MINISTRY OF PUBLIC FINANCE

GOVERNMENT DEBT MANAGEMENT STRATEGY

2012 – 2014

General Directorate for Treasury and Public Debt

Bucharest, JUNE 2012

Contents

Acronyms

AFA	Association of Fund Administrators
CDS	Credit Default Swap
CEB	Central European Bank
DG TPD	Directorate General for Treasury and Public Debt
EC	European Commission
EIB	European Investment Bank
ESA 95	European System of Accounts 1995
EU	European Union
FED	Federal Reserve
GCAST	General Current Account of the State Treasury
GCB	General Consolidated Budget
GDP	Gross Domestic Product
GPD	Government Public Debt
IBRD	International Bank for Reconstruction and Development
IFI	International Financial Institutions
IMF	International Monetary Fund
ISC	Insurance Supervision Commission
JPY	Japanese Yen
LPD	Local Public Debt
LTRO	Long term refinancing operations performed by CEB
MoPF	Ministry of Public Finance
MTN	Framework Program for the issuance of Medium Term Notes on the foreign markets
NBR	National Bank of Romania
NPC	National Prognosis Commission
NSC	National Securities Commission
SCPPS	Supervision Commission of the Private Pension System
SDR	Special Drawing Rights
TAU	Territorial Administrative Units
WB	World Bank

Methodological clarifications

Where no otherwise specified, the numbers in this document have been calculated according to the national legislation.

The government public debt, according to the national legislation, is formed of the debt that is either directly contracted or guaranteed by the Government, through Ministry of Public Finance.

The public debt according to national legislation includes, in addition to the public debt according to the EU system, the debt that is guaranteed by the Government, through MoPF, and by TAU, and is reimbursed from the own sources of the guarantee beneficiaries, as well as from the borrowings and the funds available in GCAST, whereas the public debt according to the EU methodology includes, in addition to the above, the debt of the companies that have been reclassified and included in the general government sector.

1. Introduction

In line with the Government Decision 1470/2007 on approval of the application guidelines of the provisions in the Government Emergency Ordinance 64/2007 on the public debt, as amended, the Ministry of Public Finance, in its capacity as sole administrator of the government public debt, after consultations with the National Bank of Romania, prepares the Medium Term Debt Management Strategy (hereinafter the Strategy) and submits it to the Government, for approval, and to the Parliament, for information purposes.

The Strategy presents the medium term debt management strategic objectives and the instruments to be used for implementing these objectives, taking account of the macroeconomic and financial market developments and outlook during the respective time interval.

In line with the legal provisions in force, for the purpose of boosting transparency and predictability, the government public debt management strategy is published every year by the MoPF, along with the strategy objectives over three years upcoming and details regarding the financing plan for the current year.

The 2012-2014 Debt Management Strategy is mostly a continuation of the strategy approved in March 2011, with the main objective of covering the government financing needs and the payment obligations, while minimizing the costs on the medium and long term and limiting the risks attached to the government public debt portfolio. At the same time, the development of the government securities market is an important strategic objective in the upcoming time period.

A prudential and efficient debt management, taking into account the government debt profile in terms of maturity, repayment schedule, currency composition or exposure to the interest rate risk is important for the sustainability of the budget and of the debt, and for providing a stable macroeconomic framework. In addition, a proper debt strategy implementation requires a proper coordination with fiscal and monetary policies and a dialogue with the relevant government institutions with supervision attributions (NBR, NSC, SCPPS, ISC).

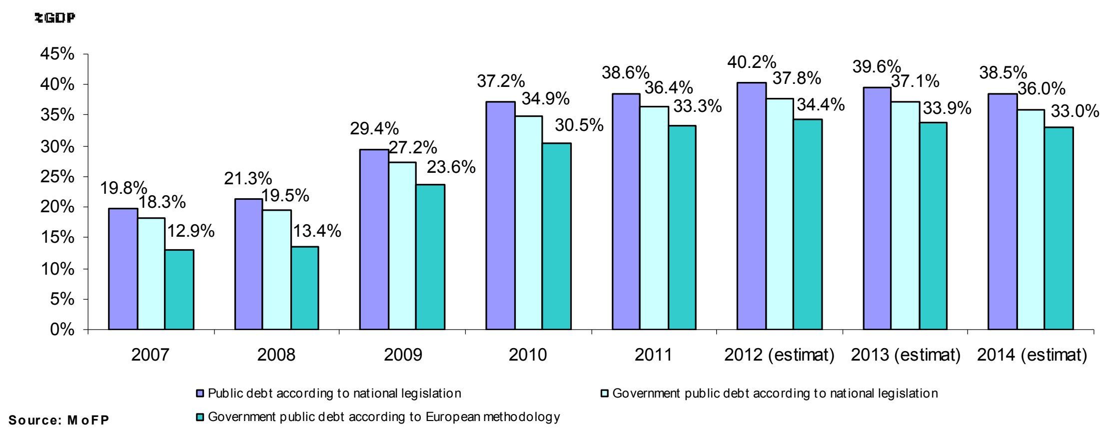
The 2012 - 2014 debt management strategy is in line with the fiscal and budgetary policy assumed in the 2012-2014 Fiscal and Budgetary Strategy and the medium term expenditure framework, as well as with the commitments made by the Romanian Government in the agreements concluded with the international financing organizations (IMF/WB/EU).

The tax adjustment process consolidation taking into account the Stability, Coordination and Governance Treaty within the European and Monetary Union signed by Romania in early March 2012, and the last year's developments on the financial markets, required a revision of the government financing needs estimates and of the assumptions used in the March 2011 Strategy.

For the 2012-2014 debt strategy we assumed a moderate growth, a strengthened disinflation process, the stability of the banking system, a relatively balanced foreign macroeconomic environment, a steady course of the domestic currency and a continuation of the fiscal consolidation process, by keeping the budget deficit in cash terms below 2.5% for the whole time interval under consideration.

The chart below presents the government debt developments up to date and the main estimates until 2014.

Chart 1: Public Debt Evolution in 2007 – 2014

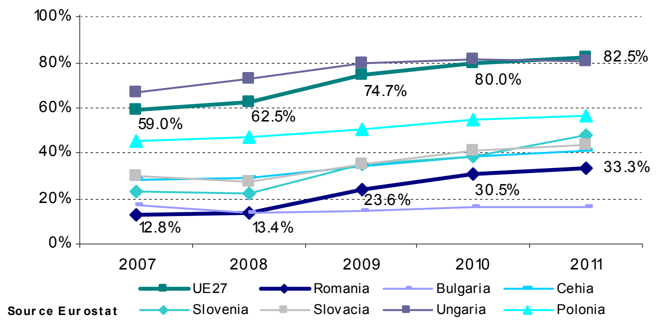


The main cause for the increase in the government public debt amount in 2011 was the budget deficit of 4.1% of GDP (according to the national legislation). For the current year, we expect the government public debt share to GDP, calculated according to the national methodology, to go slightly up to 37.8%, and in 2013-2014 a gradual decrease to 36.0% due to a higher economy and a declining budget deficit.

Considering a moderate economic growth, we expect the public debt according to the national legislation to stay under 40.5% of GDP, with the government public debt below 38% of GDP.

The public debt according to EU methodology is expected to remain clearly below the 60% ceiling required by the Maastricht Treaty, with no risk expected to push it close or above this ceiling for the whole time period covered by this Strategy. The share of public debt (EU methodology) to GDP is one of the EU lowest. Hence, with its 33.3% of GDP in 2011, Romania is in the fourth place among the EU Member States with the lowest indebtedness level, considering an EU average of 82.5%.

Chart 3: Public debt / GDP In Central and Eastern European countries in 2007 - 2011



2. Government Public Debt Management in 2011 and Q1 2012

2.1. International macroeconomic and financial background

Throughout the year 2011 and in the first part of 2012 the investors' risk aversion went up, against a background of uncertain debt sustainability in the Euro Zone border countries. The investors' fears have been fuelled by poor results of the fiscal adjustment reforms, given an unstable political environment and worrying macroeconomic data. In addition to the above, we saw the inability of the European leaders to reach an agreement regarding the support measures to the affected states, cause the economy to grow and control the spillover effect.

The lowered sovereign ratings for several European states put additional pressure on the financing costs and, by this, on the banking system. As a result of the growing uncertainty, the European banks reduced their operations on the interbank markets, with many banking groups (some present in Romania as well) downgraded following their exposure on the sovereign debts of the border states.

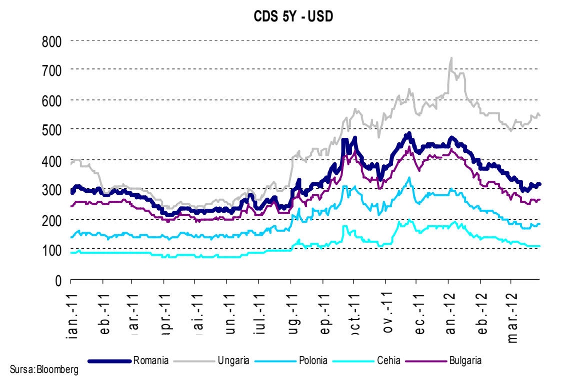
The events described above prompted the investors to take shelter under low risk assets, and caused the yields of top rating countries to drop to a historical minimum level and the spread between the bonds issued by these EU Member States and those issued by the Euro Zone border countries to increase significantly.

In order to counteract the effect of the crisis, the Central European Bank decided to lower the reference rate to 1% (practically reversing the two increases of 0.25% each introduced in the first half of 2011) and reactivated the repurchase program of the sovereign bonds, in August. At the same time, ECB increased the maturity of the loans extended to the banks in the system, expanding the range of instruments qualified as collateral.

In December 2011, all EU Member States but Great Britain and the Czech Republic approved the Stability, Coordination and Governance Treaty of the Economic and Monetary Union, which includes a fiscal pact aimed at strengthening the economic governance in Europe. Moreover, the liquidity injections performed by ECB through long term refinancing operations in amount of around 1.018.7 billion Euros (489.2 billion Euros on December 22, 2011 and 529.5 billion Euros on March 1, 2012) contributed to alleviating the severe tensions that the European banking system and the financial markets having been facing lately, significantly reducing the financing costs for the Euro zone border states.

The tensions on the foreign markets impacted Romania's risk perception, reflected in the country risk premium, the international issuance quotations of the Romanian government and the volatile exchange rate.

Chart 3: Risk premium comparative view (CDS at 5 years) in 2011 – Q1 2012



The success of the first step in the Greek swap plan and the second bailout package approved for Greece in February 2012, the fiscal pact signed by the European leaders in early March 2012 and the fiscal adjustment measures adopted by some EU Member States, helped relaxing the circumstances and pushed down, at least for the moment, the borrowing costs.

2.2. Romania's macroeconomic developments

In 2011, the real economic growth in Romania was 2.5% of GDP, mainly driven by the very good performance of the farming sector (value added up by 11.3%) and of the industry (value added up by 5%), via exports. The current account of the balance of payments saw a deficit of 6 billion Euros, higher by 8.7% compared to 2010, mainly as a result of the increase in the deficit of the balance of revenues by 23.9%. In 2011, 32% of the current account deficit was financed by direct investments of non-residents, amounting to 1.9 billion Euros, lower by 13.5% compared to 2010.

Hence, in 2011, the general government deficit (in cash) was 23.9 billion RON (4.1% of GDP), down by 9.7 billion RON as compared to 2010. The adjustment from 6.4% of GDP in 2010 was due to high revenues (mainly VAT collections, personal and corporate income tax collections) and expenditure cuts (wage bill and social protection). In 2011, the budget deficit according to EU methodology (ESA95) amounted to 5.2% of GDP.

Throughout 2011, the domestic currency's exchange rate fluctuated between 4.1 – 4.4 RON for 1 Euro, and 2.7 – 3.4 for 1 US Dollar, with a slight tendency for stability in the first half of 2012 in the upper part of these intervals.

The annual inflation rate went down to 3.14% at end-2011, decreasing by 4.82 percentage points from 7.96% in December 2010, close to the core point of 3% of NBR's target band. Convergence of annual inflation rate by the central bank target for 2011 was the result of first round effects of higher VAT rate in July 2010, the downward trend of volatile price dynamics, mainly the food and splitting of core inflation. The latter reflected the persistent large deficit aggregate demand and inflation expectations improved, supported including maintaining prudent monetary policy conduct.. In May 2012, the annual inflation rate dropped to 1.79%, from 2.72% in January.

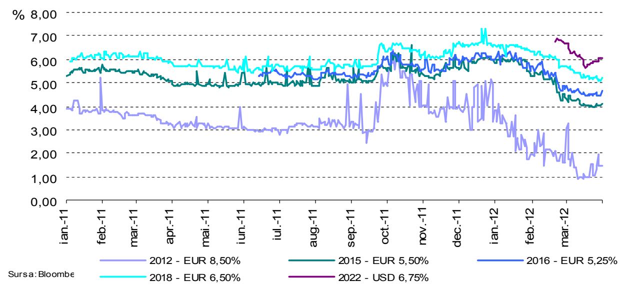
As of November 2011, following a consolidation of the disinflation process, NBR initiated a decreasing trend of the monetary policy interest rate, from 6.25% to 5.25%, by implementing four successive cuts of 0.25 percentage points each. The cut in the reference interest rate was reflected in the interbank market interest rates as well, and in the yields of short term government securities undergoing significant adjustments in Q1 2012.

Chart 4: Yields of government securities issued in domestic currency, in 2011 – Q1 2012

The prudential fiscal and budgetary policy promoted by the Government and the correct monetary policy of the National Bank of Romania, the positive outcome of the fiscal adjustment measures adopted by the Government and the anchor provided by the IMF Stand-By Agreement helped attenuating the impact of the financial crisis and allowed, at the same time, a good macroeconomic performance with positive consequences on the debt refinancing and budget deficit financing costs.

The rating agencies confirmed these good economic results. Thus, Fitch decided to raise Romania's credit rating to investment grade in July 2011, with Moody's and Standard & Poor's at the end of last year reaffirming Romania's ratings, outlook remaining stable.

Chart 5: Yields of Romanian foreign bonds on the secondary market, in 2011 – Q1 2012



The yields of bonds issued on the foreign markets in EUR and USD performed well, against the background of an improved macroeconomic and financial domestic environment.

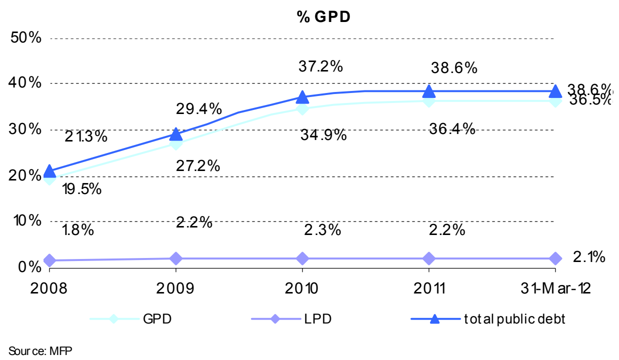
2.3. Changes in the amount, composition and cost of the government public debt

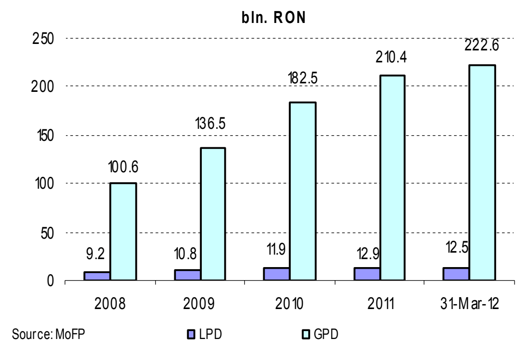
This section presents the changes in the debt amount, cost and composition, with the debt portfolio playing a crucial role in reaching the objectives set for the minimization of medium and long term public debt costs and the management of risks attached to the debt portfolio.

