MINISTRY OF PUBLIC FINANCE

PUBLIC DEBT MANAGEMENT STRATEGY

2011 - 2013

General Directorate for Treasury and Public Debt

CONTENTS

I. INTRODUCTION

In August 2008, the Romanian Government approved the first medium term debt management strategy that covered the interval 2008-2010 (hereinafter referred to as the Strategy). The Strategy was conceived as a broad framework including the guidelines of financing policies at Government level and management of Government Debt portfolio based on the then-estimates and macroeconomic forecasts. The Ministry of Public Finance, after consultations with the domestic central bank NBR, prepares the medium term strategy for the management of public debt in accordance with the Government Decision 1470/2007 regarding the implementation guidelines of GEO 64/2007 on the public debt; this strategy is submitted for approval by the Government and forwarded to the Parliament for information purposes only; the strategy is subject to annual revisions or periodical revisions as required by the market conditions and/or the financing needs.

The developments on the domestic and foreign financial markets, adding to the worsening macroeconomic conditions, have led to a significant change in the Government financing needs and in the assumptions for the analyses included in the 2008-2010 Debt Management Strategy, which resulted in a need to revise the Strategy. Taking into account the revision time and the need to keep an medium term time horizon for this, this Strategy will cover the time interval 2011-2013. In addition, given the uncertainty of various drivers and the volatility related to the domestic and foreign financial market developments, the objective of this Strategy has been to establish a number of guidelines, without attempting in a rigid manner to impose strict ceilings of the indicators included in the Strategy. However, indicative targets will be set as well as the policies and instruments to be used in order to allow the Government debt management to preserve the debt within sustainable limits and secure the sources to finance budget deficits and debt service resources with minimum cost and an acceptable risk level, in the medium and long run.

Hence, the following were taken into account in revising the Strategy:

i. the macroeconomic indicators (budget deficit, primary deficit, gross domestic product, exchange rates) that had been estimated by the Ministry of Public Finance (MPF) and the National Prognosis Commission (NPC) during the time interval covered by the analysis and discussed with the IMF and the European Community during the joint review missions (Annex 1).
ii. various pessimistic scenarios compared to basic scenarios, in order to determine the sensitivity of the debt indicators to fluctuations of macroeconomic indicators, as below:
    a. reduced economic growth during the time interval under review;
    b. higher interest rates on the foreign markets (LIBOR and EURIBOR) and higher yields of government securities for interest payments related to the Government debt; and
    c. the exchange rate depreciation against the main foreign currencies in the government debt portfolio (EUR and USD).

From a macroeconomic perspective, the strategy must not be seen as an isolated separate document, since:

i. it has used the releases and official reports of the authorized institutions as data source of macroeconomic indicators included in the analyses;
ii. it is connected with policies and strategies that have been already elaborated and approved (2011-2013 Budgetary and Fiscal Strategy; 2011-2013 Expenditure Framework), as well as the with commitments made to international financing organizations (IMF/WB/EC).

In principle, the objectives of this Strategy remain the same as the previous Strategy, as these objectives remain unchanged despite the changes of the market conditions and macroeconomic framework:

i. controlled increase of the government debt and keeping it at a sustainable level;
ii. reduce government debt long term costs, with an acceptable risk level in the government debt portfolio;
iii. develop the market of government securities.

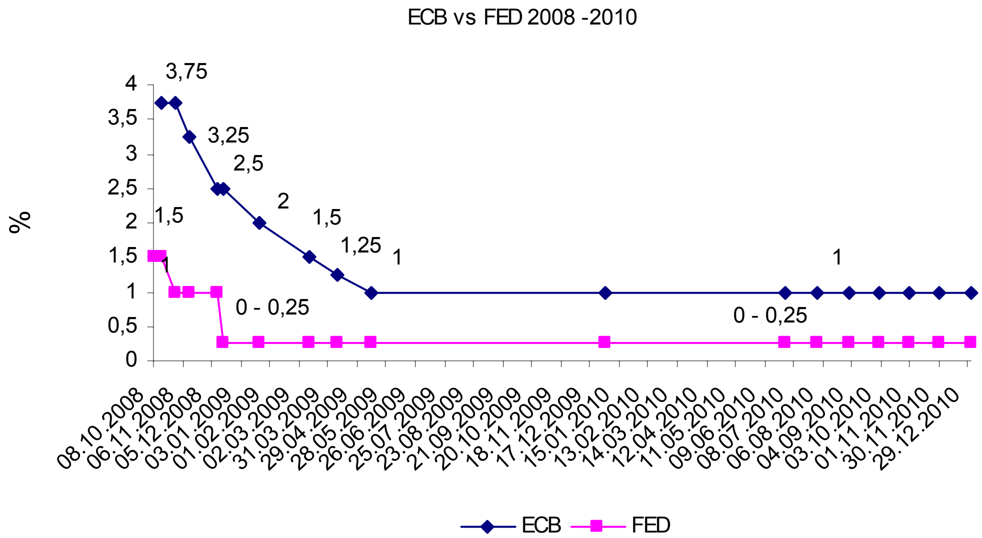
The specific debt and cash management instruments will be used to reach the above objectives, in the risk environment described for the government debt portfolio.

II. ASSESSMENT OF THE 2008 -2010 DEBT STRATEGY

II.A. DEVELOPMENTS ON DOMESTIC AND FOREIGN FINANCIAL MARKETS, MACROECONOMIC CONTEXT OF THE ROMANIAN ECONOMY IN THE SECOND HALF OF 2008 AND UP TO NOW

The disturbances on the international financial markets occurred in the fall of 2007, when the US financial crisis that started on the high risk mortgage market and triggered the worldwide economic crisis, hitting hard the world's economic growth.

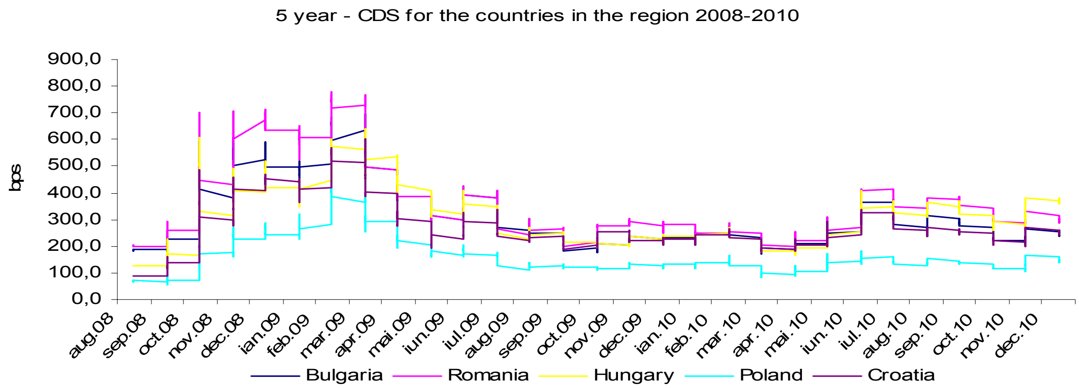
The central banks' policies focused on reducing official rates down to a historical minimum, doubled by asset purchasing strategies (US Government Bonds and other types of financial assets such as Mortgage Bonds – MBS – or other types of asset backed securities, such as Sovereign Bonds issued by various European States), aimed at preserving a purchasing pressure for these instruments and low interest rates for longer maturities. Hence, in 2008, the system of US central banks - FED pushed down the key interest rate to the lowest level ever, between 0% and 0.25%, which is today's level. In addition, towards the end of 2008, the European Central Bank (ECB) pushed down the monetary policy interest rate by 0.75 percentage points from 3.25% in November 2008 to 2.5% - the biggest change ever of the official rate in the history of this financial institution, against the background of a Euro zone in recession. In early May 2009, the ECB monetary policy interest rate hit a new record and reached the level of 1% that has continued until the present day.



Some new MS of the European Union faced severe financial and/or economic crisis under the spiral effects of the developments on the global financial markets and the economic slowdown and/or recession of the main economic partners. Thus, these countries requested foreign financial help and signed joint financial programs with IMF/EU/WB.: Hungary in 2008, Latvia, Romania in 2009 and Greece in 2010.

Whereas all European economies were hit by the crisis, important differences still persist. The factors explaining them include open commerce, financial turmoil exposure and domestic and/or foreign imbalances.
The Greek rating decreased to "junk" at end-April 2010 (below the investment grade) by S&P pushing the country rating down at BB+ (identically to Romania) made Greece the first state in the Euro zone under the minimum accepted attractiveness level. The same rating agency on April 27, 2010 cut Portugal rating two notches from A+ to A-; outlook negative on sustainability risks in financing the government debt. One day later, S&P lowered Spain sovereign rating due to the same reasons. As a consequence of the financial crisis and given the macroeconomic imbalances in our country at the end of 2008, rating agencies Standard & Poor's, Fitch and JCRA lowered Romani's rating for long term foreign currency borrowings from BBB- and BBB (both in investment category), to BB+ (speculative), negative outlook. According to current ratings, Moody's maintains Romania in the investment category, based on some positive appreciations regarding the economic and institutional capacity seen in the medium term, consolidated by a long term convergence process and the EU membership.

The effects of the debt crisis in Greece and the lowered ratings of other EU States by had a negative impact on both CDS ratings and the margins on bonds for emerging countries, including Romania; in their attempt to secure their financing sources, most countries tried to act on market opportunity windows, which resulted in very short period of high amounts issuances alternating with very long periods of no issuances at all. Some European States attempted to secure in advance the 2010 financing (lesson learned in 2009), after the situation in Greece became stable in May.



Source: Bloomberg

Romania's CDS prices were highly volatile especially in Q1 2009, in line with CDS prices for the region, but still above them in absolute terms during the entire time interval under review. By signing the international financial aid package Romania gained credibility due to the investor confidence rising over measures agreed with the foreign institutions. These developments in the EEC Region reflected the uncertainty on the foreign markets and the resulting impact on the deficit targets assumed under the financial package.

The crisis deepened and propagated internationally and this indirectly reflected on the domestic market, with domestic lending institutions (most of them part of foreign financial groups) cutting on their financing, and on the government securities yields on the domestic market which went significantly up.

In 2008, Romania's policy was pro-cyclical and based on overestimated revenues, on one hand, and an increase of expenditures in the public sector, on the other hand, which led to significant macroeconomic imbalances reflected in the high current account deficit (- 11.6% of GDP) and the soaring inflation rate (6.3%). The economic growth of 2008 was 7.3% of GDP, while in 2009 the economy contracted by 7.1% of GDP, with the volume of economic activity being significantly adjusted in many sectors as a result of the financial crisis impact on the Romanian economy and the reduced domestic and foreign demand.

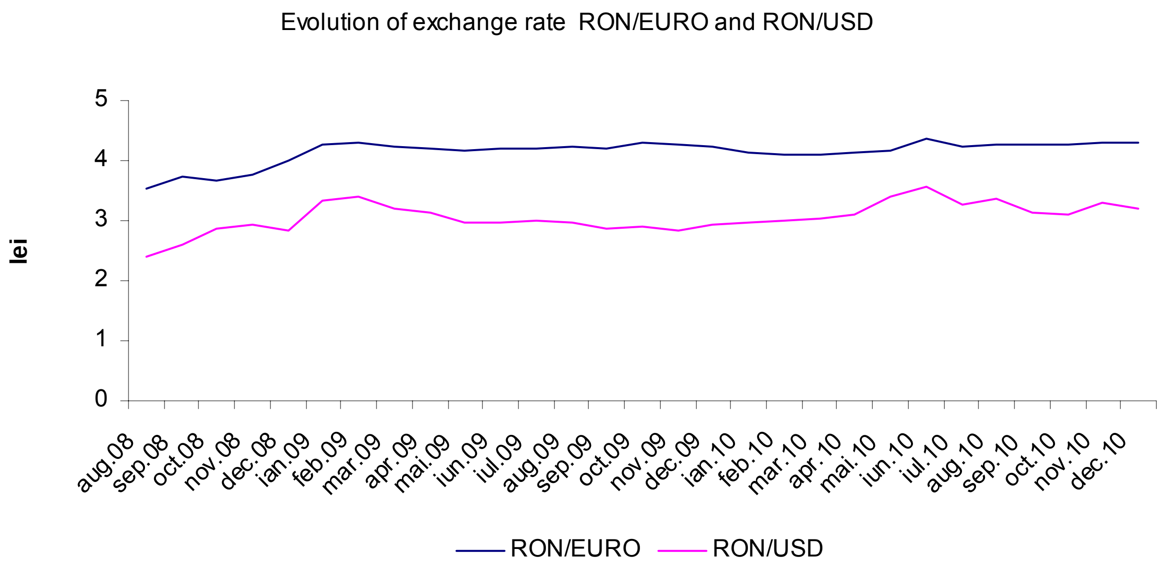
In 2010 as well, the economy is expected to shrink by 1.9 % of GDP[1], with export remaining, as in 2009, the main economic driver in Romania. For the end of 2010 the current account deficit is estimated at 5.7% of GDP.

At end-2009 compared to December 2008, the inflation rate was 4.7%, with a 5.6% annual average, while the annual inflation at September 2010 was 7.8%. The increased inflation rate in the second half of 2010 was mainly due to the increase of the VAT rate in July, with the estimates for the end of 2010 at 8.1%[2].

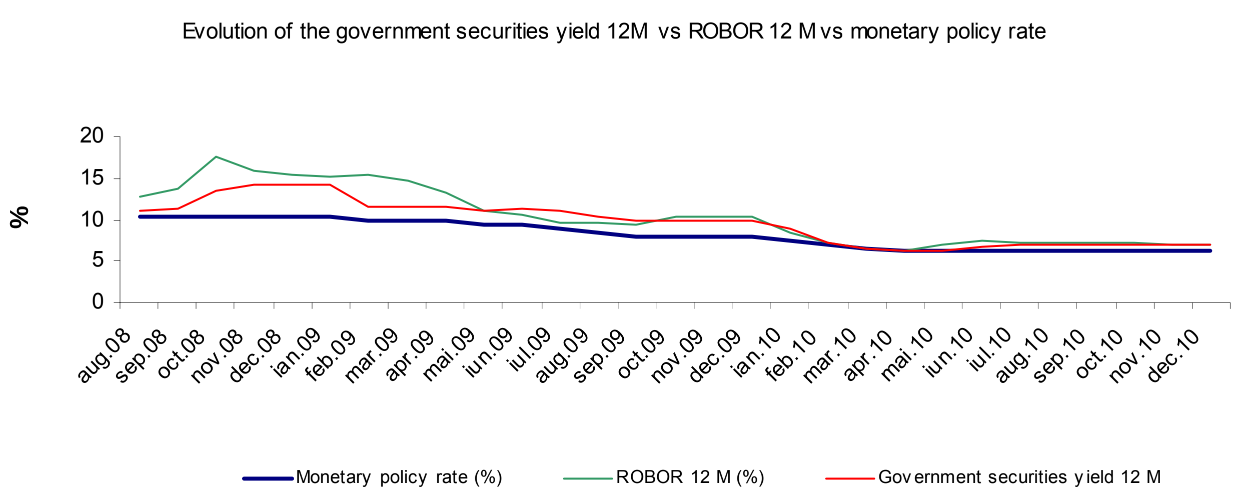
As of April 2010, the RON/EUR rate has shown a descending trend, i.e. 0.6% in September compared to the previous month.

