ANNUAL REPORT

2005 - 2006

DEBT AND LIQUIDITY MANAGEMENT AGENCY

Content

Debt and Liquidity Management Agency in 2005 and 2006

From January 2005 onwards, the Debt and Liquidity Management Agency (ARDAL) has been fully performing its main tasks specified in the State Treasury Act and the State Debt and Government Guarantees Act, as all public sector clients have been connected to the state treasury system since then. Thanks to the functioning entire state treasury system, the state procured financial resources not only by issuing Government Bonds, Government Treasury Bills and by drawing loans, but also from the public sector‘s centralized finances and the interbank market.

In 2005 and 2006, the financial benefits from the state treasury system comprised reduced debt service costs and reduced liquidity management costs owing to the active use of the funds of State Treasury clients, use of a good ratio and structure of resources from the local and foreign interbank markets (money and capital) and an increased flexibility in managing the above areas.

From January 2005 onwards, ARDAL has been organizing electronic auctions of government securities. During the years, ARDAL issued Government Treasury Bills to its own portfolio in order to make REPO deals, which is a standard instrument aimed at ensuring liquidity.

In 2005 and 2006, ARDAL carried on with the state debt management processes and in performing its responsibilities it maintained indicators set in the approved 2006 State Debt Management Strategy. The main indicators included:

- optimizing the costs (expenses) of the state budget of servicing the state debt,
- maintaining the average maturity of over 4 years and continuing to extend it towards 5 years, maintaining the indicator of the target duration of the portfolio in the 3.5 to 4-years interval,
- reducing the number of new issues of Government Securities and ensuring a standard size of individual issues,
- gradually increasing the state debt coverage in foreign currencies at the expense of debt in Slovak korunas,
- improving the transparency of the issuer‘s intentions and its communication with investors and financial markets.

Although interest rates on the local and European financial markets rose in 2006, ARDAL succeeded in maintaining unchanged and even slightly reducing the average interest rates on the outstanding Government Bond portfolio from 6.286% per annum in 2003, 5.92 percent per annum in 2004, 4.998 percent per annum in 2005 to 4.841 percent per annum in 2006. Similarly, ARDAL managed to restructure the Government Bond portfolio and to increase bond duration from 2.8 years in 2002 to 3.729 years in 2006, and to increase the average maturity from 3.29 years in 2002 to 5.139 years in 2006, thereby reducing the portfolio‘s sensitivity to changes in interest rates. Wherever possible, ARDAL restructured also the Government Loan portfolio either by early repayment or by changing financial conditions by abolishing the margin and reducing the cost of borrowing to the market rate. In 2005 and 2006, ARDAL repaid early 11 Government Loans, and reduced the margin on other 4 loans from 2 percent per annum to 0 percent per annum or from 1 percent per annum to 0 percent per annum. The above restructuring saved a total of about SKK 329 million.

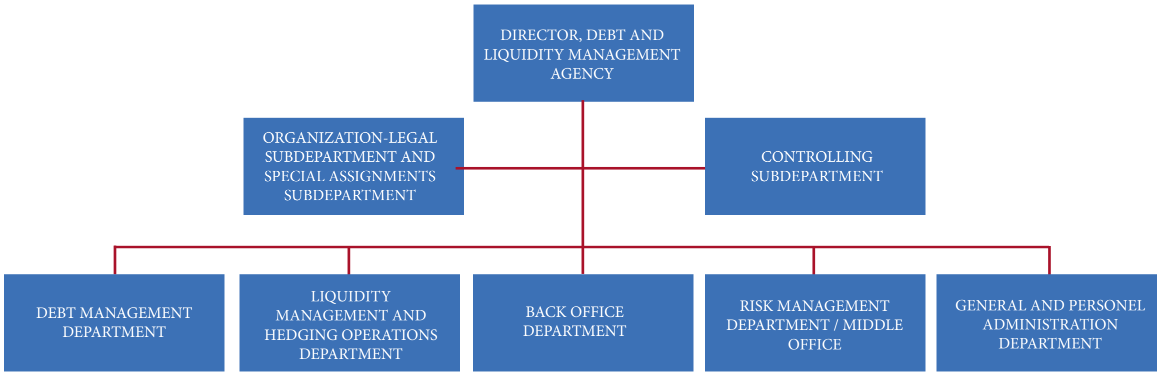
In accordance with the objectives of the debt management strategy, Slovakia issued a Bond on the European market in 2006. The issued Bond has a 15-years maturity and a face value of EUR 1 billion and carries a fixed coupon interest rate of 4 percent per annum. In this issue, Slovakia had the best spread in comparison with benchmark instruments. The spread from ASW mid was as little as 7 basic points, which is the smallest spread not only in the V4 countries but also in all eastern European nations.

