MINISTRY OF PUBLIC FINANCE

GOVERNMENT PUBLIC DEBT MANAGEMENT STRATEGY

2016-2018

General Directorate for Treasury and Public Debt

Bucharest, 2016

Contents

Acronyms

ATM	Average time to maturity (years)
FSA	Financial Supervisory Authority
ATR	Average time to re-fixing (years)
EIB	European Investment Bank
IBRD	International Bank for Reconstruction and Development
NBR	National Bank of Romania
NCP	National Commission of Prognosis
PDs	Primary dealers
EMBIG	Emerging Markets Bond Index Global of JP Morgan
FED	United States Federal Reserve
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
GDP	Gross Domestic Product
EU	European Union

1. Introduction

The present Public Government Debt Management Strategy for 2016-2018 (hereinafter the "Strategy") is a continuation of Public Government Debt Management Strategy for 2015-2017 and was prepared after consultations with NBR and following the international sound practice as defined in the WB-IMF Guidelines for debt strategy design[1] .

As it has been the case with previous documents, the Strategy updated for 2016-2018 is consistent with the budget indicators[2] in the Medium Term Fiscal and Budgetary Strategy and it is based only on the government public debt portfolio composition, in particular on the aspects which fall under the authority and mandate of the government public debt manager[3]. 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:

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

The implementation of the Public Government Debt Management Strategy for 2015
In 2015 all risk indicators remained within the targets set out in the public government debt management strategy for 2015-2017, as reflected in the presentation of financial indicators in the table below:

Table 1: Risk indicators at the end of 2014 and 2015

Indicators *	**31/12/2014 ****	**31/12/2015 *****	**Indicative targets according to the Strategy 2015-2017**
A. Currency risk			
Share of domestic currency debt in total (% of total)	39,7%	42.7%	40% (minimum) – 55%
Share of EUR denominate debt in foreign currency denominated debt (% of total)	81.8%	80.6%	80% (minimum) – 95%
B. Refinancing risk			
Debt maturing in 1 year (% of total)	17.0%	18%	15% - 25% (maximum)
Local currency debt maturing in 1 year (% of total)	24.0%	28.0%	20% - 30% (maximum)
ATM for total debt (years)	5.3	5.7	5 years (minimum) –7.0 years
ATM for local currency debt (years)	3.6	3.4	3.0 years (minimum) – 5.0 years
C. Interest rate risk			
Debt re-fixing in 1 year (% of total)	22.0%	23.0%	15% - 25% (maximum)
Local currency debt re-fixing in 1 year (% of total)	19.0%	28.0%	20% - 30% (maximum)
Average time to re-fixing for the total debt (years)	5.4	5.7	4.5 years (minimum) – 6.5 years
Average time to re-fixing for the debt in domestic currency (years)	3.6	3.4	3 years (minimum) – 5 years

* without loans from the availabilities of the State Treasury General Current Account. ** for 2014, the indicative targets set forth in the 2014-2016 Government Public Debt Management Strategy were taken into account. *** preliminary data.
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] Calculated based on the projection of the main macroeconomic indicators of the NPC 2015 fall forecast
[3] 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 2016 - 2018

The following principles shall guide the government funding decisions during the period 2016-2018:

1. The net financing in local currency is to be favored 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[4].
2. Pursue a smooth redemption profile, avoiding to the extent possible the concentration of principal repayments/refinancing of government securities in the short-term.
3. Mitigate the refinancing risk and the liquidity risk by maintaining a foreign currency buffer and possibly other instruments depending on the terms and conditions thereof.
4. Maintain a presence on the international capital markets, through issuances of Eurobonds mainly in EUR 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.
5. In the process of external financing, the debt will be contracted mainly in EUR.
6. The issuances denominated in Euro on the domestic market can be considered only under the circumstances of reimbursement/refinancing of similar instruments issued on the domestic market, which is, if there is a liquidity surplus in Euro on the domestic market, a very high demand and very favorable costs.
7. 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.
8. Use financing instruments offered by the international financial institutions to benefit of the favorable terms and conditions attached to those instruments.

These principles translate into[5] indicative target ranges 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:

- *to manage foreign currency risk*

1. keep the share of local currency denominated debt in total government public debt between 40% (minimum) and 60%.

2. keep the share of debt denominated in EUR in total foreign currency debt between 80% (minimum) and 95%.

- *to manage refinancing risk*

1. maintain the share of debt maturing in the next year between 20% and 30% (maximum) for the local currency debt and between 15% and 25% (maximum) for the total debt.

2. the average maturity remaining should be maintained between 3.0 (minimum) and 5.0 years for local currency denominated debt and between 5.5 (minimum) and 7.0 years for total debt.

3. maintain a foreign currency buffer[6] at a comfortable level, in order to mitigate the risks corresponding to high volatility times on the financial markets.

- *to manage interest rate risk*

1. the share of debt re-fixing its interest rate in the next year should remain between 20% and 30% (maximum) for the local currency debt and between 15% and 25% (maximum) for the total debt.

[4] 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, in particular, with respect to the structure of maturities in the financing process, given the high appetite of those investors for government securities with medium and long maturities.

[5] The limit 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).

[6] The foreign currency buffer representes the funds in foreign currency available to the State Treasury, and the current buffer level is set to cover 4 months of gross financing needs.

2. maintain the average maturity remaining until the next refixing between 3 (minimum) and 5 years for local currency denominated debt and between 5.0 (minimum) and 6.5 years for 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:

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

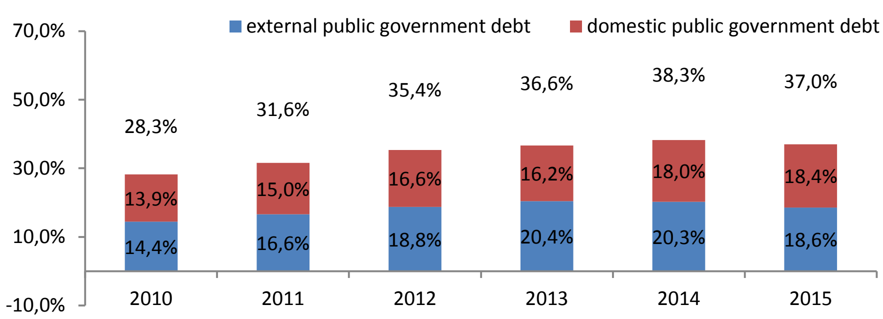
The first two objectives are stated in the GEO 64/2007 and are complemented by the government securities domestic market development objective which was formulated in the previous strategies as well. The development of a liquid market of government securities and the construction and consolidation of 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[7].

3. Description of the public government debt portfolio[8]

Evolution of government public debt

At the end of 2015, the government public debt was RON 263.6 billion, accounting for 37.0 % of GDP, with an economic growth of 3.8% of GDP and a budget deficit of 1.5% of GDP.
In the government public debt at the end of 2015, 49.6% was contracted by resident investors and 50.4% by non-resident investors.

Graph 1: Government public debt composition considering the investor residency criterion (% of GDP)

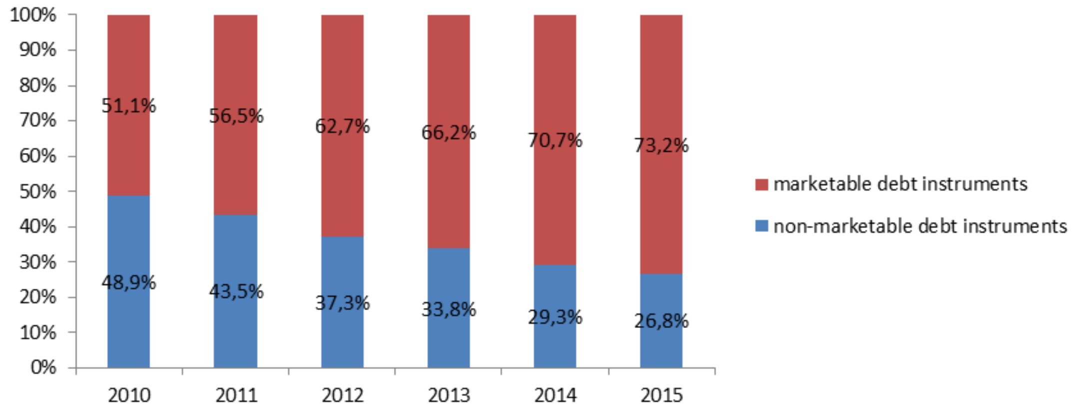


Source: MoPF

[7] 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.
[8] This is preliminary data according to national legislation, and does not include temporary financing.

As illustrated in graph 2, the structure of the public government debt has continuously improved from a portfolio comprising mainly non-marketable debt (external loans contracted with IFIs) before 2009, to one with more marketable debt instruments (with a growing share issued in local currency).

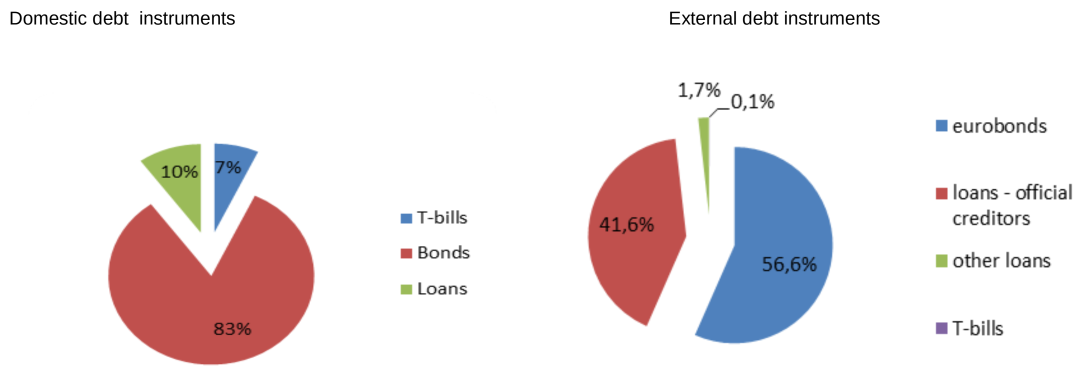
Graph 2: Marketable debt instruments vs non-marketable debt instruments



Source: MoPF

While the government borrowings' share to total government public debt was 26.8%, the government securities issued on the domestic and foreign markets accounted for 73.2% of total debt, of which 44.9% were government securities denominated in lei.
As presented in graph 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. The foreign debt includes government securities held by non-resident investors.

