Ministry of Public Finance

Report on the government public debt

December 31, 2016

General Directorate for Treasury and Public Debt

Contents:

1. Developments in the Romanian economy in 2016

The Romanian economy grew by 4.8% in 2016, at its best pace since 2008, against the background of the domestic demand supported by the increased wages, the reduced indirect taxes and lower interest rates, the highest annual growth in the EU.
Romania closed the year 2016 on a negative inflation rate of -0.5%, mainly as a result of the reduced VAT standard rate as of January 1, 2016.

The current account of the balance of payments closed on a deficit of 3.97 billion Euro in 2016, accounting for 2.3% of GDP, and this is the highest level since 2012, triggered by the deterioration of the trade balance, given the intensified private consumption. In 2016, the foreign direct investments went up for the second year in a row (4.1 billion Euro), the highest level since 2009.

Macroeconomic indicators

Indicators	2015	2016
GDP - billion lei - real growth, %	 711.1 3.9	 761.5 4.8
Current Account Balance (% of GDP)	-1.2	-2.3
Consumer Price Index (CPI) - end of year - annual average	 -0.93 -0.59	 -0.54 -1.55
Average exchange rate - lei/euro - lei/USD	 4.4450 4.0057	 4.4908 4.0592

Source: NCP

The cash deficit of the general government was 2.4 of GDP in 2016and the ESA budget deficit (according to the EU methodology, ESA 2010) was 3.0% of GDP. Due to the relatively low budget deficits, the gross borrowing requirement was driven mainly by the amount needed to refinance the government public debt, as shown in the table below.

Financing needs

Indicator	2015	2016
Revenues of the central government[1] (billion lei)	177.7	173.7
[2]Expenditures of the central government (billion lei)	190.2	194.7
Central Government Budget Deficit (I) (billion lei)[3]	12.6	21.1
Refinancing of the government public debt[4] (II) (billion lei)	49.7	50.7
Gross financing needs (I+II) (billion lei)	62.3	71.8

Source: MoPF

[1] Cash, applying the EU methodology.
[2] Cash, applying the EU methodology.
[3] Cash, applying the EU methodology.
[4] The principal repayments and refinancing of bonds on account of the government public debt, under the national legislation, calculated based on the debt balance at the end of 2016 (it includes guarantees but it does not include temporary financing).

The rating agencies' risk assessments confirmed the positive development of the general economic framework, with a focus on the fiscal and budgetary consolidation and the sustained economic growth, including against other states of the region which have the same rating. Hence, in March 2016, JCRA raised from BBB-/BBB to BBB/BBB+ the long term domestic currency and foreign currency debt rating. Both Moody's and Standard & Poors confirmed once more the Baa3/A3 and BBB-/BBB ratings, respectively, attached to the Romanian long term foreign and domestic currency government debt. Fitch changed the long term domestic currency debt rating from BBB to BBB-, stable outlook, a change that was announced as resulting from the changes in the methodology and impacting the ratings of other states in the same rating class as Romania. At the same time, Fitch maintained at BBB- the long term foreign currency debt rating.

2. 2016 budget deficit financing and government public debt refinancing strategy

2.1. Budget deficit financing

In 2016, the budget deficit was financed mainly from domestic sources (77.0%) and foreign sources were used to reach the needed amount. The sources for refinancing the government public debt came from the markets on which the respective debt had been issued and from the foreign currency financial buffer of the State Treasury, which at the end of 2016 was in amount of 6.0 billion Euro, accounting for 3.6% of GDP.

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

a) government securities in lei, namely discounted Treasury Bills and benchmark bonds issued on the domestic market, with medium and long term maturities up to 15 years.

In 2016, government securities in amount of 45.4 billion lei were issued regularly, as a move to achieve the objective of developing the domestic market of government securities and building and consolidating the yield curve of government securities on the domestic market.

b) *government securities in Euro issued on the domestic market*

MoPF issued 5-year government bonds denominated in Euro, in a total amount of 775.0 million Euro, to help creating the resources needed to repurchase the Euro-denominated government bond of 1,570.4 million Euro, maturing in the month of February.

c) Eurobonds issued in Euro on the foreign capital markets

The total funds borrowed by MoPF from the foreign financial markets in 2016 amounted to 3.25 bn Euro, from the re-opening of eurobonds denominated in Euro maturing in 2025 and 2035, that were issued in October 2015, in amount of 1.25 bn Euro, and from an issuance, in May, in amount of 1 bn Euro, maturing in 2028 that was re-opened in September for an amount of 1 bn Euro.

d) *foreign loans contracted to finance the projects.*

e) *loans contracted by the territorial-administrative divisions.*

f) temporary borrowings from the balance of the state treasury general current account.

To improve the public debt management and avoid the seasonal pressure of providing the sources to finance the budget deficit and refinance the government public debt, in order to reduce the refinancing risk and the liquidity risk, consideration was given to keeping the financial buffer in foreign currency at the disposal of the State Treasury in an amount equivalent to the funds needed to cover the needs for financing the budget deficit and refinancing the debt for a period of around 4 months.

2.2. The domestic market of government securities

Primary Market

As a result of a consistent strategy over the recent years to develop the market of government securities, corroborated with the favorable circumstances of the market, the domestic market of government securities continued to trend positively in 2016, thus proving its resilience in the volatility periods generated by external factors.

