AGENTÚRA PRE RIADENIE DLHU A LIKVIDITY
DEBT AND LIQUIDITY MANAGEMENT AGENCY

ANNUAL REVIEW 2017 AND OUTLOOK 2018






JANUARY 2018

Foreword

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Managing Director
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The year 2017 was very successful from the ARDAL point of view and even remarkable in many areas of debt management in Slovakia.

In February Slovakia joined the euro area countries with a standard securities settlement infrastructure thanks to the successful migration of the Central Securities Depository to TARGET2-Securities. Settlement on the principle of DVP (delivery versus payment) has brought the long-awaited impulse to improve liquidity of the Slovak Government Bonds.

The year 2017 was also significant for Slovakia in the area of bond issuance. The 20-year bond issuance in the spring tested the investors' interest in the Slovak credit and opened the door to another significant milestone - the autumn bond issue with a maturity of 30 years. This bond issue with the longest maturity in history of Slovakia has confirmed the excellent position of the country on the financial market.

Both transactions benefited from favorable conditions on the financial market. However these transactions would not be successful without the consolidation efforts of the government, good macroeconomic results of the country, and clear and transparent debt management.

In 2018 ARDAL celebrates 15 years of its activity. The main challenge will be the start of the MTS Slovakia platform for trading with Slovak Government Bonds.

Allow me to thank all business partners for their excellent cooperation and investors for their trust throughout the year 2017.

Key Information – Overview

Ministry of Finance of the Slovak Republic raised funding of EUR 6.1 billion in 2017 (covered by syndicate, auctions of Government Bonds and Loans). The total funding requirements were reduced to 91% of the planned gross funding set out in the State Budget Act 2017 thanks to the improved government deficit over the past year.

Last year ARDAL accomplished 9 auction sales of 19 Government Bonds and two T-Bill auctions. The overall demand reached EUR 14.9 billion and securities in total nominal value of EUR 6.9 billion were sold, including T-Bills matured in November 2017. In addition to the auctions, ARDAL opened two new bond lines through the syndicates in 2017. A new line of 20-year bond with a nominal value of EUR 2 billion was opened in the spring (total demand of EUR 3 billion) followed by the autumn 30-year bond transaction. The longest transaction in the Slovak history attracted investors in the total worth of EUR 2.7 billion while EUR 1 billion was sold.

Also the year 2017 persisted in the atmosphere of historically lowest interest rates resulting from the presence of the ECB in the secondary market as by its quantitative easing operations - the PSPP program. Favorable interest rate development and active portfolio management were also reflected in the further decline in the average weighted interest rate on government liabilities from 2.58% p.a. in 2016 to 2.31% p.a. at the end of 2017.

The average weighted maturity of the Slovak debt portfolio rose to historically the longest value of 8.5 years and the average weighted duration to 7.4 years. Performance of the debt and liquidity management was in line with the current Debt Management Strategy and the risk parameters reached historically the lowest levels compared to the benchmark indicators.

Debt Management Office of the Slovak Republic

Bratislava, January 2018

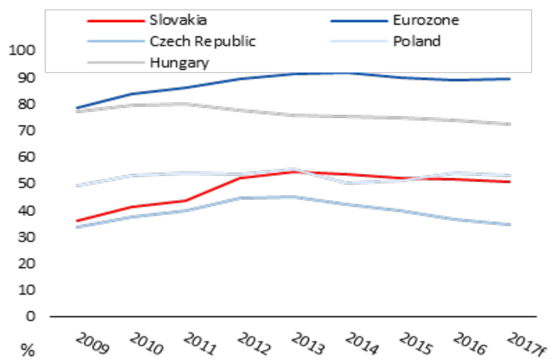
Macroeconomic Developments

In 2017, the Slovak economy accelerated to 3.4 percent fuelled primarily by household consumption, which benefitted from the strength of the Slovak labour market. Moreover, for the first time in four years, household consumption dynamics surpassed that of disposable pension growth. As a result the consumption grew at the fastest rate since the crisis. Meanwhile the export growth lagged behind its foreign demand fundamentals, owing to temporary factors, including ending lifecycles of domestically produced car models and the expected onset of new production in automotive industry.

The investment activity recovered following the 2016 decline, the latter resulting from slow absorption of EU funds under a new programming period. Investment dynamics improved especially in the second half of the year, thanks to the new car production site of Jaguar Land Rover in the Nitra region. The improved investment dynamics was partly offset by subdued government expenditure.

