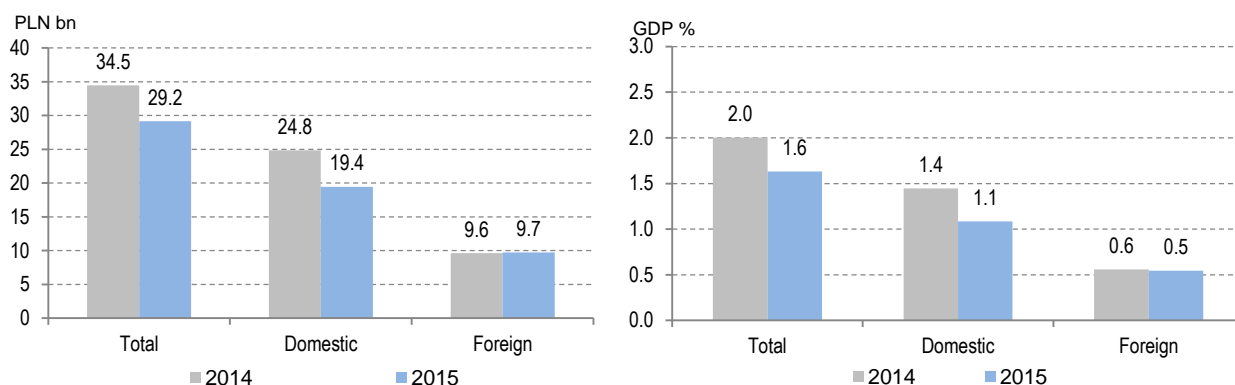
5) Deposits from public finance sector entities with legal personality – their value does not increase public debt.

6) Court deposits from public finance sector entities with legal personality and entities outside public finance sector.

In 2015 ST debt servicing costs decreased, both in nominal terms - from PLN 34.5bn in 2014 to PLN 29.2bn, as well as in relation to GDP – from 2.0% to 1.6%. The decrease in yields and the issuance policy aimed at increasing the share of floating rate instruments, for which interest adjustment to declining interest rates is much faster, contributed to the reduction of debt servicing costs.

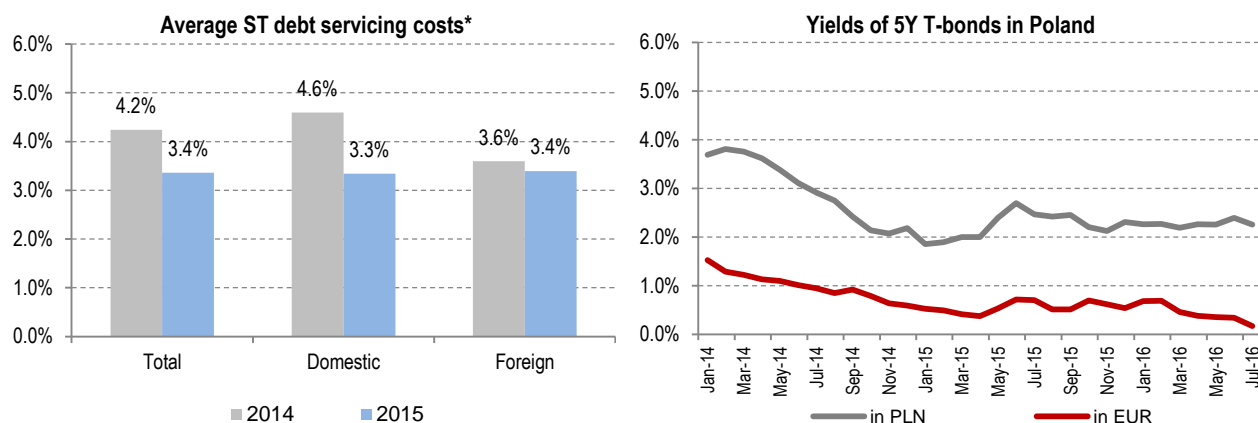
Debt servicing costs for foreign debt were lower than for domestic debt, which resulted mainly from smaller share of foreign debt in total ST debt.

Chart 3. ST debt servicing costs in years 2014-2015



The average costs of debt servicing in 2015 decreased from 4.2% in 2014 to 3.4%, which resulted mainly from a significant reduction of average domestic debt servicing costs (from 4.6% to 3.3%). The level is still higher than the current cost of market financing, which results from servicing of debt incurred in the past at higher yields. Due to a higher duration of foreign debt, the adjustment of servicing costs to lower interest rates is slower than in case of domestic debt.

Chart 4. Market interest rates and average ST debt servicing costs

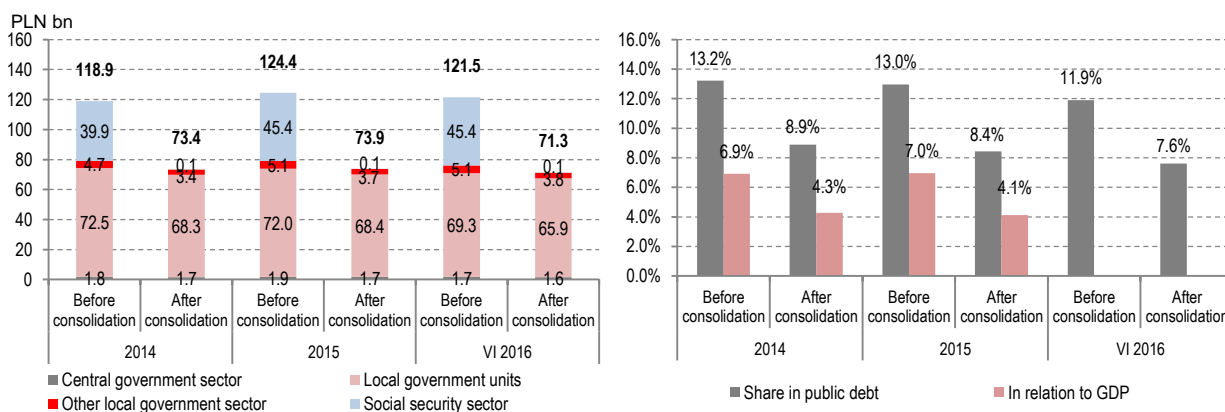


*) Average ST debt servicing costs were calculated as a ratio of the difference between debt servicing costs and revenues in a particular year to the average debt volume in this year (due to the substantial decrease of domestic debt in 2014 as a result of the cancellation of TS transferred to OFE on February 3, 2014, the average was calculated for the period from the end of February to the end of December).

At the end of 2015, debt of entities other than ST constituted 13.0% of public debt before consolidation (8.4% after consolidation), compared to 13.2% before consolidation (8.9% after consolidation) at the end of 2014. After the first half of 2016 these ratios amounted to 11.9% and 7.6%, respectively.

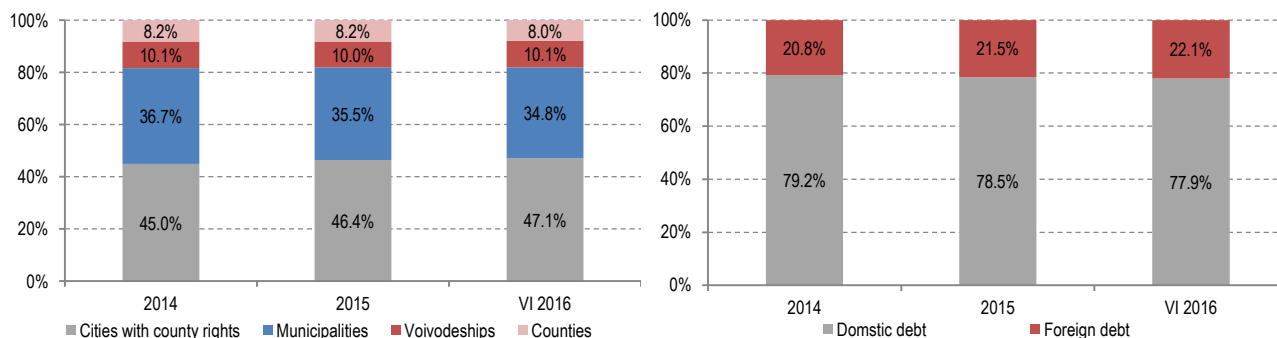
The local government sector debt, in particular that of local government units (LGUs), had the highest share in this part of the debt. Social insurance fund (FUS) liabilities constituted almost entire debt of social security sector. The difference between the level of social security sector unconsolidated and consolidated debt resulted from financing of a part of FUS deficit with loans from the State budget.

Chart 5. Volume and structure of debt of public finance sector entities other than the ST in years 2014-2016



Over the recent years, debt of LGUs and their associations stabilised. At the end of 2015, debt of this group of entities (before consolidation) amounted to PLN 72.0bn compared to PLN 72.5bn at the end of 2014. Following the second quarter of 2016 LGU debt reached the level of PLN 69.3bn. Similar to previous years, debt of cities with county rights had the highest share in the total debt of LGUs – 46.4% at the end of 2015 and 47.1% at the end of the first half of 2016. The share of municipalities debt remained at a level of approx. 35%, voivodeships – approx. 10%, and counties – approx. 8%.

Chart 6. Structure of debt of local government units*



*) The structure of debt according to the place of issue criterion includes both LGUs and their associations.

The structure of debt of LGUs and their associations is dominated by domestic debt (78.5% at the end of 2015 and 77.9% after the first half of 2016). Loans and credits prevailed in the debt of LGUs and their associations (94.0% at the end of 2015 and 93.6% after the first half of 2016).

III. EVALUATION OF IMPLEMENTATION OF THE STRATEGY OBJECTIVE IN 2015 AND IN THE FIRST HALF OF 2016

In 2015 and in the first half of 2016, debt management was conducted in accordance with *The Public Finance Sector Debt Management Strategy in the years 2015-2018*, adopted by the Council of Ministers in September 2014 and *The Public Finance Sector Debt Management Strategy in the years 2016-2019* adopted in December 2015 along with the erratum.

Both documents defined the same debt management objective, i.e. long-term minimization of debt servicing costs, with the adopted constraints related to the level of risk. Risk minimization was understood in terms of two aspects: selection of instruments and ensuring the effectiveness of the TS market.

III.1. Minimization of debt servicing costs - selection of instruments

In accordance with the assumptions of the *Strategy*, the domestic market remained the main source of financing borrowing requirements. In 2015 TS with the face value of PLN 110.3bn were issued, whereas funds with the face value of PLN 27.5bn were raised on foreign markets, including PLN 9.5bn of loans from international financial institutions (IFIs). In the first half of 2016 funds at a level of PLN 83.2bn were raised on domestic market (including T-bills) and PLN 17.4bn - on foreign markets.

Table 3. Sale of Treasury securities on domestic and foreign markets and loans from IFIs

Instrument	2014		2015		January - June 2016	
	PLN bn	%	PLN bn	%	PLN bn	%
Domestic TS	116.9	81.0	110.3	80.0	83.2	82.7
Foreign TS	17.4	12.1	18.0	13.1	17.4	17.3
IFIs loans	10.0	6.9	9.5	6.9	0.0	0.0

In the sale structure of instruments issued on the domestic market, securities offered at auctions dominated (they constituted 97.0% of the value of all securities sold in 2015, and 97.4% in the first half of 2016, respectively).

In the sale structure of TS offered at auctions in 2015 and in the first half of 2016, medium- and long-term securities prevailed (with the maturity over 4 years). As of January 2016, after three years' break, Treasury bills (with the maturity of 32-37 weeks) were included in the sales offer. Yields gained in bill auctions reached their all-time lows (1.29% in February) whereas funds raised through the issue were used for the current liquidity management of the State budget.

