Governance Dimensions of a Public Debt Management Strategy: After Design Comes Approval

The case of Poland

Public Debt Department
October 2013
Plan of presentation:

- General background
- Governance related to debt management strategy
- Legal background of the strategy
- Discussion with fiscal and monetary authorities
- Approval process
- Dissemination
- Lessons learned
- Appendix: The Public Finance Sector Debt Management Strategy in the years 2014-2017
Background

• Poland is a unitary state but the autonomy of local government units is granted by the Constitution.

• The DMO is in the Ministry of Finance.

• Public debt in brief:
  • Debt to GDP ratio at the end of 2012: 52.7% according to national methodology and 55.6% according to EU methodology.
  • The share of foreign currency debt in State Treasury debt as of June 30, 2013 – 30.4%
  • Domestic currency debt – mainly Treasury bonds (maturity up to 30Y)
  • Foreign currency debt – mainly foreign bonds (EUR, USD, CHF, JPY), supplemented with loans from international financial institutions
Governance arrangement and process

Legislation - Sejm

Council of Ministers

draft budget act
debt strategy (to acknowledgement)

draft budget act
debt strategy for approval

Minister of Finance

Public Debt Department (DMO)

Supreme Audit Office

Evaluation of the execution of budget act and debt management strategy

debt management activities – within powers delegated by the Minister

legally authorized to incur debt on behalf of the State Treasury

draft budget act
debt management strategy

borrowing requirements

budget act
Legal background of the strategy

1. 60% cap on the public debt-to-GDP ratio introduced in the Constitution of the Republic of Poland (1997) and the prudential and remedial procedures in case the ratio exceeds certain thresholds included in the Public Finance Act (1998).

2. Minister of Finance (MoF) is responsible for the control over the public debt-to-GDP ratio in order to sustain its level below the 60% threshold.

3. Legal obligation of the Minister of Finance to prepare annually a 4-year public debt management strategy (first strategy published in 1999)

4. Two strategies in one document:
   • management of the State Treasury debt (direct role of the MoF as a classic DMO)
   • influencing the public finance sector debt (indirect role of the MoF as macro-prudential authority, responsible for constitutional debt limit).
Sharing and discussing proposed debt management strategy with fiscal authorities

The duality of levels of debt management strategy in Poland means that:

- co-ordination with fiscal policy is ensured (Minister of Finance responsible for both, assumptions of the Strategy are consistent with draft Budget act for the following year)
- other than DMO departments of the Ministry of Finance are asked for inputs while preparing the strategy

Main areas of inputs in non-core DMO areas:

- macroeconomic assumptions
- budgetary assumptions with an impact on State Treasury borrowing requirements
- contingent liabilities
- debt of public finance sector entities other than State Treasury:
  - changes in legal environment
  - debt levels and structure
Sharing and discussing proposed debt management strategy with monetary authorities

- Independence of the central bank guaranteed by the Constitution
- No formal role of National Bank of Poland (central bank) in the process of developing the debt management strategy – separate mandates of fiscal and monetary authorities
- NBP provides (and presents to the Parliament) a formal opinion on the draft Budget Act and the debt management Strategy after they are approved by the Council of Ministers
- Regular discussions on interactions between public debt management and monetary policy – through Debt Management Committee (advisory body comprising policymakers from MoF and NBP)
Sharing and discussing proposed debt management strategy with monetary authorities

Debt Management Committee:

• Advisory body – no formal decisions taken but:
  • Consists of high level policymakers from Ministry of Finance and National Bank of Poland – helps to facilitate co-ordination between policies, with respect to mutual independence
  • Regular meetings (at least once a quarter) and exchange of information and views
Approval of the debt management strategy

Framework of the Strategy is relatively stable and includes:

- discussion of execution of the previous year’s strategy
- macroeconomic, budgetary and market background
- objective and tasks of the Strategy
- forecasts of debt levels and debt servicing costs
- projections of debt structure and risk parameters

