

Ministry of Public Finance

Report on government public debt management

December 31, 2012

General Directorate of Treasury and Public Debt



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1. Macroeconomic background in Romania and the fiscal and budgetary policy in 2012

The cautious fiscal-budgetary policy of the state, the adequate monetary policy of the National Bank of Romania (NBR), the positive effects of the fiscal consolidation measures adopted by the Government, as well as the anchor offered by the preventive financial assistance package agreed with the European Union (EU), the International Monetary Fund (IMF) and the World Bank has contributed to alleviating the effects of the financial crisis at local level and has allowed at the same time a positive macroeconomic performance, with favorable effects on the costs of public debt refinancing and financing of budget deficit.

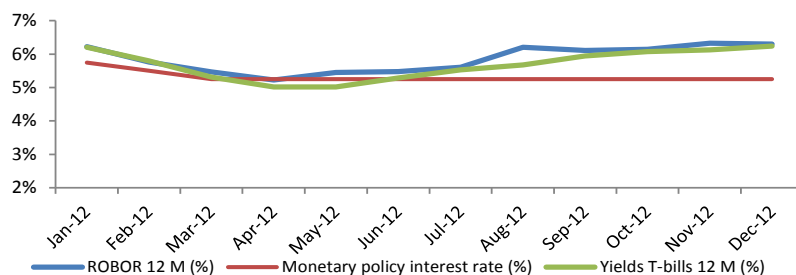
In 2012, Romania continued the fiscal consolidation process, being at the same time one of the few countries in the European Union to record economic growth, even if a low one (0.7% of the GDP). The low increase of the GDP was due to the severe draught that affected agricultural production, the recession in the Euro Zone which led to the decrease of external demand, the low rate of absorption of structural funds as a result of the suspension of operational programs, as well as the budget restrictions.

At the end of 2012, the inflation rate was at 4.95%, remaining outside the variation interval of 1 percentage point from around the annual target of 3%, a tendency caused by the volatility of food prices. The current account of the payment balance recorded a deficit of 5.2 billion EUR (representing -3.9% of the GDP), decreasing compared to 2011 by 13.2% in light of the decrease of the deficit of the balance of income and the commercial balance and of the increase of the excess of the balance of services and current transfers.

The deficit of the general consolidated budget in cash terms in 2012 decreased to 2.5% of the GDP, from 4.3% which was recorded in 2011, slightly over the target of 2.2% of the GDP which was agreed upon within the preventive financial assistance package. In 2012, the deficit calculated according to the EU methodology (ESA95) represented 2.9% of the GDP.

As of January 2012, due to the consolidation of the disinflation process, the National Bank of Romania (NBR) started a trend of decrease of the monetary policy interest rate from 5.75% to 5.25%. The decrease of the monetary policy interest rate was also reflected in the evolution of the interest rates on the interbank market and on the yields of government securities on the short-term.

Graph¹ no. 1: Government securities yields at 12 months vs. ROBOR 12 months vs. monetary policy interest rate



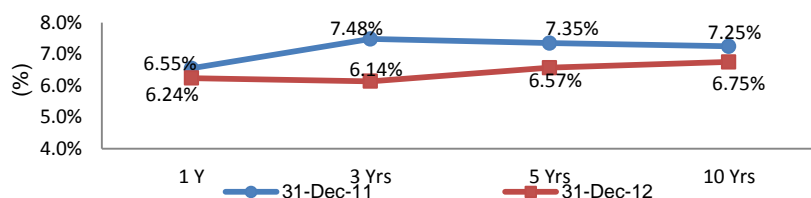
Source: MPF, NBR

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The political stability obtained after December 2012 and the macroeconomic performances in 2012 have consolidated the positive perception of foreign investors due to the fulfillment of the necessary conditions, and Romania's exit from the excessive deficit procedure in June 2013² has strengthened this perception.

Also, the announcement regarding Romania's inclusion in the regional reference indices (of Barclays and JP Morgan GBI-EM) has caused an increased interest of nonresident investors in government securities and substantial capital inflows. The inclusion of government securities among these reference indices represent a positive signal for the medium term development of the domestic market of government securities and contributes both to the gradual decrease of medium-term financing costs for the Ministry of Public Finance (MPF) and to the extension of the maturity of government securities issued on this market, through the issuance of government securities mainly with medium and long term maturities, thus decreasing the refinancing risk.

Graph no. 2 : Yields of the government securities issued on the primary domestic market



Source: MPF

¹ Rates at the end of the month

² On June 21, 2013, the ECOFIN ministers unanimously approved the repealing of the excessive deficit procedure for Romania

2. The strategy of budget deficit financing and of refinancing of government public debt in 2012

In 2012, Romania covered its financing needs through issuances of government securities launched on the domestic market, through drawings of foreign loans from official creditors (international financial institutions and bilateral institutions/government agencies) and commercial banks, as well as through the issuance of Eurobonds on the international capital markets. The sources necessary to refinance the government public debt were ensured from the markets for which these debts were issued and from the financial reserve in foreign currency available to the MPF.

The financing of the budget deficit in 2012 was made to an extent of 65% from external sources and the rest from domestic sources.

