

# Guidelines for public debt management for 2002-2003

## 1. Public debt objectives.

The debt management objective is to ensure the coverage of requirements in the Public Sector and re-financing of debts near maturity so as to minimize the financing cost with the same risk.

As previously recalled in the strategic guidelines for 2001-2002, over the past few years, thanks to an appropriate policy for the debt structure reorganization, considerable results have been achieved for the reduction of the rate-related risk level. The current exposure represents a satisfactory target that the Treasury plans to establish in a context where the indebtedness cost and the financing risk will tend more to guide management options.

## 2. The issue policy for 2001: effects on the composition of the debt stock.

The issue policy for 2001 has continued with the optimisation process of call on the market in order to reduce the cost of debt, still limiting the exposure to unexpected fluctuations of interest rates.

As regards the composition for instruments of the debt stock, the issue policy which was adopted while combining greater flexibility in the use of short term instruments with regularity and continuity in the offer of medium and long-term securities, has kept the share of fixed-interest medium and long-term securities rather stable (approximately 63%). The CTZ component though has dropped in this share (-1%), thus contributing to prolong the average life of debt, which went from 5.6 years in December 2000 to 5.7 years in December 2001. This effect is mainly due to the elimination of the 18-month CTZ issue and replacement with fixed-interest medium and long-term securities, and was announced in the previous strategic guidelines.

In the variable interest sector, the slight increase of the BOT share - which went from 9.2% at the end of 2000 to 10.4% at the end of 2001 - was more than offset by the drop in the share of CCT which went from 21.6% at the end of 2000 to 19.7% at the end of 2001. That is why the financial duration of the domestic debt underwent a moderate reduction going from 3.8 years in December 2000 to 3.55 years in December 2001.

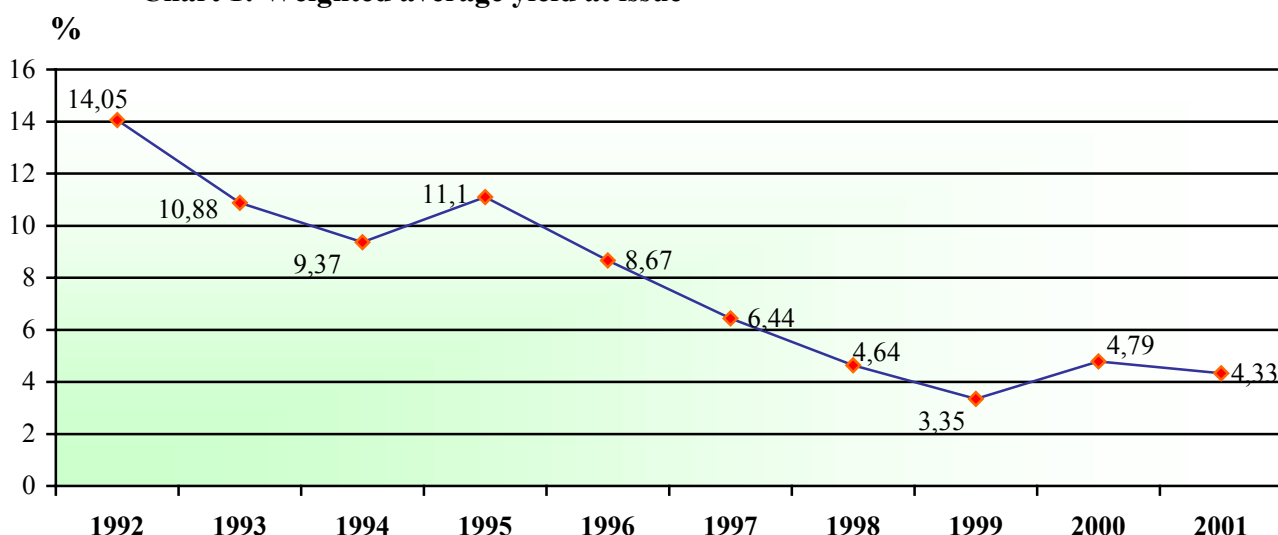
These figures though only partially reveal the strategy adopted by the Treasury during the past year - more sensitive than in the past in controlling the cost of indebtedness and the risk of re-financing.

And this is because the choices which were made still with a certain continuity over the last few years, have taken into consideration the various phases financial markets were in. A more careful analysis shows that the issue policy for 2001 was marked by a greater use of six-month BOT (for their role of indexing parameter for CCT - as announced in the previous strategic guidelines) and by a process of gradual reallocation of issues in the fixed-interest sector, with the aim of privileging the 3 and 10 year segment to the detriment of the 5 and 30 year one.

## 3. Results achieved in 2001

The above-mentioned policy has allowed for the reduction of the *annual average cost* of new 4.33% issues, against 4.79% of last year, in a context where the market yield curves underwent a sharp drop and downward shift.