The volume and the composition of the government public debt

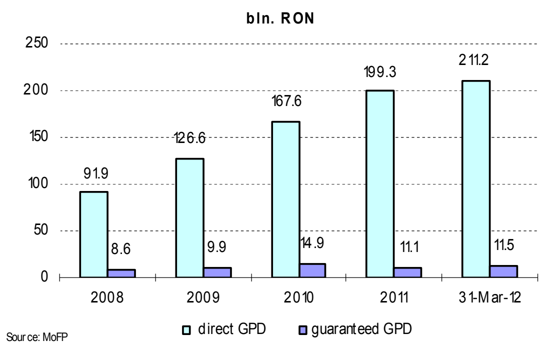
The total public debt increased in 2011 by 28.8 billion RON, accounting for 1.4% of GDP, mainly due to the debt committed for the purpose of covering the needs to finance the budget deficit and refinance the government public debt. The local public debt (LPD) stood on a fairly steady path as share to GDP over the past 3 years, GPD being responsible for the increase of the total public debt.

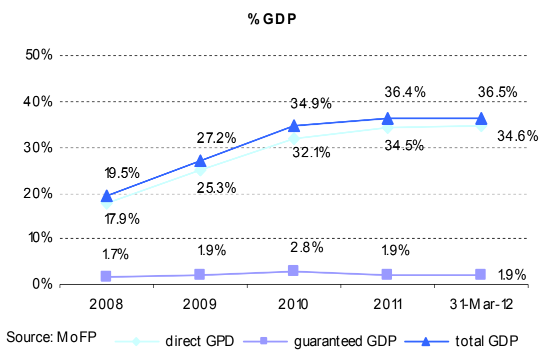
Chart 6: Evolution of the Public Debt





In total government public debt at end-2011, direct GPD was 94.7%, increasing from 91.9% in 2010; the difference is represented by the

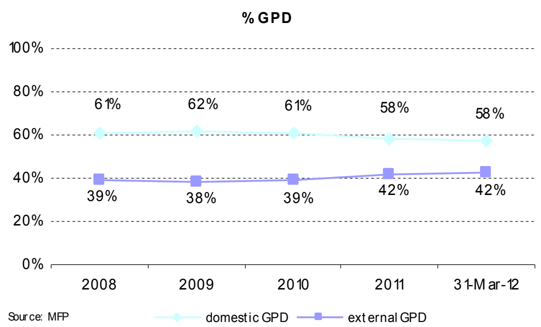


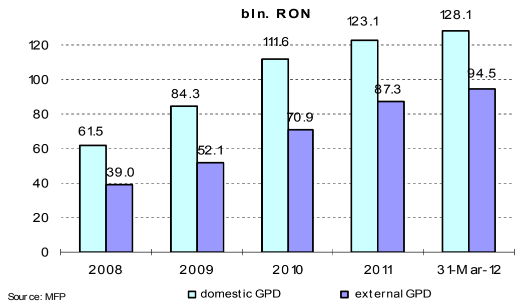


guaranteed GPD. In 2011, in a narrower fiscal room agreed with the international financial institutions (budget deficit of 4.1% of GDP compared to 6.4% of GDP in 2010), and with revised terms of guarantee in some government programs, the guaranteed GPD kept on a descending path, thus leading to a lower repayment risk for the Ministry of Public Finance in its capacity as guarantor.

With regard to the market on which the government debt was issued, the trend of the past three years is preserved, with a decreasing share of the debt contracted on the domestic market, a path that is consistent with the objectives of the debt management strategy regarding the diversification of financing sources and issuances under the MTN Program.

Chart 7: GPD depending on the market of issuance



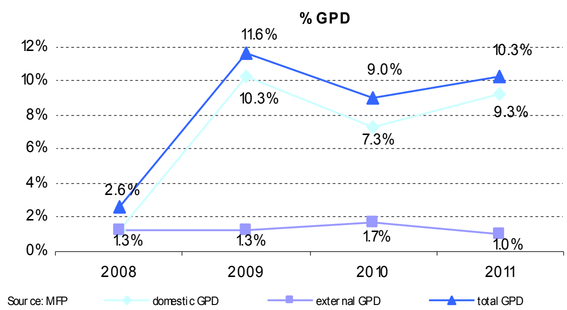


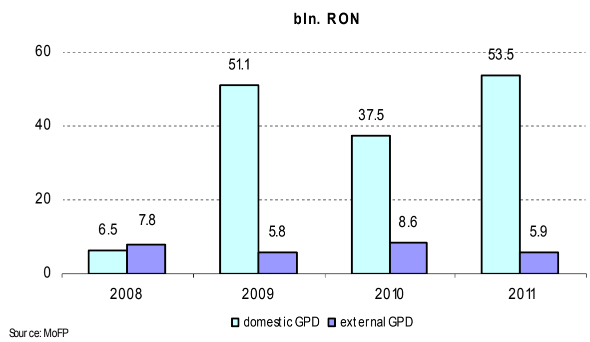
Public debt servicing and the cost of government public debt

In 2009, the public debt servicing (including reimbursements of principal and the cost of debt) went significantly up to 59.4 billion RON from 14.3 billion RON in 2008, against the background of a public debt on an ascending trend, and due to the fact that, with conditions on the domestic and foreign capital market worsening because of a deepened financial crisis, short term government securities were issued to finance the budget deficit and refinance the public debt. A high share (17-18%) of these instruments in GPD as of 2009 generated a higher public debt servicing during the period of time under consideration.

The disbursements from the foreign financial package agreed with IMF, EU and WB signed in 2009 led to a significant decrease of the public debt servicing as share to GDP in 2010; it went down to 9% form 11.6% in 2009, while the foreign debt servicing went up following the repurchase of a 2003 Eurobond in amount of 0.7 billion Euros. In 2011, the public debt servicing went slightly up, reaching 10.3% of GDP, primarily due to the short term domestic debt.

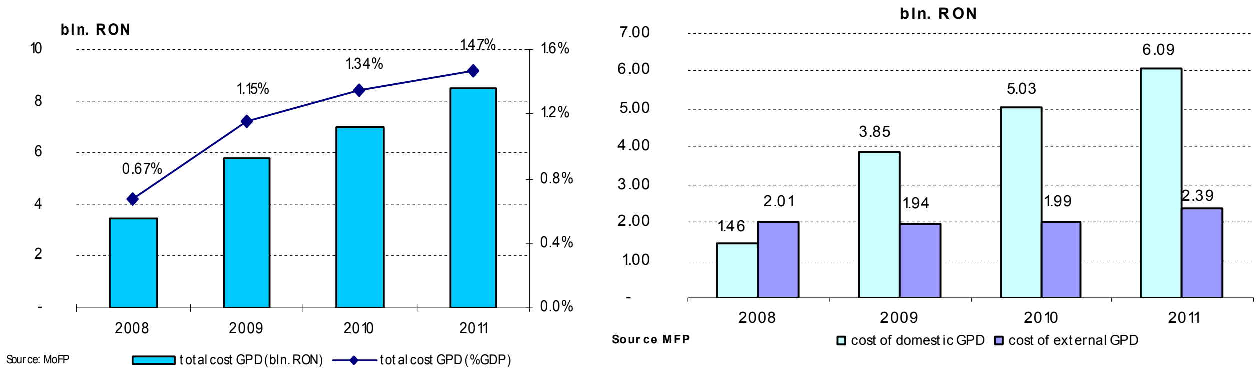
Chart 8: Public Debt Servicing





The increase of the government public debt (interests and fees) over the recent years, both as absolute value and as share to GDP, was caused by an increase in the amount of the government public debt and the higher interest rates on the local market after Romania was hit by the crisis.

Chart 9: The cost of government public debt



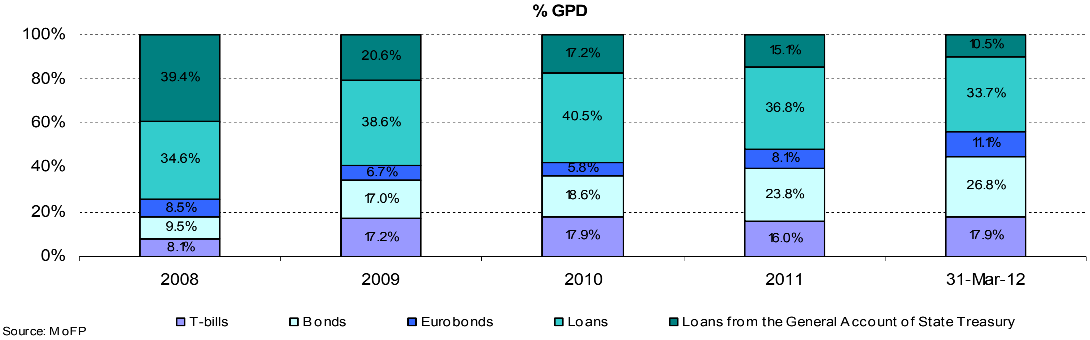
In 2011, the cost of domestic GPD accounted for 71.9% of the total government public debt cost, the share remaining roughly unchanged compared to the previous year, and increasing from 66.5% in 2009. A significantly diminished share of the foreign GPD despite of the gradual increase of this financing component as of 2009, has been triggered by the differential between the interest rates in lei and the interest rates for the main foreign currencies, and by the favorable financing terms of the loans contracted with EU, IMF and WB.

Analysis of the public debt

As regards the financing instrument composition of public debt, the past year's trends have been kept. Hence, the share of bonds issued on the domestic market continued to go up, from 9.5% in 2008 to 26.8% in Q1 2012, with the share of borrowings from GCAST decreasing significantly, from 39.4% to 10.5% over the same time interval.

The loans intended to project financing from commercial banks, international financial institutions and under bilateral relations, cash loans intended for various programs such as IBRD and EU) and the loans in the foreign financial package concluded with IMF(only the portion contracted by MoPF), EU and WB were included in the loan category.

Chart 10: Instrument composition of the government public debt

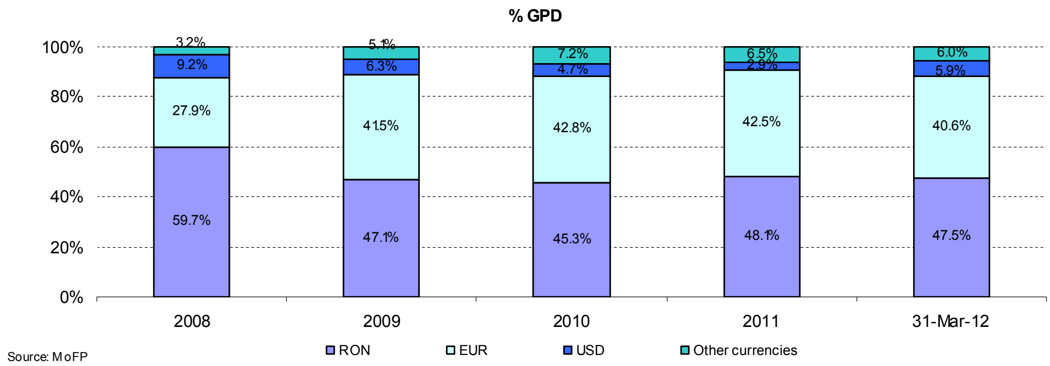


Source: MoFP

Currency risk

GPD currency composition has changed a lot since 2009, after the economic crisis hit Romania and with the loan contracted from IMF, EU and WB; the share of domestic currency GPD went down from 59.7% in 2008 to 47.5% at the end of Q2 2012, with a minimum level of 45.3% in 2010.

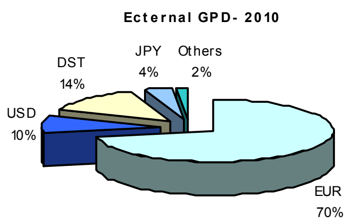
Chart 11: Currency composition of the government public debt

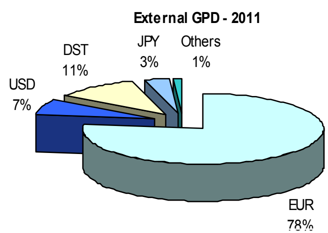


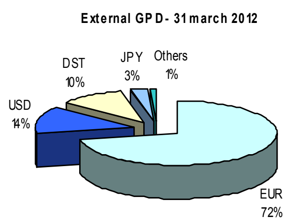
Source: MoFP

The EUR debt holds the highest share of foreign GPD (Chart 12), increased to 78% in 2011 (compared to 72% in 2009 and 70% in 2010) mainly as a consequence of the EUR 1.5-billion Eurobond contracted under the MTN program mid-last year, but also due to the disbursements / drawings from the foreign financial package agreed with IMF, EU and WB. The higher share of USD debt (Chart 11) at the end of March 2012 (5.9% as against 2.9% in 2011) has been a consequence of the 10-year Eurobond in amount of USD 2.25 billion issued in January and reopened in February 2012.

Chart 12: Currency composition of foreign GPD





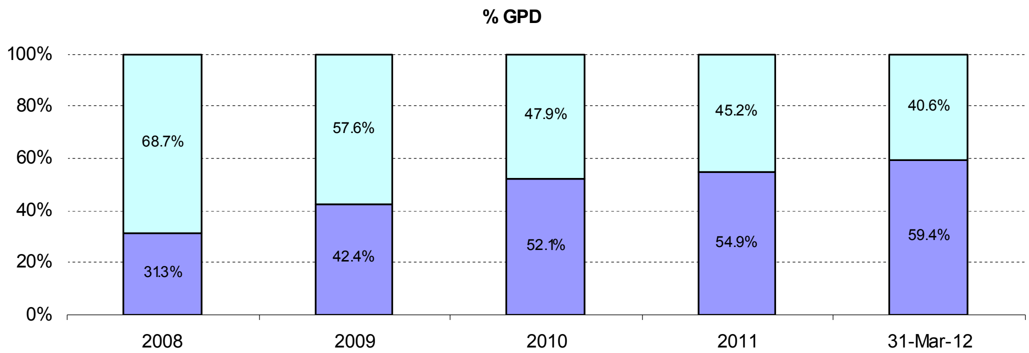


Source: MoPF

Interest rate risk

The interest rate composition of GPD has improved considerably starting 2010. In Q1 2012, the share of fixed debt amounted to 59.4% (compared to 54.9% in 2011 and 52.1% in 2010), an increase that has been generated primarily by the amount of bonds issued on the domestic market and the Eurobonds issued on the foreign capital markets, but the decrease in borrowings from the funds available in the general current account of the state treasury played an important role as well.

Chart 13: Interest composition of GPD

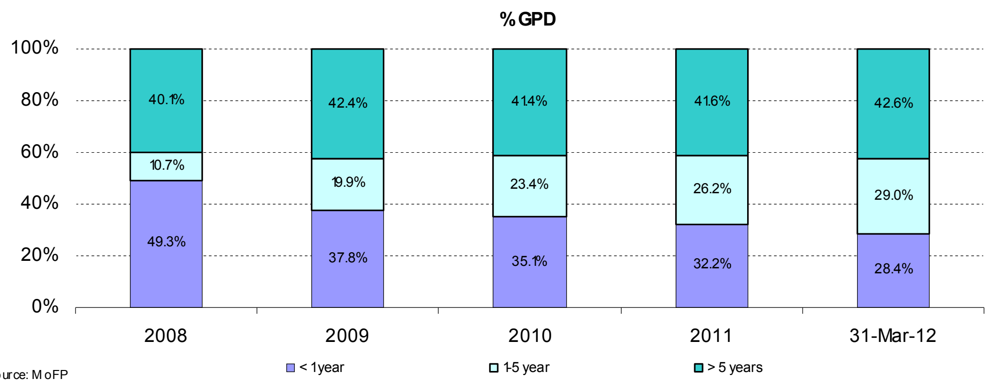


Source: MoFP

Refinancing risk

The performance of the government public debt with respect to the initial maturities has been positive over the recent years. GPD composition has seen an improvement, with an increasing share of medium term bond (1 to 5 years) on the domestic and foreign markets, due to T-Bills. The high share of long term bonds at the end of Q1 2012 (accounting for 42.6% of GPD, as against 41.6% in 2011) comes primarily from the 10-year Eurobond in amount of 2.25 billion USD at the beginning of 2012.