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

- *issuances of government securities in RON, namely discount treasury bills and benchmark government securities on the domestic market, with medium and long term maturities, up to 15 years.*

In order to fulfill the objective of development of the domestic market of government securities and to build and consolidate the yield curve corresponding to government securities on the domestic market, in 2012 government bonds in RON were regularly issued on the domestic market of RON 58.2 billion, according to the announced issuance schedule.

- *issuances of government securities in EUR on the domestic market*

In 2012, in order to refinance the issuance of bonds denominated in EUR and amounting to EUR 793.8 million which was due in November 2012, the MPF reopened two issuances of government bonds denominated in EUR and attracted the amount of EUR 763.3 million, as follows:

- in October 2012, the MPF reopened the issuance of EUR bonds launched in July 2011, with initial maturity of 4 years, and attracted the amount of EUR 421.5 million, at a yield of 3.76%, and
- in November 2012, the MPF reopened the issuance of bonds in EUR launched in May 2011, with initial maturity of 3 years, thus attracting the amount of EUR 341.75 million at a yield of 3.4%.

- *the issuances of Eurobonds in EUR and USD in the international capital markets:*

As part of the Framework program of issuance of government securities on the medium term (MTN):

- in January 2012, the MPF successfully launched the issuance of Eurobonds in USD amounting to 1.5 billion, with maturity of 10 years and a coupon of 6.75%, followed by a reopening in February due to the interest of foreign investors in Romanian assets, when the MPF attracted 750 million USD at an yield of 6.45%, 42.5 base points less compared to the initial transaction when the yield was of 6.875%;
- in October 2012, the MPF again launched successfully an issuance of Eurobonds in EUR, amounting to EUR 1.5 billion and with maturity of 7 years, with a coupon of 4.875% and a yield 5.04% lower than the yield of 5.1% obtained for the reopening in September of the issuance of Eurobonds launched in 2008 and due in June 2018.

Apart from the MTN program, in September 2012 the MPF reopened the issuance of Eurobonds launched in June 2008 and attracted EUR 750 million at a yield of 5.1% and a coupon of 6.5%.

- *the inflows of foreign loans dedicated to project financing;*
- *the drawings from loans contracted from the local public administration authorities;*
- *the amounts recovered by AVAS from nonperforming banking assets.*

For the improvement of public debt management and the avoidance of seasonal pressures for the assurance of financing sources of the budget deficit and the refinancing of government public debt, as of 2010 the MPF created a financial reserve in foreign currency (buffer), amounting to the equivalent of coverage of the financing needs of the budget deficit and refinancing of the public debt up to approximately 4 months.

2.1. Evolution of the issuances of government securities on the primary and secondary market

Primary market

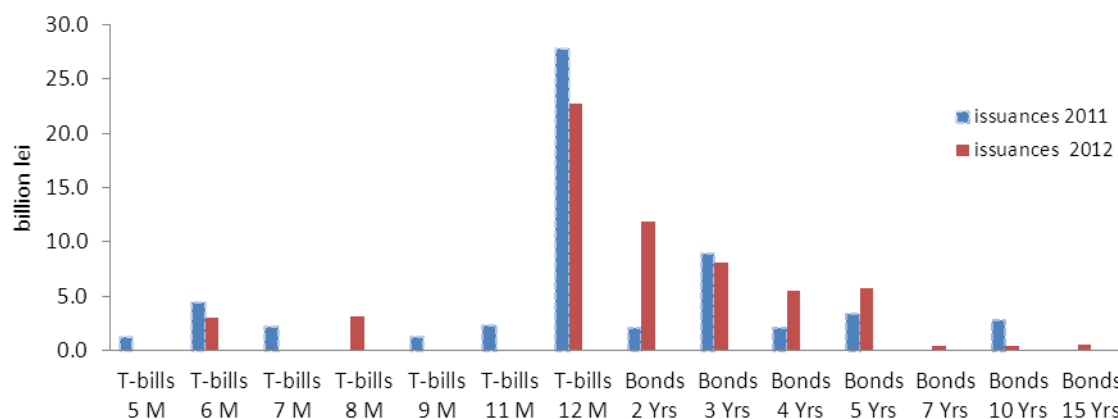
In the previously presented economic and financial framework, **the volume of government securities** issued in RON and EUR **on the primary market** in 2012 has increased to RON 61.6 billion compared to RON 57.2 billion in 2011.

The issuances of government securities were denominated both in RON and in EUR as a result of the permanent dialogue with the primary dealers and of the liquidity in foreign currency existing on the capital market.

The government securities issued for coverage of the financing needs in 2012 were:

- treasury bills in RON with maturity of up to 1 year, amounting to RON 29.0 billion,
- benchmark bonds in RON with maturity of up to 15 years, amounting to RON 29.2 billion,
- government securities in EUR, with maturities at 3 and 4 years, with an equivalent value of RON 3.5 billion (763.3 billion EUR).

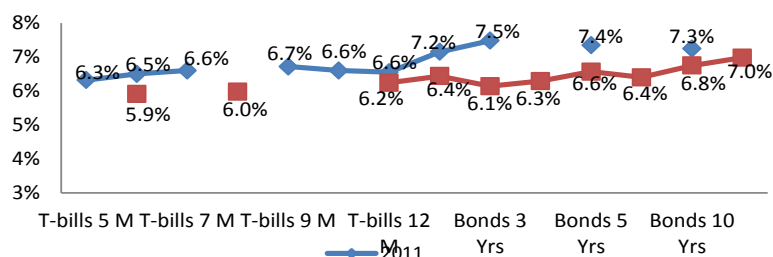
Graph no. 3: Issuances of government securities on the primary market (RON and EUR) in 2012 vs. 2011



Source : MPF

The structure on maturities of government securities, RON and EUR, improved in 2012 and reached 47% issuances of government securities on short term and 53% issuance of government securities on medium and long term compared to 2011 when this structure was of 67% on short term and 33% on medium and long term.

