Ministry of Public Finance

Government Public Debt Management Report

December 31, 2014

Directorate General Treasury and Public Debt

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1. Performance of the Romanian economy in 2014

In 2014, the nominal convergence criteria of the Maastricht Treaty were achieved 100%, for the first time in the post-accession period. The real convergence process continued, with GDP performing significantly above the average growth rate of the European Union. [1]

The gross domestic product went up in 2014 by 2.8%, in its fourth year of economic growth in a row, (1.1 % in 2011; 0.6% in 2012; 3.4% in 2013) which consolidated the recovery trend after the crisis which also affected Romania in 2009 and 2010. The growth in 2014 came mainly from the positive contribution of the domestic demand, the main growth driver, with the private consumption sustained by a strong growth of the real wage and by interest rates down to their lowest ever.

The annual inflation rate at end-2014 decreased to its lowest after 1990, i.e. 0.83%, which is by 0.72 percentage points below the level seen at the end of 2013. The inflation as annual average went down to 1.07%, by 2.91 percentage points below the previous year. In 2014, however, Romania's annual inflation at end-year was the highest in the EU, with most countries reporting a deflation process.

Table no. 1: Macroeconomic indicators

Indicators	2013	2014
GDP		
- billion lei	637.6	666.6
- real growth, %	3.4	2.8
Current account balance (% of GDP)	-0.8	-0.4
Consumer Price Index (CPI)		
- end-of-year	1.55	0.83
- annual average	3.98	1.07
Average exchange rate		
- lei/euro	4.419	4.4446
- lei/USD	3.3279	3.3492

Source: NPC (Main macroeconomic indicators projected - May 2015)

The cash deficit of the general consolidated budget was, in 2014, 1.7% of GDP, while the budget deficit according to EU methodology (ESA95) was 1.5% of GDP. Due to relatively low budget deficits, the gross financing needs came mainly from the amount of government debt refinancing, as in the table below:

Table no. 2: Financing needs

Indicator	2013	2014
Revenues of the central public administration[2] (billion lei)	156.3	165.9
Expenditures of the central public administration [3] (billion lei)	172.4	179.5
Budget deficit of the central public administration [4] (I) (billion lei)	16.1	13.6
Refinancing of the government public debt [5] (II) (billion lei)	55.8	47.9
Gross financing needs (I+II) (billion lei)	71.9	61.5

Source: MoPF

In 2014, Romania's ratings improved, as both Moody's and Standard & Poor's confirmed the improvement of the Romanian fiscal and budgetary framework. Hence, in April 2014 Moody's

[1] Source NBR "2014 Annual Report"

[2] Calculated according to the cash methodology by applying the EU methodology

[3] Idem 2

[4] Idem 2

[5] According to the national legislation, the amount of principal and government securities refinancing reimbursements on behalf of the government public debt, calculated based on the debt balance at end-2014 (it includes the guarantees but inot the temporary financing).

increased the rating for the government debt from *negative* to *stable* and reconfirmed its Baa3 rating.
Later on, in May 2014, it was the turn of Standards & Poor's to increase the Romanian debt rating to BBB-, which promoted Romania to the group of countries recommended for investments, with a stable outlook. In addition, Standard & Poor's improved Romania's short term sovereign debt rating from B+ to A-3 and this has been the first time for an international rating agency to place Romania in the A category, reflecting the increased confidence in the country's capacity to observe its financial obligations.
Fitch Ratings and JCRA[6]confirmed Romania's ratings in 2014, confirming the progress made in the public finance consolidation process and the good performance in the implementation of structural reforms.

2. 2014 Strategy to finance the budget deficit and refinance the government public debt

2.1. Budget deficit financing

In 2014, the budget deficit was financed mainly from sources (around 60%) and as a supplement from domestic sources, through government securities issued in the domestic market. The sources needed to refinance the government public debt were secured from the markets on which the debt was originally issued and from the foreign currency buffer available to MoPF, which was consolidated by around 1.4 billion EUR in 2014.

The debt instruments used to finance the budget deficit and refinance the debt included:
a) government securities issued in lei, namely discounted treasury bills and benchmark bonds issued on the domestic market, with average and long term maturities of up to 15 years.
To meet the objective of developing the domestic market of government securities and to build and consolidate the yield curve of government securities on the domestic market, regular government securities denominated in lei in total amount of 40.5 billion lei were issued in 2014.
b) *government securities denominated in EUR on the domestic market*
MoPF issued 5 years government securities denominated in EUR, in total amount of approximately 928.7 million EUR, to help building the resources for repurchasing the 1.3 billion EUR bond maturing in May and preserve the State Treasury foreign currency buffer at a comfortable level.
c) Eurobonds denominated in EUR and USD on the foreign capital markets
The favorable perception of financial markets regarding Romania allowed the country to attract from the US market, in January 2014, the amount of 2.0 billion USD in two tranches, of 10 and 30 years maturity, respectively. In April 2014 followed an Eurobond issuance of 1.25 billion EUR with 10 years maturity, and in October 2014 a 10-year Eurobond was issued in amount of 1.5 billion EUR.
d) *foreign loans used to finance the projects.*

In order to improve debt management and avoid seasonal pressures in providing funding sources for the budget deficit and refinancing sources for the government public debt, and to reduce the refinancing risk and liquidity-related risk, consideration was given to preserve the foreign currency financial buffer of the State Treasury in an amount sufficient to cover around four months of budget deficit financing and public debt refinancing needs, as established in the preventive assistance agreement with IMF and EU.