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



Source: MoPF

The cost, approximated by the average interest rates[9], decreased slightly in 2015 driven by lower interest rates especially of external debt. Debt in local currency at end-2015 remains more expensive than debt in foreign currencies[10] as presented in table 2.

[9] Calculated as interest payments projected for 2016 divided by outstanding amount for each debt instrument at end-2015.
[10] 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.

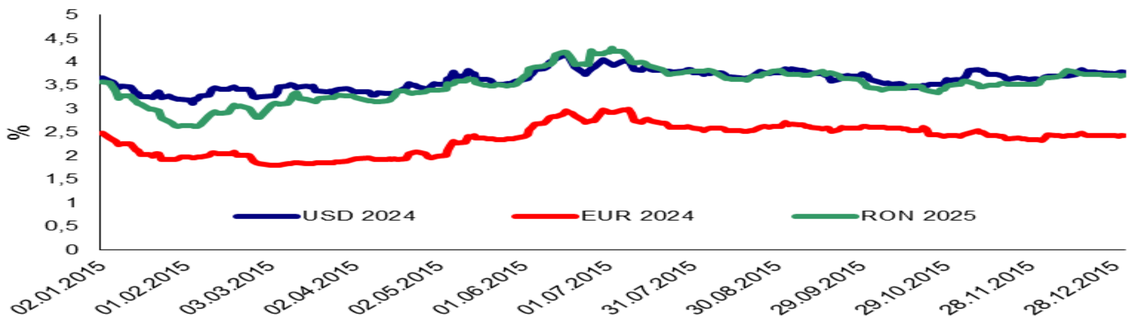
Table 2: Cost of direct debt by type of instruments[11]

	12/31/2014	12/31/2015
Average interest rate of public government debt (%)	*4.3*	*4.1*
1. in local currency, o/w	*5.3*	5.0
a. a. T-Bills with 1 year maturity	2.0	1.2
b. b. T-Bonds fixed with 1 - 5 year maturity	5.7	5.0
c. T-Bonds fixed with 5 - 10 year maturity	6.0	5.9
2. in foreign currencies, o/w:	*3.6*	*3.6*
a. a. EUR bonds with 10 years maturity	4.5	4.2
b. EUR bonds with 3-5 years maturity	4.3	4.0
e. EUR multilateral	1.9	2.6
f. a. USD bonds with 30 years maturity	5.7	5.9
g. USD multilateral	1.4	1.7

Source: MoPF

The still significant portion of loans contracted from IFIs at concessional rates explain the lower cost of external funding. In addition, bonds denominated in EUR placed in the international capital markets are usually issued at nominal yields (without considering the impact of currency risk on the costs) which are lower compared to local currency securities as illustrated in graph 4. In addition, in the first half of 2015, the costs corresponding to financing in RON on the domestic market decreased for the first time a lot below the levels of the costs of USD financing on similar maturities (for example, for the 10 years maturity, the yields of bonds in RON are at levels ranging between 2.6% - 3.5%, while the yields corresponding to bonds with similar maturities denominated in USD are around 3.2% - 3.6%), which is favorable to the increase of financing in RON, reducing the attractiveness of external financing in USD (the analysis considers not using hedging instruments for the financing in USD).

Graph 4: Domestic benchmark bond yield vs Eurobonds issued on the external market in Euro and USD with a maturity of approx. 10 years



Source: MoPF

The dollar has appreciated at the highest level against the euro in the first half of 2015, supported by the signs of strengthening of the US economy and the growing interest of investors in US assets, and in the second half of the year as a result of the decisions made by FED to increase the interest interval by 1/4 percentage points (between 0.25% and 0.5%).

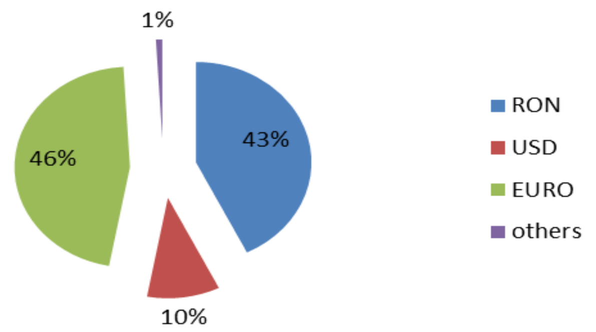
[11] The table shows the average interest rates for selected debt instruments, aggregated as all debt instruments forming the government public debt portfolio

Risks of the public government debt portfolio at end 2015

Currency risk

At the end of 2015, 57.3% 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. In fact, as Moody's highlighted in its Report on Romania in June 2015, while the local currency were particularly stable over the recent years (the exchange rate floated around 4.4 lei/euro), the debt servicing costs are exposed to the future currency volatility and changes in the risk appetite world-wide. While this ratio would suggest a significant exposure to foreign currency risk, the relative low volatility of the RON/ EUR rate and the share of long-term foreign currency debt denominated in EUR[12] make the risk related to this exposure easier to manage.

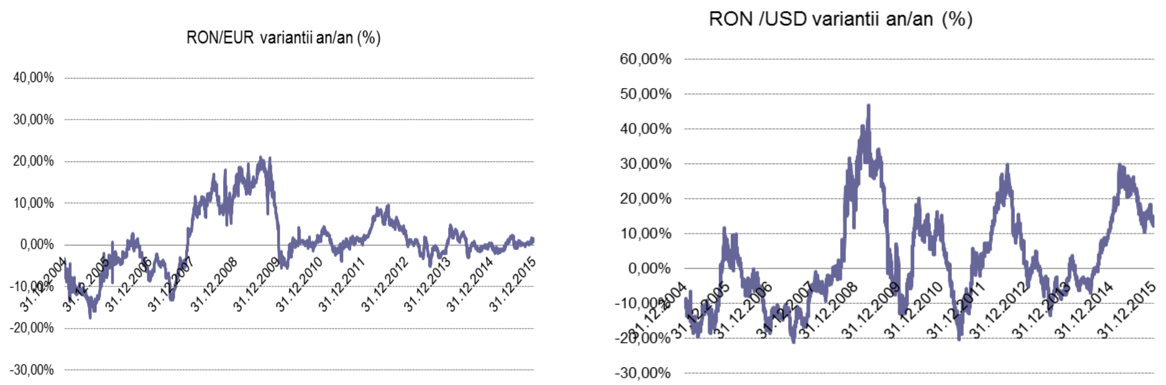
Graph 5: Public government debt by currency



Source: MoPF

As illustrated in Graph 6, debt contracted in USD is significantly riskier than that contracted in EUR. Over the last 3 years the volatility of the RON/USD has been four to five times higher compared to the RON/EUR exchange rate. In 2015, USD appreciated strongly against other currencies and particularly against the Euro, as a result of US economic performance and FED decision to increase the interest interval and the increased interest rates for instruments denominated in USD, with market expectations for a parity of 1:1 by the end of 2016.

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



Source: MoPF, NBR

In the case of a pessimistic scenario, for example, a depreciation of the local currency against EUR by 10% and against USD by 30%, in 2016 would increase the debt stock by RON 22.2 billion or

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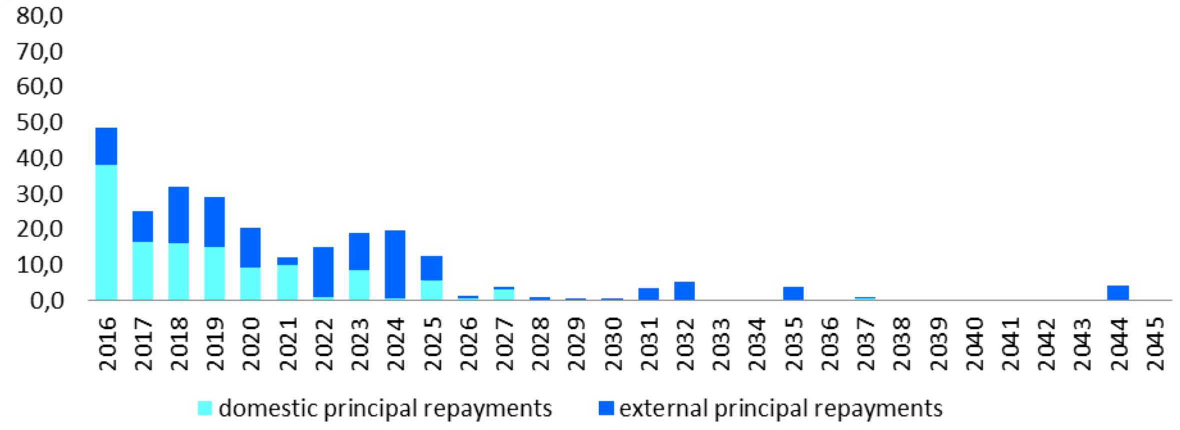
[12] Long-term euro denominated debt issued with a bullet structure implies a redemption of the principal within a time-horizon in which euro adoption is feasible and therefore a reduced implied currency risk.

