Ministry of Public Finance

Report on Government Public Debt

December 31, 2015

General Directorate of Treasury and Public Debt

Contents:

1. *Evolutions of the Romanian economy in 2015*

In 2015, *economic growth* in Romania continued the positive tendency started in 2011, the economy advancing by 3.8% on the basis of the domestic demand for investments and consumption, thus recording one of the biggest annual economic growths in the EU.

The disinflation process continued in 2015, as of June recording even negative inflation, as a result of the decrease by 15 percentage points of the VAT rate for food products and public catering services, so that at the end of 2015 this indicator was of -0.93%.

In 2015, *the current account of the payment balance* registered a deficit 2.7 times bigger than the one of 2014, reaching a weight of the GDP of 1.1%. The financing of the current account deficit was made entirely through foreign direct investments, which reached the value of EUR 3 billion and were bigger by approximately 25% compared to 2014.

Table 1: Macroeconomic indicators

Indicators	2014	2015
GDP - billion lei - real growth, %	 667.6 3.0	 712.8 3.8
Current account balance (% of the GDP)	-0.5	-1.1
Consumer price index (CPI) - end of year - annual average	 0.83 1.07	 -0.93 -0.59
Average exchange rate - Lei/EUR - Lei/USD	 4.4446 3.3492	 4.4450 4.0057

Source: NCP (Projection of the main macroeconomic indicators for 2016-2019 for the Convergence Program - April 2016)

The deficit of the general consolidated budget in cash terms in 2015 was of 1.4% of the GDP, while the budget deficit calculated in accordance with the EU methodology (ESA2010) was of 0.7% of the GDP. Due to the relatively low budget deficits, the necessary gross financing was determined mainly by the volume of refinancing of Government public debt, as presented in the table below:

Table 2: Necessary financing

Indicator	2014	2015
Revenues of the central public administration[1] (billion lei)	165.9	170.2
Expenses of the central public administration[2] (billion lei)	179.5	182.8
Budget deficit of the central public administration[3] (I) (billion lei)	13.6	12.6
Refinancing of the Government public debt[4] (II) (billion lei)	48.0	49.7
Necessary gross financing (I+II) (billion lei)	61.6	62.3

Source: MPF

[1] Calculated in accordance with the cash methodology through the application of the EU methodology
[2] Idem 2
[3] Idem 2
[4] The volume of reimbursements of capital rates and refinancing of Government securities on account of the Government public debt, in accordance with the national legislation, calculated on the basis of the debt balance at the end of 2015 (includes guarantees, but does not include temporary financing).

The risk assessments of the *rating agencies* confirmed the positive evolutions of the general economic framework, with a focus on the efforts in the process of fiscal-budgetary consolidation and sustained economic growth, including by comparison with other countries from the region with the same rating. Thus, in April 2015, the rating agency JCRA improved the perspective from stable to positive for the rating given to Romania's Government debt on the long term in foreign currency and local currency, BBB-/BBB, and in December Moody's improved the perspective of the rating Baa3 given to Romania from "stable" to "positive" based on the positive evolutions in the process of fiscal consolidation and reduction of vulnerability to external shocks. In 2015, both the Fitch agency, and Standard & Poor's, reconfirmed the rating that corresponded to Romania's Government public debt on long-term, in foreign currency and local currency, to BBB-/BBB, with stable perspective, and to BBB-A-3.

2. Strategy of financing of the budget deficit and of refinancing of the Government public debt in 2015

2.1. Financing budget deficit

Financing budget deficit in 2015 was mainly made from domestic sources (93%) and external sources for completion. The sources necessary for the refinancing of Government public debt were ensured from the markets where these debts were issued and from the financial reserve in foreign currency available to the State Treasury, which was of 5.9 billion EUR at the end of 2015, representing 3.7% of the GDP.

The debt instruments used to finance the budget deficit and refinance public debt were:

a) issuances of Government securities in Lei and Treasury certificates with discount and benchmark bonds on the domestic market, with medium and long term maturities, of up to 15 years.

for the purpose of fulfilling the objective of development of the domestic market of Government securities and for building and strengthening the yield curve of Government securities on the domestic market, in 2015 were issued on a regular basis Government securities of lei 36.4 billion.

b) issuances of Eurobonds in EUR on the international capital markets

In 2015, the MPF attracted from the foreign markets a volume of 2 billion EUR through an issuance in October in two installments within the MTN Program, with maturities of 10 years (EUR 1.25 billion) and, respectively 20 years (EUR 750 million). This issuance received a lot of interest from the investors, reaching a degree of over-subscription of over 2 times and a number of approximately 460 investors. In addition, for 10 years maturities Romania obtained the lowest premium of issuance of 5 base points, compared to the other sovereign issuers in the CEE area during that period.

c) *entries of external loans* of 1.05 billion EUR that corresponded to the loans contracted from international financial institutions, including the DPL loan from the IBRD of 750 million EUR.

d) *domestic and external loans contracted by the local public administration authorities, including the issuances of securities launched on the domestic market by these authorities.*

For the purpose of improving the management of public debt and avoiding seasonal pressures in the assurance of financing sources for the budget deficit and of refinancing of the Government public debt, in order to reduce the refinancing risk and liquidity risk, it was considered to maintain the financial buffer in foreign currency available to the State Treasury at the value equivalent for the coverage of the financing needs of the budget deficit and the refinancing of the public debt for about 4 months.

