2009

Guidelines for public debt management

Ministry of the Economy and Finance
Department of Treasury
Directorate II

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Foreword

In 2008 government debt management (for the part represented by tradable government securities) has been significantly affected by the stream of events that have further amplified instability throughout all sectors of the international financial system, starting from the money and interbank market and ending with the fixed income and equity markets. From the month of September the general picture has become even more critical due to the consequences stemming from the patrimonial and financial crisis of several fixed income players (such as investment banks, commercial banks, insurance companies, hedge funds, mutual funds and so on) that, in some cases, led to a bankruptcy status, and in some other, to bailouts organized by government and central banks according to different schemes.

Government securities have been severely involved in the crisis not only because they become the main focus for many investors needing to rebalance their portfolios with respect to non-performing assets, such as shares or structured products, but also because the crisis itself has deeply reshaped and it is still reshaping the composition by typology of players operating on this market and the way this market works.

In pursuing its goal of providing the financing for the State Sector Borrowing Requirement, the Italian Treasury had to address the financial markets new environment in order to continue to provide satisfactory efficiency levels in terms of cost and risks of the funding activity, preserving at the same time full transparency and predictability of its issuance decisions, in a contest of continuous and strict dialogue with market participants.

Differently from previous years, this year the "Guidelines" have been split in two parts: the first part, the present document, is focused on the issuance strategy for 2009; the second one will instead be devoted to a synthetic and analytical account of the debt management activity carried out during 2008 and it will be released in January 2009. This choice is essentially due to the need to have more time to go through and describe what happened in 2008, given the uniqueness of that year, without having investors and market participants waiting too long to know the main guidelines of the Treasury debt strategy for next year.

The issuance program for 2009

Introduction

Even if market conditions in 2009 are supposed to be rather different than in the previous years, government debt management will continue to be aimed at containing the cost of funding in medium run without changing the exposure to financial risks (in particular interest rate and refinancing risks).

The government securities issuance activity will continue to rely on principles of regularity, transparency and predictability that have characterized the Italian Treasury issuance policy in the last decade. Therefore the full commitment to guarantee liquidity to on-the-run bonds will be reaffirmed through the traditional yearly auction calendar and the issuance program published quarterly.

The Treasury, however, in order to address the evolving conditions of the government securities demand and their liquidity will adopt a more flexible approach, keeping for itself the faculty to offer, in addition to on-the-run bonds, also off-the-runs, thereby following the same policy chosen in 2008 (especially during the last quarter) to cope with a contest of extreme volatile markets.

The choice regarding which off-the-run to offer to the market will be based mainly on demand conditions and on the need to enhance the efficiency of negotiations on the secondary market.

Auctions will continue to be the main government securities issuance method, as in this way the access to primary market will be characterized by full transparency and uniformity for a large base of participants, both resident and nonresident.

In order to fairly calibrate the volumes on offer in a contest of high volatility, as long as the current market conditions prevail, for medium-long term conventional bonds, inflation-linked bonds and floaters (the CCTs) - both for the on-the-run and the off-the-run ones - the Treasury will adopt the auction pricing mechanism whereby it will discretionally set the total allocated volume within a range previously announced.

As in the past, syndications will be used to introduce new long-term nominal bonds (having a maturity longer than 10 years) and new Euro area inflation-linked bonds (the BTP€is). In case demand conditions and the general market environment will make it necessary, the method of syndication may be employed in situations different from those just mentioned.

As far as short term instruments are concerned, the supply of 3-month and with no standard maturity Treasury bills (BOTs), besides the regular issuance program of 6-month and 12-month Treasury bills, will be set in order to manage temporary cash flow shortfalls.

Foreign currency products and private placements, as in the previous years, will be tailored to support the presence of the Italian Treasury on international markets and to broaden the base of investors; issuance decisions in this respect will be determined both by demand and cost conditions and they will follow a largely flexible approach in terms of timing of placements and issuance methods.

Issuance program of securities placed through public auctions

Auctions of conventional securities (the BOTs, CCTs, CTZs and BTPs) and inflation-linked bonds (the BTP€is) will take place according to the *yearly auction calendar* published on the Public Debt Directorate Web site (www.publicdebt.it). Besides the auction dates, the calendar sets the announcement dates as well as the settlement dates for the different types of securities.

As in 2008, for Euro area linkers monthly auctions dates have been set, even if for this kind of bonds the Treasury will reserve the faculty of not offering them in case market conditions are considered to be unsatisfactory.

During the year, the publication of the *Quarterly Issuance Programs* will allow investors to be informed about the new bonds that will be on offer during next quarter.