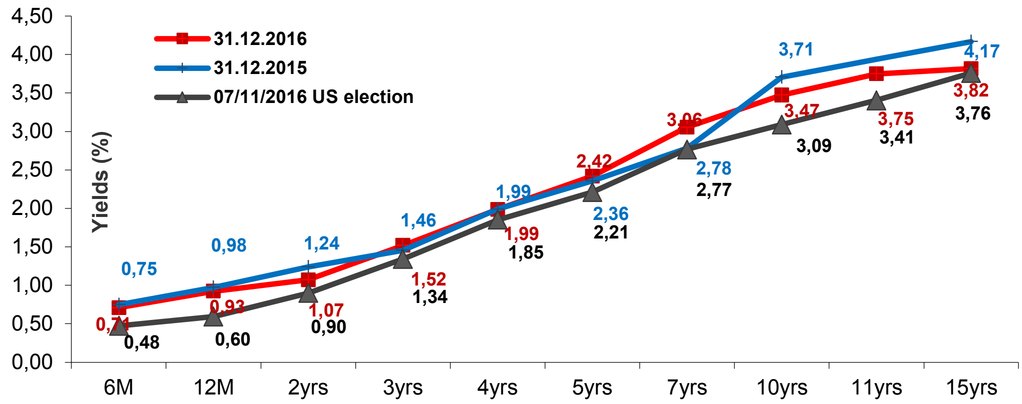
In the first six months of 2016, the Romanian government securities' yield trended up, due to, on the one hand, the favorable context provided by the eurozone by keeping the ECB accommodating policy, with ECB continuing its programme of purchasing assets in an effort to re-launch the economic activity in the eurozone and the interest of benchmark bonds in the eurozone entering in the negative interval, and, on the other hand, due to the local context given by the improvement of macroeconomic fundamentals.

The effects of the UK decision on June 23, 2016, to go for the Brexit were short time effects, with the yields afterwards, in particular the medium and long term yields, going sharply down. Thus, right after the publication of the referendum outcomes, the medium and long term maturity yields went slightly up, by 10 basis points, but in an interval of one week after they dropped and remained by approx. 20 basis points below the level before the referendum.

The USA November's elections outcome and the fact that the significant tax-related measures announced by the Trump administration aimed at encouraging the growth and would result in higher inflation have pushed up the interest rates on the US market and on the global markets as well, a fact reflected, towards the end of 2016, by the increase of Romanian government securities yields.

As resulting from the chart below, at the end of 2016, the interests rates of Romanian long and medium term government securities dropped below the rates seen at the end of 2015.

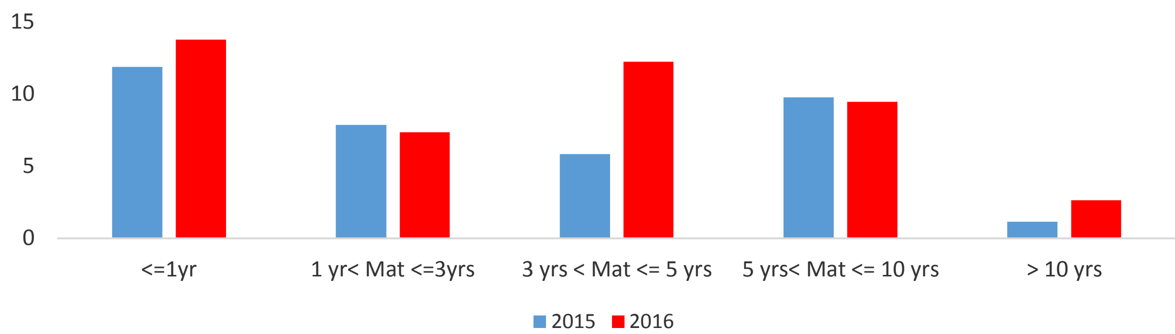
The development of the yields on the secondary market at the end of 2016 vs the end of 2015



The government securities issued on the domestic market in 2016 amounted to 45.4 billion lei, namely 775 million Euro, accounting for 68.2% of the gross borrowings of the central government, and had the following composition: a) 28.1% discounted T-Bills with a maturity of up to 12 months and benchmark bonds with remaining maturities of up to 1 year; b) 38.6% benchmark bonds with remaining maturities between 1 and 5 years; and c) 33.3% benchmark bonds with remaining maturities between 5 and 14 years. The 3, 5 and 7 years benchmark bonds denominated in lei were issued and reopened almost every months. The efforts made by MoPF to extend the average maturities of government securities, in an international context featuring low yields and an increasing appetite of non-resident investors for long maturities, have doubled the amount of long term government securities, compared to the year 2015.

In February and March 2016, as a result of an increase in the foreign currency resources available to lending institutions after the central bank BNR decided to cut the minimum foreign currency reserve requirements, the government securities issued in Euro on the domestic market amounted to a total of 775 million Euro, with a 5-year maturity, under the circumstances of more favorable costs and against the background of a significant demand from the investment environment.

The composition of government securities considering the maturities (initial maturity, in billion lei)

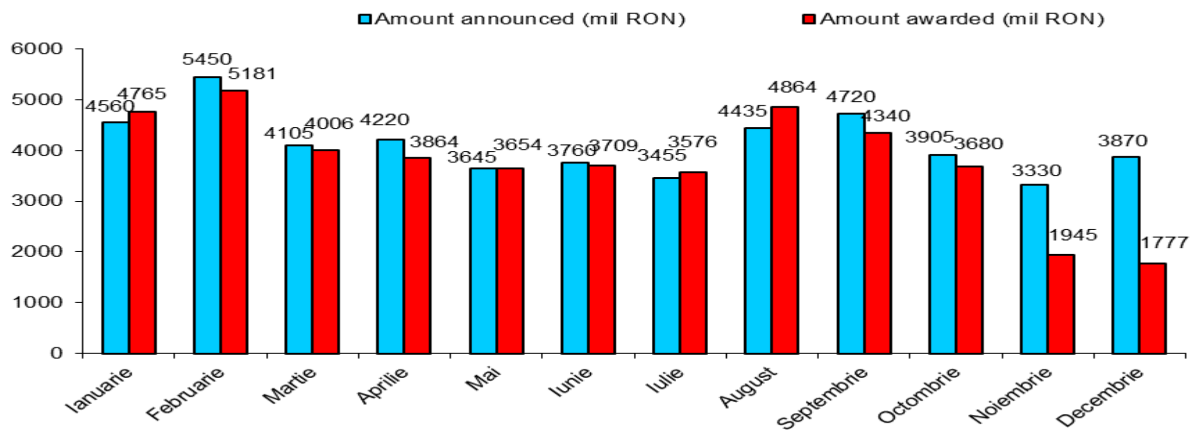


Source: MoPF

The fact that the Romanian government securities are still included in the JPMorgan and Barclays indexes continues to have a positive influence on the local market and maintaining the investors' interest. At the end of 2016, 11 series of Romanian government bonds were included in the JP Morgan GBI-EM Global Diversified index with a 4.85% weight and 13 series were included in the Barclays EM Local Currency Government index, with a 1.2% weight.