2.2. Domestic securities market

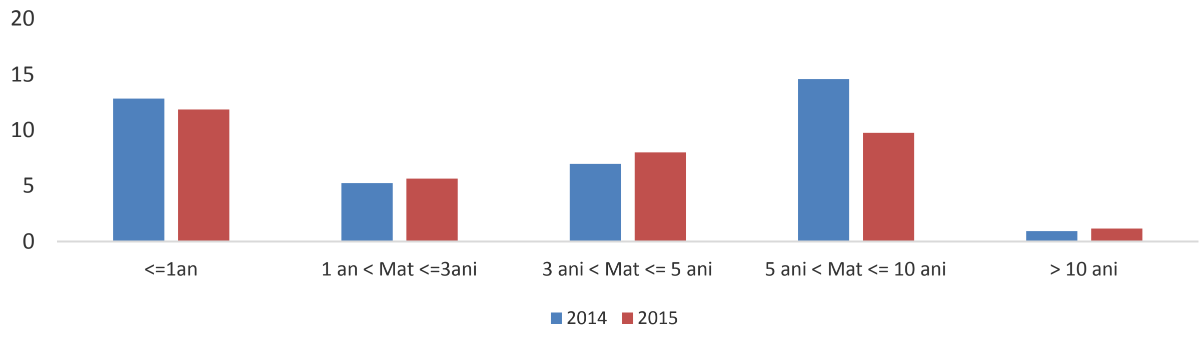
Primary market

In 2015, the MPF continued the efforts for extension of the average maturity of government securities, but on the background of a period of volatility on the international markets (for example, the tensions in Greece), long-term government securities were issued in a lower volume compared to 2014, as a result of the reduction of the non-resident investors for these maturities, as well as of the cautious investment strategy of the local institutional investors. The NBR gradually reduced the monetary policy rate, from a level of 2.75% in December 2014, to 1.75% in May 2015. Thus, the interest rates of short and medium-term Government securities registered a more accentuated decrease, on the basis of a bigger offer on these maturity segments, below the level of the monetary policy interest rate of the NBR for maturities below 2 years, in the framework of maintenance of a surplus of liquidity on the domestic market. The yield curve became more abrupt on the medium and long term segment, presenting investment opportunities for non-resident investors.

In the economic and financial framework presented above, the volume of government securities issued in lei on the primary market in 2015 was of 36.4 billion lei, through the use of the following debt instruments:

- Treasury certificates in lei, with a maturity of up to 1 year, of lei 11.8 billion,
- Benchmark bonds in lei, with a maturity of up to 15 years, of lei 24.6 billion.

Graph 1: Structure of the government securities in lei according to initial maturity (billion lei)

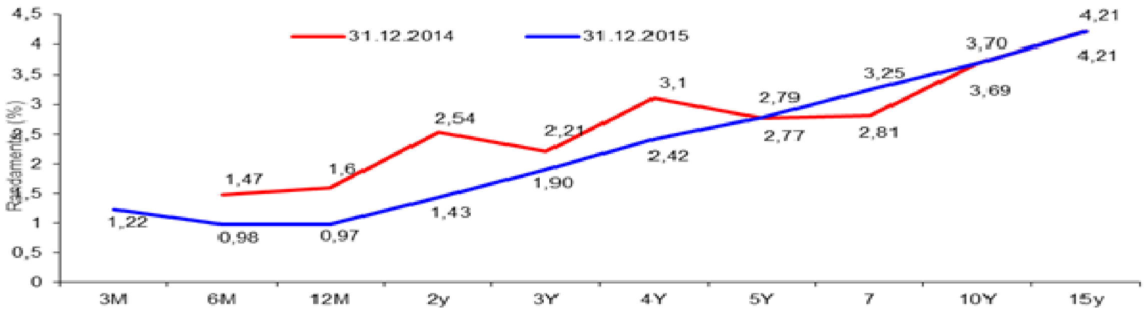


Source: MPF

As shown by the graph above, the biggest part of the issuances was focused on the segment of short and medium maturities. Government securities of benchmark type denominated in lei with maturities of 3, 5, and 7 years were issued and reopened almost every month.

The average term left for the government securities issued on the domestic market was of 3.0 years at the end of 2015, as well as at the end of 2014.

Graph 2: Yields on the primary market at the end of 2014 vs. the end of 2015

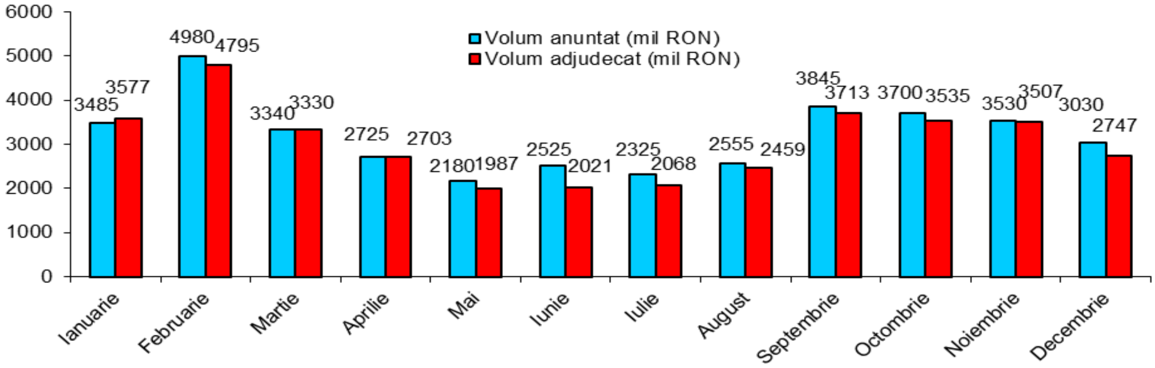


Source: MPF

The presence of Romanian Government securities in the JPM Morgan and Barclays indexes continues to have a positive influence on the local market and the increase of investors' interest. At the end of 2015, 9 series of Romanian government securities were included in the GBI-EM Global Diversified Investment Grade Index, with a weight of approximately 3.49% and 12 series of government securities in Barclays EM Local Currency Government Index, with a weight of 1.26%.

