Domestic Debt Market Development in Poland

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I. Historical perspective
Developing debt management process

1. 1989 the starting point of political and economic transformation
   - High level of non-marketable debt, most of which seized to be serviced due to the 80-ies solvency problems

2. From 1989 transition from passive servicing to active public debt management
   - Restructuring and reducing of foreign debt:
     - 1991 and 1994 - the Paris Club
     - 1994 - the London Club
   
   - Establishment and development of domestic Treasury Securities market:
     - regular Treasury Bills issuance since 1991
     - regular Fixed Income Treasury bonds issuance since 1994
   
   - Incurring financial liabilities on international markets:
     - first foreign bond issue 1995
Main Trends

1. Domestic Market Development
   - Investor base development (key feature – pension reform in 1999)
   - Yield curve extension
   - Transparent Primary and Secondary Markets’ Development (Primary Dealers System since 2003)

2. Active Debt Management
   - Instrument base development
   - Debt Management Strategy
   - Infrastructure
   - Long-term approach to debt management

3. Risk Management
## Domestic market instruments development

<table>
<thead>
<tr>
<th>Date</th>
<th>Marketable instruments</th>
<th>Savings instruments</th>
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<tbody>
<tr>
<td>1989</td>
<td>1989 - first T bonds</td>
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<tr>
<td>1991</td>
<td>1991 - T bills</td>
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<td>1992</td>
<td>1-year inflation-linked bonds</td>
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<td>3-year floating rate bonds</td>
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<td>1994</td>
<td>2 and 5 year fixed rate bonds</td>
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<td>1995</td>
<td>10-year floating rate bonds</td>
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<td>1999</td>
<td>10-year fixed rate bonds (in response to demand of Open Pension Funds)</td>
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<td>2001</td>
<td>Switching auctions</td>
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<td>2002</td>
<td>20-year fixed rate bonds (in response to demand of insurance companies)</td>
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<td>2004</td>
<td>12-year inflation-linked bonds</td>
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<td>3 and 7 year floating rate bonds (WIBOR)</td>
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<td>Derivatives (first IRS transaction)</td>
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<td>2005</td>
<td>First FX swap transaction</td>
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<td>2007</td>
<td>10-year floating rate bonds (WIBOR)</td>
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<td>30-year fixed rate bonds</td>
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<td>2008</td>
<td>15-year inflation-linked bonds</td>
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<td>1999</td>
<td>2 and 4 year savings bonds</td>
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<tr>
<td>2004</td>
<td>10-year savings bonds</td>
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## Foreign market instruments development

<table>
<thead>
<tr>
<th>Year</th>
<th>Markets and tenors</th>
<th>Annotations</th>
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<tbody>
<tr>
<td></td>
<td>USD</td>
<td>DEM</td>
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<td>1995</td>
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<td>2009</td>
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<td>2010</td>
<td>5</td>
<td>7; 10; 15</td>
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<td>2011</td>
<td>10</td>
<td>10</td>
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- diversification of sources by Poland’s access to the investor base in major financial markets
- strengthening Poland’s position in the euro market – deemed strategic due to the perspective of full integration under the EMU
Public Debt

Dec 2010

Public Debt by sector and by instrument

Dec 2010

GDP %
Debt increases in the EU

Change in General Government debt-to-GDP ratios in the period 2007-2010 (percentage points of GDP)
State Treasury Debt

State Treasury debt - place of issue criterion

State Treasury debt – currency structure

Dec 1999
- PLN: 47.9%
- EUR: 16.5%
- USD: 25.1%
- Other: 9.9%

Dec 2010
- PLN: 72.5%
- EUR: 19.8%
- USD: 3.6%
- Other: 4.1%
Risk parameters

Refinancing risk: average term to maturity (in years)

Interest rate risk: duration (in years)

- Lengthening ATM and duration
Steady growth of Treasury Securities holdings by stable, long-term domestic investors

Diminishing role of domestic banks and gradual increase of foreign investors share (trend halted in 2008-2009)

Depth of domestic investor base and huge banking sector overliquidity allows for smooth accommodation of foreign capital flows
Investor base on the Domestic Market (2)
Non-banking sector financial institutions

Assets under management – major non-banking sector investors

Constant increase of stable and long-term investors’ assets
Most stable investor groups: pension funds and insurance companies

Treasury bonds share in assets held by the major non-banking sector investors
Investor base on the Domestic Market (3)

- Inflow of foreign investors into domestic market in 2009: PLN 26bn; continued in 2010 (PLN 46bn) and 2011 (further PLN 20bn so far)
- Holdings of non-residents at a record high levels of approximately PLN 150bn (27% of domestic debt)
II. Debt Management Strategy
Objective:

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
Public debt management strategy in the years 2011-14 (2)

Flexible approach to the financing structure

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

FOREIGN FINANCING
- diversification of sources - access to investor base in major financial markets
- taking into account the foreign currency borrowing requirements
- strengthening Poland’s position in the euro market – (future domestic market)
- access to attractive financing in international financial institutions
- stabilising the domestic market – flexibility in choosing markets in case of market disruptions
Public debt management strategy in the years 2011-14 (3)

**Rеfinancing risk**

**DOMESTIC DEBT**
- aiming at increasing the role of medium- and long-term instruments in financing the State budget borrowing requirements – at a pace dependent on investors’ demand
- aiming at even distribution of redemptions and interest payments of domestic and foreign debt
- average term to maturity (ATM) reaching $\geq 4.5$ years

**FOREIGN DEBT**
- current level of foreign debt refinancing risk does not restrain cost minimisation objective, ATM at 8.1 at the end of 2010
Public debt management strategy in the years 2011-14 (4)

*Exchange rate risk*

- maintaining the acceptable share of foreign currency debt in total debt to the range of 20-30%, in connection with high volatility of exchange rates and flexible approach to choosing markets
- maintaining an effective share of the euro in foreign currency debt at ≥ 70%
- possible use of derivatives
Public debt management strategy in the years 2011-14 (5)

*Interest rate risk*

**DOMESTIC DEBT**
- maintaining duration in the range of 2.5 – 4.0 years
- possible separating the management of the interest rate and refinancing risks by using floating rate bonds, inflation-linked bonds and derivatives

**FOREIGN DEBT**
- current level of risk is not a constraint for cost minimisation objective, at the end of 2010 duration amounted to 5.5 years
Public debt management strategy in the years 2011-14 (6)

Strategy’s 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
   – Large liquid issues in the euro market
   – Adapting issuance policy to market circumstances, including demand in different segments of the TS market

2. 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

3. 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
III. Recent market developments
Strong demand for Polish bonds in 2010 and 2011

- Average bid-to-cover ratio on domestic T-bonds auctions 2.4 in 2010 and 2.2 in 2011 (YTD)
- Average maturity of TS sold in 2010 on domestic market 5.29 years
- Stable average time to maturity of domestic and foreign debt
- 6 visits to international markets in 2010, in 2011 so far 4

Domestic T-bonds sale in 2010 and 2011 (PLN bn)

International T-bonds issued in 2010 and 2011
Safe and well-balanced financing structure

Maturity breakdown of T-securities sold in 2011 in Poland and other countries
(auctions and syndicates, local currency, data from Jan 2011 to Apr 2011)
Polish T-bonds secondary market performance

5-year CDS (bps)

Yields of local currency 10-year bonds (%)

Spread to Bunds (10Y EUR-denominated bonds, bps)
THANK YOU

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