[6] Japan Credit Rating Agency

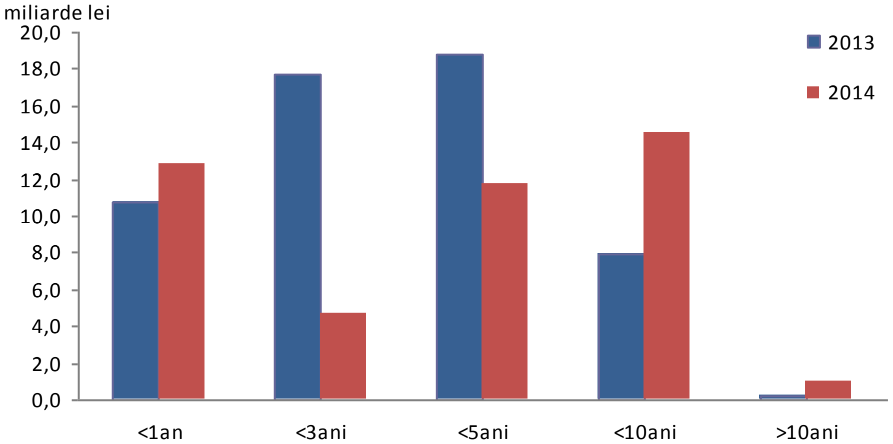
2.2. Domestic market of government securities

Primary Market

Under the economic and financial circumstances described above, the amount of government securities issued in 2014 in lei and euros on the primary market was 44.7 billion lei, and the following debt instruments were used:

- T-bills in lei with one year maturity in amount of 12.8 billion lei;
- benchmark bonds in lei with maturities of up to 15 years, in amount of 27.7 billion lei;
- government securities in euros, with maturities of five years in amount equivalent to 4.2 billion lei (928.7 million euros).

Chart no. 1: Composition of government securities in lei and euros, by maturities:



Source: MoPF

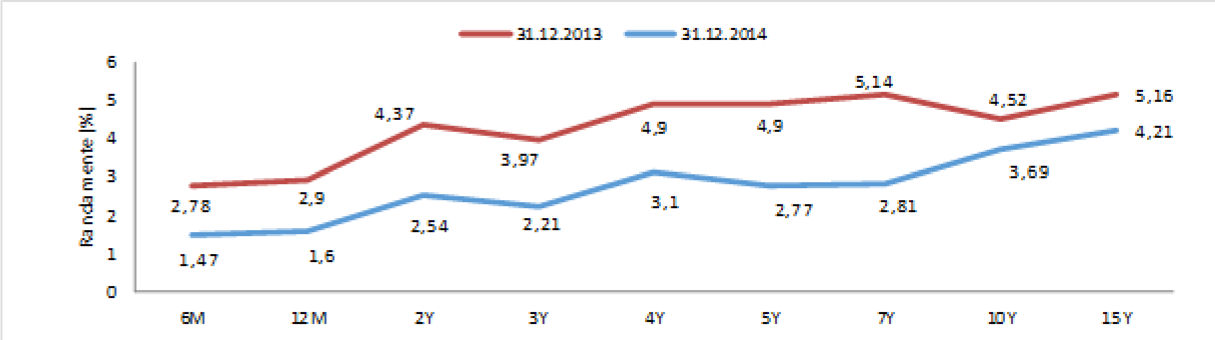
As shown in the above chart, MoPF continued its effort to extend the average maturity of government securities by increasing the share of medium and long term securities, which allowed an increase in the funds attracted on the maturity segment of over q0 years. Benchmark bonds denominated in lei with a maturity of five years and the new ones with 10 years maturity were issued and reopened almost every month.

In line with the financing plan in the first half of 014, MoPF issued 5 year government bonds in EUR, to help building the resources necessary to repurchase the government bond denominated in EUR maturing in May (in amount of 1.3 billion euros) and preserve the State Treasury foreign currency buffer at a comfortable level. [7] While these instruments allow extending the remaining maturity in the portfolio and taking advantage of some opportunity windows, MoPF medium term policy is to gradually do away with government securities issued in euros on the domestic market for the purpose of creating and consolidating the yield curve in lei, as required by the government public debt strategy for 2015 - 2017.

As reflected in the below chart, the interest rates for the short and medium term government securities trended more sharply down due to an increased supply on the respective maturity segments, below the monetary policy rate of the National Bank of Romania.

[7] The foreign currency buffer is needed to reduce the refinancing and liquidity risks, and the net interest paid for this buffer is a cost that is necessary to protect against any potential shocks.

Chart no. 2: Yields on the primary market at the end of 2013 compared to end of 2014



Source: MoPF

The reduced interest rates for short term securities due to a smaller supply on this maturity segment and the circumstances on the money market generated a higher cost for extending the average life of the domestic debt portfolio. The average remaining maturity of government securities issued on the domestic market increased to 3.0 years at the end of 2014, compared to 2.4 years at the end of 2013.

One key factor which added to the increase in the demand for government securities was the decision made by S&P to include Romania in the investment grade category, which resulted in the government bonds being counted, as of July 2014, among the regional reference indicators for the emerging markets. Thus, at the end of 2014, 9 series of Romanian government bonds were included in the GBI-EM Global Diversified Investment Grade, accounting for 2.52%, and 8 series of government bonds were included in the Barclays EM Local Currency Government index. The yield cut was significant for the securities issued in euros with a maturity of 5 years, with yields decreasing from the time of issuance in January 2014 by 173 basic points, to 1.345 % at the end of 2014.

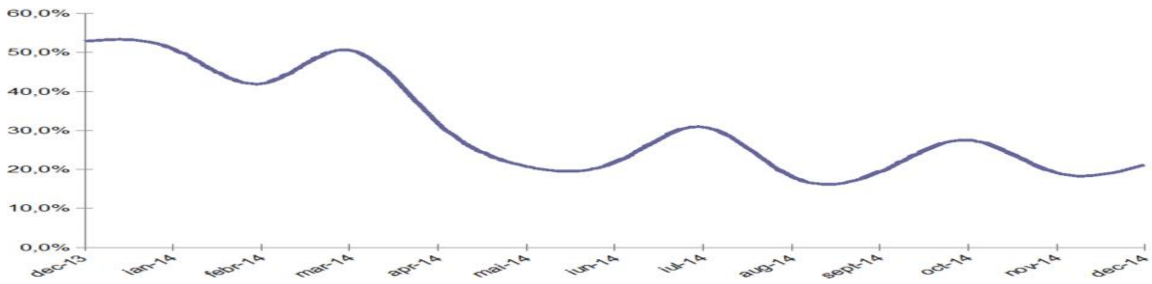
Secondary market

Unlike the robust performance on the primary market, the liquidity on the secondary market, which is an important indicator of the government securities market development, dropped in 204 and is at low levels compared to the international standards. The liquidity degree calculated as total amount of the government securities in total amount of monthly transactions conducted on the secondary market , dropped to 21.1 % in December 2014 from 52.8% at end-2013.

The low levels of the secondary market transactions with government securities could be reflection of external market factors such as expectations that the yields would go down as a result of the accommodative policy of the central bank and structural deficiencies such as fact of not using the secondary market instruments like repos and the that the State Treasury does not actively participate in operations such as repos, reverse repos, buy backs, bind exchange etc.