Also, the efforts of maintenance of a predictable policy of issuances were continued, in most auctions the amounts announced being fully adjudicated (graph 3), with the exception of certain periods of volatility, when the adjudicated volume was affected by temporary price variations, at long-term issuances being possible to adjudicate superior volumes to those announced, in order to benefit of windows of opportunity in the framework of a high level of demand and considering the objective of extending the medium residual maturity.

Graph 3: Announced volume vs. adjudicated volume

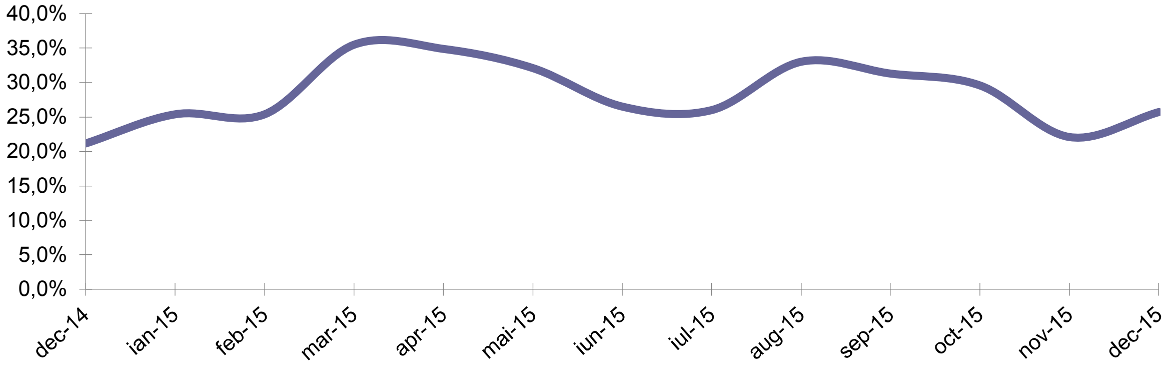


Source: MPF

Secondary market

Liquidity on the secondary market, which is an important indicator related to the level of development of the Government securities' market, has increased in 2015, but is still at low levels compared to international standards. The degree of liquidity calculated as ratio between the total volume of monthly transactions on the secondary market and the total volume of government securities has increased to 25.7% at the end of 2015, compared to 21.1% at the end of 2014. Also, it has been noted during the year a decrease of the sale-purchase margin at quotations on the secondary market of government securities (bid-ask spread) on average of 5 base points[5], which indicates an improvement in the liquidity of government securities.

Graph 4: Evolution of the degree of liquidity of government securities in lei assets between December 2014 and December 2015



Source: MPF

The low levels of the transactions on the secondary market of government securities could reflect factors of the market, like the expectations of reduction of yields due to the accommodating policy of the NBR, but also to structural efficiencies, like the absence of secondary market instruments of the type of repo operations and the absence of the MPF's

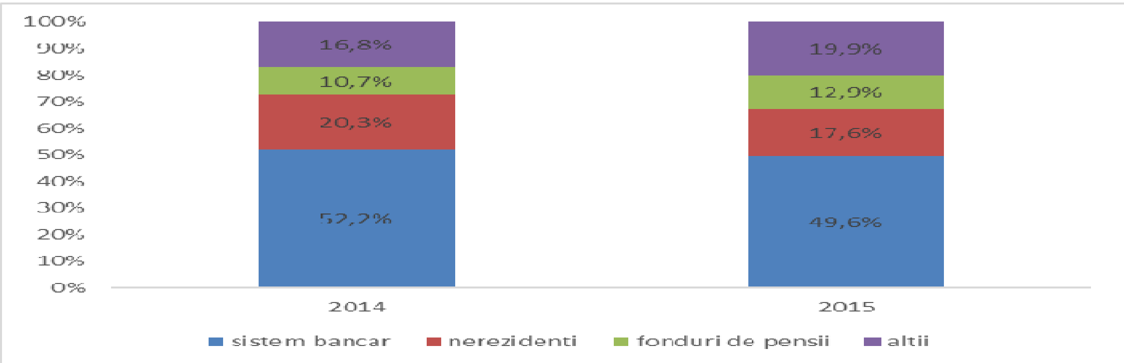
[5] Based on the sale-purchase quotations at the end of the day supplied by Bloomberg

active participation to operations of the type of repo, reverse repo, buy backs, bond exchange or the weak development of the market of swaps, especially for medium and long maturities.

For the purpose of increasing transparency in the formation of prices for government securities on the secondary market, as of May 2015 it has become operational the electronic platform of quotation and trading of government securities, which is dedicated to primary dealers, and the effective implementation thereof through the monitoring of the minimum mandatory conditions of quotation shall be made after completing and harmonizing the legislative and procedural framework of the primary market.

At the end of 2015, the market of government securities continued to be dominated by commercial banks, which had in their portfolios 49.6% of the total volume of government securities issued on the market, followed by non-resident investors, whose holdings represented 17.6%, while pension funds had a share of 12.9%.

Graph 5: Evolution of the government securities according to the type of holders



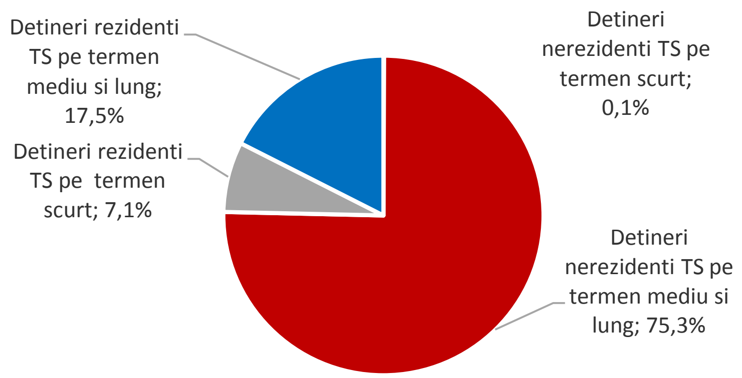
Source: NBR

In the framework of a moderate advance of the crediting activity in 2015 on the part of financial institutions, the main investors on the domestic market were commercial banks. The preference of local investors was focused on maturities of up to 7 years, and marginally up to 10 years, especially in the case of the most liquid instruments included in the regional indexes.

