

STRATEGIC GUIDELINES OF THE PUBLIC DEBT MANAGEMENT

1. Results achieved in the last years.

1.1. The objectives of the debt management in the last four years.

In the last years the Treasury, responsible for the public debt, introduced important changes in the liability structure in order to reduce the exposition to the interest rate volatility and attenuate the frequent recourse to the market. This policy was pursued taking into consideration the need of containing the financing cost, matching the process of structural reduction of interest rates due to the birth of the Euro currency with management policies aiming at increasing the liquidity of the securities issued. The Sinking fund of Government bonds, established with the aim of reducing the debt stock through earnings coming from privatisations and through the recourse to a series of innovations introduced in the issuance policy, contributed to the pursuit of these objectives.

1.2. Actions undertaken

1.2.1. Reduction of the exposition to interest rate variations: changes in the debt composition

The reduction of the exposition to the interest rate risk was obtained through a considerable change in the public debt composition. By comparing the situation of the end of 1993 with that of the end of October 2000, it is possible to note that the amount of medium and long-term fixed rate securities, more than doubled. In particular, BTP share increased from 27.8% (end of 1993) to 56% (end of October 2000) leading the fixed rate debt share to 62% of the total, if Zero Coupon Bonds (CTZs) are included.

At the same time, short-term and floating rate securities reduced. CCT share went down from 34% (of the end of 1993) to 20.9% (end of October 2000), whereas BOT share from 25% to 9.8%.

As a consequence for this change in the structural composition of the debt, its average life increased from 3 years of 1993 to 5.7 years of the end of October 2000, whereas the financial duration of the debt passed from 1.6 years of 1993 to 3.6 years of the end of October 2000.

1.2.2. Reduction of the financing cost: Government bond liquidity and the role of the syndicated issuance programme

The liquidity of the instruments issued is the main factor on which the Treasury counted to obtain a structural reduction of the financing cost, operating on the primary market in order to foster the efficiency of the negotiation on the secondary market.

First of all the number of new securities issued in one year was reduced, increasing the average outstanding amount of every issue. Consequently the number of monthly auctions was reduced: today only 3 year BTPs are offered twice a month, taken into account the need not to create concentration of maturities in the mid period.

This policy led to a high level of efficiency of the negotiations on the secondary market. In this regard it is useful to remember that today, negotiation volumes registered on the secondary market are very big (10 billion Euros on a daily basis) and are characterized by bid-ask spread extremely reduced, not only for 10 year benchmark securities (1-2 cent of the price), but also for less liquid issues (4-5 cent of price on average for all the other securities with term of maturities of between 3 and 20 years). These results were obtained thanks to an efficient system of negotiation rules (use of an electronic circuit, a system of primary dealers who have the obligation to submit their bids for a minimum amount of 2.5 million Euros), which ensure the liquidity on the secondary market at any market condition.

An important contribution to the reduction of the financing cost came from the use of the foreign currency issuance programme (included commercial papers) and from syndicated loans designed to meet the investor needs (E-MTN programme). These loans, through the flexibility of the structures proposed, allowed to answer better to the investor preferences and therefore to issue securities at a cost smaller than that of similar structures offered on the domestic market. These programmes contributed also to the spread of domestic Government bonds by international investors.

Finally thanks to the different composition of the debt, Italian Government bonds reached a prestigious position in international security indexations, better than that of Germany and France. Therefore, investors interested in the Italian Government bond market, trying to repeat the benchmark trend, are always more.

1.2.3. Reduction of the financing cost: the role of the Sinking fund for Government bonds

Security redemption and buy-back also marked the policy of the Treasury in the last years. These operations are carried out drawing money from the Sinking Fund of Government bonds. This programme was started by the Treasury with the aim of using incomes coming from important privatisation realised in the 90s to reduce the public debt stock. Established in 1993, the Fund, in the last 5 years, has been supplied with an amount equal to 61 billion Euros. Through buy-back operations, realized mainly through an auction mechanism (reverse auction) reserved to Specialists, the Treasury could withdraw from the market Government bonds for a volume of 25 million Euros. Through redemption operations, the Treasury reduced the debt stock of about 39 billion Euros. In the following table, the amounts referring to the single operations and securities concerned are showed.