In order to improve liquidity and trading on the secondary market, the Ministry of Public Finance introduced, as of January 2013, in the Regulation 11/2012 regarding the primary market of government securities, with a focus on the secondary market activity assessment.

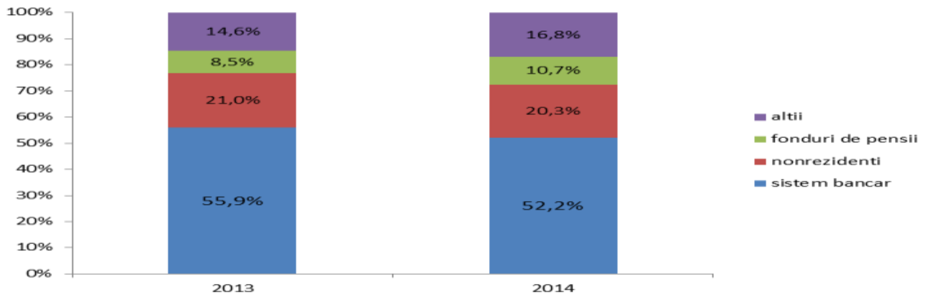
Chart no. 3: Evolution of the liquidity of government securities denominated in lei from December 2013 to December 2014.



Source: MoPF

At the end of 2014, the market of government securities continued to be dominated by commercial banks, which had in their portfolio 52.2% of the total amount of government securities issued on the market, followed by non-resident investor, with holdings of 20.3%, and the pension funds with 10.7%.

Chart no. 4: Evolution of government securities by types of investors



Source: NBR

The banks will probably continue to be the main investors for the State. The sustained demand of government securities coming from the commercial banks is generated by the decrease, in 2014, of the total stock of loans extended to the private sector after the outsourcing of non-performing loans, and the lending process is expected to gradually resume. The preferences of local investors focus in maturities of up to 7 years, marginally 10 years, especially in the case of the most liquid instruments included in the regional indicators.

2.3. Eurobonds and foreign loans contracted in 2014

Taking advantage of the opportunity window on the international capital markets, the Ministry of Public Finance issued in January 2014, under the Medium Term Notes Program, two series of bonds denominated in USD, with maturities of 10 to 30 years, in total aggregate amount of 2 billion. Hence, Romania borrowed 1 billion USD for 10 years and a 4.875% coupon (trending down compared to the previous year issuance) and 1 billion UD for 30 years (the longest maturity of a government security ever) and a 6.125% coupon.

In addition, in April 2014 MoPF issued Eurobond denominated in EUR with a 10-year maturity (the first time after the financial crisis) and extended the yield curve in EUR at the lowest cost ever for issuances of Eurobonds by Romania (yield 3.701% and coupon 3.625%).

In October 2014, MoPF issued Eurobonds denominated in EUR in amount of 1.5 billion, with a maturity of 10 years and a coupon of 2.875%.

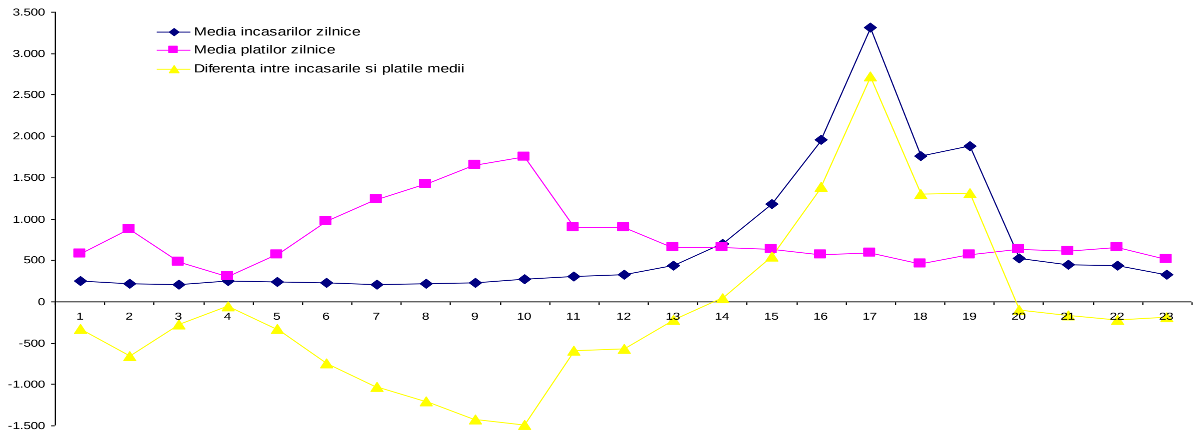
In addition, MoPF continued the partnership with the international financial institutions to benefit of the financial advantages of products issued by those institutions. In this case, the amount of 300 million Euros was drawn in June 2014, remained from the IBRD DPL DDO loan.

The amounts attracted were earmarked to finance the budget deficit, refinance the public debt and consolidate the financial buffer in foreign currency available to the State Treasury.

2.4. Cash management in 2014

The cash management operations meant to cover the temporary cash shortages during the year were used because of the gap between the collections and payments to/from the state treasury general current account, as shown in the chart below:

Chart no. 5: Average daily collections and payments during one month of 2014

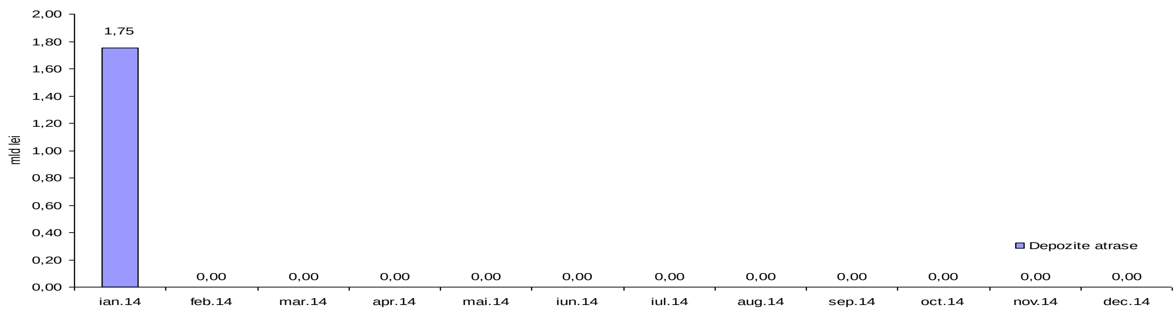


Source: MoPF

The temporary cash shortages of the state treasury general current account were covered through short term deposits attracted on the interbank market from the lending institutions and currency exchange operations.