As far as zero coupon securities (BOTs and CTZs) are concerned, 12-month and, eventually, 3-month Treasury bills will be offered in mid-month auctions, while 6-month Treasury bills and CTZs will be auctioned at the end of the month. Issuance of the so-called “flexible BOTs” (i. e. Treasury bills having a non standard maturity) will be driven by cash managements needs, as usual.

As far as the medium-long term fixed rate nominal bonds (the BTPs) are concerned, normally at the mid-month auctions the Treasury will offer the 5-year BTP while the 15 and 30 year BTPs will be issued according to market conditions; at the end of the month auctions the 3-year and the 10year BTPs and CCTs will be normally issued as well as BTP€is. That schedule could be modified should market and demand conditions require to do so in order to ensure a smooth issuance process. It cannot be ruled out, in other words, that a 3-year BTP (both an on-the-run and/or an off-the-run bond) is issued at the mid-month auction or that a 5-year BTP (on-the-run or off-the-run bond) is issued at the end-month auction.

In case the Treasury, on an exceptional basis, decides to hold additional auctions (both for the short term and medium and long term bonds) with respect to the annual calendar, aimed at ensuring market liquidity and/or to respond to demand conditions, they will be announced via the usual communication tools.

The following table shows the schedule of the auctions for each instrument.

Tabel 1: Auction schedule

	Mid-month Auctions	***End-of-month Auctions***
Flexible Bots	***Issued according to cash needs***	
3-month BOTs	***Issued according to cash needs***	
6-month BOTs		***X***
12-month BOTs	***X***	
24 -month CTZ		***X***
*3-year BTPs**		***X***
*5-year BTP**	***X***	
*10-year BTP**		***X***
*15 and 30 -year BTP**	***The two maturities will be issued on the basis of demand and market conditions***	
*7 -year CCT**		***X***
*BTP€i **		***X***

* It is not ruled out that the instrument will be issued at medium-long term auctions different than the ones reported in the Table.

Nominal Securities

BOTs and cash management:

The BOTs will continue to be issued on the traditional maturities – i.e. three, six and twelve months.

12-month BOTs will be offered regularly at the mid-month auctions and on the basis of demand and market conditions.

The Treasury commits to regularly issue the 6-month bills. The amount offered at the ordinary auctions as well as at the reopening reserved to Specialists will be calibrated according to the redemptions in order to ensure efficiency of the CCT market.

The amount offered at the reopening reserved to Specialists, as a general rule, will continue to be the 10% of the amount issued at the ordinary auction; however, that amount is the minimum threshold which the Treasury reserves the right to raise after the closing of the ordinary auction, according to demand coming from investors and market conditions.

During 2009 the Treasury will analyze the opportunity to introduce the reopening reserved to the Specialists also for the 12-month BOTs.

3-month bills, as well as non-standard maturity BOTs (the flexible BOTs), will be offered by fully exploiting the flexibility of this type of security in relation to the Treasury cash requirements.

As far as the primary market is concerned, as usual BOTS will be placed through the multiple-price (competitive) auction system but, during 2009, the bidding system in terms of prices will be replaced by that in terms of yields, thereby following a common standard in use throughout the money markets in the euro area. This innovation, allowed by the new placement procedure set up by the Bank of Italy, will be used only for BOTs auctions and could be implemented starting from the first months of 2009, in parallel with the adoption of yield trading for BOTs on the major trading venues, both wholesale and retail.

Furthermore, during 2009 the Treasury will continue to use Commercial Papers, also in non euro-denominated currencies, to achieve maximum flexibility in terms of volumes and maturities, which are essential prerequisites for a timely cash management. The use of Commercial Papers will also be targeted to enhance the diversification of investors in Italian Treasury short and very short paper.

Finally, during 2009, the Treasury will continue to be present in the money market on short and very short-term maturities by means of operations related to the management of the Treasury account daily balances (OPTES). Those operations, executed via auctions or bilateral trades, will have overnight or longer maturity depending on the Treasury's cash requirements and market conditions.

24-month CTZs

The Treasury will continue to regularly issue, on a monthly basis, the 24-month CTZs. This instrument has witnessed an increasing interest from international investors besides the resident ones, whose demand has been sustained also because of the support by the retail component.

The issue amount, out of the overall gross issuance, will be in line with that of 2008. Due to lower redemptions with respect of 2008 (for about 5 billion euro), the outstanding volume at the end of 2009 will increase in absolute terms and, likely, as share of the total negotiable debt.

CCTs

The issuance strategy during 2009 will be characterized by gross issuance volumes in line with 2008. Taking into account the redemptions (slightly above 45 billion euro), this means that only a percentage between 40% and 50% will be refinanced with the same instrument; therefore at the end of the year CCTs outstanding will reduce significantly.