Table 1: Buy-backs and redemptions carried out by the Treasury from 1995 to 2000 exploiting the Sinking Fund of Government bonds (Millions euro)

Year	Buy-back				Redemptions					Total
	BOT	CTZ	CCT	BTP	CTO	CCT	BTP	CTE	CTZ	
1995			871	1,985	-	-	-	-	-	2,856
1996			1,528	643	2,302	-	2,324	-	-	6,797
1997			3,787	1,068	-	-	7,747	-	-	12,602
1998			-	-	-	69	1,759	-	9,539	11,367
1999			3,688	-	-	950	6,575	1,500	6,410	19,123
2000	57.5	915.6	2,949	7,353						11,275
Total	57.5	915.6	12,823	11,049	2,302	1,019	18,405	1,500	15,949	64,020

The securities to be bought back were chosen on the basis of criteria consistent with the general objectives of the public debt management illustrated at the beginning of this section. In particular, through buy-back auctions, the Treasury subtracted debt from the market at favourable conditions in terms of costs, and reduced the concentration of short-dated securities in the same day or month.

1.2.4. Innovations

In the last year, the Treasury, following the principle of security transparency, regularity and predictability, introduced a series of important innovations in order to increase the level of general efficiency of the debt management policy. In addition to what has already been mentioned in the paragraph 1.2.2. it must be noted that, for the first time, BOTs with maturity less than 3 months were issued as cash-management instruments, aiming at matching temporary liquidity needs.

As far as 6 month BOTs are concerned, from November 2000, the Treasury has offered to Specialists in Government bonds, the opportunity to take advantage of reserved reopenings, as for medium and long-term securities, for amounts generally equal to 10% of the amount offered in the auction. Moreover the Treasury has introduced the opportunity for dealers to submit bids for BOTs during the auction using also the third decimal cypher.

For all securities the time available for Specialists to submit their bids during reserved reopenings was lengthened until 12.00 of the day following the auction.

Finally, during the year 2000 the frequency of 5 year BTP issue, now offered exclusively at mid month, was changed in order to rationalize the auction calendar and increase the liquidity of the security concerned.

1.3. Results achieved

1.3.1. Reduction of the exposition to the interest rate volatility

As far as the debt cost sensitivity to interest rate variation is concerned, the result of the policy pursued in the last 4 years can be judged taking into account the reduction of the impact on the costs for interests of a parallel variation of the yield curve by 1%. In 1996, the impact of such a variation would have been equal to 6,000 billion liras in the first year, 11,000 in the second, 16,000 in the third. Today this variation would be equal to 4,500 billion liras in the first year, 9,650 in the second and 11,600 in the third.

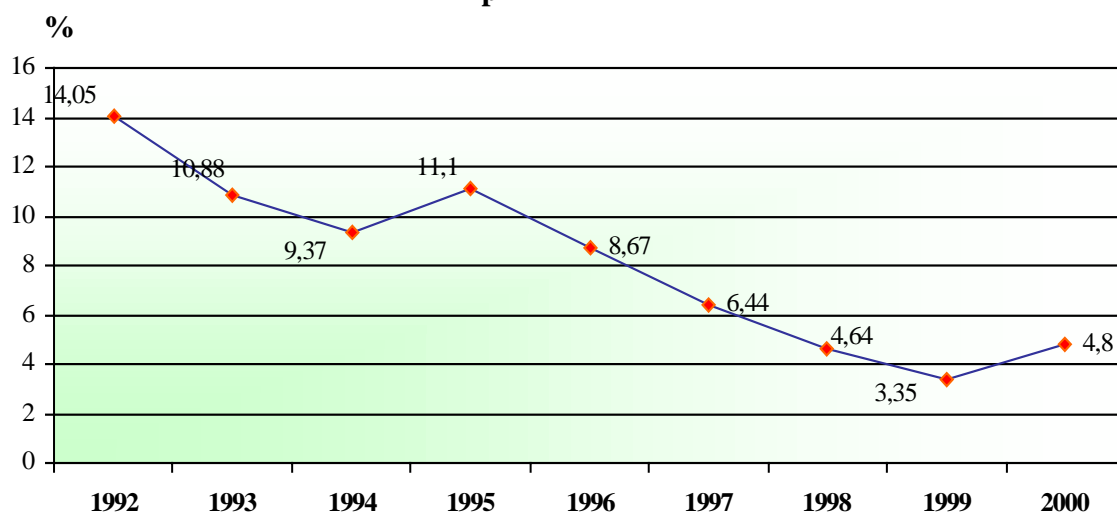
1.3.2. Reduction of the frequent recourse to the market