In the segment of institutional investors, local funds of administration of assets and private pension funds, although they hold a relatively low share on the market of government securities, represent a significant potential of support of the local market's development in the following period. The total net assets held by private pension funds have known a significant increase, from 10.2 billion lei at the end of 2012 to 25.9 billion lei at the end of 2015 (pillar II + III). Seen in structure, the assets of privately administered pension funds were invested to a large extent in government securities, approximately 17 billion lei at the end of 2015.

Non-resident investors represent an important segment of investors in government securities, ensuring a complementary demand to the demand coming from the local investors, due to the interest for long maturities.

Graph 6: Structure of holdings of resident and non-resident investors at the end of 2015



Source: NBR

In 2015, the holdings of government securities of non-residents were slightly below the level of 2014, the evolution remaining at a constant level throughout the entire year 2015, at approximately 18-20%, but below the level registered in comparable countries (like, for example, Poland and Hungary).

2.3. Issuances of Eurobonds and external loans contracted in 2015

Based on a climate of revival from the crisis of European sovereign debts and on a period of calm on financial markets, the financing conditions in Romania have significantly improved. The good economic performance, especially in the tax sector, the maintenance of Romanian bonds within the reference indexes of emerging markets, i.e. Barclays and JP Morgan, have contributed to improving the rating perspective to “positive” by Moody’s and have favored the improvement of the investors’ feelings towards Romania, which has led to the reduction of financing costs on the external markets, to the extension of maturities and to the diversification of the investor base.

Interest rates for Government bonds denominated in foreign currency have had a volatile evolution in 2015, caused by the evolution of interest rates in the EU, by the perception of investors with regard to the evolution of divergent policies of the EDF (expectations of increase of reference rates) and of ECB (policy of maintenance of quantitative relaxation measures) and by the tensions generated by Greece’s situation. Eurobonds denominated in EUR have had higher performances, and those denominated in USD have been traded in line with market tendencies, being attractive for the investment environment, because they still offer higher performances relative to comparable countries.

Thus, in the first months of 2015, the performances of Eurobonds issued by Romania on the external market followed an accentuated descending trend, with a minimum of performances in March. Then, the level thereof deteriorated, due to the tensions in Greece, based on the difficulties in reimbursing the payment obligations towards the IMF, and once with the conclusion of an agreement with Greece's multilateral creditors, the volatility of the financial markets reduced, the performances and credit margins recovering in the framework of the expectations of investors of the EDF increasing the level of interest rates, which was confirmed in December by the meeting of FOMC (Federal Open Market Committee), when the monetary policy rate was increased by a quarter of percentage point.

In 2015, the MPF attracted from the foreign markets a volume of 2 billion EUR through an issuance in October in two installments within the MTN Program, with maturities of 10 years (EUR 1.25 billion) and, respectively 20 years (EUR 750 million). This issuance received a lot of interest from the investors, reaching a degree of over-subscription of over 2 times and a number of approximately 460 investors. In addition, for 10 years maturities Romania obtained the lowest premium of issuance of 5 base points, compared to the other sovereign issuers in the CEE area during that period.

In addition, the MPF continued its partnership with the international financial institutions (IFIs), in order to benefit of the financial advantages of their products. Thus, the operations from the external market included drawings of EUR 1.05 billion corresponding to the loans contracted from IFIs, mainly as a result of contracting a loan of DPL type from the World Bank in June, of EUR 750 million.

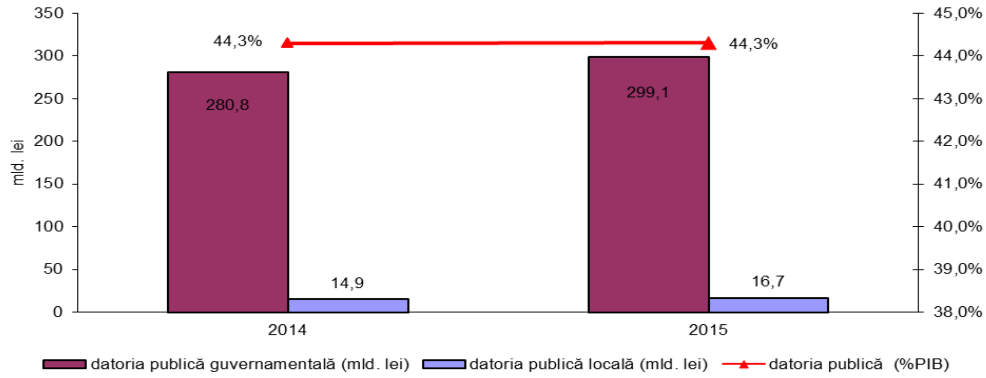
The amounts that were attracted were dedicated to financing the budget deficit, refinancing public debt and strengthening the financial reserve (buffer) in foreign currency available to the State Treasury.

3. Analysis of the Government public debt portfolio and of the risks associated to this debt

In the framework of the macroeconomic evolutions and of the domestic and foreign markets, public debt contracted in accordance with the provisions of Government Emergency Ordinance no. 64/2007 on public debt, as subsequently amended and supplemented, was at December 31, 2015 of lei 315.8 billion, of which government public debt of lei 299.1 billion (representing 94.7% of the total public debt), while the local public debt was of lei 16.7 (representing 5.3% of the total public debt).