Graph no. 4: The evolution of the medium yields corresponding to government securities in RON at the end of 2012 compared to the end of 2011, is the following:



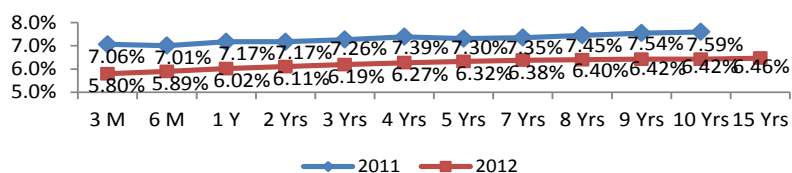
Source : MPF

During the second part of 2012, in light of the cash in foreign currency on the interbank market, the MPF reopened the issuances of government securities in EUR launched in 2011 with maturities of 3 and 4 years to cover the financing needs in foreign currency and obtained a total amount of EUR 763.3 million. These issuances of government securities in EUR represented a medium term financing alternative which led to the decrease of the refinancing risk and an opportunity for keeping certain financing costs at a low level.

Secondary market

The evolution of the yield curves in government securities on the secondary market at the end of 2012 compared to the end of 2011, is the following:

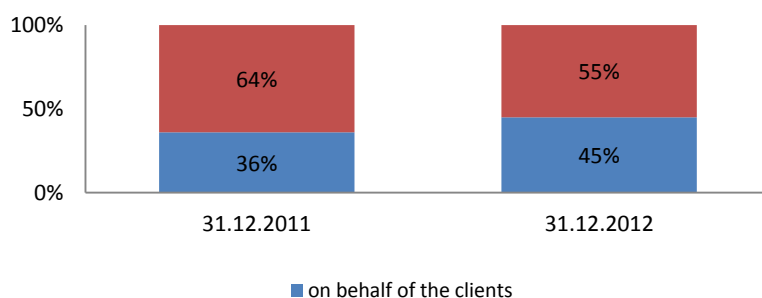
Graph no. 5



Source: Bloomberg

With respect to the holders of government securities, a decrease of government securities holdings is noted for local commercial banks which represented 55% at the end of 2012 compared to 64% at the end of 2011, in favor of other investors.

Graph no. 6 : Holdings of government securities at December 31, 2012 vs. December 31, 2011



Source : NBR

Thus, the weight of the holdings of government securities by nonresidents has increased at approximately 14% (it includes the government securities held by Clearstream) in the total government securities issued on the domestic market compared to 2011 when they were of 12% of the total government bonds issued on the domestic market. The increased interest of nonresidents in the last months of 2012 appeared in response to the eligibility of Romanian bonds in national currency of inclusion in the reference indices of JPMorgan and Barclays and of strengthening of the political and economic stability.

2.2. Foreign loans contracted in 2012

Romania's presence on the international capital markets favors the diversification of financing sources and attracts new categories of investors, supplying at the same time a transparent and credible reference of the country risk price, which facilitates the access of the private sector on foreign markets.

Thus, in 2012, in light of a favorable international framework (sufficiently liquid financial markets and based on a reasonable margin), windows of opportunity have arisen, and they were used by other sovereign issuers as well, and the Ministry of Public Finance launched issuances of Eurobonds denominated in USD and EUR amounting to approximately EUR 4 billion, both as part of the MTN program and through the reopening of Eurobonds issuance launched in June 2008 and due in 2018.

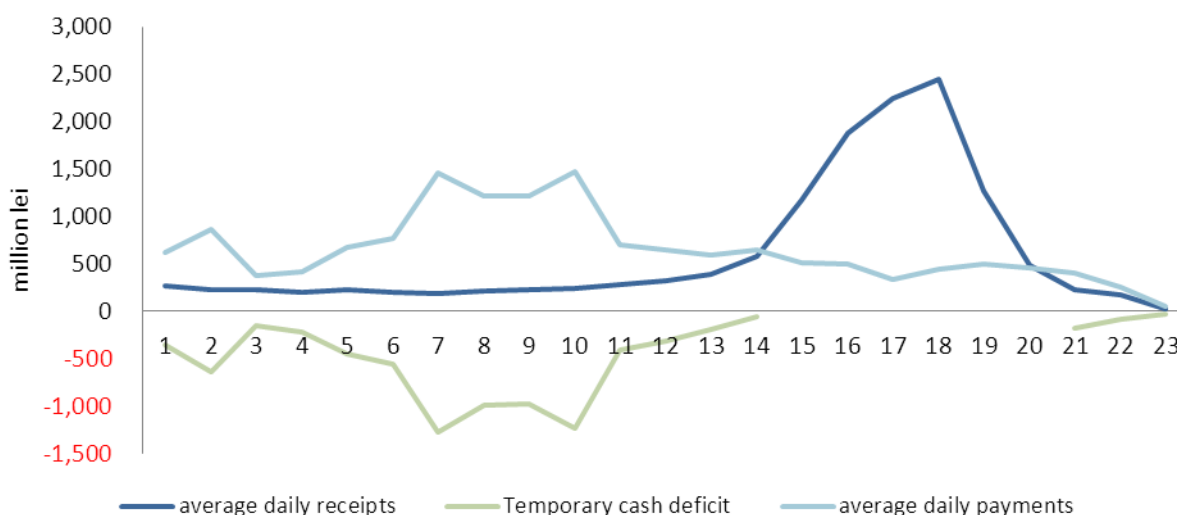
The amounts that were attracted were dedicated to financing the budget deficit, refinancing public debt and consolidating the financial reserve (buffer) in foreign currency of the MPF.