As far as the distribution of short-term amounts is concerned, the debt average life lengthening policy reduced the short-dated debt share every year, leading it to less than 1/3 of the total, as against less than 1/2 of 1995.

Furthermore, in a single year, the standard deviation of daily volumes of short-dated securities was reduced considerably. By comparing 1993 data with those of 1999 it is possible to note how this variable decreased by 25%.

The important results achieved in terms of increase of debt financial duration and security liquidity, mainly for medium and long-term securities, gave a structural character to the process of reduction and stabilization of the average cost for financing. Indeed this process, begun during the phase of fall and less volatility of interest rates in the years preceding Euro birth (1997-1998), continued even more recently although rates finished their decreasing trend (second half of 1999). This can be understood by the trend of the weighted average issue yield during the last ten years. (See chart 1)

Chart 1: Weighted average yield at issue



However, the reduction of the financing cost was due to the strategies adopted for the debt management in the last years. A specific role, indeed, must be given to single actions aiming at reforming the issue policy. The auction calendar rationalization, for example, was one of the factors that contributed to the variation, consolidated in the last months, of the past value of 5 year BTPs, in terms of asset swap, from 7 bps to 17 bps below the equivalent EURIBOR rate.

2. The strategy of the public debt management in the mid period

2.1. Objectives and ties

In the next 2 years, the objective of the public debt management will be that of covering the borrowing requirements in order to minimize the financing cost for a certain level of financial risk, in particular that of refinancing and interest.

As far as the risk control is concerned, the management policy of the last 4 years accelerate the process of lengthening the average life and financial duration of the debt in spite of the size of the latter. This process was pursued in a context of interest rates reduction, but allowed to give the debt a more solid and stable structure that reduced the exposition to financial market turmoils. In a medium-term run, in accordance with conditions prevailing on financial markets, the Treasury will keep on pursuing this goal, exploiting mainly more profitable market phases.

Taking into account the evolution of the demand, the short-term amounts and a context of general improvement of the public finance (as required by the Stability and Development Pact of the Maastricht Treaty), the fixed-rate security share should represent, in the medium-term, $\frac{3}{4}$ of the total stock of the debt.

2.2. Guidelines

The issuance policy will continue to stick to the following guidelines:

- Issue and secondary market of Government bond liquidity;
- Transparency, regularity and predictability of the Treasury policy;
- Regular activity on international markets.

As far as maturities are concerned, issues will be scheduled in order to guarantee to the securities issued a high float, thus contributing to maintain an efficient secondary market.

High levels of liquidity will keep up with the widespread distribution of Italian securities among international investors, allowing the Treasury to rely on a more stable demand and a more uniform geographic contribution.

The Treasury policy will also be based on regular and predictable issues. The issuance annual calendar for year 2001 is available on the Treasury web site (www.tesoro.it/publicdebt) from October 2000, with the indication of auction and settlement dates for any type of security. Regular quarterly programmes will be released with the indication of securities to be issued in the next quarter and the announcements preceding the auction specifying the quantities to be issued in the following auction. The typology offered will stick to the following monthly scheme:

	First half of the month	Second half of the month
Cash Management Bills	Issue determined by cash requirements	
6 month BOTs		X
12 month BOTs	X	
24 month CTZs	X	X
3 year BTPs	X	X
5 year BTPs		X
10 year BTPs	X	
30 year BTPs		X
7 year CCTs	X	

The transparency of the Treasury procedures will be ensured with the continuous update of the web site and ensured by a tested system of placement through auction. The high level of reliance of our placement system was demonstrated both during the week-end of Government bond conversion in Euro and in the passage to the new millennium. On these occasions, the Italian Treasury was the only one in Europe to respect the issuance programme making the auction regularly by the beginning of the new year. It must be also noted that the electronic system through which auctions are carried out, allowing the dealers to access also outside the national borders, offers the opportunity to enlarge the basis of dealers involved without jeopardizing the high security standards achieved.

