MINISTRY OF PUBLIC FINANCE

GOVERNMENT PUBLIC DEBT MANAGEMENT STRATEGY

2019-2021

General Directorate for Treasury and Public Debt

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Acronyms

ATM	Average time to maturity (years)
FSA	Financial Supervisory Authority
ATR	Average time to re-fixing (years)
ECB	European Central Bank
CEDB	Council of Europe Development Bank
EIB	European Investment Bank
EBRD	European Bank for Reconstruction and Development
IBRD	International Bank for Reconstruction and Development
NBR	National Bank of Romania
NCP	National Commission for Strategy and Prognosis
PDs	Primary dealers
EMBIG	Emerging Markets Bond Index Global of JP Morgan
FED	United States Federal Reserve
EFGA	European Fund for Guarantees in Agriculture
IMF	International Monetary Fund
GMTN	Global Medium Term Note Program for the Eurobonds issuances on the foreign markets
IFIs	International Financial Institutions
NIS	National Institute of Statistics
MoPF	Ministry of Public Finance
NSRF	Financing Facility of the National Strategic Financing Framework
GDP	Gross Domestic Product
NRDP	National Rural Development Program
EU	European Union

1. Introduction

The present Public Government Debt Management Strategy for 2019-2021 (hereinafter the "Strategy") is a continuation of Public Government Debt Management Strategy for 2018-2020 and was prepared after consultations with NBR and following the international sound practices as defined in the WB-IMF Guidelines for debt strategy design[1] .
As it has been the case with previous documents, the updated 2019-2021 Strategy update is consistent with the budget indicators provided in the 2019-2021 Fiscal and Budgetary Strategy and it is based only on the government public debt portfolio composition, mostly the aspects which fall under the authority and mandate of the government public debt manager[2]. Hence, the Strategy provides the direction in which the authorities intend to steer the funding and the structure of the debt portfolio, to meet the *Ministry of Public Finance's government public debt management objectives* as follows:

- Secure the funding needs of the central government, while minimizing the costs of the medium and long term debt;
- Limit the risks of the government public debt portfolio; and
- Develop the domestic market for government securities.

The implementation of the Public Government Debt Management Strategy for 2018

In 2018, all risk indicators remained within the targets set out in the public government debt management strategy for 2018-2020, as reflected in the presentation of financial indicators shown in the table below:

Table 1: Risk indicators at the end of 2017 and 2018

Indicators *	**12/31/2017 ****	**12/31/2018**	**Indicative targets according to the 2018-2020 Strategy**
A. Currency risk			
Share of domestic currency debt in total (% of total)	46,5%	48.6%	45% (minimum) – 60%
Share of EUR denominate debt in foreign currency denominated debt (% of total)	84.0%	82.2%	80% (minimum) – 95%
B. Refinancing risk			
Debt maturing in 1 year (% of total)	12.0%	14.0%	10% - 20% (maximum)
Local currency debt maturing in 1 year (% of total)	18.0%	17.0%	15% - 25% (maximum)
ATM for total debt (years)	5.9	6.3	5.5 years (minimum) – 7.0 years
ATM for local currency debt (years)	3.7	4.0	3.5 years (minimum) – 5.0 years
C. Interest rate risk			
Debt re-fixing in 1 year (% of total)	15.0%	17.0%	10% - 20% (maximum)
Local currency debt re-fixing in 1 year (% of total)	17.0%	16.0%	15% - 25% (maximum)
Average time to re-fixing for the total debt (years)	5.9	6.3	5.5 years (minimum) – 7.0 years
Average time to re-fixing for the debt in domestic currency (years)	3.7	4.0	3.5 years (minimum) – 5.0 years

* without loans from the cash balance of the State Treasury General Current Account. ** for 2017, the indicative targets set forth in the 2017-2019 Government Public Debt Management Strategy were taken into account.
Source: MoPF

[1] Please refer to the "Medium Term Public Debt Management Strategy"- a guide to government authorities prepared by the World Bank and the International Monetary Fund, February 24, 2009.
[2] As a consequence, this document will avoid committing to fiscal policy targets such as debt share to GDP or debt cost to GDP, since the first indicator depends on the budget deficit targets and the second one depends on the budget deficit targets and the market developments, therefore both of them are outside the control of the public debt managers.

Strategic guidelines for 2019 - 2021

The following principles shall guide the government funding decisions during the period 2019-2021:

1. The net financing mainly in local currency, implemented as a move to further facilitate the development of the domestic market of government securities and help mitigate foreign currency exposure, at the same time considering the domestic market absorption capacity and, in general, the demand for debt instruments denominated in lei[3], as well as the need for a further diversification of the investor base of government securities.
2. Depending on the market circumstances, the Ministry of Public Finance takes into consideration to partially pre-secure the next year's estimated financing needs.
3. Pursue a smooth redemption profile, avoiding to the extent possible the concentration of principal repayments/refinancing of government securities in the short-term.
4. Mitigate the refinancing risk and the liquidity risk by maintaining a foreign currency buffer[4] at a comfortable level, and possibly by using other instruments depending on the terms and conditions thereof.
5. Maintain a presence on the international capital markets, through issuances of Eurobonds mostly in euros, and access the USD market or other foreign currency markets on an opportunistic basis, giving consideration to the extension of the debt portfolio average maturity and to the cost/risk ratio associated thereto and the diversification of the investment base.
6. In the process of external financing, the debt will be contracted in euros, for the most part.
7. The euro issuances on the domestic market will be considered only if there is a specific demand from domestic investors in the absence of alternative lending instruments, provided that there is a beneficial maturity/cost ratio.
8. Maintain the exposure to interest rate risk under control by monitoring the share of domestic debt refixing within the next year and the average time to refix for the total portfolio.
9. Use financing instruments offered by the international financing institutions having in view the favorable terms and conditions attached to those instruments.

These principles translate into indicative target ranges[5] for key risk indicators that allow flexibility in managing government public debt to respond to the changes of the conditions in the financial markets, as follows:

- *manage foreign currency risk:*

1. keep the share of local currency denominated debt in total government public debt between 45% (minimum) and 60%.

2. keep the share of debt denominated in EUR in total foreign currency debt between 80% (minimum) and 95%. At the time that derivatives are used, this indicator will be calculated after the evaluation of the debt following the use of currency swaps.

- *manage refinancing risk*

1. maintain the share of debt maturing in the next year between 15% and 25% (maximum) for the local currency debt and between 10% and 20% (maximum) for the total debt.

2. the average maturity remaining should be maintained between 3.5 (minimum) and 5.0 years for local currency denominated debt and between 6.0 (minimum) and 7.0 years for total debt.

3. maintain a foreign currency buffer at a comfortable level, in order to mitigate the risks corresponding to high volatility times on the financial markets.

- *manage interest rate risk*

[3] In addition to the domestic demand for the government securities denominated in lei, non-resident investors could play an important part when it comes to both the amounts placed on the domestic market and the maturity composition in the financing process, given the investors' high appetite for government securities with medium and long maturities.

[4] The foreign currency buffer has to cover a number of months pertaining to the gross financing needs (set forth at a level that should cover 4 months of the gross financing needs).

[5] The limits referred to as the minimum or maximum can't be exceeded during the period covered by the strategy (the hard bound), while the other limit is the one to be achieved and can be exceeded (the soft bound).

1. the share of debt re-fixing its interest rate in the next year should remain between 15% and 25% (maximum) for the local currency debt and between 10% and 20% (maximum) for the total debt.
2. maintain the average maturity remaining until the next refixing between 3.5 (minimum) and 5 years for debt in local currency and between 6.0 (minimum) and 7.0 years for the total debt.

2. Objectives and scope

The Strategy is the debt management policy document and the Ministry of Public Finance is to achieve the related objectives as follows:

- Secure the funding needs of the central government, while minimizing the costs of the medium and long term debt;
- Limit the risks associated to the government public debt portfolio;
- Develop the domestic market for government securities.

The first two objectives are stated in the GEO 64/2007 and are complemented by the government securities domestic market development objective which was formulated in the previous strategies as well. The development of a liquid market of government securities and the construction and consolidation of a yield curve in national currency are important objectives both for the purpose of the first two objectives of the strategy, and for the development of the Romanian financial market.
The scope of this Strategy is limited to directly contracted debt or debt that is guaranteed by the Government, through the Ministry of Public Finance, but it does not include the borrowings from the State Treasury General Current Account ("temporary financing"). Temporary financing is a cash management instrument and cannot be viewed as a medium-term financing instrument. Nevertheless, considering that it is important to coordinate the government public debt management strategy with the cash management policy, including through temporary financing, as well as the interference between them, cash management strategy is presented in Annex 2[6].

3. Description of the public government debt portfolio[7]

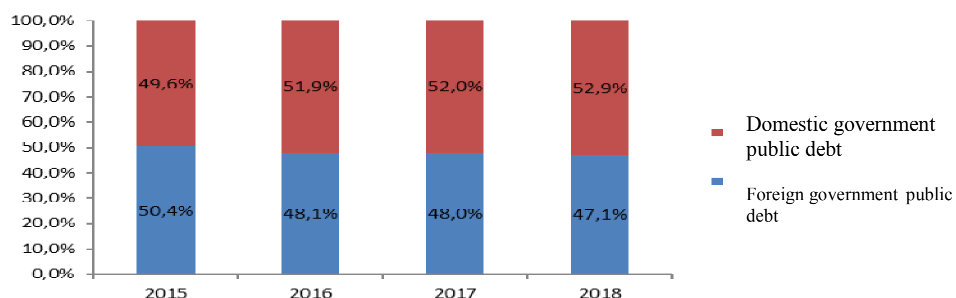
Evolution of government public debt

At the end of 2018, the government public debt was RON 331.1 billion, accounting for 35.1% of GDP, with an economic growth of 4.1% of GDP and a deficit of the general government of 2.98% of GDP.

As a result of the Strategy adopted in the recent years with regard to the budget deficit financing mainly by issuing government securities on the domestic market, but also after the increase of the resident investors' demand for Romanian Eurobonds, the composition by residency of the government debt has changed, favoring the domestic government debt since 2015, the government public debt at the end of 2018 showing a share of 52.9% resident and 47.1% non-resident creditors.

[6] It should be noted however that drastic changes in the level of temporary financing may have an impact on the issuance of government securities and may impair the plans for developing the domestic market of government securities.
[7] This is preliminary data according to national legislation, and does not include temporary financing.

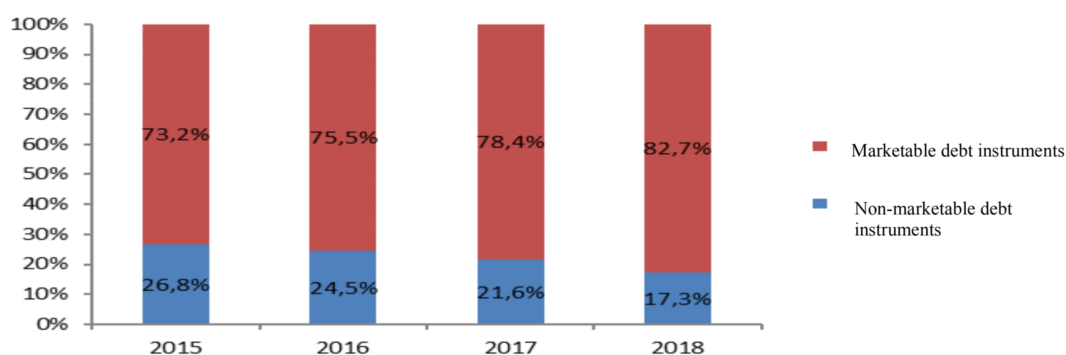
Chart 1: Government Public Debt composition based on investor residency criterion



Source: MoPF

Chart 2 shows that the composition of the government public debt improved continuously, with a portfolio now formed mainly of marketable debt instruments (issued mostly in the domestic currency), which allow, because of the debt instruments features, flexibility and expediency in attracting funding sources and the ability to adjust to the needs of investors.