In 2014, the deposits attracted from the interbank market lending institutions on a very short term (less than 2 weeks) amounted to 1.75 billion lei, with an average interest rate of 0.85%.

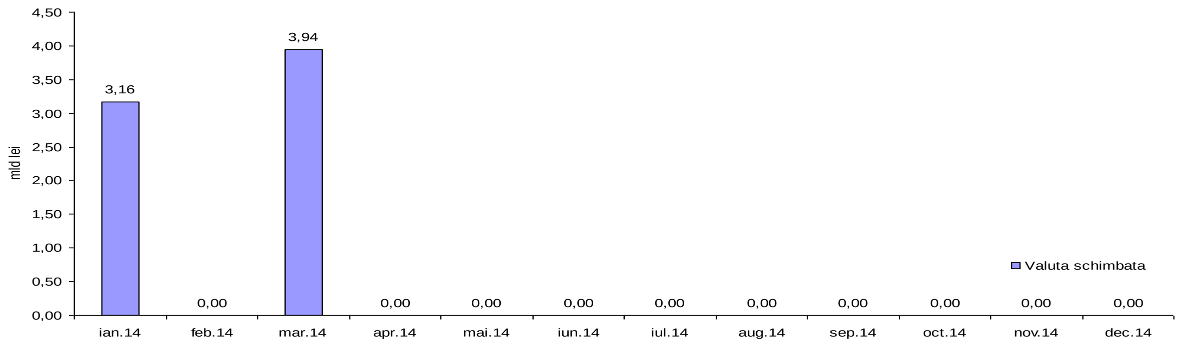
Chart no. 6: Evolution of deposits attracted in 2014 on the interbank money market



Source: MoPF

Fx operations were conducted for the drawings from foreign loans, for the issuances of government securities on the domestic market and the Eurobond issuances denominated in EUR and USD on the foreign capital markets.

Chart no. 7: The sale of foreign currency by the state Treasury for the purpose of financing the temporary shortages and finance/refinance the public debt, in 2014



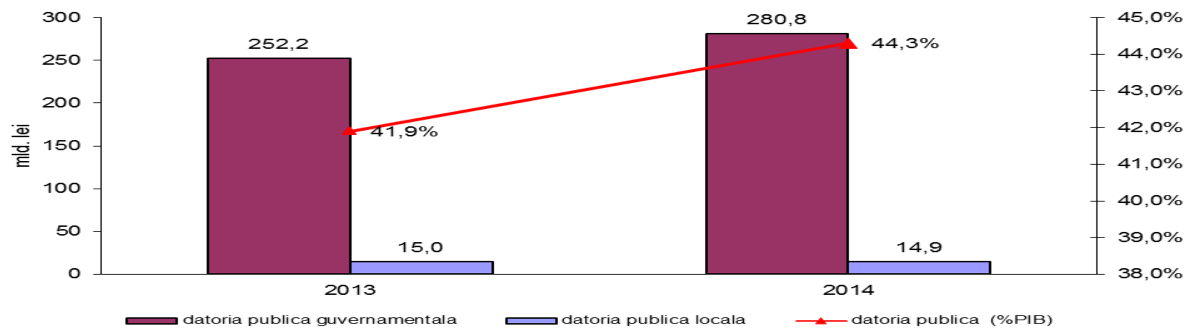
Source: MoPF

3. Government public debt portfolio analysis and assessment of risks associated to public debt

Under the circumstances of macroeconomic developments and the domestic and foreign financial markets, the public debt contracted in accordance with the provisions of the Government Emergency Ordinance no. 64/2007 on the public debt, as revised, amounted - on December 31 2014 - to 295.7 billion lei, of which the government public debt was 280.8 billion lei (which accounts for 95% of the total debt), while the local public debt amounted to 14.9 billion lei (accounting for 5% of the total debt).

The increase by 28.5 billion lei of the public debt in 2014 compared to 2013 was mainly triggered by the debt committed for financing the budget deficit and refinancing the government public debt, and for consolidating the foreign currency buffer of the State Treasury as well.

Chart no. 8: Evolution of the public debt



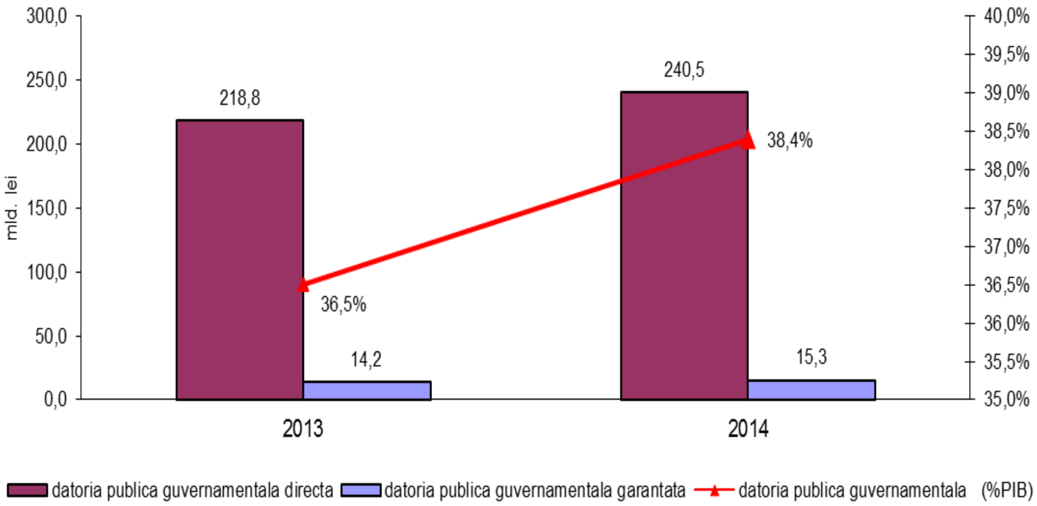
Source: MoPF

3.1. Government public debt portfolio and associated risks [8]

The government public debt on December 31 2014 amounted to 255.8 billion lei, accounting for 38.4% of GDP.