Times elapsing between the auction closing and the communication of the results were reduced to 20 minutes. Information given refers to auctions made in the same moment, in which a number of dealers bigger than in other countries (about 40) participate, in conditions of high guarantee of security and transparency given to all participant.

In the next 2 years the Treasury, with the cooperation of Bank of Italy will examine the possibility of further reducing times and increasing the efficiency of the auction mechanisms.

Through proceeds coming from privatisations scheduled for the next years, the Treasury intends to continue the buy-back and redemption programme that form the Sinking Fund, according to the modalities above illustrated. The Treasury intends to achieve the following goals:

- Reducing debt stock in line with what required in the Stability and Development Pact;
- Minimizing the debt cost through the buy-back on the market of securities more expensive for the issuer, thus contributing to the realignment of the conditions of the different Government bonds on the secondary market;
- Making the volume profile of short-term securities more uniform.

2.3. Syndicated issuance programme

The programme of syndicated issues in foreign currency and in Euro contributed to contain debt cost both directly and indirectly.

On the one hand, indeed, opportunist issues (MTN) aims at – through the flexibility of the structures proposed – making profit from specific investor preferences and therefore at issuing securities at a cost inferior to that necessary for similar structures offered on the domestic market.

On the other hand, issues in currency characterized by a high liquidity (benchmark) allow an increasing number of global investors to reach domestic securities issued by the Treasury, thus concurring to enlarge the basis of domestic security investors and therefore to produce competition as far as the demand is concerned.

Both strategies also contribute to contain the supply of domestic securities with consequent cost advantages.

Given the programme objectives, the amount depends mainly on the financial market conditions.

3. Issuance programme for the year 2001

3.1. Domestic security issuance programme

As for the current year, for the year 2001 the issue calendar includes the following auction frequency: 3 and 10 year BTPs, 7 year CCTs, 3 and 12 month BOTs, 24 month CTZs will be issued in the first half of every month, whereas 3, 5, 30 year BTPs, 6 month BOTs and 24 month CTZs will be issued in the second half.

The principle according to which auction settlement dates depend on the settlement currency of short-term securities, will remain valid also for the year 2001 in order to smooth the system liquidity profile.

3.2. Cash management

As announced in the last quarter issuance programme for year 2000, 3 month BOTs and those BOTs with maturity different from 3 months will be considered as cash management tools.

As far as the 3 month BOT is concerned the Treasury will stick to the regular issuance calendar whereas BOTs with maturity different from 3 months will be offered also on dates different from those set in the calendar and will be announced with specific press releases.

The liquidity management will also be carried out through the Commercial Paper programme that gives access to the international market at extremely interesting cost and through the recourse to the interbanking money market.

3.3. 6 and 12 month BOTs

BOTs are well known to be a very desirable instrument for final investors and for the treasuries of financial brokers for the liquidity management. This supply composition brings consequently on a

level of negotiations on the secondary market extremely reduced which makes it difficult for the issuer to decide the amounts of the new issues. It must also be considered that the individual investor demand, still high for these instruments, is not very predictable.

To guarantee a more efficient CCT market, ensuring a better correspondence between supply and demand for the 6 and 12 month BOTs, the issuance policy of these instruments will be opportunely gauged. Therefore, **6 month** security issue will be regular and significant in the amount. Moreover for amounts equal to 10% of the volumes offered during the auction, they will continue to be offered in reopenings reserved to Specialists. At this first step, lasting until March 2001, any Specialist will be reserved a percentage in relation to the allocations of the last 3 auctions, as for medium and long-term securities. Afterwards, this share will be related both to the auction and secondary market performance to stimulate a bigger liquidity of the instrument.