Table 4. Sale of Treasury Securities on domestic market by maturity

Instrument	2014	2015	January-June 2016
T-bills	0.0%	0.0%	8.0%
T-bonds with maturity up to 4 years (incl.)	30.7%	14.5%	26.5%
T-bonds with maturity over 4 years up to 6 years (incl.)	37.4%	50.7%	34.3%
T-bonds with maturity over 6 years	31.9%	34.8%	31.2%

Securities with a fixed interest rate had a predominant share in the sale structure of domestic TS at auctions, with the decreasing share of instruments with floating interest rate (decline from 29.5% in 2014 to 15.1% in the first half of 2016). On the other hand, a minor share of inflation-linked bonds was recorded in connection with their sale at the auction in May 2016.

Table 5. Sale of TS on domestic market by the type of interest rate

Instrument	2014	2015	January–June 2016
Fixed rate bonds	55.5%	66.4%	56.6%
Zero-coupon bonds	15.0%	13.2%	18.9%
Floating rate bonds	29.5%	20.5%	15.1%
Inflation-linked bonds	0.0%	0.0%	1.4%
Treasury bills	0.0%	0.0%	8.0%

In the analyzed period, in foreign markets, six issues of euro denominated bonds were conducted, with the total nominal amount of EUR 6.25bn (EUR 3.75bn in 2015 and EUR 2.5bn in the first half of 2016, respectively) as well as one issue of US dollar denominated bond, with the nominal amount of USD 1.75bn (in March 2016). In April 2015, bonds in Swiss franc were issued, with the value of CHF 580 million and a negative yield.

Moreover, in August 2016 bonds denominated in Chinese Renmibi were issued for the first time in history, so-called Panda bonds with the face value of RMB 3bn. Simultaneously, the proceeds were swapped into euro, hedging the future cash flows from bond servicing and redemption. After swap transaction performed in the Chinese onshore interbank bond market the yield on issue reached a negative level.

Table 6. Issuance of bonds on foreign markets in 2015 and in the 1st half of 2016

Period	Maturity (years)	Currency	Nominal amount (in millions)	Coupon	Yield
2015	12	EUR	1 000	0.875%	1.022%
	3	CHF	580	0.000%	-0.213%
	10	EUR	1 000	1.500%	1.592%
	6	EUR	1 750	0.875%	0.940%
January – June 2016	10	EUR	1 000	1.500%	1.542%
	20	EUR	750	2.375%	2.471%
	10	USD	1 750	3.250%	3.339%
	20	EUR	750	2.375%	2.275%

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

- drawing credits from IFIs (in 2015 and in the first half of 2016, the total of EUR 2.3bn, including EUR 1.3bn from the EIB and EUR 0.94bn from the World Bank);
- market FX swap transactions, CIRS type, for liabilities with a lower interest rate. In 2015 transactions with the total value of EUR 0.9bn (for CHF) were concluded, whereas those concluded in the first half of 2016 amounted to USD 1.75bn (for EUR).

Main factors taken into account while deciding on the financing structure of borrowing requirements in 2015 and in the first half of 2016 included:

1) external factors, in particular:

- the monetary policy carried out by main central banks in the world:
 - **USA:** expectations on the launch of monetary policy normalization, increase of rates by 25 bp in December 2015 and expectations of further increases;
 - **Euro area:** extension of asset purchase programme by government bonds (as of March 2015) and corporate bonds (as of June 2016), increase of the monthly scale of asset purchase from EUR 60bn to EUR 80bn (as of April 2016), introduction of long-term refinancing operations for banks as of June 2016 (TLTRO II), two reductions of interest rates (in December 2015 and May 2016) to the record low level, including the repo rate to 0.0% and the deposit rate to -0.4%;

- **Switzerland:** interest rate cutting by 50 bp and discontinuing of the minimum Swiss franc to euro exchange rate (in January 2015), resulting in strong appreciation of Swiss franc in relation to other currencies, including Polish zloty and transitional strong Polish zloty depreciation against euro and US dollar;
 - **China:** reductions of interest rates and Yuan devaluation, aimed at supporting the Chinese economy;
 - **Japan:** introduction of the negative interest rate (in January 2016) and maintaining the asset purchase programme with no changes (JPY 80bn per annum);
 - uncertainty in financial markets associated with the debt crisis in Greece (reaching final agreement in August 2015) and concerns related to the growth rate of the global economy, in particular, the economic downturn in China;
 - victory of Brexit supporters in the referendum in Great Britain (in June 2016); as a response, risk aversion increased, resulting in transitional depreciation of zloty and other currencies of our region and growth in T-bond yields;
 - euro depreciation towards US dollar as a result of deepening divergence between the monetary policy of the ECB and Fed (by 8.2% in the analyzed period).
- 2) local factors, in particular:
- monetary policy of Monetary Policy Council (RPP) and the situation in the domestic financial market, including:
 - cutting of interest rates by 50 bp, including the repo rate to the all-time low level of 1.5% (in March 2015) and the declaration of keeping the interest rates unchanged in the long run;
 - acceleration of the growth rate in 2015 (to 3.6% y/y from 3.3% in 2014) and a slight weakening of its dynamics in the 1st quarter of 2016, with the deflation in y/y terms continuing since July 2014;
 - abrogation of the excessive deficit procedure for Poland in June 2015;
 - adoption of the draft Budget Act for 2016 implementing governmental social programmes (including the family support programme - “500 plus”) and assuming growth in tax income (inter alia, as a result of improvement in tax collection and introduction of new taxes);
 - downgrading of Poland’s rating by S&P rating agency to the level BBB+ and the outlook to negative (in January 2016) and downgrading of rating outlook to negative by Moody’s agency (in June 2016);
 - changes in the flows of foreign capital in the domestic TS market (capital inflow for the amount of PLN 10.8bn in 2015 and outflow in the first half of 2016 by PLN 10.2bn, arising from the strong decrease of debt in short-term Treasury bonds, with the increase in the portfolio of medium- and long-term bonds);
 - growth of banks’ exposure in domestic TS (PLN 20.7bn in 2015 and PLN 53.4bn in the first half of 2016); in 2016 largely resulting from TS exclusion from tax on certain financial institutions;
 - significant fluctuations in the exchange rate of Polish zloty: in 2015, the EUR/PLN exchange rate was fluctuating in the range of 3.99-4.36 (volatility at a level of 7.2%), and USD/PLN exchange rate - in the range of 3.52-4.04 (12.6%), against the EUR/USD volatility at a level of 12.3%. In the first half of 2016 the EUR/PLN exchange rate was fluctuating in the range of 4.24-4.49 (volatility of 6.2%), and the USD/PLN exchange rate - in the range of 3.72-4.13 (9.4%), against the EUR/USD volatility at a level of 6.5%;
 - increase in yields of medium- and long-term domestic Treasury bonds in 2015 and, to a lesser extent, in the first half of 2016, with the decrease in yields of short-term securities in 2015 and stabilization in the first half of 2016.

- uneven distribution over time of the State borrowing requirements, arising from budget execution and the redemption of large series of bonds falling in January, April, July and October;
- implementation of the second stage of liquidity management consolidation (as of January 2015) allowing for decrease in borrowing requirements by the value of deposits of public finance sector units, placed on Ministry of Finance accounts in the state owned bank - BGK;
- maintaining a safe level of state budget liquidity, through prefinancing of a significant part of gross borrowing requirements of the next year (respectively, 33% of the requirements for 2015 and ca. 20% for 2016) at the end of the preceding year.

III.2. Minimization of debt servicing costs - ensuring the effectiveness of the TS market

The most important measures aimed at cost minimization included:

- the issuance policy assuming creation of liquid benchmark bond series. In mid-2016, the value of 14 issues exceeded PLN 20bn (12 issues at the end of 2015). Benchmark issues constituted 69.2% of the face value of medium- and long-term bonds with fixed interest rate (against 58.7% at the end of 2015). High value of issue is a significant factor affecting the level of liquidity in the secondary market. The average liquidity ratio² in the first half of 2016 amounted to 160.8% against 164.2% in 2015, which was a consequence of a lower scale of growth in turnover in the secondary market as compared to the growth of debt in marketable bonds);
- issue of bonds in the euro and US dollar market with face value ensuring liquidity of a given series;
- adjusting the level and structure of the TS supply to the current market situation and influencing this situation through information policy;
- issue of 11-month saving bonds, so-called KOS, in November 2015 (PLN 879m sold). The objective of the issue was the occasional extension of the standard saving bond offer corresponding to preferences of individual investors, increasing of individual investors' share in financing state budget borrowing requirements, promotion of all saving bonds;
- continuation of conducting sell-buy-back transactions between Primary Dealers (PDs) and PD candidates and BGK under special terms (the mechanism was introduced in February 2014 in order to support the clearing under the circumstances of temporary and significantly limited availability of bonds of a given issue in the secondary market). In 2015 and in the first half of 2016, transactions with the face value of PLN 2.9bn were concluded.

² Liquidity ratio –the quotient of the monthly value of transactions involving bonds to the debt month-end.

III.3. Constraints of the level of risk

Table 7. Assessment of implementation of the Strategy objective constraints related to the level of risk

Constraints of the Strategy objective						
Constraint	Level of implementation*	Implementation method	Measure	Value		
				2014	2015	June 2016
Refinancing risk	High	<ul style="list-style-type: none"> High sale of medium and long-term bonds in 2015 and in the first half of 2016 (respectively, 85.5% and 65.5% of all TS sold at outright and switching auctions); Significant role of switching auctions (29.2% of the initial debt in bonds maturing in the period from January 2015 to June 2016 was bought back); Maintaining the average maturity of domestic debt at a safe level above 4 years defined in the Strategy and growth towards the target level of 4.5 years; Maintaining the average maturity of ST debt at a safe level above 5 years defined in the Strategy; Increasing the average maturity of foreign debt due to large issues of long-term bonds (10- and 20-year) in foreign markets; Return to issuance of T-bills at a limited scale in the 1st quarter of 2016 as an instrument of state budget liquidity management. 	ATM (in years)			
			<ul style="list-style-type: none"> - domestic - foreign - total 	4.19	4.27	4.27
			Share in domestic TS:			
			- TS up to 1 year	12.3%	14.2%	14.4%
			- T-bills	0.0%	0.0%	1.1%
Foreign exchange risk	High	<ul style="list-style-type: none"> Decreasing the share of foreign debt, in accordance with the Strategy assumptions; The effective share of euro denominated debt in the foreign debt remained above the minimum level assumed in the Strategy (70%). 	Share of foreign debt in ST debt	35.5%	34.9%	34.1%
			Share of euro denominated debt in foreign debt	70.9%	73.0%	73.4%
Interest rate risk	High	<ul style="list-style-type: none"> ATR of domestic debt remained in the range of 2.8-3.8 years, set in the Strategy; Interest rate risk for foreign debt remained at a safe level and did not pose a threat to cost minimization. 	ATR (in years)			
			<ul style="list-style-type: none"> - domestic - foreign - total 	3.17	3.24	3.31
			Duration (in years)			
			- domestic	3.03	3.04	3.06
			- foreign	4.80	4.54	4.85
			- total	3.71	3.61	3.73

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 2015, bonds of the face value of PLN 28.2bn were bought back, while in the first half of 2016, the value reached PLN 8.2bn); • interest-bearing PLN-denominated deposits at the NBP- deposits of the total value of PLN 106.0bn were made in 2015, while those made in the first half of 2016 amounted to PLN 46.1bn, respectively; • PLN denominated deposits where BGK acted as an intermediary - in 2015 transactions with the total value of PLN 932.0bn were concluded, whereas those concluded in the first half of 2016 amounted to PLN 733.7bn; • market FX swap transactions enabling temporary usage of currencies held, in order to raise funds denominated in PLN - in 2015 transactions with the value equivalent to USD 1.2bn were conducted; • FX deposits – in 2015 deposits for the amount of EUR 108.3bn were made and in the first half of 2016 - for the amount of EUR 16.5bn; • 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 2015, foreign currencies equivalent to EUR 6.4bn were sold) and in the NBP (EUR 8.2bn in 2015); • deposits of liquid funds of public finance sector units in the accounts of the Ministry of Finance in BGK as part of liquidity management consolidation - at the end of 2015, the accumulated funds amounted to PLN 36.7bn and at the end of June 2016 - to PLN 39.1bn. <p>The level of state budget liquid assets in 2015 and in the first half of 2016 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 in BGK, 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 in 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 risk	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"> • Coupons of new issues were set at a level slightly below their forecasted yields; • Switching auctions in domestic market and EUR and USD denominated bond buy-back auctions contributed to smooth distribution of costs. <p>The level of debt servicing costs in 2015 was affected by swap transactions concluded in 2014 within the management of the Budget Act limit and the distribution of costs between years (decrease in costs by PLN 1.97bn).</p>

*) In accordance with the 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 include the role of both domestic and foreign investors in the domestic TS market as well as the potential development of the situation in the major international markets.