The government securities issuance policy was predictable and flexible and adjusted to the requirements of the investment environment. Most auctions were awarded to in their total amounts (please refer to chart 10), with even higher amounts than announced accepted in long term auctions and using the opportunity windows offering favorable yields to extend the remaining average maturity of the government public debt portfolio. November and December were marked by a series of foreign (US elections, the increase of the FED interest rate by 0.25%, the Italian referendum on the constitutional reforms) and domestic (the parliamentary elections on December 11) events that generated times of volatility and, as a consequence, a number of auctions were only partially awarded or even rejected, thus avoiding short term pressures on the yield curve.

Amount announced vs amount awarded in 2016

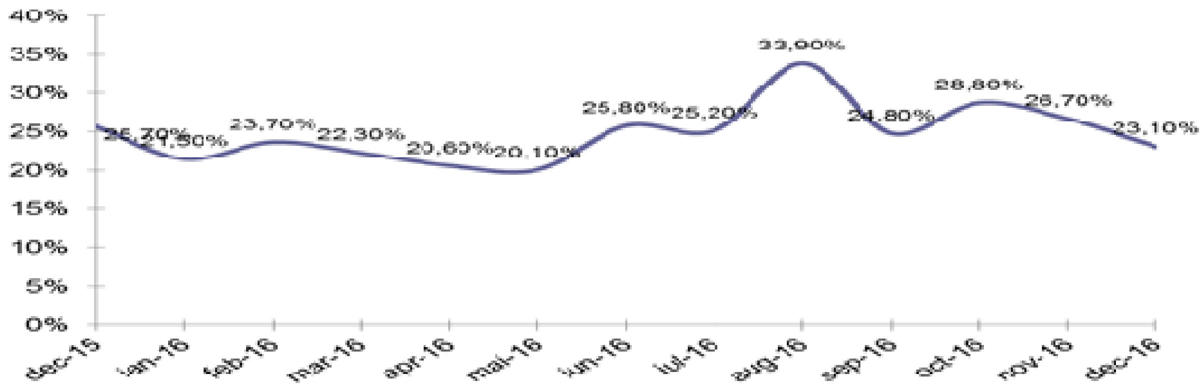


Source: MoPF

Secondary Market

The liquidity of government securities on the secondary market is an important indicator showing the level of development of the government securities market. The liquidity rate, calculated as total amount of monthly transactions conducted on the secondary market in the total amount of government securities, remained relatively flat throughout 2016, but it still remains low compared to international standards. In August, the liquidity increased significantly and to 33.9% as a consequence of a reduced outstanding amount of government securities after a benchmark bond series in total amount of RON 7.5 billion was repaid.

Liquidity of the government securities in lei active between December 2015 and December 2016



Source: MoPF

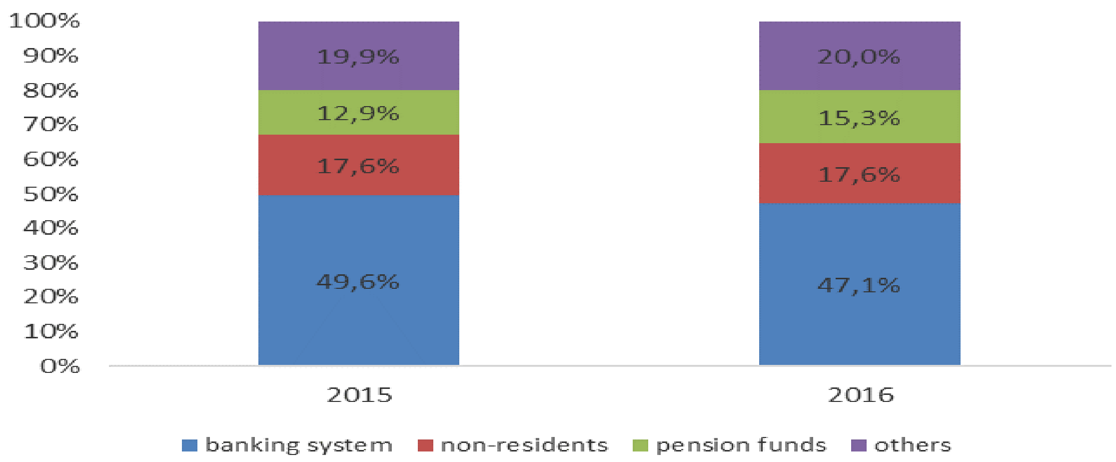
The low levels of trading in the secondary market of government securities could reflect market specific circumstances, and also deficiencies that have a structural nature, such as internal limitations of the commercial banks to include specific maturities in their trading portfolio, as well as the weak trading in secondary market instruments like repos, reverse repos, buy backs, binds exchange operations or the weak swap market in particular for average and long maturities.

Important progress was made in 2016 in this direction, when the electronic platform provided by Bloomberg was implemented for quotations and trading of Romanian government securities (EBND); the platform is expected to help increase liquidity and form, in a transparent and competitive way, the prices of government securities on the secondary market. On this platform, the primary dealers have the obligation, as of 2017, to provide firm quotations for a number of government securities, at the same time with meeting a minimum set of requirements related to the amount, maturity, quotation time, sale/buy spread, with the performance of the primary dealers reflected in the periodical assessment of their activity on the market of government securities.

The commercial banks, under the circumstances of a moderate advance of the financial institutions' lending in 2016 and a liquidity surplus on the market, continued to be the main investors on the domestic market of government securities, still having a lower share by 2.3% compared to 2016, with 47.1% of the total amount of government securities issued on the market and followed by non-resident investors who kept a flat share of 17.6% compared to the end of 2015, with the share of pensions fund holdings at 15.3%, trending up from the 12.9% at end-2015.