Chart 14: GPD composition by initial maturities



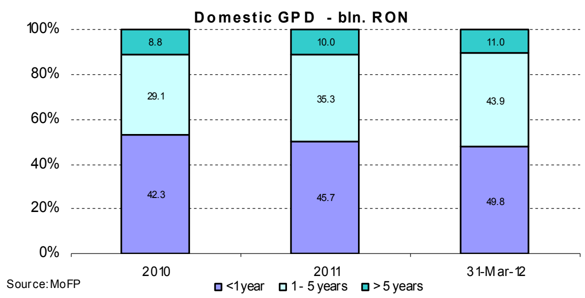
Source: MoFP

In terms of remaining maturities in the domestic GPD, according to the state of play at the end of Q1 2012, compared to 2011, for 10.5% of the domestic GPD the remaining maturity was over 5 years, as compared to 11.0% at end-2011, with the share of the debt having a remaining maturity under 1 year decreasing from 50.2% to 47.5% during the same time interval.

The composition by remaining maturities of the foreign GPD has been almost unchanged since 2010 until the end of Q1 2012, with roughly 55% in the segment 1 to 5 years and less than 10% under 1 year. The remaining maturity over 5 years went up compared to 2011 as a consequence of the USD Eurobonds issued on the foreign capital market in Q1 2012.

Chart 15: The domestic*) and foreign GPD composition by remaining maturities

*) it does not include the borrowings from the state treasury general current account



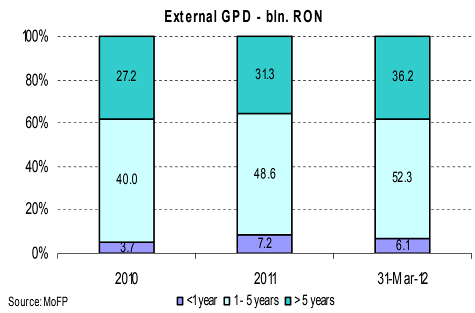
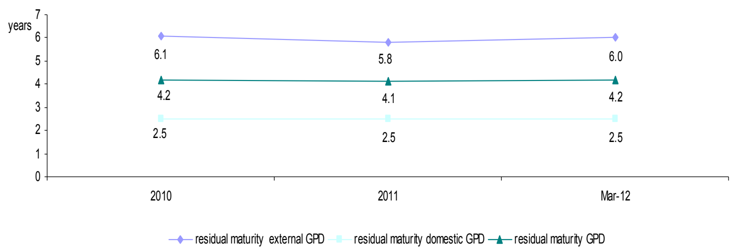


Chart 16: GPD average remaining maturity *)

*) it does not include the borrowings from the state treasury general current account



The average remaining maturity went down in a first stage from 4.2 years in 2010 to 4.1 years in 2011, but went back up to 4.2 years at the end of Q1 2012; this has been generated exclusively by the foreign component that has been massively influenced by the USD Eurobond issued in January and reopened in February 2012.

2.4 Assessment of the strategy implementation in 2011 and Q1 2012

The government public debt management process aimed at implementing the objectives established in the 2011 – 2013 debt strategy, as follows:

Table 1: Assessment of the objectives assumed in the Strategy

Objective / Progress	Indicators	Level as per the Strategy	2010	2011
1. ***Controlled public debt increase***:			***Importance: Medium***	

Public debt has been contracted primarily to finance the budget deficit and refinance GPD. In 2011, the 2.5% economic growth generated a lower increase (by 1.4%) of the total debt share to GDP. At the end of Q1 2012, the total debt share to GDP was 36.5%.	% GPD in GDP	-	34.9	36.4
2. Minimize long term GPD costs with acceptable portfolio risks			***Importance: High***	
The relatively slow increase of the annual cost attached to the new debt contracted to finance the budget deficit and refinance the debt. The cost of GPD was set by the domestic and foreign market financing terms at the debt contracting time.	% GPD Cost in GDP	-	1.34	1.47
3. Limit the risk attached to the debt portfolio			***Importance: High***	
3.1 Refinancing risk			***Importance: High***	
A flexible approach in selecting the financing sources and the debt instruments. At the end of Q1 2012, the short term debt share in total GPD was 28.4%.	% short-term debt in total GPD	-	35.1	32.2
Financing deficit and refinancing debt through T-Bills and medium and long term benchmark bonds issued on the domestic market, including with a maturity of 15 years, in February 2012. At the end of Q1 2012, this indicator amounted to 48%.	% new medium and long term issuances in total new issuances	-	25.0	33.0
The objective related to the average remaining maturity of GPD (excluding GCAST borrowings) could not be reached because of a relatively higher amount of short term securities issued on the market, required by bad market terms and the lack of investor interest for medium and long maturities. At the end of Q1 2012, the average remaining maturity was 4.2 years.	Average remaining maturity of GPD	4.5 years	4.2 years	4.1 years
3.2 Liquidity risk			***Importance: High***	
In order to reduce the liquidity risk and avoid seasonal pressures in providing the sources for deficit financing and GPD refinancing, MoPF tried to consolidate the foreign currency financial buffer, in line with the objective related to securing the funds needed to cover 4 months of deficit financing and debt refinancing needs. This objective, established in the loan agreement with IMF, WB and EU, has been under continuous monitoring by all joint IMF/WB/EU missions.				
3.3 Currency risk			***Importance: High***	
Currency risk indicators remain within the limits set in the Strategy. At the end of Q1 2012, the domestic currency debt accounted for 47.5% in total GPD.	% RON GPD in total GPD	Min. 45%	45.3	48.1
The new debt is both lei- and euro-denominated; looking ahead to the adoption of Euro as domestic currency, the currency risk may be seen as lower. At the end of Q1 2012, the share of EUR debt in total foreign currency GPD was 77.3.	% EUR GPD in total foreign currency GPD	Min. 75%	78.2	81.9
The Eurobond issued in January 2012 and reopened in February, in total amount of 2.25 billion USD, has triggered a higher currency risk. In GPD portfolio, the diversification brought by USD issuances generated an improvement in	% EUR GPD	Max. 50%	42.8	42.5

the cost-risk profile. At the end of Q1 2012, this indicator was 40.6%.	in total GPD			
3.4 Increase of negotiable debt share in total government debt				***Importance: Medium***
Starting in 2011 Eurobonds in amount of 7 billion Euros (or equivalent) were issued on the foreign capital markets under the 2011-2013 EMTN Program. In June 2011, MoPF launched the first issuance under EMTN, in amount of 1.5 billion Euros a 5-year maturity and a 5.25% coupon. In the second half of 2011, the MTN Program was adjusted to allow MoPF access the foreign capital markets by issuing USD-denominated government securities. Taking advantage of the opportunity window opened in the foreign capital markets after the first liquidity injection by ECB under the LTRO Program in December 2011, MoPF issued the first USD Eurobonds under the MTN Program, in January 2012. This issuance, in amount of 1.5 billion USD a maturity of 10 years and a 6.75% coupon was oversubscribed by around 4.5 times. Against the background of a positive performance of the USD Eurobond yield and of a decreasing risk aversion, MoPF reopened the initial USD issuance at the end of February 2012, obtaining an additional amount of 750 million USD, considering a decreasing yield by 0.42%. This reopening was around 4 times oversubscribed.				
3.5 Even distribution of GPD servicing				***Importance: Medium***
The decisions regarding the contracting of public debt took into account an even distribution of the GPD servicing and aimed at avoiding annual and monthly peaks.				
3.6 Credit risk				***Importance: Medium***
The credit risk is limited to the exposures attached to the guarantees that have been issued and the on-lending by MoPF, which are reimbursed from the own resources of the economic agents. At the end of Q1 2012, this indicator stood at 0.01%. Currently, MoPF does not use any hedging instruments for the risks attached to the debt management, therefore it is not exposed to a direct counterpart risk.	% payments from the risk fund for the repayment of guarantees and sub-loans, in GDP	-	0.03	0.02
3.7 Interest rate risk				***Importance: Medium***
The share of fixed debt in total debt went up due to fixed debt issued on the domestic market, the Eurobonds and the drawings from the loans contracted under the package concluded with IMF, WB and EU. At the end of Q1 2012, the fixed debt accounted for 59.4% of the total GPD.	% fixed debt in total GPD	-	52.1	54.9
3.8 Operational risk				***Importance: Medium***
Update GPD database in debt management IT systems. Continuous training of staff involved in debt management.				
4. Development of the government securities market				***Importance: High***
4.1 Primary market of government securities				***Importance: High***
The good performance of the Romanian Government in implementing structural reforms and consolidating tax and budget policies improved Romania's credibility and helped reducing the financing costs, despite highly volatile domestic markets in the second part of 2011. In order to develop the primary market of government securities, MoPF took the main following actions: a. Publish the annual calendar, the quarterly announcements and the monthly prospectuses for the government securities issued on the domestic market; b. Adjust the government securities' amount in line with market requirements, taking into consideration the investors' expectations; c. Increase the liquidity of government securities by increasing the amount of benchmark bonds through monthly reopenings in response to the investors' appetite.				

4.2 Secondary market of government securities	Importance: High
Starting in January 2011, the National Bank of Romania started to publish daily, on its website, the reference rates of the government securities. At the end of Q1 2012, commercial banks continued to hold over 60% of the government securities issued on the domestic market (69.2% of the total securities in lei and 66.9% of the securities in Euros) while the government securities held by non-resident investors were lower[1] (11.1% in lei and 17.6% in Euros). As of July 2011, Piraeus Bank Romania became the first Market Maker for three new benchmark bonds on the BSE regulated market.	

2.5 Government guarantees

In 2011, The Government through MoPF, continued to implement the government programs by issuing government guarantees intended to stimulate the economic recovery. No guarantees have been issued to economic operators during this interval, and the exposure of the First Home Program went down last year after the amount of guarantees issued to commercial bans was cut by 50% as a move to equally distribute the risks between the Government and the financing institutions.

Table 2: Guaranteed Government Public Debt

Million RON

	2010	2011	31-Mar-12
1. Government Guaranteed GPD	*14,858.9*	*11,104.1*	*11,460.8*
a) Companies	7,161.2	6,125.1	6,195.9
b) Banking system (special laws)	1,742.2	200.6	201.1
c) Government Programs	5,955.5	4,778.4	5,063.8
of which:			
I. First Home	5,955.5	4,684.8	4,970.0
II. Kogălniceanu Program	0.0	17.2	17.4
III. Support Program	0.0	76.4	72.7
IV. Thermal rehabilitation of buildings	0.0	0.0	3.7
2. Guarantees issued in the year of reporting	*5,251.1*	*1,745.6*	*426.3*
a) Companies	1,302.9	0.0	0.0
b) Banking system (special laws)	0.0	0.0	0.0
c) Government Programs	3,948.2	1,745.6	426.3
of which:			
I. First Home	3,929.3	1,670.7	426.2
II. Kogălniceanu Program	0.0	17.1	0.1
III. Support Program	18.9	53.7	0.0
IV. Thermal rehabilitation of buildings	0.0	4.1	0.0
Source: MoPF			

In 2012, MoPF plans to issue government guarantees for:

- Strategic projects having a multiplication effect on the economy: the Nabucco Project or other projects in the energy sector;

[1] Include government securities deposited in Clearstream

- Co-financing the EU-funded projects and projects financed by other multilateral financing institutions (approved ceiling: 0.3 billion Euros);
- The First Home housing purchase program (approved ceiling: 0.75 billion Euros);
- The SME support Kogălniceanu Program (approved ceiling: 1.2 billion RON)
- Loans for the thermal rehabilitation of buildings (approved ceiling: 0.20 billion RON);
- The government program on various measures for the improvement of residential parks in terms of architecture and environment requirements (approved ceiling: 0.2 billion RON).

3. Macroeconomic and financial assumptions for the 2012 – 2014 debt strategy

Permanent monitoring of macroeconomic and financial developments on domestic and foreign markets is crucial in respect of debt strategy decisions and implementation. This section is a review of the macroeconomic and financial assumptions on which this strategy was based.

3.1 International background

The approval of a second bailout package for Greece, the tax adjustment measures secured by some European states and the decisions made by European leaders as a move to work against the sovereign debt crisis (the fiscal pact and the increase of EFSF resources) helped reducing the risk of severe episodes and led to a stabilization of the financial markets. But despite all the above, the risks in respect of future developments remain high.

Investors' confidence picked up and this is reflected by the increase of the share markets early this year and the reduced pressure on the sovereign bond yields, while the spreads remain high for some states in the Eurozone. The confidence in the financial sector showed signs of recovery, and the performance of risk premiums is a confirmation, despite the levels which are still high from a historical perspective.

Economic performance outlook shows significant differences among regions, and the disconnection between the economic growth in the US versus the Eurozone has been obvious. At the same time, the variations in the economy are visible on the labor market as well. Thus, in USA, the unemployment rate continued on a descending trend, while in the Eurozone the average unemployment rate started to rise again (showing significant differences across the states).

The economic growth is expected to slow down in the emerging countries too, reflecting worsening exports (following a decrease in the demand of the developed countries), a decrease of capital flows and a reduced domestic consumption in the main emerging economies. Various counter-cyclical measures have already been taken by some of the emerging countries, as they hold sufficient instruments to stimulate economic growth through both the monetary levers and the fiscal and budget-related measures.

Foreign developments are particularly important in the case of Romania, considering the economic and financial connections, the domestic economy performance being more sensitive to the economic performance of its main foreign commercial counterparts.

In order to reach the main strategy objectives and support the financing decisions, the following foreign factors are very important in respect of the government public debt management:

- the interest rates for the currencies in the foreign debt portfolio, the most relevant in the Eurozone and USA;
- the sovereign debt crisis in the Eurozone and the risk seen by investors as attached to this investment area;
- investors' risk perception of the Romanian trustworthiness, namely the spread of the risk category of the government issuances;
- the performance of the European banking sector and the banks' strategy with respect to the exposure on the East European countries;
- the competition in attracting investors, considering the increasing financing needs of the countries in the Eurozone and in the region, given the past years' budget deficits.

Eurozone

Recent EC estimates regarding the economic performance of the Eurozone show a slight recession, with a contraction of 0.3% expected in 2012. The poor performance in the first half of the year could be followed by a moderate economic recovery in the second half, with both consumers and investors becoming more confident.

The economic performance across the Eurozone is significantly different. The outlook is positive for Germany, France, Austria or Finland, while the economy is expected to slow down not only in the Eurozone border states, but in other states as well, such as Netherlands and Belgium. The fiscal consolidation measures adopted by some member states, which are crucial in the efforts to restore the investors' confidence, negatively affect the economic growth despite the monetary relief measures adopted by CEB.

While ECB provided liquidity through the 3-year LTROs to the banks, the private loan market continued to deteriorate, though a sharp contraction was avoided. In addition to worsened credit terms, the low credit demand added to this picture.