IV.1. Macroeconomic assumptions of the *Strategy*

The assessment of the macroeconomic situation and directions of the fiscal policy are presented in the justification to the draft Budget Act for 2017. Table 8 contains the macroeconomic assumptions of the *Strategy*, compliant with the assumption of the draft budget.

Table 8. *Macroeconomic assumptions of the Strategy*

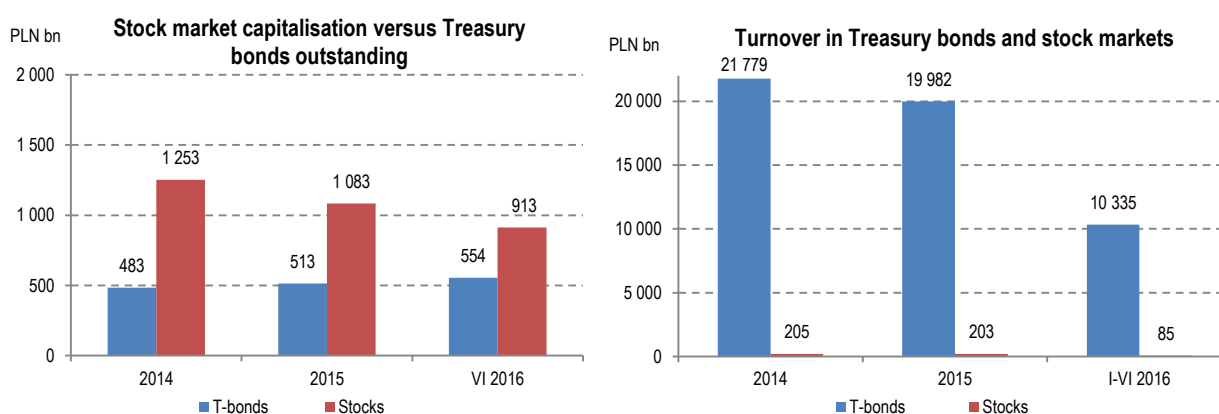
Item	2015	2016	2017	2018	2019	2020
Real GDP growth (%)	3.6	3.4	3.6	3.8	3.9	3.9
GDP at current prices (PLN bn)	1,789.7	1,857.6	1,954.2	2,068.1	2,197.3	2,341.1
Average CPI (%)	-0.9	-0.5	1.3	1.8	2.2	2.5
USD/PLN - end of period	3.90	3.96	3.93	3.85	3.80	3.73
EUR/PLN - end of period	4.26	4.30	4.26	4.18	4.13	4.05

IV.2. 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 this market are significant determinants of debt management. Under the conditions of free capital flow, a well-developed and deep domestic market allows for absorption of external shocks and outflows of foreign capital.

In terms of value of traded securities, the value of the domestic T-bonds market at the end of June this year corresponded to 61% of stock market capitalization. However, the market demonstrates a definitely higher liquidity - turnover in T-bonds (despite their decline in 2015) exceeded trade in the stock market by approximately hundred-fold.

Chart 7. *Domestic Treasury bonds debt and stock market capitalization versus turnover on those markets*



Entities investing in the domestic TS market can be divided into three main groups: domestic banking sector, domestic non-banking sector and foreign investors. In 2015 and in the first half of 2016, the following changes in the structure of domestic TS debt were observed:

- domestic banking sector' TS holdings increased significantly (by PLN 74.1bn in total, including PLN 53.4bn in the first half of 2016), as a result of which in February 2016 debt held by this group of investors exceeded debt held by foreign investors;
- following the increase by PLN 10.8bn in 2015, in the first half of 2016 a decline in foreign investors' debt by PLN 10.2bn occurred;

- a relatively slight growth in TS portfolios held by the domestic non-banking sector (by PLN 4.8bn in total) resulted in the decrease in this sector share in the structure of debt.

Chart 8. Structure of domestic TS portfolios held by main groups of investors

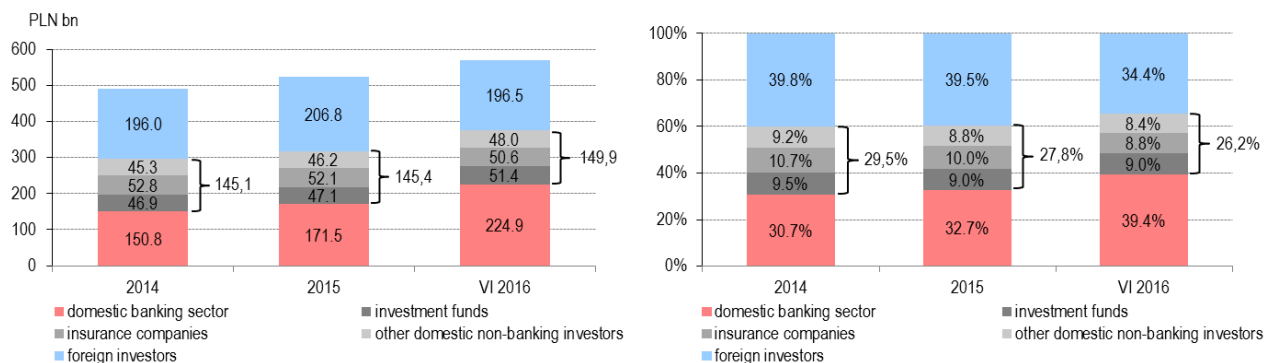
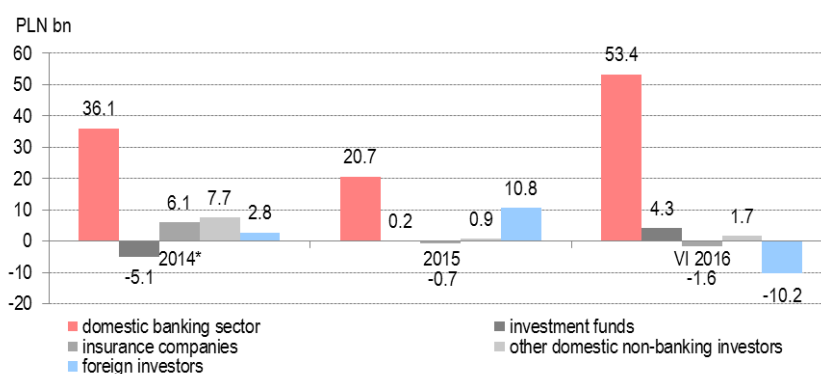


Chart 9. Changes in domestic TS portfolios held by main groups of investors

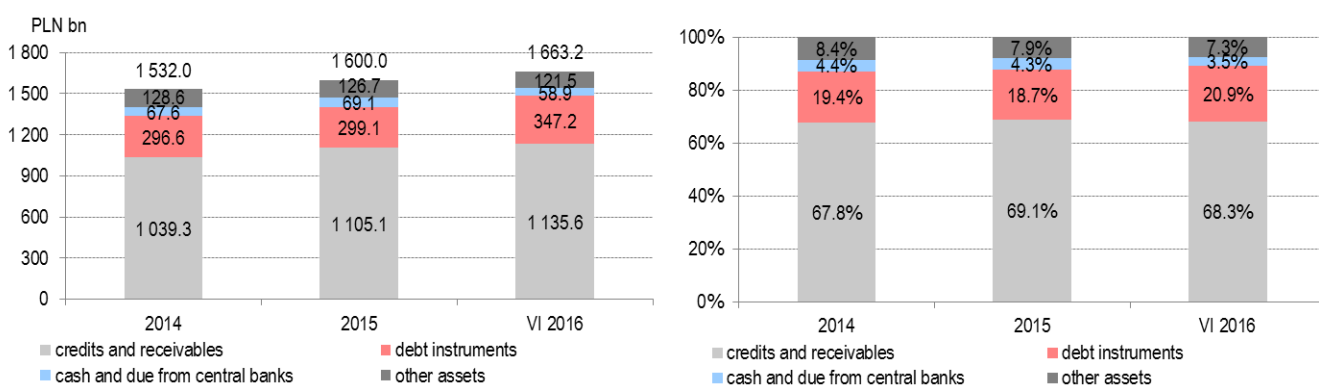


*) Excluding effect of TS cancellation of nominal value amounted to PLN 130.1bn in February 2014 resulted from pension reform.

IV.2.1. Domestic banks

As at the end of June 2016 domestic investors held 65.6% of domestic TS debt, which meant an increase by 5.4 pp compared to the end of 2014, which resulted mainly from a high increase in the banks' portfolio.

Chart 10. Structure of domestic banks' assets



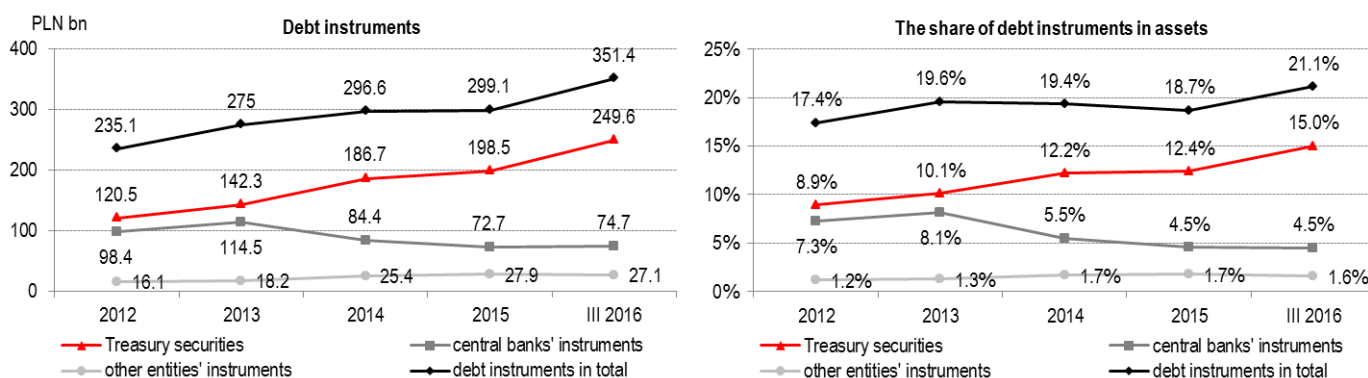
Source: data of Polish Financial Supervision Authority

At the end of June 2016 assets of domestic banks' reached almost PLN 1.7tn (increase by 8.6% compared to the end of 2014), with the dominant share of credits and receivables (ca. 68%). Debt instruments represented the second largest component of assets, simultaneously constituting the largest group of instruments in financial assets of domestic banks. Their share increased from ca. 19% at the end of 2014 to ca. 21% at the end of June 2016. In the structure of debt instruments TS, mainly Polish ones, had a prevailing share as well as instruments of central banks, mainly NBP

money bills. Since the end of 2013, an upward trend of banks' Treasury instruments holdings has been observed, with the simultaneous reduction of the portfolio of money bills.