The increase of public debt in 2015 compared to 2014 by 20.1 billion lei was mainly caused by the debt contracted to cover the financing needs of the budget deficit and the refinancing of government public debt, but also to refinance the government public debt, as well as to consolidate the financial reserve in foreign currency available to the State Treasury.

Graph 8: Evolution of the public debt



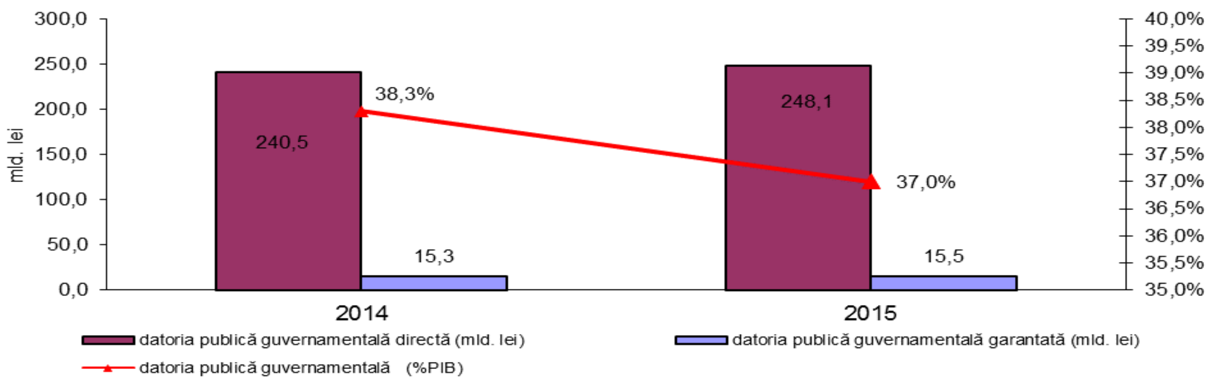
Source: MPF

3.1. Government public debt portfolio and risks associated thereto [6]

Government public debt at December 31, 2015 was of lei 263.6 billion, representing 37.0% of the GDP.

The biggest share of the total government public debt continues to be represented by direct government public debt (34.8% of the GDP), decreasing by 1.2 percentage points compared to the end of 2014, the difference being represented by secured government public debt. In 2015, the secured government public debt remained at relatively the same level, as a result of the guarantees granted within the Government programs.

Graph 9: Government public debt according to the debt type



Source: MPF

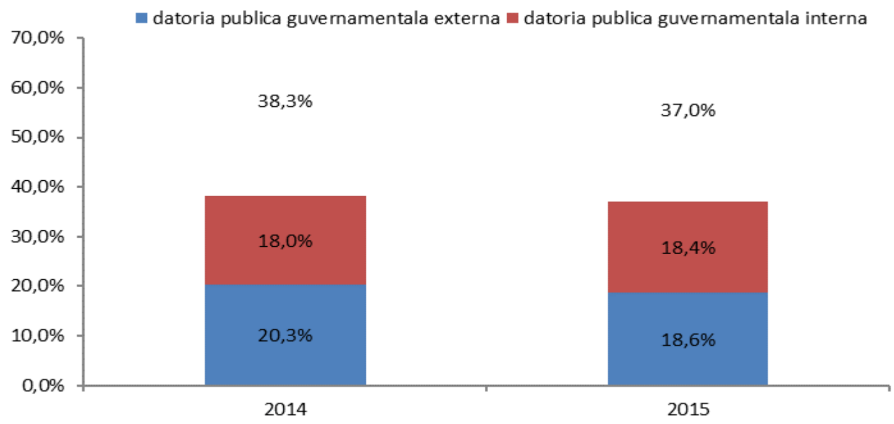
[6] Does not include temporary financing

The State guarantees given in 2015 were of lei 2,985.1 million, for the following government programs:

- the government program “First Home”;
- the program of thermal rehabilitation of residential buildings with financing through bank loans;
- the program of guarantee of loans for small and medium enterprises;
- the program of stimulation of the purchase of new motor vehicles.

Of the existing government public debt at the end of 2015, 49.8% was *debt contracted by resident creditors* and 50.2% by non-resident creditors. Most of the *domestic government public debt* was represented by Government securities, while the external debt was made up of Eurobonds issued on the international capital markets and external loans contracted from official creditors and commercial banks.

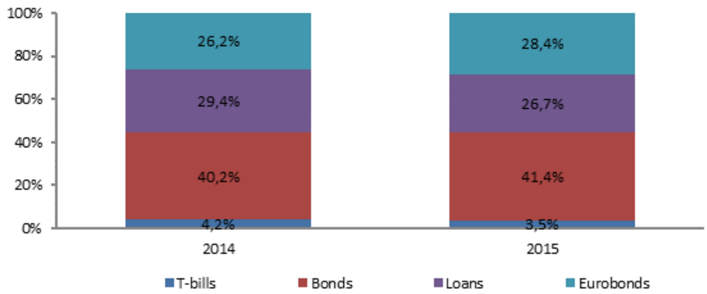
Graph 10: Government public debt according to the criteria of the creditor’s residency (% of the GDP)



Source: MPF

In 2015 as well, the MPF continued the policy of mainly issuing *negotiable debt instruments*, so that at the end of 2015 the share of government securities increased to 73.3% of the total government public debt, compared to 70.6% at the end of 2014. With regard to short-term government securities, they represented 3.5% of the total government public debt, which caused a decrease of refinancing risk, the main risk associated with the government public debt portfolio.