At the same time, the European Bank Authority expects banks to fulfill the new capital requirements at the end of June 2012, without resorting to significant asset sale (deleveraging). However, the risk to see the European banks reducing their assets is still present, given the fairly high indebtedness level of these banks compared to US and the emerging countries.

As a move to counteract the sovereign debt crisis and support economic recovery, ECB decided to push the reference interest rate down to 1%. This move has been reflected by the interest rates in the interbank market and the long term swap rates. In the short run, other stimulating measures may come from CEB, such as interest rate cuts or higher loans to the private sector, if the pressure put on debtors in the Eurozone continue to grow or to encourage the economy.

The poor economic performance, the high unemployment rate, the austerity measures, as well as under used production capacities are elements that could counterbalance the increase in prices. At the same time, oil price and tax hikes in some European states generate inflation pressures. To top it all, the gap between the economic performance in Germany compared to the rest of the Eurozone is an additional challenge to ECB when it comes to balancing the anti-inflationist measures with the need to implement measures for supporting the recovery of the other economies in the Eurozone.

According to statements released by ECB representatives, the central bank does not intend to withdraw the short term stimulating measures and, if necessary, it is prepared to take action, by using specific instruments, against the inflation. Given the tax consolidation measures that must be implemented in some states, the modest economic growth expectations and the persisting worries regarding the debt sustainability of some member states, a long period of time with low interest rates is expected, in parallel with a continuing high level of liquidity in the system. At the same time, the maturity of long term loans extended by ECB to the banks in the system starting at the end of 2014, may put pressure on the banks to find financing alternatives.

USA

In US, the positive performance of the labor market and the improvement in the consumers' feelings reflected in an increase of domestic consumption, supported the economic activity. At the same time, recent data regarding the industrial output, the increase in private crediting and car sales showed an intensification of the economy.

Across G7, USA shows the best outlook in terms of economic growth in 2012 and 2013, namely 1.8% and 2.2%, respectively, according to the IMF estimates in January 2012.

The positive economic performance in the USA has been supported by the stimulating measures adopted by the government, which led to a budget deficit and debt increase. This has caused the S&P decision to lower the US rating in August 2011 from AAA to AA+, but the consequence was limited by the tensions in the Eurozone and the lack of comparable alternatives of the institutional investors.
In addition, as a move to support the economic recovery, the central bank (FED) decided to maintain the reference interest rate within the 0 – 0.25% band, as of December 2008, at the same time resorting to long term government bonds purchase programs (QE - Quantitative Easing). Considering the positive economic developments, FED decided not to reactivate a new bond purchase program, a decision on this matter to be taken in the future depending on the economic and inflation performance. At the same time, FED reaffirmed its commitment towards preserving the reference interest rate close to zero, at least until the end of 2014.

The positive economic data, as well as the FED decision not to start a new government bond purchase program, led to higher long term yields for the government securities, without a clear trend for the moment.

3.2. Macroeconomic background in Romania

The financing needs (which are generated primarily by the deficit of the general consolidated budget and the refinancing needs of the government public debt) and the exchange rate of the domestic currency against the main foreign currencies in GPD portfolio are the main macroeconomic indicators driving the amount of government public debt. The actual GDP growth and the evolution of prices affect the debt share to GDP, as well. The main factors impacting the debt cost include the interest rates and the exchange rates.

Romania's ratings by Standard & Poor's (BB+), Fitch (BBB-), Moody's (Baa3) and Japan Credit Rating Agency (BBB-), all of them showing the outlook stable also influence the cost of financing.

Macroeconomic assumptions for the debt strategy are included in the below table:

Table 3: Macroeconomic assumptions for the 2012 – 2014 debt strategy

Indicator	*2012*	*2013*	*2014*
Nominal GDP (billion RON)	607.6	649.0	694.4
GDP – actual growth (%)	1.7%	3.1%	3.6%
General government deficit (% GDP)	-2.2%	-1.8%	-1.4%
Inflation (year end)	3.5%	2.8%	2.5%
Average EUR/RON rate	4.40	4.37	4.35
Average USD/RON rate	3.37	3.34	3.32

Source: NCP, MoPF

A 1.7% economic growth is expected in 2012(EC spring forecast: 1.4%), decreasing from the level forecast in autumn, due to uncertain financial market performance and the persisting worries regarding the sovereign debt sustainability in the Eurozone. In addition, the economic performance in the Eurozone will have consequences of the Romanian exports in the region, reflected by the economic activity.

Domestic demand will be the main growth driver, with unemployment and inflation expected to go down, which will have a positive effect on the population income and the private consumption, respectively. Public sector investments supported by an improved EU funds absorption rate will also help the economic activity.

However, the fiscal consolidation measures will limit the contribution to government expenditures to the GDP growth. At the same time, private investments may go down due to high domestic and international uncertainties.

An economic performance under expectations may be caused by the financial market developments and the sovereign debt crisis in the Eurozone, as well as the poor performance of the domestic consumption, generated by the worsening credit terms or the population incomes.

The economic growth is expected to be moderate during the interval considered by this Strategy, depending on the economic performance in the Eurozone.

The budget deficit assumed by the Government for 2012 is 2.2% of GDP (in cash terms) in line with a level below 3% of GDP according to EU methodology (ESA95). The deficit target is far below the 3% level committed in the Fiscal and Budgetary Strategy approved by the Government in August 2011. The adjustment in the deficit target took into account the tensions of an unpredictable international context and the domestic and foreign financing constraints.

Since on March 2, 2012 Romania joined the Stability, Coordination and Governance Treaty of the Economic and Monetary Union, which aims at strengthening the fiscal discipline and introducing a more strict supervision in the Eurozone, particularly through the budgetary position rule, the budget deficits may be further adjusted in the upcoming years to reach the medium term budget objective for 2013-2014. In the longer run, the 0.5% of GDP ceiling of the structural deficit will drive a significant decrease of the public debt (in terms of share to GDP).

The fiscal consolidation process and maintaining the budget deficit below 2.5% in cash terms and below 3% according to EU methodology is expected to continue throughout the time interval covered by this Strategy.

The basic scenario in respect of inflation[2] assumes a continuation of the disinflation process in the first part of 2012, followed by an increase in the second part of the year, with the inflation level to remain, at year-end, within the NBR targeted band (3% ± 1 percentage point). At the same time, for 2013 - 2014, NBR projected a inflation rate target of 2.5%.

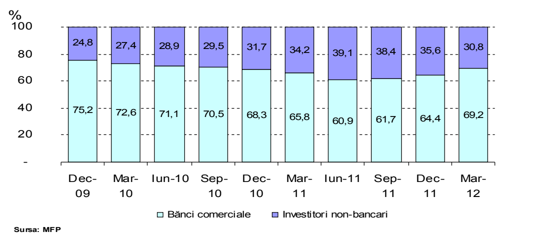
The main foreign risks with an impact on the inflation conduct are related to the persisting fears regarding the sustainability of sovereign debts in the Eurozone, the possible political changes following the elections in the European States, Greece possibly leaving the Eurozone and the political and social turmoil in the Middle East. Such events will cause a hike in the financial market tensions and the investor risk aversion, with an impact on the cost and the access to foreign financing and a potential depreciation of the exchange rate. The escalating tensions in the Middle East may substantially push the oil price up, which will be reflected at domestic level by an increase in fuel prices and production costs.
On the domestic market, the risks attached to the administered prices evolution and those related to the implementation of the fiscal policies and the structural reforms may cause deviations in the basic inflation scenario.

During the time interval covered by this Strategy, the domestic currency is expected to follow a steady path compared to Euro, supported as well by the current account deficit of the payment balance.

3.3 The market of government securities

An important objective in the Strategy is to develop the domestic market of government securities, given its potential role in attenuating the foreign shocks and providing a sustained demand of government securities. The increase of non-bank and non-resident investor share is an important strategic target during the interval under consideration.

Chart 17: Government securities holdings in RON issued on the domestic market



With regard to government securities in lei issued on the domestic market, the share of non-bank holdings in total issuances have fallen from 32% at the beginning of 2011 to 30.8% at the end of Q1 2012. The peak for non-bank customers was reached in June 2011 (39.1%).

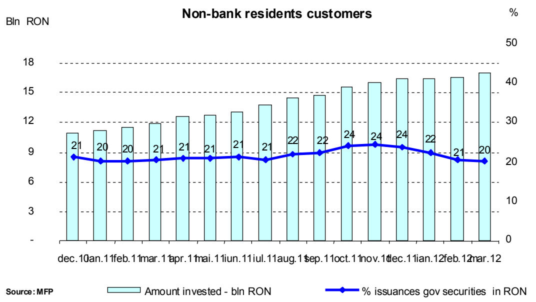
Thus, starting with the second half of 2011, with the sovereign debt crisis deepening in Europe

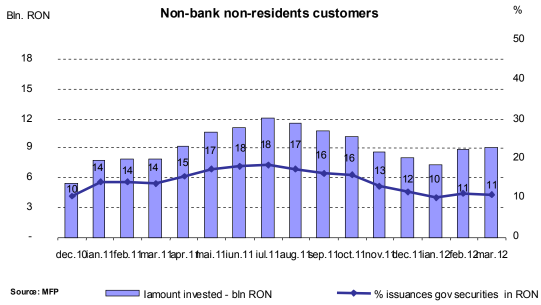
[2] NCP springtime 2012 forecast

and the expectations regarding the yields dropping for lei coming true, the holdings of non-residents started to go down (from around 12 billion RON in June 2011, to 8 billion RON at year-end), to pick up slightly in the first quarter of 2012 (up to 9.3[3] billion RON).

The lowered exposure of non-resident investors for government securities denominated in RON was offset by the investments of the domestic commercial banks and non-bank resident investors, with their holdings going up by 45% and 23%, respectively, in the interval July 2011 - March 2012.

Chart 18: Non-bank customers' holdings of government securities[4] in RON





Domestic commercial banks

The banking sector investments in government securities depend on the economic cycle and the capital adequacy restrictions and the maturities preferred are fairly short.

Given a persisting low credit appetite in the Romanian economy in 2011, against the background of the economic crisis and the lowered indebtedness capacity of the population and the private corporate sector, and also due to higher capital adequacy requirements, the commercial banks significantly increased their holdings of government securities in lei, from 35 billion RON at the beginning of 2011, to 57.5 billion RON at the end of Q1 2012.

In order to encourage the trading of government securities in lei on the secondary market and increase the maturities on the primary market, MoPF and NBR, in capacity as agent of the government, will revise the eligibility and performance criteria for primary dealers playing on the domestic market of government securities. Primary dealers shall be assessed annually focusing on their activity on the secondary market and the maturities of the government securities they have been trading.

Resident investors

The development of non-bank resident investor sector, especially the institutional sector, is particularly important in order to provide a steady demand for government securities and extend the maturities of issuances.

[3] Include government securities deposited in Clearstream
[4] Does not include government securities deposited in Clearstream

The higher non-bank domestic investor share has been supported by the pension system reform in the public sector and the newly introduced, starting with, mandatory and optional private pension arrangements. At the end of Q1 2012, SCPPS reports showed that the assets managed by private pension funds amounting to 7.75 billion RON (of which 93.7% in mandatory pensions); these saw a steady increase backed by the collections of monthly contributions and the yields from administration. The contribution rate is currently 3.5% of the participant's gross income, but it will go gradually up to 6% in 2016.

The performance of pension funds industry will play an important part in developing the market of government securities, given the sustained increase of assets managed by private mandatory pension funds and the high share of low risk placements in their strategic allocation, the still underused potential provided by the optional arrangements and the fact that long term placements are preferred in the latter case.

The development of the domestic market of government securities is supported by the development of the investment fund industry, which saw an important increase of the low risk fund segment in the recent years, and the performance of the insurance industry. At the end of Q1 2012, according to AFA reported data, 35% of the assets amounting to 8.6 billion RON of the domestic mutual funds were invested in T-Bills and T-Bonds.

At the same time, with the decreasing interest rates for bank deposits and the fiscal advantage provided by the investments in government securities, the domestic demand for government securities placements in RON of other investor categories (such as retail) is expected to increase, either directly, or through the agency of investment funds.

Non-resident investors

In 2011, non-resident investments on the domestic market have been volatile, influenced by the risk appetite and the tensions in the foreign markets, as well as by the domestic developments.

The improved macroeconomic and financial outlook for Romania, the continuation of structural reforms and fiscal and budgetary consolidation process made room for a significant risk premium cut and lowered yields on the market of government securities in domestic currency, which attracted non-resident investors whose holdings amounted to a maximum of 12 billion RON in June 2011. The maturity of securities purchased by non-residents is fairly short, with the investments occurring in general through carry-trade strategies. The fact that their expectations in terms of yields came true triggered a marking of profits towards the end of last year, but they came back to purchase in the first quarter of 2012 and their holdings amounted to 12% of the total amount of government securities, given the relatively better outlook of the Romanian economy.

Looking forward, the non-resident investments on the domestic market of government securities will be backed by a positive difference between the interest rates for lei and the interest rates for the main foreign currencies, by the swap rate performance and the increased liquidity on the domestic market of government securities. In addition, if Romania is included in the regional or global indicators of bonds denominated in domestic currency and if the country rating is improved, all this will lead to a significant increase of the non-resident investor interest for the domestic market of government securities in the future.

4. Objectives of the 2012 – 2014 Debt Strategy

4.1 The main strategic objectives in 2012 – 2014

The main objectives set in the debt[5] management strategy for 2012 – 2014 are as follows:

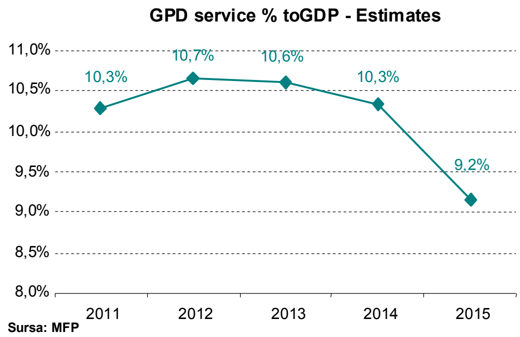
1. Cover the government financing needs and payment obligations, while minimizing medium and long term costs;

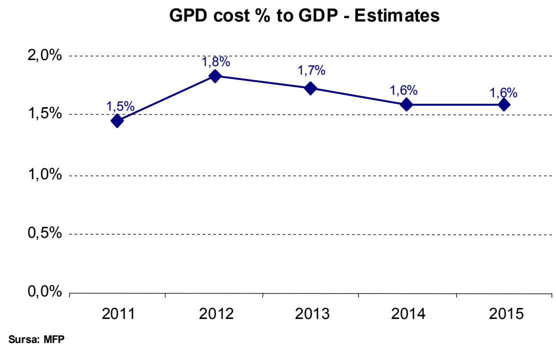
- *Set a ceiling of **1.6%** of GDP for the cost of debt and a ceiling of **10.5%** of GDP for the medium term servicing of the government public debt (in 2014);*

During the time interval covered by this Strategy, due to a consolidation of the interest rate reduction process on the domestic market and the diminished difference between the rates on the domestic market and the rates on the foreign markets, the basis will be created for an optimization of the GPD cost, with the maximum target level of 1.6% of GDP to be reached by end 2014, even though the public debt will be increasing.

In addition, with the diversification of the foreign financing sources and the increase of maturities of issuances on the domestic market, the basis is laid for an optimal distribution of the GPD servicing, so that the objective of maximum 10.5% of GDP will be reached by end-2014.

Chart 19: Estimated GPD cost and servicing as share to GDP*)





*) includes the cost, namely the debt servicing for the debt that is to be contracted in order to finance the budget deficit and refinance the government public debt during the time interval under consideration.

