

2011

Guidelines
for public debt management

Ministry of the Economy and Finance
Department of Treasury
Directorate II



Public Debt Management Guidelines **2011**

Foreword

These Guidelines are laid out by the Treasury to provide the widespread base of investors in Italian Government bonds with some indications of a general nature on the strategy for 2011, remembering that if the volatility on the financial markets were to continue during the year it will be impossible for it not to affect the issuance decisions, as has occurred in the last three years.

As usual, the detailed analysis of public debt management for 2010 will be in the form of an in-depth document to be published during the coming year.

The 2011 issuance programme

INTRODUCTION

The last three-month period of 2010 witnessed a strong rise in volatility of the euro area Government bond markets with a marked decrease of trading and of the depth of price quotations. However, we did not see an even trend but quite different situations from country to country. In the case of Italy in fact, even in a context of widespread instability, the debt market continued to show liquidity levels that were on the whole adequate and were able to guarantee the dealers the possibility of making their investment choices with minimal transaction costs.

Also in 2011 the issuance policy will be carried out with the aim, among others, of continuing to guarantee the proper functioning of the secondary market and, following on the results obtained in the past years, to manage exposure to market risks, mainly interest rate and refinancing risks. The way in which the Treasury will place debt, apart from following the usual principles of regularity, transparency and predictability, in the choice of instruments and of quantities to propose to the market, will be characterised by a close analysis of market conditions in order to obtain overall favourable cost conditions, taking into account the above-mentioned risks.

Issues in 2011 will mainly follow the Annual Auction Calendar and, as regards the detailed information of the bonds placed by auction, initial issues or issues following the first, they will be communicated by means of the Quarterly Issuance Programmes¹. Apart from issues of on-the-run bonds, the Treasury will continue to make use of re-openings of off-the-run bonds (i.e. no longer being issued) in order to: better negotiation conditions on the secondary market, for both spot and forward contracts, for specific bonds and/or segments of the yield curve; to contribute to reaching the debt management objectives from the point of view of cost and risk; meet the extra demand of specific bonds whose good distribution in investors' portfolios make them difficult to obtain on the market.

Also during 2011 auctions will represent the main method of issue, insomuch as it is a transparent instrument that gives uniform access to the primary market of Italian debt, with the innovations introduced in recent years.

Therefore, medium- and long-term auctions will continue to be conducted according to the principle of discretionary determination by the Treasury of the amount placed within an announced range: for on-the-run issues the range will refer to the single bond while for off-the-run issues it will include all the bonds offered in the same auction. As always, Euro area inflation-linked bonds are not

¹ As in the past, both these documents are accessible on the Italian Public Debt website (www.debitopubblico.it).

included, since for every auction they will be announced in a single range on offer that includes both on-the-run and off-the-run bonds.

For the new long-term nominal inflation-linked bonds the issues will be through syndication – whose flexibility also during the last year has proven crucial for the success of these placements within the context of a particularly volatile market.

CCTeus, instruments that were introduced in 2010 and that were very positively received by the market, will be regularly issued by auction according to the normal issuance programme, so that all bonds maintain adequate standards of liquidity, with satisfactory penetration in national and international portfolios. As for traditional CCTs, they will as a rule no longer be issued; while the Treasury, if necessary, will continue to carry out exchange operations in which *CCTeus* are issued against the old CCTs, as already announced in the communiqué issued at the new instrument's first appearance.

In 2011 the Treasury will continue to use money market instruments, such as three month or non-standard (flexible) BOTs, Commercial Paper and Treasury Operations (OPTES), so as to administer temporary cash imbalances and steady the balance of the availability account held by the Treasury at the Bank of Italy. 6- and 12-month BOTs will be issued regularly also according to the State's cash needs, whereas the corresponding amounts offered will be calculated heeding demand and costs. All BOTs will continue to be offered through competitive auctions, in which dealers have the possibility of making up to five bids expressed in yield terms.

With the goal of diversifying the offer and confirming the presence on international markets the Treasury will issue in foreign currency, both in the Global format in dollars and through the E-MTN programme. Issuance decisions will be determined by the aim of diversifying the offer and reducing the cost of financing with respect to national instruments; therefore, as in the past, placements will be made with maximum flexibility in terms of time and modality of issuance.

1. THE ISSUANCE PROGRAMME OF BONDS PLACED THROUGH PUBLIC AUCTION

Auctions of nominal and euro area inflation-linked bonds for 2011 will take place according to the annual calendar, published in the Treasury Department's Public Debt Management website (www.debitopubblico.it) which also lists, in addition to auction dates, announcement and settlement dates of the different kinds of bonds.

Information regarding the bonds to be issued in each three-month period will be published in the Quarterly Programmes, which will announce the new bonds to be issued in the following three-month period, together with the minimum outstanding volumes that the Treasury commits itself to reach for each bond.