Also, in the framework of the efforts of consolidation of fiscal reserve and maintenance of the coverage level of the gross financing needs for four months, in order to protect public finances against unpredicted external shocks, the loan with drawing postponement option (DPL DDO) was contracted from the International Bank for Reconstruction and Development (IBRD) amounting to EUR 1 billion, which was ratified through GEO no. 51/September 19, 2012. The loan is granted for a term of three years and can be made available according to the fulfillment of certain actions monitored during the development of the loan, which comprises a series of reform measures in the following sectors: public finance, fiscal administration, health and economy.

2.3. Administration of liquidities in 2012

Cash management operations performed in order to cover temporary cash deficits during the year were performed as a result of the existing gap between collections and payments in/from the treasury general current account, as shown by the graph below:

Graph no. 7: Average of daily collections and payments during one month of 2012

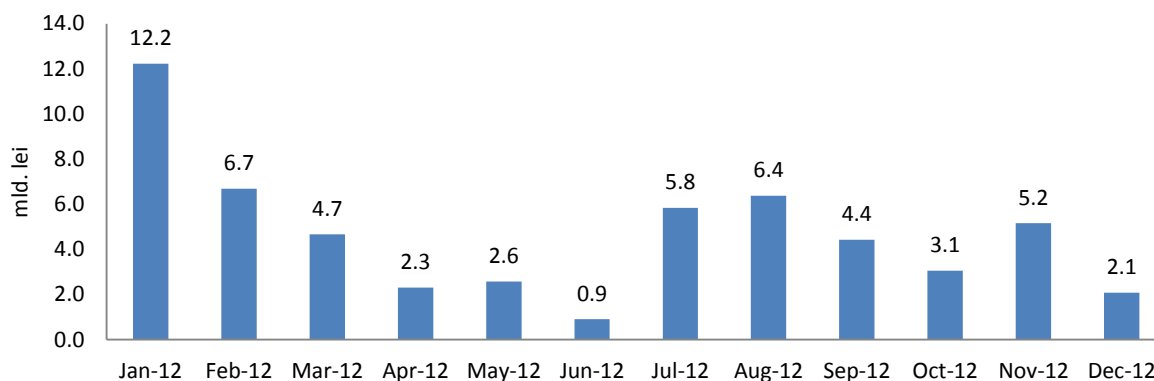


Source: MPF

The coverage of temporary cash deficits in the state treasury general current account was made through attracting short term deposits from the interbank market from credit institutions and through currency exchange operations.

In 2012, the deposits attracted from the interbank market from credit institutions on very short term (less than 2 weeks) were of 56.3 billion RON, with an average interest rate of 4.56%.

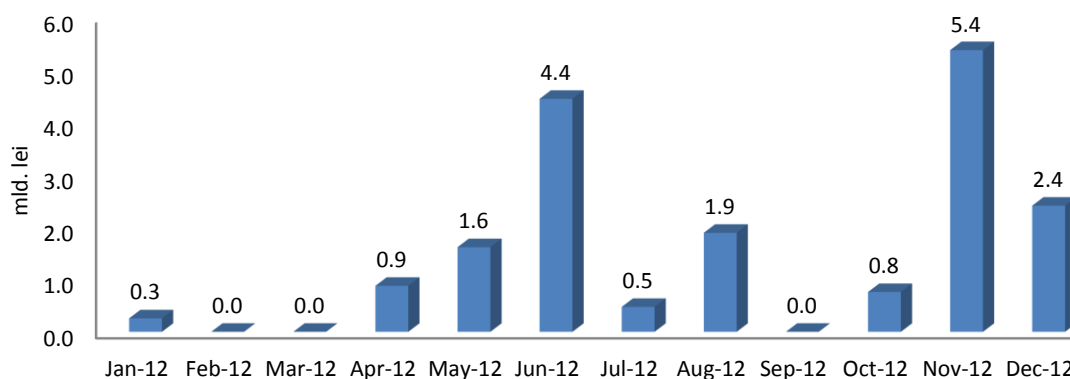
Graph no. 8: Evolution of deposits attracted in 2012



Source : MPF

Currency exchange operations were performed from external loans, issuances of government securities in EUR from the internal market and issuances of Eurobonds in EUR and USD from international capital markets.