In the first half of 2016 the introduction of the tax on certain financial institutions as of February 1st, 2016, comprising mainly banks and insurance companies was an additional factor significantly fostering banks' demand for TS. Assets decreased by, inter alia, own funds and Polish TS, make banks' tax base. The construction of the tax encouraged banks to adjust their structure of assets in the first months of the tax operation and, as a consequence, to increase the share of Treasury instruments.

Chart 11. Debt instruments in domestic banks' assets



Source: data of Polish Financial Supervision Authority

The most significant factors to affect banks' demand for domestic TS in the timeframe of the Strategy include:

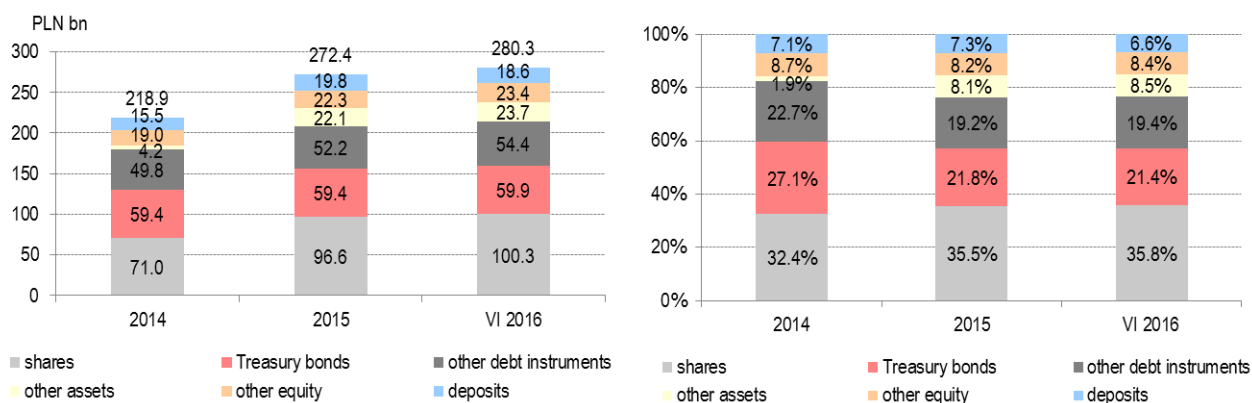
- development of economic situation affecting the size and structure of banks' assets, inter alia, the scale of loans granted and development of the level of deposits;
- the level of over liquidity of the banking sector;
- persisting low interest rates;
- tax on certain financial institutions, enhancing the attractiveness of investing in TS against other debt instruments (in particular, money bills), however, simultaneously increasing costs of banks operation;
- potential other regulatory changes related to the banking sector.

IV.2.2. Domestic non-banking investors

Investment funds and insurance companies represent two largest groups of domestic non-banking sector investors. As at the end of June 2016, these entities held 9.0% (a decline by 0.5 pp compared to the end of 2014) and 8.8% (a decrease by 1.9 pp compare to the end of 2014) of domestic TS, respectively. The main factors affecting the value of TS portfolio held by investment funds and insurance companies include the value of assets and the investment policy of those entities.

As at the end of June 2016 net assets of investment funds amounted to PLN 280.3bn, which meant an increase by PLN 61.4bn, i.e. by 28.1% compared to the end of 2014. However, the growth in assets was mainly related to the shares portfolio and the 'other assets' category; the value of T-bonds in funds' assets remained at a level of ca. PLN 60bn. This was mainly associated with low interest rates, encouraging to invest in more risky instruments with potentially higher rates of return.

Chart 12. Structure of investment funds' net assets*

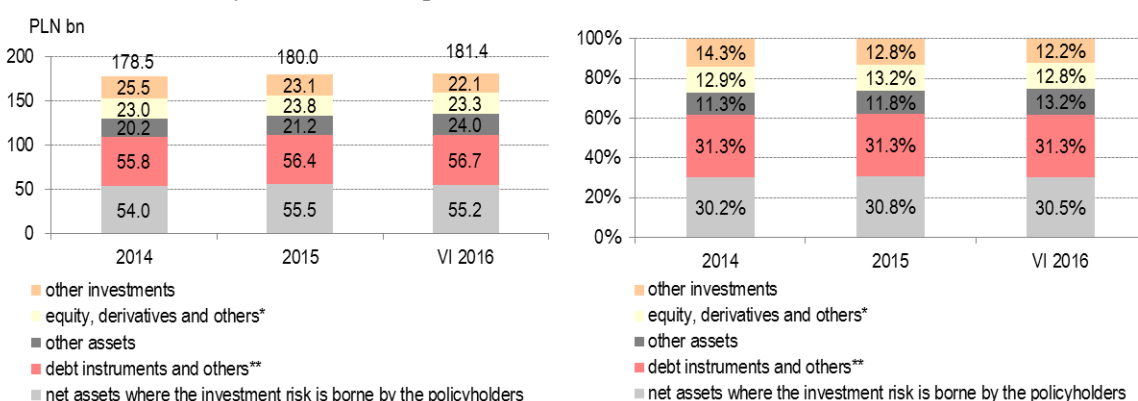


Source: data of National Bank of Poland

*) Excluding money market funds and funds in liquidation as defined in the ECB methodology

In case of insurance companies, as at the end of June 2016 a slight increase in assets compared to the end of 2014 was observed – by PLN 2.9bn (i.e. by 1.6%), up to the level of PLN 181.4bn. Growth was mainly recorded in the ‘other assets’ category as well as in net assets for life insurance where the investment risk is borne by the policyholder. The value of the portfolio of debt instruments and other fixed income securities, where Treasury instruments definitely prevail, remained at a stable level amounting to ca. PLN 57bn.

Chart 13. Structure of insurance companies' assets



Source: data of the Polish Financial Supervision Authority.

*) Other floating income securities

***) Other fixed income securities

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

- further development of the insurance and investment funds markets;
- developments of the level of domestic savings, including, as a result of the Capital Accumulation Programme implementation, assuming, inter alia, increase in the scale of savings in the economy through introduction of new instruments as well as building the culture of households' long-term saving;
- situation in the stock market, which is one of the factors determining households' decisions on savings allocation;
- persisting low interest rates, encouraging households to search for capital investment opportunities, alternative to bank deposits;

- regulatory factors, inter alia the tax on certain financial institutions.

Besides the aforementioned factors, the developments of the share of domestic investors in the holder's structure of domestic TS debt in the forthcoming years will also depend, to a major extent, on the level of borrowing requirements, determining the level of TS supply offered to investors.

IV.2.3. Role of foreign investors

Foreign investors play a significant role in financing the State budget borrowing requirements on the domestic market – as at the end of June 2016 their share in domestic TS debt amounted to 34.4%, however, it decreased significantly as compared to the end of 2014 (by 5.4 pp). The decline in the share of non-residents resulted mainly from the reduction in the TS portfolio during the first two months of 2016, however, it was mainly related to instruments with the shortest residual maturity. In the following months inflow of foreign investors to the Polish TS market was observed (a decline in the portfolio was recorded only in April, which was associated with the redemption of PS0416 bonds). TS with the longest maturity definitely attracted most interest among non-residents.

The foreign investors' demand depends, to a large extent, on international situation and, as a consequence, is highly volatile. However, the risk of sudden outflow of foreign capital from Poland is limited due to high diversification, both institutional and geographical, of the non-residents structure. The structure of debt held by non-residents is dominated by stable institutional investors, in particular, central banks and public institutions constitute over ¼ of the total. The geographical structure of domestic TS holders also demonstrates high diversification – as at the end of June 2016 TS were held by investors from 55 countries.

The most significant factors to affect non-residents' demand for Polish TS in the timeframe of the *Strategy* include:

- actions undertaken by central banks;
- global economic situation, including: the consequences of Great Britain exit from the EU, economic slowdown in China, strong economic foundations of Poland;
- assessment of Poland's credit risk;
- persisting disparity in interest rates;
- functioning of a large and liquid financial market in Poland (in particular, the TS market) and its adequate infrastructure;
- highly diversified structure, both institutional and geographical, of foreign investors holding domestic TS;
- access of Poland to the flexible credit line of the International Monetary Fund, playing a stabilising role under the circumstances of increased volatility in international financial markets.

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 Polish zloty exchange rate. Therefore, this factor determines a flexible approach to shaping the financing structure in terms of selection of the market and currency.

IV.3. International conditions

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;

- ECB announcements concerning maintaining of interest rates at a current or lower level over a longer period of time and continuation of the asset purchase programme, to last at least by the end of March 2017 as well as plans to conduct, in total, 4 series of targeted longer-term refinancing operations (TLTRO II) and the declaration of readiness to use all available instruments so that a sustainable recovery of the inflation path towards the inflation target is guaranteed;
 - Fed declarations indicating that further increases of interest rates will be performed gradually, depending on the economic conditions;
 - continuation of the asset purchase programme and the declaration made by the Bank of Japan concerning a possibility to decrease the main interest rate if required to reach the inflation target;
 - maintaining of the negative deposit rate and the negative fluctuation band for the three-month LIBOR CHF rate by the Swiss National Bank and the declaration of readiness to undertake intervention on foreign exchange market if required to counteract excessive CHF appreciation;
 - maintaining of interest rates at a historically low level and the reduced rate of reserve requirement by the People's Bank of China, accompanied by the continuation of expansive monetary policy to stimulate the Chinese economy.
- the perception of Poland's credit risk and liquidity preferences of buyers of Polish bonds operating in global markets, which affect the height of the premium in relation to core markets.

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 at 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 understood in terms of two aspects, as:

- **selection of instruments**, aimed at cost minimisation within the timeframe of the longest maturities of debt instruments with a significant share in debt volume, through the adequate selection of markets, debt management instruments, structure of financing borrowing requirements and issuance dates;
- **ensuring the efficiency of the TS market**, contributing to the lowering of TS yields. It means the strive to eliminate or limit potential unfavourable factors in market organisation and infrastructure.

The approach to accomplishment of the objective of minimisation of debt servicing costs has not changed in comparison with 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 this 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 the financing cost in the long term, taking into consideration constraints resulting from the acceptable risk levels.

Experience in debt management indicates a significant role of flexibility and diversification of sources of financing borrowing requirements, depending on market situation. It contributes both to ensuring the security of financing the State borrowing requirements as well as to the reduction of raised capital costs, which is particularly important in the period of turbulences in financial markets.