[1] Source : the National Prognosis Commission forecast on November 5, 2010.

[2] Source : Idem 1



In 2008, the central bank NBR increased six times the monetary policy interest rate to reach 10.25% in July. As of February 2009, NBR started a 5-step cutting process of the monetary policy interest rate, down to 8% in September 2009. This descending trend continued in the first half of 2010 with the monetary policy interest rate in May 2010 reaching 6.25%, where it is now.



In the beginning of 2010, both Standard & Poor's and Fitch raised the country outlook to "stable" from "negative' (Annex 4). The main reasons for raising the outlook included, in the case of both agencies, a positive appreciation of the Government's efforts to implement budgetary reforms, the fiscal consolidation actions aimed at reaching the 2010 agreed deficit targets and the fact that the Government showed decided to stick to the fiscal goals agreed with IMF, EC and other donors under the bailout loan program extended in March 2009, in amount of 19.95 billion Euros. EIB and EBRD contribution to the foreign aid financial package is 1 billion Euros, to support the private sector. For financing the budget deficit, this financial package was the optimal move, at that moment, aimed at avoiding the refinancing risk of issuing short term government securities in high amounts, and obtaining a reduction of the financing costs taking into account the cost advantage of borrowing from the foreign financial institutions. This financial package secures the comfort of investment environments as well.

Because of the economic contraction of 2009, the budget deficit target has been successively resized, after consultations with IMF/EC/WB to reach 7.3% of GDP. The execution of the general consolidated budget of 2009 revealed a deficit of 36.4 billion lei, accounting for 7.4% of GDP, in accordance with the nominal value provisioned in the Technical Memorandum of Understanding concluded with IMF [3] and the Memorandum of Understanding with the European Community[4]. For 2010 the deficit target of the general government budget was set at 6.8% of GDP, the budget execution showing a budget deficit of 6,6% of GDP (preliminary data).

II.B. DEBT AND CASH MANAGEMENT

In October-November 2008, the interbank interest rates saw a transitory increase. Thus, during this interval, the monetary interbank market was temporarily affected by the effects of the global financial crisis, consisting of: "lack of trust contamination of banks" , the very probable downward adjustment of the exposure limits among them, and the amplification of the speculative demand of lei from non-residents.

The 3-month Treasury-Bills were re-introduced, following a reduction in the budget revenues collections in the first 3 months of 2008, as a result of the first effects of the financial crisis and an increase of the budget deficit in November. The Ministry of Public Finance adjusted in this way its financing strategy to the demand of the primary market participants. Given the very extensive increase of the government securities yield (in November and December 2008 the yield of short term government securities almost reached the Lombard rate level – 14,25%) as a result of worsening conditions on the interbank market, in order to temporary

[3] GEO 99/2009 for ratification of the stand-by agreement between Romania and IMF as agreed in the Letter of Intent sent by the Romanian authorities and signed in Bucharest on April 24, 2009, and the Decision of the IMF Board of May 4, 2009; the additional LOI signed by Romania on September 8, 2009 and approved by IMF Board in the Decision issued on September 21, 2009, as amended, approved in Law 37/2010

[4] GEO 82/2009 for ratification of the TMU between EC and Romania signed in Bucharest and Brussels on June 23, 2009; Loan Agreement in amount of maximum 5,000,000,000 Euros, between Romania, in capacity as borrower, NBR, in capacity as borrower's agent and EC, in capacity as lender, signed in Luxemburg on June 23, 2009 and in Bucharest on June 18, 2009, approved and amended in Law 364/2009.

cover the budget deficit, the government resorted to borrowings from the cash available in the state treasury general current account (committed on a short term with under 1% interest rate) and to selling foreign currency revenues collected from privatization, in accordance with the legislation in force.
The budget deficit financing strategy in the first half of 2009 focused on government securities issued on the domestic market, since the borrowing terms on the foreign capital markets were very unfavorable, the investors lacking appetite for high risk financial assets charged a high premium leading to a higher increase of foreign loans costs.
The implementation of the debt strategy as described above led to a very high amount of government securities, i.e. RON 20.3 billion, in the first 3 months of 2009, when the one month T-Bills were re-introduced. As of February 2009, the yields of government securities were reduced to an average yield of 11.5 %. In August 2009, after the financing was secured from the foreign aid package (July 2009), the normal practice of issuing 6 and 12 months T-Bills and Benchmark Bonds was resumed.

Initially, only the EU loan and the IBRD's DPL were contracted from the foreign aid package agreed with IMF/EU/IBRD [5] in April 2009; however, because of the deteriorating macroeconomic framework the Romanian authorities together with IMF representatives decided to channel part of the IMF loan to finance the budget deficit and refinance the public debt (half of the 2009 tranche II and of the 2010 tranches III and IV).
In the beginning of 2010 the composition of government securities remained the same as in 2009, mainly short term debt.
Starting with 2010, in order to improve debt management and avoid seasonal pressures of financing the budget deficit and refinancing the debt, the Ministry of Public Finance decided to establish the foreign currency financial buffer – in amount equivalent to the needs of financing the budget deficit and refinancing the public debt over a time period of around four months.
Under the above circumstances, the general government deficit in the period covered by the Strategy was covered mainly from domestic sources supplemented by foreign sources (please refer to Annex 3).

II.B.a. FINANCING ON THE DOMESTIC AND FOREIGN MARKET

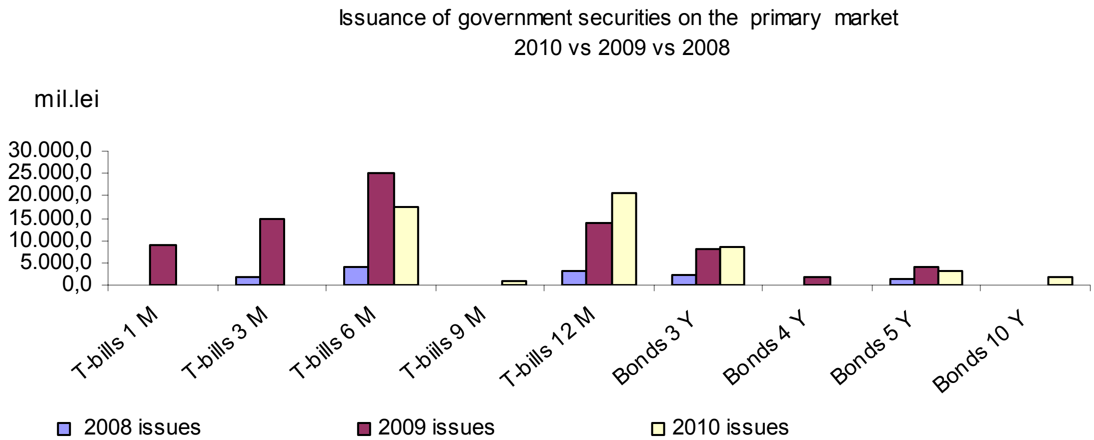
DOMESTIC MARKET

Taking into account the above economic and financial circumstances, government securities were issued in higher amounts on the primary market to cover the high financing requirements due to excessive budget deficits (4.8% of GDP in 2008, 7.4% in 2009 and 6.6% in 2010) and the debt refinancing needs; the high amounts of securities issuances included the short and very short term T-Bills that were re-financed during the year and pushed up the refinancing risk (2008: 12.5 billion lei, 2009: 76.1 billion lei and in 2010 : 51.9 billion lei).

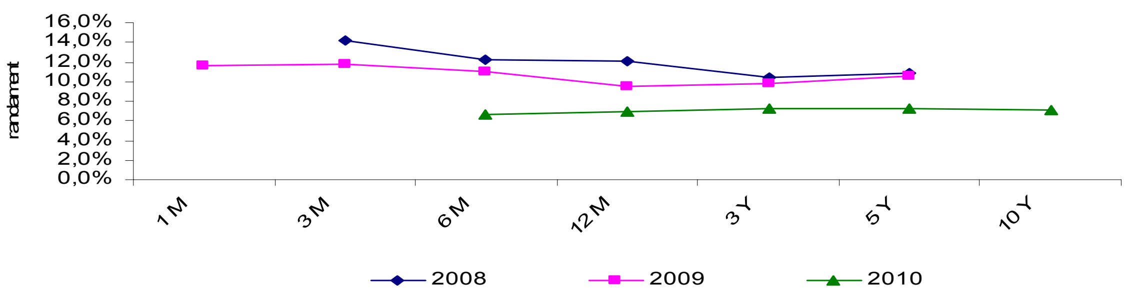
The investors' risk aversion doubled by the prudential policies of lending institutions reflected in tightened lending terms, caused a preference for placements in government securities. T-Bills and Benchmark Bonds were used as lei debt instruments to cover the financing

[5] Part of the World Bank Group

requirements. The 3 and 5 years benchmarks (issued in 2008-2009) and the 10-year benchmark bond (7 years remaining maturity), in the first half of 2010.



2010 Government securities yields[6] in lei compared to end-2009 and end-2008 are as follows:



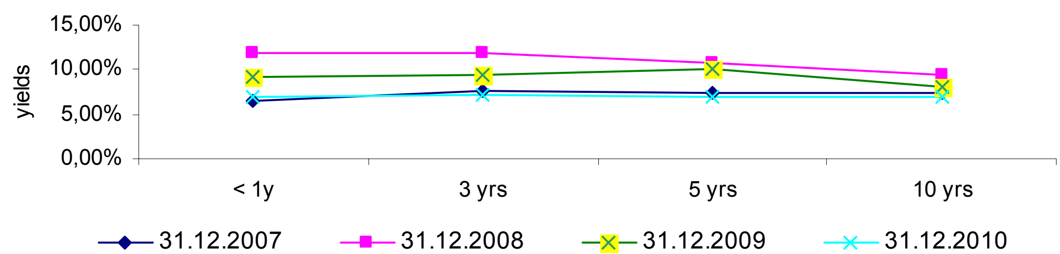
Government securities were issued both in lei and Euro, following the dialogue with the primary dealers and the foreign currency liquidity in the local market. Government securities denominated in Euros issued on the domestic market in 2009 amounted to 2.7 billion Euros, with 1, 3 and 4 years maturities and 4.25% interest rate at 1 year and 5.25% at 3 and 4 years. This was a financing alternative on a medium term, aimed at reducing the risk of using only

[6] The yield is annualized based on maturities. For 3 months securities we have the formula Y={(1+y/400)^4 – 1}*100, where y is the yield.

short term financing instruments in lei. Hence, the foreign currency issuances on the domestic market were an window of opportunity allowing low financing costs in a difficult market time. High volatility and uncertainty about future market conditions required an adjustment to the investment needs and opportunities in the market, therefore the decision was made to issue foreign currency government securities on the domestic market (although not included in the initial calendar), upon request by the most important 9 foreign banks[7] in Romania, including for preserving the exposures of these banks in line with the European Bank Coordination Initiative signed in Vienna and Brussels[8].

At the end of July 2010, MPF launched a T-Bond issuance in foreign currency on the domestic market in amount of 1,2 billion Euros, taking into account the level of foreign currency liquidity on the interbank market and to cover the financing requirements and compensate for the amounts that could not be attracted in recent auctions since the yields on market exceeded 7 %; the amount attracted by this T-Bonds issuance was approximately 3 times higher than the amount announced, and in November MPF issued one other foreign currency 3 year T-Bond in amount of 1.3 billion Euros. Thus, the government securities maturity was extended and the MPF foreign currency reserve consolidated.
On the secondary market of government securities, the yield curves before and after the occurrence of the financial crisis are as follows:

Evolution of the yield curves before and after the occurrence the financial crisis 2007, 2008, 2009 si 2010



With regard to investor, during the time interval under review we can see an increase of government securities holdings[9] by local commercial banks, to the detriment of non-financial institutions.

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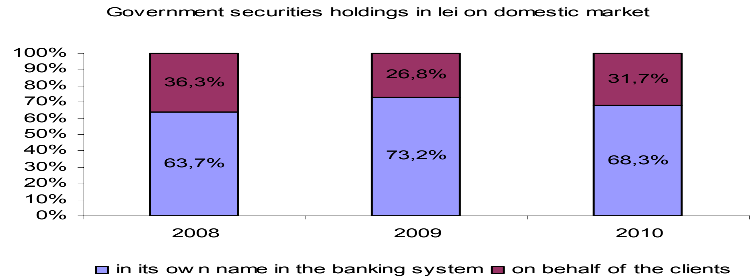
[7] Erste Group Bank, Raiffeisen Group, Eurobank EFG, National Bank of Greece, UniCredit Group, Société Générale, Alpha Bank, Volksbank International and Piraeus Bank
[8] Under this *gentlemen's agreement*, 9 banks pledged not to reduce their exposure in Romania during the stand-by agreement and to act proactively to increase capitalization according to the NBR requirements.

[9] Source: NBR



If at the end of 2009 commercial banks' holdings were over 70% of total issuance of government securities, at the end of 2010 they were 68.3%, while the non-residents' holdings share increasing by around 10.5% of total securities denominated in lei.

FOREIGN MARKET

Foreign financing in 2008 focused on issuing Eurobonds on the foreign markets and, marginally, other foreign financing, including already committed foreign loans (drawings thereof), and other new loans contracted with the international financial institutions.

With the financial and economic crisis showing its effects in the domestic economy, the Eurobond market terms and conditions became unfavorable (in terms of costs and maturities); the other available instruments, especially the foreign financial package agreed with IMF, EU and the World Bank became vital for ensuring the financing needs under the most optimal cost/risk conditions.

Hence, in the second half of 2009, with the first tranche of the EU loan disbursed in July 2009 (1.5 billion Euro) and the second tranche from the IMF loan disbursed by the Fund in September 2009 (859 million SDR) the financing sources for financing the budget deficit became available. In addition, the first IBRD's DPL was contracted in September 2009 (300 million Euro), and drawn in October 2009.

The IMF, EU and IBRD foreign loans contracted with a very favorable interest rate, help reaching the objectives of minimizing the debt cost on an average and long term and reducing the refinancing risk by balancing the debt maturities, without giving up domestic issuances of government securities, taking into account the objectives of reducing the currency risk and developing the market of government securities.