Chart 2: Marketable debt instruments vs. non-marketable debt instruments

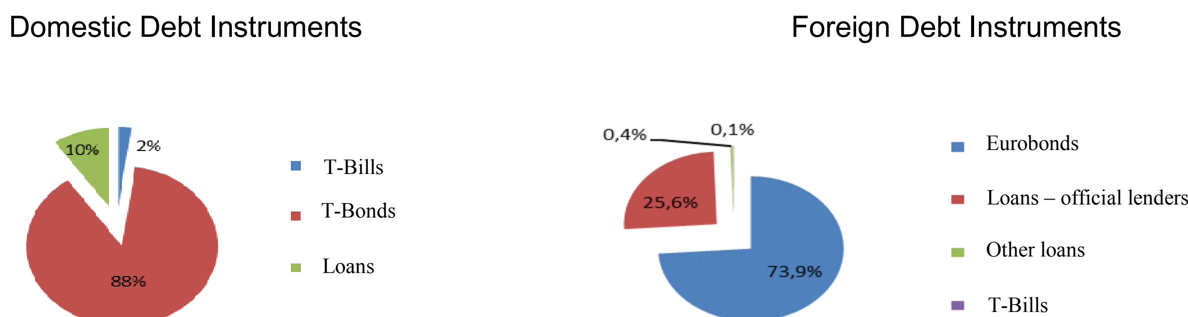


Source: MoPF

While the government borrowings' share to total government public debt was 17.3%, the government securities issued on the domestic and foreign markets accounted for 82.7% of total debt, of which 49.1% government securities issued on the domestic market and 33.6% on the foreign market. MoPF efforts to diversify the investor base of government securities, by issuing the government securities in the TEZAUR program is part of this pattern.

As presented in Chart 3, the bulk of the domestic debt is represented by government securities, namely T-bills and T-bonds whereas the external debt is mainly represented by bonds issued on the foreign capital markets and loans contracted with IFIs. While the foreign debt structure includes the government securities issued on the domestic market for non-resident investors, the domestic debt includes the Eurobonds of resident investors.

Chart 3: Composition of the debt portfolio by residency of creditors and debt instrument



Source: MoPF

The costs, shown as average interest rates[8], increased in 2018, driven by higher interest rates, in particular for domestic debt. The debt in local currency at end-2018 remains more expensive than the debt in foreign currency[9] as shown in table 2.

Table 2: Cost of direct debt by type of instruments[10]

	12/31/2017	**12/31/2018**
Average interest rate of public government debt (%)	*3.4*	*3.7*
1. in local currency, o/w	3.5	*3.9*
a. a. T-Bills with 1 year maturity	1.1	2.6
b. b. T-Bonds fixed with 1 - 5 year maturity	3.8	3.8
c. T-Bonds fixed with 5 - 10 year maturity	5.6	5.5
2. in foreign currencies, o/w:	*3.3*	*3.4*
a. a. EUR bonds with 10 years maturity	3.3	2.7
b. EUR bonds with 3-5 years maturity	4.2	4.1
e. EUR multilateral	2.0	3.1
f. a. USD bonds with 30 years maturity	5.7	5.7
g. USD multilateral	1.4	1.4

Source: MoPF

The still significant portion of loans contracted from international financing institutions at concessional rates explains the lower cost of external funding. Moreover, the bonds denominated in euros issued on foreign capital markets have lower nominal yields compared to the government securities issued in domestic currency and dollars (without taking into account the currency risk impact on costs), as shown in Chart 4.

Throughout 2018, the cost of financing in domestic currency on the local market remained above those in USD with similar maturities.

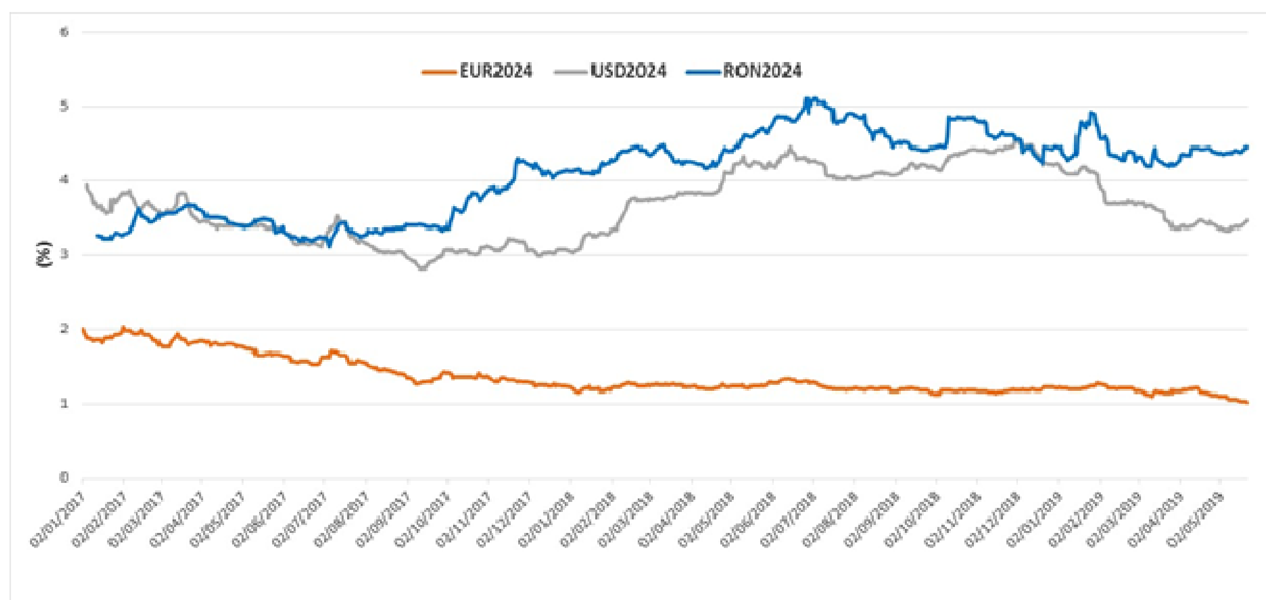
The yields of government securities in lei increased, more for short maturities, they aligned to the higher inflation rates.

[8] Calculated as interest payments projected for 2019 divided by outstanding amount for each debt instrument at end-2018.
[9] Excluding the influences due to currency risk which can significantly change the cost of debt in foreign currency (interests corresponding to debt in foreign currency), in case of a depreciation of the national currency.
[10] The table shows the average interest rates for selected debt instruments, aggregated as all debt instruments forming the government public debt portfolio

Since MoPF objective is to preserve the share of EUR-denominated debt in total foreign currency debt between 80 - 95%, in 2018 the issuances on the foreign markets were mainly denominated in euros, with the advantage of more advantageous costs, compared to USD.

In addition, for the first time an USD issuance maturing in 2022 was subject to a partial buy-back and switched to a new 30-year USD-denominated Eurobond.

Chart 4: The yield of a benchmark bond on the domestic market vs the yields of Eurobonds issued on the foreign market (in EUR and USD) with a 5-year maturity.



Source: MoPF

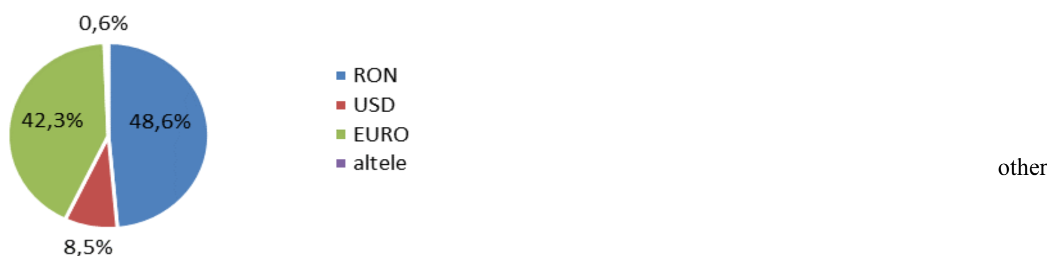
Risks attached to the public government debt portfolio at end-2018

Currency risk

At the end of 2018, 51.4% of the government public debt portfolio was denominated in foreign currencies. This share is higher compared to other EU Member States which have not joined the Euro. This high exposure to the currency risk can be managed under the circumstances of a relatively low volatility of the RON/EUR exchange rate and as a result of the share of the long term foreign currency debt issued in Euro[11]. Given the fact that around 8-9% of the debt portfolio is denominated in USD and the volatility of the leu/USD exchange rate over the past three years was by around three times higher than the leu/Euro, the debt contracted in USD has a much higher risk attached than the debt contracted in euro, and this is shown in chart 6.
Moreover, the policy of keeping a foreign currency reserve takes into account the limitation of the currency risk attached to foreign currency reimbursements, with this reserve being used directly for servicing the government public debt in foreign currency.

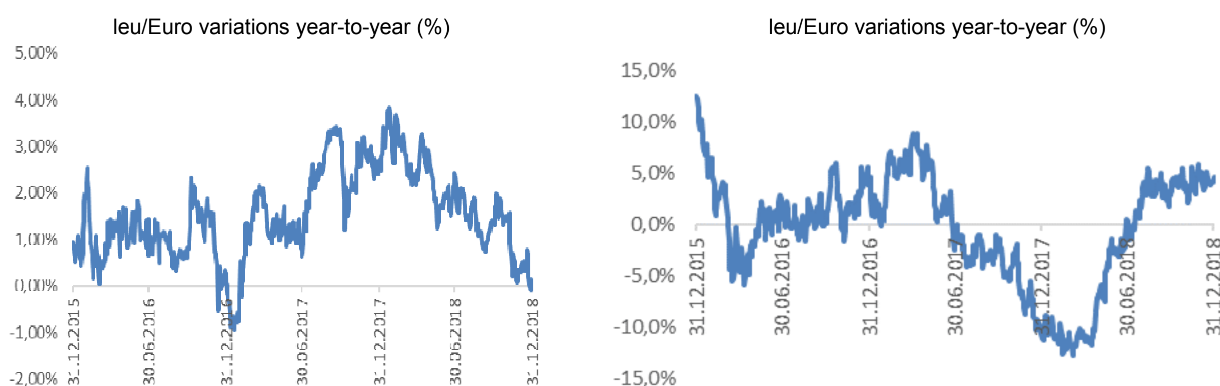
[11] Long-term euro denominated debt issued with a bullet structure implies a redemption of the principal within a time-horizon in which euro adoption is feasible and therefore a reduced implied currency risk.

Chart 5: Public government debt by currency



Source: MoPF

Chart 6: Annual change in the RON/EUR and RON/USD exchange rates



Source: MoPF, NBR

In a pessimistic scenario, for example, a depreciation in 2019 of the local currency against EUR by 5% and against USD by 15%, would increase the debt stock by RON 10.8 billion or 1.04% of GDP and the debt service payments (including the repayment of principal and the refinancing of government securities and interest payments) by RON 1.5 billion or 0.5% of central government revenues[12]. As a result, the currency risk exposure may be seen as moderate.