The direct government public debt continues to have the highest share of the total government public debt (36.1% of GDP), and it is trending up by 1.8% to GDP compared to the end of 2013, with the difference represented by the guaranteed debt. During 2014, the guaranteed debt increased and reached 15.3 billion lei at the end of the year, mostly due to the guarantees issued under the government programs.

Chart no. 9: Government public debt by type of debt



Source: MoPF

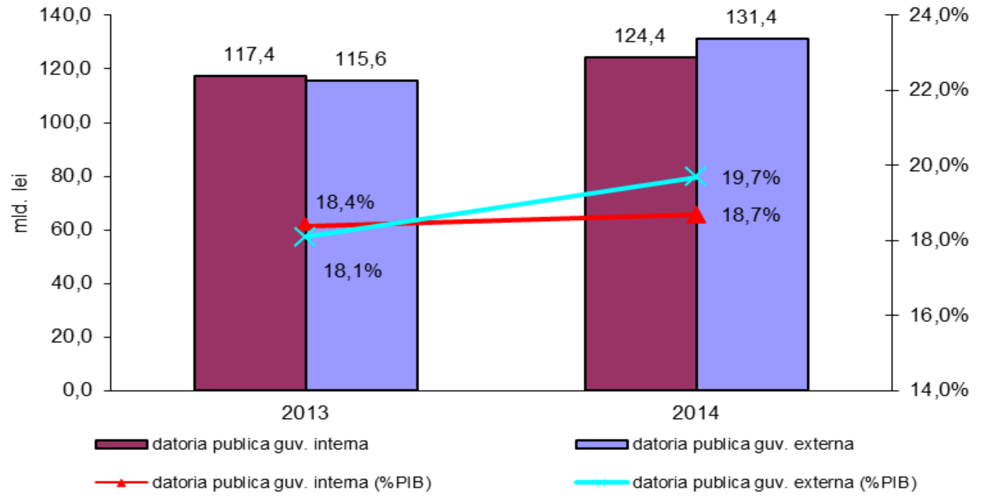
The government guarantees issued in 2014 amounted to 2.273.7 million lei, and were issued for the following government programs:

- the government program called "First House";
- the support program dedicated to beneficiaries of projects which are a priority for the Romanian economy, funded from EU structural instruments;
- the building thermal rehabilitation program funded from bank loans;
- the loan guarantee program dedicated to SMEs.

The debt was contracted 48.6% on the domestic market and 51.4% on the foreign market. Most of the domestic government public debt was contracted in the form of government securities, while the foreign debt was contracted as Eurobonds issued on the foreign capital market, foreign loans from official lenders and from commercial banks.

[8] Does not include the temporary financing

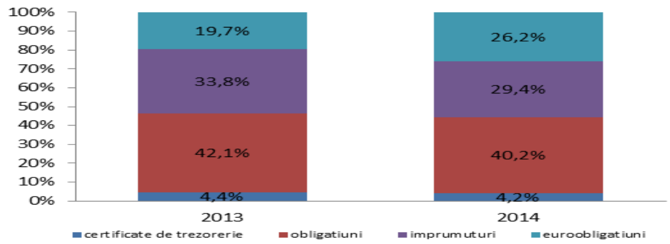
Chart no. 10: The government public debt, by the market on which the debt was issued



Source: MoPF

In 2014 MoPF continued the policy of issuing mainly negotiable debt instruments, therefore at the end of 2014 the share of government securities went up to 70.6% in total government public debt, from 66.2% at the end of 2013. In their turn, the short term government securities accounted for 4.2% in total government public debt, which pushed down the refinancing risk, the main risk in the government public debt portfolio.

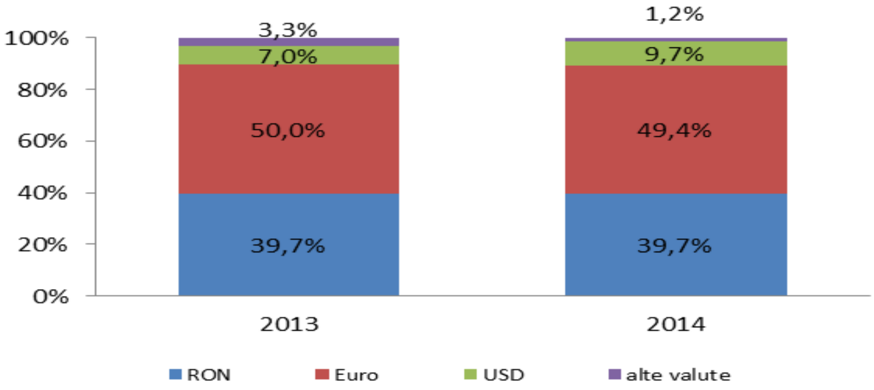
Chart no. 11: The government public debt by types of instruments
(% of government public debt)



Source: MoPF

At the end of 2014, the debt denominated in foreign currency accounted for 60.3% of the total portfolio, and most of it was in EUR (accounting for 81.8 of total foreign currency government debt). The high share of foreign currency debt in total government public debt resulted from the long term Eurobonds in both EUR and USD, intended to cut the refinancing risk and extend the remaining maturity of the debt portfolio.

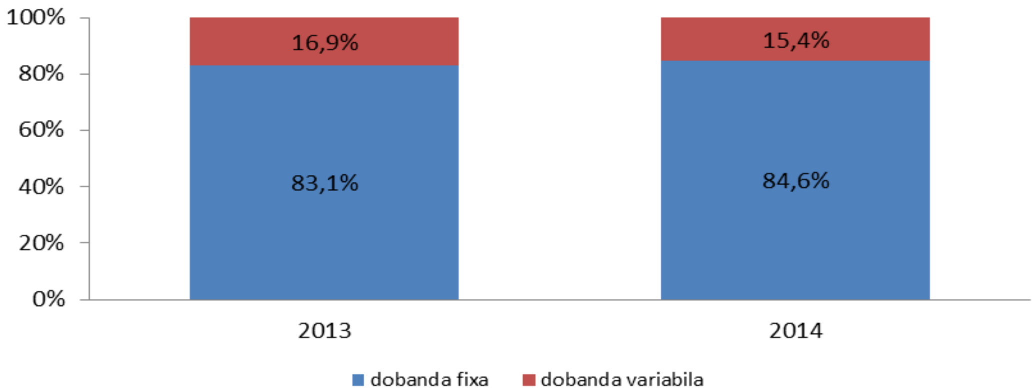
Chart no. 12: Government public debt by currency
(% of government public debt)



Source: MoPF

The policy of covering the financing needs especially through government securities was reflected by the government public debt composition by type of interest rate as well, so that the share of fixed rate borrowing went up from 83.1% at the end of 2013 to 84.6% at the end of 2014, mostly as a result of bonds issued on the domestic market and the Eurobonds issued on the foreign capital markets.