3.0% of GDP and the debt service payments (including the repayment of principal and the refinancing of government securities and interest payments) by RON 2.9 billion or 1.6% of central government revenues[13]. Accordingly, the exposure to exchange rate risk could be considered moderate but not negligible, given the established timing for adopting the EUR in the future.

Refinancing risk

The structure of principal repayments and refinancing of government securities presented in graph 7 shows some accumulation of repayments in the first 4 - 5 years. The concentration of repayments over the short term is particularly noticeable in the domestic debt[14] and reflects the importance of Treasury-bills in the government funding reaching 9 billion RON at end 2015 and also the bond issuances maturing in this interval. The refinancing of these obligations may pose a challenge in the financing process from the domestic market if the banks were to find alternative and more profitable placements with the revival of demand for credit from the private sector. 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 following the issuance of Eurobonds with long and very long maturities.

Graph 7: Principal repayment schedule on public government debt at end- 2015



Source: MoPF

The redemption profile of the debt portfolio results in an average time to maturity (ATM) of 5.7 years: 3.4 years for local currency denominated debt and 6.6 years for debt denominated in foreign currency.

Table 3: Refinancing risk indicators

Indicators	2014			2015		
	Debt denominated in domestic currency	Debt denominated in foreign currency	Total	Debt denominated in domestic currency	Debt denominated in foreign currency	Total
Debt maturing in 1 year (% of total)	24.0	12.3	17.0	28.0	13.0	18.0
Average time to maturity (years)	3.6	6.4	5.3	3.4	6.6	5.7

Source: MoPF

13 Revenues according to cash methodology applying EU methodology.
14 By market of issuance.

In addition, the management of refinancing/liquidity risks attached to the bonds issued in lei and foreign currencies (these could amount to levels such as 2 billion Euros or equivalent) is performed based on a policy focused on a foreign currency buffer that is sized depending on gross financing needs for a certain number of months (NB - an amount which covers the gross financing needs for a period of 4 months).

In order to improve the public debt management and avoid seasonal pressures to secure sources to finance the budget deficit and refinance the government public debt, in 2010 MoPF set out the financial buffer in foreign currency, that at the end of 2015 amounted to 5.9 billion Euros, accounting for 3.7% of GDP.

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

	2012	2013	2014	2015
Gross government public debt (% of GDP)*)	35.4	36.6	38.3	37.0
Financial buffer (% of GDP)	2.6	3.9	4.6	3.7
Net government public debt (% of GDP)	32.8	32.7	33.7	33.3

*) exclusive of temporary financing
Source: MoPF

Interest rate risk

Given the small portion of debt contracted at floating rates (see Table 5), interest rate and refinancing risks are similar: high for local currency obligations and low for foreign currency ones. Thus, a 1% increase in interest rates in 2016 will increase debt service payments by RON 1.1 billion, i.e. 0.6% of central government revenues[15] in the local currency debt and RON 1.5 billion, i.e. 0.9% of central government revenues, in the foreign currency debt. It is important to mention that 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 accounted for the bulk of this debt at the end of 2015.

Table 5: Interest rate risk indicators

Indicators	2014			2015		
	Debt denominated in domestic currency	Debt denominated in foreign currency	Total	Debt denominated in domestic currency	Debt denominated in foreign currency	Total
Share of fixed interest rate debt (% of GDP)	86.7	83.1	84.5	89.1	81.0	84.7
Share of debt re-fixing in 1 year (% of total)	19.0	24.0	22.0	28.0	10.0	23.0
Average time to re-fixing interest rate - ATR (years)	3.6	6.6	5.4	3.4	7.3	5

Source: MoPF

Given the above, we can conclude that the refinancing and interest rate risks for the debt denominated in lei continue to be the most important risks associated to public government debt portfolio, whereas the exposure to currency risk is easier to manage but cannot be neglected given the established timing for adopting the EUR in the future.

15 The same as 13

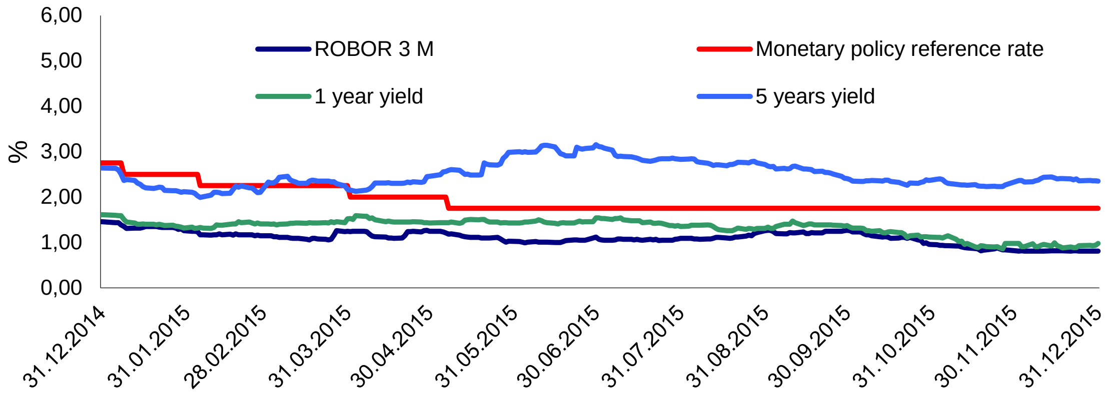
4. Domestic and foreign financing in the context of local and foreign financial markets in 2015 and medium term expectations

Domestic market

Domestic market performance in 2015

The yields of government securities trended down, against the background of monetary relief measures implemented by NBR, and under the influence of the money market liquidity, the minimum reserves diminished for the liabilities in local currency of lending institutions and appetite of the non-resident investors, in the context of improved macroeconomic fundamentals that are the foundation of the lending risk for Romania and the interest rate at minimum levels ever on the foreign markets.

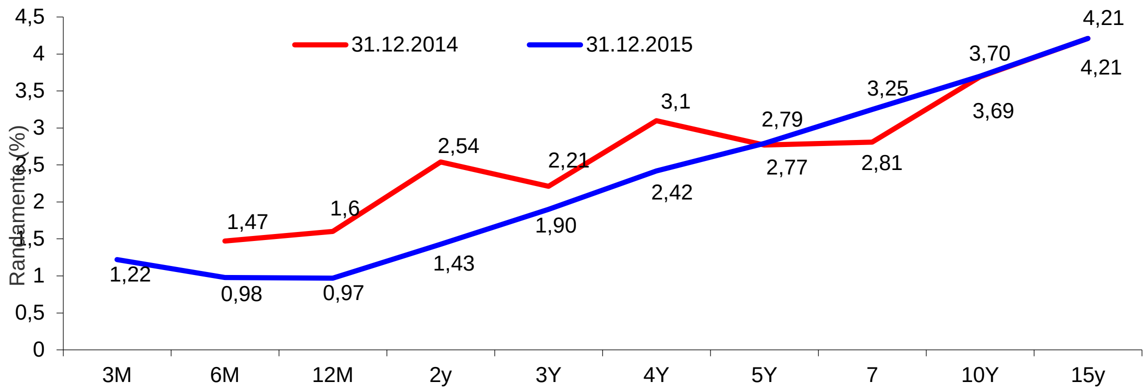
Graph 8: Comparison between the monetary policy rate, 3M ROBOR and yields for 1 and 5 years



Source: MoPF, NBR

NBR brought the monetary policy rate in successive cuts from 2.75% in December 2014 to 1.75% in May 2015. As shown in graph 9, the interest rates for government securities on short and medium term registered an accentuated decrease below NBR policy rate given an increased offer for these maturities, for maturities below 2 years, with a surplus of liquidity on the domestic market. The yield curve became sharper on the medium and long term segment, with investment opportunities for the non-resident investors.

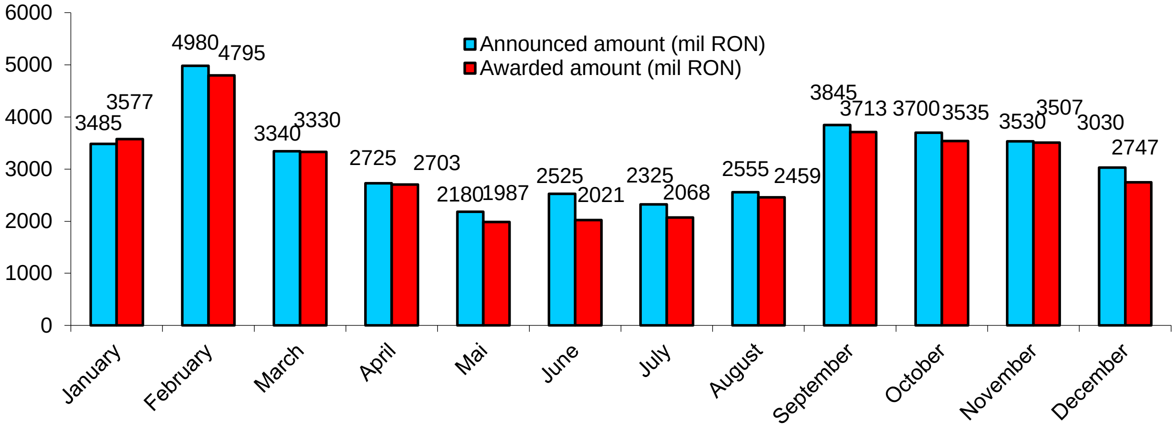
Graph 9: Primary Market Yields at the end of 2015 vs the end of 2014



Source: MoPF

The fact that the Romanian government securities are still included in the JPM Morgan and Barclays indexes continues to have a positive influence on the local market and the increase of investors' interest. At the end of 2015, 9 series of Romanian government bonds were included in the JP Morgan GBI-EM Global Diversified index with a 3.49% weight and 12 series were included in the Barclays EM Local Currency Government index, with a 1.26% weight.
In addition, as results from Graph 10, efforts continued to preserve a predictable policy of issuances, in most auctions the amounts announced being fully awarded, with the exception of some periods of volatility in which the awarded amount was impaired by temporary variations of the price, and for the long term issuances the award was possible for amounts higher than announced, to take advantage of the opportunity windows given a high demand and the objective of extending the average remaining maturity.