Refinancing risk

The structure of capital reimbursements and government securities refinancing presented in chart 7 shows an accumulation of reimbursements in the first 3 to 6 years, while the trend is to adjust the repayment schedule with a diminishing effect of the refinancing risk in the medium and long run. Reimbursements are concentrated in the first five years, and this mostly visible for the domestic debt[13] reflecting how important the treasury bills are the government financing, particularly because of the investors preferring government securities with a remaining maturity of 3 to 5 years.

The policy of building liquid series of benchmark bonds on a range of long and medium term maturities, which helps the consolidation and extension of yields curves in lei induces a refinancing

[12] Revenues according to cash methodology applying EU methodology.
[13] Based on the issuance market.

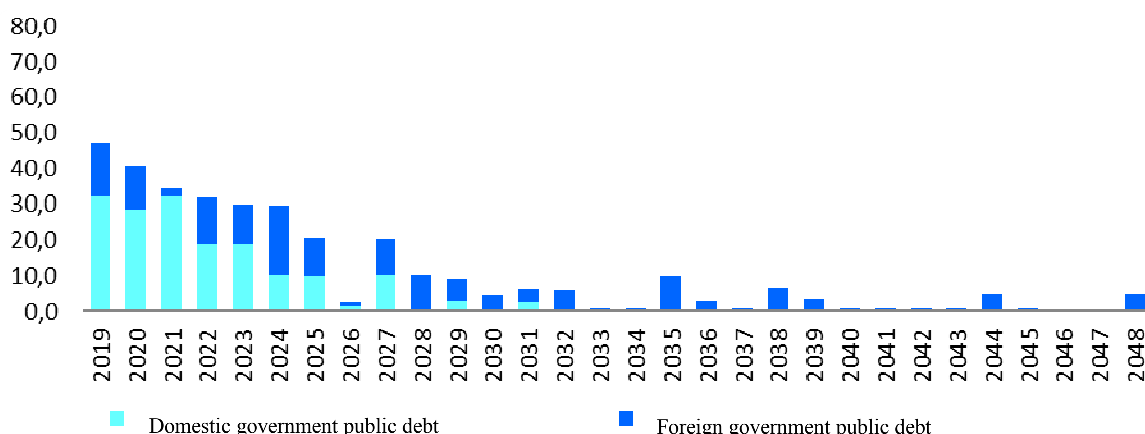
risk at maturity, as these series are reopened until to the consolidation of an amount of up to the equivalent of approximately 2.5 billion euros. For instance, in January and November 2018, 2 benchmark bonds matured, in the amount of approximately 16 billion lei. The refinancing of these obligations, while decreasing, could have been a challenge to the financing process on the domestic market, with the commercial banks, still the most important investor segment for government securities (holding approx. 46% of the market of government securities accounting for over 19% of the bank assets) would have used alternative placements, more profitable when the private sector financing demand increases.

It is visible, at the same time, that commercial bank holdings trend down compared to other institutional investor groups, such as private pension funds.

In addition, it should be pointed that government securities are, by far, the most liquid instrument on the domestic financial markets, while being, at the same time, the most liquid instrument eligible for money market operations.

On the external side, refinancing risk is low mainly as a result of the repayment structure of the loans contracted with the international financial institutions, but also as a result of the extension of the average remaining maturity for the external debt portfolio against the backdrop of Eurobonds issued with long and very long maturities (up to 30 years).

Chart 7: Principal repayment schedule on government public debt at end-2018 (bn lei)



Source: MoPF

The redemption profile of the debt portfolio results in an average time to maturity (ATM) of 6.3 years: 4 years for local currency denominated debt and 8.4 years for the debt denominated in foreign currency.

Table 3: Refinancing risk indicators

Indicators	2017			2018		
	Debt in domestic currency	Debt in foreign currency	Total	Debt in domestic currency	Debt in foreign currency	Total
Debt maturing in 1 year (% of total)	18.0	10.4	12.0	17.0	13.0	14.0
Average time to maturity (years)	3.7	7.7	5.9	4.0	8.4	6.3

Source: MoPF

The refinancing/liquidity risks attached to the bonds issued in lei and foreign currencies are also managed based on a policy focused on a foreign currency buffer that covers four months of the gross financing needs.

To improve the public debt management and avoid seasonal pressures in securing the sources for financing the budget deficit and refinancing the government public debt, MoPF created the foreign currency financial buffer, in 2010, which at the end of 2018 accounted for approximately 4.1 months of the 2019 gross financing needs.

Table 4: Performance of the gross and net government public debt (% of GDP)

	2015	2016	2017	2018
Gross government public debt (% of GDP)*)	37.0	37.0	35.0	35.1
Financial buffer (% of GDP)	3.7	3.6	2.9	2.6
Net government public debt (% of GDP)	33.3	33.4	32.1	32.5

*) exclusive of temporary financing
Source: MoPF

Interest rate risk

Given that only a small portion of the debt has been contracted at variable rates (see Table 5) and as a result of the strategy aimed at extending the debt portfolio duration, the interest rate risk and the refinancing risk are moderate, displaying different characteristics according to the indicators specific to such risks, if we distinctly look at the RON and the foreign currency debt portfolios. On the one hand, the still significant share of the short-term debt within the total government debt denominated in lei entails higher refinancing and interest rate risks for this portfolio. On the other hand, the exposure to the interest rate risk is diminished for the foreign currency debt portfolio due to the fact that issuances of Eurobonds and fixed rate loans from international financial institutions contracted on long and very long maturities accounted for the bulk of this debt at the end of 2018. Thus, a 1pp increase in interest rates in 2019 will increase debt service payments by RON 1.6 billion, i.e. 0.56% of central government revenues[14] in the local currency debt and RON 1.7 billion, i.e. 0.60% of central government revenues, in the foreign currency debt.

Table 5: Interest rate risk indicators

Indicators	2017			2018		
	Debt in domestic currency	Debt in foreign currency	Total	Debt in domestic currency	Debt in foreign currency	Total
Share of fixed interest rate debt (% of GDP)	93.3	86.8	89.9	93.3	88.6	90.9
Share of debt re-fixing in 1 year (% of total)	17.0	8.0	15.0	16.0	7.0	17.0
Average time to re-fixing interest rate (years)	3.7	7.8	5.9	4.0	8.8	6.3

Source: MoPF

[14] Revenues according to cash methodology applying EU methodology.

In relation to the data presented above, we may conclude that the refinancing risk and interest rate risk of the domestic currency debt, despite a relatively steady level throughout 2018, continue to remain attached to the government public debt portfolio and must not be neglected. Comparatively, currency risk exposure is easier to manage while it still needs to be correlated with the third objective of the Medium-term government public debt management strategy, which is to develop a domestic market for government securities. As far as limiting the refinancing and the liquidity risks, the policy to set and to maintain a foreign currency financial buffer shall be continued.

4. Domestic and foreign financing in the context of local and foreign financial markets in 2018 and in the first five months of 2019, and medium term expectations

Domestic Market

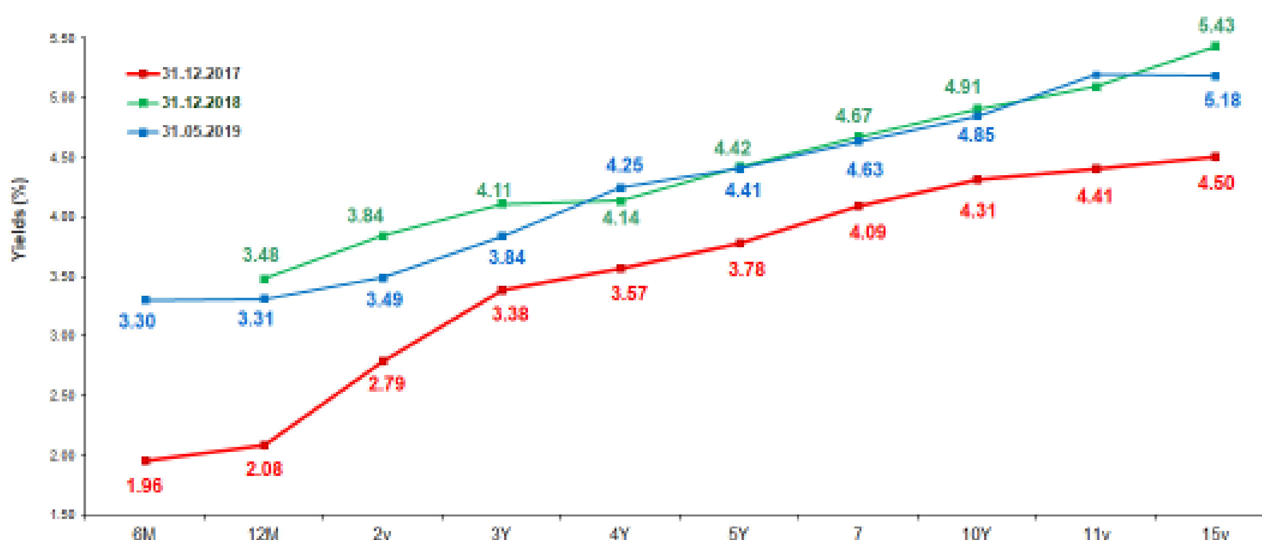
Developments on the domestic market in 2018 and the first 5 months of 2019

Over the course of 2018, the performance of the government securities market was influenced by internal factors - the growing inflation, the liquidity conditions on the interbank money market and the expectations of lending institutions as to NBR continuing to adjust its monetary policy conduct, but also the foreign context came into play - the investors' expectations as to a standardization of FED's/ECB's monetary policies, geopolitical and trade tensions (Italy, Brexit), worldwide economic growth marked by uncertainties.

Against this background, after a relatively floating evolution displayed over the course of Q1 2018, the benchmark quotations on the secondary market started to trend up, as of mid-April, and continued on a growing trend, more pronounced in the case of short-term maturities.

As indicated by chart 8, at the end of 2018, the interest rates pertaining to Romanian government securities denominated in lei reached levels that exceeded those at the end of 2017, whereas during the first 5 months of 2019, the segment of short-term maturities displayed a decreasing path as opposed to its trend in late 2018.

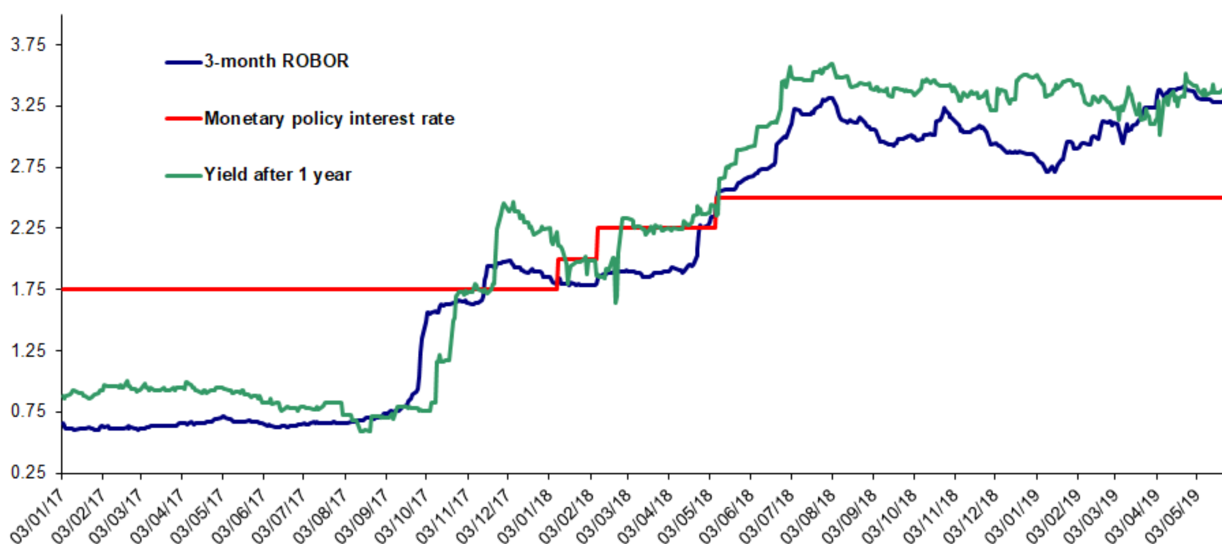
Chart 8: Yields on the domestic secondary market



Source: Bloomberg

During January, February and May 2018, NBR increased the monetary policy rate by 0.25 percentage points, from 1.75% to 2.5%, while maintaining the symmetric corridor comprising the interest rates of permanent facilities within +/-1 percentage point around the monetary policy rate. At the same time, NBR strengthened its control over the liquidity throughout the banking system. Against this backdrop, the ROBOR quotations on the interbank money market displayed an upward trend.