Within this framework new content can be introduced with each yearly update of the Strategy

For example, major new changes to content introduced in the strategy for the years 2014-2017 are:

- new tasks (the broadening of the scope of the public finance sector liquidity management consolidation)
- special topics (planned changes in pension system and their impact on both public finance and Treasury Securities market)
Approval of the debt management strategy

Ministry of Finance
Public Debt Department
Developing the Strategy

Minister of Finance
Adopts the Strategy

Presented for approval

Council of Ministers

Lower House of Parliament (Sejm)

The Chancellery of the Prime Minister submits together with the justification of the draft Budget Act (after the approval of Council of Ministers)
Dissemination of the debt management strategy

• After the approval of the Council of Ministers, main assumptions of the Strategy are announced in a communiqué of the Government Information Centre (CIR) and the strategy is published on the website of the Ministry of Finance – first Polish version and then English one.

• Aspects most interesting to the general public are widely covered by the media, news agencies etc. within hours of publication

• Strategy is presented during the following meeting of Debt Management Committee

• Strategy is widely read by investors and discussed during various meetings
Lessons learned and recommendations to other countries going through the process

• Debt management strategy is an official document approved by the government – having it as a basis for daily activity facilitates communication with:
  • the Parliament, the Supreme Audit Office,
  • Primary dealers, investors, rating agencies

• Scope and process of the Strategy is shaped by a unique duality of debt management strategy in Poland:
  • management of the State Treasury debt
  • influencing the public finance sector debt

• Broader scope of the Strategy logically places it as an integral part of the medium-term fiscal policy of the government – hence involvement of other than DMO departments of the MoF
Appendix:

The Public Finance Sector Debt Management Strategy in the years 2014-2017
Macroeconomic assumptions

<table>
<thead>
<tr>
<th>Item</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth (%)</td>
<td>1.9</td>
<td>1.5</td>
<td>2.2</td>
<td>3.8</td>
<td>4.3</td>
<td>4.3</td>
</tr>
<tr>
<td>GDP in current prices (PLN bn)</td>
<td>1 595.3</td>
<td>1 642.9</td>
<td>1 721.5</td>
<td>1 829.8</td>
<td>1 955.6</td>
<td>2 089.6</td>
</tr>
<tr>
<td>CPI annual average (%)</td>
<td>3.7</td>
<td>1.6</td>
<td>2.4</td>
<td>2.5</td>
<td>2.5</td>
<td>2.5</td>
</tr>
<tr>
<td>USD/PLN (end of year)</td>
<td>3.10</td>
<td>3.14</td>
<td>3.02</td>
<td>2.95</td>
<td>2.92</td>
<td>2.92</td>
</tr>
<tr>
<td>EUR/PLN (end of year)</td>
<td>4.09</td>
<td>4.07</td>
<td>3.92</td>
<td>3.84</td>
<td>3.80</td>
<td>3.80</td>
</tr>
</tbody>
</table>
Objective of the Strategy

- Objective of the Strategy

minimisation of the long term debt servicing costs subject to constraints on the level of:
  - refinancing risk
  - exchange rate risk
  - interest rate risk
  - State budget liquidity risk
  - other risks, in particular credit risk and operational risk
  - distribution of debt servicing costs over time

- Two aspects of the Strategy’s objective:
  - Choice of instruments
  - Efficiency of the TS market
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Flexible approach to financing structure

DOMESTIC FINANCING
• main source of financing the borrowing requirements of the budget

FOREIGN FINANCING
• ensuring diversification of sources by Poland’s access to the investor base in major financial markets
• taking into account the foreign currency borrowing requirements, including principal and interest payments on foreign debt
• maintaining Poland’s position in the euro market and strengthening the position in the US dollar market
• utilizing an access to attractive financing in international financial institutions
• stabilising the domestic market by:
  ➢ ensuring safety of financing the State budget borrowing requirements in case of temporary disruptions on the domestic market
  ➢ absorbing foreign investors’ demand for Polish treasury securities
• possible sale of foreign currencies on the financial market or in the NBP as an available instrument of managing foreign and domestic currency borrowing requirements, while taking into account considerations of monetary policy and financial rationale
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Risk constraints of the Strategy’s objective: refinancing risk (1)