The domestic market shall remain the main source of financing the State budget borrowing requirements. The offer of instruments in this 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. Financing in international markets will supplement domestic financing and its level should:

- take into account the borrowing requirements of the budget in foreign currency as well as inflow of EU funds,
- 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 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 assumptions have been made in the scope of:

1) refinancing risk:

- striving to increase the role of medium and long-term instruments in the State budget borrowing requirements financing in the domestic market at a pace dependent on market situation,
- maintaining of the average maturity of the domestic debt at a level not lower than 4 years and aiming at increasing it to 4.5 years ultimately,
- maintaining the average maturity of ST debt at a level close to 5 years,
- aiming at an even distribution of redemption in the following years;

2) exchange rate risk:

- decrease in the share of foreign currency debt within the timeframe of the *Strategy* below 30%, at a rate depending on market and budgetary conditions,
- possibility to use derivative instruments in order to shape desired debt currency structure,
- maintaining, within the timeframe of the *Strategy*, the effective (i.e. taking into account derivative transactions) share of Euro in foreign currency debt at a level of at least 70%, with a possibility of temporary deviations in case of unfavorable market situation;

3) interest rate risk:

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

4) State budget liquidity risk:

- maintaining the safe level of State budget liquidity while managing liquid assets in an effective way. Their level will be the resultant of the current and predicted budgetary and market situation, taking into account seasonality as well as striving for the even distribution of TS supply within a year,
- a possibility to use FX funds and derivative transactions in managing the currency structure of liquid assets,
- utilisation of free funds of public finance sector entities and funds held in court deposits in managing the State budget liquidity;

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

- concluding of transactions involving derivative instruments with entities of 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:

- aiming at an even distribution of debt servicing costs in individual years, including also through the use of derivative instruments,
- setting bond coupons at the levels slightly below their forecasted yield in the period of sales.

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.

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. 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.

VI.1. Ensuring liquidity of the TS market

This task relates both to liquidity of the entire TS market and individual issuances, and it is associated with the strive to eliminate the premium for inadequate liquidity (and the associated high costs of disinvestment) as well as to the increase in the demand from investors interested only in liquid issues. Both factors contribute to the decrease of TS yields and, accordingly, to the minimisation of ST debt servicing costs. In the timeframe of the *Strategy*, continuation of the former policy is planned, i.e.:

- building large series of bonds (benchmarks) on the domestic market - in case of medium- and long-term bonds with fixed interest rate their value should amount to at least PLN 25 billion, taking into account the aim of an even distribution of redemption over time;
- large liquid bond issues in the euro market and, depending on market conditions, also on the US dollar market;
- adapting the issuance policy, including sale, switching and buy-back auctions to market conditions, including the demand in different segments of the TS market.

VI.2. Ensuring efficiency of the TS market

This task is aimed at minimising debt servicing costs under the second out of two aspects of implementation of this objective, discussed in Chapter V and covers measures both in the primary and in the secondary market:

- adjusting the issuance timing in the domestic and foreign market to the market and budgetary conditions;
- 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;
- removing technical and legal obstacles associated with the TS market;
- direct contacts with investors aimed at on-going exchange of information along with consultations and surveys of investors' needs, 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 new 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 on domestic and foreign markets;
- active participation in conferences and seminars attended by investors;
- improvement of electronic communication channels with domestic and foreign investors.

VI.3. Ensuring transparency of the TS market

This task is aimed at limiting the uncertainty connected with TS market functioning and enables its participants to receive reliable information on current market prices and to formulate expectations concerning the developments in 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. In this scope, the following activities will be continued:

- promoting the electronic market through the appropriate regulations in the PD system regulations, maintaining 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;
- maintaining transparent communication in the scope of issue plans in the timeframe of the current year, quarter and month.

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 finance sector debt, including the debt of units other than the State Treasury entities, which are autonomous in incurring liabilities, the influence on their 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 (article 38a), exceed 55%.

Moreover, the stabilising expenditure rule included in the Public Finance Act sets the thresholds for the relation to GDP of the amount specified in article 38a of the Act at the levels of 43% and 48%. Exceeding the thresholds with a fulfilment of additional conditions defined in the Act triggers the automatic correction mechanism, that limits the growth rate of expenditures for the specific budgetary year.

Annex 3 presents constraints related to incurring public debt, provided in the Public Finance Act (arising from prudential and remedial procedures and rules of incurring liabilities by the LGUs), as well as the correction mechanism of the expenditure rule.

VIII. EXPECTED EFFECTS OF IMPLEMENTING THE STRATEGY

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

- the volume of public debt and the costs of its servicing,
- changes in the scope of risk related to public debt,
- the level of debt of public finance sector entities other than ST.

These are the expected results of the implementation of the *Strategy* objectives under the adopted macroeconomic and budgetary assumptions. Moreover, the most important threats to the implementation of the *Strategy* objectives are indicated in subchapter VIII.4.

VIII.1. Debt volume and its servicing costs

Under the adopted assumptions, in 2016-2017 the public debt-to-GDP ratio shall increase to 52.3%, and then it will decrease gradually to reach 49.5% in 2020. The ratio of the amount specified in Article 38a of the Public Finance Act shall reach the level of 49.8% in 2016 and 51.1% in 2017, to decrease gradually to 48.4% in 2020.

The general government debt-to-GDP ratio will increase to 55.0% in 2017 and stabilise at this level in 2018, to be followed by its subsequent gradual decrease to reach the level of 53.0% in the timeframe of the *Strategy*.

The limit of debt servicing costs assumed in the draft Budget Act for 2017 will be lower than the limit for 2016, both in nominal terms and in relation to GDP, and it will reach PLN 30.4bn (from PLN 31.8bn) and 1.56% of GDP (from 1.71% of GDP), respectively. It was assumed that in the timeframe of the *Strategy*, the debt servicing cost-to-GDP ratio will decrease to the level of 1.38% - 1.43%.

Table 9. Forecasts of the level of debt and debt servicing costs

Item	2015	2016	2017	2018	2019	2020
1. Dług Skarbu Państwa						
a) PLN bn	834.6	914.2	985.7	1,038.1	1,094.4	1,133.7
- domestic	543.3	611.3	675.0	723.3	774.2	810.2
- foreign	291.3	303.0	310.7	314.8	320.3	323.6
b) in relation to GDP	46.6%	49.2%	50.4%	50.2%	49.8%	48.4%
2. Public debt						
a) w mld zł	877.3	953.9	1,021.4	1,069.6	1,122.7	1,158.8
b) in relation to GDP	49.0%	51.4%	52.3%	51.7%	51.1%	49.5%
3. The amount specified in the article 38a of the Public Finance Act *						
a) w mld zł	847.1	925.4	998.3	1,046.8	1,098.2	1,134.2
b) in relation to GDP	47.3%	49.8%	51.1%	50.6%	50.0%	48.4%
4. General government debt						
a) w mld zł	920.1	997.2	1,075.3	1,138.4	1,198.7	1,241.0
b) in relation to GDP	51.4%	53.7%	55.0%	55.0%	54.6%	53.0%
5. ST debt servicing costs (cash basis)**						
a) PLN bn	29.2	31.8	30.4	31.0 - 32.1	30.8 - 31.8	32.4 - 33.4
- domestic	19.4	21.7	20.0	21.2	21.7	24.0
- foreign	9.7	10.1	10.4	9.9 - 10.9	9.1 - 10.2	8.4 - 9.4
b) in relation to GDP	1.63%	1.71%	1.56%	1.50% - 1.55%	1.40% - 1.45%	1.38% - 1.43%

*) 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 2018-2020 account for the exchange rate risk provisions.