Graph no. 9: Evolution of sales of foreign currency made by the State Treasury to finance temporary deficits, as well as to finance/refinance public debt in 2012



Source: MPF

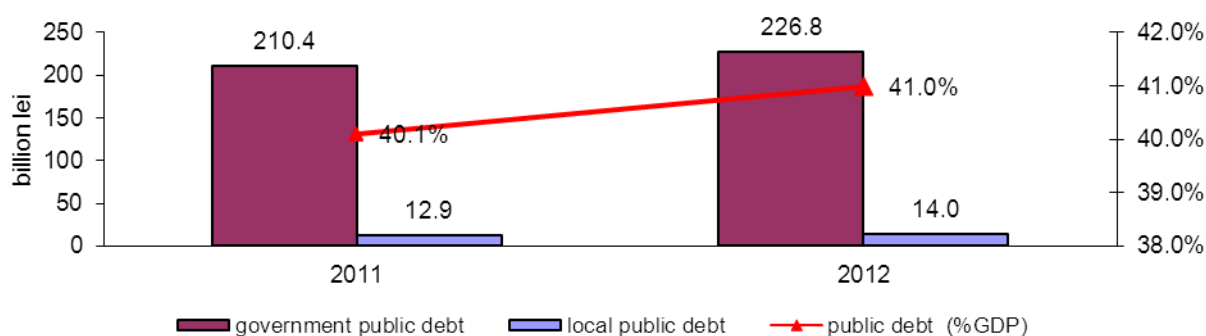
3. Analysis of the government public debt portfolio and of the risks related thereto in 2012

Public debt

In the framework of macroeconomic evolutions and those of the internal and external financial markets, the 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, 2012 of RON 240.8 billion (representing 94.2% of the total public debt), while the local public debt was of RON 14.0 billion (representing 5.8% of the total public debt).

The increase of public debt in 2012 compared to 2011 by 17.6 billion RON was mainly caused by the debt contracted to cover the financing needs of budget deficit and to refinance the government public debt.

Graph no. 10: Evolution of the public debt



Source : MPF

Government debt according to EU methodology

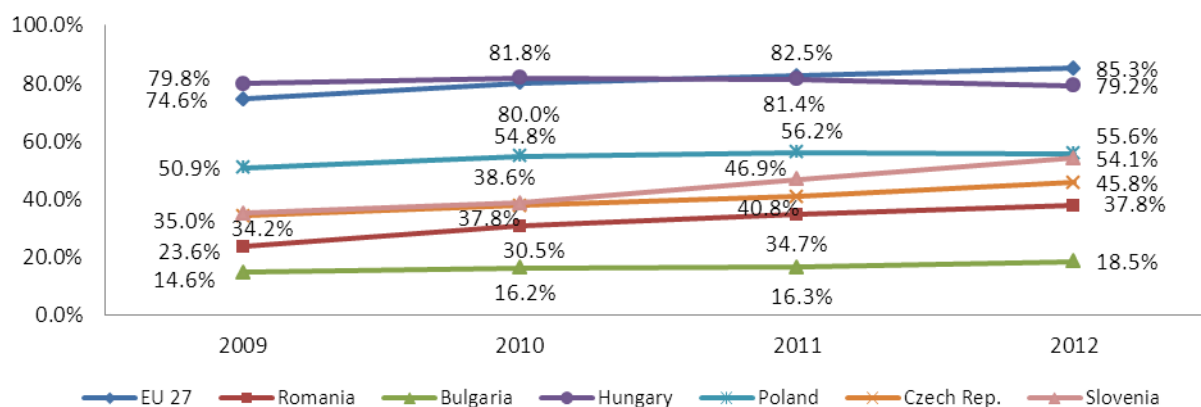
At the end of 2012, **the gross government debt calculated according to the EU methodology**³ represented 37.8 % of the GDP, being thus below the ceiling of 60% established through the Maastricht Treaty, and if the liquid financial assets⁴ are considered, the level of the net government debt was of 30.5% of the GDP.

³ Represents the public administration debt in nominal value, consolidated in the subsectors of the public administration and does not include the guarantees granted by the state and the administrative-territorial units, with the exception of those paid from the budget or for which 3 successive payments were made by the guarantor.

⁴ AF1(gold and DST), AF2(cash deposits), AF3(securities, other than shares),AF5 (shares and other capital contributions, if listed, including shares of mutual funds).

At the level of the member states of the European Union at the end of 2012, Romania held the 4th place among the EU countries with the lowest indebtedness level, after Estonia (10.1%), Bulgaria (18.5%) and Luxemburg (20.8%).

Graph no. 11: Public indebtedness degree (% GDP) in Central and Eastern European Countries between 2009 and 2012



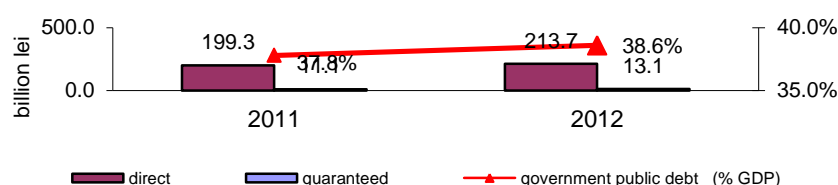
Source : Eurostat

Structure of government public debt

Government public debt at December 31, 2012 was of RON 226.8 billion, representing 38.6% of GDP, increasing by 0.8% of the GDP compared to the end of 2011.