Chart no. 13: Government public debt by type of interest
(% of government public debt)



Source: MoPF

Government public debt servicing

The government public debt service in 2014 dropped by 8.6 billion lei; this can be seen in the table below:

bln lei

	2013	**2014**
Government public debt servicing of which:	66.1	57.5
- direct [9]	64.9	56.4
- guaranteed	1.2	1.1
Government public debt servicing of which:	66.1	57.5
- principal payments	55.8	47.9
- interest and fees	10.3	9.6

Other indicators[10] regarding the government public debt servicing:

	2013	2014
1. Foreign debt servicing /Export of goods and services[11]	4.7%	4.6%
2. Interest attached to the foreign government public debt /Export of goods and services [12]	1,5%	1.6%
3. Interest and fees/Revenues of the general government[13]	5.1 %	4.5%
4. Interest and fees /Expenditures of the general government[14]	4.8%	4.3%

3.2 The implementation of the government public debt management strategy in 2014 - 2016

The 2014 - 2016 debt management strategy was approved in March 2014 after consultations with the National Bank of Romania (in line with the provisions of GEO 64/2007 on the public debt, as revised) and in accordance with the best practices defined in the Guidelines of the World Bank and the International Monetary Fund regarding the public debt strategies.

The main objectives in the Strategy for 2014 are to:

1. provide the financing needs for the central public administration and the payment obligations, while minimizing the medium and long term costs,
2. confine the financial risks in the debt portfolio, especially by extenting the remaining average maturity, and
3. develop the domestic market of government securities,

At the same time, the underlying principles of the financing decisions in 2014 were expressed as indicative targets for the main risk indicators in the government public debt portfolio.

[9] Reimbursements made from borrowings from the State Treasury general current account balance and reimbursements on behalf of cash management instruments not included.

[10] Data regarding the general government expenditures and revenues are final, while for the indicators at points 1 and 2 we took into account the export of goods and services as published in the spring forecast of the National Prognosis Commission - May 2015.

[11] The indicator shows the extent to which the foreign government public debt servicing payments are covered from the collections from exported goods and services.

[12] The indicator shows the extent to which the interest payments for the foreign government public debt are covered from the collections from exported goods and services.

[13] The indicators shows the extent to which the interest and fees attached to the government public debt are covered from the revenues to the general consolidated budget.

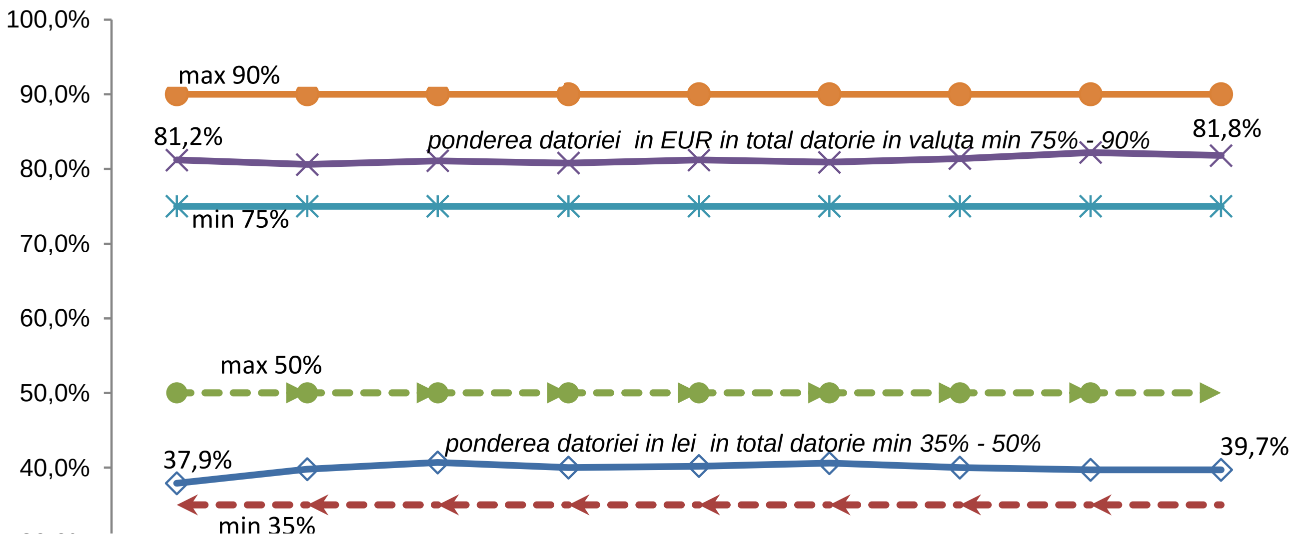
[14] This indicator shows the share of interest and fees payments attached to the government public debt in total expenditures of the general government.

Performance of risk indicators in April - December 2014

a. Currency risk indicators

The share of EUR-denominated debt in total foreign currency debt was above the minimum threshold set by the Strategy (please refer to Chart 14), as it increased from 81.2% in April to 81.8% in December 2014 after foreign currency debt was contracted from external sources, mainly through Eurobond issuances on the international capital markets, but also due a disbursement of 300 million Euros balance of the IBRD DPL DDO loan, meant to extend the average remaining maturity of the debt portfolio and, implicitly, to reduce the refinancing risk, but also to consolidate the foreign currency buffer of the State Treasury. In addition, the lei-denominated debt in total government public debt remained within the band set in the Strategy throughout the year (going up from 37.9% in April to 39.7% in December 2014) after the issuance of benchmark bonds with medium and long term maturities.