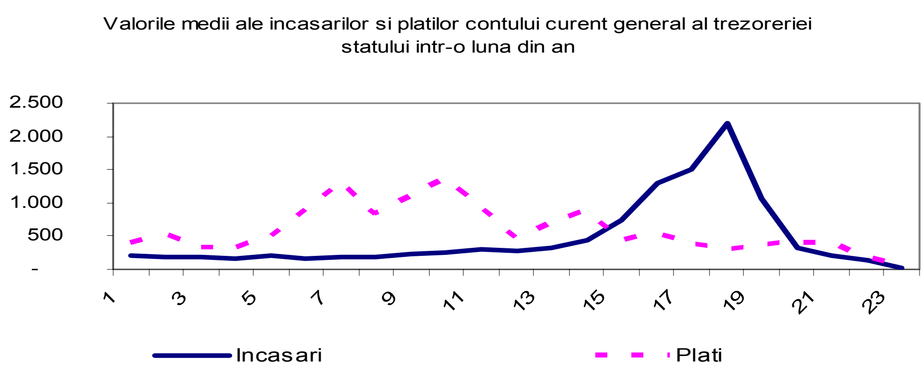
In March 2010, a favorable context (liquid enough financial markets and reasonable margins) created windows of opportunity benefiting other sovereign issuers as well, and the Ministry of Public Finance launched an Eurobond issuance on the foreign capital markets in amount of 1 billion Euro a 5% coupon a 5 years maturity. This issuance was oversubscribed about 5 times, which proves that there is significant interest for the Romanian government securities in lei on the foreign capital markets. The amounts attracted were used to refinance the 700 million Euro Eurobond issued in 2003 maturing in July 2010, with the difference used to finance the budget deficit and refinance the debt.

From the foreign financial package, for financing the budget deficit in February 2010 half of the tranches 3 and 4 were drawn from the IMF loan (1,087.5 million SDR), while in March 2010 the second tranche in amount of 1 billion EUR was drawn from the EU loan. On September 22, 2010 the third tranche of the EU loan in amount of 1.15 billion Euro was disbursed.
To supplement the presented foreign loans for financing the budget deficits in 2009-2010, the project funding foreign sources were used.

In 2010, MPF issued only one government guarantee for the companies in amount of 320 million Euro for the loan contracted in March by SC FORD Romania Company from EIB.

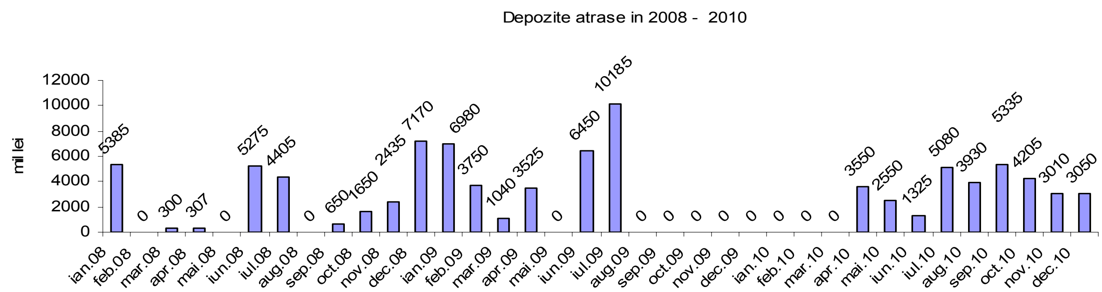
II.B.b. CASH MANAGEMENT

Cash management operations were caused by the high gap between collections and payments to/from the state treasury general current account, as it can be seen in the graphic below:

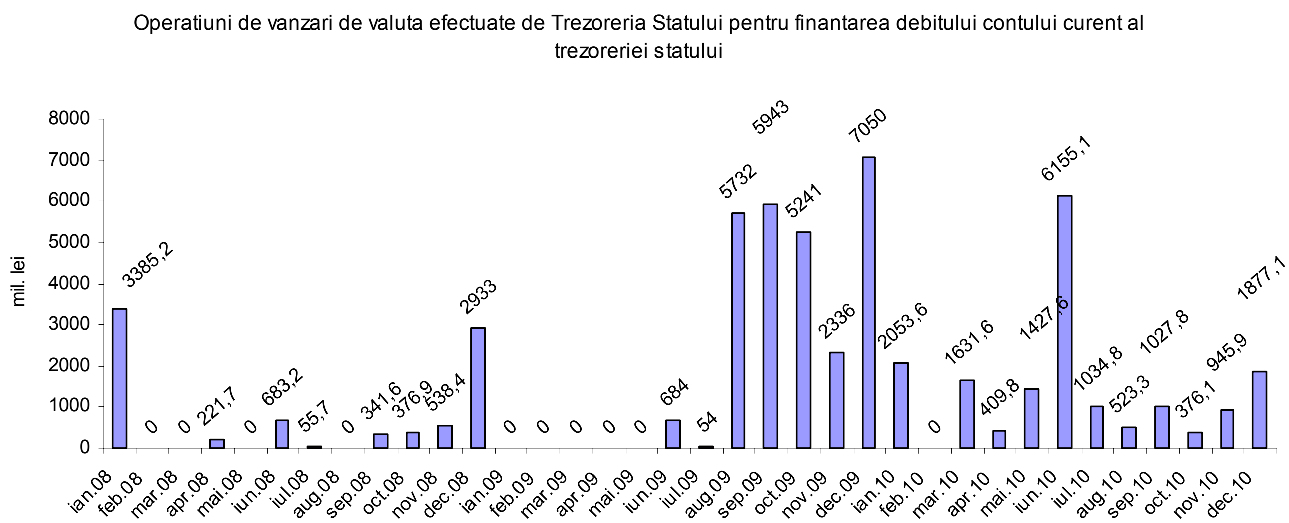


Temporary cashier deficits in the state treasury general current account were covered by attracting short term deposits of credit institutions on the interbank market, and by fx operations.

The very short term deposits attracted on the interbank market (less than one month), ranged between approx. 20 and 30 billion lei (2008: 27.6 billion lei, at an average interest rate of 8.7%, 2009: 31.9 billion lei, at an average interest rate of 11.1% and in 2010: 32,0 billion lei, at an average interest rate of 4.0%).



Fx operations were conducted with the foreign loan drawings, including the foreign financial package, the Eurobonds issuance (in 2008 and 2010), as well as 2008 collections from privatization.



II.C. GOVERNMENT PUBLIC DEBT STRATEGY IMPLEMENTATION IN 2008-2010

The main objectives of the 2008-2010 Debt Management Strategy have been as follows:

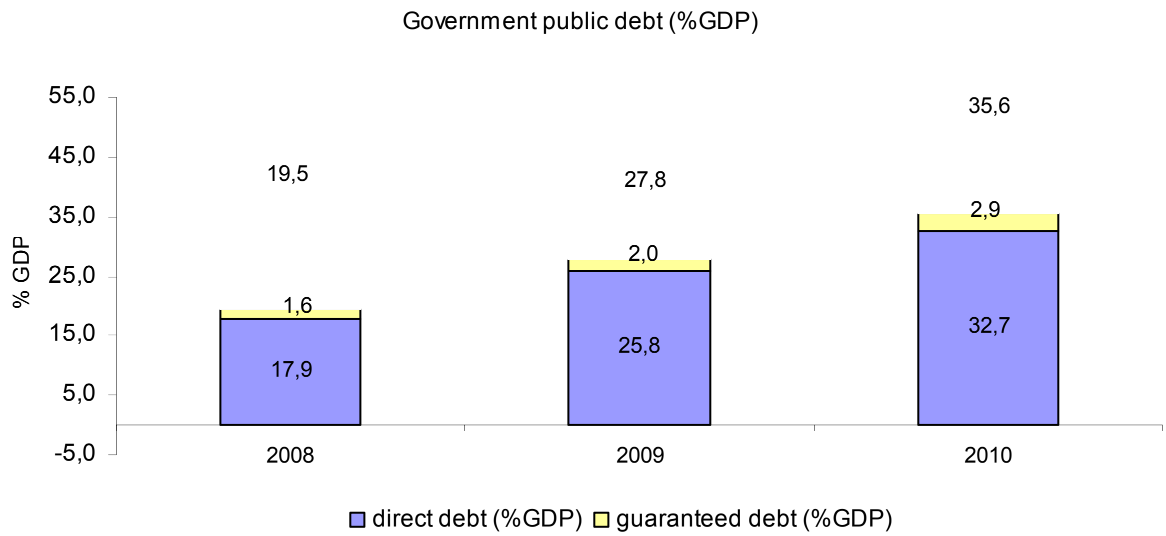
1. Control the government debt increase;
2. Reduce government debt long term costs, with an acceptable risk level in the government debt portfolio;
3. Limit the risks in the government debt portfolio;

4. Develop the government securities market.

The achievements related to the main Strategy objectives during the time interval 2008 – 2010:

OBJECTIVES	2010	2009	2008	Limits set in the Strategy
1. Controlled increase of the government debt (%GDP)	35.6%	27,8%	19,5%	
2. Reduce the long and medium term government debt costs while controlling the risks associated to the debt portfolio - interest payments share in the general government budget to GDP	1.4%	1,2%	0,7%	
3. Control the risks by: A. Currency risk				
a. Increase the lei government debt share in total government debt (%);	45.3%	47.1%	59.7%	**minimum 55%**
b. Increase the EUR government debt share in total foreign currency government debt (%);	78.2%	78.5%	69.5%	**minimum 65%**
c. Decrease the EUR government debt share in total government debt (%), B Refinancing risk	42.8%	41.5%	28.0%	**maximum 40%**
d. Reduce the refinancing requirements for the government debt (short term debt share in total government debt) (%)	35.2%	37.8%	49.3%	
e. Average remaining maturity in the debt portfolio (years)	4.0	3.7	3.0	
C. Interest Rate Risk				
f. Increase fixed rate debt in total government debt (%)	52.0%	42.4%	31.3%	
g. increase negotiable debt in total government debt (%);	42.4%	40.8%	26.1%	
4. Develop government securities market (billion lei) - government securities issuances for the period, less for refinancing maturing securities (new issuances)	20.0	29.3	8.5	

1. Due to the deterioration of the macroeconomic environment, the budget deficits increased in 2009 and 2010 to 7.4% of GDP and 6.6 % respectively, which led to an increase of the government debt triggered by the government securities issuances on the domestic and foreign market and the newly contracted loans under the foreign financial aid package. The fiscal consolidation measures implemented in 2009 and 2010 in a move to reduce the budget deficit in line with the medium term calendar contributed to the reduction of the government debt increase risk in 2009 and 2010.



In 2009, given the financial crisis impact on the loan access terms and conditions of companies implementing strategic projects with a multiplying economic effect, MPF took into consideration issuing government guarantees as a move to attract financial resources into this type of projects. The 2009 guarantee ceiling, which is also a performance criterion in the Stand-by Agreement with IMF[10] was first set at 7.7 billion lei, than increased to 12 billion lei for 2009 and 2010 cumulatively. The additional amount has been granted to cover the guarantees issued to secure co-financing of EU-funded projects and projects financed by other institutions. Hence, as of July 7, 2009 the “First Home” housing project has become operational[11]; under this project, MPF authorized the SME lending guarantee fund, to issue government guarantees, on behalf of the state, to banks that extend loans to individuals who wish to buy a home under the program. The guarantees under the program amounted in 2009 to 2.1 billion lei, with 6.0 billion lei for 2009- 2010.

2. The government debt costs should be interpreted in the context of the market financing terms at the moment of contracting/issuing the debt and taking into account the objectives relating to controlling risks in the debt portfolio. Therefore, the costs associated to the high amounts of government securities issued on the domestic market to cover the budget deficit and refinance the government debt, were directly reflected by the indicator showing the share of interest payments to GDP, which increased to 1.2% of GDP in 2009, from 0.7% at the end of 2008. The government securities issuances were mainly intended for short term maturities due to the decreasing liquidity on the interbank markets (2009), and to uncertainty over the economic growth and inflation prospects (especially for 2010).

The conclusion of the financial aid package agreement doubled by the economic recovery trend at global level and the central banks’ measures, led to an increasing investor confidence

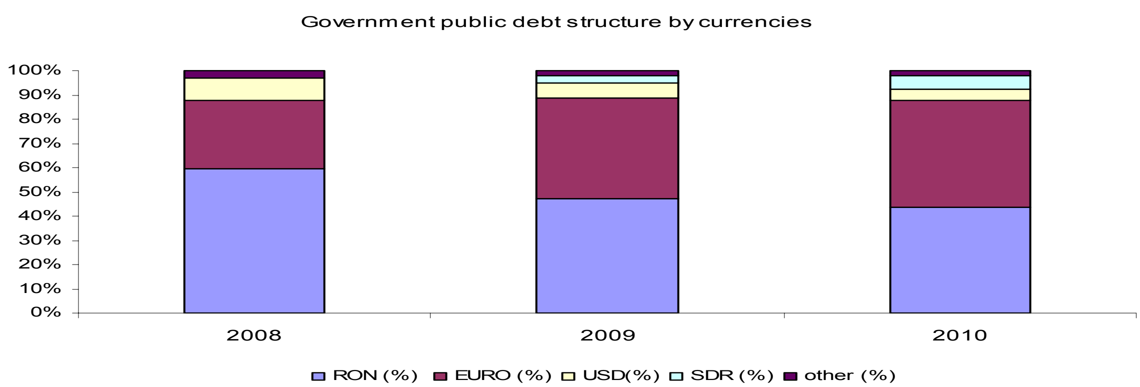
[10] ratified in GEO 99/2009 as subsequently supplemented and amended
[11] GEO 60/2009 on various measures for implementing the « First Home » housing program, as amended in Law 368/2009 and GD 717/2009 for approval of application guidelines for the « First Home » housing program

reflected in a significant decrease of the CDS rates for Romania from 610 bps at the beginning of February 2009 to about 290 bps at the end of 2010.

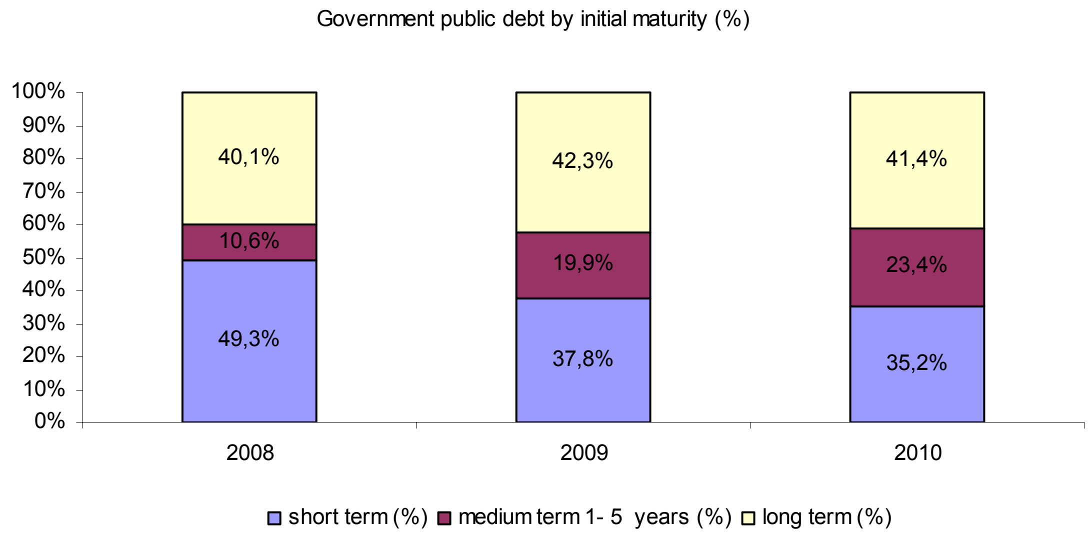
It is important to mention that the foreign financial package was contracted under very advantageous interest terms, i.e. 3.125% for the first EU loan tranche (July 2009), 3.375% for the second tranche (March 2010) and 2,375% for the third tranche (September 2010), around 2% (Libor at 6 months for Euro + 0.95%) for World Bank's DPL1 and around 2.3% for half of the IMF loan tranche 2 (September 2009) and half of tranches 3 and 4 (February 2010), calculated based on interest payments made in May 2010. However, this led as well to an increase of the Euro-denominated government debt.