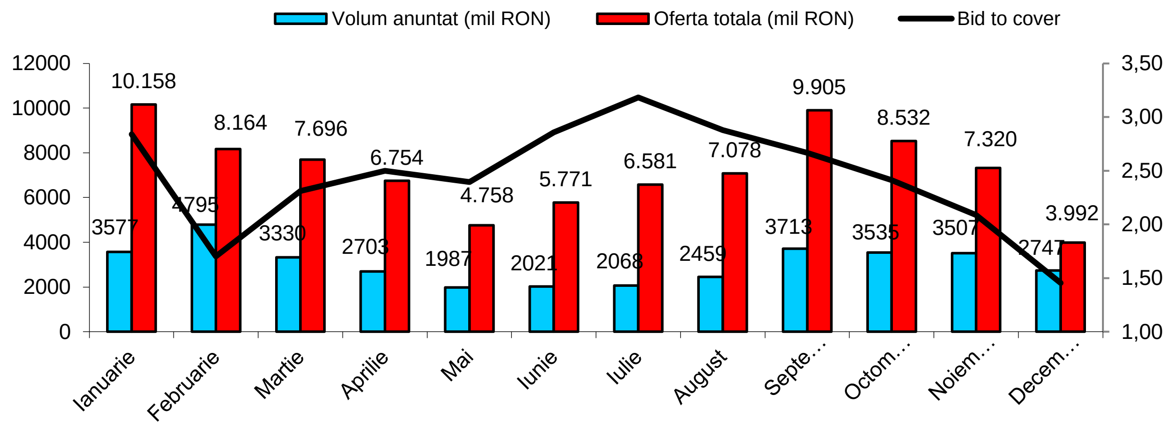
Graph 10: Announced vs awarded amount



Source: MoPF

Graph 11 shows the demand in the auctions during the year, most of which were over-subscribed.

Graph 11: Demand and supply of government securities on the primary market

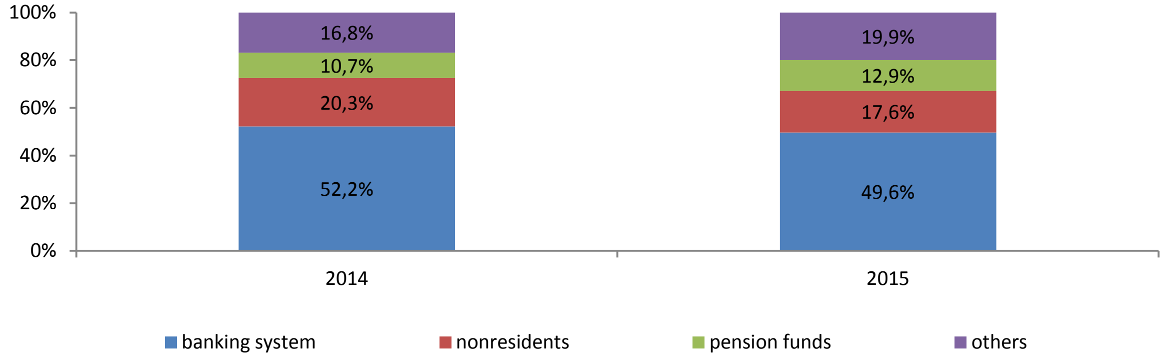


Source: MoPF

Investor Base

At the end of 2015, the domestic government securities market continued to be dominated by commercial banks with 49.6% of the total government securities issued on the market; next in importance were the non-residents with holdings to 17.6%, while pension funds' holdings reached 12.9%.

Graph 12: Government securities by holders



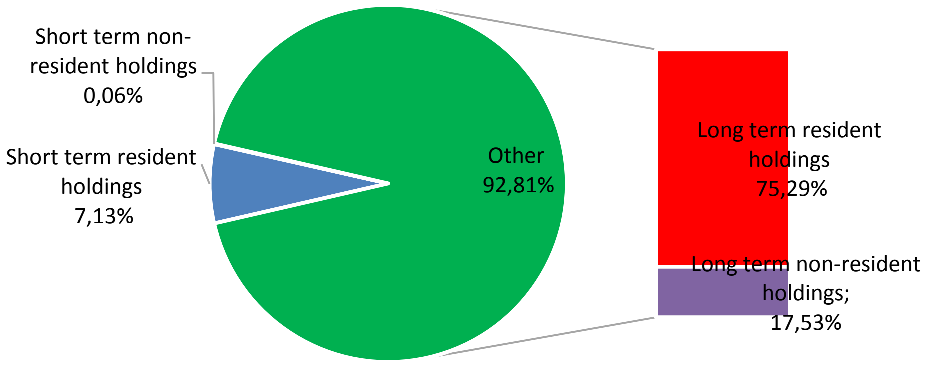
Source: NBR

Commercial banks remained the main investors on the domestic market, with the moderate advance of the lending by financial institutions in the course of 2015. The investors' preference focused on maturities of up to 7 years and marginally to 10 years, especially for the most liquid instruments included in the regional index.

As institutional investors, local asset managers and private pension funds have a relatively small share in the government securities, however they have a significant potential to support the development of the local government securities market in the upcoming period of time. Total net assets of the private pension funds increased significantly from RON 10.2 billion in 2012 to RON 14.7 billion at the end of 2013 and 20.33 billion at the end of 2014 (pillars II+III). In structure, the assets of private pension funds are mostly Romanian government securities amounting to around 17 billion lei at the end of 2015 (66% of the pension funds managed privately and 63% of the optional pension funds[16])

Non-residents investors remained an important segment of investors in government securities, providing a complementary demand besides the demand of local investors, given the preference for long maturities. The behavior of non-resident investors is slightly volatile, being influenced by developments on financial markets, following the divergent monetary policy decisions taken by FED and ECB, the concerns about the economic growth and the size of China's private debt, the Brexit following the referendum in June 2016, the financing difficulties in Greece and the plunging oil price. The policies adopted by the two central banks have different effects in terms of investors' appetite for assets issued by European countries (such as Romania).

Graph 13: Composition of holdings of resident and non-resident investors at the end of 2015

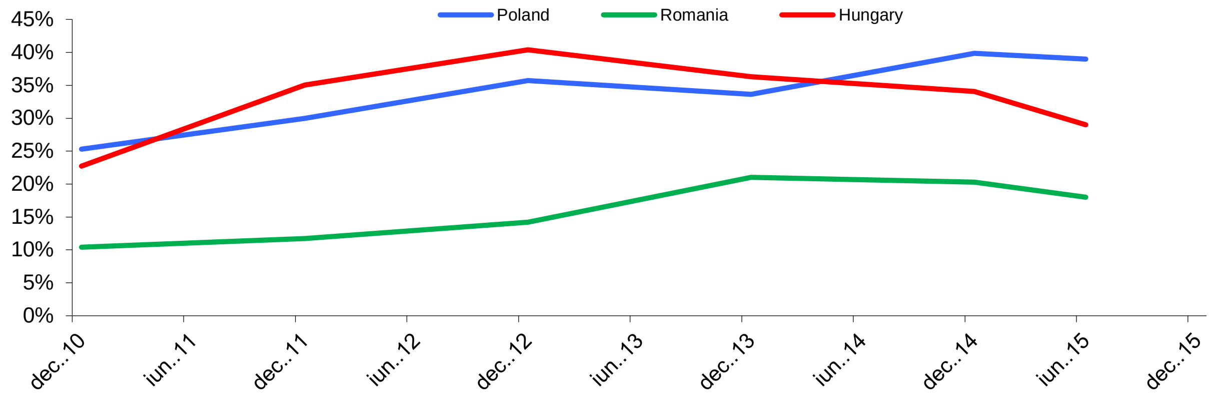


Source: NBR

[16] Source: FSA, "Trends and risks on the local and foreign markets", December 2015

In 2015, non-residents holdings remained slightly below the level of 2014, trending constantly throughout the year 2015 at approximately 18-20%, a level which is below the level registered in peer countries such as Poland and Hungary. Limited holdings of non-resident investors in conjunction with their conduct in selling and rebalancing their portfolios in the context of sell-off or risk-off times, lead to a limited vulnerability of the market of government securities and the yield curve in such periods of time. Moreover, under normal market circumstances, expectations lead to an increase of non-residents' holdings, but this evolution is correlated with other factors, of either technical nature (a more liquid Romanian swap market for longer maturities, a more liquid secondary market as well), or more exogenous factors, such as the share of Romanian bonds included in the international JP Morgan index, since part of the institutional investors have an investment policy that depends on the index structure or the global indexes of the global emerging markets.