2. Risk limitation in the government public debt portfolio

The limitation of risks attached to the government debt portfolio is an important objective set in this Strategy, aiming at providing an optimal and sustainable composition of the government public debt.

The risks and the attached target indicators will be discussed in Section 5.

3. Development of the domestic market of government securities

[5] According to the national legislation.

The objectives of the domestic market development relate to increasing liquidity, transparency and predictability, as well as reducing the yields of government securities by doing away with inefficiency in the market.

Thus, revising the eligibility criteria of primary dealers (focus on long and medium term tradings of government securities on the secondary market), including Romania in the regional and global indicators of government bonds denominated in domestic currency, and increasing the maturities and amounts of benchmark bonds as a move to meet the needs of institutional investors, all these create the support for developing the secondary market of government securities.

The measures considered for reaching the above objectives are presented in Section 6.

4.2 Strategic orientations and actions to be taken for implementing the Strategy objectives

In order to achieve the objectives of the 2012 - 2014 Strategy, the following actions are considered:

a) a flexible approach in respect of selecting the financing sources (in terms of markets, instruments of currencies used in financing) and the time of issuance. the flexibility in selecting the financing structure is justified by the persisting uncertainties on the financial markets, with the financing decisions made based on an assessment of market terms at the time of issuance and the expected performance of the financial markets;

b) increase the maturity of the debt portfolio and build a balanced maturity profile;

c) combine domestic and foreign market sources in a balanced manner to finance the budget deficit. the domestic market will continue to be the main refinancing sources for the maturing issuances. in order to reduce the cost of government securities on the domestic market, consideration will be given to set the benchmark bond coupons as closely as possible to the expected yield rates of such bonds for their lifetime;

d) increase the maturities of issuances on the domestic market, in parallel with consolidating and expanding the government securities yield curve;

e) expand and diversify the domestic market investor base, by increasing the share of non-resident and non-bank investors;

f) access foreign capital markets in a flexible manner, to allow capitalizing on the financial market evolutions. The debt contracted on the foreign markets will aim at the following purposes:

- cover the budget deficit financing needs as well as the refinancing need of the maturing foreign debt;
- diversify the financing sources and the investor base, providing a financing alternative in case of turmoil on the domestic market;
- develop the yield curve for the foreign issuances of the Romanian government and strengthen Romania’s position on the foreign capital markets;
- use the opportunity provided by the loans contracted with the international financing institutions, under favorable interest rate terms and with longer maturities.

g) increase the debt portfolio composition flexibility to allow an active debt management, by increasing the share of negotiable debt to the detriment of the non-negotiable debt. Thus, in 2012-2014, the budget deficit and the refinancing needs will be covered mainly from government securities issued on both the domestic and the foreign capital markets;

h) consolidate the foreign currency financial buffer of the State Treasury, providing the funds to cover the financing needs for minimum four months, in order to allow MoPF to conduct a proper treasury business in times of turmoil in the financial markets.

4.3 Instruments used to implement the Strategy

The debt isntruments under consideration in 2012 - 2014 are as follows:

1. Government securities issued on the domestic market

The T-Bills and Benchmark Bonds, denominated in domestic or foreign currency, will be issued taking into account the market terms at the time of issuance, the targeted composition of the debt portfolio and the ceilings set by this Strategy and the investor demands.

Consideration will be given to increasing the share of medium and long term issuances, as main financing instrument on the domestic market, the targeted share set at **minimum 60%** in total issuances on the domestic market. Treasury Bills will be issued mainly as part of the cash management policy, and to meet the investor demand for short term government securities.

The intention is to consolidate and expand the yield curve of government securities, through benchmark bonds issued on a medium and long term, and later on reopened up to a maximum amount of around 1-1.2 billion Euros, as a move to provide a relatively even distribution of amounts issued for the yield curve and to avoid a massive concentration on a segment of the curve and distortion the yields.

2. Bond issuances on the foreign capital markets

Bonds will be issued on the foreign capital markets in 2012-2013 under the MTN Program, with MoPF considering the opportunity to extend the program beyond this deadline. The expected amount of issuances on the foreign capital markets is 2.6 billion Euros in 2012 (amounts already issued in Q1 accounting for 1.7 billion Euros), 2.2 billion Euros in 2013 and 2.4 billion Euros in 2014.

In order to strengthen and develop the yield curve for the foreign issuances of the Romanian government and taking account of the ceilings set in this Strategy and of the opportunities on the foreign capital markets, MoPF will issue debt instruments denominated in Euro and other foreign currencies, based on a risk-cost assessment at the time of issuance.

MoPF will take actions to build a yield curve for the foreign issuances in Euros and Dollars, and to consolidate its position on the US market. These measures will aim at facilitating the private sector financing from the foreign markets as well, while setting a transparent and reliable price benchmark for the country risk.

3. Loans from IFIs

The purpose of IFI loans is to finance the budget deficits for the account of various budget expenditures (for instance the IBRD result-oriented loan) or development programs (for instance dedicated to the social sector) or Deferred Drawdown Option loans (DDO) to consolidate the foreign currency buffer of the State Treasury.

These loans may provide longer maturities with attractive interest rate terms (compared to the maturities provided by the foreign capital market) baking the efforts made to reduce the refinancing risk and balance the maturity composition of the debt portfolio.

4.4 Instruments used in the GPD portfolio management

The financial isntruments used to manage the government public debt portfolio are as follows:

1. Instruments used in MoPF tradings on the secondary market

For the purpose of having the government securities liquidity concentrated in an optimal number of benchmarks, in line with this Strategy provisions, in parallel with a proper refinancing risk management, MoPF will use bond exchange operations (exchanging the government securities with a remaining maturity broadly under one year, for longer maturities) and buy-backs, by repurchasing in advance the maturing issuances when the available funds allow this transaction.

In addition, for the purpose of reducing the cost of the government public debt, the possibility to repurchase the non-liquid issuances with a low nominal value and a high coupon will be considered, based on an efficiency assessment of this type of operations. Moreover, in order to increase the activity of the secondary market of government securities and boost its market efficiency and liquidity, MoPF considers the opportunity of direct tradings of government securities and repos.

2. Risk management instruments

For a proper currency risk and interest rate risk management, this Strategy provides for the establishment, by the end of 2012, of the contractual, legislative (third level legislation), methodological and technical framework for using derivatives (forwards, currency swaps and interest rate swaps), with domestic financial institutions and foreign institutions as well.

Derivatives used as hedging tools provide flexibility in adjusting the debt portfolio profile in a rapid and efficient manner.

5. Risk management Strategy

The management of risks attached to the debt portfolio takes into account the following risks: refinancing risk, currency risk, liquidity risk, interest rate risk, credit risk, operational risk.

It is crucial, when it comes to providing the sustainability of the debt portfolio, to properly build the government public debt portfolio taking into account the risk factors. In addition, a balanced debt structure helps controlling the financial risks in the doemstic economy, playing an important part in the prevention and attenuation of economic and financial crises and providing a stability factor to the domestic financial industry considering its exposure to the sovereign debt.

The presence of various risks in the debt portfolio structure is generated by the country's economic and financial state of development, as well as the development of the domestic market of government securities and the investor base, with keeping risk at a sustainable level being very important under the current circumstances.

The long term objective aimed at providing a proper composition of the debt portfolio is to develop the domestic market of government securities and build an investor base for the long term debt denominated in domestic currency.

The assessment of the risk attached to the debt portfolio involves the assessment of risks attached to other sectors than the debt portfolio as well, such as the imbalances in the domestic financial system and the elasticity of exports with the fluctuation of exhange rates. The assessment is aimed at both the direct GPD and the potential impact of guarantees issued by MoPF under the influence of risk factors.

Risk management requires the permanent monitoring and assessment of risk factors, taking into account the debt portfolio composition and the expectations related to future performances. The propsoed scenarios take into account the market risk factors (such as the exchange rate) and the economic risks, with the impact and likelihood thereof being considered for the debt portfolio and at macroeconomic, budgetary level. The scenarios are aimed at identifying any potential changes in the cost of debt under the impact of risk factors and of any difficulties that may appear in the debt management process (refinancing and liquidity issues). The conclusions are submitted to MoPF management and are the foundation of any financing decisions during the year.

Various ceilings are established in respect of the portfolio composition, for the purpose of managing the risks attached to the debt portfolio. These ceilings define the targeted composition of the GPD portfolio resulting from a cost-risk analysis and take into consideration factors such as the size of GPD, the flexibility of the debt portfolio composition, its sensitivity to economic and financial risks, in other words the constraints trigerred by the development of the domestic market of government securities.

The ceilings may be revised from time to time, as a response to the market developments and structural economic changes, but any revision due to short term market movements should be avoided. Any deviation from these ceilings is reported to the MoPF management, with remedial decisions to be taken following an assessment of the causes and the market conditions.

5.1. Refinancing risk

This is the most important risk being monitored at the debt portfolio level, as it is the element of reference for the MoPF issuance policy.

The action of managing the refinancing risk requires the following measures:

- *limit the share of debt maturing within one year in total GPD (exclusive of borrowings from the state treasury general current account) to **25%** on a medium term*

The time horizon for this ceiling is 2014, but revising is possible depending on the market developments. This ceiling gives consideration to the relatively short maturity of government securities issued on the domestic market, which is dependent on the market development stage and the investor demand, as well as on the borrowings from the GCAST available funds (around 15% at end- 2011), short-term debt instruments.

For the purpose of reducing the short term debt share, consideration is being given to increasing the average maturity of issuances on the domestic market and to gradually replace the GCAST borrowings with securities issued on the domestic market.

- *Set a lower ceiling of **4.5 years** for the average remaining maturity in the debt portfolio (exclusive of borrowings from GCAST) and a lower ceiling of **2.0 years** for the average remaining maturity of medium term government securities issued on the domestic market*

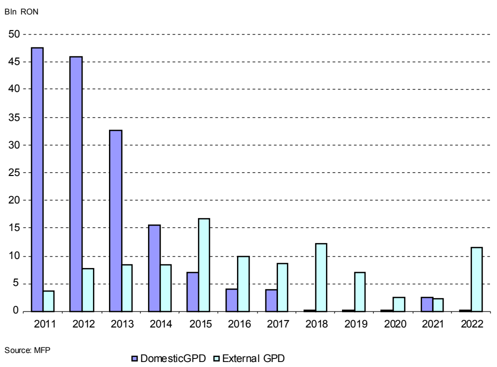
These two indicators at end 2011 stood at 4.1 years (exclusive of borrowings from GCAST) and 1.6 years, respectively. The lower ceilings set for 2014 take into consideration both the current maturity profile and the objective related to the gradual maturity increase for the new issuances on the domestic and foreign markets.

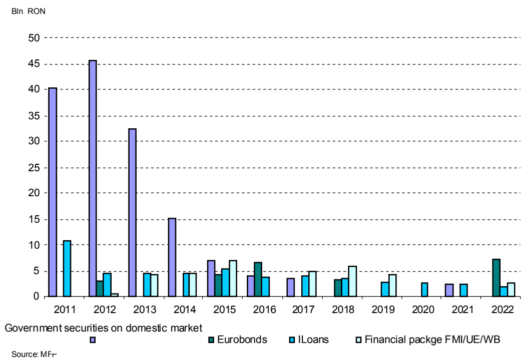
- *The most even distribution of repurchases of government securities / repayments of principal of loans forming the government public debt*

The debt contracting and issuing policy shall target a distribution of maturities allowing to avoid payment peaks in a short lapse of time in order to keep the refinancing risk under control. The benchmarks issued on the domestic market will be reopened up to an amount of 1-1.2 billion Euros.

Chart 20: Principal repayments schedule *)

*) a projection founded on the GPD contracted at March 31, 2012, it does not include the borrowings from GCAST available funds





- *Gradual reduction of borrowings from the state treasury general current account*

In the previous years, the purpose of GCAST borrowings was to temporary refinance the state budget deficits and the deficits of social security funds. Given its specific financial terms, namely the short contracting term and the floating interest rate, this financing instruments is a concern in terms of refinancing risk and interest rate risk.

The amount of borrowings from GCAST was 31.8 billion RON at the end of 2011, with MoPF intending to repay these loans within 10 years by issuing on the domestic market an increasing amount of government securities every year (around 3.2 billion RON annually), for refinancing purposes. As these borrowings are reimbursed, the funds available in GCAST will be actively managed by using placements.

- *bond-exchanges and buy-backs will be used to repurchase benchmarks with a short remaining maturity and replace them with medium and long term issuances*

These operations will give investors the possibility to exchange the issuances that are close to maturity and/or with low liquidity for other, more liquid benchmarks, as a move to adjust the maturity profile in line with the objectives set in this Strategy.

5.2. Currency risk

The currency risk is highly important, given the fairly large share of foreign currency debt in total GPD (51.9% in 2011 and 52.5% at the end of Q1 2012). The amount of foreign currency debt increased mainly as a result of the long term financing from the foreign markets aimed at reducing the refinancing risk (taking into account the low demand of the domestic market for long term issuances) and also as a consequence of the foreign financing package contracted with IMF, EU and WB.

The currency risk is somehow kept under control by the large share of the Euro-denominated debt in total foreign GPD (78% in 2011 and 72% at the end of Q1 2012). The use of Euro as the main foreign financing source is justified by the postion of the Euro zone as the main commercial partner of Romania in the international commerce, as well as by the high share of this currency in the government's foreign currency reserves, in foreign direct investments and in the non-resident portfolio investments, as well as in the Romanian citizens' remittances. At the same time, the drawings on European funds may be an important source of foreign currency for the purpose of repaying the foreign debt.

In addition, the Euro currency is preferred as a foreign financing solution since part of the fiscal revenues are adjusted based on the EUR/RON exchange rate. Looking ahead, once Romania will adopt the European currency, the currency risk will be substantially diminished due to the high share of this currency in total foreign debt.

The currency risk attached to GPD portfolio is monitored in order to assess the potential impact of the domestic currency depreciation against the other foreign currencies in which the contracted foreign debt is denominated, on the level of debt and the financing costs. Moreover, the currency risk is monitored in respect of the non-resident investments on the domestic market of government securities, since the decisions made by these investors may cause substantial exchange rate fluctuations.

The sustainability assessment of the foreign GPD takes account of other factors such as short, medium and long term foreign debt in different sectors of the economy, the performance of exports and of the balance of payments, as well as the currency position of the financial sector.

The 2012-2014 debt strategy will create de framework that will allow derivative transactions for currency and interest rate risk management purposes; derivatives will be conducted with both domestic and international financing institutions.

The currency risk management involves the following actions:

- *limit to **50% on the medium term** the share of foreign currency GPD in total debt*

Compared to last year, this ceiling was lowered by 5 percentage points, a decision made as a move to increase the share of issuances on the domestic market and to replace some of the maturing Euro-denominated issuances on the domestic market with domestic currency debt.

The substantial depreciation of the exchange rate or the difficulties to obtain financing from the domestic market, against the background of turmoil on the domestic market, could lead to temporary deviations from the targeted ceiling.

For this reason, the medium term objective is aimed at reducing the foreign debt share, primarily for the reasons listed below:

a) the relatively low share of revenues/assets denominated in other currencies, which creates a net currency exposure;
b) the depreciation trend of the domestic currency in times of financial crisis/recession, increasing the amount of debt and the cost thereof;
c) as a long term trend, the negative connection between the domestic currency interest rates and the domestic economic cycle favoring the loans in domestic currency.

- *Set a minimum **75%** ceiling for the Euro-denominated GPD in total foreign currency debt*

The majority share of the European currency in total foreign currency GPD is given by the important role of the Eurozone in international commercial relations, by Romania’s commercial relationship with the Member States of the Eurozone and Romania’s plans to join it.