3. Still, the exposure to various risks increased, reflected in a decrease of the *lei-denominated government debt share in total government debt and implicitly, the increase of Euro-denominated government debt share in total government debt.*
Hence, despite of the fact that in 2008 the indicator showing the lei government debt share in total government debt observed the ceiling set in the Debt Strategy, in 2009 and the first nine months of 2010 this indicator deteriorated as a result of the foreign currency loans contracted on the domestic market, the foreign loans that have been contracted and the Eurobond issued in March 2010 needed to support the high budget deficits of 2009 and 2010 and balance the maturities in the debt portfolio. Given the level of liquidity on the market, after NBR's move of pushing down the minimum level required for the foreign currency reserves (for the year 2009), and the commitment made by the first 9 foreign banks to keep their exposures unchanged, the short term and medium term issuances of government securities denominated in Euro remained the financing alternative under favorable cost terms and with medium maturities.

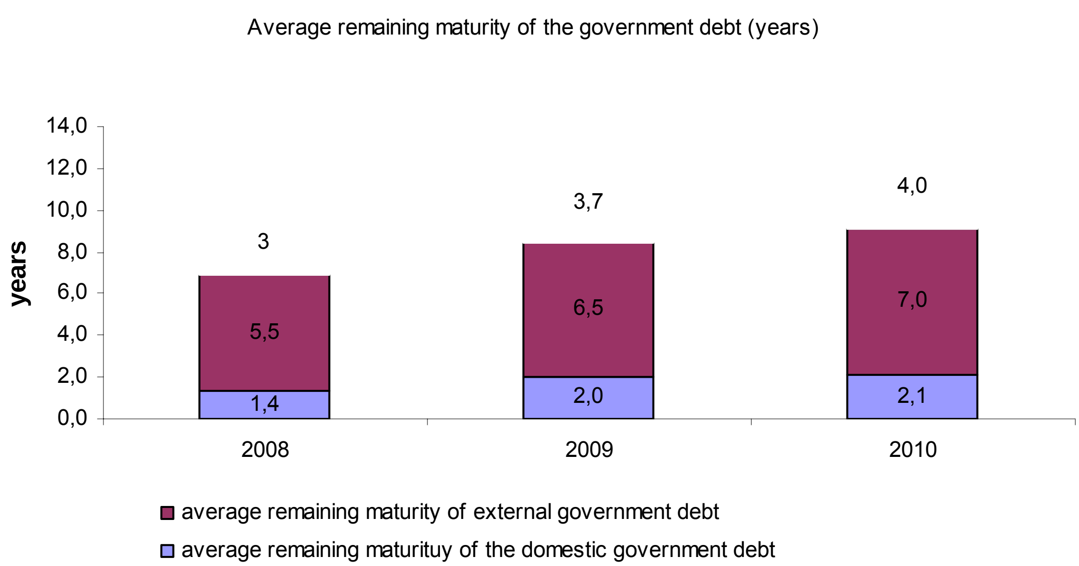
For the same reasons, the 40% ceiling set for the indicator Euro government debt share in total government debt at end 2009 and end 2010 was exceeded.



In terms of refinancing requirements, this indicator improved in 2009 and 2010, by increasing the share of medium and long term debt (over one year), from 50.7% in 2008 to 64.8 % at the end of 2010. The high short term debt share, although decreasing, reveals a high refinancing risk in the public government debt portfolio, due to the temporary financing from the holdings of the state treasury general current account, as well as to the more frequent issuances of Treasury-bills in 2009 and the first half of 2010.



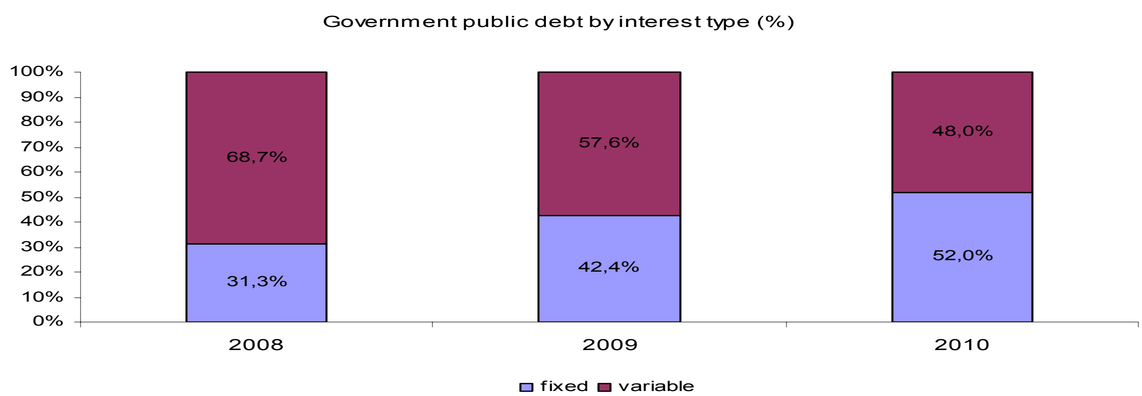
Hence, against the background of new debt contracted, on a medium and long term, in government securities on the domestic and foreign market, and also from the foreign financial package, we can see an increase of the average remaining duration of the government debt to 4.0 years at the end of 2010 as compared to 3 years at the end of 2008.



Despite of the gradual reduction of the temporary financing requirements targeted by the Debt Strategy, in 2008 the debt went up by 10.2 billion lei and impacted on the indicators showing the refinancing requirements and floating interest rate debt share in total debt, whereas in 2009, when the budget deficit was covered from foreign loans and government securities issuances on the domestic market, the borrowings from the state treasury general current account were no longer used as debt instrument. Under the circumstances, in 2009 these borrowings went down by 11.5 billion lei as against end-2008, at the end of 2010 they were in absolute value at the level of 31.4 billion lei (up by 3.3 billion lei as compared to the end of 2009).

Despite the advantage of this instrument of temporarily financing the budget deficit with low costs (under 1%) on a short term, there are also disadvantages. This in a non-typical instrument, that is specific to our country, and it is used depending on the holdings in the state treasury general current account and determines the increase of the refinancing and liquidity risk exposure, as well as the interest rate risk , with a negative impact on the debt management. The accumulation of temporarily financed budget deficits (not finally financed) is one more reason why we must refinance the temporary financing gradually, through government securities, over a long period of time, in a move to reduce the impact on the domestic market and in order not to significantly impact on the cost of these financing operations.

The composition of debt depending on the interest rate type reveals a continuous increase of the fix debt share from 31.3% as at the end of 2008, to 42.4% at the end of 2009 and 52 % at the end of 2010, mainly as a result of the loans contracted from EC, the foreign currency borrowings on the domestic market and the benchmarks issued on a medium term and the March 2010 Eurobond. This type of dynamics reduces the risk of an increasing interest rate in the public debt portfolio.

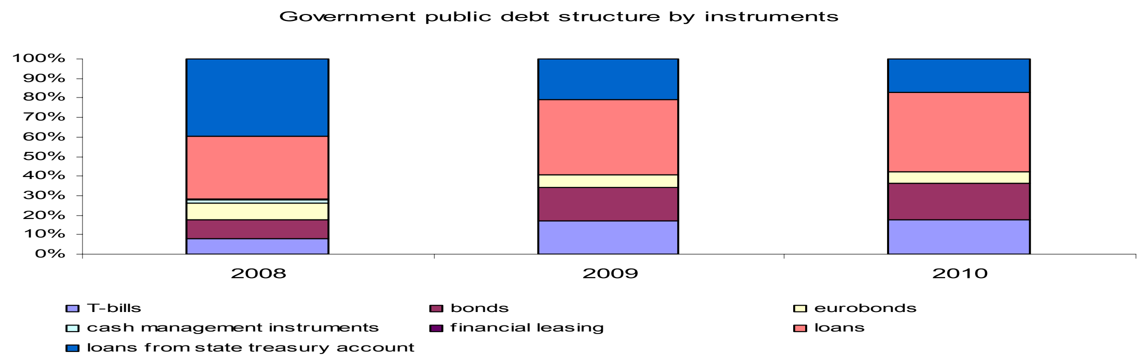


4. The deviation from the maturity composition established in the 2008 Debt Strategy (30% short term and 70% medium and long term) was mainly a consequence of the changes in the investor demand, with investors targeting more low risk assets with short and medium maturities, especially with regard to non-investment grade investments.

In both 2008 and 2009, investors preferred medium and short term maturities. The maturity composition of the 2008 debt was 71% short term and 29% medium term, while in 2009, due to worsening financial crisis conditions and investors' increased appetite for short term and very short term debt instruments, the composition of government securities in domestic currency continued to deteriorate and reached at 87% short term and 13% medium term debt.

If we take into account government securities in foreign currency, the maturity composition of securities issued on the domestic market in 2009 was 83% short term and 17% medium term.

In 2010 the government securities composition improved compared to 2009, but remained detrimental in terms of refinancing risk: 75% short term and 25% medium and long term in the end of 2010. In April and May 2010 only, the practice of issuing long term government securities was resumed by reopening the 10 years issuance launched in 2007 (7 years remaining maturity), based on a nonetheless insignificant demand coming from certain investors.



Credit Risk and Operational Risk

With regard to the **credit risk accommodated by the budget risks of issuing government guarantees and on-lending,** we mention that in 2009 the payments from the risk fund[12], made to repay the loans and sub-loans extended to economic operators and guaranteed by the state, went down to 0.09% of GDP, from 0.1% of GDP at end- 2008, whereas in 2010[13] the payments made from the risk fund accounted for 0.03% of GDP.

As a measure to reduce the **operational risk** and secure the debt servicing, as of January 1, 2009, under the legal framework provided by the Government Emergency Ordinance 64/2007 on the public debt, as amended, and the Government Decision 683/2008 for approving the application guidelines of art. 14 in GEO 64/2007 on the public debt, the Ministry of Public Finance took over the loans[14] contracted by the main spending agencies or the economic operators with government guarantees and/or contracted for on-lending by MPF, for which the only repayment source is the state budget, the social security budget and the unemployment budget, with the previous approval of the donors.

[12] In 2009, payments from the risk fund amounted to 446.3 million lei
[13] In 2010, payments from the risk fund amounted to 163.9 million lei.
[14] 146 loans.

III. 2010-2013 MACROECONOMIC FRAMEWORK

III.A. EU TRENDS , ESPECIALLY IN THE EUROZONE

Looking into the future and taking into account various temporary effects, EU expects a moderate but uneven growth rate of the actual GDP, both across the economies and the Euro zone sectors. The economic growth at global level and the impact thereof on the export demand in the Euro zone, in parallel with ongoing quantitative monetary policies conducted by ECB and the measures adopted to restore the soundness of the financial system, should be able to continue to prop up the Euro zone. However, the process of putting the economic activity back on a sound track is expected to be toned down by the balance sheet adjustments needed in various sectors and the not very optimistic prospects about the labor market.

Inflation rates are expected to remain at levels compatible with the objective of keeping inflation under control, but close to the level of 2% on a medium term. Controlling inflation remains a priority.

III.B. MEDIUM TERM MACROECONOMIC FORECAST

Economic Growth

During the time interval 2011-2013, the macroeconomic forecast [15] took into account the implementation of the loan agreement concluded with EU, IMF and the World Bank, and by this the structural reforms and the established terms and targets. The active measures aiming at improving the business environment, reducing macroeconomic imbalances and causing the financial and banking sectors to become stable, are expected to allow sustainable economic growth and create new jobs as of 2011. The 2011 macroeconomic framework takes account of the fact that the economic and financial situation will improve, the economic recession will fade out in the first six months of the next year to accommodate a 1.5% growth rate. In the last 2 years of the time interval covered by the Fiscal Strategy, the economic growth is expected to speed up and push up the gross domestic product by over 4% (3.9% in 2012 and 4.5% in 2013).

Inflation and Exchange Rate

In 2011-2013, the disinflation will be kept on a sustainable path, since the impact of VAT rate increase will weaken and prudential wage policies and structural reforms will be continued. Hence, the inflation rate is expected to go down to 2.8% (Dec/Dec) in 2013. The continuing disinflation process will help reducing the inflation expectations.

[15] According to the Budgetary and Fiscal Strategy.

- % -

Inflation and GDP Deflator	2011	2012	2013
Inflation			
- year-end	3.2	3.0	2.8
- annual average	5.3	3.5	3.2
GDP Deflator	4.8	5.9	5.3
Exchange rate (RON/EURO) – annual average	4.21	4.18	4.16

Source: The National Prognosis Commission

Budget Deficit

In line with the Council Decision [16] of July 7, 2009, Romania is facing the excessive deficit procedure with a deadline to cut the deficit calculated according to SEC 95 Standard to below 3% of GDP until 2011. The Romanian authorities strictly implemented the EU recommendations but taking into account the higher than expected negative impact of the worsening global circumstances on the Romanian economy, the European Council issued in February 2010 a revised recommendation to keep the budget deficit below 3% of GDP until 2012.

On September 21, 2010, the European Commission announced that Romania has met the main commitments regarding the deficit target, as it concluded that the state took adequate and appropriate measures to reduce its budget deficit below 3% by the deadline agreed that the end of 2012 – the excessive deficit procedure remaining in abeyance until the fulfillment of all commitments.

IV. GOVERNMENT DEBT RISK POLICY

The risk indicators were revealed by a “Cost at Risk” analysis (CaR), based on the model used for the 2008 Strategy. The assumptions and constraints remain the same, this time using the government debt portfolio estimated at December 31, 2010.

The analysis of risk indicators in various financing scenarios (taking into account recent developments and financing prospects in the medium run) as well as of their importance, revealed that the optimal scenario is the one in which the budget deficit would be financed more from foreign sources. However, given the budget deficit high financing needs and refinancing of the public debt in 2011-2013, as well as the need to consolidate and develop the domestic market of government securities in particular brought to light by the financial crisis, and taking into account the high volatility of the foreign capital market and its impact on the Eurobonds issued on the foreign markets, we consider that the optimal scenario is the one in which the budget deficit would be financed in a balanced manner, from both domestic and foreign sources.

[16] The excessive deficit procedure is governed by the provisions laid down in Article 126 of the Treaty and Council Regulation for speeding up and clarifying the implementation of the excessive deficit procedure.