Graph 14: A comparative analysis of holdings of non-residents in Romania, Poland and Hungary



Source: Bloomberg

Secondary Market

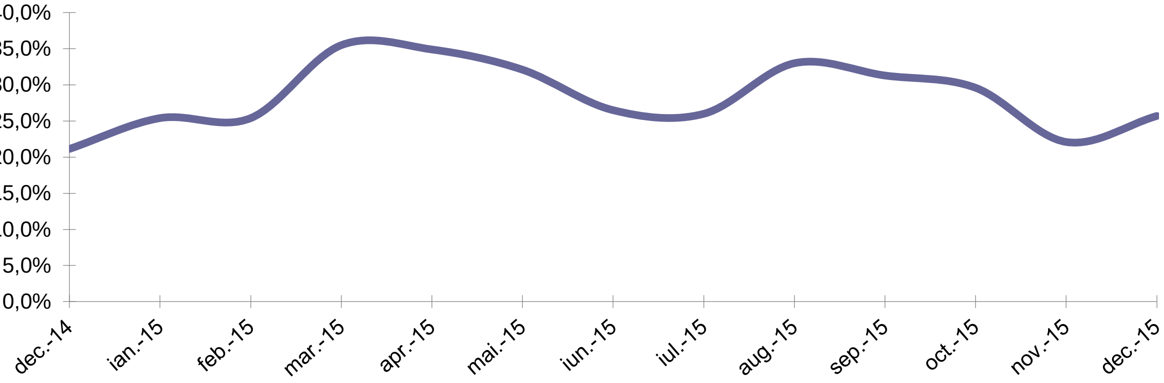
Liquidity on the secondary market, which is an important indicator about the level of development of the market of government securities, increased in 2015, but it still performs at low levels compared to international standards. The degree of liquidity, calculated as the ratio of the amount of monthly transactions in the secondary market and the total amount of government securities, went up to 25.7% at the end of 2015 from 21.1% at the end of 2014.
In addition, the bid-ask spread dropped for the quotations on the secondary market of government securities in average by 5 basic points[17], which indicates an improved liquidity of the government security.

The low levels of trading in the secondary market of government securities could reflect market factors, such as the anticipation of further yield reduction following the NBR accommodative policy and structural deficiencies, such as the lack of secondary market instruments such as repos, reverse repos, buy backs, binds exchange operations or the weak swap market in particular for average and long maturities.

To boost transparency in pricing the government securities on the secondary market, as of May 2015, the electronic trading platform (ETP) became operational; this platform is dedicated to primary dealers and it is to be actually implemented, from the viewpoint of the monitoring of the minimum mandatory requirements for quotation, after the completion and the approximation of the legal and procedural framework for the primary market.

[17] Based on the bid-ask quotations at the end of the day provided by Bloomberg

Graph 15: Evolution of the degree of liquidity of the government securities in lei active between December 2014 and December 2015



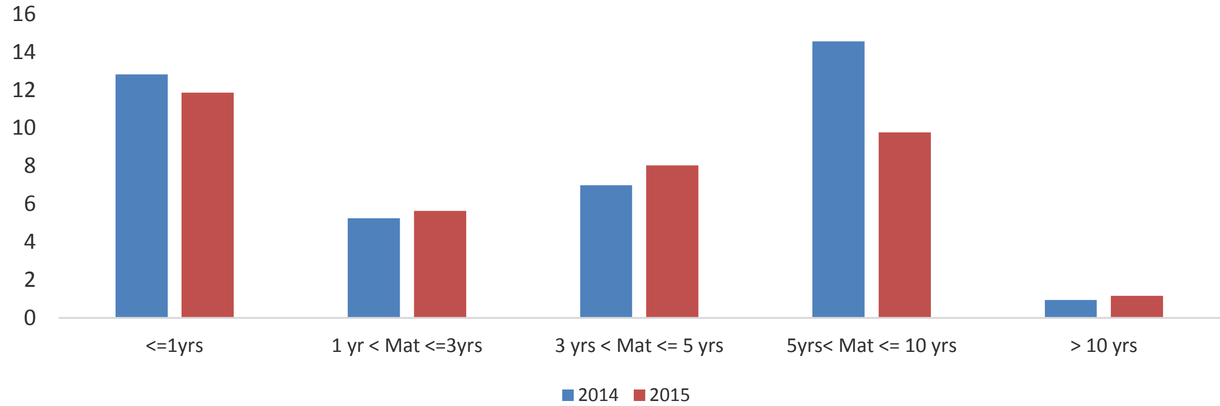
Source: MoPF

Domestic market financing in 2015

In the course of 2015, MoPF intended to secure a constant and continuous presence on the domestic market, by arranging regular auctions of government securities both to meet the investor demand and avoid potential pressure in attracting financial resources, with the budget deficit achieved in the last month of the year.

In 2015 the government securities issued on the domestic market amounted to 36.4 billion lei, accounting for 57.5% of the gross financing borrowing needs of the central government[18]. Hence, 1-year T-bills were issued in amount of 11.8 billion lei, with T-bonds issued in amount of 24.6 billion lei. As Graph 16 shows, the majority of issuances concentrated on the short and average maturities. MoPF continued to make efforts to extend the average maturity of government securities, but against in times of volatile markets (for instance due to the tensions in Greece), the long term government securities issued in a lower amount compared to 2014, as a result of a reduced non-resident investor appetite for these maturities, and the prudential strategy of the local institutional investors. The 3, 5 and 7 years benchmark bonds denominated in lei were issued and reopened almost every months.

Graph 16 The composition of government securities considering the maturities (in billion lei)



Source: MoPF

[18] Presented in chapter 5

External market

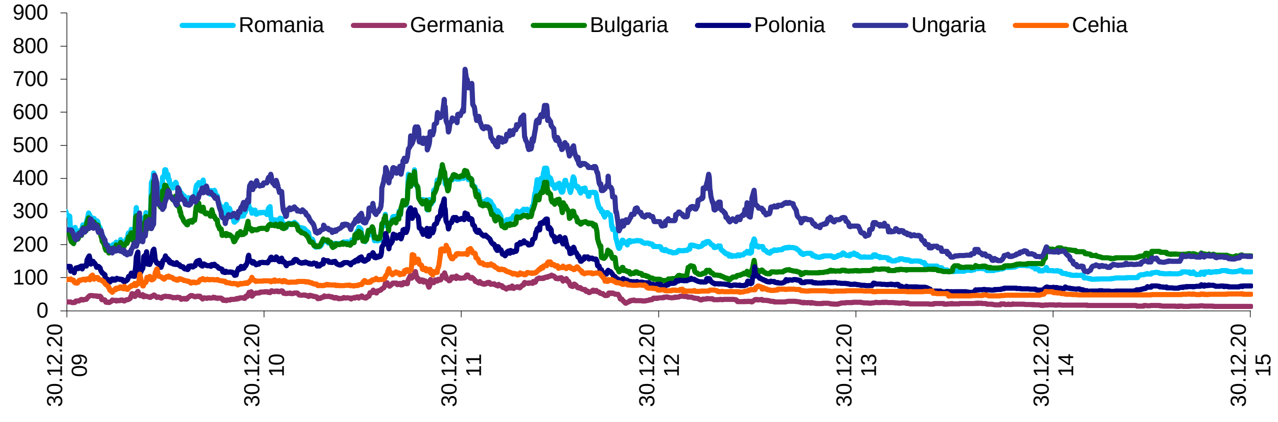
External markets in 2015

Against the backdrop of a climate of recovery after the European sovereign debt crisis and a period of calmness on the financial markets, the financing conditions in Romania improved considerably. The good economic performance, in particular on the budgetary side, along with the inclusion of the government securities in Barclays' and JP Morgan's emerging market index, helped the improvement of the positive rating outlook by Moody's and fostered positive investor sentiment towards Romania, helping to further reduce borrowing costs, extend the maturities and broaden the investor base.
Interests rates of government bonds denominated in foreign currencies were volatile in 2015, following the trend of interest rates in EU, the investor perception of FED divergent policies (expectations of increased reference rates) and ECB policies (the quantitative relaxation measures) and the tension generated by the situation in Greece. The Eurobonds denominated in EUR performed better, and the ones in USD traded in line with the market trend, as they were attractive to the investment environment as still offering higher yields compared to peer countries.

Hence, in the first months of 2015, the yields of Eurobonds issued by Romania on the foreign market trended sharply down, reaching a minimum in the month of March. The yields deteriorated later because of the tensions in Greece having difficulties in reimbursing the payment obligations to IMF and the uncertainty related to its political, economic and financial situation in the absence of an agreement with the international lenders (IMF and EC) which generated fears related to a potential default or even an exit from the Eurozone. When Greece concluded an agreement with its multilateral investors, the financial market volatility decreased, the yields and lending margins picked up in the context of the investors' expectations related to an increase of the interest rates by FED, in December, a fact that was confirmed by the Federal Open Market Committee (FOMC) on December 16 2015, at this time the monetary policy rate being raised by 1/4 percentage points.

In 2015, the low monetary policy rates in the developed economies helped preserving a relatively low yield on the main bond markets, leading to a higher investor interest for the bonds issued by European countries with a lower rating and for those issued by the emerging states (please refer to Graph 17).

Graph 17: EU rates



Source: Reuters

Funding on the external markets in 2015

In 2015, MoPF raised EUR 2 billion on the external markets through an issuance in October, in two tranches, under the MTN Programme, with a 10 years maturity (1.25 billion Euro) and 20 years maturity, respectively (750 million Euro). This issuance enjoyed a high interest from investors being oversubscribed over two times, by a number of approx. 460 investors. In addition, the for the 10 years maturity Romanian obtained the lowest issuance premium, 5 basic points, compared to the other sovereign EEC issuers in the same time interval.
The operations on the external market included drawings of 1.05 billion Euro from the loans contracted with the international financial institutions, in principal a World Bank DPL[19] resulting in an aggregate funding on the foreign markets of around 21,4% of the gross funding needs of the central administration.