The employment grew by 2.2 percent and the labour market added 51 thousand jobs within the year 2017. The jobs were created across all sectors of the domestic economy, while the number of vacancies (according to ÚPSVaR[1] methodology) reached an all-time high, signalling further labour market improvements in the future period. Almost every fourth vacancy was filled by a foreign worker.

Chart 1: Public Debt to GDP



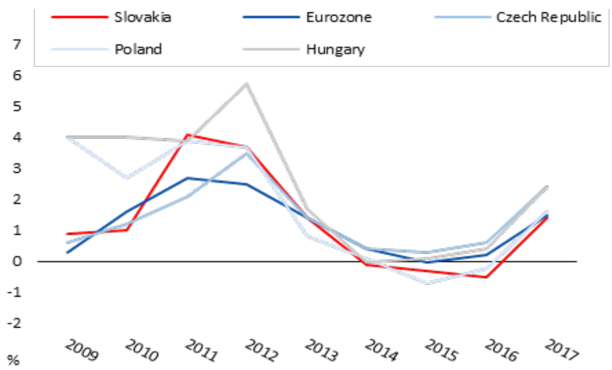
[1] *Central Office of Labour, Social Affairs and Family*

Page Source: Institute for Financial Policy/Ministry of Finance of the Slovak Republic

Turning to nominal developments, the average nominal wage reached 4.6 percent in 2017 according to the estimate of Ministry of Finance of the Slovak Republic. The reccuring price growth pressed down real wage dynamics, which stood marginally over 3 percent over the same period. Across sectors, wages recorded the fastest growth in the industry, which faced the most severe labour shortages. The wage growth surpassed the labour productivity to some extent, while unit labour costs (ULC) increased for the fourth consecutive year. Despite the recent dynamic ULC growth, its level ranks one of the lowest in EU28.

The inflation accelerated to 1.3 percent in 2017, partly owing to persistently higher food prices. The acceleration of inflation in services indicates a renewed relationship between prices and wages in the economy. Stronger exchange rate of the euro along with declining oil price trajectory curbed the inflation of tradable goods, while the decision of the Regulatory Office to decrease energy prices in January 2017 constrained the headline inflation.

Chart 2: Annual Change in Inflation



In terms of the Slovak external position, the current account deficit reached 1.8 percent of gross domestic product in 2017. The main reason was a weaker trade balance-subdued export and stronger import performance linked to recovery in investments, and strong consumption. The balance of services contributed positively to the overall balance, while the primary and secondary income balances improved marginally. The external position along with the structure of current account balance do not indicate macroeconomic imbalance risks in the near future.

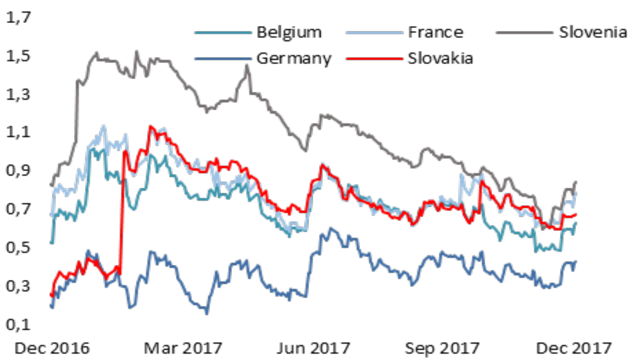
Debt Management

The Debt and Liquidity Management Agency is the government debt management office, acting in the name and on behalf of the Slovak Republic. Its mission includes securing the government´s funding at all times at the lowest possible cost over the long term while avoiding excessive risk.

The interest rates development on capital markets in the Eurozone in 2017 was mainly driven by the undergoing quantitative easing from the ECB and by changing expectations about the date when the ECB would start to slowly taper.

The yields of euro area countries were mostly oscillating around the values from the beginning of the year. The German 10-year bond was moving around the 0.4% p.a. level and the Slovak 10-year bond around the level of 0.7% p.a. The yields of 10-year bonds of all Eurozone countries remained safely in the positive territory.

Chart 3: 10-Year Government Bond Yields



Source: Bloomberg

There were 19 tranches of government securities sold in competitive auctions in 2017. On the top of the auctions, two new bond lines were opened via syndicated sales through the Primary Dealers. The total demand in face value (including syndicated sale but no T-bills) reached EUR 13.2 billion and accepted bids in face value reached EUR 6.1 billion (including syndicated sale but no T-bills). The Treasury Bills were sold in two auctions in the beginning of the year.