Given the uncertain prospects of the world economy and the Romanian economy, as well as the high volatility on both domestic and foreign financial markets, in monitoring the financial risks of the government debt portfolio we propose to use for 2013 minimum or maximum limits that will ensure a certain elasticity in fulfilling the objectives of the current Strategy and will be used to regularly compare the performance of the actual portfolio:

Indicator	Lower limit	Upper limit
Debt in domestic currency (lei) as share of the total government debt	45%	
Debt in EURO as share of the total foreign currency debt	75%	
Refinancing at 1 yr)*		35%
Refinancing at 5 yrs)*		75%
Refixing at 1 yr)*		50%
Refixing at 5 yrs)*		85%

*) To the extent that the domestic market will allow giving up temporary refinancing from the State Treasury General Current Account holdings, with this debt to be refinanced through government securities issuances.

The proposed indicators for the 5-year refinancing level and 5-year refixing percentage largely help keeping the debt portfolio risks under control, though these are calculated for a period of time that goes beyond the Strategy interval. The use of these indicators is required all the more since for keeping the refinancing risk under control there are instruments that are specific to the secondary market of government securities that may be used, such as bond exchange and buyback operations, and when this moment comes the above-mentioned risk indicators will be considered.

V. OBJECTIVES OF THE 2011-2013 DEBT MANAGEMENT STRATEGY

V.A. OBJECTIVES OF THE DEBT MANAGEMENT STRATEGY

The main objectives of the Strategy are, in principle, the same as for the previous Strategy, as they remained unchanged despite the changes in the market conditions and the macroeconomic framework:

1. control the increase of the public debt and keep the public debt within sustainable limits;

2. reduce the costs associated with the government debt in the long run, with an acceptable risk level in the government debt portfolio;

3. develop the domestic government securities market.

Hence, in 2011-2013 consideration will be given to the following objectives related to the government debt management:

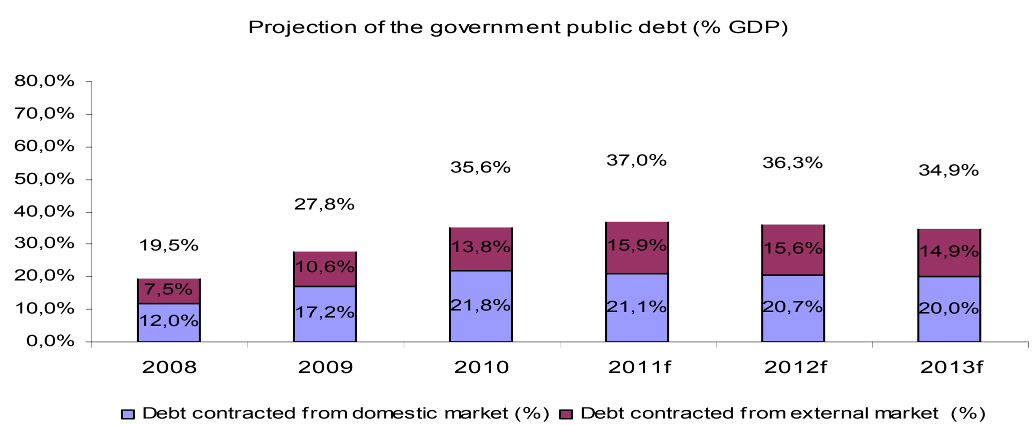
1. Control the increase of the government debt

The debt management process will give consideration to keeping government debt indicators within sustainable limits. Despite the high financing needs for the budget deficit and the government debt during the time interval covered by this analysis, no failures are foreseen that could lead to unsustainable increase of the government debt.

If the Romanian economy starts recovering by 3.3 % of GDP in 2011-2013, once the fiscal consolidation measures are implemented (as of 2011), i.e. the unitary wage law in the public sector, the pension system reform and the medium term budget expenditure framework) and if the calendar agreed with the IMF and the European Community to reduce the budget deficit under 3% of GDP in 2012 is observed, the financing needs will go significantly down, as well as the debt committed to cover such needs.

In addition, in the time interval covered by the Strategy, MPF will issue government guarantees only with a view to pre-finance a number of projects/programs of national interest, that have a multiplying economic effect and for co-financing EU-funded projects and projects financed by other foreign donors, as well as other priority programs.

Given the relatively low level of the government debt to GDP as well as the current economic and financial environment, which is uncertain and highly volatile, no indebtedness ceiling is established on a medium term, however, MPF will strictly monitor the main debt indicators to keep them at sustainable levels.



On a medium and long term, the risks of seeing the expenditures associated with the old population raising against the background of an accentuated ageing process and a reduction of the active population numbers may be substantially reduced by adopting and implementing the Law 263/2010 on the single public pension system expected to improve the pension system viability and significantly contribute to ensuring the sustainability of public finance. Since the economic dependency ratio (number of employees/ number of retired) deteriorates at a rapid pace, the implementation of a set of consistent measures for reforming and modernizing the current pension system aimed at ensuring the same rights as currently to the next generations will reduce the potential risk of continuous borrowings to cover pension obligations.

2. Reduce government debt long term costs with acceptable risks in the debt portfolio

The objective of reducing costs must not be seen as an independent objective, as it is linked with reducing risks associated to the debt portfolio. Basically, the target will be to minimize long term costs against an acceptable risk level.

Correlated with the objective of reducing debt costs, consideration will be given to increasing flexibility in selecting debt instruments as well as markets for the financing sources (domestic vs. foreign market) and the currency of the debt instruments on both domestic capital market (lei – Euro) and foreign capital market (Euro – other currencies).

Domestically, the government debt is expected to be contracted with decreasing yields, in line with the downward trend of the money market interest rates as a result of reduced inflation.
However, externally, whereas the 2011 budget deficit financed from foreign sources will include the proceeds from the EU[17] and WB loans extended under the foreign financial package with very favorable terms (approx. 2.0 billion Euro), for the entire interval under discussion the foreign financing sources will have to consist mainly of issuances on the foreign capital market.

To this purpose, all necessary preparations will be made in the first half of 2011 to have the Euro Medium Term Note (EMTN) operational. This programme will allow full flexibility in accessing the foreign financial markets, for a timely use of opportunity windows to ensure efficiency and effectiveness in trading on these markets.

In order to add to fulfilling these expectations, the Ministry of Public Finance seeks to adopt predictable and transparent financing policies, to help minimizing costs in the long run and avoid sudden and unjustified changes (i.e. no issuances on the domestic and/or foreign markets for a longer period of time) that could result in charging a liquidity premium and ensuring a permanent Romanian presence on these markets.

In 2010 - 2013, the government debt const to GDP will go up in both absolute terms and as share to GDP, mainly due to the already contracted debt/ debt that is to be contracted in order to finance high budget deficits[18]. The estimated debt cost to be paid from the budget shows a significant increase of this indicator in 2010 (1.4 %) compared to 2009 (1.0 %), with the prospects for 2012-2013 favorable to preserving a constant level provided that fiscal consolidation is reached.

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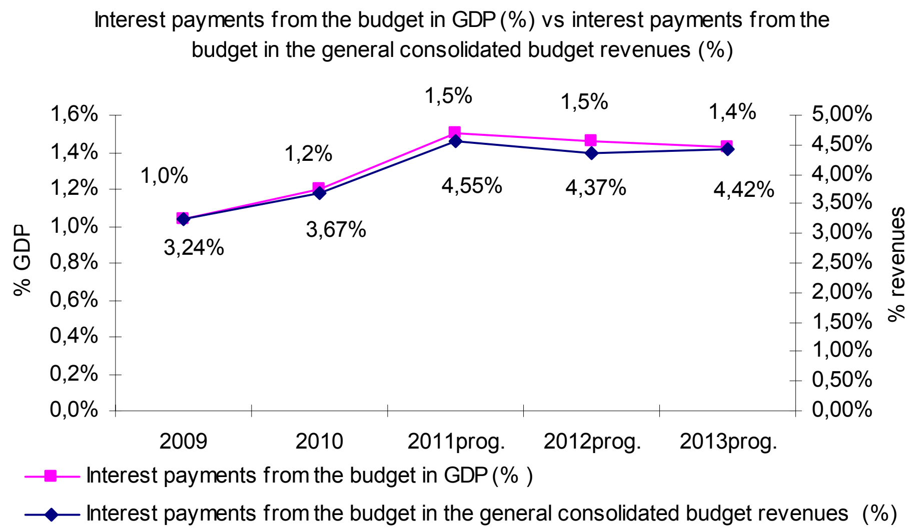
[17] EU loan to be disbursed based on the fulfillment of conditionality attached to the foreign financial package
[18] Which exceed the 3% Maastricht threshold.



3. Reduce risks associated with the government debt portfolio

To reduce debt portfolio risks, the debt portfolio will be improved by:

I. <u>reducing financial risk (currency risk, interest rate risk liquidity/refinancing risk)</u>

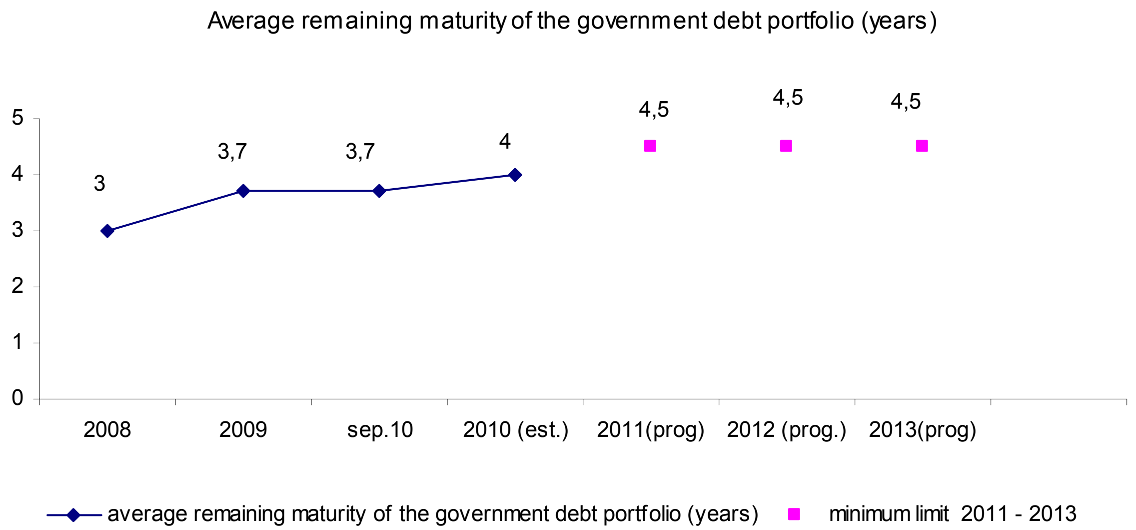
a. *Reduce refinancing risk*

Given the high amount of T-Bills issued in 2009 and so far in 2010, as well as high borrowings from the State Treasury General Current Account, it becomes all the more important to reduce refinancing risk since the budget deficit financing needs in the upcoming years will be high (budget deficit ranging between 4.4% and 2.5%).

During the time interval covered by the current Strategy, taking into account the expectations that inflation and interest rates will go down, in parallel with an increasing institutional investors' demand for longer maturities (private pension funds, insurance companies etc.) in line with their investments needs on the up, we expect an improvement in the terms of government securities with long and medium maturities. Thus, if in 2010 most government securities issued on the domestic market had short maturities (75% of total amount issued), MPF will seek to extend government securities' maturities issue more medium and long maturities, in a move to improve the maturity composition of government securities issued on the domestic market - up to 50%-60% short term and 40-50% medium and long term.

At the same time, MPF will increase maturities of T-Bonds issued on the foreign capital markets, after the success of the 5-year 1 billion Eurobond issuance in March 2010. In addition, MPF will contract long and very long term IFI loans given their advantage in terms of costs.

With a view to giving the investors a signal regarding the disinflation expectations of the issuer, the opportunity will be considered to issue inflation index-linked government securities, in an opportunity analysis compared to other debt instruments that will take into account the inflation rate on the down and in order to increase the debt portfolio maturity and implicitly reduce the refinancing risk.

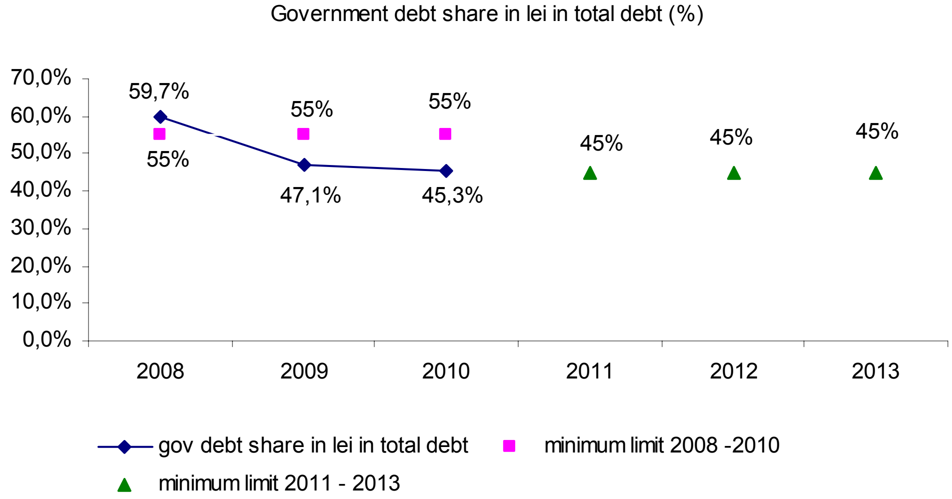


In addition, consideration will be given to evenly distribute debt servicing in a move to ensure an adequate profile with regard to the government debt refinancing and the level of interest and fees, especially for the interest paid from the budget which is reflected in the deficit level.

b. *Reduce currency risk, by:*

- *Increase the share of domestic currency debt in the total government debt:*

The currency risk will be limited through this measure, if we take into account that budget revenues will be collected in domestic currency and the government debt is contracted in domestic currency as well, but this measure serves the objective of developing the market of government securities too. Thus, 50% of the budget deficit will be financed from domestic sources through government securities issuances, with the government securities to be refinanced using sources from the market where they were contracted (domestic/foreign market), except for the foreign currency loans contracted by MPF on the domestic market that can be repaid as well from the buffer funds of MPF's foreign currency account opened with the National Bank of Romania.
Our proposal is to keep the share of domestic currency debt in total government debt at minimum 45% at end-2013 taking into account the important role of foreign currency borrowings in reducing the refinancing risk and minimizing the costs of long and very long term borrowing, given the likelihood of preserving the cost difference for instruments with similar maturities contracted on the domestic and foreign market.