The investors' preference focused on maturities of up to 7 years and marginally to over 10 years, particularly for the government securities included in the regional index.

Government securities by type of investors



Source: NBR

As institutional investors, local asset managers and private pension funds have a relatively small share in the government securities, however they have a significant potential to support the development of the local government securities market in the upcoming period of time. The total net assets of the private pension funds amounted to 32.0 billion lei at the end of 2016 (Pillars I+III) with the holdings in government securities of approximately 21.3 billion lei.

Non-resident investors represent an important segment, as they secure a demand that is complementary to the local investors' demand, given their interest particularly focused on long maturities and helping the diversification of the investor base. The non-residents behavior is more volatile, as it is influenced by the foreign financial markets and the country risk perception. While 2016 started with the expectations that the main central banks, BCE and FED, would have divergent monetary policies, the deferred increase of interest rates in USA to the last meeting in December helped maintaining the investors' interest in the more attractive yields offered by the segment of emerging countries, among which Romania, due to a lack of investment alternatives.

2.3. Eurobonds issued, and foreign loans contracted, in 2016

The quantitative relaxation measures implemented by ECB in 2016 paved the way to decreasing yields for bonds issued by the eurozone countries and launching issuances with very long maturities.

The USA central bank FED decided in 2016 to increase the monetary policy interest rate by 25 basis points, from 0.25% to 0.50%, and this was the first increase in the past ten years, against the background of a significant improvement of economic fundamentals and a significant growth outlook and an inflation rate close to 2%. This has been a long expected decision by the markets, the FED officials revealing three other potential decisions to increase the interest rate in 2017 (first decision to increase the interest rate by 0.25% has already been made in the March 2017 meeting), if the US economy confirmed the positive evolution.

The yields of eurobonds issued by Romania performed similarly to the trends seen in other countries of the region, which proves that the main drivers were global, therefore the effects were felt similarly in the countries of the region. The spread between the yields of eurobonds issued by Romania and the German ones saw a slight increase in the third quarter and dropped significantly after the Brexit decision was made.

In 2016, MoPF attracted on the foreign markets an amount of 3.25 billion Euro in three issuance under the MTN Program. The first issuance in February 2016 reopened the two bonds denominated in Euro that had been issued in October 2015, in a total amount of 1.25 billion Euros, of which 750 million Euro with 10-year maturity and 500 million with 20-year maturity. The issuance was oversubscribed by around 2 times, with yields trending down compared to the initial issuance from 2.845% to 2.55% for the 10-year tranche and from 3.93% to 3.90% for the 2-year tranche.

In May 2016 a new issuance with 12 years maturity was launched, in amount of 1 billion Euro and 2.992% yield, which was also oversubscribed by around 2 times, thus adding a new maturity to the yield curve.

In September the third issuance of 2016 was launched on the market, in amount of 1 billion Euro, by re-opening the 12-year maturity issuance launched in May 2016. The investors' interest was reflected by the size of oversubscribed offers, with an over-subscription of 2.5 times, and in the 2.15% yield, trending down by 0.842% compared to the initial issuance, the lowest cost ever obtained by Romania for this maturity.

The operations conducted on the foreign markets included drawings in amount of around 59 million Euro in loans contracted from international financing institutions.

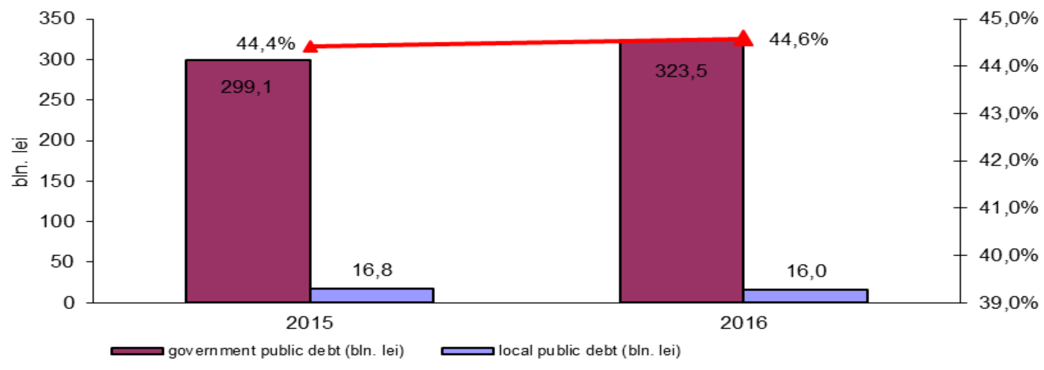
The amounts attracted were intended to finance the budget deficit, refinance the public debt and consolidate the foreign currency buffer available to the State Treasury.

3. Assessment of the government public debt portfolio and associated risks

In the macroeconomic context and of developments on the domestic and foreign financial markets, the public debt contract in accordance with the provisions of the Government Emergency Ordinance 64/2007 on the public debt, as revised further revised and supplemented, amounted on December 31, 2016 at 339.5 billion lei (accounting for 95.3% of the total public debt) with the local public debt of 16.0 billion lei (accounting for 4.7 % of the total public debt).

The 23.6-billion lei 2016 increase of the public debt compared to 2015 was caused mainly by the debt contracted for covering the needs to finance the budget deficit and refinance the public debt, and also for the consolidation of the foreign currency financial buffer of the State Treasury.