Table 1: Issues of the Slovak Republic Government Securities in 2017

Auction Date	Auction Type	Accepted Bids (EUR mn.)	Bid/Cover Ratio	Average YTM (% p.a.)
GB 223 (SLOVGB 3 ⅜ 11/15/24, ISIN SK4120008871)				
16.01.2017	american	112.5	2.0	0.407
18.09.2017	american	88.6	4.2	0.439
GB 227 (SLOVGB 3 ⅝ 01/16/29, ISIN SK4120009762)				
16.01.2017	american	150.9	1.5	1.207
20.02.2017	american	238.8	1.5	1.360
GB 228 (SLOVGB 1 ⅜ 01/21/27, ISIN SK4120010430)				
20.03.2017	american	214.7	2.6	1.178
15.05.2017	american	182.0	2.7	1.035
16.10.2017	american	117.0	4.8	0.780
GB 229 (SLOVGB 1 ⅝ 01/21/31, ISIN SK4120011420)				
18.04.2017	american	137.5	1.8	1.271
15.05.2017	american	144.8	2.2	1.390
GB 230 (SLOVGB 0 11/13/23, ISIN SK4120011636)				
20.03.2017	american	103.1	3.3	0.540
16.10.2017	american	104.0	2.3	0.176
GB 231 (SLOVGB 0 ⅝ 05/22/26, ISIN SK4120012220)				
16.01.2017	american	297.7	1.8	0.887
20.02.2017	american	167.3	2.5	1.004
18.04.2017	american	184.5	2.5	0.906
19.06.2017	american	160.1	2.8	0.706
20.11.2017	american	130.9	2.3	0.557
GB 232 (SLOVGB 1 ⅞ 03/09/37, ISIN SK4120012691)				
14.01.2016	syndicate	2 000.0	1.5	1.991
19.06.2017	american	201.8	1.6	1.729
18.09.2017	american	222.3	2.8	1.692
20.11.2017	american	106.5	4.5	1.633
GB 233 (SLOVGB 2 10/17/47, ISIN SK4120013400)				
10.10.2017	syndicate	1 000.0	2.7	2.027
T-BILLS 15 (SLOVTB 0 11/27/17, ISIN SK6120000154)				
09.01.2017	dutch	500.0	2.4	-0.2400
15.02.2017	dutch	300.0	2.4	-0.2500

Including non-competetive auction results.

The total demand reached EUR 1.75 billion together in both auctions and T-bills in total amount of EUR 800 million were sold to investors.

The yields in auctions ranged from 0.18% p.a. in the case of a 6 year bond to 1.69% p.a. in the case of a 19.5 year bond. The yields via syndicated deals of the 20-year and the 30-year bond reached 1.99% p.a. and 2.03% p.a. respectively.

The average weighted yield of bonds issued from auctions and syndicated sales in 2017 reached 1.53%p.a.

The T-bills were sold at negative rates -0.25% p.a. and -0.24% p.a.