The issuance frequency will be that of 2010. 3-month BOTs may be offered at mid-month, according to cash requirements, which is typical also for the issuance choice of so-called flexible BOTs (that may be offered either at end-of- or mid-month auctions). 6-month BOTs and 24-month CTZs will continue to be placed at end-of-month auctions, while 12-month BOTs will remain at mid-month.

Medium- and long-term on-the-run bonds will be proposed as per the time-tested schedule: 3 and 10 year BTPs at the end-of-month auction and 5 year BTPs at mid-month; 15 and 30 year BTPs will be offered, when conditions permit, at mid-month auctions.

Auctions for off-the-run bonds will take place, if it's the case, with a more flexible timing which takes into account the nature of these placements that strive to guarantee a better functioning of the secondary market going to meet specific needs of demand: normally, however, the preference will be to concentrate these issues at mid-month.

CCTeas will maintain the usual placement frequency of old CCTs, which see them at end-of-month auctions together with 3 and 10 year BTPs.

Auctions for inflation-linked bonds will be in the dates listed in the Annual Calendar. The regularity of inflation-linked auctions may be interrupted by the launching of a new bond through syndication.

Finally, the Treasury cannot exclude that it, as stated in the 2010 Guidelines, may resort, in exceptional cases, to the re-opening of outstanding bonds (both short-term and medium/long-term) that go beyond the Annual Calendar, announcing these placements via the standard means of communication: these decisions may be justified by specific liquidity needs and market demand, corroborated by extensive consultation with market participants.

Chart 1 below summarises the auction frequency for each instrument.

Chart 1: Auction frequency

	<i>Mid-month Auctions</i>	<i>End-of-month Auction</i>
<i>Flexible Bots</i>	<i>Issued according to cash requirements</i>	
<i>3-month BOTs</i>	<i>Issued according to cash requirements</i>	
<i>6-month BOTs</i>		<i>X</i>
<i>12-month BOTs</i>	<i>X</i>	
<i>24-month CTZs</i>		<i>X</i>
<i>3 year BTPs*</i>		<i>X</i>
<i>5 year BTPs*</i>	<i>X</i>	
<i>10 year BTPs*</i>		<i>X</i>
<i>15 and 30 year BTPs*</i>	<i>The two bonds will be offered on the basis of market demand</i>	
<i>CCTeus</i>		<i>X</i>
<i>BTP€is</i>		<i>X</i>

* Please note: for the categories marked with an asterisk, off-the-run bonds with similar residual maturity at issuance, may be offered at medium/long-term auctions other than those in the chart.

NOMINAL BONDS

a. BOTs and liquidity management

BOT (Ordinary Treasury Bond) issues will continue to be conducted according to the traditional maturities of 3, 6 and 12 months.

12- and 6-month BOTs will be offered regularly, respectively at the middle and at the end of each month, and amounts will be determined according to demand and market conditions. In particular, the Treasury in 2011 will consider the possibility of introducing a slight reduction for those 6-month BOT issues that do not determine the indexation of traditional CCT coupons, continuing instead to carefully gauge the offer on other sectors to guarantee market efficiency of the outstanding above mentioned CCTs.

For both maturities, 6 and 12 months, during 2011 the Treasury will continue to offer bonds through ordinary auctions and re-openings reserved to Specialists in Government bonds. The amount offered at the re-opening will usually be 10% of the nominal amount offered in the ordinary auction; this percentage is however a minimum value, which may be increased, after the ordinary auction closes, taking into account market conditions and demand needs expressed by the dealers.

3-month bonds, like those BOTs issued with non-standard maturities (so-called flexible BOTs), will be offered making complete use of the elasticity of the instrument with regards to cash requirements.

As for the functioning of the primary market, the competitive auction will continue to be the placement system for the entire BOT sector. Issues will thus continue to be conducted with the auction system inaugurated in 2009. This provides that the bids be presented in yield terms, instead of price terms; this system, since May 2010, gives dealers the possibility of making five bids for each BOT on offer in the auction (with respect to the three bids allowed in the auctions of other kinds of Government bonds).

The Treasury in 2011 will also continue to make use of Commercial Paper (CP), also in currencies other than the euro, to obtain maximum flexibility in terms of quantities and maturities, essential requirements for an accurate liquidity management. The use of CPs will also aim at a greater diversification of investors operating on short- and very-short-term instruments offered by the Treasury.