Chart: Evolution of public debt



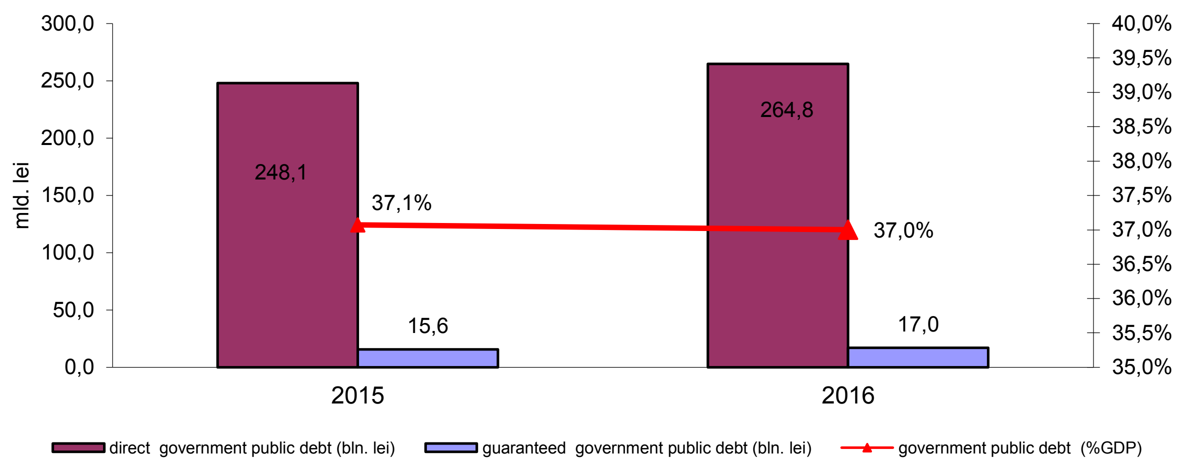
Source: MoPF

3.1. Government public debt portfolio and associated risks [5]

The government public debt on December 31, 2016 amounted to 281.8 billion lei, accounting for 37.0% of GDP.

The direct debt continued to have the highest share (94%) to the total debt, and the difference in the contingent debt. During 2016, the contingent debt remained relatively flat, because of the government guarantees issued for the government programs.

Chart: Government Public Debt by type of debt



Source: MoPF

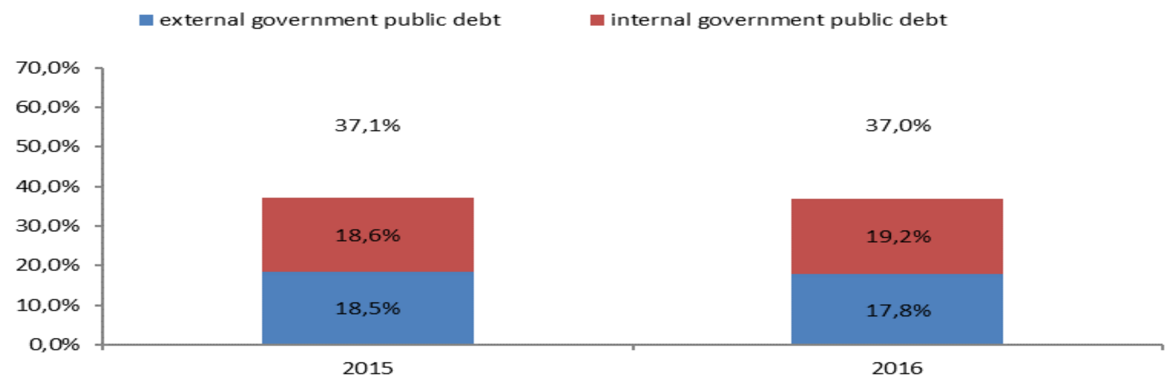
[5] Not including the temporary borrowings, according to the 2016-2018 public government debt management strategy

The guarantees in 2016 amounted to 3,338.3 million lei and were issued for the programs below:

- the first home housing program „Prima Casă";
- the SME loan guarantees program;
- the car park renewal program for the purchase of new cars.

In the government public debt at the end of 2016, 51.9% was contracted by resident investors and 48.1 % by non-resident investors. The majority of domestic government public debt consisted of government securities, with the foreign debt composed of eurobonds issued on the foreign capital markets and foreign loans contracted from official lenders.

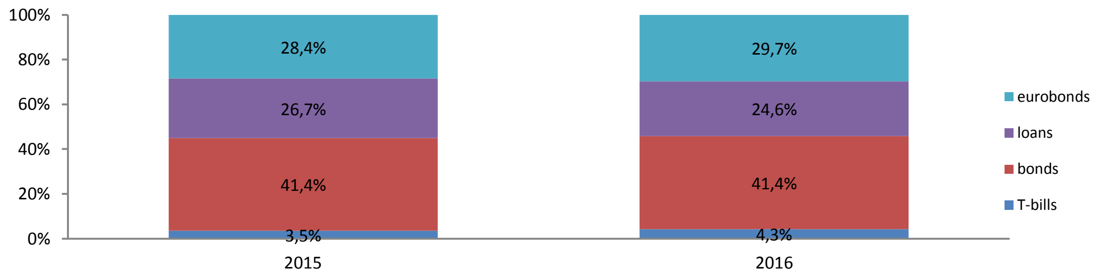
Chart: Government Public Debt composition considering the investor residency criterion (% of GDP)



Source: MoPF

In 2016, MoPF continued to implement its policy focused mainly on negotiable debt issuing, therefore at the end of 2016 the share of government securities increased to 75.4 % of the total government debt from 73.3% at end-2015. As for short term government securities, they accounted for 4.3% of the total government public debt, triggering a decrease in the main risk attached to the government portfolio - the refinancing risk.

Chart: Composition of the government public debt by types of debt instruments
(% government public debt)



Source: MoPF

Debt service

The government public debt service for the year 2016 increased by 1.8 billion lei, as in the table below:

Bn Lei

	2015	2016
Debt servicing of which: - direct debt [6] - contingent debt	 58.9 56.3 2.6	 60.7 59.2 1.5
Debt servicing of which: - capital installments - interest and fees	 58.9 49.7 9.2	 60.7 50.7 10.0

Other indicators[7] of the government public debt servicing are as follows:

	2015	2016
1. Foreign debt servicing /Exports of goods and services[8]	7.7%	5.0%
2. Interest attached to the foreign government public debt /Exports of goods and services [9]	1.7%	1.6%
3. Interest and fees /Revenues of the general government[10]	3.9%	4.5%
4. Interest and fees /Expenditures of the general government[11]	3.8%	4.1%

3.2 The implementation of the 2016-2018 public government debt management strategy

In May 2016, the 2016-2018 Government Public Debt Management Strategy (The Strategy) was approved; the Strategy was drafted following consultations with the central bank BNR (in line with the provisions of GEO 64/2007 on the public debt as further revised and supplemented) and took into account the best practices defined in the WB and IMF Guidelines on public debt management.