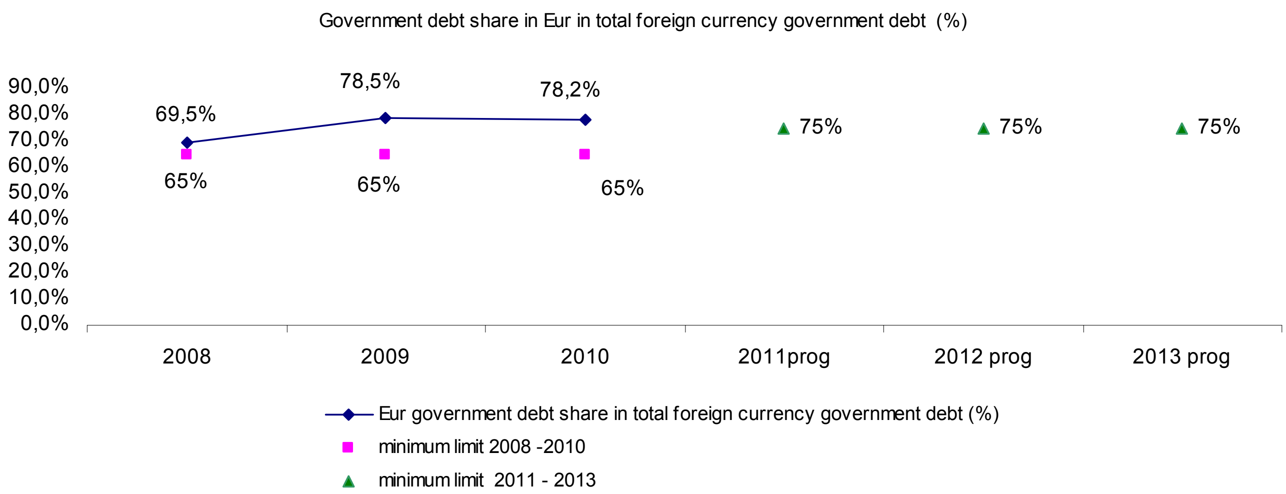


- *Increase the share of EUR-denominated debt in total foreign currency debt*

Consideration is being given, on one hand, to minimizing costs against the background of preserved interest margins between the sovereign loans in domestic currency and the loans in EURO contracted on a medium and long term, given the favorable terms of loans contracted under the foreign financial package. On the other hand, if we take into account the foreign currency borrowings contracted mainly on a short and medium term on the domestic market, because of the investors' preferring these maturities, the fact that there is a foreign currency buffer fund in the State Treasury account helps reducing the currency risk, since these funds can be used to repay the principal for the foreign currency loans.

In order to reduce long term currency risk, the borrowing from the foreign market will be mainly contracted in Euro, except for the T-Bond issuances on the foreign capital markets where depending on the financing needs, the opportunities in the market and the comparative cost analysis we have the possibility to issue government securities in other currencies as well.

Given the target established for the indicator *"share of the lei-denominated debt in total government debt"*, for the interval 2011-2013 we recommend a maximum 50% ceiling for the EURO-denominated debt in total government debt and a minimum of 75% in total foreign currency debt.



If currently the risk currency objective is considered by the MPF with regard to the newly contracted debt (passive management) during the time interval covered by the current strategy MPF intends an active management of the currency risk and the interest rate risk by using the derivative instruments provisioned by the debt legislation. To this purpose, by the end of June 2011 the necessary legislation will prepared to allow MPF conclude ISDA agreements with the main foreign financial institutions, so that it can control the market risks associated with the debt portfolio by using derivatives (currency swap, interest rate swap).

c. *Reduce interest rate risk by increasing the fixed rate debt share in total government debt:*

The increase of the fixed debt share in total government debt aims at reducing interest rate risk especially for the foreign currency debt, as well as reducing the uncertainty about the annual budget efforts for making interest payments.
With regard to the lei debt, in order to increase the share of fixed interest rate debt, benchmark bonds with fixed coupon will be issued, and for the foreign currency debt, T-Bonds will be issued on the foreign capital markets and loans with fixed interest rate will be contracted from the IFIs. Since interest rates are at a historical minimum, floating debt will come with higher interest costs given that both EURIBOR and LIBOR will most probably go up during the time interval covered by the Strategy. As in the case of the currency risk objective, interest rate risk can be reduced on one hand by contracting new fixed debt and on the other hand, by using an active risk management through derivative instruments (interest rate swap to turn floating debt into fixed rate debt).

d. Increase negotiable debt share in total government debt

Having in view the objective of developing the government securities market, increasing government securities liquidity, putting in motion the secondary market for these securities and gaining flexibility in actively managing the government debt portfolio through these debt instruments, during the interval under review, the budget deficit financing needs and government debt refinancing needs are to be mostly covered through issuances of government securities on the domestic market and the foreign capital markets, taking into account the liquidity terms of such secondary markets and the advantages offered by consolidating and extending the yield curve for government securities on the domestic market and for the Romanian Eurobonds, with the current share of the negotiable debt in total debt being 40% only.

The only exception is the year 2011, when tranches from the foreign financial package are to be used as well for financing the budget deficit and refinancing the government debt.

Under the circumstances, in accessing the foreign capital markets through the EMTN programme consideration will be given to the following:

- Cover budget deficit financing needs and the refinancing needs for the foreign currency debt;

- Diversify the investor base through accessing the most important financial markets, especially the Euro market taking into account the aspects mentioned under the risk currency section;

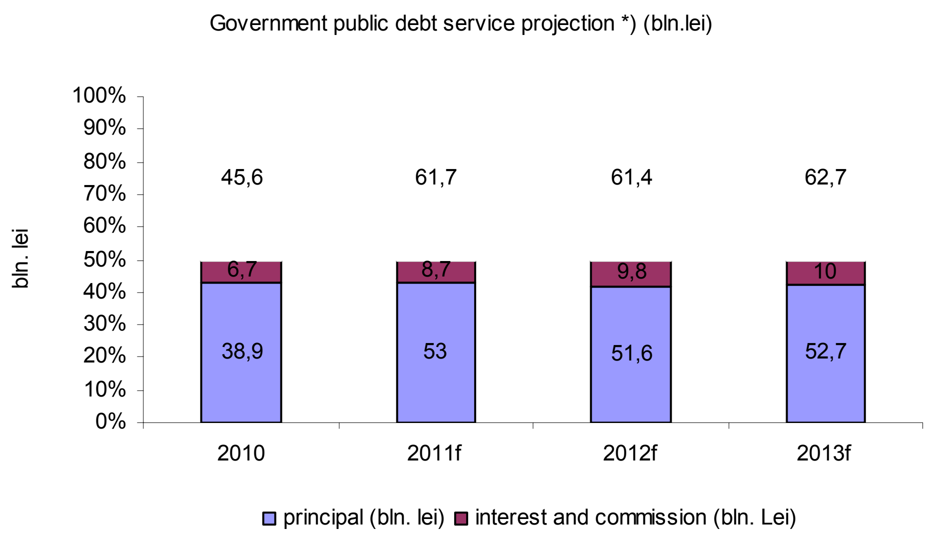
- Carefully monitor the capital markets and identify existing opportunities on these markets, and – if developments prove favorable – launch additional Eurobonds to help consolidate the MPF foreign currency reserve.

Eurobonds will be issued on the foreign capital markets under the EMTN in total amount of 7 billion Euro, that is to become operational in the first half of 2011. This program will not only allow maximum flexibility in accessing the foreign financial markets and use opportunity windows, but it will also cover the budget deficit needs from foreign sources and the refinancing needs of the foreign currency debt. Depending on the terms offered by these markets, the first operation and the EMTN program may be conducted in the first quarter of the current year, in a move to finance the 2011 budget deficit and consolidate the foreign currency reserve, with the possibility to access the US market as well, using the 144A rule.

In order to reach the objective of increasing the negotiable debt, which allows an active debt management, special attention should be paid to the borrowings from the State Treasury General Current Account to temporary finance the previous years' deficits of the state budget and of the social security budget. Given its financial features (short term floating debt) this debt instrument affects the fulfillment of the objective regarding the reduction of financial risk, as it amounts to 31.4 billion lei at end 2010. As a consequence, MPF plans - for a limited time (10 years, starting with 2011) - to issue government securities in higher amounts that it would be needed for the respective year (around 3.4 billion lei annually), so that it could reach to financing the current year deficit, with holdings of the state treasury general current account being actively managed in term deposits. Currently, the holdings of the state treasury general current account include the proceeds from privatization, which is a cash management risk, since these amounts can be used, during the time interval covered by the Debt Strategy, through the National Development Fund, in line with the earmarking under the relevant legislation in force.

e. Evenly distribute debt servicing

In the borrowing process/issuing government securities on the domestic and capital markets, maturities will be established in such manner to avoid repayment peaks over short time intervals, in order to control refinancing risk and ensure a relatively constant level or, if this is possible, a descending trend, of interest and fee payments associated with the government debt, i.e. payments from the state budget.



*) projection includes the debt services for new debt (domestic and external, includes external financing package with the IMF, EC and IBRD) to be issued for financing the deficits of the next years and refinancing of public debt.

f. Reduce liquidity risk

In order to reduce liquidity risk and avoid seasonal pressures related to ensuring the sources to finance the budget deficit and refinancing the debt, *MPF establishes a foreign currency buffer* in amount equivalent to the needs of financing the budget deficit and refinancing the public debt over a time period of around four months.

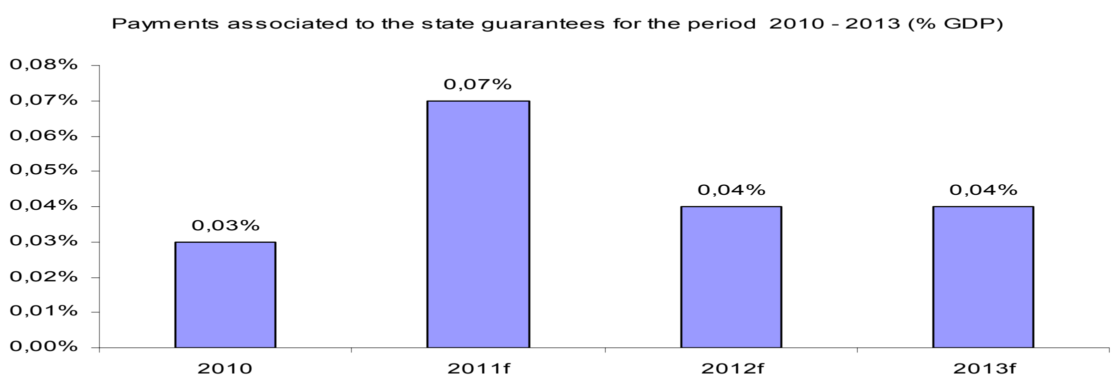
This buffer – that will be used to repay loans and repurchase foreign currency issuances in high amounts – is necessary to avoid capital market pressures by issuing high amounts of government securities in certain months of the year, with relatively high costs, and for ensuring a constant presence on the domestic capital market by issuing a relatively constant amount of government securities every month, irrespective of the state treasury general current account balance, in accordance with GEO 64/2007 on the public debt as amended and supplemented, a measure that will help improving transparency and predictability on the primary market of government securities.

II. <u>reduce credit risk (counterpart risk)</u>

a. Reduce budgetary risk caused by on-lending and government guarantees

The share of payments made by MPF in its capacity as guarantor will remain at a comfortable level, on one hand because of repayment of loans guaranteed by the state and on the other hand because of the fact that on-lending and guarantees will be granted in accordance with GEO 64/2007 only to priority/strategic projects, under a special law that will be issued to this purpose and based on the creditworthiness proved by the beneficiaries of on-lending/guarantees.

The state guarantees issued in the previous years are now in the repayment period and according to estimates the payments associated to such guarantees that are to be made from the state budget will go under 0.07 % of GDP to drop to 0.04% in 2013. Included here are payments associated to the state guarantees that have already been issued, or are to be issued in connection with projects/programs run in priority areas for the domestic economy.



b. Perform an active cash management

With regard to credit risk management, since cash management is only passive for the time being, with no positions open to counterparts, we may say that this risk is to be considered in the future, when MPF will perform an active cash through placements on the money markets.
In accordance with GEO 64/2007 on the public debt, the budget deficit is financed, and the government debt is refinanced, by using various debt instruments irrespective of the budget execution, as well as the holdings of the state treasury general current account; therefore, in 2011 – 2013 consideration will be given to evenly distribute the borrowing in government securities issued according to the calendar for the year, as well as to actively manage the holdings of the treasury account balance.

To this purpose, MPF has already established the legal framework for cash management operations, however, given the current level of holdings in the state treasury current account this activity is taken into account for the future years.
The instruments that will be used in the management of cash available in the state treasury general current account are as follows:

- Term Deposits with domestic financing institutions collateralized with government securities (this instrument is used at present), or
- Reverse Repos (purchase of government securities with an agreement to resell them at a higher price at a future specific date).

c. set counterpart limits in using derivatives.

In transactions involving financial derivatives, all MDA (such as ISDA) counterparts will have exposure limits attached, in order to reduce counterpart risks.

d. credit risk associated to collections and payments in foreign currency by MPF

During the time interval covered by the current debt strategy, in order to conduct direct collection and payment operations in foreign currency, MPF intends to open correspondent accounts with domestic and/or foreign financing institutions[19] which will imply an additional credit risk and a higher responsibility, since SWIFT messages need to be used for the specific foreign currency operations through the electronic payment system.

In order to control this risk, special norms will be issued to regulate the counterpart risk associated with the operations performed through the correspondent accounts opened with domestic and foreign financing institutions, the management of European funds and the foreign currency drawings and debt servicing.

III. reduce operational risk

In a move to reduce the operational risk, which does not include the reputation risk, consideration will be given to developing/improving the IT infrastructure of the General Directorate for Treasury and Public Debt) both through implementation and consolidation of the IT system used for the debt management and the implementation, as soon as possible, of an electronic auction application. The completion and thorough testing of these systems is crucial, so that when the systems go “live”, all facilities and functions could be delivered promptly and in a secure and accurate manner (double communication lines and electronic signature in place).

In addition, to the same purpose, the staff involved in debt management operations will be continuously trained in specialized treasury and debt management courses, in line with the evolution of debt instruments (cash and debt management) and hedging tools.

[19] The documentation has been prepared for the selection of financial institutions with a view to opening the correspondent accounts. Foreign currency operations are currently conducted by NBR which is the state agent for foreign currency payments and collections, using a MPF multi-currency account.

The below priorities will be taken into account in the assessment of risks associated with the debt portfolio during the implementation period:

Risk	Priority
Refinancing risk	High
Liquidity risk	High
Currency risk	High
Interest rate risk	Medium
Even distribution of the government debt servicing	Medium
Minimize long term government debt costs	High
Credit risk	Medium
Active cash management	Medium
Operational risk	Medium

4. Develop the market of government securities

Developing the domestic government securities market is a long and ongoing process, especially under the current economic circumstances, when MPF needs to take actions for increasing the *liquidity, efficiency and transparency of the government securities market.*

The Strategy consisting of financing around 50% of the budget deficit in 2011-2013 and of refinancing the domestic currency government debt from domestic sources will be focused on government securities issuances, in a move to help developing the domestic market of government securities. This strategy focusing on the domestic market as main financing source has the advantage of reducing the currency risk as well as the number of operations related to the government debt, through re-opening benchmark bonds on the primary market up to high volumes (around 1 billion Euro) to secure enough liquidity on the secondary market of government securities. The objective of developing the government securities market takes into account that after the implementation of the pension pillar II started in 2008, medium and long maturity government securities have to be issued to cover the financing requirements of these institutions and control the refinancing risk. Government securities will be issued in accordance with the annual calendar, but this policy will be adjusted as well to the market demand in terms of debt instruments and maturities, keeping in mind the objectives included in the current Debt Strategy. For instruments that can protect against inflation, based on a sensitivity analysis of budget revenues, in parallel with a scenario analysis regarding the budget revenues sensitivity to the inflation rate, the possibility is being considered to relaunch index-linked bonds (inflation).