Graph 11: Structure on types of government public debt instruments
(% of government public debt)



Source: MPF

Government public debt service

Government public debt service of 2015 increased by 1.3 billion lei, as results from the table below:

billion lei

	2014	2015
Government public debt service of which: - direct [7] - secured	 57.6 56.5 1.1	 58.9 56.3 2.6
Government public debt service of which: - capital rates - interests and commissions	 57.6 48.0 9.6	 58.9 49.7 9.2

Other indicators[8] *about government public debt service* are as follows:

	2014	2015
1. External government public debt service /Export of goods and services[9]	4.6%	7.6%
2. Interests that correspond to the external government public debt/Export of goods and services[10]	1.6%	1.7%
3. Interests and commissions/ Revenues of the general consolidated budget[11]	4.5%	3.9%
4. Interests and commissions/ Expenses of the general consolidated budget[12]	4.3%	3.8%

[7] Does not include the reimbursements from loans from the available funds of the general current account of the State Treasury and those from the account of cash management instruments.
[8] The expenses and revenues of the general consolidated budget are definitive data, and for the indicators under points 1 and 2 it was considered the export of goods and services published in the spring prognosis of the National Commission of Prognosis of 2016-2019 for the Convergence Program - April 2016.
[9] The indicator shows the extent to which the payments in the account of external government public debt service are covered from the collections from export of goods and services.
[10] The indicator shows the extent to which the cost for the interest related to the external government public debt is covered from the collections from export of goods and services.
[11] The indicator shows the extent to which the interests and commissions that correspond to the government public debt are covered by the revenues of the general consolidated budget.
[12] The indicator represents the weight of the payments of interests and commissions that correspond to the government public debt in the total expenses of the general consolidated budget.

3.2. Implementation of the Strategy of administration of the Government public debt for 2015-2017

In March 2015 was approved the **Strategy of administration of the government public debt for the period of 2015-2017 (Strategy),** elaborated in consultation with the NBR (according to the provisions of the GEO no. 64/2007 on public debt, as subsequently amended and supplemented), and in accordance with the good practices defined in the Guidelines of the World Bank and of the International Monetary Fund, related to the elaboration of public debt strategies.

The main objectives set through the Strategy for 2015 were:

1. Provide the funding needs of the central government and for the payment of obligations, at the same time with minimizing the medium and long term debt costs,
2. Limit the financial risks of the government public debt portfolio, and
3. Develop the domestic market for government securities.

At the same time, the principles that form the basis of the financing decisions of 2015 were expressed as indicative target intervals[13] for the main risk indicators associated with the government public debt portfolio.

Performance of the risk indicators in 2015 [14]

a. Evolution of currency risk indicators

Although in the first three months of 2015 *the indicator of weight of government public debt in EUR in the total government public debt in foreign currency* was within the interval set through the strategy, after this period this indicator was slightly below the minimum indicative target set, as a result of the postponement of the plan of issuances of Eurobonds on the external capital markets, due to certain difficulties caused by certain requests for garnishment of the amounts that were paid or collected by Romania through accounts opened with different financial institutions from abroad (see the Micula case). The accessing of external markets was made only towards the end of the year, in the external framework marked by increased volatility, based on the tensions generated by the institutional difficulties in reimbursing the payment liabilities of Greece corresponding to the loans from the IMF, as well as the uncertainties related to the political, economic and financial situation of Greece in the framework of the absence of an agreement with the international creditors.

Nevertheless, as of October *the weight of the government public debt in EUR in the total government public debt in foreign currency* observed the target interval set through the

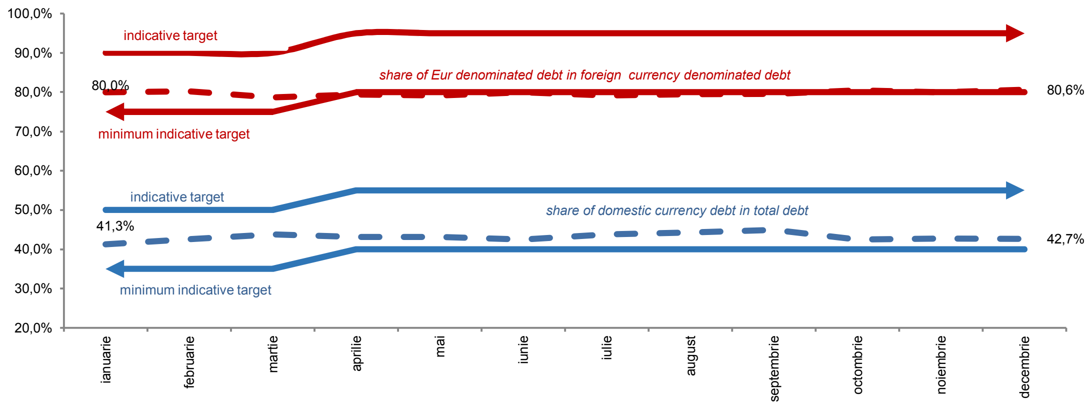
[13] The limit mentioned as minimum or maximum cannot be exceeded in the period covered by the strategy (hard bound), while the other limit is the limit towards which the tendency is and which can be exceeded (soft bound)

[14] For the period of January - March 2015 were considered the indicative targets set through the Strategy of administration of the government public debt for the period of 2014-2016

Strategy. At the end of December 2015 this indicator was of 80.6%, due to the contracting of debt in foreign currency from external loans, namely the issuances of Eurobonds on the international capital markets, but also the drawings of EUR 1.05 billion that corresponded to the loans contracted from IFIs, of which one loan of DPL type from the World Bank in June of EUR 750 million.

On the other hand, *the weight of government public debt denominated in lei in the total government public debt* remained within the indicative targets set through the Strategy during the whole year (increasing from 41.3% in January to 42.7% in December 2015), as a result of the issuance of mainly (approximately 70%) benchmark government bonds with medium and long term maturities.