[6] The figure does not include the reimbursements from borrowings of the State Treasury's general current account and those from cash management instruments.
[7] The expenditures and revenues of the general government are final data, and for the indicators in points 1 and 2 took into account the net exports of goods and services as released in the spring forecast of the National Commission for Prognosis for 2017 - 2020 for the Convergence Program - April 2017.
[8] The indicator that shows the extent to which the payments of the foreign government public debt servicing are covered by the funds collected from the exports of goods and services.
[9] The indicator that shows the extent to which the interest costs attached to the foreign government debt is covered by the funds collected from the exports of goods and services.
[10] This indicator shows the extent to which the interest rates and fees attached to the government public debt are covered by the revenues of the general government.
[11] This indicator accounts for the share of interest and fee payments attached to the government public debt to the total general government expenditure amount.

The main objectives introduced by the Strategy for 2016 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 a domestic market for government securities

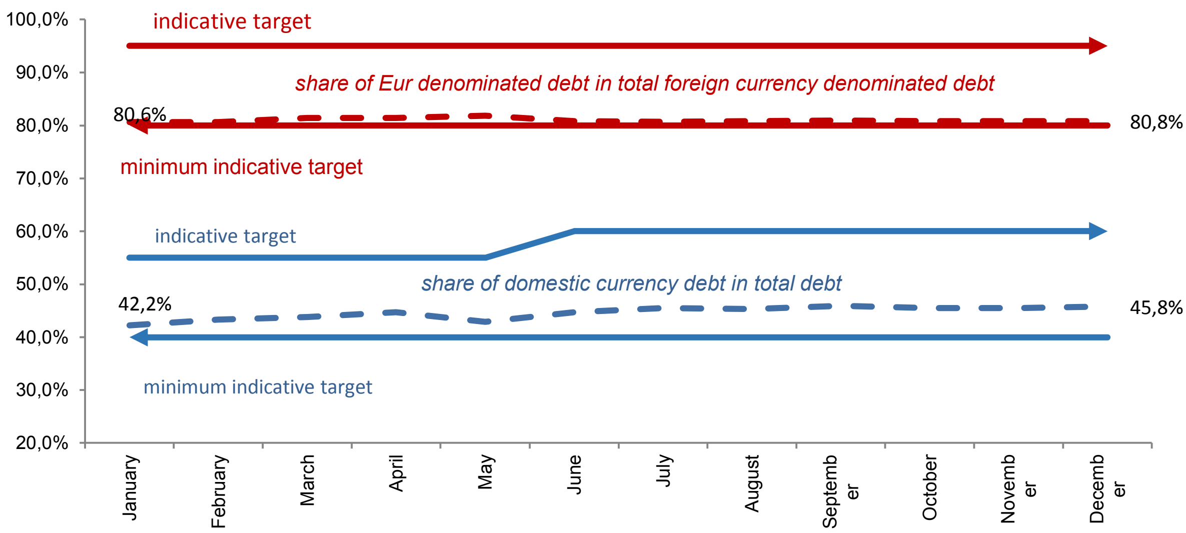
At the same time, the principles on which the funding decisions relied on in 2016 were formulated as indicative target ranges[12] for the main risk indicators associated with the government public debt portfolio.

Risk indicators performance in 2016 [13]

a. Performance of currency risk indicators

The share of government public debt denominated in Euros in total government public debt denominated in foreign currency remained inside the target range established in the Strategy. At the end of December 2016, this indicator was at 80.8% after the debt in foreign currency was contracted from foreign sources, namely the eurobond issuances on the foreign capital markets and the drawings on foreign loans under project financing. On the other hand, the share of lei-denominated public debt in the total government public debt remained throughout the year within the indicative targets set out in the Strategy (it increased from 42.2% in January to 45.8% in December 2016) due in principal to benchmark bonds issued for medium and long terms.

Chart: Performance of currency risk indicators



Source: MoPF

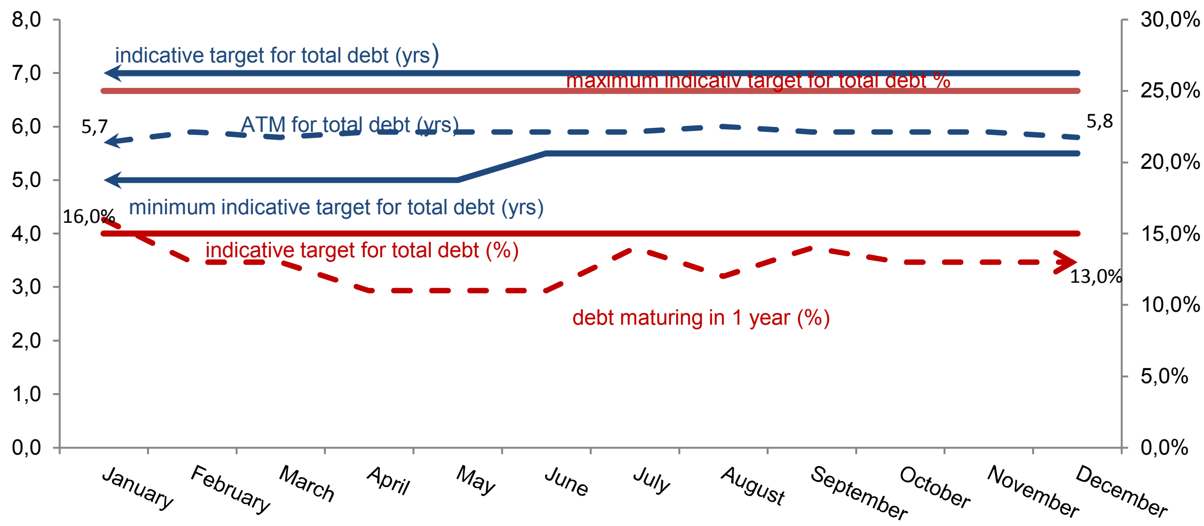
[12] The limits referred to as the minimum or maximum can't be exceeded during the period covered by the strategy (the hard bound), while the other limit is the one to be achieved and can be exceeded (the soft bound).
[13] For January-May 2016, the indicative targets set forth for the interval 2015-2017 Government Public Debt Management Strategy were taken into account.

b. Performance of refinancing risk indicators

The refinancing risk indicators for the whole portfolio of government public debt remained within the target intervals set out in the Strategy, for the whole year.