Finally, during the coming year, the Treasury will maintain its presence in the money market for short- and very-short-term maturities, through financial transactions on the availability account for treasury purposes (OPTES). These transactions may be conducted via auction or bilateral

negotiation and may have overnight or longer duration, in relation to cash needs and market conditions. During 2011, the Treasury, in agreement with the Bank of Italy, might introduce new methods of conducting OPTES transactions, also according to what has been determined in the Public Accounting and Finance Law (law no. 196/2009).

b. 24-month CTZs

In 2011 around 37 billion euros of CTZs will reach maturity, an increase of 7 billion on 2010. Also so as to reduce pressure on the short-term sector and not augment the maturities in 2013 the Treasury will tend not to burden this sector, taking into account cost and demand conditions that will arise during the year. CTZs will be issued and re-opened regularly at end-of-month auctions and the timing of issues of new bonds will be calibrated in function also of the proper functioning of the secondary market. The amounts that will be offered in each single auction will also take into account the performance of the single bonds in relation to the main indicators of the European money market and of the response given by those categories of investors with a meaningful presence in that instrument, from retail and national institutional investors (funds of various types and insurances) to European and international asset managers.

c. CCTeus / CCTs

Contrary to CTZs, 2011 will see a decrease of maturities compared to 2010, going from 38 to 30 billion euros. As already announced at the launch of the new product linked to 6-month euribor, the CCTeu, the Treasury will continue to issue this instrument according to the regular end-of-month auction programme. Overall issues on the whole during the year will be determined also considering the response the instrument had in 2010 with retail national investors. With respect to 2010 the Treasury will dedicate particular attention towards consolidating the international investor base through suitable promotional activity.

Also CCTeus, as for the other medium/long-term bonds, the auction will be marginal with discretionary price fixing by the Treasury according to the secondary market's situation, within a previously announced range of amounts on offer. Old CCTs will not normally be proposed to the market, unless this is needed to make the secondary market function more efficiently. In continuity with 2010 the Treasury will be able to offer the holders of old CCTs the possibility of selling them in exchange for the new type, always being careful not to upset the liquidity conditions of the former, which will be preserved also maintaining congruous outstanding volumes for each bond.

Finally, both in the issue and exchange decisions, the Treasury will tend to privilege stability and diversification of coupon cycles both for CCTeus and old CCTs.

From a strategic point of view, by offering the new instrument to the market, the aim of debt management by reducing the percentage of nominal floating-rate bonds on the entire debt, so as to keep the interest rate risk in check, will remain unchanged.

d. Medium-term nominal BTPs (3, 5 and 10 years)

Three, five and ten year maturities will continue in 2011 to make up the larger part of nominal BTP issues, a sector in which the Treasury has always maintained to its commitment to regularity and predictability. The number of new bonds on offer will be essentially in line with the proposals of 2010 but the timing will be treated with particular attention to sustain secondary market liquidity.

Three and ten year bonds will continue to be offered together at end-of-month auctions and, as always in deciding the amounts to place, the need to guarantee an adequate performance of the bonds on the secondary market will be taken into account. Since there are future contracts with these two maturities the Treasury, when possible, will determine the closing and opening of new lines also to guarantee the proper functioning of these contracts.

The placements of five year bonds, issued at mid-month together with a possible issue of a long-term bond, will be conducted on the basis of analogous criteria of regularity and predictability.

Re-openings of off-the-run bonds of these maturities may take place if market conditions request them and if permitted by the general strategy for debt management. Marginal auctions, for all maturities of this sector, will be held with the criteria of discretionary price setting mentioned above for CCTeus and, for each auction session, on-the-run bonds will be proposed, each with its own range on offer while off-the-run bonds, when present, will be offered communicating a range of volumes that will include them together: in this manner the former are given full importance within the issuance policy and, at the same time, maintain ample flexibility in the placement of the latter according to the preferences that will arise.

e. Long-term nominal BTPs (15 and 30 years)

In full continuity with 2010, but assessing market conditions that will arise during the year, the Treasury will confirm its presence in the long-term BTP sector also in order to consolidate the

results attained in terms of debt exposure to market risks. By always choosing, in mid-month auctions, whether to issue 15 or 30 year on-the-run bonds, or whether to integrate or alternatively re-open long-term off-the-run bonds, the Treasury will make use of this flexibility to assert its strategic presence in this segment of the curve, to which numerous national and international institutional investors participate (in particular pension funds and insurances) with a long-term oriented investment profile. In selecting the bonds to offer the market, cost will of course be taken into account, but discretionary elements regarding market volatility conditions will not be missing, in their capacity to influence the implementation of the placements and the performance of the bonds in the market participants' portfolios. Auctions will be conducted in the same way as those of the medium-term BTP sector, both for on-the-run and off-the-run bonds.

As is now established practice, when market conditions exist for the introduction of a new bond, the Treasury will avail itself of a placement syndicate, especially for the flexibility traits that this issuance procedure permits: in markets that have become more volatile and unpredictable the syndicate is a useful instrument that helps the issuer achieve significant placement results regarding the aspects both of implementation and of distribution among investors according to geographic dislocation and type.