**Chart 1: Weighted average yield at issue**



In order to keep the *interest rate risk* unchanged, the management policy has offset the implicit risk in the wider offer of short-term securities through 10-year issues.

The sensitivity of the debt cost compared with the interest rate fluctuations has not changed greatly over the last year, especially if we consider the first two-years' period.

The one point percentage increase for the entire yield curve would determine an increase in the expense for interests with reference to GDP amounting to 0.18% for the first year (previously 0.19%), 0.38% for the second year (0.39% in 2000), 0.49% for the third (0.45% in 2000) and 0.54% for the fourth (0.50% in 2000).

Finally, thanks to the reform concerning taxation of Government securities for non-residents which was passed by Parliament in November, it will be possible for the Treasury to focus on a much larger audience of non-resident institutional investors.

#### **4.Guidelines for debt management**

As to the composition of issues, in view of the continuity with choices already made during 2001, the Treasury plans to pursue a balanced strategy aimed at leveraging the opportunities offered by the shaping of the yield curve.

The offer policy adopted by the Treasury will continue to be inspired by criteria of transparency, regularity and predictability of issues which will be planned so as to guarantee high stocks for each issued share also with respect to the liquidity reached on the secondary market.

The growing diversification of investors achieved through transparency and regularity of issues and liquidity of the secondary market will be supported by initiatives aimed at promoting investments in Italian public debt securities. The main factors, which will be taken into account for this purpose, are the following:

1. *liquidity of securities*. The number of new securities issued in each sector will be limited and rationalized in order to keep on ensuring the already high level of efficiency and liquidity of the secondary market;
2. *increasing the basis of investors*. Also thanks to the previously recalled taxation reform, the Treasury plans to further diversify its basis of investors in order to reduce and stabilize the cost of indebtedness. Amongst the measures which will be adopted it should be mentioned that:
  - a. The assessment of the activity of Specialists on the secondary market will take more closely into account the capacity of distribution – geographic and per type of investors – of government securities;

- b. In placing government securities, the Treasury through an appropriate promotional policy and instruments studied for the small investor, plans to increase considerably the volumes of government securities offered through retail distribution networks (banking and postal channel, Internet);
3. *Diversification of the offer.* So as to be present in all market segments, focusing on flexibility especially in those sectors, which are not adequately explored by other European issuing bodies, the Treasury:
- a. *In the medium and long-term sector,* is studying how to diversify the offer (7-year BTP, BTP with a 15 or 20 year maturity, *index-linked* and convertible securities); in order to limit the innovation costs, these instruments will be introduced on the market during a first phase through syndicated transactions, preferably by using the BTP offer. This will enable the Treasury to increase the relative weight in the securities index, thanks to the level of liquidity that these issues will reach. Only later during the second phase, once the market interest has been appreciated, it could be possible to place such instruments by using the usual procedures (auctions);
- b. *On international markets,* continuing along the lines followed during the past years, it will be present on international markets next year too with the objective of attracting new investors. The programme, in relation to the market conditions, will cover an amount between 15 and 20 billion Euro;
- c. *For syndicated issues,* it will continue to adopt an opportunistic approach (EMTN programme) through the flexibility of proposed structures.

## 5. Programme of issues for the year 2002

### 5.1 Programme of issue for domestic securities

This year too during the month of November, the web site ([www.tesoro.it/publicdebt](http://www.tesoro.it/publicdebt)) published the calendar of issues indicating the dates of announcement and settlement of domestic securities. The dates of settlement of auctions are gauged upon the currency of securities near maturity, in order to reduce the liquidity fluctuations of the banking system.

In relation to the market conditions and demand expressed by operators the Treasury will keep to the following calendar of issue:

	First half of the month	Second half of the month
Cash Management Bills-3month BOTs	<b>Auction held depending upon by cash requirements</b>	
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		February <u>or</u> March, May, September and November
7 year - CCTs	X	