Chart 4: Gross and Net Issuance

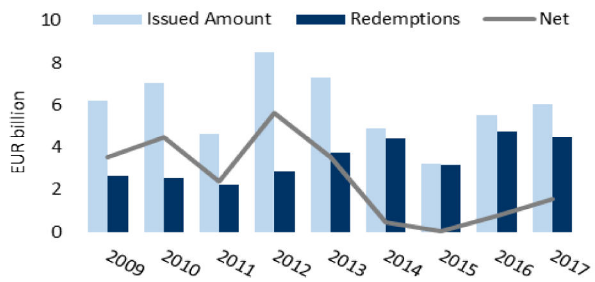


Chart 5: Redemption Profile as of 31.12.2017

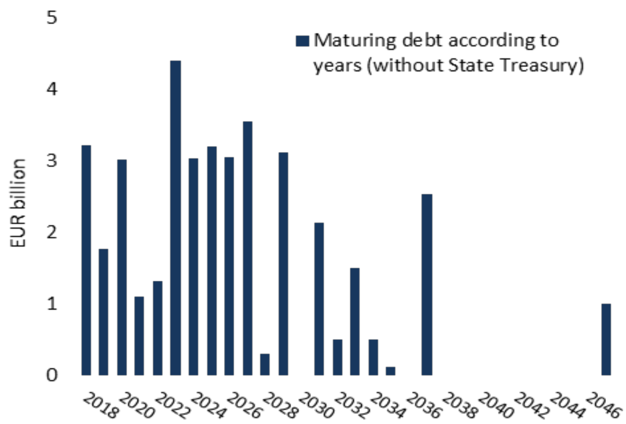
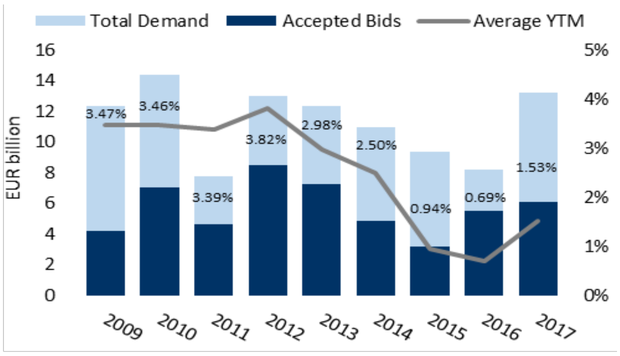


Chart 6: Primary Market of the Slovak Government Bonds



Credit Ratings

The Slovak Republic has high rating for short and long term debt with stable outlook by all major rating agencies. High investments foster strong economic growth prospects for the coming years.

Slovakia has had rating on A level or better for the last 14 years. Slovakia is ranked 29th out of 65 countries worldwide in sustainable country rating.
(Source: RobecoSAM, November 2017)

„The ratings on Slovakia reflect the country's solid economic growth prospects, gradually improving fiscal position, and low external debt. However, the ratings remain constrained by modest GDP per capita compared to European peers. Although we expect strong economic performance in the medium term, we believe that there are structural challenges, including demographic trends, that will pressure Slovakia over the long-term if not addressed and resolved".
(Source: Standard&Poor's, July 2017)

Table 2: Credit Rating

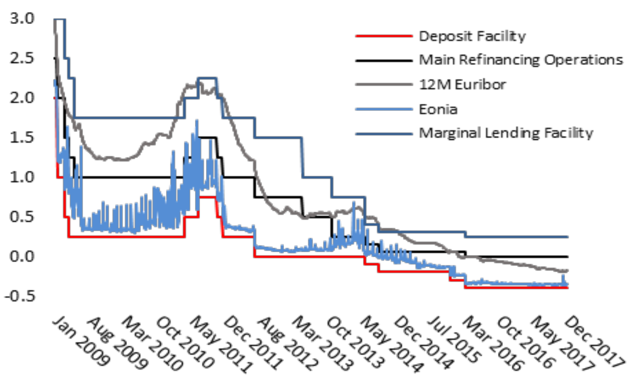
Ratings of the Slovak Republic as of January 2018		
Standard&Poor's	**A+**	**stable outlook**
Moody's	**A2**	**positive outlook**
FITCH	**A+**	**stable outlook**
DBRS	**A**	**stable outlook**

Cash Management and Markets

ARDAL is responsible for the operational cash management of the State Treasury Target2 account on the daily basis. The cashflow of this account reflects all flows of the state budget, flows connected to debt and risk management as well as flow of State Treasury clients. All transactions concluded by ARDAL are in the name and on behalf of Ministry of Finance of the Slovak Republic.

The ECB key interest rates were unchanged throughout the year 2017. Due to the monetary policy of the ECB the European banking sector remained in a huge surplus of liquidity. For this reason the appetite of commercial banks for short term deposits was very limited and ARDAL was forced to leave part of the liquidity surplus on the Target2 account of the State Treasury.

Chart 7: Key ECB and Market Interest Rates

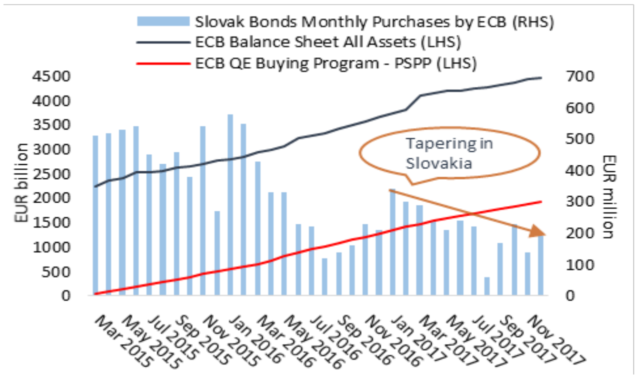


Source: ECB, Bloomberg

ARDAL concluded 1,921 money market transactions in 2017, including deals with the State Treasury. Most of the deals were done with Primary Dealers which are the preferred counterparties in respect of the liquidity management. The average maturity of the money market deposits portfolio reached 3 months at the end of the year 2017. The Act on Fiscal Responsibility was a significant factor which limited ARDAL in placing liquidity surplus over the end of the year.