Out of the total government public debt registered at the end of 2012, direct government public debt represented 36.4% of the GDP, increased by 0.6% of the GDP compared to the end of 2011, the difference being the secured government public debt. In 2012, the secured government public debt increased and reached RON 13.1 billion at the end of the year, especially due to the guarantees granted as part of the government programs.

Graph no. 12: Government public debt by type of the debt



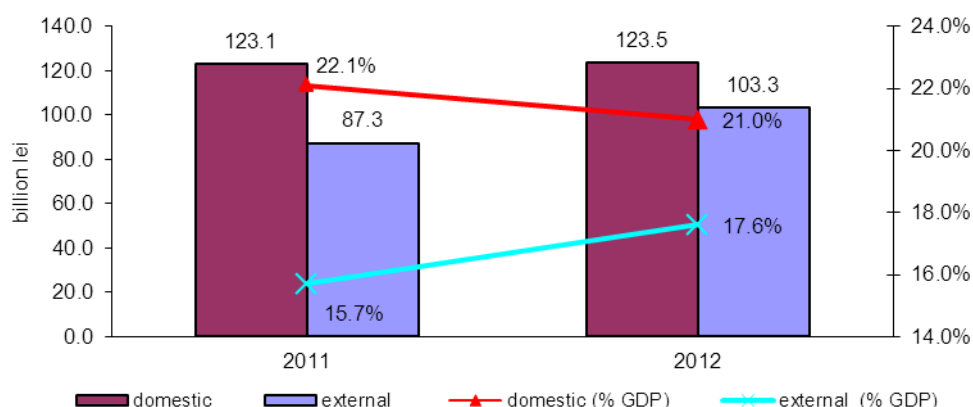
Source : MPF

The guarantees granted in 2012 were of RON 3,146.4 million, as follows:

- part of the “First Home” government program – RON 2,219.7 million;
- part of the thermal rehabilitation program of homes, with financing through bank loans – RON 2.1 million;
- part of the support program for the beneficiaries of projects in priority fields for the Romanian economy financed through structural instruments of the EU – RON 54.9 million;
- part of the Mihail Kogalniceanu program for SMEs – RON 75.4 million;
- the guarantee granted for the loan contracted⁵ by Compania Națională de Căi Ferate „CFR” S.A. from EBRD to be used in support of the company’s financial restructuring – EUR 175.0 million (RON 794.3 million).

With respect to the market on which the government public debt was issued, 54.5% of the total government public debt was contracted on the domestic market and 45.5% on the foreign market. Most of the domestic government public debt was represented by government securities (treasury bills, benchmark bonds in RON and government securities in EUR), while the foreign debt was made up of Eurobonds issued on the international capital markets, foreign loans contracted from official creditors (international financial institutions and bilateral institutions/government agencies) and from commercial banks.

Graph no. 13 : Government public debt by the market of issuance



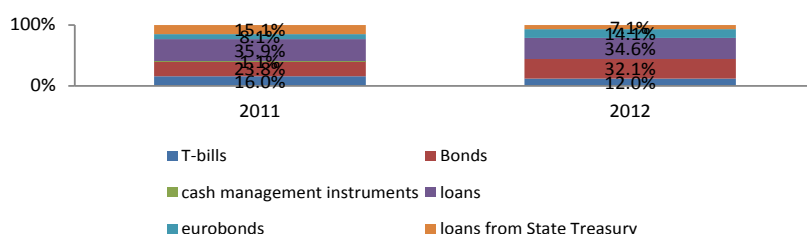
Source : MPF

⁵ Government Emergency Ordinance no. 86/2012 approving the Guarantee Agreement between Romania and the European Bank for Reconstruction and Development, signed in Bucharest on November 28, 2012, regarding the guarantee of up to 100% of the liabilities corresponding to the Loan Agreement (Financial restructuring of Compania Națională de Căi Ferate "C.F.R." - S.A.) between Compania Națională de Căi Ferate "C.F.R." - S.A. and the European Bank for Reconstruction and Development amounting to EUR 175,000,000

At the end of 2012, *the tradable debt* (government securities) represented 58.2% of the total government public debt, out of which 44.2% were government securities issued on the domestic market, increasing by 4.4% compared to 2011.

According to the *structure on instruments* of the government public debt at the end of 2012, the loans from the available funds of the state treasury general current account decreased significantly to 16.2 billion RON (7.1% of the total government public debt) from 31.8 billion RON (15.1% of the total government public debt) which was the figure at the end of 2011.

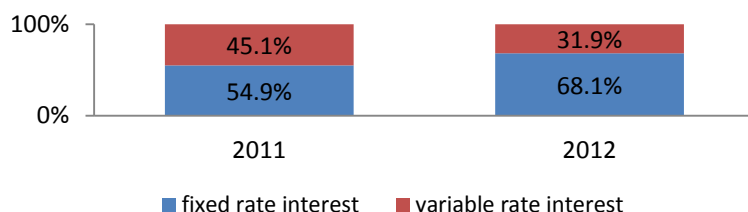
Graph no. 14: Government debt composition by type of instruments (% government public debt)



Source : MPF

The structure of the government public debt according to the type of interest rate reveals an increase of the weight of contracted loans with fixed interest rate, from 54.9% which was recorded at the end of 2011, to 68.1% at the end of 2012, mainly determined by the volume of bonds issued on the local market and the issuances of Eurobonds launched on the international capital markets.