## 5.2 Cash management

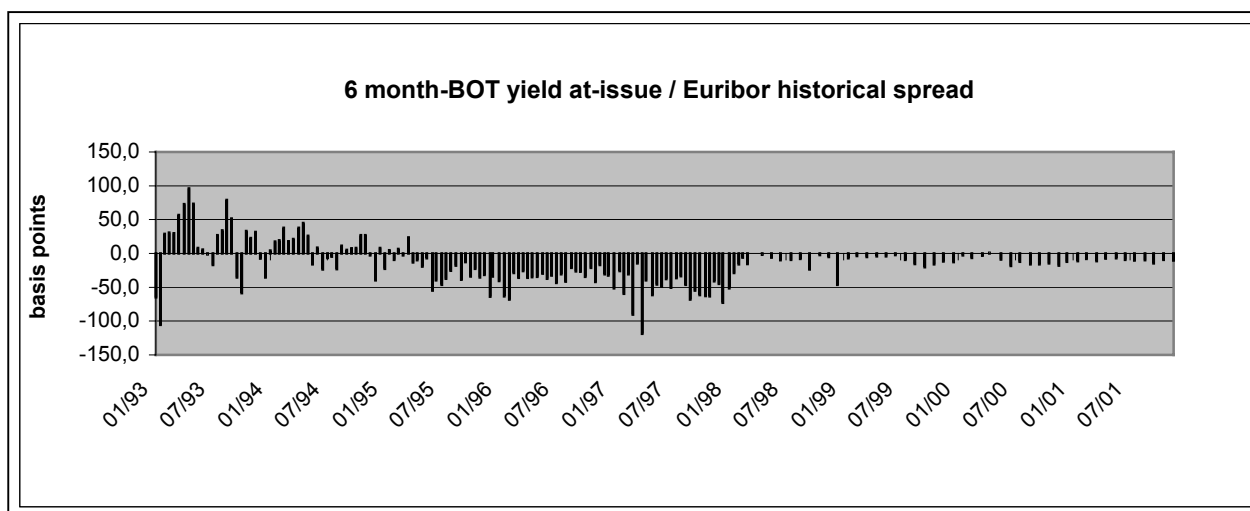
As regards the more general public debt management policy, a special role is played by *cash management* transactions. The Treasury, as everybody knows, starting from last year, has decided to use three-month BOT and the so-called “mini-BOT” for the exclusive coverage of temporary liquidity requirements. . Along the same lines, the Treasury will rely on a more active liquidity management to:

1. Achieve cost reduction through the identification and use of appropriate instruments of short term requirements coverage avoiding resort to medium/long term issues;
2. Reduce and stabilize fluctuations of the cash account balance, through a continuous presence on monetary markets, in accordance with market efficiency and transparency and in agreement with the competent Monetary Authorities.

During the year 2001 the Programme for the collection of Commercial Papers and mini-BOT ensured the Treasury a greater flexibility in accessing the capital market, allowing individual issues on differentiated maturities and optimising *matching* with the availability account flows. For 2002 the Treasury will continue to make use of these instruments. Furthermore, it will be possible to carry out swap transactions through a stable and automatic system of intervention which will allow the Issuing Body to carry out transactions with the aim of using and/or collecting short and very short term financial resources, as well as determining considerable positive effects on the liquidity of the secondary market itself.

## 5.3 Six-month BOT and CCT

The amount of six-month BOT offered will take into account the flows for maturity and the need to guarantee CCT market efficiency. This instrument in fact, is the only fluctuating rate public security, which shows liquidity equal to that of fixed-rate securities.



The interest shown towards these securities has greatly increased over the past two years thanks to the progressive stabilization of the six-month BOT spread – Euribor that the Treasury has pursued through an adequate issue policy of 6-month BOT. Currently the spread has stabilized at 10bp and its volatility is around 1/6 of what it was 4 years ago. **Therefore the Treasury will issue CCT regularly at the beginning of each month, providing for placement on the market of at least 3 new securities with an average stock amounting to 10-13 billion Euros.**

#### 5.4 Annual BOT

As far as annual BOT securities are concerned, a policy of gradual disinvestment will be pursued which began last year in order to limit the interest rate risk.

#### 5.5 BTP

Continuing with the issue policy followed over the past years, in this sector the traditional maturities will be offered (3, 5, 10 and 30 years). Next year the BTP issue will be based on the following scheme:

Type of security	Number of new securities for 2002	Stock to be reached at the end of issue	Frequency of issue
3-year BTP	5-6	9-12 bill. Euro	Beginning & 2 <sup>nd</sup> half of the month
5-year BTP	2-3	12-15 bill. Euro	2 <sup>nd</sup> half of the month
10-year BTP	1	18-22 bill. Euro	Beginning of the month
30-year BTP	1	22-26 bill. Euro	Once per quarter (February or March, May, September and November)

#### 5.6 CTZ

As to CTZ securities, the Treasury will continue with its policy of gradual reduction of the existing stock. The Treasury will continue with its regular issues twice a month, at least for the first six months. During the second part of the year, depending on the market conditions, the Treasury plans to turn to the market to place this instrument with a shorter frequency.

On the whole, 3-4 new securities will be issued amounting to an average stock of 9-10 thousand million Euros.

### 6. Innovations: share swap transactions

Next year a programme will be offered for the exchange of securities nearing maturity with securities in the process of being issued (share swap transaction). The objective is to make the profile of maturities more uniform thus allowing a more regular call on the market.

In order to make it easier for investors the share swap transactions can be made according to two procedures:

1. Through auction, by following the practices used for *buy back* made valid on the depreciation fund. These transactions will preferably be made half way through the month, concurrent with 3 and 5-year BTP auctions.
2. By operating directly on the secondary market regulated by government securities, leveraging the opportunities offered by the existing technology. These transactions will only be reserved to Specialists in government securities, since they represent the most active operators of the secondary market and those on whom the Treasury relies to keep the high conditions of liquidity and efficiency.