Graph 12: Performance of currency risk indicators



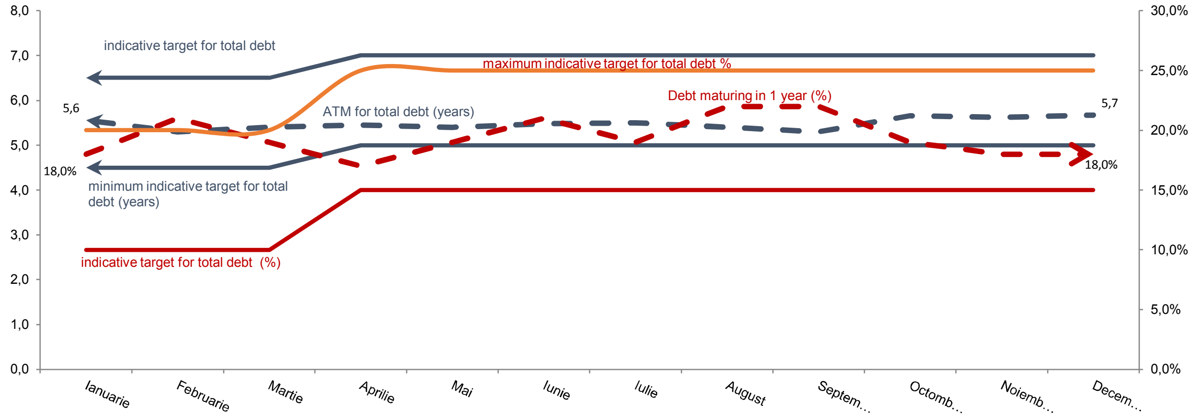
Source: MPF

b. Evolution of refinancing risk indicators

The refinancing risk indicators for the total government public debt portfolio observed the target intervals set through the Strategy throughout the entire 2015.

The indicator of *average maturity left of the government public debt portfolio* remained relatively constant throughout the whole 2015, reaching 5.7 years in December, a level due mainly to the issuances of medium and long term Government securities, but also to the loans contracted in foreign currency on the long term. *The weight of debt due within 1 year in the total government public debt* fluctuated throughout the whole year, reaching 18% at the end of 2015, thus observing the target interval set through the Strategy.

Graph 13: Performance of the refinancing risk indicators for the total government public debt



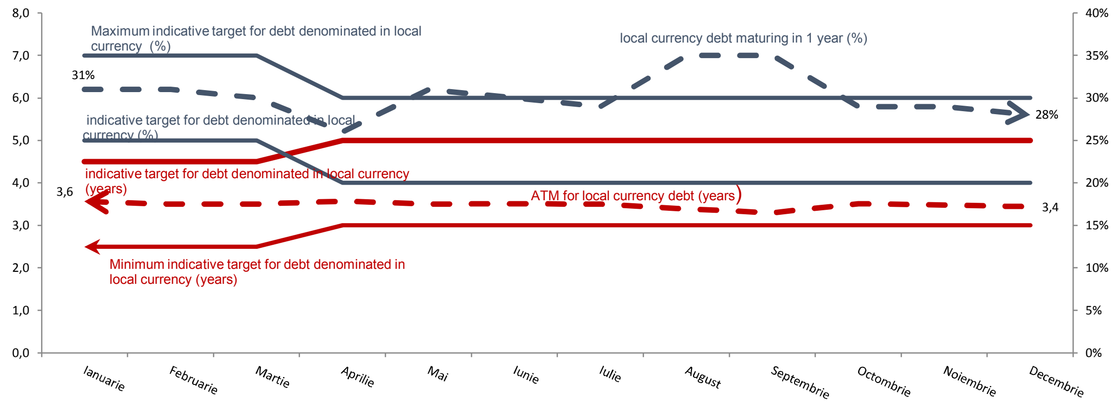
Source: MPF

With regard to the refinancing risk indicators that correspond to the government public debt denominated in lei, they observed the indicative targets set through the Strategy, at the end of the year *the average maturity left of the debt in lei reached 3.4 years, and the weight of the government public debt in Lei due within one year reached* 28%.

In 2015, the indicator of *average maturity left of the debt in Lei* observed the target interval set through the Strategy, while the deviation from the maximum indicative target of the indicator of *weight of the government public debt in Lei due within 1 year* in Q3 was due on the one hand to the bigger volume of Treasury certificates issued during this period in the framework of the high volatility on the external capital markets and to the reduction of activity on the market of Government securities during the summer, and on the other hand to the closeness to the due date (October 2015) of the issuance of benchmark government bonds of lei 7.3 billion, which has influenced this indicator related to the refinancing risk for the debt in lei.

Once the procedural and operational framework necessary for using the buy-back and bond exchange operations is completed by the NBR, the MPF will be able to administer the refinancing risk caused by issuances of benchmark Government bonds with high values which are close to their due date and have a significant impact on the refinancing indicators in the months prior to the redemption date.

Graph 14: Performance of the refinancing risk indicators for the debt denominated in lei



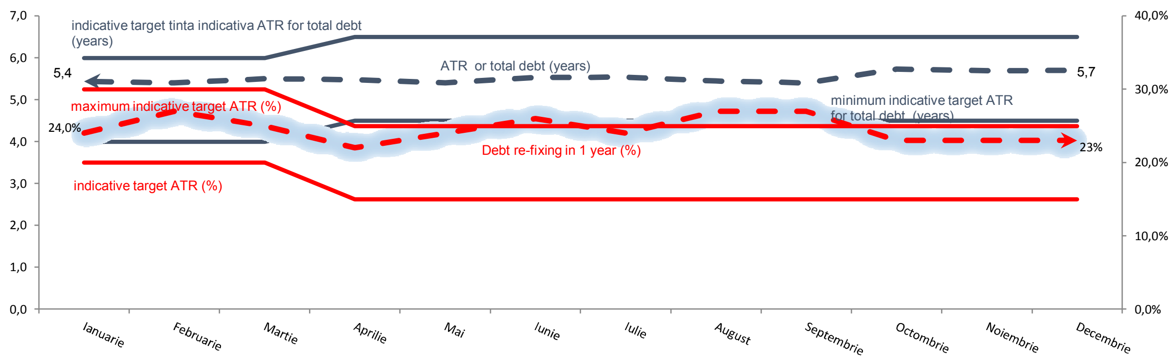
Source: MPF

c. Evolution of the interest rate risk indicators

The graph below illustrates the performance of the government public debt administration with respect to the exposure to the interest rate risk.