Chart no. 14: Performance of foreign currency risk indicators

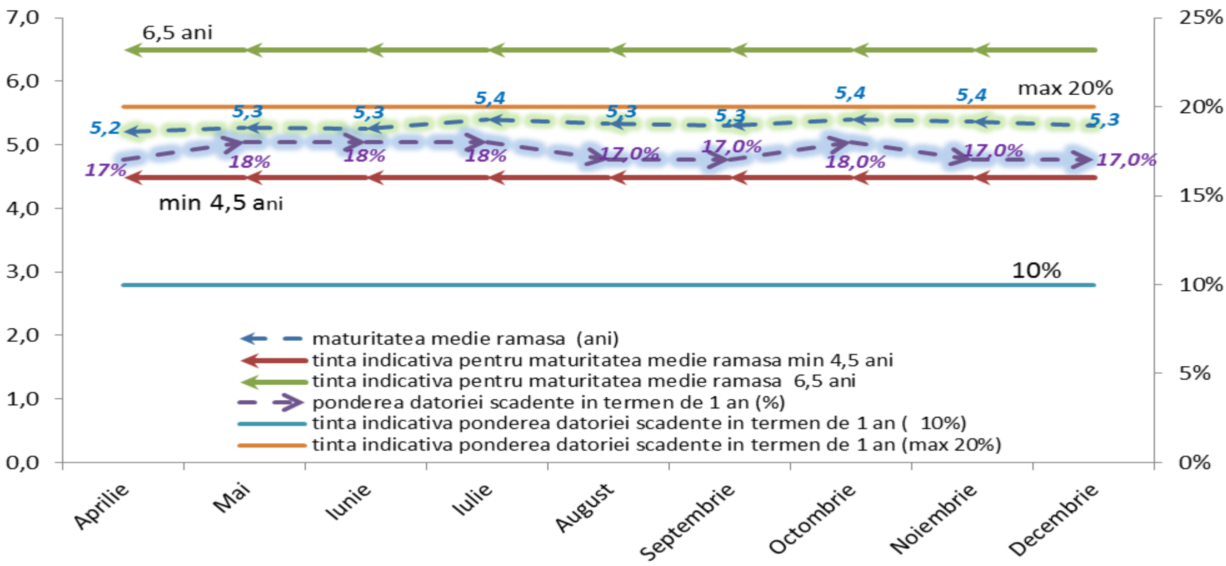


Source: MoPF

b. Refinancing risk indicators

Compared to the end of 2013, the average maturity of the government public debt portfolio raised constantly, to reach 5.3 years at end-2014, mainly on the back of long term foreign currency loans. The share of debt maturing in less than one year remained relatively constant in 2014 and arrived at 17% at end-2014, thus remaining within the band set in the Strategy.

Chart no. 15: Performance of refinancing risk indicators in respect of the total government public debt

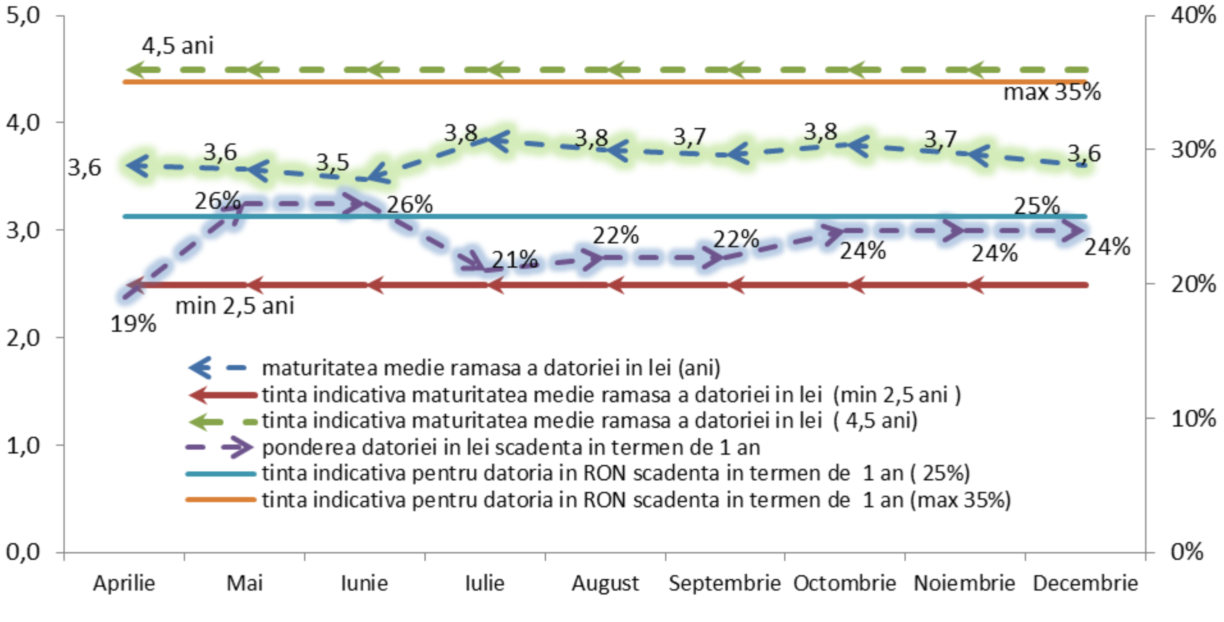


Source: MoPF

While showing difficulties in extending the maturity of government securities in H1, the refinancing risk indicators of the lei-denominated debt remained within the indicative targets set in the Strategy. Thus, the average remaining maturity of the debt in lei arrived at 3.6 years at end-year, and the share of the debt in lei maturing in less than one year was 24%, below the minimum set in the Strategy (25%).

The refinancing risk indicators improved especially because of the lower amount of T-bills issued in 2014 compared to previous years, at the same time with an increase in the medium and long term government securities.

Chart no. 16: Performance of refinancing risk indicators in respect of the lei-denominated debt



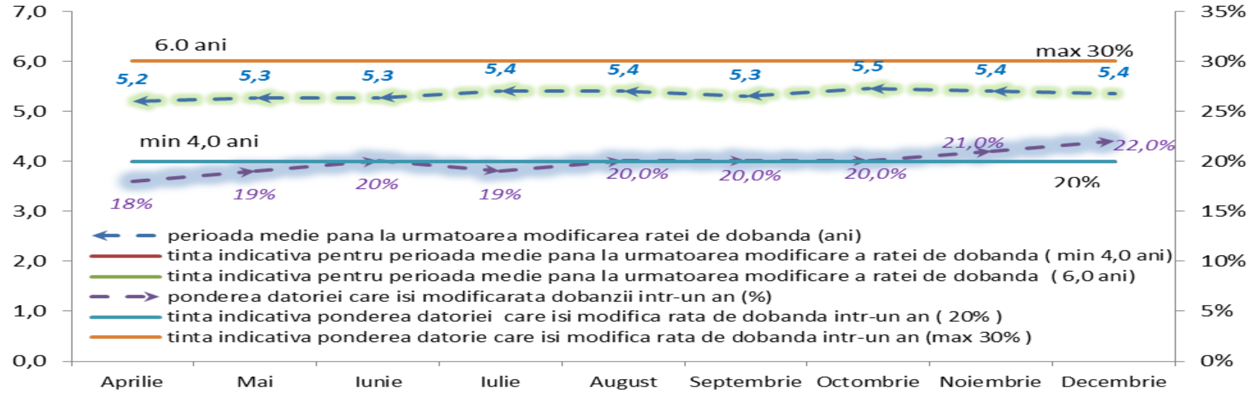
Source: MoPF

c. Performance of interest risk indicators

The chart below shows how performing the debt management was in respect of the interest rate risk exposure.