One connected objective with the government securities market development is to extend and consolidate the yield curve. With government securities liquidity increasing due to a large range of maturity, especially under the current circumstances when volatility is extremely high, an actual point of reference will be created for both future issuances, investors and other issuers in domestic currency.

Consideration will be given, in the short run, to the implementation of the electronic auction system will be implemented in a move to improve efficiency of the government securities market, and all due diligence will be ensured in a joint effort with by the national bank (BNR) to connect to Clearstream and Euroclear, in order to improve the settlement of government securities for non-residents.

One important aspect that is expected to boost efficiency and liquidity of the government securities market is the fixing quotations for government securities on the support platform for the secondary market, which have been implemented in January 2011, to be followed by the revision of the primary market regulations. The new regulations regarding the primary market of government securities are intended to boost competitiveness of primary dealers, as well as rewarding the primary dealers for their activity: the primary dealers may be selected as trading administrators for Eurobond issuances, or they will be given the possibility to purchase, in a next day auction, government securities with medium and long maturities at the average yield of the previous day auction session, or even qualitative and quantitative criteria will be introduced to assess primary dealers on both primary and secondary markets.

Domestic market participants (primary dealers, retirement funds, insurance companies etc.) will be periodically invited to consultations, in a move to improve transparency and predictability of how the lei-denominated government debt is contracted and managed, as well as to regularly assess the market investment needs and the expectations regarding the market conditions.

In order to coordinate the actions for reaching the objectives of managing the monetary and public debt policies, regular meetings will continue to be held by the representatives of the Ministry of Public Finance and the National Bank of Romania within the already established formal framework of the Monetary and Fiscal Policy Coordination Committee.

V.B. DEBT STRATEGY INSTRUMENTS

The debt instruments considered for use in 2011-2013 are as follows:

1. government securities issuances on the domestic market, i.e. 1-year Treasury-Bills (364 days) and 3, 5, 7 and 10 years benchmark bond, responding to investor demands and denominated in both domestic and foreign currency depending on the market opportunities; longer maturities can be considered as well provided there is a sufficient demand on the market, under reasonable cost and liquidity terms. Depending on the market appetite, and as a measure to optimize the government securities portfolio, previous years' benchmark bonds will be re-opened up to an amount that would allow increasing liquidity on the secondary market.
In addition, with the development of institutional investor segment and the increase of its investment requirements, government securities' maturities will be extended and

consideration will be given to issue specific instruments to this purpose (based on a cost opportunity analysis), such as CPI linked or zero coupon bonds.

2. government securities issuances on the foreign capital market, taking into account the budget deficit financing needs and the government debt refinancing needs, as well as the developments on these market in terms of financial conditions and the terms offered by the domestic market giving consideration to cost/risk ratio and in line with the medium term framework approved for government securities in amount of 7 billion Euro.

As of 2012, the foreign sources for financing the budget deficit (around 50% of it during the time interval covered by this debt strategy) will mainly consist of issuances on the foreign capital markets; MPF will extend the maturities and consolidate the yield curve of the relevant debt instruments.

Given the ongoing diversification of debt instruments in line with the capital market opportunities, both EURO and other foreign currencies instruments will be used, based on comparative cost analyses of standard lei and Euro instruments.

The decision may be made, in agreement with the relevant financing institutions (in an attempt to reduce the portfolio fragmentation and bring the associated costs in line with the current levels) to allow early repayment[20] of a number of loans for which interest payments are currently extremely high (past loans contracted in unfavorable terms), if the decision regarding this type of operations proves efficient in terms of achieving the debt strategy objectives and if there will be enough funds in the state treasury account.

3. loans from the international financing institutions, that will be used – based on a comparative analysis of financing costs offered by IFIs – to finance specific budget expenditures (result-based IBRD financing) or development programmes.

In 2010-2011, the financial package from IMF, EU and WB will be an additional foreign source for financing the budget deficit. In fact, under the current market circumstances, IFIs may offer long and very long maturities in very good interest terms (compared to what is currently offered by the market) therefore the IFI loans can help alleviating refinancing risk and balancing the maturity composition of the debt portfolio.

However, if liquidity on the foreign capital markets improves and associated costs go down, IFI loans will be the only foreign financing source taking into account the objective of developing a yield curve for Romanian Eurobonds.

The main financial instruments of the government debt management will be as follows:

1. To keep currency risk and interest rate risk under control, regular scenario and sensitivity analyses will be performed and a permanent dialogue will be maintained with the financing institutions, so that depending on the opportunities on the foreign financial markets to use derivatives as a risk management tool (currency swap and interest rate swap). MPF will replace the passive management (contracting new debt) with an active management (use of specific instruments).

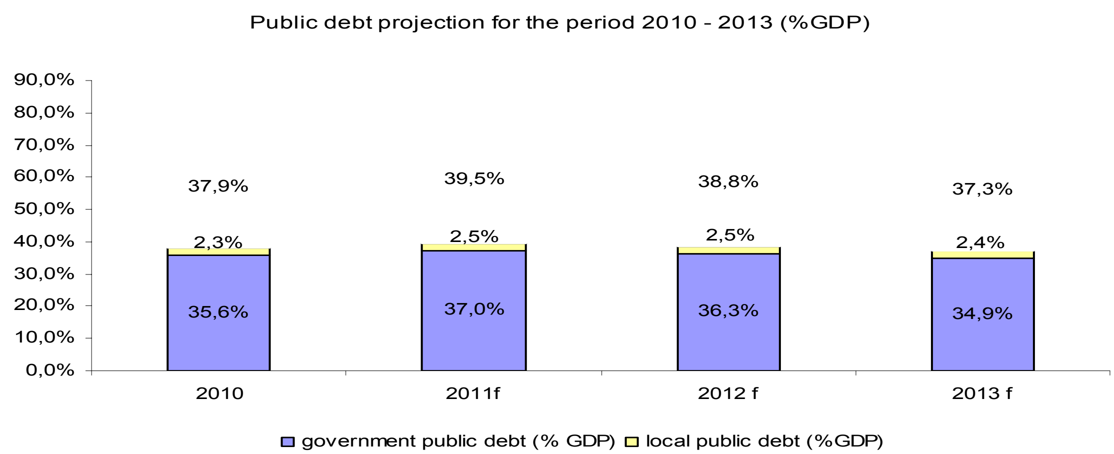
[20] This decision will depend on the early repayment terms (fees) and the cost-risk analysis involving the alternative of not choosing the early repayment against the alternative of exercising the early repayment through sovereign loans contracted on the foreign capital markets.

2. In order to control refinancing risk, the opportunity will be analyzed of using **bond exchanges transactions** on a medium term (exchange outstanding medium term government securities for longer maturity securities) or **buybacks** (repurchase government securities in advance) and repos, operations that are expected to improve the secondary market dynamics and potentially reduce future costs; all these operations are to be announced in the calendar of annual and quarterly issuances of government securities.

VI. NEW STRATEGY IMPACT ON THE GOVERNMENT DEBT

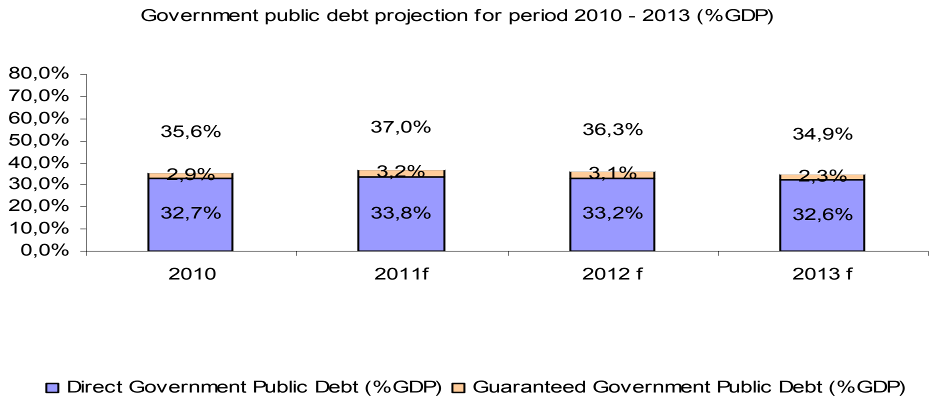
VI.A. GOVERNMENT PUBLIC DEBT MEDIUM TERM FORECAST

During the time interval covered by the Strategy, against the background of an economic growth, the expected appreciation trend of the domestic currency against the Euro, the main foreign currency in the foreign debt portfolio, but also due to the extended maturities of government securities and implicitly the average remaining maturity of the public debt portfolio, according to estimates the public debt will not go over 40.0% of GDP, as illustrated in the graphic below.



In 2011-2013, the local public debt will be contracted by the territorial units in observance of the annual ceilings related to the drawings from the contracted loans or loans that are to be contracted, as established in the Budgetary and Fiscal strategy for 2011-2013, in amount of 1.4 billion lei for 2011 and 2012 and in amount of 1.2 billion lei in 2013.

The Government Public Debt will go up during the interval under analysis as a result of the debt contracted in order to finance the budget deficits in observance of the limits established in the Budgetary and Fiscal Strategy, as well as to refinance the public debt, but without exceeding 37.0 % of GDP.



One other factor pushing up the government public debt will be the state guarantees issued for the „First Home" Program, for projects of national interest with a multiplying economic effect and those for pre-financing/co-financing European and IFI-funded projects. Thus, in order to have a controlled increase of the government public debt, the Medium Term Expenditure Framework introduced annual ceilings for the guarantees issued by the state - 10.0 billion lei for 2011 and 2012 and 6.0 billion lei for 2013, on top of the aggregated ceiling for 2009 -2010 of 12.0 billion lei agreed with IMF, EC and the World Bank.

VI.B. SUSTAINABILITY ANALYSIS OF THE GOVERNMENT DEBT

The factors adding to the government debt increase in the medium run are included in the table below:

% of GDP	**2009**	**2010**	**2011**	**2012**	**2013**
1.Government debt level	27,8	35,6	37,0	36,3	34,9
2. Government debt change(%)	8,3	7,8	2,1	-0.7	-1,4
Contribution to debt change					
3. Primarz deficit	-6,2	-5,2	-2,6	-1,5	-1,2
4. Real growth (GDP)	-1,4	-0,5	0,5	1,3	1,5
5. Rata reală a dobânzii	2,6	1,9	1,3	0,4	0,1
6. Stocks – flows adjustemts	13,3	11,6	2,9	-0.9	-1.8
Out of which:					
- net accrual of financial assets(from privatization)	0,0	0,0	0,0	0,0	0,0

- effects from evaluation and other*)	13,3	11,6	2,9	-0,9	-1,8
7. implicit interest rate for the debt	5,1%	5,5%	5,1%	4,8%	4,8%

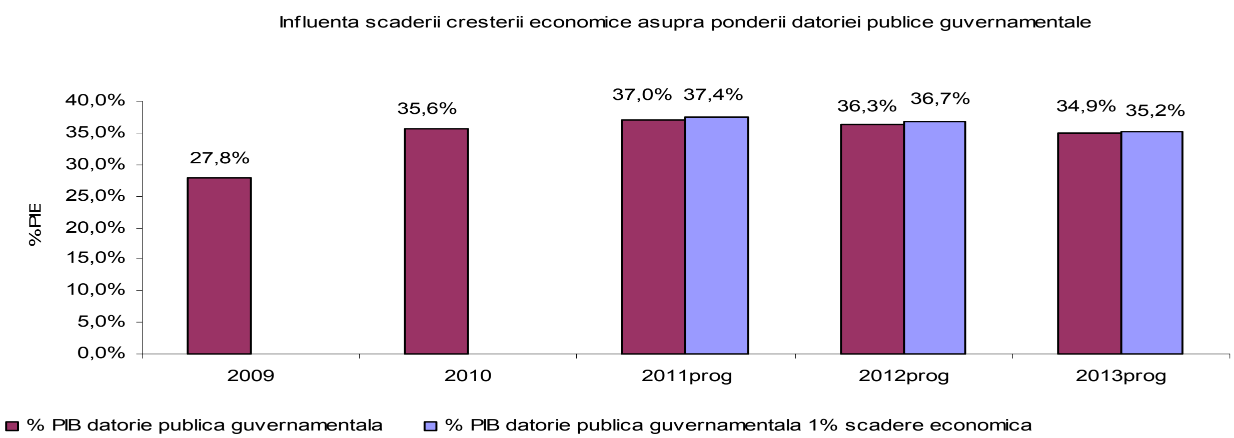
*) floating exchange rates and need to balance the holdings of the state treasury general current account, operations associated with the on-lending extended to economic operators and with the loans guaranteed by the state.

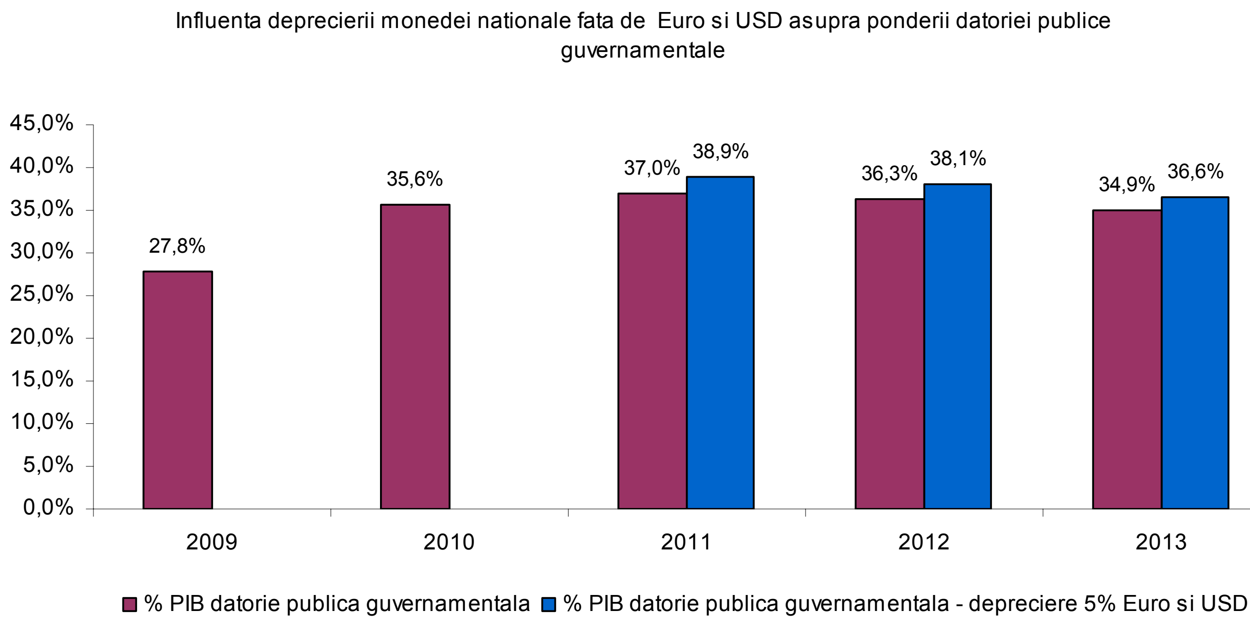
Potential revenues from privatization were not accounted for (mainly companies in the transport and energy sectors) since the privatization of the relevant state assets was postponed until the time when the Romanian economy would be recovered. To the extent that such revenues are collected, they could become the source for financing various budget revenues in accordance with the legislation in force, through the agency of the National Development Fund.