The indicators for the entire government public debt portfolio observed at the end of 2015 the indicative targets set through the Strategy, namely *the average period until the next amendment of the interest rate* (ATR) was of 5.7 years, and *the weight of the debt which changes its interest rate in one year* was of 23%.

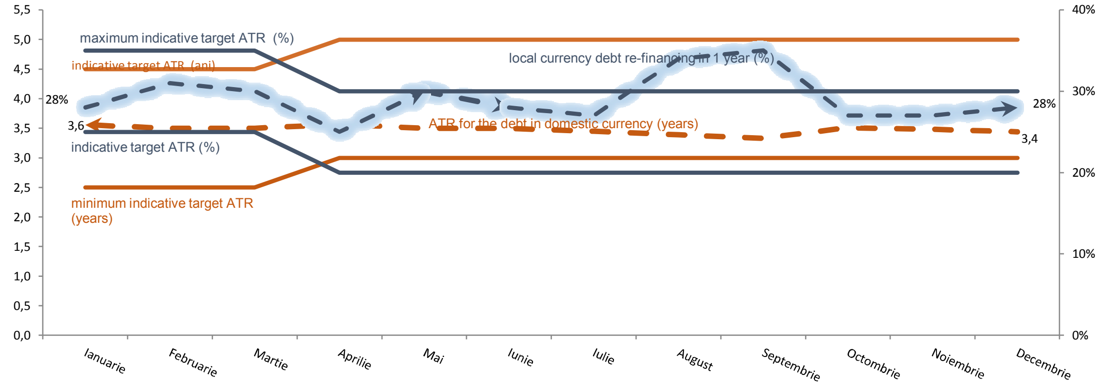
Graph 15: Performance of the interest rate risk indicators for the total debt



Source: MPF

With regard to the interest rate risk for the indebtedness indicators in local currency, they slightly fluctuated in Q3, following the evolution of the refinancing risk indicators for the debt in lei, determined by the same considerations. At the end of the year, the indicators observed the indicative targets set through the Strategy, namely *the weight of the debt in Lei which changes its interest rate within one year* was of 28%, and *the average period until the next amendment of the interest rate for the debt in lei* (ATR) was of 3.4

Graph 16: Performance of the interest rate risk indicators for the debt in lei



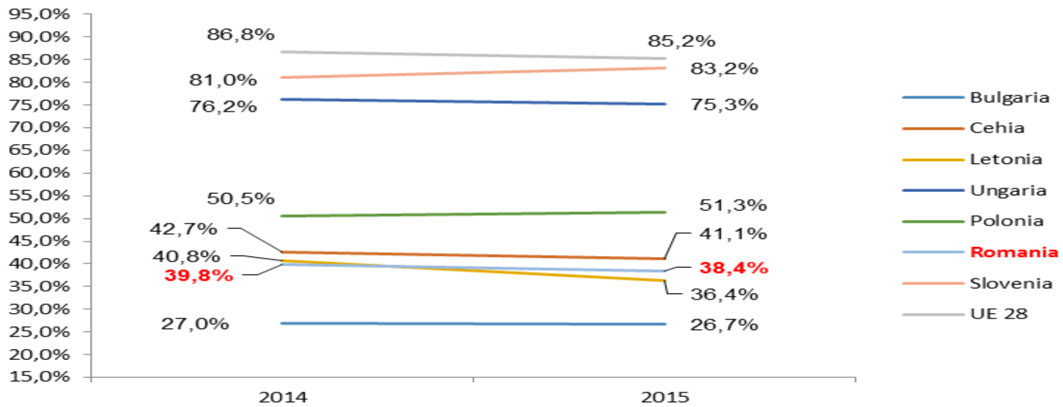
Source: MPF

4. ***The Government public debt according to the EU methodology***

With regard to the government debt according to the EU methodology at the end of 2015, the gross government debt[15] continued to be at a sustainable level of 38.4% of the GDP, below the ceiling of 60% set through the Maastricht Treaty, and if the liquid financial assets are considered[16], the level of the net government debt was of 28.9% of the GDP.

At the level of the Member States of the European Union, at the end of 2015[17], Romania was ranked 5th among the EU Member States with the lowest indebtedness degree, after Estonia (9.7%), Luxembourg (21.4%), Bulgaria (26.7%), and Latvia (36.4%).

Graph 17: EU28 comparisons (% government debt in the GDP)



Source: Eurostat

ANCA DANA DRAGU

MINISTER OF PUBLIC FINANCE

[15] Represents the debt of the public administration at nominal value, consolidated within the sub-sectors of the public administration, and does not include the guarantees given by the State and by the administrative-territorial units, with the exception of those paid from the budget, or for which 3 successive payments were made from the grant.

[16] AF1(gold and DST), AF2(deposits and cash), AF3(securities, other than shares),AF5 (shares and other capital participations, if quoted on the stock exchange, including units of mutual funds).

[17] Source: Eurostat newsrelease euroindicators 76/2016 - 21April 2016