Chart 14. Debt-to-GDP ratio

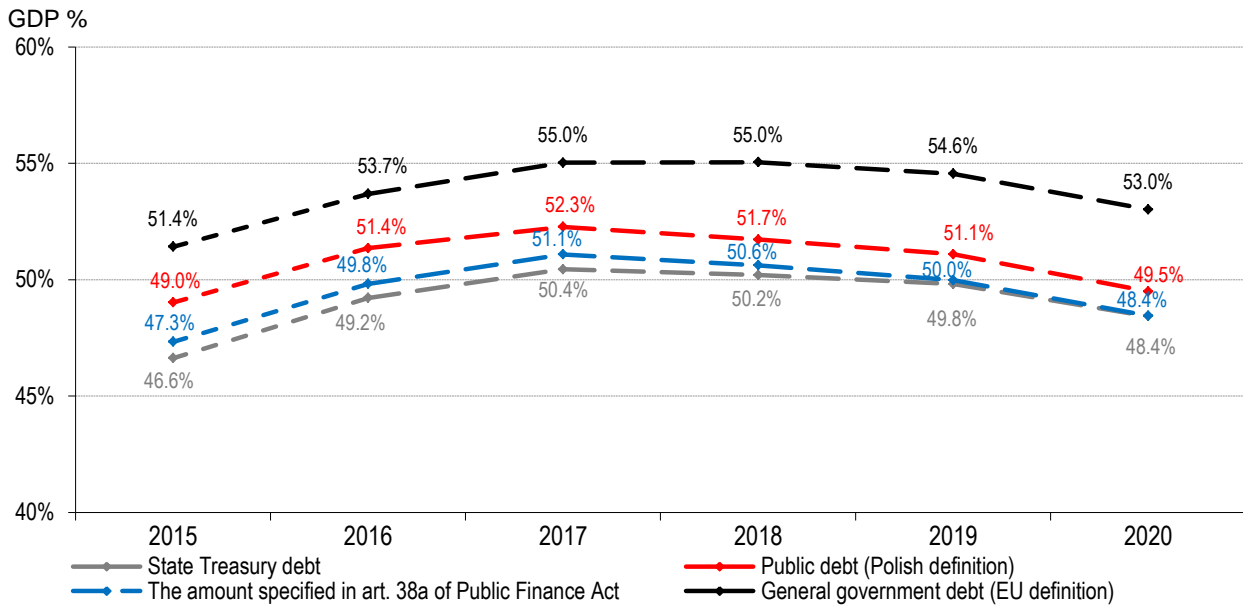


Chart 15. ST debt servicing costs-to-GDP ratio

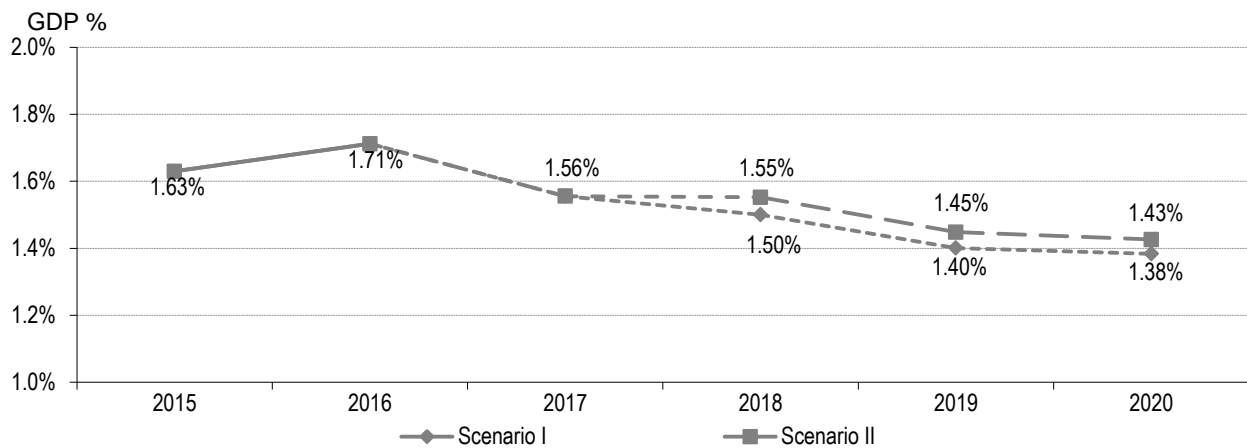
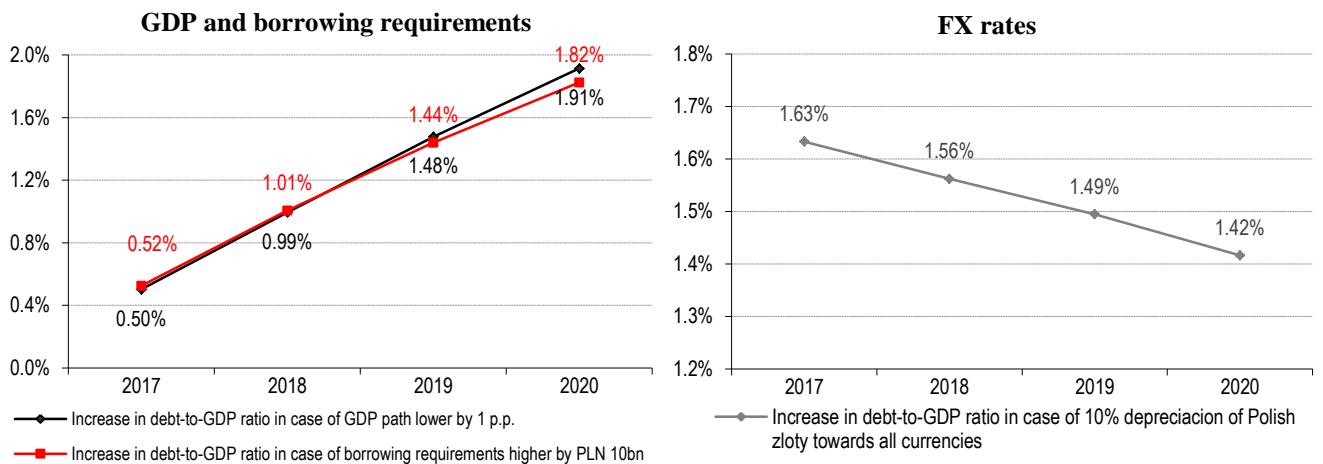
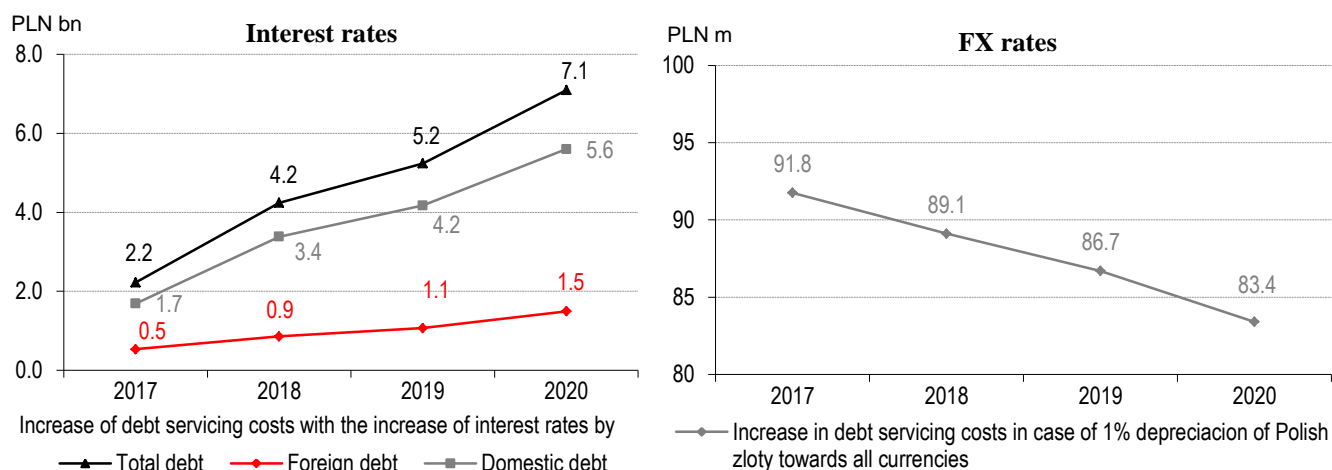


Chart 16. Sensitivity of public debt-to-GDP ratio to changes in assumptions *



*) Assuming the change of paths since 2017.

Chart 17. Sensitivity of ST debt servicing costs-to- GDP ratio to changes in assumptions



VIII.2. Structure of the State Treasury debt

It is expected that in the timeframe of the *Strategy*:

- regarding the refinancing risk – the direction of changes in the ATM of the ST domestic marketable debt will depend on market conditions, so that the average maturity in 2020 may reach the value in the range from 4.0 to 4.6, and for the total ST debt, 4.9-5.3 years against, respectively, 4.4 and 5.25 years at the end of 2016;
- 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. 3.1-3.4 years compared to 3.3 at the end of 2016, and for the total debt - ca. 3.7-4.0 years, whereas the duration of the domestic marketable debt will stay in the range of ca. 2.9-3.2 years compared to ca. 3.1 at the end of 2016, while that of the total debt will range from ca. 3.5-3.6 years;
- the share of foreign currency debt will be reduced and in the timeframe of the *Strategy* it should fall below 30%.