Over the past 3 years, the share of Euro currency debt in total foreign currency GPD remained constantly above 70%, with 81.9% exposure at the end of 2011. At the same time, since at end-2011 around 10% of the foreign GPD was denominated in SDR, the influence of the European currency on the foreign debt is even higher.

Euro will remain the main currency for contracting the foreign debt in the upcoming period, with any decisions to contract debt in other currencies depending on the performance of interest rates in the Eurozone, the access to financing on the Eurozone market, and the arbitration opportunities provided by other currencies (for instance, depending on the financing costs and the swap rates, sometimes contracting debt in USD and later use a currency swap to convert this debt into EUR may prove less costly than contracting directly in Euros).

The 50% ceiling for the debt contracted in Euro in total debt was removed, given the increased minimum share of domestic currency debt to 50%.

- *Use of derivatives (currency swap)*

While so far MoPF has tried to limit the currency risk at the time of debt contracting / refinancing, in 2012-2014 consideration is being given to an active risk management involving the use of derivatives, in accordance with the public debt legislation. To this purpose, until the end of 2012, the framework will be finalized to allow MoPF to work with derivative financial instruments. The purpose of these instruments will be to reach the target currency composition in terms of domestic vs. foreign currency as well as in the foreign GPD portfolio.

5.3. Interest rate risk

GPD cost is directly influenced by interest rates of the currencies in which the debt has been contracted, the future interest rates for contracting / refinancing the fixed debt and the interest rate on the floating debt reset dates.

At the end of 2011, the floating debt accounted for 45.2% in total GPD, after having been on an constantly decreasing trend over the 4 previous years (in 2008, the share of floating debt was 68.7%). In Q1 2012, the floating debt share in total GPD went down once again, to 40.6%, as a result of new medium and long term government securities issued in RON and USD. In total floating debt, the loans in lei accounted for 75% (including borrowings from GCAST), with the difference in floating debt contracted in foreign currency (mostly Euro).

Taking into consideration that the reference interest rates in the Eurozone as well as in the US are now at historical minimum levels, the cost of foreign loans with floating interest rates may go up in the future.

In order to reduce the interest rate risk and increase the predictability of the GPD cost, consideration is being given to the following measures:

- *Set a target band for the indicator average time until next re-fixing for the GPD portfolio, without temporary financing, between* ***3 and 4 years,*** *in parallel with setting a maximum ceiling to GPD expected to change coupon in one year (re-fixing at 1 year) to* ***40%*** *of total GPD*

The deadline for both targets mentioned above is the year 2014, and for obtaining the desired composition consideration is being given to changes in the financing program structure and derivatives.

At the end of 2011, the average time to next re-fixing (exclusive of borrowings from GCAST) was 3.2 years, and at the end of Q1 2012 it went up to 3.3 years.

- *Increase fixed GPD issued on medium and long term*

Financing operations on the domestic market will focus on an increase of benchmarks, and in respect of the foreign debt, fixed bonds will be issued to refinance the loans maturing in 2012 - 2014 and fixed rate IFI loans will be accessed.

- *Use of derivatives*

The infrastructure that will allow the use of derivatives is to be finalized by the end of 2012. Derivatives provide increased flexibility in shaping the debt portfolio profile, and in selecting the financing sources (negotiate better terms for floating debt that may be swapped to fixed interest rate debt instruments at a later stage).

5.4. Liquidity risk

The performance of the State Treasury liquidity position is influenced by several factors, but the most important is the government budget deficit and the success of the issuances aimed at financing the budget deficit and refinance the maturing debt. Under the circumstances, preserving a liquidity buffer allows the government to meet its payment obligations, and at the same time provides the necessary flexibility to cope with any possible turmoil on the financial markets, at times when access to financing is more difficult of very expensive.

The management of liquidity risk requires the following actions:

- *continuously monitor the government financing needs and the performance of budget revenues and expenditures*

This involves estimating the future performance of revenues and expenditures, considering their seasonality (revenues from direct taxes or VAT, wage expenditures etc).

- *consolidate the MoPF's foreign currency financial buffer covering, equivalent to around* ***4 months*** *of budget deficit and government debt refinancing needs*

This buffer allows improving the financing program by an even distribution of government securities and provides flexibility in difficult times experienced by the financial markets.

- *link the maturities of government securities to the cyclical nature of budget collections*

- *temporary financing solutions: issue T-Bills, attract deposits from domestic banks or borrowings from the general current account of the state treasury*

- *use preventive financing*

On June 12, the WB Executive Board approved an a 10-year DPL-DDO loan in amount of 1 billion Euro for Romania. This loan is part of the fiscal buffer consolidation effort and it is viewed by the Romanian authorities as an instrument that will protect the public finances against any sudden foreign shocks.

Draw on the amounts available to the Romanian government under the preventive agreement with IMF and EU (in amount of around 5 billion Euros), in the event of a significant worsening of the foreign payment balance and of a considerable and unexpected deterioration of the economic situation and/ or financial situation, caused by factors that are not under the control of the Romanian authorities and leading to an acute financing deficit

The liquidity of placements made as part of the active management of GCAST funds and the liquidity of positions opened by the use of derivatives are taken into account for liquidity risk purposes.

5.5. Credit risk

Credit risk management takes account of both government guarantees / on-lending and the exposures generated by the transactions initiated by MoPF.

Credit risk management involves the following actions:

- *introduce strict evaluation criteria for the issuance of guarantees / on-lending, in parallel with a periodic review of the beneficiaries' financial position and of the impact of such guarantees / on-lending on the government financial position (including the liquidity position)*

A risk fund is established to hedge against financial risks attached to government guarantees and on-lending. The sources for this risk fund are:

a) fees[6] collected from the beneficiaries of on-lending / guarantees;

b) the amounts collected from the beneficiaries of guarantees / on-lending in principal, interest, fees and other costs attached to the loans or sub-loans reimbursed by MoPF on behalf of the beneficiaries;

c) interest payable for funds in the risk fund.

The guarantee-related payments made by MoPF amounted to 0.02 – 0.03% of GDP over the past 2 years; a comparable level of payments is expected in the upcoming period of time, taking into account the solid financial position of the beneficiaries and the fact that over the recent years most guarantees were issued under the "First Home" housing programme with a very low default rate.

In order to reduce the risk attached to guarantees/ on-lending operations, and to cut the budgetary risk resulting from the payments that MoPF should make under the guarantees issued in accordance with Public Debt GEO 64/2007 the following ceilings were approved in the medium term fiscal and budgetary strategy:

Table 4: Guarantee ceilings approved for 2012 - 2014

- billion RON -

	2012	*2013*	*2014*
Guarantees*) issued by MoPF and TAU	10.0	6.0	6.0

* The 2013 -2014 ceiling for the guarantees issued by TAU and by the government through MoPF will be adjusted in the event that the Nabucco project starts, requiring Romania to issue a government guarantee;

- *set counterpart ceilings for cash management operations, namely selection of financial institutions based on their creditworthiness (rating and outlook, financial solidity of the parent bank in respect of domestic financing institutions etc.)*

In order to manage counterpart risk the government securities-backed placements will be prioritized.

Given MoPF's intention to use derivatives for hedging purposes, the legal and methodological framework will include procedures and norms aimed at assessing the counterpart credit risk.

- *set counterpart ceilings for the use of derivatives and specific hedging techniques (such as netting operations).*

5.6. Operational risk

[6] Set following a risk assessment of the beneficiaries of guarantees / on-lending.

The operational risk is related to any potential loss generated by a mismanagement of internal processes and systems, human errors, inefficient internal control procedures or foreign events. Operational risk includes legal risk and reputational risk.

Operational risk management requires the following:

- *Front Office, Back Office and Middle Office internal working procedures;*
- *monitoring, assessment and management of the operational risk attached to the internal procedure;*
- *database updates and full implementation of the debt management IT application (including provisions regarding the guarantees issued under various government programmes);*
- *qualified legal counsel for contracts and operations conducted by MoPF as part of the government public debt management.*

6. Measures taken to develop the domestic market of government securities

The development of the domestic market of government securities is a strategic medium and long term objective, with the lines of actions aimed at doing away with market inefficiencies as a move to push down yields (for instance by eliminating the liquidity premium), increase liquidity, transparency and predictability.

The measures that will be taken will aim at consolidating the domestic market and establishing a large investor base, primarily for medium and long term investment instruments.

The success in achieving this objective depends on both the domestic macroeconomic environment influencing the investors' risk perception, and the implementation of specific measures that will help boosting the attractiveness of government securities across a larger investor range.

A developed and liquid domestic market of government securities and a well-defined yield curve are pre-requirements to a developed financing market of the private sector. This helps attenuating foreign shocks on the economy and provides financing solutions on the domestic market when foreign market financing solutions become difficult and expensive. In addition, building the yield curve will help developing a derivative market, in the long run.

In parallel with developing the yield curve on the domestic market, MoPF is interested in building a yield curve for the foreign issuances denominated in Euro and Dollars, as well as in the consolidation of its position on the US market. These measures will also facilitate the financing of private sector on the foreign markets, in addition to providing a transparent and credible price benchmark for the country risk.

Increase efficiency of government securities

The measures for increasing the efficiency of the government securities market involve actions on both the primary and secondary markets, as follows:

a) *introduce, in the second half of 2012, a system for assessing the primary dealer performance*

Criteria to be used in the assessment of primary dealers' performance include:

- the activity conducted on the primary market, namely the amounts awarded in auctions, measured individually, for each category of financing instruments (treasury bills, medium and long term government securities), the regularity of purchases in auctions and the pricing strategy;
- the activity conducted on the secondary market, namely the amounts awarded in auctions, measured individually, for each category of financing instruments (treasury bills, medium and long term government securities) and depending on the type of customers (final investors or brokers/ dealers) the amount of reversed operations;
- the number of operations conducted on the secondary market, in order to facilitate the distribution to a higher number of investors;
- the marketing activity and the distribution of government securities, namely the efforts made to expand and diversify the investor base in respect of government securities issued on the domestic market;
- the contribution to the safety in conducting transactions on the primary and secondary markets, and the consistency of opinions with actions taken under the operations being conducted;
- the cooperation with MoPF and NBR (in capacity as government agent), consisting in providing market data and analyses, the institutional customers' feedback, the exchange of information, technical and human resources on topics of shared interest.

Primary dealer monitoring is aimed at assessing dealers' contribution to the development of the government securities' market and rewarding the most performing dealers by giving them the right to participate in non-competitive bidding procedures, access to syndicated issuances in capacity as lead managers or book-runners, or by inviting them to attend consultation events on topics such as the debt management strategy or the issuance policy.

The final performance assessment criteria will be decided after discussions with NBR and the primary dealers, this approach being viewed as crucial by MoPF in developing the market of government securities.

b) Consolidate and expand the yield curve on the domestic market of government securities

The following measures are envisaged:

- increase the share of market instruments in financing the debt and use standard financing instruments;
- use benchmarks as main financing instrument on the domestic market; a considerable amount will be secured for each issuance through reopenings aimed at providing liquidity and representativeness on the yield curve;
- consolidate, expand and promote the fixing system organized by NBR as a reference to the domestic market of government securities;
- evenly distribute benchmarks across the yield curve;
- repurchase low and illiquid issuances distorting the yield curve and replace them with liquid benchmarks after an efficiency assessment.

c) *Diversify the investor base by increasing the share of non-resident investors*

The measures to be implemented for the purpose of achieving this objective include:

- regular meetings with non-resident investors on the main foreign markets (other than the presentation road-shows of foreign market issuances) including through ad-hoc meetings upon their request;
- secure considerable amounts for foreign issuances, so that these may be eligible for an increasing number of investors;
- adjust the issuance schedule and the financing solutions based on the investors' feedback;
- identify and remove barriers to investments, of any nature; to this purpose, upon a request by the investor environment, the SAFIR Depository was connected to Clearstream and Euroclear;
- promote Romani's foreign image in conferences and seminars dedicated to investors.

d) *Meetings with investors and participants on the primary and secondary markets of government securities, focused on topics related to the mutual exchange of information and incorporation of investors' demands in the financing programme*

Here we include:

- Regular meetings with primary dealers;
- Meetings with non-bank investors and representatives of pension, investment or insurance funds;
- Meetings with customers upon a request by primary dealers.

e) *Promote the incorporation of government securities issued on the domestic market into global / regional indicators for sovereign bonds and the development of a local indicator for government securities*

f) *Introduce and IT system for electronic auctioning of government securities*

g) *Introduce an electronic trading system on the secondary market, as a move to increase transparency, liquidity and investor base and to monitor the conduct of participants to the secondary market of government securities and the amount of government securities denominated in domestic currency issued on the secondary market*

h) *Promote the role of government securities as a financing instrument through repos or sell-buy backs*

i) *Analyze the opportunity of issuing specific investment instruments for the population, with the purpose of enlarging the investor base, supporting the market of government securities and promoting the long term saving behavior*

Increase the liquidity of government securities' market

The increased liquidity of the government securities' market will help doing away with the premium requested by the investors in the event of insufficient liquidity and attracting a larger range of investors having high liquidity as a criterion in making investment decisions. This should add to reducing the yield of government securities and, by this, to a lower cost of the government public debt.

The envisaged actions include:

- concentrate the liquidity of government securities in a small number of benchmarks to be issued and reopened at a later time, in amount of 1 – 1.2 billion Euros, and provide an optimal distribution in order to avoid refinancing peaks;
- use bond-exchange or buy-back operations to repurchase the government securities with low liquidity drawing to maturity and replace them with more liquid medium and long term issuances; these operations will be organized taking into account the demands of participants to the primary and secondary market of government securities;
- repurchase non-benchmarks with low nominal amount and liquidity;
- direct sell/buy operations conducted by MoPF on the secondary market with the purpose of increasing liquidity and efficiency; MoPF aims at building its own government securities' portfolio, allowing repos or securities lending for the purpose of supporting the activity of market makers;
- adjust the issuance schedule based on the investors' demands; hence, MoPF will be able to organize auctions, outside the announced schedule, on a recommendation by NBR or upon a request by the primary dealers, if there is a demand from the investors.

Increase the transparency and predictability of the government securities' market

A transparent and predictable environment for the primary and secondary market operations with government securities will be able to boost the investors' confidence and help formulating expectations as to future developments.

The measures under consideration for boosting transparency and predictability include:

- update and publish annually the debt management strategy, showing the objectives, targeted composition and observing the established ceilings and the lines of actions for the upcoming three years;
- a transparent issuance policy including the annual and quarterly schedule, and the monthly prospectuses, with details regarding each individual auction;
- the most strict compliance with the announced issuance calendar, with any potential changes in line with the investors' demands;
- introduce an electronic trading system on the secondary market of government securities;
- a continuous dialogue with the participants to the domestic market (primary dealers, pension and investment funds, insurance companies, non-resident investors) to communicate as early as possible the actions under consideration by MoPF;
- the regular and timely publication of information that is relevant to investors in terms of debt amount and composition. This information may be found on the MoPF website (www.mfinante.ro) under the ''Treasury and Public Debt" section.

7. Impact of the 2012-2014 debt strategy on the government public debt

7.1. Public Debt Sustainability Analysis

The public debt sustainability is influenced by the amount and dynamics of the debt stock, as well as by the composition of debt portfolio (in terms of maturity, exposure to currency risk, the fixed / floating debt ratio etc.). In addition, the sustainability of the public debt is dependent on the broad macroeconomic environment and the vulnerabilities of the private sector, particularly in respect of the foreign debt.

For the purpose of assessing the debt sustainability, MoPF conducts regular analyses / simulations of the risk factors and the impact thereof on the debt portfolio. Moreover, the feedback received from the participants on the primary and secondary markets of government securities is highly important when it comes to assessing the sustainability of the public debt.