Sensitivity Analysis

Taking into account the composition of the government debt at end-2009, with the purpose of reflecting the portfolio sensitivity to various important factors during the time interval covered by the Debt Strategy (2011-2013), the following scenarios were analyzed:

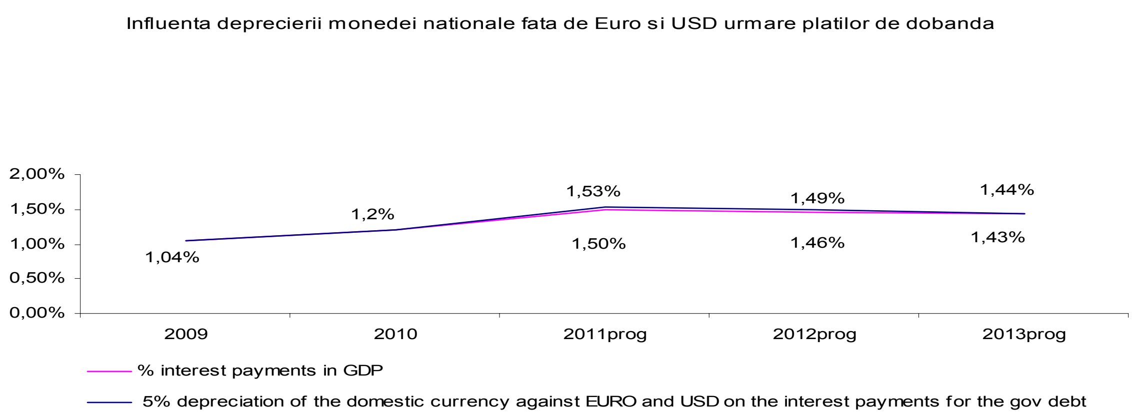
1. the influence on the government debt of: economic growth going down by 1%; and domestic currency dropping by 5% against EUR and USD, the main foreign currencies of denomination for the government debt.



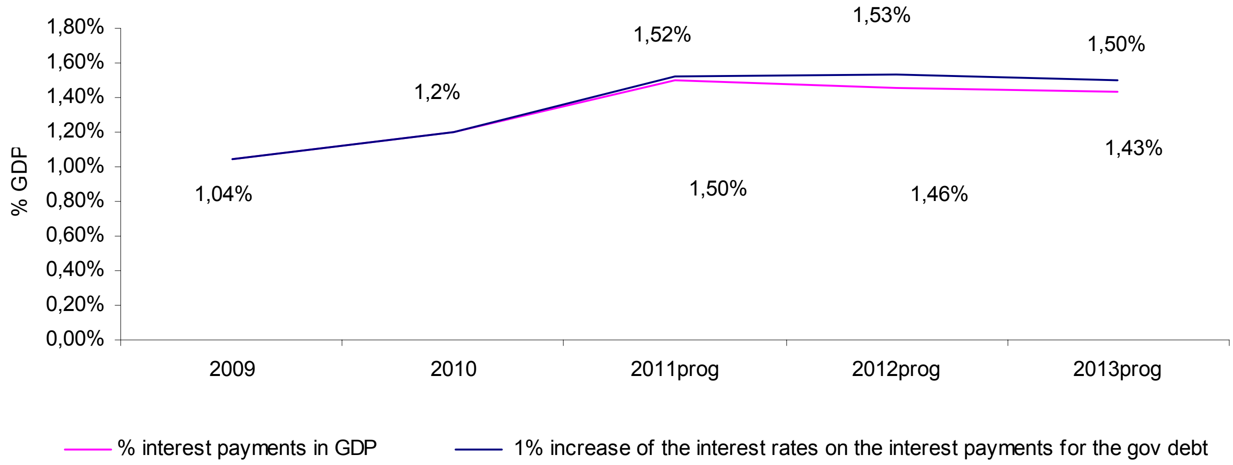


As illustrated in the above graphics, the economic growth below expectations has a permanent impact of 0.3% - 0.4% of GDP on the indebtedness level, whereas the depreciation of the domestic currency has a higher impact up to 1.9 % of GDP.

2. the impact of a 5% depreciation of the domestic currency against EUR and USD and of a 1% increase of the interest rates (for government securities, Libor and Euribor) on the interest payments for the government debt.



Influenta cresterii ratelor de dobanda asupra platilor de dobanda (in PIB)



The impact is relatively low (under 0.1% of GDP) in both cases, with regard to the interest payments from the state budget to GDP.

VII. FACTORS THAT MAY HAVE A NEGATIVE INFLUENCE ON THE DEBT STRATEGY

The factors that have been identified as having a potential negative impact on the debt strategy are as follows:

1) worsening macroeconomic indicators

On a highly volatile foreign capital market and in an uncertain environment due to the debt crisis in Greece and in other European states, one important factor is a potential hold back of the global economy growth and even a potential double-dip recession of the US economy ("W-shaped" recession), or a lower capital inflow that would significantly weaken the economic growth. The recovery pace below expectations would be due to the developments of the world economy, especially the European economy, given the structure of economic exchanges, and to internal factors too, such as low consumption and low credit recovery pace in 2011-2013.

A highly important factor with a view to the recovery of the world economy and the achievement of exports as economic driver is the floating Euro rate against USD and other currencies; this rate must be taken into account, along with the accelerated appreciation of the official bank rates.

2) poor fiscal consolidation due to economic growth below expectations

The economic growth below expectations may lead to budget revenues below the forecast figures taken into account in setting the budget deficit; this will push up deficit targets unless additional fiscal consolidation measures are implemented.

One other important factor when it comes to fiscal consolidation on a medium term is the implementation of structural reforms, in line with the schedule agreed with IMF, EU and the World Bank, that would help meeting the deficit targets. Any failure in implementing these reforms will trigger additional adjustments through more fiscal consolidation measures, and the additional financing, if necessary, will be covered from the financial buffer in the MPF foreign currency account. An alternate financing source is represented by the revenues that could be collected from the sell-off of various state assets in which would secure the inexpensive resources needed to finance the budget deficit, in parallel with helping reducing the indebtedness (since a lower than necessary volume of debt will be contracted).

Indicators	2009 (execution)	2010 (estimate)	2011 (forecast)	2012 (forecast)	2013 (forecast)
Nominal GDP (billion lei)	491.3	511.6	544.4	599.1	659.4
GDP growth (%)	-7.1	-1.9	1.5	3.9	4.5
Average Inflation (%)	5.59	5.9	5.3	3.5	3.2
Annual inflation Dec/Dec. (%)	4.74	7,96	3,2	3,0	2,8
General Gvt. budget deficit *) (% of GDP)	-7.4	-6.79	-4.4	-3	-2.5
Gvt. Debt *) (billion lei)	136.5	182,3	201.6	217.6	230.0
Debt Share to GDP (%)	27.8	35,6	37.0	36.3	34.9
Exports of goods & services (billion EUR)	36.1	38.6	42.2	46.2	51.4
Debt Service**) (billion lei)	56.9	45,6	61,7	61,4	62,8
Foreign Debt Service (billion EUR)	1.4	2.0	1.6	2.6	2.7
Foreign Debt Service Share in Total Exports (%)	3.9	5.2	3.8	5.6	5.3
Government Debt Service Share to GDP (%)	11.5	8,9	11,3	10,2	9,5
Average exchange rate EUR	4.2373	4,2099	4.21	4.18	4.16
USD	3.0493	3,1779	3.21	3.19	3.18

*) budget deficit and government debt presented in accordance with the national legislation.
***) including refinancing of government securities for the debt contracted and the debt to be contracted to finance deficits from domestic sources during the time interval under review (2011 – 2013)*
Data Source: MPF (deficit, debt, debt indicators); National Prognosis Commission (GDP, inflation for 2011-2013, exports of goods & services, average exchange rate for 2011-2013 from macroeconomic forecast in the Fiscal and Budgetary Strategy), INSSE (inflation for 2009 -2010), NBR (average exchange rate for 2009 – 2010)

Annex no. 2

Indicators	2008	2009	2010
Government Debt	**100,556.4**	**136,493.8**	182.321,9
of which:			
1. by type	*100,556.4*	136,493.8	182.321,9
Direct	61523.1	84349.2	167449,3
Guarantees	39033.3	52144.6	14872,6
2. by creditor	*100,556.4*	136,493.8	182.321,9
Multilateral	20533.5	34643.1	52549,2
Bilateral	312.9	272.4	287,1
Private banks and other	79710.0	101587.3	129485,6
3. by instrument	*100556.4*	136493.8	182.321,9
Interbank T-Bills in domestic and foreign currency	8106.9	23432.2	32659
Cash management instruments	1825.0	0	0
T-Bonds	9505.7	23146.2	34021,3
Eurobonds	8569.9	9093.6	10497,8
Financial Leasing *)	243.5	79.2	63
Sovereign loans	32710.7	52608.2	73644,2
Borrowings from the State Treasury General Current Account	39594.7	28134.4	31436,7
4. by currency	*100556.4*	136493.8	182.321,9
RON	60024.8	64302.0	82634,3
USD	9227.5	8629.1	8395
EURO	28102.8	56646.1	77971,2
DST	20.5	3984.4	9645,5
CHF	306.8	235.5	197,5
CAD	714.9	623.2	806,8
JPY	1914.0	1904.9	2541,3
WON	124.3	128.5	130,3
GBP	121.0	40.0	0
5. by maturity	100556.4	136493.8	182.321,9
Short term	49526.6	51566.6	64095,8
Medium term	10712.5	27096.1	42745,1
Long term	40317.3	57831.1	75481,0
6. by interest rate	100556.4	136493.8	182.321,9
Fixed	31495.2	57934.4	94877,2
Floating	69061.2	78559.4	87444,7

Data source: MPF, in accordance with GEO 64/2007 on the public debt, as amended.

Annex no. 3

Budget Deficit Financing in 2008-2010

Interval	2008 (execution)	2009 (execution)	2010 (execution)
Budget deficit financing (million lei)	24858.1	36435.4	33.642,5
Domestic financing - % in total financing	89.3	68.7	60,6
Foreign financing - % in total financing	9.2	30.5	38,5
Privatization proceeds and amounts recovered by AVAS - % in total financing	1.5	0.8	0,9

Annex no. 4

S&P, Moody's, Fitch and JCRA ratings on long term sovereign loans in foreign currency

Year	S&P	FITCH	MOODY'S	JCRA
2010	BB+ (reaffirmed on April 15, 2010) outlook stable	BB+ (reaffirmed on August 2, 2010) outlook stable	Baa3 (reaffirmed on January 18 2010) outlook stable	BBB- (reaffirmed on December 14, 2010)
2009	BB+ outlook negative	BB+ outlook negative	Baa3 (reaffirmed on September 2, 2009) outlook stable	BBB- outlook negative
2008	BB+ BBB- (Jan.- Oct.)	BB+ BBB (Jan.- Nov.)	Baa3	BBB- BBB (Jan - Dec.)
2007	BBB-	BBB	Baa3	BBB
2006	BBB-	BBB BBB- (Jan.- Aug.)	Baa3 Ba1 (Jan.- Sept.)	BBB BBB- (Jan.- Nov.)
2005	BBB- BB+ (Jan.- Sept.)	BBB-	Ba1 Ba3 (Jan.- March)	BBB- BB+ (Jan.-Sept.)
2004	BB+ BB (Jan.- Sept.)	BBB- BB (Jan-Nov.)	Ba3	BB+ BB (Jan.-Nov.)
2003	BB BB- (Feb.- Sept.) B+ (Jan.-Feb.)	BB BB- (Jan.- Dec.)	Ba3 B1 (Jan.- Dec.)	BB
2002	B+ B (Jan - April)	BB- B+ (June-Oct.) B (Jan.-June)	B1 B2 (Jan.- Dec.)	BB BB- (Jan.-Dec.)
2001	B B- (Jan.-June)	B	B2 B3 (Jan.- Dec.)	BB-
2000	B-	B B- (Jan.-Nov)	B3	BB-
1999	B-	B- B (Jan. – March)	B3	BB-
1998	B- B+ (May-Oct.)	B BB- (Jan.- Dec.)	B3 (Nov.- Dec.) B1 (Sept.- Nov.) B3 (Aug.- Sept.)	BB- BB+ (April-Dec.)
1997	BB-	BB-	Ba3	

Rating Scales: S&P, Fitch and JCR:	Moody's Rating Scale:
» Investment: from BBB-, BBB, BBB+, A- to AAA » Speculative: from D to BB-, BB and BB+	» Investment: from Baa3, Baa2, Baa1, A3 to Aaa » Speculative: from D to Ba3, Ba2 and Ba3

Acronyms and Glossary

MPF : Ministry of Public Finance
NBR: National Bank of Romania
EIB : European Investment Bank
NPC: National Prognosis Commission
STGCA: State Treasury General Current Account
DMFAS : Debt Management Application

ISDA : International Swap and Derivatives Association

MDA : Master Derivatives Agreement

Government Debt*): all state liabilities at any given time, formed of reimbursable financing either contracted or guaranteed by the Government through the Ministry of Public Finance.
Guarantee*): the commitment made by the Government, in the name and on behalf of the State, through the Ministry of Public Finance, or the commitment made by the administrative-territorial units through the local public administration authorities, in capacity as guarantor, to pay at maturity the obligations not paid by the beneficiary of the guarantee.
On-lending*): reimbursable financing committed by the State through the Ministry of Public Finance and transferred to the beneficiary under a subsidiary loan agreement.
Risk Fund – at central level*): a fund with the MPF formed of fees charged to the beneficiaries of Government on-lending/guarantees and of other sources allowed by the law.
Refinancing risk – inability to refinance the debt or refinancing with very high costs (depending on the domestic market development level and on the developments on the foreign financial markets).
Currency risk – foreign currency debt increase over domestic currency depreciation against EUR and USD, with state revenues collected in domestic currency.
Interest rate risk - rising interest rates on the domestic or foreign capital markets.
Credit risk - counterpart bankruptcy.
Payment risk – errors in the payment system.
Operational risk – errors in the debt management system or human errors, lack of working procedures, lack of personnel.
Legal risk - interpretation of the law.

*) in accordance with GEO 64/2007 on the public debt.