EURO AREA INFLATION-LINKED BONDS (BTP€is)

In 2010 the general macroeconomic conditions did not supply an adequate support to the demand for these bonds. The Treasury therefore, went along with this trend by reducing overall volumes issued, without renouncing however to the continuous monthly presence on the market through auctions or syndications. In this way, notwithstanding rough overall market conditions, performance of single BTP€is was consistent with that of the main issuers, taking into account repercussions stemming from movements observed on corresponding nominal bonds. The policy for 2011 will not digress substantially from that of the year about to end: placements will as a rule be monthly and may be through auction or, in the case of new bonds, placement syndicate; in those months in which there may be a syndicate, the auction, even if it is present in the Annual Calendar, will be cancelled. Also for the purpose of favouring to the utmost demand necessities, as in 2010, in the same auction session various bonds may be on offer together, both on-the-run and off-the-run, within a single range of volumes on offer, within which the marginal price will be discretionally fixed and the resulting quantity placed for each bond.

Overall strategy

In a year in which no bonds in the inflation-linked sector reach maturity, the Treasury will aim at a moderate increase in terms of percentage of overall end-of-year debt, as permitted by market conditions. The goal will be to propose dealers a vast range of maturities, which allows the Treasury on one hand to diversify the inflation risk and to place debt in an efficient manner and, on the other, allows investors to enter this sector by means of instruments featuring suitable liquidity and able to offer satisfactory performance. From this point of view, the Treasury will assess the possibility of introducing new bonds both on the long and the short segment of the curve, reserving itself in the latter case the possibility of choosing the issuance procedure considered most effective.

All issuance decisions will however go toward sustaining the liquidity of all outstanding bonds, also through continuous contact with the dealers specialized in this kind of debt.

2. THE FOREIGN CURRENCY ISSUANCE PROGRAMME

THE GLOBAL BENCHMARK PROGRAMME IN US DOLLARS

During 2011 two Global bonds will reach maturity, in February and in July, for an overall total of 4.5 billion USD. Therefore, if international financial market conditions and institutional investors' demand permit, and also taking into account the feeble presence in this sector of competition from Sovereign entities, supranational bodies and Agencies, the Treasury will continue to guarantee its presence on the US dollar market with one or more issues in the Global format of an amount equal to at least two billion USD.

ISSUANCE ACTIVITY ON OTHER MARKETS

The Medium Term Note programme for non-national issues, in euros or in other currencies, will continue to be widely used during the coming year, both in the public form and through private placements. This programme aims to satisfy demand coming mainly from European and Asian institutional investors. The opportunity of issues will be considered in relation to market conditions.

In particular, since an issue of 1 billion Swiss Francs reaches maturity in July considered the tendency of investors to reinvest in similar instruments, the opportunity of returning to issue also in this market, however for amounts not less than 500 million swiss francs, will be considered.

In reference to private placements, only the proposals received that satisfy the following conditions will be considered:

1. demand by one or more institutional investors who aim to keep the bond till maturity for their own portfolio needs,
2. maturity not less than 3 years,
3. nominal volume not less than the equivalent of 200 million euros, with a minimum negotiable amount of at least 500,000 euros.

The Treasury will decide whether or not to proceed with the issues verifying the reduction of the cost of financing with respect to similar national instruments and avoiding possible overlapping with public issues.

3. OTHER OPERATIONAL ASPECTS OF DEBT MANAGEMENT

EXCHANGE AND BUY-BACK OPERATIONS

In 2011, as in the last years, the Treasury will avail itself of exchange and buy-back transactions to manage the refinancing risk, by changing the maturity profile and favouring at the same time liquidity and efficiency in the Government bond secondary market. As stated in the above paragraphs, exchange operations will possibly also regard the offer of new CCTeus in exchange of old CCTs.

The Treasury, as usual, will decide each time how to execute the exchange operations by auction conducted by the Bank of Italy or by means of the electronic trading system.

Any buy-back operations will be conducted by auction or through bilateral trading.

POSSIBLE INNOVATIONS REGARDING COUPON STRIPPING

During 2011 the Treasury will consider the opportunity of stripping² also BTPs issued with initial maturities of five years, so as to facilitate the liquidity of the components that have already been separated and are outstanding. This innovation will be introduced only after ample discussion among the most active dealers of this instrument and after having considered all the implications for the primary and secondary market of this specific maturity.

Moreover, with regard to coupon stripping, considering the many requests coming from market dealers, the possibility of making separated coupons and principal with the same maturity fungible will be considered. In this case too, the pros and cons of the proposal and the possible benefits for coupon stripping and, indirectly, for the nominal BTP market will be analysed.

² All information regarding legal and organizational aspects of coupon stripping of Government bonds can be found at the following link http://www.dt.tesoro.it/it/debito_publico/titoli_di_stato/coupon_stripping/