Chart 9: **Comparison between the monetary policy rate, 3M ROBOR and 1-year yields**



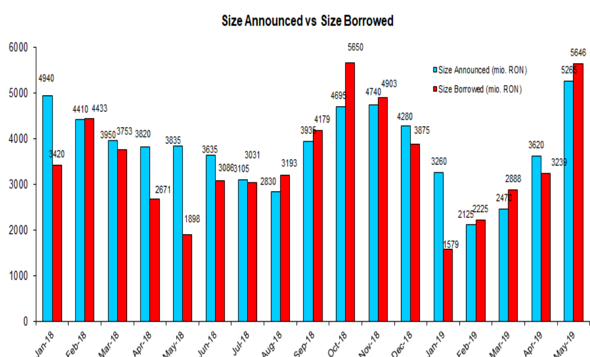
Source: MoPF, NBR

These measures were also reflected by the yields, which followed an upward trajectory, as well as by the participation of local lending institutions in auctions for government securities. While from January to May 2018 the awarded amounts were considerably lower than announced, later on the investors' participation in government securities auctions improved.
The early part of 2019 was marked by the string of uncertainties related to the adoption of the 2019 state budget, as well as by the measures enacted as per GEO no. 114/2018, which also influenced the demand for government securities expressed by both local and international investors.

After the state budget was adopted in February and following the measures provided by GEO no. 19/2019, namely the new mechanism for implementing the tax on bank assets and the new reference index for consumer loans granted in lei, we see an increase in the oversubscription level at auctions for government securities.

Chart 10: Amount announced vs. amount awarded, from January 2018 to May 2018

Chart 11: Demand and supply on the primary market of government securities, January 2018 - May 2019



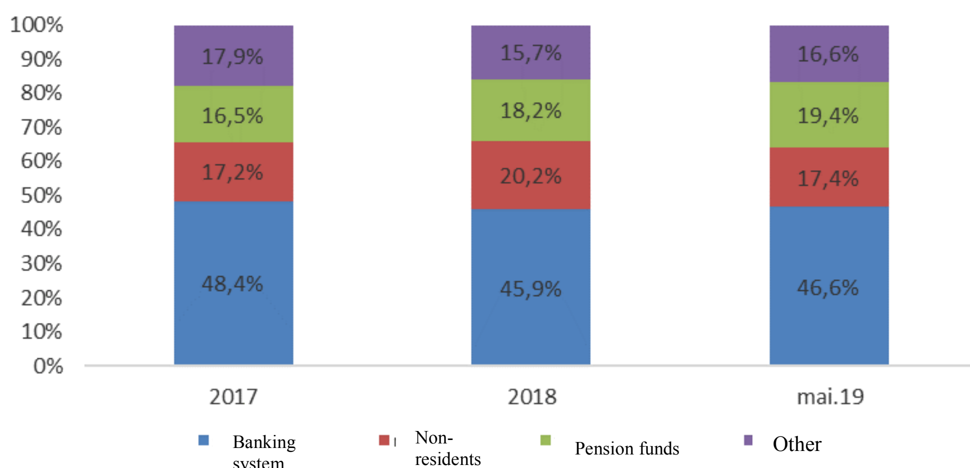
Source: MoPF

Investor Base

The fact that the Romanian government securities are still included in the JPMorgan and Barclays indexes continues to have a positive influence on the local market and maintaining the foreign investors' interest. At the end of May 2019, 10 series of Romanian government bonds were included in the GBI-EM Global Diversified Investment Grade, with a 3.09% weight and 16 series were included in the Barclays EM Local Currency Government index, with a 1.18% weight, as against the 1.25% in previous May, for 14 bond series.

The commercial banks remained the main investors on the domestic market of government securities, holding in their portfolio, at the end of May 2019, 46.6% of the total amount of government securities issued on the domestic market, indicating an increase as opposed to 2018, being followed by non-resident investors with relatively constant holdings, around 17.9%, whereas the pension funds managed to increase their holdings from 16.5% in late 2017 to 19.4% at the end of May 2019.

Chart 12: Government securities by holders



Source: NBR

As institutional investors, local asset managers and private pension funds, while having a relatively small share of the government securities market, were a steady participant to the government financing.

The total net assets held by the private pension funds (pillars II+III) displayed a significant increase, from 10.2 billion in 2012 to 55.6 billion lei at the end of May 2019, with around 60% of these assets invested in government securities. At the end of 2018, their holdings in government securities issued on the domestic market in lei and Euro amounted to approx. 31.4 billion lei, and to 30.7 billion lei at the end of April 2019.

Non-resident investors continue to account for an important segment, as they secure a complementary demand to the local investors' demand, given their interest particularly for long maturities, and help diversify the investor base.
The non-residents' holdings in government securities issued on the domestic market maintained a relatively steady level throughout 2018 (around 18 - 18.5%) and displayed a slight increase by the end of 2018 (20.2%).
The relatively low holdings of non-residents limited the domestic market vulnerability to periods of volatility, when investors tend to liquidate or lower their exposures in emerging countries.

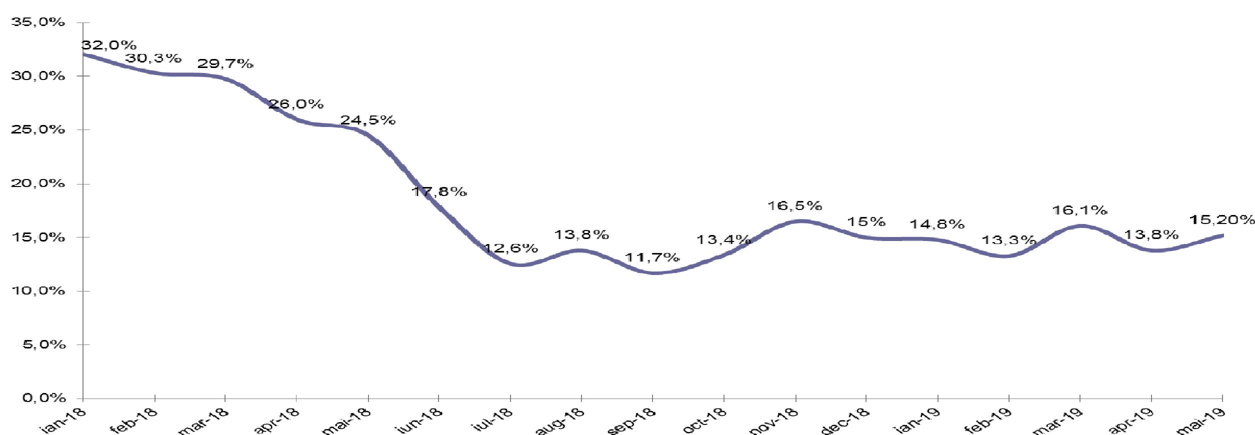
The non-resident investors' presence increase is influenced by a multitude of internal factors, internal ones, such as the development of a more liquid swap market in Romania for longer-term maturities, liquidity increases for government securities across all segments, the introduction of secondary market operations, the share increase of Romanian government securities in international indexes (JP Morgan/Barclays), considering that the vast majority of institutional investors set forth their investment policies in relation to the structure of these indexes.

Secondary Market

The liquidity of government securities on the secondary market is an important indicator for the level of development of the government securities market. The degree of liquidity, calculated as a ratio between the total volume of monthly transactions on the secondary market and the total amount of government securities, displayed a relatively constant decrease during the first 9 months of 2018, reaching the absolute yearly low point in September 2018 (11.7%) and returning to 15% at the end of 2018, in parallel with an increase of the government securities stock available on the market by approximately 10 billion lei for the entire year. At the end of May 2019, the degree of liquidity reached 15.2%, showing a decrease from the level reached in late May 2018 (24.5%).

At the end of the second year into the operation of the electronic trading platform for Romanian government securities (the E-bond platform – supplied by Bloomberg), there is a visible positive impact upon the government securities market. In 2018, the primary dealers quoted several series of government securities by means of the platform, in higher numbers, also taking into account the increased listing time. On the other hand, we see an increase of the margin between ask and bid quotes, reflecting the primary dealers' increased risk aversion to the market conditions.

Chart 14: Liquidity of the government securities in lei, outstanding between December 2018 and May 2019



Source: MoPF

Implementation of the domestic market financing plan in 2018 and the first 5 months of 2019

Throughout the year 2018, the Ministry of Public finance maintained a predictable and flexible issuance policy, adjusted to the investment environment demands, in particular against the backdrop of highly fluctuating market conditions.

In 2018, the government securities issued on the domestic market amounted to 42.9 billion lei and 612 million euros, respectively, and the government securities for the individual investors amounted to 2 billion lei, accounting for around 67.2% of the gross borrowing needs of the central government[15]. The government securities issued on the interbank market had the following structure:
a) 10.0% discounted T-Bills and benchmark bonds with residual maturities up to 1 year;
b) 54.9% benchmark bonds with residual maturities between 1 and 5 years; and
b) 35.1% benchmark bonds with residual maturities between 5 and 14 years.

The 3, 5 and 7 years benchmark bonds denominated in lei were issued and reopened almost every month. The policy of the Ministry of Public Finance also aimed the extension of the average maturity of government securities, the vast majority of which were issued with medium- and long-term maturities.
In 2018, the TEZAUR Program was launched for the segment of individuals who prefer a classic savings instrument provided by the state, a program that comprised issuances of dematerialized

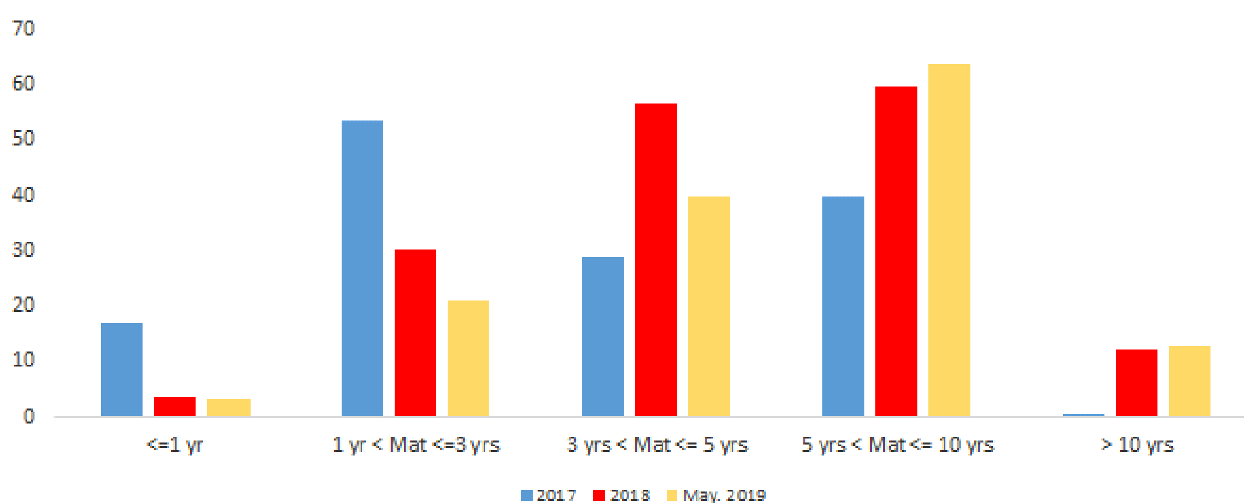
[15] Presented in chapter 5.

government securities intended for the population, via the State Treasury work units and the postal subunits of the Romanian Post National Company.