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

ISIN	Data emisiune	Moneda	Maturitate	Adjudecat	Cupon (%)	Spread Emisiune	Randament initial	Randament 31.03.2016
XS0371163600	18.06.2008	EUR	18.06.2018	0.75 bl.	6,5	+213.10bp vs DBR 4 ¼ 18	6,698	0,199
	11.09.2012			0.75 bl.		+404bp vs Mid Swap	5,100	
XS0638742485	17.06.2011	EUR	17.06.2016	1.5 bl.	5,25	+255bp vs Mid Swaps	5,315	0,101
US77586TAA43	07.02.2012	USD	07.02.2022	1.5 bl.	6,75	506.60bp vs T 2 02/15/22	6,875	3,205
US77586RAA86	06.03.2012			0.75 bl.		453.70+UST	6,450	
XS0852474336	07.11.2012	EUR	07.11.2019	1.5 bl.	4,875	+370bp vs Mid Swaps	5,040	0,496
US77586TAC09 US77586RAB69	22.02.2013	USD	22.08.2023	1.5 bl.	4,375	+235.5bp vs Mid Swaps	4,500	3,370
XS0972758741	18.09.2013	EUR	18.09.2020	1.5 bl.	4,625	+295bp vs Mid Swaps	4,769	0,763
	28.10.2013			0.5 bl		+250bp vs Mid Swaps	4,150	
US77586RAC43 US77586TAE64	22.01.2014	USD	22.01.2044	1 bl.	6,125	+245.00bp vs T 3 ⅝ 08/15/43	6,258	4,678
US77586RAD26 US77586TAD81	22.01.2014	USD	22.01.2024	1 bl.	4,875	+215.00bp vs T 2 ¾ 11/15/23	5,021	3,357
XS1060842975	24.04.2014	EUR	24.04.2024	1.25 bl.	3,625	+200bp vs Mid Swaps 223.10bp vs DBR 1 ¾ 02/15/24	3,701	2,113
XS1129788524	28.10.2014	EUR	28.10.2024	1.50 bl.	2,875	+185bp vs Mid Swaps 209.90bp vs DBR 1 08/15/24	2,973	2,199
XS1312891549 XS1313005818	29.10.2015	EUR	29.10.2025	1.25 bl.	2,75	+190bp vs Mid Swaps 227.10bp vs DBR 1 08/15/25	2,845	2,394
	25.02.2016			0,75 bl.		239.2bp vs DBR 1 08/15/25	2,550	
XS1313004928 XS1312891895	29.10.2015	EUR	29.10.2035	0.75 bl.	3,875	+245bp vs Mid Swaps 283.50bp vs DBR 4 ¾ 07/04/34	3,930	3,574
	25.02.2016			0,50 bl.		322.9bp vs DBR 4 ¾ 07/04/34	3,900	

Source: MoPF

Increased convergence of actions by the central banks at the beginning of 2016 helped the financial markets at global level, thus most developed economies shape a new normality of low levels of interest rates for a longer period of time. In its March meeting, ECB announced a new package of measures aimed at the relaxation of the monetary policy, such as reducing the interest rates for refinancing operations from 0,05% to 0%, the lowest level ever, the interest of the financing facility from 0.35% to 0.25% and the interest on overnight deposits from -0.3% to -0.4%. In addition, ECB included on the assets list all the bonds denominated in Euro issued by the non-banking companies of the Eurozone, at investment grade, and issued a new series of four refinancing operations on a long term (TLTRO II), each with a 4-year maturity. After FED in its March meeting signaled a lower growth pace of the key interest, investors shifted towards the emergent countries, showing more interest in assets with a higher risk.

On February 25 2016, 1,25 billion Euros were raised from the foreign capital markets, of which 750 million Euro with a 10-year maturity and 500 million Euro with a 20-year maturity. This amount was raised by reopening the two bonds in EUR issued in October 2015, with yields trending down compared to the ones in October, namely from 2.845% to 2.55% for the 10-year bond and from3.93% to 3.90% for the 20-year bond. The issuance was oversubscribed almost twice.

Expectations regarding the performance of financial markets in 2016-2018

In 2016, the state budget deficit and the 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

[19] The domestic and foreign market sources were supplemented by the availabilities in lei and foreign currencies of the State Treasury.

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.

On the domestic market, to reduce funding costs and promote a better functioning of the secondary market the MoPF intends to continue building liquid benchmarks across the yield curve with a transparent issuance policy up to amounts equivalent to 2 billion Euro[20], announcing the amounts, the frequency of issuing/reopening of some maturities to the market in advance. The government securities denominated in Euro will be issued on the domestic market only along with similar maturities of comparable instruments issued in significant amounts or in the context of decisions by NBR to relax the minimum requirements reserves of liabilities in foreign currency of lending institutions. In these particular situations, the bonds denominated in Euro issued on the domestic market will be able to respond to a significant demand of the local investors in the absence of alternative instruments, thus creating the premises for a beneficial maturity/cost ratio.

In the first half of 2016 the minimum mandatory market-making requirements are expected to be implemented on the electronic platform E-bond, dedicated to primary dealers, which will help improving the transparency of quotations and, by this, the market-making with respect to the government securities, providing the foundation for cutting trading costs of participants to the secondary market of government securities.

In addition, depending on the framework of secondary market specific procedures and operations that is to be finalized by NBR[21], 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. Similarly, the plans are to use the reverse repos for an efficient cash management, after consultations with NBR aimed at coordinating the financing policies and the cash management policies with the monetary policies.

In addition, to improve the access to government securities among small investors and help their financial education, the government securities for the population will continue to be issued, with a first 2-year issuance maturing in June 2015, depending on the potential interest from the respective investors.

In the medium term, we expect the foreign investors' interest to continue for the government securities issued by EU states, in particular those with a healthy foundation and economic perspectives following the decision[22] by ECB to extend the program of buying assets from the Eurozone by increasing the monthly acquisitions of bonds from 60 billion Euro to 80 billion Euro [23]. The key risks remain the geopolitical shocks[24], the market overreaction to the increase in the Fed Funds rate in the USA and the economic developments in China. The financial market continues to be dominated by the concerns about the developments of the world economy, the situation of European banks and the movements of international oil and other raw materials prices. The gradual increase of FED's monetary policy rate could slow down if the US economy doesn't live up to the expectations, and the fact that the Chinese economy is deteriorating[25] will affect the demand for US exports.

[20] The refinancing risk of these issuances is managed by continuing the policy to maintain a foreign currency buffer

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

[22] as of March 2016.

[23] This may be extended until the Council of Governors considers the adjustment of the sustained inflation (in accordance with its objective of targeting inflation rates below, but close to 2% on medium term)

[24] Tensions in the Middle East, expansionist tendencies manifested by China and Russia alike, the migrant crisis that poses a threat to the security of European borders, the risk of Britain's exiting the EU following the referendum in June 2016 and the risk of the Greek exit from euro area in the context of pension reform and other structural reforms potentially giving rise to a new conflict between the Greek government and the country's international lenders.

[25] Risks related to China's economy have been noted by the rating agency Moody's that changed the Aa3 rating outlook from stable to negative, a decision that was driven by the weakening tax value reflected in a higher public debt, depletion of reserves due to capital outflows, which highlights political and monetary risks and the uncertainty about the ability of authorities to implement reforms to address imbalances in the economy.

Adding to this context, the manifestation of political tensions, the result of the referendum in the UK in June 2016 on the decision whether to remain or not in the EU may have a major impact on the subsequent evolution of financial markets.
Given the relatively low current level of government securities holdings of non-resident investors (approx. 18% in February 2016) compared to other countries in the region, Romania is less vulnerable to these shocks. The risks mentioned above can be mitigated by the expected increase in inflows of EU funds which will help strengthen foreign exchange reserves.

MoPF intends to maintain its presence in the international capital markets, given the preference for bonds denominated in euro to strengthen and expand the reference prices of government securities, particularly on longer maturities depending on market conditions. However, the issuances denominated in USD or in other currencies on foreign markets may offer advantages by extending the maturity, increased market capacity to absorb new issuances and diversification of the investor base. This source of funding is particularly important for Romania as alternative funding in case of external events that may limit access to some maturity segments to finance on the European market.

MoPF will remain flexible about the time of accessing external international markets and the amount of foreign issuances, taking into account the associated costs, risk considerations, the potential implications for the central bank's objectives and policies, as well as local market developments. In addition, depending on developments of capital markets during 2016, MoPF might use specific secondary market operations, such as buy back and bond exchange, to facilitate refinancing the series issued in high amounts and with high interest rates coming due in the next period.

In addition, the implementation of structural reforms in key economic sectors, as well as priority programs/projects for the Romanian economy will continue to be financed by loans from international financial institutions (World Bank, EIB, ECB, EBRD), which play an important role in limiting costs and extend the maturity of the debt portfolio in terms of cost and maturity offered. Thus, in the medium term, MoPF intends to continue its partnership with international financial institutions to benefit from the advantages of their products, such as IBRD Development Policy Loans (DPLs) and those contracted to finance the budget deficit and refinance government public debt public, with funds being made available depending on the implementation of certain measures and/or other actions necessary to sectoral reforms.

Table 7: Funding sources for the estimated funding needs

	Maturity/grace period (in years)	Amount (billions foreign currency)		
Domestic Market		**2016**	**2017**	**2018**
1. Treasury Bills	6 months to 1 year	14-15	14-15	12-13
2. Benchmark Bonds in RON	up to 15 years	32-35	31-33	32-33
3. Benchmark Bonds in EUR	5 years	1.1	0	0
Foreign Market				
1. Eurobonds issued under MTN Programme				
- EUR	up to 15 years	3	2.5	2.5
-USD	between 10 and 30 years	0	0.7	0.7
2. Loans from IFIs:				
a) EIB loans (incl. NSRF and NRDP), EBRD and ECDB loans	15/20 years of which 2-5 years of grace period	0.03	0.205	0.1-0.5
b) IBRD loans, other than DPLs	10/18 years	0.06	0.095	0.1-0.2
c) DPL	18/20 years	0.75	0-0.70	0-0.70

Source: MoPF

5. Macroeconomic background in Romania

In 2015, the economic growth in Romania continued the positive trend started in 2011, advancing by 3.8% on the back of the domestic demand for investment and consumption, thus recording one of the highest annual economic growth in the EU.