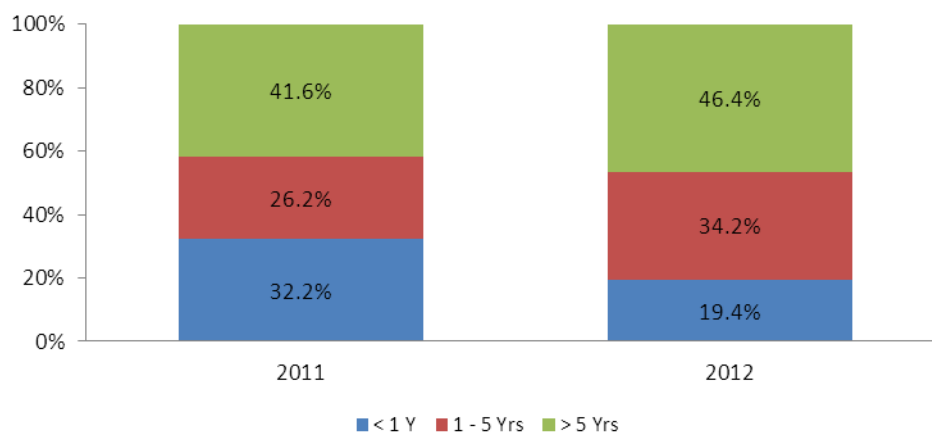
Graph no. 15 : Government debt composition by interest rates (%government public debt)



Source : MPF

According to the initial term of the loans, the highest weight of 80.9% was held by loans contracted on medium and long term (over 1 year). The low weight of the short term debt (19.1% of the total government public debt) was due to the decrease of the value of loans from the available funds of the general current account of the State Treasury and to the issuances of treasury bills.

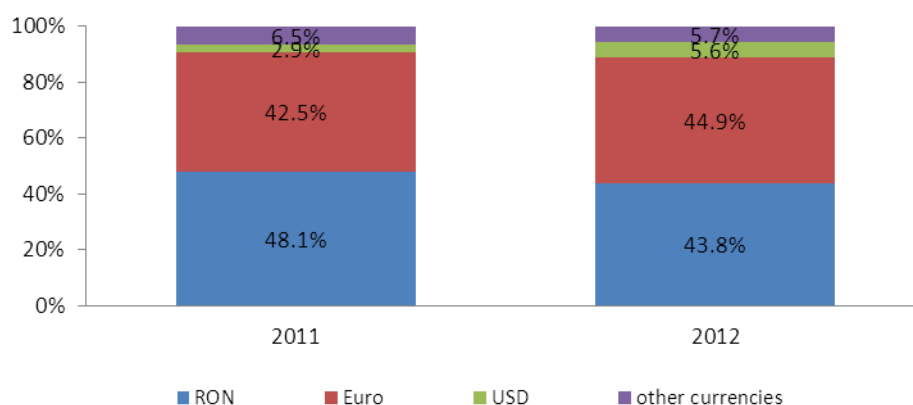
Graph no. 16 Government debt composition by initial maturity
(% government public debt)



Source: MPF

The analysis of the government public debt according to the component foreign currencies shows that at the end of 2012, 56.2% of the government public debt portfolio represented debt denominated in foreign currency, mainly in EUR. In 2012, for the financing from foreign sources of the budget deficit, loans were contracted and issuances of Eurobonds were launched in EUR and USD, on long and medium term, in order to decrease the refinancing risk and extend the average duration left in the debt portfolio.

Graph no. 18: Government debt composition by currencies
(%government public debt)



Source : MPF

Government public debt service

The government public debt service for 2012 was of RON 64.3 billion, out of which RON 63.1 billion represented the government debt service contracted directly by the state⁶ and 1.2 billion RON was the government debt service guaranteed by the state. Out of the total service, RON 53.7 billion was capital installment reimbursements (including government securities refinancing) and RON 10.6 billion were payments of interests and fees.

Out of the government public debt service, the one corresponding to the debt contracted from the domestic market was of RON 53.1 billion, and the difference was the service of the debt contracted from the foreign market.

Other indicators⁷ related to government public debt service are presented as follows:

	2011	2012
1. Service of foreign gov. public debt /Export of goods and services ⁸	2.7%	4.8%
2. Interests corresponding to foreign gov. public debt service /Export of goods and services ⁹	1.1%	1.4%
3. Interests and fees/Income of the general consolidated budget ¹⁰	4.7%	5.5%
4. Interests and fees/Expenditures of the general consolidated budget ¹¹	4.1%	5.1%

The increase of the expenditures for interests paid from the state budget in 2012 compared to 2011 is due both to the new debt contracted to cover the budget deficits corresponding to previous years, and to the issuance of government securities, mainly on short term (below 1 year), for which the payment of the discount is made at maturity.

Fulfillment of the objectives set through the Strategy for government public debt management on medium term 2012-2014

In July 2012, the **Strategy on government public debt management on medium term 2012-2014 (the Strategy)** was approved following the consultations with the NBR (according to the

⁶ does not include the reimbursements from loans from the available funds of the general current account of the State Treasury and those in the account of cash management instruments

⁷ the expenditures and income of the general consolidated budget are operative execution data and for the indicators under points 1 and 2 the figure published in the Spring forecast of the National Commission of Prognosis – May 2013 was considered

⁸ the indicator shows the extent to which the payments in the account of the foreign government public debt service are covered from the collections from exportation of goods and services.