The measures aimed at building a balanced debt profile with respect to risk factors were described in the risk management section.

This section is dedicated to an assessment of the debt amount and cost performance indicators compared to the other EU Member States, and the analysis of the impact of various risk factors on the debt stock and the attached cost.

As a consequence of the fiscal consolidation measures adopted by the Government, the 2011 budget deficit dropped to 4.1% (in cash), which accounts for a 2.3% decrease compared to 2010, remaining below the 4.4% agreed with IMF and the European Commission. The lower budget deficit and the GDP dynamics (increasing by 10.7% in nominal terms and 2.5% in actual terms) facilitated a limited increase of the debt share to GDP of only 1.4% (according to the national methodology).

Table 5: Public debt indicators

Indicator	***2007***	***2008***	***2009***	***2010***	***2011***
Budget deficit – cash (% in GDP)	-3.1	-4.8	-7.3	-6.4	-4.1
Budget deficit - ESA95 (% in GDP)	-2.9	-5.7	-9.0	-6.8	-5.2
Budget revenues - ESA95 (% in GDP)	35.3	33.6	32.1	33.4	32.5
Public debt according to national legislation (% in GDP)	19.8	21.3	29.4	37.2	38.6
General government debt (EU methodology)					
% in GDP	12.8	13.4	23.6	30.5	33.3
% in budget revenues (ESA95)	36.2	39.9	73.7	91.4	102.7
Interest expenditures according ESA95					
% in GDP	0.7	0.7	1.5	1.5	1.6
% in budget revenues (ESA95)	2.0	2.1	4.8	4.6	4.8
GPD according to the national legislation (% in GDP)	18.4	19.5	27.2	34.9	36.4
GPD servicing according to the national legislation (% in GDP)	2.5	2.8	11.6	9.0	10.3

Source: MoPF, Eurostat

During the time interval covered by this Strategy, we expect the public debt (according to the national legislation) to remain under 40.5% of GDP. The factors with influence on the public debt share to GDP in 2012-2014, including stock-flows adjustments, are given in the above table.

Table 6: Public debt performance – estimates*)

% in GDP	***2011***	***2012***	***2013***	***2014***
Public debt according to the national legislation	38.6	40.2	39.6	38.5
Public debt change (%)	1.4	1.6	-0.6	-1.1
Contribution to the public debt change				
Primary deficit	-2.6	-0.5	-0.1	0.3
Interest expenditures in the general consolidated	1.5	1.7	1.7	1.7

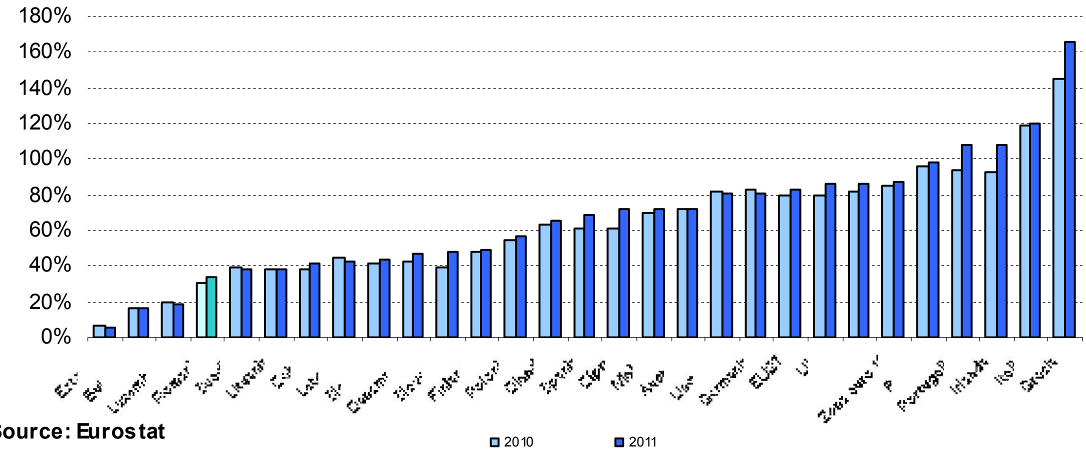
budget				
Stock-flow adjustments	-2.7	-0.6	-2.4	-2.5
Net accumulation of financial assets	1.1	0.6	0.0	0.0
of which: from privatization	0.0	0.6	0.0	0.0
Effects of the assessment and other**	-3.8	-1.2	-2.4	-2.5
Implicit interest rate over public debt (%)***	4.6%	4.6%	4.5%	4.6%

Source: NCP, MoPF
* according to the national legislation.
** exchange rates fluctuation, the fluctuation of the balancing needs of the treasury general current account, operations on behalf of on-lending and government guarantees issued to commercial companies
*** as the annual interest payments / initial public debt stock ratio.

The debt share in GDP, measured according to the European methodology, saw an increase of 2.8% in 2011, and amounted to 33.3%. For the interval 2012 - 2014, against the background of an expected average economic growth of around 2.8% and with budget deficits calculated according to EU methodology (ESA 95) of below 3% of GDP, we expect the public debt share to GDP not to exceed 34.5% (according to EU methodology).

At the end of 2011, Romania was ranking 4th among the EU Member States with low indebtedness levels, significantly lower than the EU average (82.5%) or the Eurozone average (87.4%).

Chart 21: Debt to GDP in 2010 and 2011

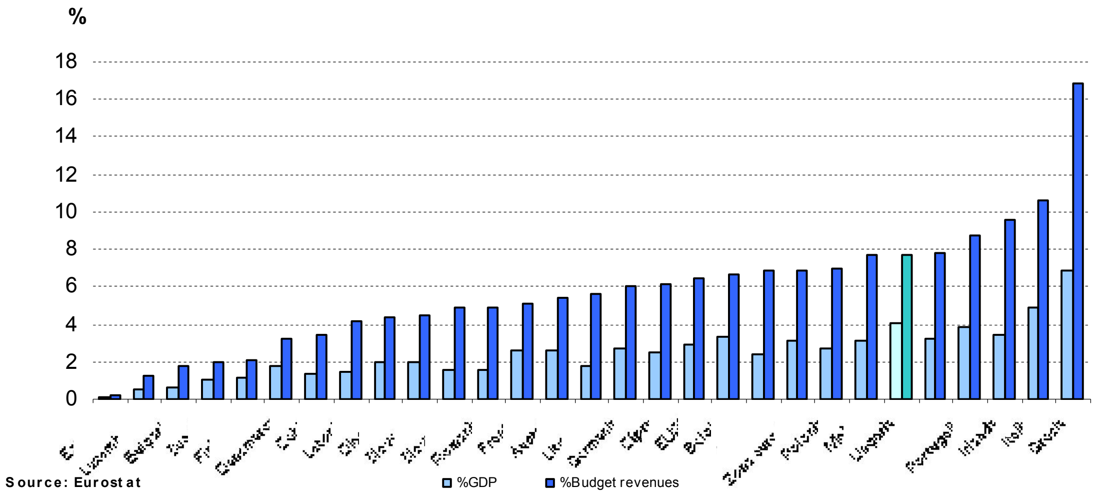


Source: Eurostat

The expenditures with interest attached to the public debt amounted to 1.6% of GDP in 2011 (EU methodology), showing a slight increase compared to 2010. The interest payments share to GDP is significantly lower compared to most European states and compared to the EU average (2.9%) or the Eurozone average (3.1%).

In addition, the share of interest expenditures in total budget revenues amounted to 4.8% at the end of 2011 (EU methodology), showing a slight increase compared to the previous year. EU average at the end of 2011 was 6.5%, and the Eurozone average amounted to 6.8%.

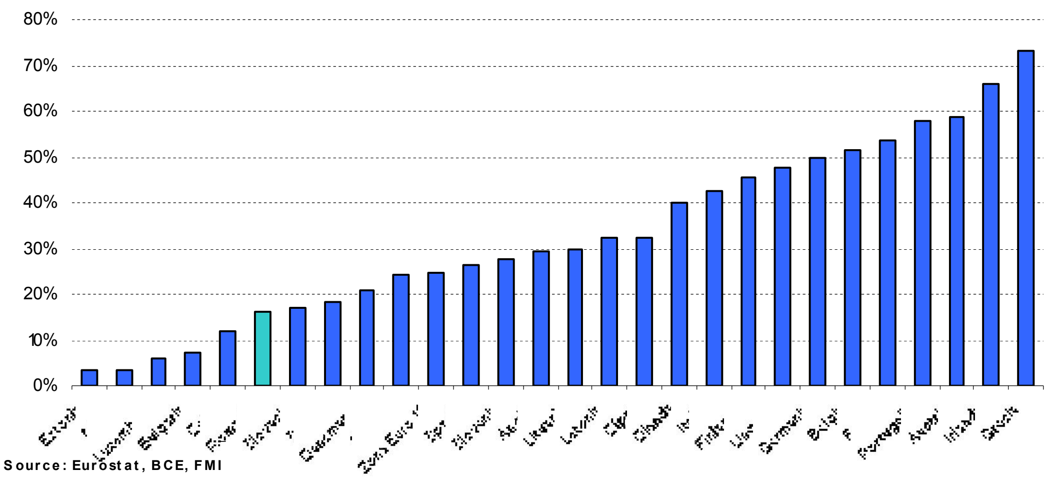
Chart 22: Interest expenditures attached to the public debt in 2011 (%)



The foreign public debt share at end-2011 was 16.4% of GDP. Compared to the previous year, the increase was 1.5%, an obviously lower growth rate compared to the 2 previous years.

At the end of 2011, Romania has the sixth lowest foreign debt share to GDP in the European Union, significantly below the 25% average of the states members of the Eurozone (data at end-September 2011).

Chart 23: The foreign debt share to GDP at end-2011 (%)

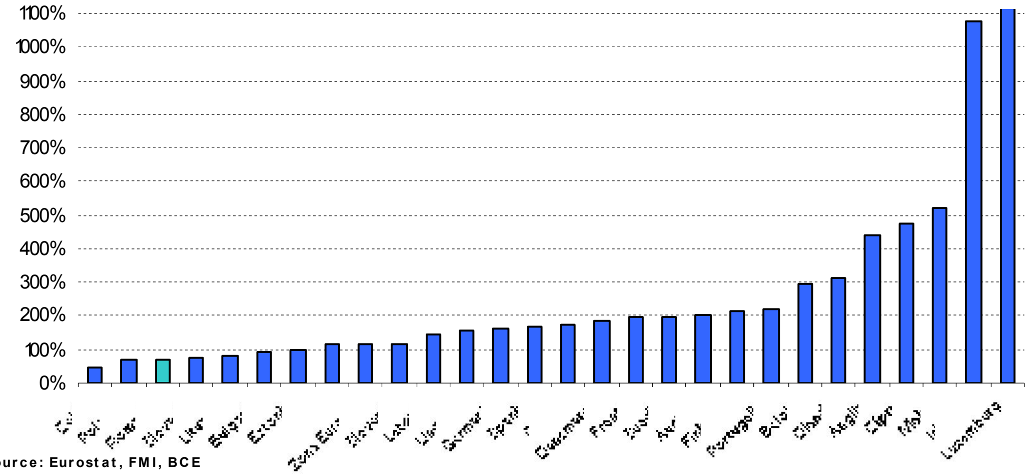


Foreign GPD servicing accounted for 1% of GDP in 2011, showing a decrease compared to the 1.6% in the previous year. Considering the payment deadlines for the upcoming time period, and the plans to contract medium and long term debt on the foreign financial markets the foreign GPD servicing for the following three years will remain at a low level.

It is worth noticing that the foreign debt share to GDP went down to 72.1% in 2011 while the foreign debt servicing decreased both in absolute terms (39.9 billion Euros as against 43.8 billion Euros), and as share to GDP (29.2% as against 35.3%).

At the end of 2011, Romania has the third lowest foreign debt share in GDP, significantly below the 117% average of the Eurozone (data at end-September 2011).

Chart 24: Foreign debt share to GDP at end- 2011 (%)



Source: Eurostat, FMI, BCE

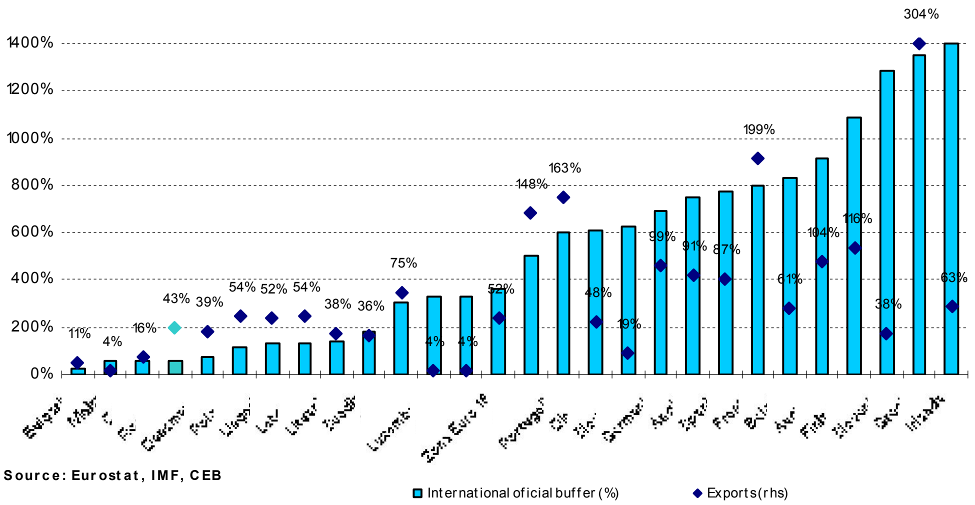
The foreign debt share to total exports (Chart 25) amounted in 2011 to 42.6%, placing Romania in the upper half of the EU MS top in respect of this indicator. In addition, this level is below the 52% average of the Eurozone states (data at end-September 2011).

The foreign debt servicing in total exports improved considerably in 2011, when it went down to 76.4%, as against 99.5% in 2010 and the peak of 135.7% in 2009.

However, the foreign debt share in the international official buffer (Chart 25) went up in 2011 by 8.3%, reaching 59.8%. This increase follows the pattern of the 2 previous years, with the international buffer seeing slower growth pace (in 2009 and 2010, the buffer increase was backed by the IMF loan proceeds). At the end of 2011, Romania had the third lowest foreign debt share to the international buffer, significantly below the 365% average of the states in the Eurozone (data at end-September 2011).

The foreign debt servicing share in the international buffer performed positively as well, going down to 107.2%, the past 5 years' lowest. Moreover, the foreign GPD servicing over the international official buffer ratio amounted to a comfortable 3.7%, and no significant increase is expected for this indicator in the time interval considered in this Strategy.