From July 2018 to May 31, 2019 the issuances were launched for maturities varying between 1 and 5 years, with more than 84,982 individuals investing 3.8 billion lei. For 2019, the amount to be borrowed from individual investors is estimated at around 5 billion lei.

During the first 5 months[16] of 2019 the government securities issued on the domestic market amounted to a total of 18.9 bn lei, of which 14.7 bn lei on the interbank market, issuances of Euro-denominated government securities amounting in total to 506.7 mil. Euro (the equivalent of 2.4 bn lei), as well as issuances of government securities intended for the general public, amounting to 1.76 bn lei, which accounts for a 38.4% achievement of the financing plan.

Chart 15: Government securities by maturities (initial maturity, bn lei) - in 2017 - 2018 and the first 5 months of 2019



Source: MoPF

The policy of the Ministry of Public Finance focused, in 2018, as well, on enhancing the performance of primary dealers, the issuance of benchmark securities designed to meet the liquidity requirements for their inclusion into reference regional indexes, enhancing the secondary market infrastructure by developing the functionality of the trading platform for primary dealers (E-Bond) and the access of other market participants to the quotes provided by market makers, increasing the transparency level in disseminating information and statistical data on the public debt, via updates to the www.datoriepublica.mfinante.gov.ro website and taking part in various international-scale events intended to increase visibility for Romania within the investment environment.

Foreign Market

Developments on the foreign markets and the Romanian Eurobond market in 2018 and the first 5 months of 2019

Throughout 2018, the dynamic of government bonds markets was largely influenced by the Brexit negotiation, intensified expectations that the reference interest rates might increase, particularly on the US market, as well as tensions between the USA and China regarding the increase of custom duties.

[16] On June 3, 2019.

The first 6 months of 2018 were marked by times of uncertainty, first signaled by the sharp decrease of the stock market indexes[17], against the background of a market adjustment and increased yields of government bonds[18], the investors anticipating that the higher inflation in the United States would determine the Federal Reserve (FED) to expedite the increase of interest rates. Hence, in 2018, FED increased the benchmark rate from the 1.25% - 1.5% to the 2.25% - 2.5% interval, via four money market decisions, during the months of March, June, September and December, each time by 25 basis points. During the June 19, 2019 reunion, FED introduced a monetary policy change. While leaving untouched the key interest rates for the moment, FED did indicate that the interest rate would soon be lowered[19], mentioning the economic decline risks and the inflation target lowering estimates (the inflation forecast for 2019 was lowered from 1.8% to 1.5%, and for 2020 from 2.0% to 1.9%). The most recent FOMC[20] reunion highlighted the fact that the inflationary expectations are currently the decisive factor in FED's decision-making process.
On the other hand, within the Euro area, ECB maintained the benchmark rate throughout 2018, notifying on the completion of its procurement program for December 2019 and anticipating that the rates of benchmark interests would remain at their current levels, so as to ensure the continued consistent convergence of inflation rates towards lower levels, but close to 2% in the medium run. Moreover, ECB intends to continue to fully reinvest the matured securities purchased as part of the asset procurement program in order to secure favorable liquidity conditions, over an extended period of time after the date when it would commence raising the rates of benchmark interests. Furthermore, as of September 2019 there shall be a new series of longer-term targeted refinancing operations launched[21], intended to maintain favorable bank lending conditions and disseminate the monetary policy.

The yields of Eurobonds issued by Romania performed better compared to the trends seen in other countries of the region, which proves that the main global drivers were non-uniform and therefore the effects were felt differently by the countries in the region. The spread between the yields of Eurobonds issued by Romania and the German ones, for the 10-year maturity, took an upward path throughout the year, varying within the 150-250 basis points and almost reaching the 2017 levels.

Chart 16: Spreads of 10-year Eurobonds denominated in Euro issued by Romania, Poland and Bulgaria, calculated as against the German Bund

[17] On February 5, the Dow Jones Industrial Average index decrease by 1500 points
[18] The yield of 10-year American treasury bonds exceeded the 2.85% level for the first time since January 2014, whereas that of the German bonds with the same maturity increased by 0.05 percentage points, to 0.80%, the highest level reached over slightly more than the previous 2 years
[19] 2 monetary policy rate decreases are expected for this year.
[20] Federal Open Market Committee
[21] To be completed in March 2021 and have a two-year maturity each.

Source: MoPF

Considering the international context and the investors' perception of the changes in the Romanian economy, the yields of government Eurobonds denominated in Euro and USD had an upward trajectory throughout 2018, only to follow, as of 2019, a downward path from the maximum levels in January. The Eurobonds denominated in Euro performed significantly better than those denominated in USD, with narrower variations of yields and maintained their appeal to the investment environment, providing higher yields in relation to those in comparable countries from the same rating category.

Chart 17: Yield curve of Romanian Eurobonds issued in Euro on the foreign market

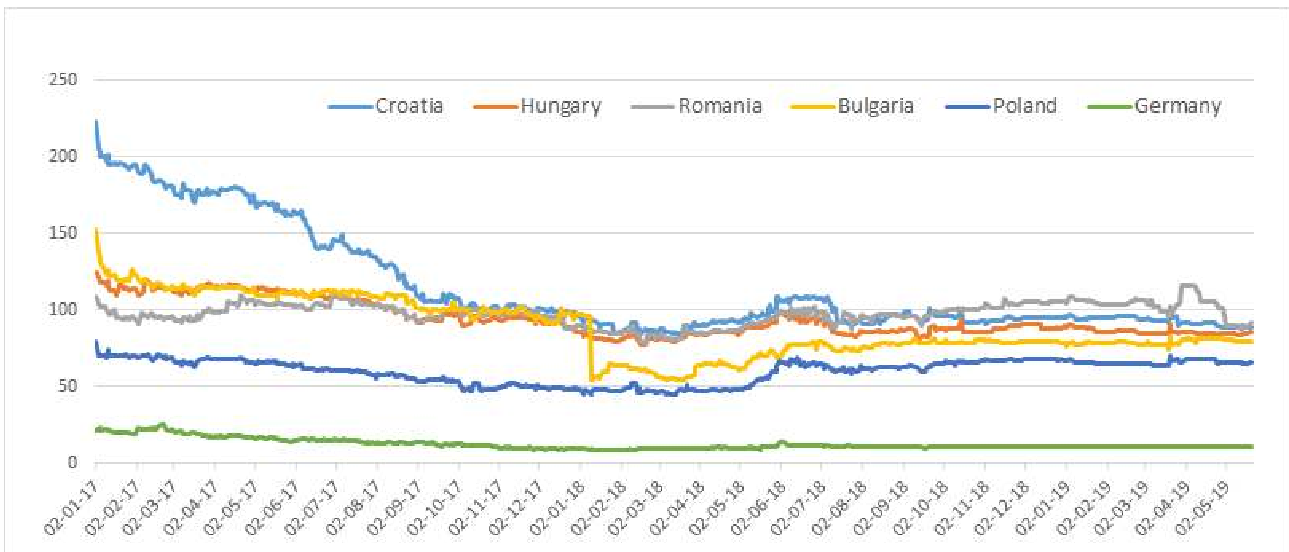
Source: MoPF

Chart 18: Yields of Romanian Eurobonds issued in USD on the foreign market, maturing in 2023 and 2024

Source: MoPF

Against a background with prevalent decreasing yields throughout 2018, the state of uncertainty generated by the effects of Brexit and due to a lack of investment alternatives, investors reduced their exposures to the emerging markets. Romania's CDS (credit default swap) quotations[22], representing the price of insurance against the default risk, remained relatively consistent throughout 2018, being very close to the levels reached by other countries in the region, such as Bulgaria and Hungary.

Chart 19: The development of 5-year CDS (Credit Default Swaps) quotations



Source: Bloomberg

Implementation of the financing plan for the foreign markets in 2018 and the first 5 months of 2019

[22] The dynamic of CDSs reflect the investors' perception of the country risk and has an impact upon the respective country's financing costs.

The implementation of the foreign financing plan for 2018 commenced in early February 2018 with the launch of the first foreign issuance, in two tranches, denominated in Euro, with 12- and 20-year maturities, coupons amounting to 2.500% and 3.375%, and a total value of 2 billion Euro, of which 0.75 billion Euro for the 12-year tranche and 1.25 billion Euro for the 20-year tranche.

June 2018 marked the launch of a new issuance in USD, with 30-year maturity and a 5.125% coupon, amounting to 1.2 bn USD, together with the first early partial redemption, performed by the Romanian state on foreign capital markets, of USD-denominated Eurobonds with maturity in 2022 and a 6.75% coupon.

The 2018 foreign financing plan was completed in October, when a total amount of 1.75 bn EUR was drawn in by means of a two-tranche transaction, of which 1.15 bn EUR via a new issuance with 10-year maturity (3.029% yield, 2.875% coupon) and 600 mil. EUR via a new issuance with 20-year maturity (4.234% yield, 4.125% coupon), whereas the total demand reached 2.8 bn EUR.

The operations conducted on the foreign market in 2018 included drawings in the amount of around 190 million Euro in loans contracted from international financing institutions.

On March 27, 2019 a first three-tranche transaction of Eurobonds was carried out, amounting to 3 billion EUR, of which 1,15 billion EUR with 7-year maturity (2.132% yield, 2.0% coupon), 500 million EUR with 15-year maturity (3.618% yield, 3.5% coupon) and 1.35 billion EUR with 30-year maturity (4.657% yield, 4.625% coupon). The total amount of 3 billion EUR accounts for the highest transaction ever performed by the Ministry of Public Finance, the first three-tranche issuance in the history of Romani, whereas the 30-year tranche is the longest maturity issued by Romania in EUR on the foreign capital market. This transaction managed to secure 70% of the financing plan with foreign market sources.