• aiming at increasing the role of medium- and long-term instruments in financing the State budget borrowing requirements on domestic market – at a pace dependent on investors’ demand

• aiming at even distribution of redemptions and interest payments of domestic and foreign debt

• reaching and maintaining the average term to maturity (ATM) of domestic debt at about 4.5 years if the demand and the term structure of interest rates make it possible

• maintaining the ATM of State Treasury debt ≥ 5.0 years
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Risk constraints of the Strategy’s objective: refinancing risk (2)

ATM of the State Treasury debt

[Graph showing ATM of the State Treasury debt from 2011 to 2017 for both domestic debt and total debt.]
Risk constraints of the Strategy’s objective: exchange rate risk (1)

- temporary increase of the share of foreign currency denominated debt in State Treasury debt to 35%-37% at the end of 2014 as a result of changes in pension system, and its gradually decrease (depending on the market conditions) to the target share of 30%

- possible use of derivatives in exchange rate risk management

- maintaining an effective share of the euro in foreign currency debt at ≥ 70%, with possible temporary deviations in case of limited access to euro market, its ineffectiveness or unfavorable situation in the derivatives market
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Risk constraints of the Strategy’s objective: exchange rate risk (2)

Share of foreign debt in ST debt

- 2011: 32.0%
- 2012: 31.6%
- 2013: 30.2%
- 2014: 34.9%
- 2015: 34.6%
- 2016: 34.1%
- 2017: 33.7%
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Risk constraints of the Strategy’s objective: interest rate risk (1)

DOMESTIC DEBT

• maintaining ATR in the range of 2.8-4.0 years
• possible separation of interest rate and refinancing risks management by using floating rate bonds, inflation-linked bonds and derivatives

FOREIGN DEBT

• current level of risk does pose a threat to the cost minimization objective: in mid 2012 ATR amounted to 6.3 years
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Risk constraints of the Strategy’s objective: interest rate risk (1)

ATR of the ST debt (in years)

Duration of the ST debt (in years)
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Strategy tasks (1)

Increasing liquidity of the TS market

- continuation of issuing medium and long term fixed rate benchmark bonds (at least EUR 5 bn) in the domestic market
- neutralizing possible inadequate liquidity of certain bond issues by reopening those which outstanding value significantly decreased as a result of changes in pension system (depending on market and budgetary conditions)
- large liquid issues in the euro and US dollar markets
- expanding uniform price auction formula to switch auctions
- adapting issuance policy to market circumstances

Increasing efficiency of the TS market, including:

- issuance schedule adjusted to market and budgetary circumstances
- increasing the role of the participants of the Primary Dealers system
- removing technical and legal obstacles
- direct meetings with investors and consultations with market participants
- broadening the investor base, including non-deal roadshows in the key foreign markets
- broadening electronic communication channels with both foreign and domestic investors
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Strategy tasks (2)

Increasing transparency of the TS market
- transparent issuance policy, including TS issuance calendars, supply plans of TS and supply offers for individual auctions
- promoting the electronic market

Broadening the scope of public finance sector liquidity management
- The public finance sector liquidity management serves the Strategy’s objective in the narrower sense i.e. by selecting instruments of debt management. The first step of the liquidity management consolidation was introduced in 2011 and it obliged selected public finance sector entities to deposit liquid funds with the Ministry of Finance.
- It increased the efficiency of asset management of public finance sector entities while maintaining their autonomy in disposing of the funds. As a result of liquidity management consolidation both State Budget borrowing requirements and public debt decreased (respectively by PLN 29.7bn and by PLN 26.8bn since inception)
- It is planned to extend both the scope of entities covered by the liquidity management consolidation and the range of instruments used.
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Debt forecasts