Monthly ECB asset purchases volume under the PSPP programme was at the level of EUR 80 billion since January. The pace of purchases decreased to EUR 60 billion since April and this volume remained unchanged until the end of 2017. Similarly, the rate of purchased Slovak Government Bonds in PSPP programme slowed down.

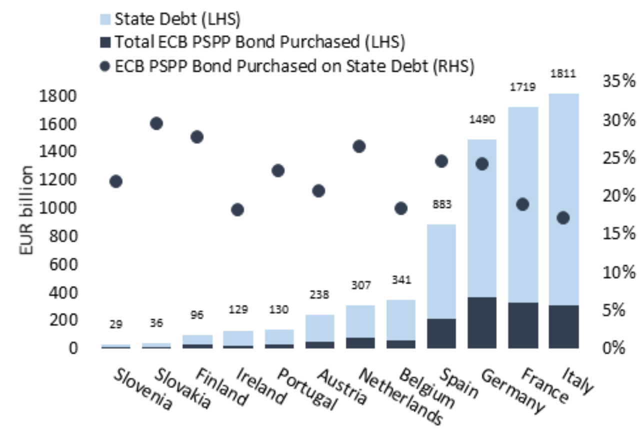
Chart 8: KECB QE Buying Programme – PSPP vs Slovak Bonds Monthly Purchases



Source: ECB

Another aspect of the PSPP programme is that the strong demand from the ECB seriously distorts yields of Government Bonds. This is particularly noticeable for the Slovakia, where about 30 percent of the bonds issued are held by ECB which is the highest level among the Eurozone countries.

Chart 9: ECB PSPP Bond Purchased vs. Total State Debt as of 30.9.2017



Source: Bloomberg

Risk Management

ARDAL manages the debt portfolio risks in accordance with the approved Government Debt Management Strategy for the years 2015-2018. This strategy continues to monitor refinancing and interest rate risks with a slightly modified target parameter values.

As regards the refinancing risk, there is a strategic intent to maintain the value of the liabilities to be redeemed within one/five years close to 20/55 percent of total liabilities.

As for the refixing risk, there is a goal to maintain the value of the liabilities to be refixed within one/five years close to 25/55 percent of total liabilities.

Chart 10: Risk Indicators of the Slovak Debt Portfolio for the Next Year

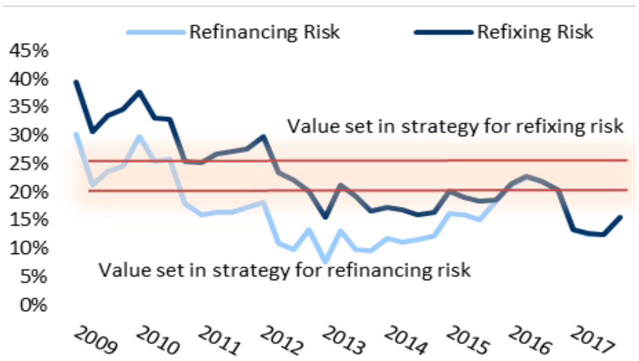
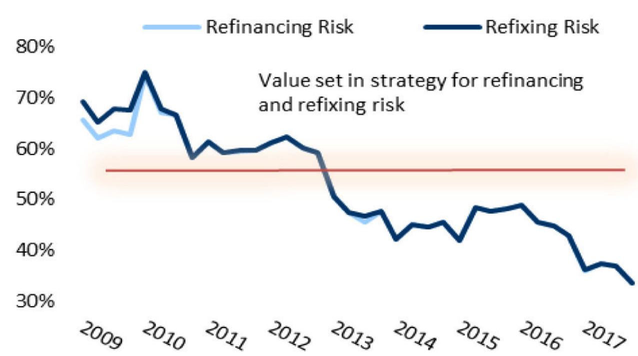


Chart 11: Risk Indicators of the Slovak Debt Portfolio for the Next 5 Cumulative Years



The weighted average maturity of the state debt portfolio reached the value 8.5 years and the duration was 7.4 years at the end of 2017.