The Treasury has thus endowed itself with another mechanism which makes the placement procedure more efficient. On the other hand the features of these reopenings, as illustrated above, guarantee that the access to this “tank” of securities takes place according to an equity criteria because any Specialists can use it according to his behaviour in the auction and to the performance registered on the secondary market.

Once the result of this innovation is assessed, the Treasury does not exclude the possibility of introducing some new ones, as for example issuing a simple one bond through following tranches as for medium and long-term securities.

Taking into account the demand trend, monitored also with the help of the Specialists in Government bonds, 12 month BOT issue will be significant until March 2001, when last CCTs indexed will have fixed their last coupon. Subsequently, amounts offered in an auction could be gradually reduced. Finally, also for annual BOTs tranches reserved to Specialists will start to be issued with the same procedure used for 6 month securities.

Obviously the mayor importance given to 6 month BOTs during year 2001, will be weighed in the issuance policy, to take into account the effects on the debt average life.

3.4. BTPs

The Treasury wants to continue with regularity the issue of the traditional maturities (3, 5, 10, 30 years). However, in order to preserve and, when possible, increase the liquidity of these instruments, the issuance policy of 3 and 5 year securities will follow a different strategy from that adopted for 10 and 30 year securities.

For the latter, results obtained in terms of liquidity, if compared to those of the other countries, are now of great importance. Indeed bid-ask spreads are equal to 2 basis points (b.p.) for 10 year securities and 6 b.p. for 30 year securities, less than the corresponding German (respectively 12 and 25 b.p.) and French (respectively 12-15 b.p.) securities. For both kinds of securities, given the role of the outstanding size to foster liquidity, issue volumes for every tranche will be substantial and the number of new securities reduced.

As far as 3 and 5 year securities are concerned, given the necessity to curb the refinancing risk, the Treasury will take into account only the outstanding size whereas the promotion of these securities at European level, touching basis with the investors, will play a fundamental role.

Therefore during year 2001, BTP issues, will have characteristics very different in terms of number of securities or indicative outstanding amount to reach, going from the 3 - 5 year group to the 10 - 30 year one.

The following table shows new security issue modalities for year 2001:

Typology	Number of new securities to issue during the year	Indicative outstanding to achieve with reopenings (billions Euro)	Frequency
3 year BTPs	Maximum 4	8-10	Beginning an second half of the month
5 year BTPs	Maximum 3	11-14	Second half of the month
10 year BTPs	Maximum 2	18-22	Beginning of the month
30 year BTPs	05/31 BTP will continue to be issued	23-27	Second half of the month

3.5. CCTs

CCTs will continue to be issued with regularity to exalt their features. That's why, the average outstanding amount for any security will be increased, whereas the number of circulating bonds will be reduced.

CCTs will be offered once a month and will benefit by 6 month BOT issuance policy, which guarantee a high level of efficiency of the primary and secondary market.

Therefore CCTs will maintain their role of instruments available to financial broker treasuries, because of the reduced negotiation costs (average bid-ask spread of 2 b.p.) and the big trade volume of trades on the secondary market (in the period August – October 2000 was on average 1.2 – 1.5 billion Euro on a daily basis).

3.6. CTZs

18 month CTZs will no longer be offered in year 2001. This choice was due to different needs. On the one hand, the Treasury wants to keep on simplifying the composition of the securities offered on the market.

On the other hand, in a context of reshaping the entire section of short-term securities, 18 month CTZ issued through following tranches causes a “crowding” of maturities close to one year, if 12 month BOT are considered. In accordance with the guidelines above illustrated, the Treasury is working to avoid the concentration of short-term security volume and to curb possible unpleasant effects in terms of cost, due to the offer of too similar instruments in the same auction or in very close auctions.

The same thing can be said if the two typologies of CTZs, 24 and 18 month CTZs, are considered. The reopenings of new tranches of the first one, turn out into the issue of a bond very similar to the second one, with the negative consequence above mentioned referring to 18 month CTZ and 12 month BOT.

24 month CTZ volumes which are offered every month, will be generally inferior to those offered before by summing up the 2 types of security. Furthermore, in order to reduce the overall supply of short-term securities, CTZs offered will be reduced progressively during the 2 years.

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