Table 6: Eurobonds issued on the foreign markets which are closed to maturity

Issuance date	Currency	Maturity	Amount awarded (thousands)	Coupon (%)	Initial yield (%)	Yields at 5/22/2019 (%)
2/7/2012	USD	2/7/2022	1.500	6.750	6.875	3.198
3/6/2012			750		6.450	
6/15/2018			-231			
11/7/2012	EUR	11/7/2019	1.500	4.875	5.040	-0.329
2/22/2013	USD	8/22/2023	1.500	4.375	4.500	3.370
9/18/2013	EUR	9/18/2020	1,500	4.625	4.769	-0.162
10/28/2013			500		4.150	
1/22/2014	USD	1/22/2044	1,000	6.125	6.258	4.861
1/22/2014	USD	1/22/2024	1,000	4.875	5.021	3.460
4/24/2014	EUR	4/24/2024	1,250	3.625	3.701	0.786
10/28/2014	EUR	10/28/2024	1,500	2.875	2.973	1.022
10/29/2015	EUR	10/29/2025	1,250	2.750	2.845	1.387
2/25/2016			750		2.550	
10/29/2015	EUR	10/29/2035	750	3.875	3.930	3.534

2/25/2016			500		3.900	
4/19/2017			750		3.550	
5/26/2016	EUR	5/26/2028	1,000	2.875	2.992	2.317
10/5/2016			1,000		2.150	
4/19/2017	EUR	4/19/2027	1,000	2.375	2.411	2.025
2/8/2018	EUR	2/8/2030	750	2.500	2.585	2.677
2/8/2018	EUR	2/8/2038	1,250	3.375	3.450	3.567
6/15/2018	USD	6/15/2048	1,200	5.125	5.200	4.938
10/11/2018	EUR	3/11/2029	1,150	2.875	3.029	2.510
10/11/2018	EUR	3/11/2039	600	4.125	4.234	3.736
4/4/2019	EUR	12/8/2026	1150	2.00	2.132	1.823
4/4/2019	EUR	4/3/2034	500	3.50	3.618	3.410
4/4/2019	EUR	4/3/2049	1350	4.625	4.657	4.145

Source: MoPF

Sovereign rating

Throughout 2018, the rating agencies reconfirmed the ratings granted to Romania, relying on the prospects of a solid economic growth and the low share of public debt to GDP and pinpointed the factors that might affect the sovereign rating over the following period, such as an increase of macroeconomic imbalances or the material deterioration of the balance of payments, as well as the international investment position.

The ratings granted to Romania are: Baa3 with stable outlook from Moody`s, BBB-/A-3 with stable outlook from Standard&Poor`s, BBB-/F-3 with stable outlook from Fitch and BBB/BBB+ from JCRA.

The same rating and outlook levels assigned to Romania were also maintained over the first months of 2019 by Moody’s, S&P and Fitch rating agencies.

Expectations regarding the performance of financial markets in 2019-2021

Over the following period, the economies of the countries in the region and the financial markets shall continue to be under the influence of monetary policy conducts both at an international and a local level, while also influenced by the toned down worldwide economic growth seen in 2019. FED is expected to pass decisions on lowering benchmark interest, whereas ECB intends to further implement the accommodative policy at least until the first half of 2020 or as long as it appears necessary in order to ensure the future consistent convergence of inflation rates towards lower levels, but close to 2% in the medium term.

At the same time, external factors, such as the trade tensions between the USA and China and the uncertainties associated to the United Kingdom’s exiting the European Union, postponed until October 31, 2019, will significantly influence the investors’ risk appetite in emerging economies.

Internally, according to the Convergence Program approved for the 2019-2022 period, the Romanian economy is expected to continue to display positive performance, as the gross domestic

should increase, on average, by 5.6% a year throughout 2019 and 2020, slightly above its potential, and economic growth should recede to 5% in 2021. The budget deficit estimates for 2019 according to the ESA methodology do not exceed the limit of 3% of GDP, and the budget deficit shall be adjusted, as of this year, up to 2.45% in 2021. NBR's Inflation Report on inflation - the May 2019 issue - estimates inflation levels of 4.2% for late 2019 and 3.3% for late 2020.

Against the backdrop of worldwide aggravated vulnerabilities, but also of the domestic economic and political developments, one may expect seasonal reactions across the yield curve of government securities, as well as adjustments to the participation of categories of local investors in the domestic financing process.

Medium-term financing process

On a medium-term, the state budget deficit and government public debt will be financed and refinanced, respectively, using in principal domestic sources, to be supplemented by foreign sources. MoPF will continue its flexible approach in the financing process, to ensure predictability and transparency to the government securities offered, precisely to be able to have a quick and adequate reaction to potential changes in market trends and investor conduct.

In 2019, the Ministry of Public Finance partially pre-secured the financing needs for 2020, which is a policy it intends to continue over the following years, as well, depending on the conditions and opportunity windows on the foreign financial markets, thus managing, for the first time, to fulfill the objective stipulated in the beginning of the year in the Indicative Program of government security issuances for 2019. In fact, this is a common practice intended to secure the financing needs of debt management agencies across the EU, reducing as such the pressure to secure sources required to cover the financing needs for the ongoing year, against the background of debt redemption volumes during the first half of the year.

On the domestic market, to reduce funding costs and promote a better functioning of the secondary market, MoPF intends to continue building liquid benchmarks along the whole yield curve, at the same time with conducting a transparent issuance policy aiming at reaching amounts equivalent to 2.5 billion Euros, announcing the market in advance on the amounts and the frequency of issuing/reopening some categories of maturities. From time to time, MoPF may reopen the Euro-denominated government bonds issued on the domestic market, if there is a significant demand of local investors in the absence of alternative instruments, thus creating the premises for a beneficial maturity/cost ratio.

In addition, depending on the framework of secondary market specific procedures and operations that is to be finalized by NBR[23], consideration is being given to using specific secondary market operations, such as buy-backs or switches, to facilitate refinancing the high amounts that have been accumulating and are now to mature, and to speed up the process of creating the liquid benchmark bonds, above the level accumulated so far.

The financing process shall take into account a flexible structure of maturities which would, however, continue to allow extending the debt portfolio duration and lowering the refinancing risk. In that respect, an important element is the structure of the local investment base, where the commercial banks' share of holdings in government securities is till high. According to the NBR June 2019 report on financial stability, the banking sector holds approximately half the public debt issued on the domestic market, with government securities accounting for nearly 22% of their assets as at December 2018.

[23] The auctions for buy backs and switches on the domestic market shall be conducted through the e-platform developed by NBR for the primary market auctions.

As such, provided that a scenario with increased interest rates or risk premium for the emerging markets, one of which is Romania, becomes a reality, the holdings in government securities may have a negative effect upon the profitability and capital redemption banks can achieve following the acknowledgement of losses from marking to market fixed income instruments they own, which may have a seasonal negative impact upon demand at auctions for government securities, even if government securities represent a significant liquidity source for the banking system, being accepted as eligible assets for monetary policy operations.

Equally significant is the dynamic of the participation achieved on the government securities market by the other local investor categories, namely investment funds, private pension funds, with their major capacity to support the development of the domestic government securities market.

In this context, in implementing the medium-term financing plan, MoPF takes into account measures to diversify holdings in government securities, with the effect of lowering the concentration risk and the pressure upon the primary market yields.
For that purpose, but also in order to increase accessibility for natural persons and diversify sales channels for government securities, as savings instruments, there is an ongoing program for the distribution of government securities to the general public both by means of the State Treasury work units as well as the network units run by the Romanian Post National Company.

With regard to accessing *the foreign market*, MoPF intends to maintain its presence on international capital markets primarily through issuances of Euro-denominated bonds, whereas issuances in other foreign currencies may be taken into account as a funding alternative, provided that favorable costs are secured or certain external events occur, limiting access to particular maturity segments on the European market.

Additionally, after an initial exercise carried out in June 2018 by means of the partial redemption of USD-denominated bonds reaching maturity in 2022, interest is shown towards forging ahead with liability management operations, provided there are favorable market conditions.

MoPF will remain flexible about the time of accessing foreign international markets and the amount of foreign issuances, taking into account the associated costs, the risk considerations, the potential implications for the central bank's objectives and policies, as well as local market developments.
Thus, in the medium run, MoPF intends to continue its partnership with international financial institutions to benefit from the financial advantages of IFIs products in limiting the costs and extending the debt portfolio maturity using the offered cost and maturities terms, such as IBRD Development Policy Loans (DPLs and/or other similar instruments), as well as the other loans contracted from the international financial institutions to finance the budget deficit and refinance government public debt, with funds being made available depending on the implementation of certain measures and/or other actions required by sectorial reforms.

Table 7: Funding sources for the estimated funding needs

	Maturity (years)	**Amount (billions)**		
Domestic Market		**2019**	**2020**	**2021**
1. Treasury Bills	6 months to 1 year	12.0	11	11
2. Benchmark Bonds in RON	Over 1	37.0	38.0	38.0
3. Benchmark Bonds in EUR	5/4 years	0.6	0.6	0.6
Foreign Market				
1. Eurobonds issued under MTN Programme (EUR equivalent)				
- EURO/USD	Over 10 years	4.25	4.0	3.8

2. Loans from IFIs (bn Euros):				
a) EIB loans (incl. SPL), IBRD, ECDB etc.	vary based on the financing entity and the stage of the loan (some loans started to be reimbursed, while for other the terms are decided at the time of the drawing, according to MoPF option) in average 15/20 years of which 4-5 years of grace period	0.1-0.26	0.2-0.36	0.2-0.42
b) CAT DDO loan (DPL-like) *	up to 20 years	0-0.2	0-0.2	0-0.2

*) In accordance with the provisions in the loan agreement, ratified by Law no. 306/2018, disbursements from this loan will be made in case of calamity (an emergency situation as defined in Emergency Ordinance no. 21/2004)

Source: MoPF

5. Macroeconomic background in Romania

In 2018, the economy enjoyed a 4.1% growth, however, keeping in mind the international economic context and the economic and financial developments within the Euro area, as well as the economic growth potential dynamic, it is estimated for the 2019-2021 time frame that the gross domestic product will increase at an average annual pace of around 5.4%[24].

In regard to the consumer-price index, Romania concluded 2018 with a *3.3% inflation rate*[25]*,* the 2019 estimates[26] placing inflation at 4.2%, with 3.3% by the end of 2020.

Unemployment has reached a historic low point, as the unemployment rate in late December 2018 was 3.3%, 0.72% lower than the one recorded at the end of December 2017 (4.0%). Employment is on the increase, Romania fulfilling its commitment made as part of the “Europe 2020” Strategy.

In 2018, the current account deficit increased to 4.5% of GDP, as opposed to the 3.2% level it reached in 2017. The medium-term estimates indicate that the current account deficit will be maintained within sustainable limits, decreasing from 3.3% of GDP in 2019 to 2.7% in 2021[27].

The macroeconomic framework set up for the 2019-2021 interval took into account: the European and the global contexts, highlighted in the European Commission’s autumn forecasts, featuring economic decline, against the background of a healthy dose of uncertainty caused by increasing trade tensions, increasing oil prices, restless financial markets and marked by multiple interconnected risks associated to negative developments; the economic and social achievements from 2018 to date, aspects that underpinned the substantiation of budget indicators for 2019 and the 2020-2021 reference time frame.

[24] Source: 2019-2021 Fiscal and Budgetary Strategy.
[25] Source: NBR Inflation Report May 2019.
[26] Source: NCSP Spring Forecast May 2019.
[27] Source: NCSP Spring Forecast May 2019.

The budget planning for the 2019-2021 interval was underpinned by the fiscal loosening measures commenced in previous years, intended to stimulate economic growth, with an additional impact upon staff and social services expenditure, but also by the fiscal and budgetary measures taken throughout 2018, which influence the macroeconomic framework and the budgetary indicators for the 2019-2021 time frame.

With budget deficits of up to 3% of GDP on the medium term, the gross financing need is still determined by the amount of government public debt refinancing, which accounts for a rough 68% of the gross borrowing needs, as shown in the table below:

Table 8: Forecast of financing needs

Indicator	2018 operative execution	2019 planned	2020 planned	2021 planned
Central Government Revenues (billion lei)[28]	247.0	285.5	298.3	317.7
Central Government Expenditure (billion lei)[29]	273.9	314.6	326.0	344.2
Central Government Budget Deficit (I) (billion lei)[30]	26.9	29.1	27.7	26.4
Refinancing of the government public debt[31] (II) (billion lei)	43.4	46.9	40.4	34.5
Gross financing needs (I+II) (billion lei)	70.3	76.0	68.1	60.9

Source: MoPF

The macroeconomic assumptions for the 2019-2021 Strategy are presented in the table below.