These values are similar to the debt portfolio characteristics of the Eurozone core countries and EFSF.

Chart 12: Average Maturity and Duration of the Slovak Debt Portfolio

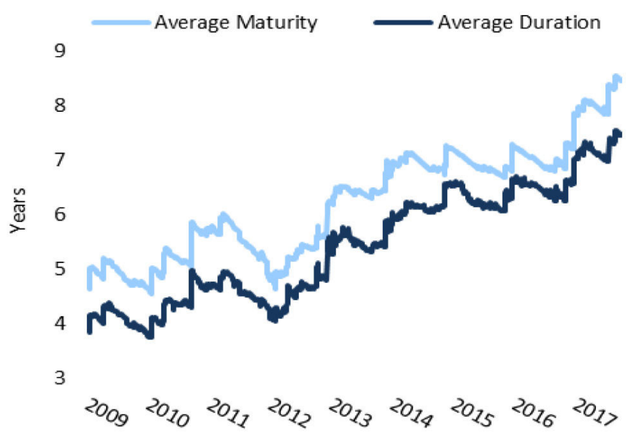
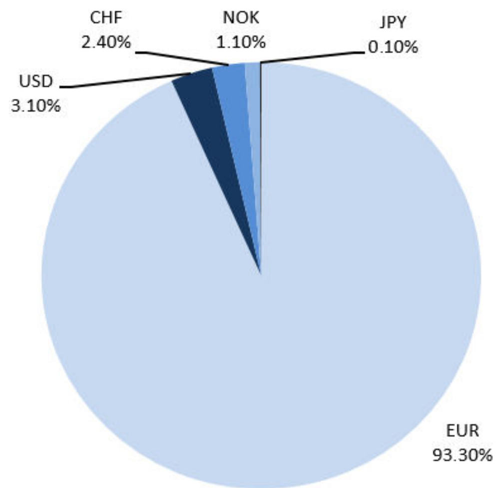


Chart 13: Slovak Debt Portfolio According Currencies before Hedging (CC IRS)



Plans for 2018

The gross funding needs (bond redemptions and deficit of the state budget) will reach EUR 4.5 billion (Government Bonds, Treasury Bills and Government Loans) in 2018. This amount is based on Act on the State Budget for 2018 and is in line with the Act on State Debt and Guarantees.

ARDAL intends to open 1 or 2 new lines of Government Bonds via syndicated sale or auction in 2018. The following lines will be opened depending on the market conditions and the investors' demand:

• new line with issue size of EUR 1 billion in spring 2018, with maturity according to market conditions (10-12 years);

• possible new line in autumn 2018, with maturity according to market conditions and government financial needs (short to middle tenor).

The total expected maximum amount to be sold via syndicated sale is EUR 2 billion, regardless of the number of transactions. Other lines of bonds can be opened based on debt management requirements and investors' demand.

The bond auctions will take place once per month – usually on the third Monday of a month. Based on cash position, debt management and demand of investors, more bonds can be auctioned in one auction day. Similarly to 2017, it is expected that auction of 1-3 bonds will take place on each auction day. To be flexible, all auctions are stated as "to be decided" in the auction calendar. The decision about the particular auctioning bonds will mainly be based on previous communication with the Primary Dealers. July, August and December auctions are not planned but can be carried out based on Primary Dealers request and agreement with the ARDAL.

The non-competitive part of the auction will take place on the next day after the competitive part of the auction. Settlement of trades resulting from both auction parts, competitive and non-competitive, will be on the same day: the competitive part of the auction D+2 and the non-competitive part of the auction D+1.

Based on "The Rules" and "The Rights and Duties", Primary Dealer whose bids were accepted in the competitive part, has the right to participate in the non-competitive part. Based on market conditions and debt management requirements, ARDAL can decide not to conduct the non-competitive part of the auction or to conduct the non-competitive part on a different day than the day after the competitive part of the auction.