Chart 18. ATM of the ST debt

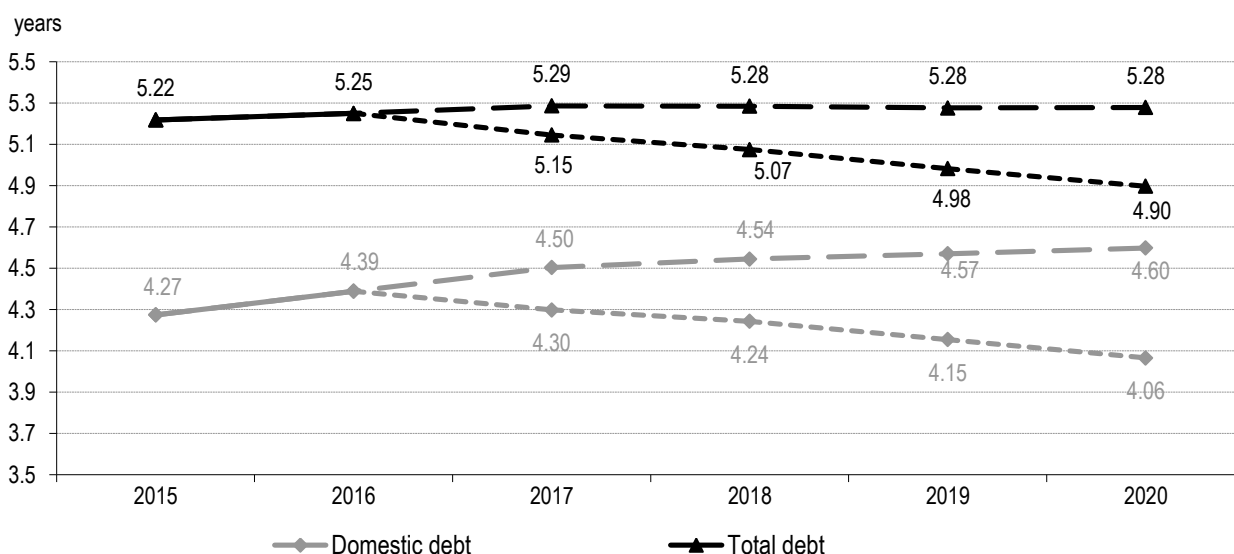


Chart 19. ATR of the ST debt

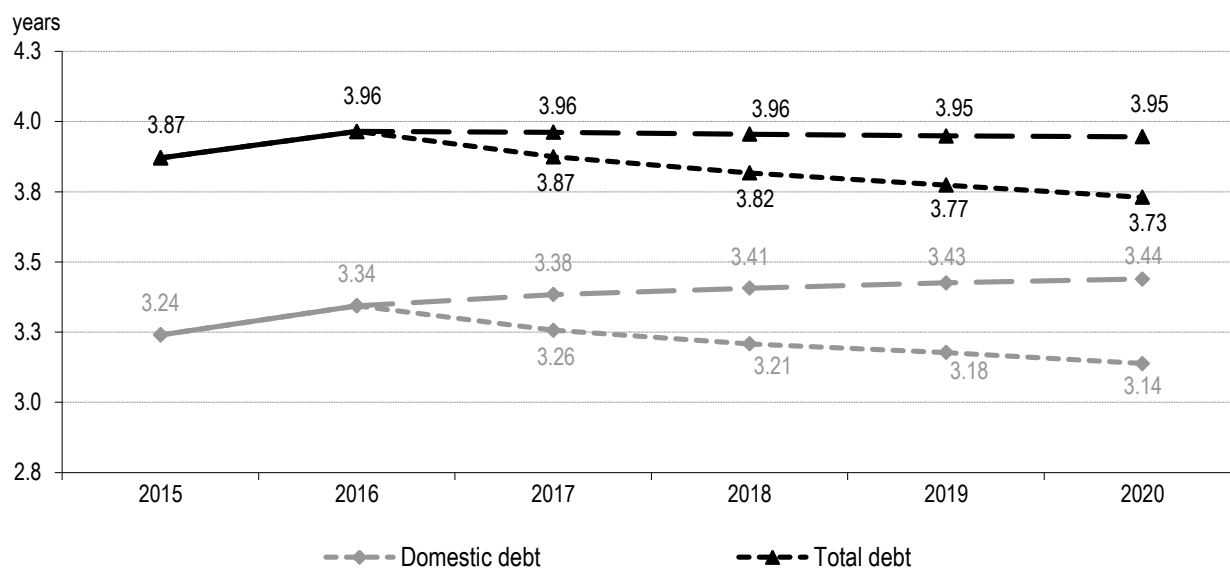


Chart 20. Duration of the ST debt

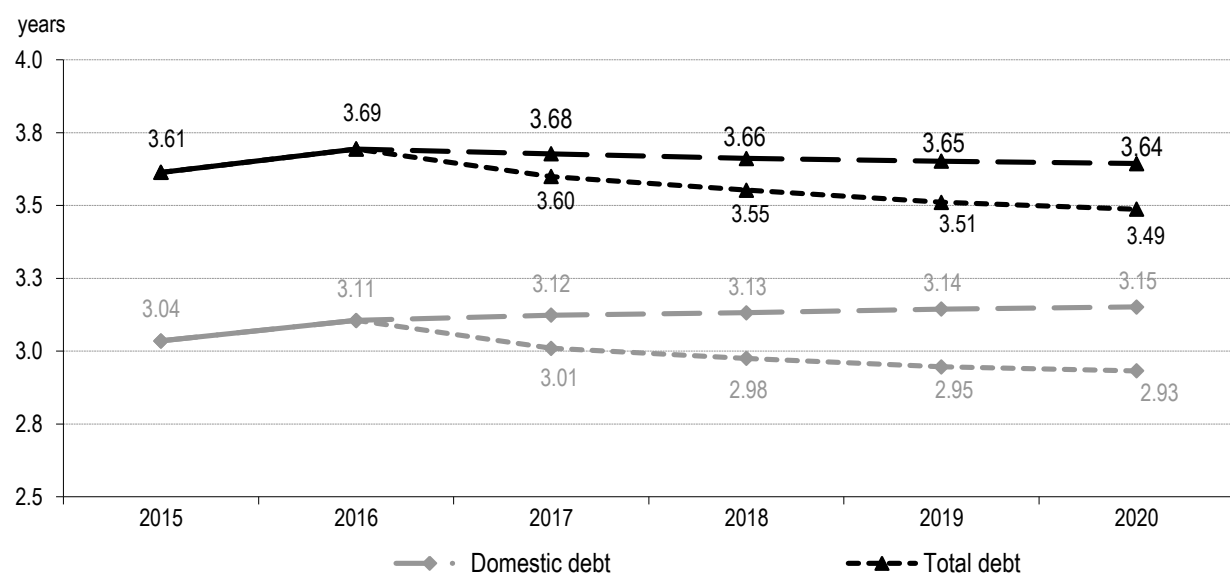
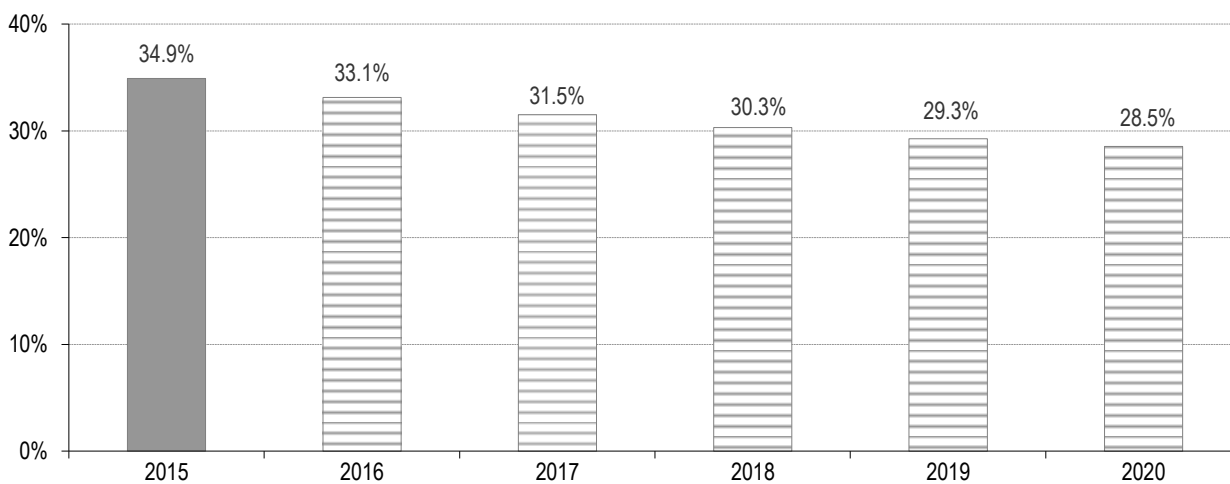


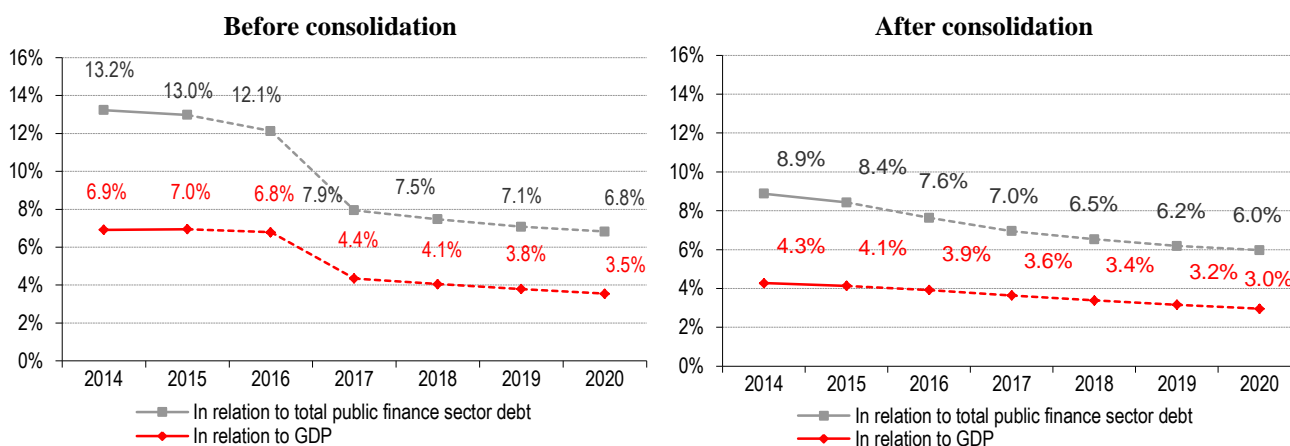
Chart 21. The share of foreign currency debt in total ST debt



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

Under the adopted assumptions, in the timeframe of the *Strategy*, the before consolidation debt-to-GDP ratio of the public finance sector entities other than ST will decrease from 6.8% to 3.5%, whereas the debt after consolidation will fall from 4.1% to 3.0%. The share of this group of entities in the public finance sector debt before consolidation will decline from 12.1% to 6.8%, and after consolidation - from 7.6% to 6.0%.

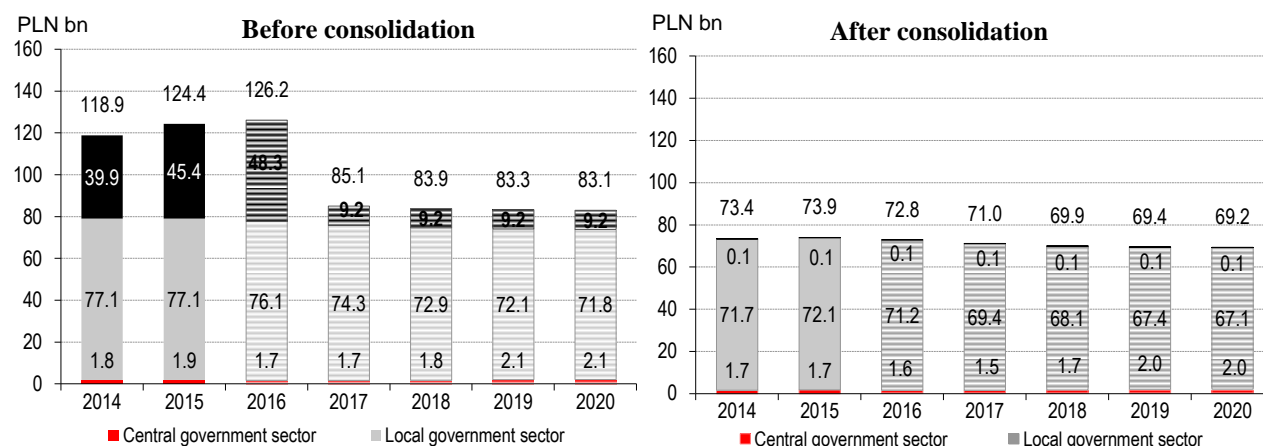
Chart 22. Debt of public finance entities other than the State Treasury before and after consolidation – in relations to GDP and as a share of total public finance sector debt



In the timeframe of the *Strategy*, the nominal debt of public finance sector entities other than ST will drop from PLN 126.2bn to PLN 82.4bn before consolidation, mainly as a result of scheduled in 2017 cancellation of loans from the State budget granted to FUS, falling due in 2017. The cancellation of loans from the State budget granted to FUS will not affect the level of debt after consolidation which, in the timeframe of the Strategy, will decrease from PLN 72.8bn to PLN 69.2bn. The decline of debt after consolidation will be the resultant of the decrease in the LGU debt and the stabilisation of debt of other units of central and local government sector.

The *Strategy* assumes that the debt of the LGUs and their associations will decrease as a result of budgetary surpluses of this group of units. The level of debt of the LGUs will be also affected by the rules regarding incurring liabilities by those entities, including the individual debt ratio which came into force as of January 1, 2014.

Chart 23. Debt of public finance entities other than the State Treasury before and after consolidation by sector



VIII.4. Threats to the Strategy implementation

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

- 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;
- international market conditions, including:
 - a slower than expected growth rate in the global economy, in particular, in Europe,
 - consequences of Great Britain's exit from the EU,
 - capital outflow towards core markets or other markets;
- the risk of excessive growth of public debt and general government debt to the 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 entities other than ST,
 - the necessity to execute sureties or guarantees granted by public finance sector entities.

IX. GUARANTEES AND SURETIES GRANTED BY PUBLIC FINANCE SECTOR ENTITIES

IX.1. Assumptions of the strategy of granting guarantees and sureties

In order to limit the risk associated with granting ST guarantees and sureties while preserving the advantages of using them as an instrument of the State economic policy, the following principles should 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;
- sureties and guarantees may be also used to support possible measures undertaken in case of potential deterioration in the Polish financial system;
- 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 value 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 ST. The limit for 2017 in the draft budget act was determined at a level of PLN 200bn. The extent of use of the ST sureties and guarantees instrument will result mainly from the continuation of infrastructural investments, as well as possible measures which can be undertaken in the event of potential distributions in the Polish financial system. 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 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.

IX.2. Analysis and forecasts of the level of guarantees and sureties

Contingent (undue) liabilities arising from guarantees and sureties owed by public sector entities at the end of the first half of 2016 amounted to PLN 130.3bn, compared to PLN 116.9bn, i.e. 6.5% of GDP in 2015 and PLN 114.5bn, i.e. 6.7% of GDP in 2014.

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 2016 they amounted to PLN 126.5bn, as compared to PLN 113.2bn, i.e. 6.3% of GDP in 2015 and PLN 110.8bn, i.e. 6.4% of GDP in 2014. The increase in contingent liabilities until the end of 2015 resulted mainly from new guarantees granted to support the development of infrastructure. The hitherto ST operations related to guarantees do not pose significant risks to public finance. At the end of 2015, c.a. 85% of contingent liabilities due to guarantees granted by the ST belonged to the low-risk group.

The biggest amounts of ST contingent liabilities (status as at 30 June 2016) resulted from:

- | | |
|---|------------|
| • guarantees granted for BGK | PLN 89.4bn |
| including, for the support of KFD | PLN 87.7bn |
| • guarantees granted for PKP Polskie Linie Kolejowe S.A. | PLN 13.9bn |
| • guarantees of payments from KFD for Gdańsk Transport Company S.A. | PLN 9.0bn |

- guarantees of payments from KFD for Autostrada Wielkopolska II S.A. PLN 6.9bn
- guarantees granted for Autostrada Wielkopolska S.A. PLN 3.5bn
- guarantees granted for PKP Intercity S.A. PLN 2.0bn

It is expected that the relation of potential ST liabilities due to sureties and guarantees to GDP will amount to approx. 7.2% at the end of 2016 and then grow subsequently, however, in the consecutive periods of forecast it will remain at a level close to 9%.

Table 10. Contingent liabilities under guaranties and sureties granted by the ST and the public finance sector units

	2014	2015	2016	2017	2018	2019	2020
Contingent liabilities under guaranties and sureties granted by:							
a) Public finance sector							
- PLN bn	114.5	116.9	137.4	185.7	195.0	202.7	213.5
- In relation to GDP	6.7%	6.5%	7.4%	9.5%	9.4%	9.2%	9.1%
b) State Treasury							
- PLN bn	110.8	113.2	133.7	182.0	191.3	198.9	209.8
- In relation to GDP	6.4%	6.3%	7.2%	9.3%	9.3%	9.1%	9.0%

Annex 1. Abbreviations and glossary

A. Abbreviations used in the Strategy

ATM – average time to maturity

ATR – average time to refixing

CIRS – currency interest swap

ECB – European Central Bank

GG – general government sector

IFIs – international financial institutions

KFD – National Road Fund

LGUs – local government units

NBP – National Bank of Poland

PD – Primary Dealers

PFS – Public Finance Sector

SPZOZ – independent public health care units

ST – State Treasury

TS – Treasury securities

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 is 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:

$$ATR = \frac{\sum_{r \in R} r N Z_r + \sum_{t \in T} t N S_t + \sum_{j \in J} \frac{1}{12} N I_j I_0}{\sum_{r \in R} N Z_r + \sum_{t \in T} N S_t + \sum_{j \in J} N I_j I_0}$$

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_r – 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. Yield of benchmark bond is the reference point for yields in a given maturity segment. Benchmark issues subject to trading on the electronic market Treasury BondSpot Poland are TS issues defined by the Minister of Finance, in particular fixed rate bonds, with maturity not less than one year and total face value not less than PLN 10bn or on-the-run issues with total face value not less than PLN 2bn. When setting benchmarks on the Polish yield curve in Reuters and Bloomberg the criterion of time to maturity is applied.
2. (*portfolio*) target characteristics of the public debt portfolio, which constitutes a *reference portfolio* for the existing portfolio and determines 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 with receivables. For the debt management unit such a situation occurs when financial derivatives are used. 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 ST is a weighted average of appropriate duration coefficients for every currency, where weights are market value of debt in particular currency.