Table 9: Baseline scenario of macroeconomic projections

Indicators	2018	2019 planned	2020 planned	2021 planned
Nominal GDP (billion lei)	944.2	1,031.0	1,110.2	1,188.5
GDP Growth (%)	4.1	5.5	5.7	5.0
Central Government Budget Deficit [32] (% of GDP)	-2.85	-2.8	-2.5	-2.2
Current Account Deficit (%of GDP)	-4.5	-3.3	-2.9	-2.7
Inflation (end of year %)	3.27*)	3.2	2.8	2.3
Inflation (annual average %)	4.63*)	3.4	2.6	2.5
RON/EUR average exchange rate	4.6535*)	4.74	4.71	4.69
RON/YSD average exchange rate	3.9416	4.19	4.17	4.15

Source: NCSP, MoPF

*) Achieved

The risks associated to initial projections

Although current yields have reached a new record (the 10-year Bund and the 10-year T-note yields reaching the lowest levels since 2017 to date), the deviations from the above-mentioned macroeconomic projections in the baseline scenario, which might cause a volatility likely to hinder

[28]Cash, applying the EU methodology.

[29] The same as 28.

[30] The same as 28.

[31]The principal repayments and refinancing of bonds on account of the government public debt, under the national legislation, calculated based on the debt balance at the end of 2018 (it includes government guarantees but it does not include temporary financing).

[32] The same as 28

the investment appetite for the financial assets issued by emerging economies, could originate in the worldwide economic decline estimates, the uncertainty brought about by Brexit negotiations, the Euro-parliamentary elections, geopolitical tensions, as well as other external events (such as challenges in the areas of economic governance and international trade – the trade disputes between the USA and the Euro Area).

The expectations that the two monetary policies (ECB and FED[33]) might worsen have significantly decreased over the past months, with balanced outcomes upon the yield curves of both the two financial markets and the emerging markets. There are still present elements of uncertainty that might have an impact upon the financing activity, such as those pertaining to Brexit and the geopolitical tensions in particular regions, plus the fact that the emerging markets, Romania being of them, remain generally vulnerable to sudden shifts in investor perception, against the background of occurrences of unforeseen events. The foreign shocks associated to these risks might lead to a decline of economic growth, by means of decreases in exports of capital outflows[34], and might require increasing the financing needs under less favorable funding terms, in conjunction with the significant risk entailed by the investors' altered impressions.

As far as the domestic market is concerned, it will be influenced by both international macroeconomic and financial trends and the domestic developments (economic and political).

Among the domestic risk factors there are the fiscal and budgetary policy conduct, in a context of uncertainties related to the impact the adopted fiscal loosening measures might have upon medium-term macroeconomic imbalances, a budget deficit hike in the medium run and the inflation rate exceeding its projected level, against the backdrop of being subjected to difficult weather conditions negatively impacting the contribution of agricultural production to the GDP target, whereas the main foreign risks are related to the fears of worldwide economic decline, the rapid deterioration of investors' confidence in emerging economies and global events that aggravate geopolitical tensions across particular regions (the trade tensions between the USA and China) and might trigger even further depreciation of the currency exchange rate.

If budget deficits will be high in the medium term (up to 3 % of GDP), the issuance of new debt to cover these needs in the domestic market should take into account the absorption capacity of the domestic market and the characteristics of holders of government bonds issued on this market (while the share of the banking sector decreased below 50%, it still remains the main holder government securities). This risk factor may be diminished in the long term by increasing the demand of institutional investors, such as pension funds or of other participants to the capital market, such as the local asset management funds and insurance companies.

Macroeconomic policy implications

Macroeconomic projections in the baseline scenario indicate diminishing financing needs and stabilizing government debt to GDP in the future. This means that financing strategies will have to be implemented taking into account both the refinancing debt amount and the budget deficits of up to 3% of GDP, in parallel with increasing the tolerance to financial risks. In the medium-term financing process, MoPF will consider achieve its specific objectives, namely to increase funding in domestic currency and extend the maturity of government securities issued in domestic currency on the domestic market and the foreign markets, and will take account of the macroeconomic context and demand changes in terms of investment base both internally and externally.

In conclusion, the main risks associated to the macroeconomic assumptions in the baseline scenario indicate that, in terms of the monetary policy decisions anticipated/estimated to take place

[33]The Federal Reserve increased seven-fold the monetary policy rate during the 2017-2018 interval, in December 2018 FED's benchmark interest being increased by a quarter point, up to the 2.25% - 2.5% range, the highest level over the past 10 years, although FED had expected to lower two-fold the monetary policy rate in 2019, the inflationary expectations being the decisive factor in FED's decision-making process

[34] Exposure to volatility in capital flows may increase also due to the presence of Romanian bonds denominated in domestic currency in the Barclays and JP Morgan index as a result of the increased access of non-residents to government securities issued on the local bond market.

both domestically and external, a relatively stable market context is expected for the second half of 2019

6. Analysis and strategic guidelines

The strategic guidelines for managing public government debt in Romania reflect the cost-risk tradeoffs in the current government public debt portfolio[35], the plans to develop the domestic market of government securities and the medium-term macroeconomic framework.

Implications on the government public debt management of the analysis of the current government public debt portfolio, the macroeconomic framework and the market context

While declining compared to previous years the exposure to refinancing risk and interest rate risk attached to the debt issued on the domestic market continue to be the main sources of risk for the existing government debt portfolio. The foreign currency risk is moderate, being mitigated by the share of foreign currency debt issued in the long run (Euro-denominated) and the availability of the foreign currency financial buffer to the State Treasury. Additionally, the advantage of long and very long maturities and the investor base diversification continues to justify the option of issuing USD-denominated Eurobonds, but strictly provided that foreign currency swaps are used. As such, the most recent analysis carried out reveals that, in the absence of the framework required to use derivatives for managing risks related to funding in other currencies, USD funding is currently more costly and riskier that Euro funding[36]. Nevertheless, one needs to consider the cost required to use long-term and very long-term hedging instruments.
Starting from the second half of 2019, the intentions are to use specific secondary market instruments, such as government security early redemption and/or switch operations, depending on the completion of the procedural and operational framework within NBR, in order to decrease the refinancing risk and enhance liquidity, by refinancing certain series with significant accumulated volumes and consolidating the investors' demand for securities issued in the national currency.

Based on these considerations, the MoPF evaluated financing alternatives that help mitigate the exposure to refinancing and interest rate risk. Two approaches were used: first relying more on as long as possible maturities of government securities in domestic currency and second replacing the financing in short-term T-Bills by long-term bonds denominated in EUR. In addition, to examine the cost-risk tradeoff resulting from the issuance of long-term bonds in USD, several borrowing strategies were simulated, with different composition of foreign currencies (EUR versus USD).

Alternative funding strategies were compared based on the projections of debt service under different scenarios of exchange rates and interest rates. The baseline scenario, defined as the most likely, was used to calculate the expected cost of the different strategies. The risk was calculated as a ration between the increase in cost resulting from applying shocks to the market rates used in the baseline scenario and the cost in the baseline scenario. Two indicators of cost and risk were used: debt-to-GDP ratio and interest-to-GDP ratio, both calculated at the end of the third projection year, 2021. The results of the cost-risk analysis are then complemented by macroeconomic considerations and considerations related to the domestic market of government securities, as described below.

Results of the analysis of alternative debt management strategies

<u>*Extension of average time to maturity (ATM) in domestic currency debt:*</u> Addressing the refinancing exposures in domestic currency debt using more RON denominated instruments on medium and long term maturity is becoming more favorable, considering the still relatively low yields of government securities during the interval under review. Under these circumstances, the cost of

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[35]At end-2018.
[36] The current yields (as at June 3, 2019) pertaining to Euro-denominated Eurobonds with maturity in 2029 is approx. 2.39%, whereas the yields of Eurobonds issued in USD, with maturity in 2024, are close to 3.39%.

extending ATM is relatively small in terms of debt-to-GDP and interest-to-GDP. Accordingly, the scenario analysis supports strategies that raise ATM as the cost increase is relatively small compared to the improvement in the redemption profile and the protection offered against a sudden and sustained increase in short-term interest rates.

This strategy could help market development by increasing the liquidity of medium and long-term government securities with an impact on the development of the secondary market. Improving liquidity can come from both increasing the weight of Romanian government securities in the regional reference indexes, by using the electronic trading platform (E-bond) on the secondary market, and using secondary market instruments (buy-backs and security switches), after the completion by NBR of the technical and operational framework that enables such instruments. Still, the cost simulations pertaining to this strategy fail to include the constraint entailed by the domestic market's capacity to absorb an increased volume of medium- and long-term government securities. Therefore, this scenario needs to take into account a reasonable increase of the net volume of issuances of medium- and long-term government securities on the domestic market, in conjunction with the banking sector's exposure to government securities.

<u>Reduce refinancing risk by rollover of T-bills denominated in lei using Euro-denominated government securities:</u> The use of Euro funding to address the refinancing risk attached to the debt denominated in domestic is advantageous when looking at the debt servicing flows. Thus, when interest-to-GDP is used as the cost indicator, the strategies with more Euro funding have a similar cost, but a lower associated risk. The analysis based on risk differential responds to the fact that domestic interest rates are significantly more volatile. However, if the analysis focuses on the stocks, the foreign currency risk dominates and increasing the share of the EUR debt amplifies the exposure of the debt portfolio to a potential correction of the domestic currency.

<u>*Composition of the foreign currency portfolio:*</u> The results of simulations indicate a clear preference for borrowing in EUR over USD. The quantitative analysis shows that at the current and implied forward yield curves, USD financing involves the increase of both the cost and the risk compared to the case in which Euro financing is used. This reflects the expectation of higher USD interest rates and a RON/USD exchange rate significantly more volatile than the RON/EUR, with the US currency appreciating against the Euro.

While the USD market is more liquid and allows Romania to borrow on very long maturities (up to 30 years) adding to the diversification of the investor base, the favorable terms on the Euro market which allowed extending the maturity of the Romanian government securities up to 30 years are additional pros to issuing Eurobonds mostly on the Euro market. However, in case of opportunities in terms of cost/maturity at issuance of Eurobonds denominated in other currencies, in conjunction with managing the risk of exposure to these currencies, using currency swaps, taking into account the cost of using the long and very long term hedging tools, the possibility to use such instruments while maintaining the main exposure in euro can be considered.

With a view to using derivatives (foreign currency swap and interest rate swap), to set up the legal, procedural and technical framework, the Ministry of Public Finance, via the General Directorate for Treasury and Public Debt, received technical assistance from the World Bank Treasury, until June 2018, as part of the project on the topic "Development of the government public debt management capacity through the use of derivatives", SIPOCA code 10. The project was financed from the European Social Fund as part of the Operational Programme "Administrative Capacity" 2014-2020. Following the completion of the project, based on the reports provided by the World Bank, additions were brought to Government Emergency Ordinance no. 64/2007 on the public debt in the form of Government Ordinance no. 14/2018, which amends and supplements GEO no. 64/2007, by introducing new definitions and concepts in order to use derivatives and authorizing the Ministry of Public Finance to carry out these transactions.

In conclusion, with budget deficits below 3% of GDP in the medium term, MoPF envisages the bulk of net lending denominated in local currency, as a move to continue to develop the domestic market, while accessing foreign capital markets in Euro and borrowing from IFIs in order to ensure robust funding sources, preserving opportunistic access to international capital markets in currencies other than EUR, under a cost/risk ratio favorable to Romania, the diversification of the investor base and the use of derivatives (currency swap).