The issuance activity will aim at ensuring a satisfactory liquidity on the secondary market to all instruments, through a regular presence on the market, but bonds and volumes on offer will be calibrated according to market demand. In particular, the Treasury will choose the bond to be issued among the on-the-run and/or off-the-run bonds with full flexibility, in order to meet market needs.

As introduced over the course of the fourth quarter of 2008, the CCTs will be placed through the usual uniform-price (marginal) auction mechanism, where the price and issuance amount are discretionally set by the Treasury, within a previously announced issuance range. When, at the same auction, two or more bonds are issued, the above mentioned range will refer jointly to all of them.

In order to foster the efficiency of negotiations on the secondary market the final outstanding of each bond will be kept lower and the widest diversification of coupon cycles will be offered to the market.

Medium-term nominal BTPs (3, 5 and 10- year maturity)

As showed in the schedule of monthly auctions (Table 1), 3-year and 10-year BTPs will be normally offered at month-end auctions, whereas 5-year BTP will be placed normally in mid-month auctions. The introduction of new benchmarks, announced through the *Quarterly Issuance Program,* will be decided taking into account the preferences expressed by the market but also considering the Treasury's objectives in terms of refinancing risk management, in particular for what concerns the maturity date of each new bond. In the monthly marginal (uniform-price) auctions, the amount offered will be decided on the basis of the market condition, in order to enhance the efficiency of placements and provide adequate liquidity levels on the secondary market. As in the last quarter of 2008, the price and issuance amount of the *on-the-run* bonds will be discretionally set by the Treasury within a previously announced issuance range. The same criteria will apply for the *off-the-run* bonds, even if the issuance range in this case will be referred jointly to all the *off-the-run* auctioned bonds, in case the Treasury decides to place more than one of them in the same auction round.

Long-term nominal BTPs (15 and 30 year)

The issuance policy pursued by the Treasury on the long-term sector, 15 and 30-year BTPs, will be fully flexible in order to adapt to changes in demand and trading conditions in the secondary market. As in the past years, new securities will be introduced in the market through syndications as in this way the Treasury is able to ensure, from the beginning, a wide penetration of the bonds into final investors portfolios and it can calibrate the issuance volume and the issuance timing to ensure an efficient placement.

The Treasury, through reopening of the bonds, is committed to gradually reach a suitable minimum final outstanding necessary for an efficient functioning of the secondary market trading activity.

The auction procedure will be the same as for the medium-term nominal BTPs both for *on-the-run* bonds and *off-the-run* bonds.

The issuance on long-term nominal BTPs will continue to keep a key role for risk management and to foster the established leading position in the European market in terms of liquidity and menu of maturities offered to the market.

Inflation-linked Bonds (BTP€is)

The Treasury is committed to issue inflation-linked securities on monthly auctions, offering one or more bonds, if market conditions are suitable and it reserves the right of not offering them if adverse conditions do not allow to.

For the launch of new securities, the Treasury will adopt the syndication issuance method. In conditions of market stability and low volatility, the launch of new 5-year securities will be carried out through public auction, following the positive experience of 2007. Should a syndicated placement take place in a given month, no auction will be held in the same month.

The overall issuance volume of BTP€i in 2009 will be in line with that of 2008; this, together with no redemptions in 2009, should lead to a slight increase of the BTP€i's share out of the stock of the outstanding negotiable debt at the end of next year.

<u>Exchange and buyback operations</u>

In 2009, like in the previous years, the Treasury could use the exchange and buyback operations to manage the refinancing risk by smoothing out the redemption profile and enhancing the efficiency of trading conditions of the various instruments in the secondary market. With regard to the latter topic, the Treasury will make use of these operations also considering the issue of lower liquidity that has been affecting most of European government bond secondary markets in 2008.

The Treasury, as in 2008, will decide whether to execute these operations on the primary market, through the new Bank of Italy auction system, or on the regulated secondary market, through the telematic trading system.

The foreign currency issuance programme

US dollar global benchmark programme

With regard to the next year, the Treasury confirms its willingness to maintain its presence on the US dollar market. Market conditions and the evolution of demand will obviously be decisive in determining to what extent it will participate into this market.

Issuance activity in other markets

For 2009, the Treasury confirms the use of the EMTN programme for its issuance activity outside the “domestic” program, in euro and in other currencies. More specifically, the opportunity for carrying out private placements will be considered, depending on market conditions, according to proposals based on reverse enquiries received from one or more institutional investors. The maturities of the securities cannot be shorter than 3 years and the minimum tradable amount should be at least of 500,000 euros. The Treasury will consider whether to proceed with these operations on the basis of cost conditions relatively to the BTP curve, avoiding potential overlapping with the “public” issuance program.