The indicators attached to the whole government public debt remained relatively flat throughout the year, remaining within the boundaries set in the Strategy. Hence, at the end of 2014, the average time to the next refixing date was 5.4 years, with the share of debt for which the interest rate is refixed in one year at 22%.

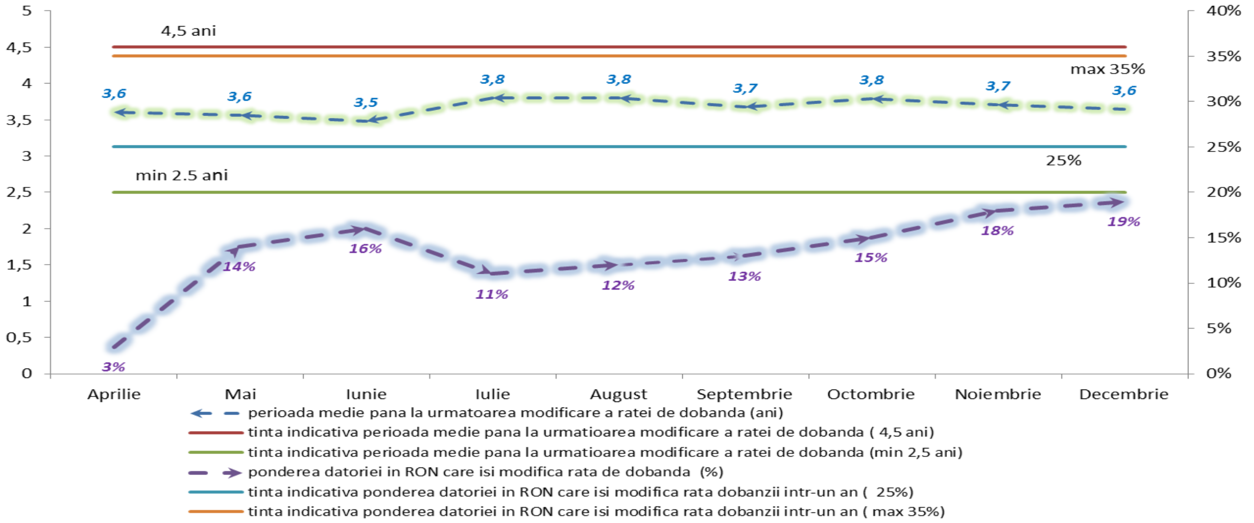
Chart no. 17: Performance of interest rate risk indicators in respect of total debt



Source: MoPF

The interest rate risk for the domestic currency indebtedness indicators remained relatively flat in the course of the year. Hence, the share of lei-denominated debt for which the interest rates floats in the course of one year was 19% at the end of 2014, below the Strategy threshold of 25%.

Chart no. 18: Performance of interest rate indicators for the lei-denominated debt



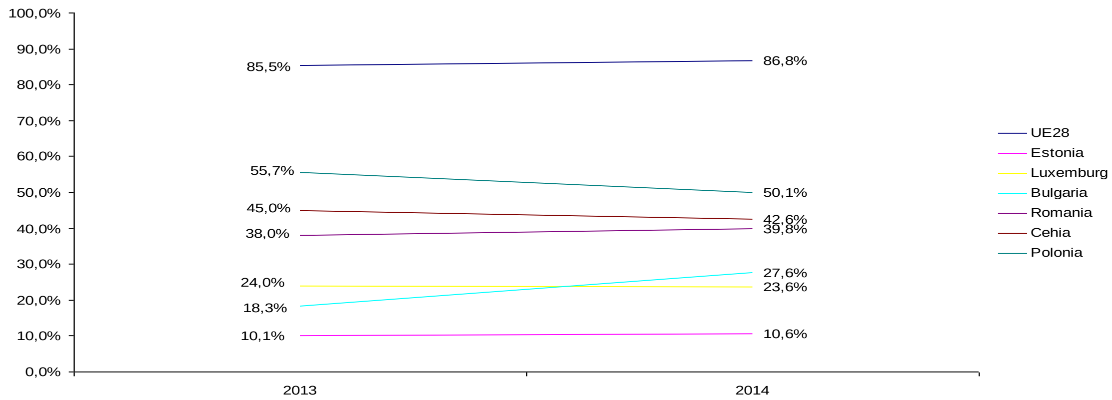
Source: MoPF

4. ***Government Debt according to EU methodology***

With respect to the government debt according to EU methodology at the end of 2014, the gross government debt [15] remained at a sustainable level (39.8% of GDP), below the Maastricht Treaty 60% threshold, and if we take into account the liquid financial assets[16], the net debt amounted to 31.4% of GDP.

Romania ranked fourth in the group of EU Member States with the lowest indebtedness level at the end of 2014[17], after Estonia (10.6%), Luxembourg (23.6%) and Bulgaria (27.6%).

Chart no. 19: EU 28 comparative review (% of government debt to GDP)



Source: Eurostat

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PUBLIC FINANCE MINISTER

[15] This is the debt of the public administration at nominal value, consolidated at the level of sub-sectors of the public administration; it does not include the guarantees issued by the central government and local governments, except for those paid from the budget, or the guarantees on behalf of which 3 successive payments were made by the guarantor.

[16] FA1 (gold and SDR), FA2 (deposits and cash), FA3 (securities, other than shares), FA5 (shares and participation to capital, if listed, including units of mutual funds).

[17] Source:Eurostat newsrelease euroindicators 75/2015 - 21 April 2015