Table 3: Government Bond Auctions in 2018

Month	Auction Date	Settlement Date	Offered Bonds
1	15.1.2018	17.1.2018	228, 232
2	19.2.2018	21.2.2018	to be decided
3	19.3.2018	21.3.2018	to be decided
4	16.4.2018	18.4.2018	to be decided
5	21.5.2018	23.5.2018	to be decided
6	18.6.2018	20.6.2018	to be decided
7	16.7.2018	18.7.2018	to be decided
8	20.8.2018	22.8.2018	to be decided
9	17.9.2018	19.9.2018	to be decided
10	15.10.2018	17.10.2018	to be decided
11	19.11.2018	21.11.2018	to be decided
12	17.12.2018	19.12.2018	to be decided

Table 4: Open Lines of Bonds (Available for Auctions) as of 31.12.2017

ISIN	Maturity	Coupon (% p.a.)	Available (EUR million)
SK4120009762	16.1.2029	3.625	355.2
SK4120010430	21.1.2027	1.375	174.1
SK4120011420	21.1.2031	1.625	1,224.7
SK4120011636	13.11.2023	0.000	255.8
SK4120012220	22.5.2026	0.625	50.0
SK4120012691	9.3.2037	1.875	469.4
SK4120013400	17.10.2047	2.000	4,000.0
Total Amount			**6,529.2**

Treasury Bills

ARDAL is planning to issue new Treasury Bill line (TB 16, total issue size EUR 1.5 billion) into own portfolio in 2018. The part of Treasury Bill line will probably be sold in the competitive auctions (2–4 auctions).

Outlook for 2018

According to the European Commission's forecast, Slovakia should be among the fastest growing economies within the euro area with estimated GDP growth 3.8% in 2018, which gives good pre-conditions for a further reduction of the structural budget deficit. The state budget deficit should fall below 1% and the gross public debt at the end of 2018 should reach 49.9% of GDP. Slovakia will remain in the euro zone indebtedness map in the group of least indebted countries.

The 2018 and the following years in the near future will mean the lowest need for government debt financing in the last ten years, mainly due to declining government deficits and smaller repayments of the existing debt. Slovakia will be on the capital market also this year and will offer to investors a wide range of Government Bonds with a maturity of one year to almost 30 years. In 2018, ARDAL will focus mainly on medium-term maturities. According to Slovakia a significant factor influencing Slovak bond yields in 2018 could be the slowdown - the tapering of ECB quantitative easing.

The average maturity of the Slovak bonds is at the level of 9 years, which corresponds approximately to the average of the OECD member countries. Government debt risk parameters are, after many years of effort, at the historically best levels. Last year, ARDAL managed to decrease interest rates on government debt in such a way that the additional interest expenditure in case of yields increase would be as small as possible.

The next year will be very specific for ARDAL. The 15th anniversary of the establishment of the Debt and Liquidity Management Agency is the right time to look back a little. On the imaginary to-do list of long-term strategic tasks, there is the last important point - to improve the liquidity of Government Securities on the secondary market. ARDAL plans to launch an electronic platform for the secondary market - MTS Slovakia, dedicated to Slovak Government Securities.

The intention of ARDAL is to improve communication with investors, especially abroad. One of ARDAL´s plan is to improve and extend information on state debt to the professional community.

Primary Dealers

The group of Primary Dealers of the Slovak Government Debt Securities for year 2018:

Barclays Bank plc

Citibank Europe plc

Československá obchodná banka, a.s. (KBC Group)

Deutsche Bank AG

HSBC France

Natixis S.A.

Slovenská sporiteľňa, a.s., (Erste Group Bank)

Société Générale S.A.

Tatra banka, a.s., (RZB Group)

Všeobecná úverová banka, a.s., (Intesa Sanpaolo Group)