The indicator that shows the average remaining maturity of the government public debt remained on a relatively flat course throughout 2016 and reached 5.8 years in December, mainly as a result of the medium and long term issuances of government securities and the long term loans contracted in foreign currency. The share of debt with a maturity of 1 year in total government public debt varied throughout the year, trending positive towards the end of 2016 when it reached 13%, that is below the 15% ceiling set out in the Strategy.

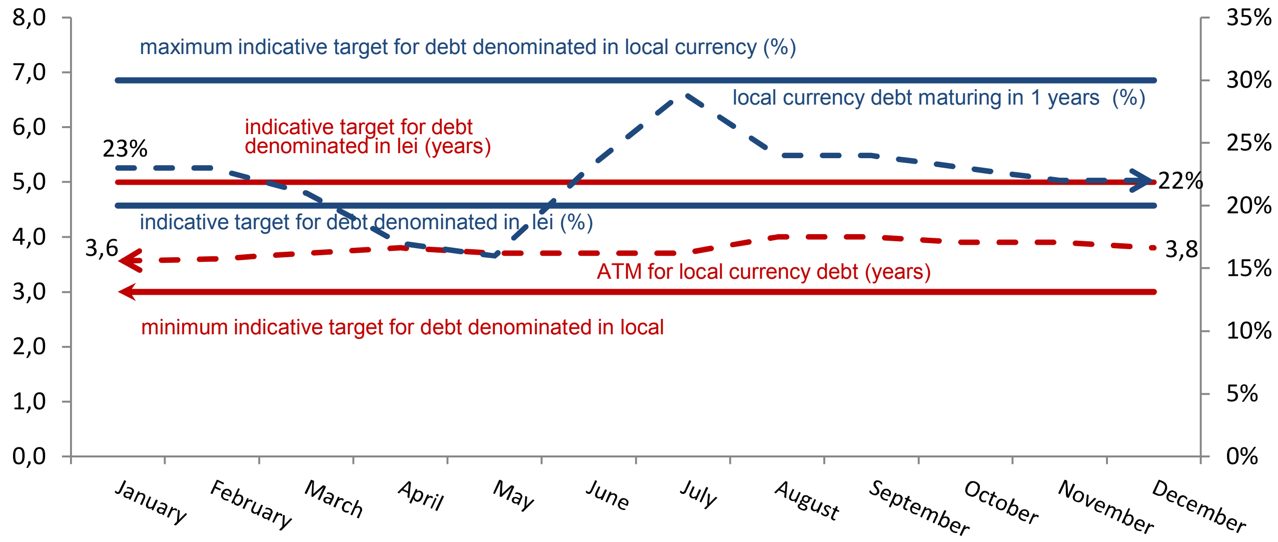
Chart: Performance of refinancing risk indicators attached to the total government public debt



Source: MoPF

The indicators showing the refinancing risk of the government public debt denominated in lei remained within the indicative targets set out in the Strategy, with the remaining average maturity for the government public debt in lei reaching 3.8 years at year end and the share of lei-denominated debt maturing in 1 year at 22%.

Chart: Performance of refinancing risk indicators attached to the debt denominated in lei



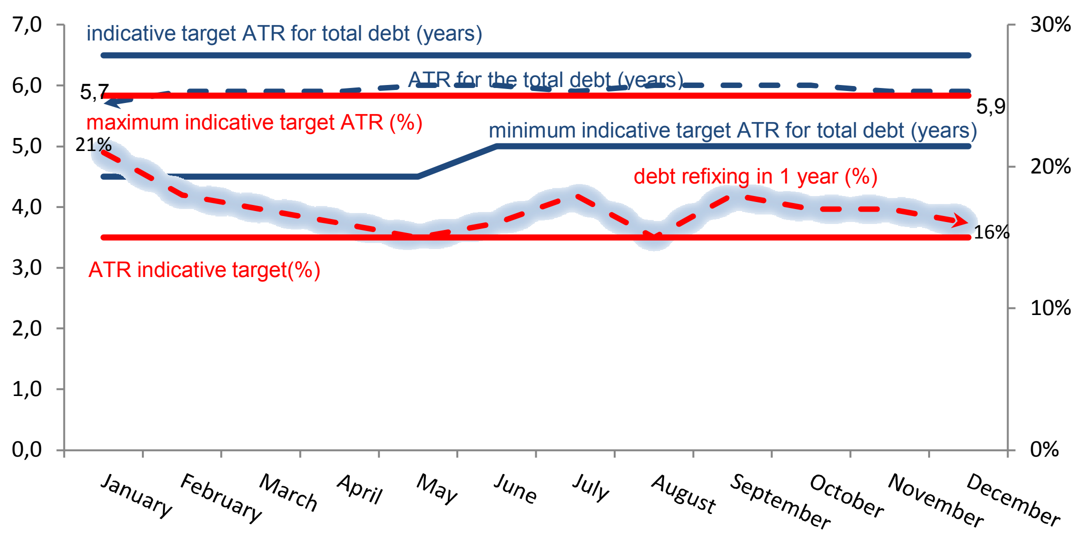
Source: MoPF

c. Performance of interest rate risk indicators

The Chart below shows the debt management to cover the interest rate risk.

The indicators for the entire debt portfolio were at the end of 2016 within the indicative targets set out in the Strategy, namely the average interest rate refixing at 5.9 years and the 1-year floating debt share at 16%.