Given the international economic environment and the economic and financial developments in the euro area, as well as the economic growth potential for 2016-2018 the Romanian economy is expected to speed up, a GDP growth by around 4.3% per year being possible[26].

In 2015, disinflation has continued, with a negative inflation since June, due to the VAT rate reduction by 15 percentage points for food and public food sector services, so that at the end of 2015 this indicator was -0.93%. During the period covered by the Strategy annual inflation[27] is estimated to remain at low rates, ranging between 0.7% annual average in 2016 and 2.5% 2018. The lower level of 2016 is due to the persistence of the base effect of the measure to reduce VAT on food by 15 percentage points and introducing the 20% rate for remaining categories of products and services from January 1, 2016. Following the results from January and February 2016 we estimate that inflation will be negative in the first half of 2016.

In the medium term, in order to consolidate the fiscal and budgetary policy, fiscal policy objectives are aimed at going further with the measures to increase the efficiency of the tax system creating, on the one hand, the possibility of simplifying taxation, eliminating disruptions and establishing the coordinates for a coherent and modern legal framework for fiscal, on the other hand, creating the premises to provide predictability to the tax system and sticking to a conduct required by a sustainable tax consolidation.

Fiscal relaxation measures, as well as those on the expenditure side, adopted in 2015, led to a projection of the general consolidated budget deviating from the medium term budget target (MTO) in the years 2016 and 2017, and a structural deficit up 1% of GDP, as set out in adjustment calendar agreed with the European Institutions, but a gradual return to a trajectory converging towards the MTO is expected from 2018 onwards. Under the circumstances of budget deficits up to 3% of GDP in the medium term, the gross financing need is still determined by the volume of refinancing the government public debt, despite of the fact that since 2017 financing needs arising from the budgetary deficit and public debt refinancing begin to equilibrate, as shown in the table below.

Table 8: Forecast of financing needs

Indicator	2015 estimates	2016 planned	2017 planned	2018 planned
Central Government Revenues (billion lei)[28]	177.4	181.3	184.0	198.1
Central Government Expenditure (billion lei)[29]	190.7	203.1	206.3	217.9
Central Government Budget Deficit (I) (billion lei)[30]	13.3	21.8	22.3	19.8
Refinancing of the government public debt[31] (II) (billion lei)	50.0	48.6	25.3	32.2
Gross financing needs (I+II) (billion lei)	63.3	70.4	47.6	52.0

Source: MoPF

[26] Source: NCP "2016 -2019 main macroeconomic indicators' forecast, the spring forecast in April 2016
[27] The same as 26
[28] Calculated in accordance with cash methodology, 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 2015 (it includes government guarantees but it does not include temporary financing).

The macroeconomic assumption for the 2016-2018 Strategy are presented in the below table.

Table 9: Basic scenario if macroeconomic projections

Indicators	2015 estimates	2016 planned	2017 planned	2018 planned
Nominal GDP (billion lei)	712.8	757.0	805.9	859.9
GDP Growth (%)	3.8	4.2	4.3	4.5
Central Government Budget Deficit [32] (% of GDP)	-1.9	-2.9	-2.8	-2.3
Current Account Deficit (%of GDP)	-1.1	-1.6	-1.7	-1.7
Inflation (end of year %)	-0.9	0.9	2.5	2.3
Inflation (annual average %)	-0.6	-0.7	2.3	2.5
RON/EUR average exchange rate	4.4450	4.46	4.44	4.42
RON/YSD average exchange rate	4.0057	4.02	4.0	3.98

Source: NPC, MoPF, NIS

The risks associated to initial projections

Deviations from the macroeconomic projections in the baseline scenario described above could come from the materialization of geopolitical risks, the fears about economic growth and the proportion of China's private debt to China, the financing difficulties faced by Greece, the risk of Britain leaving the European Union and the drop in fuel prices, especially oil prices, with an impact on the economic downturn in the oil producing/exporting Member States.

These factors may generate high volatility in international financial markets in the context of evolving divergent FED policies (expected to increase interest rates) and ECB policies (policy of maintaining easing measures extended to March 2017) which may lead to a temporary rise in risk aversion world-wide and affect emerging economies. External shocks associated with these risks could lead to lower economic growth by lowering exports or capital flows volatility[33], and could result in increased financing needs and less favorable financing terms. Low monetary policy rates in advanced economies expected at least for the next period will help however maintain recent yields of government securities issued by Romania on foreign capital markets under increased investor interest in European government bonds rating and those in the emerging countries.
The world economy has experienced recent turbulence on international financial markets, reflecting the repositioning of capital flows amid new cycle of FED monetary and structural challenges in emerging countries.

The domestic market will be influenced by both international macro - financial developments and the domestic evolutions (economic and political too). Internal risk factors include the fiscal and budgetary policy conduct, increase of the budget deficit in the medium term and the possibility of delayed structural reforms, as well as a perception of legislative instability[34], with the main external risks associated to concerns over the fragility of economic growth world-wide and tensed episodes at regional level. 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 (the banking sector still holds about 50% of government securities). This risk factor will be reduced in the long term by increasing the demand from institutional investors, particularly pension funds due to a growth in the assets of such funds, as well as other participants

[32] The same as 28

[33] Exposure to volatility in capital flows may increase also due to the inclusion 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, although non-resident holdings accounted for 17.6% of the total amount of government securities issued on the domestic market at the end-2015.

[34] Recent legislative initiatives that provide for increased wages or pensions/social benefits or promote a legislative framework allowing the population to get rid of their mortgages by returning the assets representing the collateral to the banks (the mortgage law or the debt/asset swap) may damage the perception of legislative stability with implications in respect of the risk premiums charged for the purchase of Romanian financial assets and even the country rating.

to the capital market, such as local asset management funds and insurance companies. Risk factors at political level include local and parliamentary elections in 2016.

If aggregated, all these risks can reduce the potential for sustainable economic growth, both for the euro area and the EU as a whole. Meanwhile, the cost of financing in local currency can also increase in countries where central banks[35] strengthen the monetary policy to respond either to idiosyncratic internal factors, which are specific in the context of reaching specific inflation targets.

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 should be implemented taking into account both the amount of refinancing debt and the increasing budget deficits compared to previous years, with a higher tolerance for financial risk. 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 with macroeconomic assumptions in the baseline scenario refer to amplified risks world-wide, particularly worsening geopolitical risks, uncertainties about the different monetary policies of ECB and FED, and the Brexit risk after the referendum in June 2016. In addition, the implications on the perception of investment environment and hence on market demand for government securities of internal factors should also be closely monitored (monetary policy decisions due to increased demand for consumption and the inflation outlook over the medium term, legislative instability with consequences on the financial stability and the budget deficit etc.) with implications on the implementation of the debt strategy and the borrowing terms and conditions of the Romanian Government.

6. Analysis and strategic guidelines

The strategic guidelines for managing public government debt in Romania reflect the cost-risk tradeoffs in the current debt portfolio[36], the plans to develop the domestic market of government securities and the medium-term macroeconomic framework.

Implications of the analysis of the existing debt portfolio, market development considerations and the macroeconomic analysis in the development of a debt management strategy

While declining compared to previous years the exposure to refinancing risk and interest rate risk in the domestic market continue to be the main sources of risk for the existing government debt portfolio. The currency exposure is still significant but is mitigated by the share of long-term foreign currency debt (denominated in Euro and USD as well) and the perspectives of adoption of the European currency. Longer tenors and a more diverse investor base could justify the Eurobonds issued in USD; however the analysis shows that, currently, with the framework for managing the risks associated to other foreign currencies lacking, USD funding is both more expensive and riskier compared to funding in EUR[37]. In addition, FED monetary policy with expectations of higher reference rates will push up yields for Eurobonds issued in that currency on foreign markets.

[35] According to NBR's most recent inflation report and the statements made by the management of this institution, inflation will start trending up in the second half of 2016, and measures to tighten monetary policy may be adopted in 2017. In addition, developments in lending amid strong economic growth supported by accelerating domestic consumption may lead to the adoption of restrictive measures of monetary policy, which would be at odds with the ECB policy and may create volatility with respect to the demand of non-resident investors, especially for the market of government securities.

[36] At end-2015.

[37] Currently absolute yields of funding in USD at comparable maturities (e.g. 10 years) are higher than those related to financing by issuing government securities in domestic currency. However, there is a limit to the capacity of the Romanian state to extend the maturity of its debt portfolio on the domestic market, due to investment base structure for the government securities in lei.

Current market conditions allow Romania relatively easy access to funding in the domestic debt market and in the international capital markets. Recent efforts to develop the domestic market such as the increased share of government bonds included in regional market index have resulted in maintaining a considerable demand from non-resident investors (approximately 17% of the active portfolio of government securities); other measures related to the functioning of the primary dealers system, the improvement of the infrastructure for the secondary market and the completion, in 2016, of the procedural and operational framework by NBR and MoPF for the use of specific instruments on this market (buy-backs and bond exchange) should help improve liquidity through refinancing series issued in high amounts that have accumulated , with various maturities, and the creation of liquid bonds, as well as, looking ahead, further strengthen investor demand for government securities.
Whereas forward yield curves indicate that both external and domestic interest rates are expected to increase in the future they both continue breaking historical lows. The QE policy initiated by ECB in March 2015 and the new measures encouraging the euro area adopted in March 2016 are bound to preserve the low long term interest rates. With lower yields in the euro area, Romania could continue benefiting from the investor interest in getting profits from assets denominated in Euro, which could help keep interest rates both in RON and EUR at relatively low levels.

Macroeconomic projections indicate a stable debt ratio to GDP with declining funding needs while low inflation (although trending up in the medium term) together with a relatively stable exchange rate may facilitate the extension of maturities for government securities in domestic currency and a lower cost for external financing.