Photo: Building of the State Treasury and ARDAL, Radlinskeho Street

Contacts

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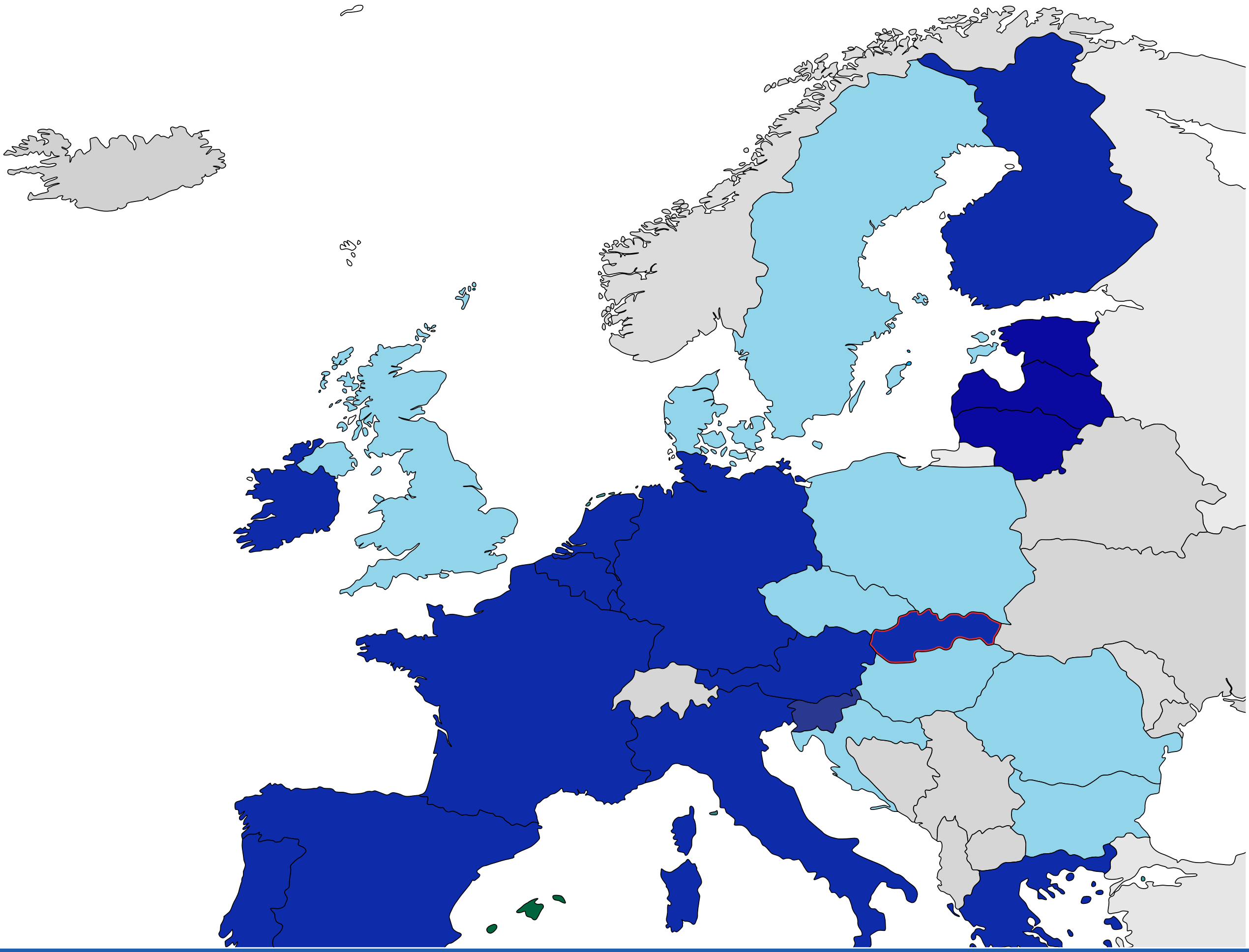
Webpage: *www.ardal.sk*

Bloomberg/Reuters: *DLMA*

Useful Links

- www.ardal.sk (Debt and Liquidity Management Agency)
- www.finance.gov.sk (Ministry of Finance of the Slovak Republic)
- www.statistics.sk (Statistical Office of the Slovak Republic)
- www.nbs.sk (National Bank of Slovakia)
- www.ecb.europa.eu (European Central Bank)
- www.pokladnica.sk (State Treasury)
- www.cdcp.sk (Central Depository of Securities)
- www.bsse.sk (Bratislava Stock Exchange)
- www.ec.europa.eu/eurostat (Eurostat)
- www.europa.eu/efc/esdm_en (ESDM)



Agentúra pre riadenie dlhu a likvidity (hereinafter referred to as the "ARDAL"), with its registered seat at Radlinského 32, Bratislava, Identification No.: 30792053 acting on behalf of the Ministry of Finance. ARDAL manages the state debt according to the Act. No. 291/2002 Coll. on State Treasury, as amended, in line with the Debt Management Strategy approved for the given period by the Government of the Slovak Republic.

For the avoidance of doubt, ARDAL notes that all the data contained herein are informational only and should not be used for legal purposes. The submitted information has no influence on investments or sales of the government securities.

ARDAL is not responsible for any claims, losses, liabilities or expenses incurred as a result of decisions of these investments based on the data provided in this document.