<table>
<thead>
<tr>
<th>Item</th>
<th>2012 (execution)</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Public debt</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) bn PLN</td>
<td>840.5</td>
<td>899.5</td>
<td>810.9</td>
<td>875.5</td>
<td>920.9</td>
<td>964.9</td>
</tr>
<tr>
<td>b) GDP %</td>
<td>52.7%</td>
<td>54.8%</td>
<td>47.1%</td>
<td>47.8%</td>
<td>47.1%</td>
<td>46.2%</td>
</tr>
<tr>
<td>2. General Government debt</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) bn PLN</td>
<td>886.9</td>
<td>952.1</td>
<td>859.5</td>
<td>934.9</td>
<td>993.9</td>
<td>1 046.6</td>
</tr>
<tr>
<td>b) GDP %</td>
<td>55.6%</td>
<td>58.0%</td>
<td>49.9%</td>
<td>51.1%</td>
<td>50.8%</td>
<td>50.1%</td>
</tr>
<tr>
<td>3. State Treasury debt servicing costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) bn PLN</td>
<td>42.1</td>
<td>42.7</td>
<td>36.2</td>
<td>35.4 – 37.0</td>
<td>37.9 – 39.5</td>
<td>41.2 – 43.0</td>
</tr>
<tr>
<td>b) GDP %</td>
<td>2.64%</td>
<td>2.60%</td>
<td>2.10%</td>
<td>1.94% - 2.02%</td>
<td>1.94% - 2.02%</td>
<td>1.97% - 2.06%</td>
</tr>
</tbody>
</table>
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Public debt volume
Under the adopted assumptions in the *Strategy* timeframe the debt-to-GDP ratio will decrease:

- to 46.2% according to Polish methodology
- to 50.1% according to EU methodology
The Public Finance Sector Debt Management Strategy in the years 2014-2017

Debt servicing costs
The debt servicing costs-to-GDP ratio will slightly decrease to 2.6% in 2013 and in following years it will drop to 2.0-2.1%, depending on the exchange rate risk.
### Sensitivity of the public debt to GDP ratio to changes in assumptions

<table>
<thead>
<tr>
<th>Item</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP and borrowing requirements (GDP %)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- growth path of GDP lower by 1 p.p.</td>
<td>0.45%</td>
<td>0.92%</td>
<td>1.36%</td>
<td>1.78%</td>
</tr>
<tr>
<td>- borrowing requirements higher by PLN 1bn a year</td>
<td>0.06%</td>
<td>0.12%</td>
<td>0.17%</td>
<td>0.21%</td>
</tr>
<tr>
<td>Exchange rates (GDP %)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- PLN depreciation by 10% towards all currencies</td>
<td>1.59%</td>
<td>1.61%</td>
<td>1.56%</td>
<td>1.52%</td>
</tr>
</tbody>
</table>

### Sensitivity of the debt servicing costs to changes in assumptions

<table>
<thead>
<tr>
<th>Item</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rates - increase by 1 p.p.</td>
<td>PLN bn</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- domestic debt</td>
<td>1.0</td>
<td>2.3</td>
<td>3.9</td>
<td>5.0</td>
</tr>
<tr>
<td>- foreign debt</td>
<td>0.2</td>
<td>0.6</td>
<td>1.0</td>
<td>1.3</td>
</tr>
<tr>
<td>- total debt</td>
<td>1.2</td>
<td>2.9</td>
<td>4.9</td>
<td>6.3</td>
</tr>
<tr>
<td>Exchange rates</td>
<td>PLN m</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- PLN depreciation by 1% towards all currencies</td>
<td>102.6</td>
<td>103.0</td>
<td>110.2</td>
<td>118.9</td>
</tr>
</tbody>
</table>
Governance Dimensions of a Public Debt Management Strategy: After Design Comes Approval

THANK YOU