The authorities will continue to promote the development of the domestic market of government securities through the measures and actions described in Annex 1.

Strategic guidelines

The government's financing decisions in 2019-2021 will rely on the following principles:

1. The net financing mainly in local currency is as a move to further facilitate the development of the domestic market of government securities and help mitigate foreign currency exposure, at the same time considering the domestic market absorption capacity and, in general, the demand for debt instruments denominated in lei[37], as well as the need for a further diversification of the investor base of government securities.
2. Depending on the market circumstances, the Ministry of Public Finance takes into consideration to partially pre-secure the next year's estimated financing needs.
3. Pursue a smooth redemption profile, avoiding to the extent possible the concentration of principal repayments/refinancing of government securities in the short-term.
4. Mitigate the refinancing risk and the liquidity risk by maintaining a foreign currency buffer[38] at a comfortable level and possibly by using other instruments depending on the terms and conditions thereof.
5. Maintain a presence on the international capital markets, through issuances of Eurobonds mainly in Euro and access the USD market or other foreign currency markets on an opportunistic basis, giving consideration to the extension of the debt portfolio average maturity and taking into account the cost/risk ratio associated thereto and the diversification of the investment base.
6. In the process of external financing, the debt will be contracted mainly in Euros.
7. The euro issuances on the domestic market will be considered only if there is a special demand from domestic investors in the absence of alternative lending instruments, provided that there is a beneficial maturity/cost ratio.
8. Maintain the exposure to interest rate risk under control by monitoring the share of domestic debt refixing within the next year and the average time to refix for the total portfolio.
9. Use financing instruments offered by the international financing institutions to benefit of the favorable terms and conditions attached to those instruments.

These principles are expressed as indicative target intervals for the main risk indicators, which reflect the targeted composition of the debt, as follows:

Currency risk.

1. Assuring net financing more from domestic sources[39] and keeping the share of local currency debt in total government public debt between a 45% (minimum) and 55%. This strategy will take account of the absorption capacity of the domestic market of government securities and the associated cost.

2. Keep the share of debt denominated in EUR in total foreign currency debt between 80% (minimum) and 95%. At the time that derivatives are used, this indicator will be calculated after the evaluation of the debt following the use of currency swaps.

[37] In addition to the domestic demand for the government securities denominated in lei, non-resident investors could play an important part when it comes to amounts placed on the domestic market and the structure of maturities in the financing process, given the high appetite of those investors for medium and long term government securities.

[38] The foreign currency buffer has to cover a number of months pertaining to the gross financing needs (set forth at a level that should cover 4 months of the gross financing needs).

[39] In the period targeted by this Strategy, around 70% of the deficit will be covered from domestic sources

Refinancing risk

1. Maintain the share of debt maturing in the next year between 15% and 25% (maximum) for the local currency debt and between 10% and 20% (maximum) for the total debt.
2. Maintain the average maturity remaining between 3.5 (minimum) and 5.0 years for local currency denominated debt and between 6.0 (minimum) and 7.0 years for total debt.
3. Maintain a foreign currency buffer at a comfortable level, in order to mitigate the risks corresponding to high volatility times on the financial markets.

Interest rate risk

1. Maintain the share of debt re-fixing its interest rate in the next year between 15% and 25% (maximum) for the local currency debt and between 10% and 20% (maximum) for the total debt.
2. Maintain the average maturity remaining until the next refixing between 3.5 (minimum) and 5 years for local currency denominated debt and between 6.0 (minimum) and 7.0 years for total debt.

Table 10: Targets of the main risk indicators

Exposure to risk	Indicator	Indicative targets for 2019 – 2021
Currency risk	Share of domestic currency debt in total debt (% of total) Share of EUR denominated debt in total foreign currency denominated debt (% of total)	45% (minimum) – 60% 80% (minimum) – 95 %
Refinancing risk	Debt maturing in 1 year (% of total) Local currency debt maturing in 1 year (% of total) ATM for total debt (years) ATM for local currency debt (years)	10% - 20% (maximum) 15% - 25% (maximum) 6.0 years (minimum) – 7.0 y 3.5 years (minimum) – 5.0 y
Interest rate risk	Debt re-fixing in 1 year (% of total) Local currency debt re-fixing in 1 year (% of total) Average time to re-fixing for the total debt (years) Average time to re-fixing for the debt in domestic currency (years)	10% - 20% (maximum) 15% - 25% (maximum) 6.0 years (minimum) – 7.0 y 3.5 years (minimum) – 5.0 y

Source: MoPF

The implementation of the 2019 - 2021 Strategy will be monitored on a monthly basis, looking at the debt indicators that must observe the established targets and be published in the monthly Newsletter of MoPF available on the MoPF website. In accordance with Government Emergency Ordinance no. 64/2007 on the public debt, as subsequently amended and revised, this strategy is subject to annual revisions and can be revised at any time if required by the market conditions and/or the funding needs.

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MINISTER OF PUBLIC FINANCE

ANNEX No. 1

Develop a domestic market for government securities

The medium-term strategic objectives for the development of the domestic market of government securities aim at increasing its efficiency through improving its liquidity, transparency and the consolidation of the yield curve. To achieve the above-mentioned objectives, MoPF has planned a set of actions, some of which will be implemented in the short-term as follows:

1. *Increase the efficiency on the government securities market:*

   1.1. Consolidate and extend the yield curve on the domestic market of government securities:
      1.1.1. Define a policy for the creation and maintenance of liquid benchmark securities, in the amount of up 2.5 billion euro equivalent, as key financing instrument on the domestic market;
      1.1.2. The use of operations specific to the secondary market of government securities to speed up the creation of liquid benchmarks (following consultations with NBR as a move to coordinate funding and cash management policies with the monetary policies), in parallel with managing the refinancing risk and supporting the implementation of the Strategy, simultaneously with increasing the amount of benchmark bonds of up to 2.5 bn euro equivalent;
      1.1.3. Short term T-bills issued as a cash management tool.

   1.2. Diversify and broaden the investor base by:

      1.2.1. Continuing to launch issuances of “FIDELIS” government securities for the general public and distributing them via various distribution channels, namely through State Treasury or the Romanian Post territorial units and any concerned lending institutions;
      1.2.2. Using a range of debt instruments as large as possible, with different maturities and taking into account the investment needs of the domestic and international investment environments;
      1.2.3. Balancing the rights and obligations of primary dealers and increase the competitiveness among primary dealers by attracting new primary dealers (including IFIs) to increase the distribution, intermediation and trading of government securities simultaneously with improving the transparency in market-making;

   1.3. Analyze the opportunity of issuing new debt instruments required by market participants (such as index-linked or floating rate bonds), as the market of government securities develops and while avoiding the fragmentation of this market;
   1.4. Explore the opportunity to reduce the individual nominal value of government securities, to ensure the widest access of small investors to these instruments.
   1.5. Continue the non-deal roadshow dedicated to investors.

2. *The measures to increase the liquidity of government securities market:*

   2.1. Monitor the electronic platform for quoting and trading government securities electronic platform by primary dealers (E-Bond), in order to improve the liquidity and transparency of government securities and lower the risks associated to the trading activities, as well as advance enhancements in the sense of allowing investors to obtain via this platform quotations from each primary dealer;
   2.2. Concentrate the liquidity of government securities in a small number of benchmarks with equivalent amounts of up to EUR 2.5 billion per issuance;
   2.3. Use secondary market operations (such as bond exchanges or buy-backs) to reduce the refinancing risk and build up the liquid benchmark bonds, increase liquidity and support MoPF measures aimed at the Strategy implementation;

3. The measures under consideration *to increase the transparency and predictability* of the government securities market include:

3.1. A transparent issuance policy by releasing the annual calendar of issuance, the quarterly announcements and the monthly prospectuses of issuance, and, where appropriate, presenting flexibly and timely any amendments due to the changes in market conditions;
3.2. A continuous dialogue with the participants on the domestic market to ensure timely communication of the actions contemplated by MoPF;
3.3. On a regular basis, post on the dedicated website www.datoriepublica.gov.ro information that is relevant to investors, such as the amount and structure of the government debt;
3.4. Manage Bloomberg page dedicated to MoPF taking into account the broad use of this page by the majority of local and international investors.

ANNEX No. 2

Cash Management improvement policy and measures to be taken

Based on the recommendations under WB TA project aimed at the "Improvement of the public debt management", implemented in 2014 in order to improve cash management the MoPF plans to implement the following measures:

1. Preserve the goal of developing and strengthening the State Treasury cash flow forecast, by issuing the forecast for the State Treasury general current account balance *for three months in advance* and improve the cooperation with other entities that will provide their forecast data. At the same time, mention should also be made that the recent legal changes in the fiscal area, implemented at the end of 2018, will lead, at least throughout 2019, to some unpredictability regarding the projections of incoming and outgoing payment flows, and will influence the time frame set as per the current state treasury general balance forecast.

2. Move to a more active cash management to reduce cash balance fluctuations, on one hand by issuing T-bills and by contracting short-term loans, depending on the budget implementation and the budget deficit, and on the other hand by an active management of current surpluses, either in the form of term deposits, or, preferably, as reverse repos.

Therefore, depending on the budget implementation dynamic throughout 2019, the State Treasury's intent is to issue treasury bills or contract short-term loans[40]. One shall also analyze the possibility to adopt a more active conduct in regard to the placement of resources, predominantly as reverse repo transactions[41], following prior consultations with NBR, in order to coordinate financing and liquidity management policies with the monetary policy ones. The introduction of treasury bills and short-term loans shall be performed in a way that does not upset the key objective of developing the domestic market of government securities, in regard to extending the average maturity of the government public debt portfolio presented in the Medium-term government public debt management strategy.

3. With a view to strengthening the institutional framework, so as to ensure a better coordination of the budget deficit financing, the government public debt management and the state liquidities management processes, the State Treasury's Financial Flows Planning Commission held, throughout 2018, monthly meetings, also attended by MoPF, NAFA and

[40]Under 1 year.
[41]The reversible transaction has the advantage of being easy to perform and the automatically collateralized, and will help develop the money market operations.

NBR representatives, to be organized over the following period, as well. The debates covered by the monthly meetings were recorded as minutes, later submitted for informative purposes to MoPF and NAFA executives.

4. Due to the gap between the budget receipts and payments carried out over the course of one month, particularly at the end of the year, the State Treasury will continue to resort to cash management operations, in the sense of contracting very short-term deposits from lending institutions, depending on the budget implementation dynamic.

5. Another short-term instrument used to finance the deficit is represented by *availability borrowings from the State Treasury General Current Account balance*, amounting at 53.8 billion lei at the end of December 2018, in line with the provisions of the Government Emergency Ordinance 146/2002 on the establishment and use of resources through the State Treasury, as revised, requiring the use of available balance funds of the State Treasury General Account to finance through temporary borrowings, budget deficits from previous years.

   Despite the advantage of using this instrument, such as the low-cost financing of the state budget deficit, since the interest rate of these borrowings was below 0.1% in 2018, this instrument has the disadvantage of depending on the funds available in the account. Where the funds available in the State Treasury General Current Account are low, other solutions are used, such as attracting deposits from lending institutions on the market terms or selling the hard currency proceeds available in MoPF foreign currency buffer.

Consequently, the use of this debt instrument brings uncertainty and refinancing risk (even when no deadline for repayment of the borrowed funds is established) impacting negatively on the government public debt management. Therefore, the intention of MoPF is to gradually refinance this instrument, in the long run, by issuing government securities against the backdrop of a diminishing gross financing need.

A very important aspect is that the funds currently available in the State Treasury General Current Account include revenues in RON from privatization, and the more this revenue is used, the less available funds are left in this account.