Significant risks associated to these baseline scenarios include worsening of geopolitical tensions and the fears about the economic growth in China which may increase the volatility in the international financial markets with impact on emerging markets, as well as a growth below potential in the member states of EU impacting the Romanian economy's growth. Domestic risk factors include fiscal and budgetary policy stance, a higher budget deficit in the medium term and the possibility of delayed structural reforms and a perception of legislative instability.

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 raised by 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 measured as the increase in cost resulting from applying shocks to the market rates used 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, 2018. The results of the cost-risk analysis are then complemented by macroeconomic considerations and considerations related to the domestic market development, as described below.

Results of the analysis of alternative debt management strategies

Extension of average time to maturity (ATM) in domestic currency debt: 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 relatively low yields of government securities during the interval under review. Under these circumstances, the cost of 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 government securities with an impact on the development of the secondary market. Improving liquidity can come both through increasing the weight of Romanian government securities in the regional reference index and particularly by introducing the electronic trading platform for the secondary market and the use of instruments of secondary market (buy-backs and bond exchanges) after MoPF in a joint effort with NBR finalize the framework allowing the use of these instruments.

<u>Reduce refinancing risk by rollover of T-bills denominated in lei using Euro-denominated government securities:</u> Addressing refinancing risk in the local currency debt with Euro funding 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 expectations about interest rates higher in USD and a RON/USD exchange rate significantly more volatile than the RON/EUR, with the appreciation of the US currency against the euro; market expectations for the end of 2016 is a parity of 1:1.
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 20 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, the possibility to use such instruments while maintaining the main exposure in euro can be considered.

In order to use financial derivatives (currency swaps and interest rate swaps), for the creation of the procedural and technical framework MoPF is to be provided technical assistance from the World Bank as part of a project for which financing from European Funds (OPAC) was requested for a period of 18 months.

In conclusion, with budget deficits below 3% of GDP in the medium term, MFP 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, but not casting out any opportunistic access to international capital markets in currencies other than EUR, under a cost/risk ration favorable to Romania.

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 following principles shall guide the government funding decisions during the period 2016-2018:

1. The net financing in local currency is to be favored 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[38].

2. Pursue a smooth redemption profile, avoiding to the extent possible the concentration of principal repayments/refinancing of government securities in the short-term.
3. Mitigate the refinancing risk and the liquidity risk by maintaining a foreign currency buffer and possibly other instruments depending on the terms and conditions thereof.
4. Maintain a presence on the international capital markets, through issuances of Eurobonds mainly in EUR 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.
5. In the process of external financing, the debt will be contracted mainly in EUR.
6. The issuances denominated in EUR on the domestic market can be considered only under the circumstances of reimbursement/refinancing of similar instruments issued on the domestic market, which is, if there is a liquidity surplus in Euro on the domestic market, a very high demand [39] and very favorable costs.
7. 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.
8. Use financing instruments offered by the international financial institutions to benefit of the favorable terms and conditions attached to those instruments.

These principles are expressed as indicative targets 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[40] and keeping the share of local currency debt in total government public debt between a 40% (minimum) and 60%. 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%.

Refinancing risk

1. Maintain the share of debt maturing in the next year between 20% and 30% (maximum) for the local currency debt and between 15% and 25% (maximum) for the total debt.

2. Maintain the average maturity remaining between 3.0 (minimum) and 5.0 years for local currency denominated debt and between 5.5 (minimum) and 7.0 years for total debt.

3. Maintain a foreign currency buffer[41] 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 20% and 30% (maximum) for the local currency debt and between 15% and 25% (maximum) for the total debt.
2. Maintain the average maturity remaining until the next refixing between 3 (minimum) and 5 years for local currency denominated debt and between 5.0 (minimum) and 6.5 years for total debt.

[38] 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, in particular, with respect to the structure of maturities in the financing process, given the high appetite of those investors for government securities with medium and long maturities.

[39] Euro liquidity conditions in the domestic market may be influenced by significant redemptions of government bonds in Euro or NBR decisions to reduce the minimum reserve requirements for liabilities in foreign currencies, as was the case in February this year, when the central bank lowered the reserve requirements on foreign currency liabilities in conjunction with the redemption of a foreign issuance on the domestic market of EUR 1.6 billion.

[40] Around 65% of the deficit will be covered from domestic sources during the period of this Strategy

[41] The foreign currency buffer representes the funds in foreign currency available to the State Treasury

Table 10: Targets of the main risk indicators

Exposure to risk	Indicator	Indicative targets for 2016 – 2018
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)	40% (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)	15% - 25% (maximum) 20% - 30% (maximum) 5.5 years (minimum) – 7.0 years 3.0 years (minimum) – 5.0 years
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)	15% - 25% (maximum) 20% - 30% (maximum) 5.0 years (minimum) – 6.5 years 3 years (minimum) – 5 years

Source: MoPF

The implementation of the 2016 - 2018 Strategy will be monitored on a monthly basis, looking for the debt indicators to observe the established targets and being published in the monthly Newsletter of MoPF available on the MoPF website. In accordance with the Government Emergency Ordinance nr. 64/2007 on the public debt, as 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.

Anca Dana DRAGU

MINISTER OF PUBLIC FINANCE

Annex 1

Development of the 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 amount of around 2 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;
      1.1.3. Issue of 3, 6 and 12 months T-bills (short term) as a cash management tool;
      1.1.4. Review the rights and obligations of primary dealers and performance evaluation criteria for primary dealers to increase competitiveness in the primary market and achieve the objectives of developing the government securities market by revising the legal framework and the related procedures and have bilateral agreements concluded between MoFP and primary dealers;

   1.2. Diversify and broaden the investor base by:
      1.2.1. Continuing the FIDELIS programme of issuances for the population, via the Romanian Securities Exchange;
      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 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.

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

   2.1. The official implementation of the electronic quotation and trading platform of government securities by the primary dealers, as a move to improve liquidity and transparency of pricing and diminish the risks associated with trading activity;

   2.2. Concentrate the liquidity of government securities in a small number of benchmarks with amounts equivalent of around EUR 2.0 billion, for each issuance, according to their maturity;

   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 implementation of the government public debt management strategy;

2.4. Conduct reverse repos and securities lending for cash management purposes and to support the activity of the market makers, based on consultations with NBR, to coordinate the government financing and cash management policy with the monetary policy;
2.5. Cooperate with NBR to revise the procedural and technical framework in order to attract and facilitate the flexibility of access for the international financial institutions on the primary market of government securities, as primary dealers.

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. Regular publication on www.mfinante.ro of information relevant to investors in terms of debt amount and composition; create a web page dedicated to the public debt;
3.4. Manage Bloomberg page dedicated to MoFP taking into account the broad use of this page by the majority of local and international investors.

Annex 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. Further develop the State Treasury's cash flow forecasting by extending the daily cash flow forecast from one month to three months and improving the co-operation with other entities for their supplying forecast information.

2. Move to a more active cash management to reduce fluctuations in cash balances, both by issuing short and very short term T-bills and by managing directly the current surpluses, using term deposits or, which is preferable, reverse repos. Although the use in 2015 of issuances with maturity of 3 months was low (3 treasury bills in the first half of the year) against the background of a considerable budget surplus achieved by November 2015, which reflected including in the positive developments of the treasury general current account balance, we expect that from a budgetary execution evenly distributed throughout the year to start the process of issuing this instrument monthly.

Depending on the budget execution during the year, the Treasury plans to issue short term treasury bills and adopt a more active conduct in placing the account balance, mostly as reverse repos[42], upon consultations in advance with NBR in order to coordinate funding and cash management policy with the monetary policy. The short-term and very short-term T-bills will be introduced in a way that does not undermine the debt management strategy, in particular the key objective that is to develop the domestic market of government securities by extending the average maturity of the debt portfolio.

For the recommendation on strengthening the institutional framework for better coordination of the debt management with the cash management a committee was established within the MoPF formed of NAFA and NBR representatives, for a better coordination of the debt management and cash management processes.

Another short-term instrument is represented by the borrowings from the State Treasury General Current Account balance amounting at 35.3 lei at the end of 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 of 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 around 0.16% in 2014 this instrument has a number of disadvantages as well, such as:

- it is an atypical instrument, as other European Treasuries use the state loans/government securities to integrally finance the budget deficits, with the liquidity surpluses placed in cash management instruments;
- depends on the funds available in the account, and in case of low available funds other solutions are used, such as attracting market deposits from credit institutions or selling the hard currency proceeds available in the foreign currency buffer of MoPF.

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

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.
A very important aspect is that the funds currently available in the State Treasury General Current Account include revenues in ROB from privatization, and the more this revenue is used the less available funds are left in this account.
In order to stimulate the absorption of the structural funds, a mechanism was created allowing a temporary allocation of the privatization proceeds sitting in the State Treasury account to the primary budget users which are managing authorities and to the Ministry of Agriculture and Rural Development; therefore, through:

- The Government Emergency Ordinance nr. 64/2009 on the financial management of structural instruments and the use thereof for the convergence objective, as revised, art. 11 [1] established that throughout the budget year the balance of funds amounts allocated from the privatization proceeds to the primary budget users in capacity as managing authorities, through the agency of the Certifying and Payment Authority, determined as a difference between the total amounts allocated and the total amounts returned to the Ministry of Public Finance, cannot exceed the ceiling of Lei 6 billion or EUR equivalent.
- The annual budget laws for the Ministry of Agriculture and Rural Development, funds from privatization proceeds were allocated to the direct payment schemes, the specific aids and the market and intervention measures and schemes.

The mechanism requires that the amounts temporarily allocated on a temporary basis from the privatization proceeds should be replenished from the amounts received from the European Commission as a result of the transmission to it of the payment applications corresponding to the operational programs.