Exchange rate risk – arises from the vulnerability of the foreign currency denominated debt level and its servicing costs to exchange rate fluctuations. The Polish 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.

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 to the level of other types of risk will increase due to infrastructure, organization and supervision of the debt management, that is inadequate to the scope of tasks. Operational risk the most difficult risk to be measured.

Limiting the operational risk can be 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.

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 after a specific event takes place. Guaranties and sureties granted by the public finance sector units are a classical example of potential debt. In case of execution of a guaranty or surety, the liabilities are due 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;

- 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 and 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 financing borrowing needs on the financial market at rational cost.

State budget liquidity risk is managed on one hand by keeping safe reserve of funds at the lowest possible level (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 – a derivative contract through which two parties exchange cash flows based on a notional principal amount with rules of calculating their value specified in advance. Swap may be a separate financial instrument or it may accompany other instruments.

Annex 2. Cyclical publications of the Ministry of Finance regarding public debt and TS market

- Annual reports:
<http://www.finanse.mf.gov.pl/en/web/wp/public-debt/publications/annual-reports>
- State Treasury debt, monthly bulletin:
<http://www.finanse.mf.gov.pl/en/public-debt/outstanding-debt/state-treasury-debt>
- Public debt, quarterly bulletin:
<http://www.finanse.mf.gov.pl/en/web/wp/public-debt/outstanding-debt/public-debt1>
- Monthly information on TS supply and its background
<http://www.finanse.mf.gov.pl/en/web/wp/public-debt/publications/monthly-bulletin>
- Monthly information on investors structure on domestic TS market:
<http://www.finanse.mf.gov.pl/en/public-debt/secondary-market/structure-of-investors>
- Monthly information on transaction on secondary TS market:
<http://www.finanse.mf.gov.pl/en/public-debt/secondary-market/secondary-market-statistics>

Annex 3. Legal regulations applied to public debt in Poland and the EU

Table 1. Public debt – basic legal regulations

Polish regulations	EU regulations
<p>1. Constitution of the Republic of Poland</p> <ul style="list-style-type: none"> ban on incurring loans and granting guaranties and sureties resulting in the public debt exceeding 3/5 of GDP (Article 216(5)); 	<p>1. Treaty on the functioning of the European Union</p> <ul style="list-style-type: none"> 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);
<p>2. Public Finance Act</p> <ul style="list-style-type: none"> 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. 	<p>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</p> <ul style="list-style-type: none"> definition of general government debt and reference value of debt to GDP ratio at 60%;
	<p>3. Council Regulation on the application of the Protocol on the Excessive Deficit Procedure annexed to the Treaty establishing the European Community</p> <ul style="list-style-type: none"> definition of general government debt with specification of categories of liabilities which constitute it;
	<p>4. Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union (ESA 2010)</p> <ul style="list-style-type: none"> 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
<p>I. Legal procedures regarding limits on public debt to GDP ratio</p> <p>1) the ratio in year x is greater than 55% and lower than 60%:</p> <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>

Public Finance Act
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,
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 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 stabilising expenditure rule pursuant to Article 112aa:
<p>1) – 2 percentage points:</p> <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 -2 GDP 48%.
<p>2) – 1.5 percentage points:</p> <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;
<p>3) + 1.5 percentage points:</p> <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. Differences between public debt (Polish definition) and general government debt (EU definition).

Polish regulations	EU regulations
public debt	general government debt
1) scope of the public finance sector	
<ul style="list-style-type: none"> Public Finance Act defines limited catalogue of units included in the public finance sector; 	<ul style="list-style-type: none"> scope of <i>general government</i>¹⁾ sector is defined in ESA2010²⁾; no limited catalogue of units is defined;
<i>differences in the scope of sector depending on regulations</i>	
<p>a) funds formed within Bank Gospodarstwa Krajowego (BGK), f. ex. : the National Road Fund (KFD), the Railway Fund (FK)</p> <ul style="list-style-type: none"> are excluded from the public finance sector; 	<ul style="list-style-type: none"> are included in the general government sector³⁾;
<p>b) public corporations that are deemed non-marketable (f. ex. PKP PLK S.A., Port Lotniczy Łódź, health care institutions)</p> <ul style="list-style-type: none"> are excluded from the public finance sector; 	<ul style="list-style-type: none"> 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>	
<ul style="list-style-type: none"> 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	
<ul style="list-style-type: none"> 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. 	<ul style="list-style-type: none"> 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 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 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.
- 3) In compliance with Eurostat guidelines on sector classification of some infrastructure projects, general government debt figures may, under specified conditions, include capital expenditures of the projects in question (imputed loan)
- 4) Matured payables are expenditure on accrual basis and thus are included in net borrowing/net lending calculated (balance of general government) in accordance with EU methodology.
- 5) 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 4. Selected statistical data concerning public finance and credit rating in Poland and EU

Table 5. General government deficit, debt¹⁾ and yields on 10-year bonds²⁾ in the EU countries in 2014-2015

	2014			2015		
	GG balance	GG debt	10Y interest rate	GG balance	GG debt	10Y interest rate
	% PKB	% PKB	%	% PKB	% PKB	%
Greece	-3.6	180.1	6.93	-7.2	176.9	9.67
Italy	-3.0	132.5	2.89	-2.6	132.7	1.71
Portugal	-7.2	130.2	3.75	-4.4	129.0	2.42
Cyprus	-8.9	108.2	6.00	-1.0	108.9	4.54
Belgium	-3.1	106.5	1.71	-2.6	106.0	0.84
Spain	-5.9	99.3	2.72	-5.1	99.2	1.73
France	-4.0	95.4	1.67	-3.5	95.8	0.84
Ireland	-3.8	107.5	2.37	-2.3	93.8	1.18
Euro area³⁾	-2.6	92.2	2.04	-2.1	90.7	1.22
United Kingdom	-5.6	88.2	2.14	-4.4	89.2	1.79
Croatia	-5.5	86.5	4.05	-3.2	86.7	3.55
Austria	-2.7	84.3	1.49	-1.2	86.2	0.75
European Union	-3.0	86.8	2.20	-2.4	85.2	1.45
Slovenia	-5.0	81.0	3.27	-2.9	83.2	1.71
Hungary	-2.3	76.2	4.81	-2.0	75.3	3.43
Germany	0.3	74.7	1.16	0.7	71.2	0.50
Netherlands	-2.4	68.2	1.45	-1.8	65.1	0.69
Malta	-2.0	67.1	2.61	-1.5	63.9	1.49
Finland	-3.2	59.3	1.45	-2.7	63.1	0.72
Slovakia	-2.7	53.9	2.07	-3.0	52.9	0.89
Poland	-3.3	50.3	3.52	-2.6	51.4	2.70
Sweden	-1.6	44.8	1.72	0.0	43.4	0.72
Lithuania	-0.7	40.7	2.79	-0.2	42.7	1.38
Czech Republic	-1.9	42.7	1.58	-0.4	41.1	0.58
Denmark	1.5	44.8	1.32	-2.1	40.2	0.69
Romania	-0.9	39.8	4.49	-0.7	38.4	3.47
Latvia	-1.6	40.8	2.51	-1.3	36.4	0.96
Bulgaria	-5.4	27.0	3.35	-2.1	26.7	2.49
Luxembourg	1.7	22.9	1.34	1.2	21.4	0.37
Estonia	0.8	10.4	:	0.4	9.7	:

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 2014 for 18 countries and 2015 for 19 countries.

Table 6. Long-term government debt rating in foreign currency of EU Member States as of September 16 2016.

	Standard&Poor's	Fitch	Moody's
Austria	AA+	AA+	Aa1
Belgium	AA	AA	Aa3
Bulgaria	BB+	BBB-	Baa2
Croatia	BB	BB	Ba2
Cyprus	BB-	B+	B1
Czech Republic	AA-	A+	A1
Denmark	AAA	AAA	Aaa
Estonia	AA-	A+	A1
Finland	AA+	AA+	Aa1
France	AA	AA	Aa2
Greece	B-	CCC	Caa3
Spain	BBB+	BBB+	Baa2
Netherlands	AAA	AAA	Aaa
Ireland	A+	A	A3
Lithuania	A-	A-	Baa1
Luxembourg	AAA	AAA	Aaa
Latvia	A-	A-	A3
Malta	BBB+	A	A3
Germany	AAA	AAA	Aaa
Poland	BBB+	A-	A2
Portugal	BB+	BB+	Ba1
Romania	BBB-	BBB-	Baa3
Slovakia	A+	A+	A2
Slovenia	A	BBB+	Baa3
Sweden	AAA	AAA	Aaa
Hungary	BB+	BBB-	Ba1
United Kingdom	AA	AA	Aa1
Italy	BBB-	BBB+	Baa2

Source: Reuters

Table 7. Public debt in Poland in 2005 – June 2016

Item	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	June 2016
1. State Treasury debt												
a) PLN bn	440.2	478.5	501.5	569.9	631.5	701.9	771.1	793.9	838.0	779.9	834.6	899.0
domestic *	315.5	352.3	380.4	420.2	462.7	507.0	524.7	543.0	584.3	503.1	543.3	592.2
foreign *	124.7	126.2	121.1	149.7	168.8	194.8	246.4	250.9	253.8	276.9	291.3	306.7
b) GDP %	44.7%	44.9%	42.3%	44.6%	46.4%	48.6%	49.2%	48.7%	50.6%	45.4%	46.6%	-
2. Public debt (Polish definition)												
a) PLN bn	466.6	506.3	527.4	597.8	669.9	747.9	815.3	840.5	882.3	826.8	877.3	936.9
b) GDP %	47.4%	47.5%	44.4%	46.8%	49.2%	51.8%	52.0%	51.6%	53.3%	48.1%	49.0%	-
3. General government debt (EU definition)												
a) PLN bn	459.7	502.3	524.4	595.4	678.3	767.8	847.7	875.5	923.0	864.3	920.1	977.1
b) GDP %	46.7%	47.2%	44.2%	46.6%	49.8%	53.1%	54.1%	53.7%	55.7%	50.3%	51.4%	-

*) place of issue criterion

Table 8. GDP and exchange rates in 2005 – June 2016

Item	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	June 2016
1. Gross Domestic Product												
PLN bn	984.9	1 065.2	1 186.8	1 277.3	1 361.8	1 445.1	1 566.6	1 629.0	1 656.3	1 719.1	1 789.7	-
2. Exchange rate (end of period)												
a) EUR	3.8598	3.8312	3.5820	4.1724	4.1082	3.9603	4.4168	4.0882	4.1472	4.2623	4.2615	4.4255
b) USD	3.2613	2.9105	2.4350	2.9618	2.8503	2.9641	3.4174	3.0996	3.0120	3.5072	3.9011	3.9803