⁹ the indicator shows the extent to which the cost for the interest corresponding to the foreign government public debt is covered from the collections from export of goods and services.

¹⁰ the indicator shows the extent to which the interests and fees corresponding to the government public debt are covered from the income of the general consolidated budget.

¹¹ the indicator represents the weight of the payments of interests and fees corresponding to government public debt in the total expenditures of the general consolidated budget.

provisions of GEO 64/2007 on public debt, as subsequently amended and supplemented), as well as of the consultations with the IMF, the European Commission and the World Bank.

The main objectives of the Ministry of Public Finance in the management of government public debt considered in 2012 were the following:

1. Ensuring the necessary government financing and the payment liabilities, under conditions of minimizing the medium and long term costs;
2. Limiting the risks related to the government public debt portfolio;
3. Development of the local market of government securities.

In the framework of the macroeconomic evolution and of the financial markets presented in detail in the previous chapters, the fulfillment of the objectives according to the Strategy in 2012 is as follows:

OBJECTIVES/Indicators	2012	Limits for 2014 according to the Strategy
1. Ensuring the necessary government financing and the payment liabilities, under conditions of minimizing the medium and long term costs:		
a. Weight of the government public debt cost (% of the GDP)	1.8%	max. 1.6%
b. Weight of the government public debt services (% of the GDP)	10.9%	max.10.5%
2. Limiting the risks related to the government public debt portfolio through:		
A. Currency exchange risk		
a. Weight of the government public debt denominated in EUR in the total government public debt in foreign currency (%);	80.0%	min. 75%
b. Weight of the government public debt contracted in foreign currency in the total government public debt (%),	56.2%	max. 50%
B. Refinancing risk		
a. Weight of the debt due within 1 year (initial term) in the total government public debt (%)	12.9%	max. 25%
b. Average term left of the government public debt portfolio (years) ¹²	4.4	min. 4.5

¹² Does not include loans from available funds of the General Current Account of the State Treasury.

c. Average residual maturity for the government securities issued on the local market (years)	1.7	min. 2
C. Interest rate risk		
a. Increase of the weight of the debt with fixed interest rate in the total government public debt (%)	68.1%	
b. Average period to the next amendment of the interest rate (years) ¹³	3.6	between 3 and 4
c. Weight of the government public debt which amends its interest within 1 year in the total government public debt (%) ¹⁴	29%	max.40%
3. Development of the government securities market		
a. increase of the weight of medium and long term issuances (% in the total issuances on the domestic market)	53.0%	min. 60%

At the end of 2012, based on the consolidation of the process of decrease of both interest rates on the domestic market and of the decrease of differences between the interests on the domestic market and those on the foreign market, the weight of the government public debt cost in the GDP was of 1.8%, thus creating the assumptions for the optimization of the government public debt cost on medium term. Also, in light of the diversification of foreign financing sources and of the extension of the maturities of the issuances on the internal market, the weight of the government public debt service in the GDP was of 10.9%, thus creating the assumptions for the optimal distribution of the government public debt service on medium and long term.

In 2012, both the weight of the government public debt denominated in EUR in the total government public debt in foreign currency (80.0%) and the weight of the government public debt contracted in foreign currency in the total government public debt (56.2%) increased, which is mainly owed to the contracting of long term financing from the international capital markets in order to decrease the refinancing risk (given the low demand on the local market for issuances of long term government securities).

With respect to refinancing risk at the end of 2012, it an improvement was found of the structure of the government public debt structure according to the initial maturity, through the increase of the weight of issuances of medium and long term bonds, both on the domestic

¹³ Idem 12

¹⁴ Idem 12

market and on the foreign market, to the detriment of the weight of issuances of treasury bills. At the same time, the average term left of the government public debt portfolio increased from 4.1 years at the end of 2011 to 4.4 years at the end of 2012.

On what the interest rate risk is concerned, in 2012 the weight of the debt with fixed interest rate in the total government public debt increased and reached 68.1%, the dynamics thereof being determined mainly by the volume of bonds on the domestic market and the issuances of Eurobonds launched on the international capital markets, but also by the decrease of the value of loans from available funds of the State Treasury general current account.

Also, in 2012, in order to decrease liquidity risk, the Ministry of Public Finance continued the consolidation process of the financial reserve in foreign currency, corresponding to the objective of covering the financial needs of the budget deficit and refinancing the public debt for approximately 4 months, as established through the preventive financial assistance package with the IMF, UE and World Bank.

Regarding the credit risk due to the budget risk caused by the granting of government guarantees and sub-loans, we mention that in 2012 the payments from the risk fund in the account of loans sub-lent to economic operators and of the loans secured by the state, were of RON 134.9 million, representing 0.02% of the GDP.

In 2012, in order to achieve the objective of development of the local market of government securities, the MPF continued its effort of extending the maturities of the issuances of government securities on the internal market in parallel with action of consolidation of the yield curve of government securities. Also, in order to encourage the dealing in government securities on the secondary market, the MPF together with the NBR as agent of payment, registration and transfer of government bonds, revised the eligibility and performance criteria for primary dealers, with enforcement as of January 2013.

LIVIU VOINEA

MINISTRY DELEGATED FOR THE BUDGET