Chart 25: The foreign debt share in exports and the international official buffer at end-2011 (%)

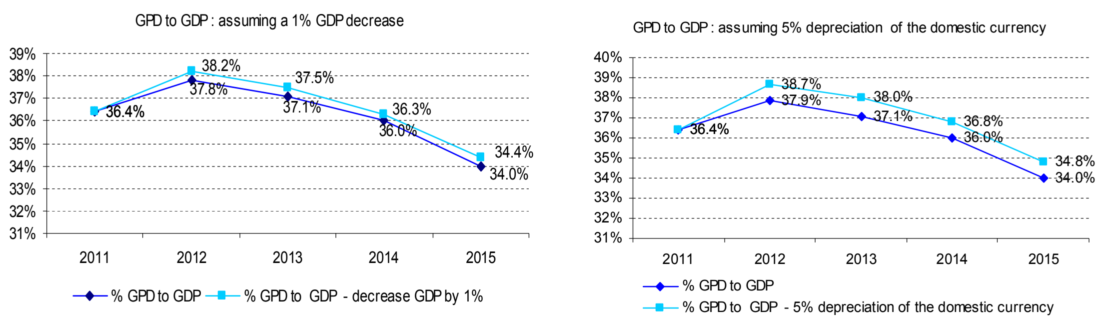


7.2. Sensitivity analyses

Considering the GPD portfolio composition at end-2011 and the financing needs for the upcoming time interval, the below scenarios have been analyzed in order to see the debt portfolio sensitivity to various factors that are important in the time period covered by this Strategy (2012-2014):

- *the influence on the level of government public debt to GDP considering a 1% GDP decrease and 5% depreciation of the domestic currency against EUR and USD, the main foreign currencies of denomination of the government public debt;*

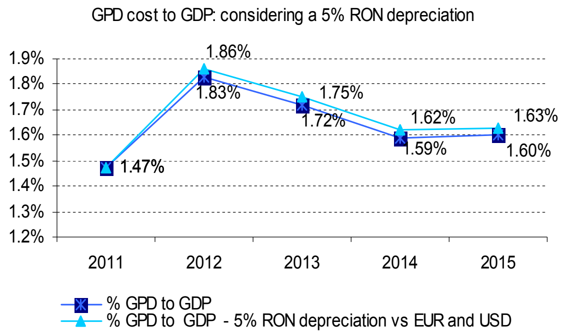
Chart 26: the influence on the level of government public debt to GDP assuming a 1% GDP decrease and 5% depreciation of the domestic currency

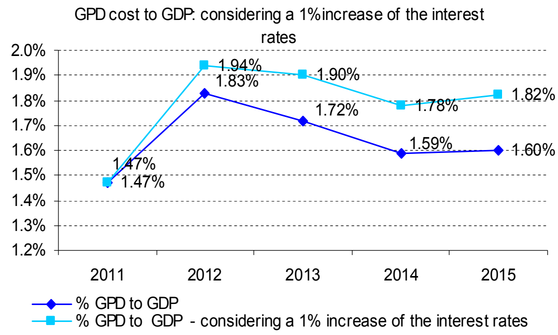


As we can see from the above charts, the influence of an economic growth under expectations in the time interval covered by this Strategy has a constant negative impact on the indebtedness level, of 0.3-0.4% of GDP, while the influence of the RON depreciation has a significant impact of 0.8-0.9% of GDP.

- *The influence on GPD cost in GDP considering a 1% increase of the interest rates (for government securities, EURIBOR and LIBOR) and a 5% depreciation of the RON against EUR and USD, the main denominations of the government public debt;*

Chart 27: The influence on GPD cost in GDP considering a 1% increase of the interest rates and a 5% RON depreciation

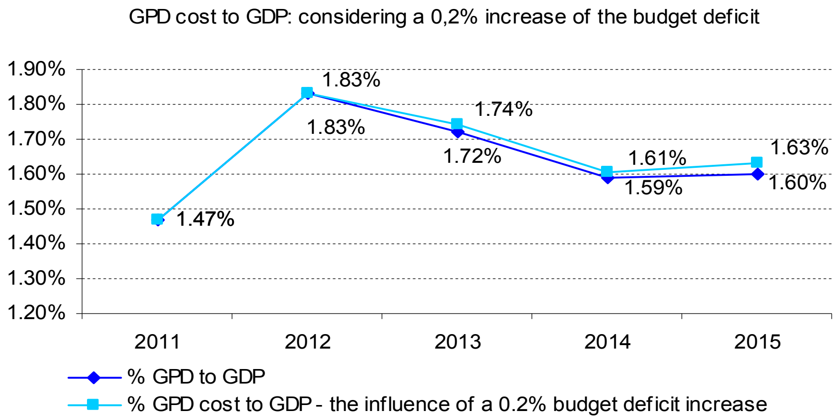




As we can see from the above charts, the impact of the domestic currency depreciation on the GPD cost is low, amounting to only 0.03% of GDP, while the 1% interest rate increase pushes the GPD cost significantly up, to 0.11% of GDP in 2012, 0.18% of GDP in 2013 and 0.19% of GDP in 2014.

- *How GPD cost is influenced by a 0.2% increase of the budget deficit.*

Chart 28: the influence of a 0.2% budget deficit increase on the government public debt cost



The 0.2% increase of the budget deficit would cause the GPD cost to go up by maximum 0.03% to GDP during the time interval under consideration by this Strategy.

7.3. Risk factors in the 2012 – 2014 Strategy implementation and an alternative financing scenario

The main risk factors that could impair the proper implementation of this Strategy relate to:

a) A significantly poorer domestic environment, macroeconomically and financially, compared to one assumed in this Strategy, showing the following main features:

- a significantly slower economic growth, under the effect of negative foreign circumstances, a recovery under expectations of the domestic demand, a low EU funds absorption rate and a contraction of private sector investments;
- a decrease of budget revenues against the background of a reduced economy, leading to a higher budget deficit and, by this, to an increasing financing need;
- a significant exchange rate depreciation leading to a higher government public debt, a higher debt cost and imbalances in other sectors of the economy;
- a generally increase of the risk aversion leading to higher interest rates on the domestic market, in parallel with a reduced investor appetite for long term placements;
- the reduction, by parent banks, of their financing lines to domestic branches, leading to a limitation of the resources needed to cover the government's financing needs and to an increased cost of financing;
- a higher default rate in respect of loans guaranteed by the government / on-lending, triggering higher budget expenditures of the Romanian government.

b) A negative foreign environment due to:

- a longer sovereign debt crisis in the Eurozone, in parallel with a generally increased investor risk aversion;
- an economic performance much below expectations especially in the Eurozone, but also in the US. Since EU is Romania's main trading partner, a shrinking economy in this region would directly impair the performance of the domestic economy;
- contracted capital flows to the benefit of the states with a high rating;
- an escalation of geo-political conflicts, leading to a higher risk aversion and a raw material price hike.

The following measures are considered for the purpose of counteracting the above negative scenarios:

a) consolidate the financial buffer of the central state treasury, in line with the provisions of this Strategy;
b) use proceeds from privatization as alternative financing source;
c) draw on the amounts available to the Romanian government under the preventive agreement with IMF and EU (in amount of around 5 billion Euros), in the event of a significant worsening of the foreign payment balance and of a considerable and unexpected deterioration of the economic situation and/ or financial situation, caused by factors that are not under the control of the Romanian authorities and leading to an acute financing deficit;
d) draw on various preventive financing lines, such as the DPL Loan with Deferred Drawdown Option in amount of 1 billion Euros provided by the World Bank;

e) for the purpose of providing financial stability, in January 2012, the Government approved the legal framework for the establishment of a bridge-bank that will take over the assets and liabilities of a domestic bank whose activity is considered to potentially impair the proper operation of the financial system.

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Annex nr. 1 – Romania's Public Debt

Indicators (million RON)	*2008*	*2009*	*2010*	*2011*	*31-Mar-12*
TOTAL PUBLIC DEBT	**109795.1**	**147329.0**	**194459.2**	**223255.2**	**235172.1**
Government Public Debt	**100556.4**	**136493.8**	**182510.3**	**2103886**	**222624.1**
of which:					
1.By type:	100556.4	136493.8	182510.3	210388.6	222624.1
Direct	91942.0	126571.7	167632.5	199284.6	211163.4
Guaranteed	8614.4	9922.1	14877.8	11104.0	11460.7
2. By creditors:	100556.4	136493.8	182510.3	210388.6	222624.1
Multilateral institutions	20533.5	34634.1	52719.3	63551.4	63501.3
Bilateral relations	312.9	272.4	287.1	203.8	202.8
Private banks and other	79710.0	101587.3	129503.9	146633.4	158920.0
3. By instrument:	100556.4	136493.8	182510.3	210388.6	222624.1
Treasury Bills (in RON and EUR)	8106.9	23432.2	32659.2	33743.8	39792.5
Cash management instruments	1825.0	0.0	0.0	2200.0	0.0
Treasury Bonds (in RON and EUR)	9505.7	23146.2	34021.4	50110.0	59607.8
Eurobonds	8569.9	9093.6	10497.8	17062.8	24678.4
Financial leasing	243.5	79.2	63.0	8.3	4.3
Government loans	32710.7	52608.2	73832.2	75418.5	75216.7
Borrowings from GCAST available funds	39594.7	28134.4	31436.7	31845.1	23324.4
4. By currency:	100556.4	136493.8	182510.3	210388.6	222624.1
RON	60024.8	64302.0	82628.7	101241.2	105736.3
USD	9227.5	8629.1	8458.2	6091.71	13165.8
EUR	28102.8	56646.1	78118.8	89349.8	90315.4
SDR	20.5	3984.7	9645.9	9977.0	9896.3
CHF	306.8	235.5	180.0	138.2	141.4
CAD	714.9	623.2	806.8	750.8	756.3
JPY	1914.0	1904.9	2542.6	2840.0	2612.6
WON	124.3	128.5	129.4	0.0	0.0
GBP	121.0	40.0	0.0	0.0	0.0
5. By maturities:	100556.4	136493.8	182510.3	210388.6	222624.1
Short-term	49526.6	51566.6	64095.9	67788.9	63116.9
Medium-term	10712.5	27096.1	42792.2	55152.1	64614.5
Long-term	40317.3	57831.1	75622.1	87477.6	94892.7
6. By interest rate:	100556.4	136493.8	182510.3	210388.6	222624.2
Fixed	31495.2	57934.4	95049.1	115406.3	132333.3
Floating	69061.2	78559.4	87461.2	94982.3	90290.9
Domestic Public Debt	**9238.7**	**10835.2**	**11948.9**	**12866.6**	**12548.0**
of which:					
1.By type:	9238.7	10835.2	11948.9	12866.6	12548.0
Direct	8530.8	10090.2	11065.8	12186.8	11995.7
Guaranteed	707.9	745.0	883.1	679.8	552.3
2. By currency:	9238.6	10835.2	11948.9	12866.6	12548.0
RON	5422.5	6494.9	7210.9	7715.6	7432.9
EUR	3783.1	4321.1	4726.8	5144.4	5109.8
USD	33.0	19.2	11.2	64	5.3
3. By maturities:	9238.6	10835.2	11948.9	12866.5	12547.9
Between 1 to 5 years	1295.1	3115.8	2350.7	549.3	3512.4
Over 5 years	7943.5	7719.4	9598.2	12317.2	9035.5

Source: MoPF, in accordance with GEO 64/2007 on the public debt, as amended.

Annex nr. 2 – Budget deficit financing

Indicator	*2008*	*2009*	*2010*	*2011*	*31-Mar-12*
Budget deficit financing (million RON)	24,858	36,435	33,643	23,899	3,388
Domestic funds (million RON)	22,198	25,031	20,387	14,711	3,194
- % in total funds	89.3%	68.7%	60.6%	61.6%	94.3%
Foreign funds (million RON)	2,287	11,113	12,952	9,188	194
- % in total funds	9.2%	30.5%	38.5%	38.4%	5.7%
Revenues from privatization (million RON)	373	291	303	0	0
- % in total funds	1.5%	0.8%	0.9%	0.0%	0.0%
Source: MoPF					

Annex nr. 3 – Foreign debt indicators

Indicator	*2007*	*2008*	*2009*	*2010*	*2011*
Foreign debt (billion Euros)	58.6	72.4	81.2	92.5	98.4
Foreign debt (% to GDP)	47.0	51.8	68.7	74.5	72.1
Short term foreign debt(% in foreign debt)	34.0	28.5	19.2	21.1	23.2
Foreign debt servicing(billion Euros)	29.9	45.6	49.0	43.8	39.9
Foreign debt servicing(% in GDP)	24.0	32.6	41.5	35.3	29.2
Foreign public debt *) (billion Euros)	9.6	10.3	13.6	18.5	22.3
Foreign public debt (% in foreign debt)	16.4	14.2	16.7	20.0	22.6
Foreign public debt (% in GDP)	7.7	7.3	11.5	14.9	16.3
Foreign GPD servicing (billion Euros)	1.6	2.1	1.4	2.0	1.4
Foreign GPD servicing (% in GDP)	1.3	1.5	1.2	1.6	1.0
Exports of goods and services (billion Euros)	36.4	42.5	36.1	44.0	52.4
Foreign debt / Exports of goods and services (%)	160.9	170.3	224.6	210.2	188.2
Foreign debt servicing/ Exports of goods and services (%)	82.1	107.3	135.7	99.5	76.4
Foreign public debt / Exports of goods and services (%)	26.4	24.1	37.6	42.1	42.6
Foreign GPD servicing / Exports of goods and services (%)	4.5	5.0	3.8	4.6	2.7
International official buffer (billion Euros)	27.2	28.3	30.9	36.0	37.3
International official buffer (import months)	6.1	5.6	8.5	8.4	7.5
Foreign debt servicing/ International buffer (%)	110.1	161.2	158.9	121.7	107.2
Short term foreign debt/ International buffer (%)	73.3	72.8	50.5	54.4	61.3
Foreign public debt / International buffer (%)	35.4	36.3	44.0	51.5	59.8
Foreign GPD servicing / International buffer (%)	6.1	7.5	4.4	5.6	3.7

Source: NBR, MoPF, INS

*) according to EU methodology.

Annex nr. 4 – Romania's ratings by S&P, Moody's, Fitch and JCRA for the long term foreign currency sovereign loans

Year	S&P	FITCH	MOODY'S	JCRA
2011	BB+ (reaffirmed November 29, 2011) outlook **stable**	BBB- outlook stable	Baa3 (reaffirmed December 22, 2011) outlook **stable**	BBB- (reaffirmed December 28, 2011) outlook **stable**
2010	BB+ (reaffirmed April 15, 2010) outlook **stable**	BB+ (reaffirmed August 2, 2010) outlook **stable**	Baa3 (reaffirmed January 18, 2010) outlook **stable**	BBB- (reaffirmed December 14, 2010) outlook **stable**
2009	BB+ outlook negative	BB+ outlook negative	Baa3 (reaffirmed September 2, 2009) outlook **stable**	BBB- outlook negative
2008	BB+ BBB- (Jan.-Oct.)	BB+ BBB (Jan.-Nov.)	Baa3	BBB- BBB (Jan-Dec.)
2007	BBB-	BBB	Baa3	BBB
2006	BBB-	BBB BBB- (Jan.-Aug.)	Baa3 Ba1 (Jan.-Sept.)	BBB BBB- (Jan.-Nov.)
2005	BBB- BB+ (Jan.-Sept.)	BBB-	Ba1 Ba3 (Jan.-March)	BBB- BB+ (Jan.-Sept.)
2004	BB+ BB (Jan.-Sept.)	BBB- BB (Jan-Nov.)	Ba3	BB+ BB (Jan.-Nov.)
2003	BB BB- (Feb.-Sept.) B+ (Jan-Feb.)	BB BB- (Jan.-Dec.)	Ba3 B1 (Jan.-Dec.)	BB
2002	B+ B (Jan-April)	BB- B+ (June-Oct.) B (Jan.-June)	B1 B2 (Jan.-Dec.)	BB BB- (Jan.-Dec.)
2001	B B- (Jan.-June)	B	B2 B3 (Jan.-Dec.)	BB-
2000	B-	B B- (Jan.-Nov)	B3	BB-
1999	B-	B- B (Jan. – Mar.)	B3	BB-
1998	B- B+ (May-Oct.)	B BB- (Jan.-Dec.)	B3 (Nov.-Dec.) B1 (Sept.-Nov.) B3 (Aug.-Sept.)	BB- BB+ (Apr.-Dec.)
1997	BB-	BB-	Ba3	

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