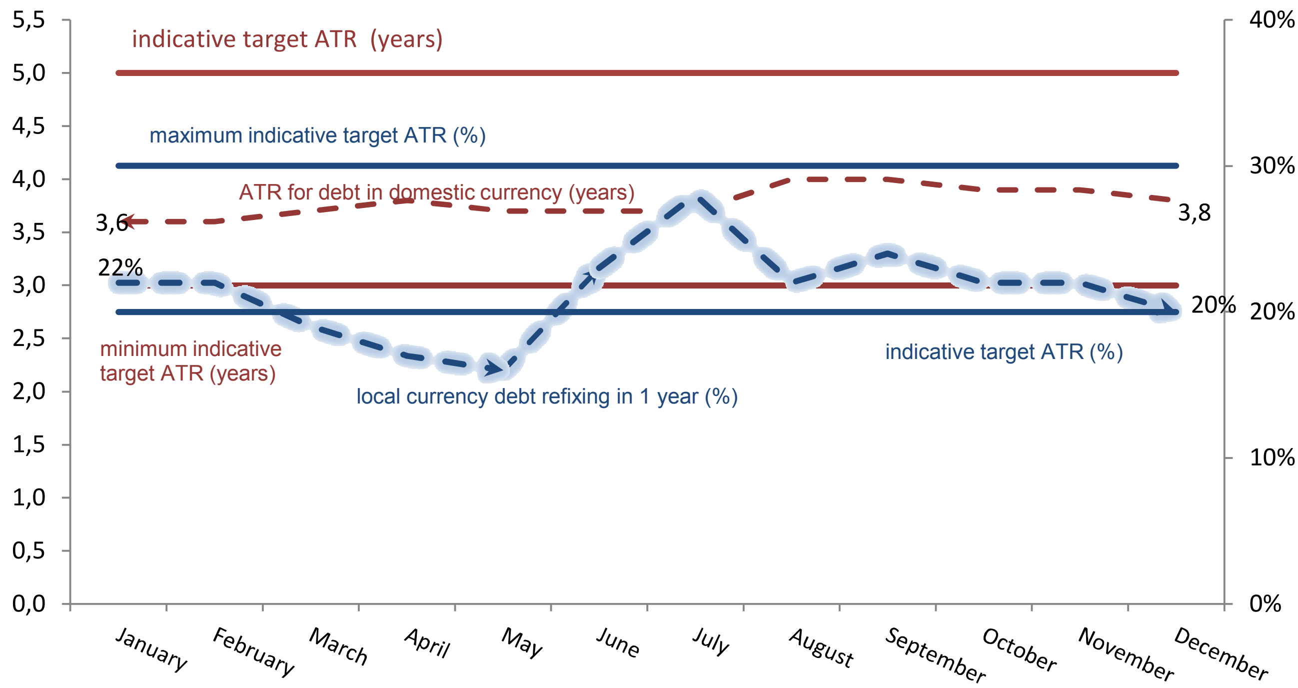
Chart: Performance of interest rate risk indicators attached to the total debt



Source: MoPF

The domestic currency indebtedness indicators of the interest rate risk fluctuated slightly in the second quarter, following the trend of the lei-denominated debt refinancing risk. However, at year end, the indicators remained inside the indicative targets set out in the Strategy, with the share of floating debt with refixing at one year at 20% and the average time to refixing for the lei-denominated debt at 3.8.

Chart: Interest rate risk indicators attached to the debt denominated in lei



Source: MoPF

4. *The government debt according to EU methodology*

In the government debt according to EU methodology, at the end of 2016 the gross debt[14] remained at a sustainable level of 37.6% of GDP, below the 60% ceiling of the Maastricht Treaty and, if liquid financial assets are considered[15], the net government debt amounted to 27.2% of GDP.

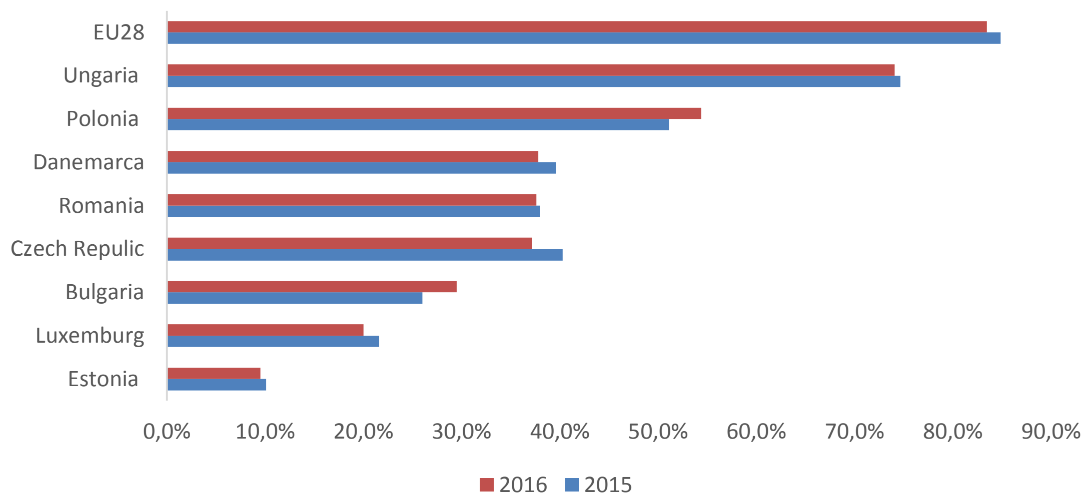
In the European Union, at the end of 2016[16], Romania ranked fifth among the member states with the lowest indebtedness rate, after Estonia (9,5%), Luxembourg (20.0), Bulgaria (29.5%) and the Czech Republic (37.2%).

[14] This is the general government debt at nominal value, consolidated across the sub-sectors of the public administration, not including the guarantees issued by the central and local governments, except for those paid form the budget or on account of which the guarantor made 3 successive payments.

[15] AF1 (gold and SDR), AF2 (deposits and cash), AF3 (securities, other than stock), AF5 (shares and other equity contributions, if listed, including mutual fund shares).

[16] Source: Eurostat newsrelease euroindicators 67/2017 -24 April 2017

Chart: Compared analysis EU28 (% of government debt to GDP)



Source: Eurostat

PUBLIC FINANCE MINISTER

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