From March 2006 onwards, ARDAL has been trading in the local currency on the money market only in the name of the Ministry of Finance of the Slovak Republic. By establishing and managing a sole position, ARDAL has introdued another efficient procedure from commercial practice. By doing so ARDAL has also created conditions for an immediate and correct reconciliation of account transactions directly with trades made by the department which made the trade concerned thereby preventing problems from taking place or reducing the time between identifying a problem and fixing it. Another factor which considerably improved conditions for a more efficient liquidity management was the modification of the whole State Treasury financial planning system thereby improving the quality of data necessary for the daily liquidity management, notably making the next-2-weeks‘ data more accurate. ARDAL‘s goal in 2006 was to ensure a balanced management of the koruna liquidity position of the Ministry of Finance of the Slovak Republic on a weekly basis and to obtaing higher yields on surplus liquidity than in the previous year. This allowed ARDAL to use the State Treasury‘s short-term financial resources not only to cover the deficit, but also to cover the Slovak Republic‘s debt to a larger extent than in the previous year. For this reason, ARDAL did not issue any Government Treasury Bills and issued Government Bonds with a face value of only SKK 33.2 billion compared with the originally anticipated SKK 60 billion.

ARDAL‘s 2004 and 2005 operations were audited by the Supreme Audit Office of the Slovak Republic which verified mainly the accuracy and completeness of the register of the state liabilities. It evaluated the efficiency of financing the state liabilities by ARDAL in accordance with decisions of the government and the Ministry of Finance of the Slovak Republic, and verified compliance with section 17 of Act 291/2002 on the State Treasury and on Amending and Supplementing Some laws as amended.

Human and Financial Resources

Organizational structure



Daniel Bytčánek	Statutory Representative – Director
Tomáš Kapusta	Head of Debt Management Department
Martin Viest	Head of Liquidity Management and Hedging Operations Department
Alena Delinčáková	Head of Risk Management / Middle Office Department
Zuzana Reindlová	Head of Back Office Department
Ján Tencer	Head of General and Personnel Administration Department

ARDAL's 2005 and 2006 Budget

ARDAL's budget expenses in 2005 were SKK 29,807,000, i.e. 99.8 percent of the revised budget and SKK 35,663,000 in 2006, i.e. 99.9 percent of the revised budget.
Current – operating expenses in 2005 were SKK 25,421,000 and in 2006 SKK 29,190,000, respectively. Actual expenses in both years corresponded to the full 100 percent of the budgets. Wages together with social and health insurance of the ARDAL personnel accounted for 51.7 percent of the operating expenses in 2005. Their share fell to 48.4 percent in 2006. Nearly ¾ of the remaining operating expenses in the two years were spent on establishing and supporting the information system. Further operating expenses comprised rent for premises used by ARDAL and purchase of small services and goods of operating character.
Capital expenses in 2005 were SKK 4,387,000, i.e. 98.4 percent of the budget expenses, and in 2006 they reached SKK 6,474,000, i.e. 99.5 percent of the budget. These funds were spent on implementing ACM Trema Suite. To further improve and increase the standard of its information technologies, the ARDAL purchased from company Reuters a program for making electronic auctions of Government Securities. The security of ARDAL's information system was increased by establishing a demilitarized zone, the system's availability was increased substantially, and the infrastructure of the information technologies was improved by adding a new hardware and software.

Human Resources

ARDAL has 17 employees, of whom 14 are employed in state service and 3 in public-interest service. In accordance with the State Service Act, 1 of the 14 employees holds a position of special importance, 12 employees are employed in permanent service and 1 employee is in fixed-term service. These personnel managed to smoothly perform their tasks only because they all worked with increased intensity and overtimes without extra pay. Therefore the ARDAL personnel are paid, in addition to their base wage, also extras and bonuses up to an approved limit for this purpose.
ARDAL expects to regulate the income of its personnel up to a maximum number of 35 employees. Hiring further personnel continues to be problematic and very arduous, particularly because their wages are limited by the set budget and do not correspond to the required skills and experience in trading in the area of banking and financial markets, including command of English language.
All employees in managerial positions and most employees in executive positions have several-year-long experience in trading on banking and financial markets in banking and financial institutions. In the reported period they successfully represented the Slovak Republic in the bodies of the European Commission and OECD in the area of state debt. The ARDAL personnel attended several events, mostly abroad, and in the majority of them they actively presented the results of the Slovak economy, notably in the area of market of Government Securities and government debt and liquidity management. The events included a Road Show, conferences and other expert meetings and negotiations with investors, with international financial-market authorities, rating agencies and auditors.

Audit‘s Results

ARDAL‘s operations in 2005 were audited by the Supreme Audit Office of the Slovak Republic which verified mainly the accuracy and completeness of registration of the state‘s liabilities. It evaluated the efficiency of financing the state‘s liabilities by ARDAL in accordance with decisions of the Slovak Government and the Ministry of Finance of the Slovak Republic and verified compliance with the provisions of section 17 of Act 291/2002 on State Treasury and on Amending and Supplementing Some Laws as amended.

The audit was concluded by a report which, among other things, stated the following:

- registers maintained by ARDAL are complete, easy to review and contain all relevant data necessary for an accurate identification of individual liabilities, and therefore are suitable for the proper performance of the agency‘s main tasks in the field of repayment of the state‘s liabilities,
- ARDAL gradually meets the government-approved goals of a debt management strategy and meeting these goals will reduce the necessary expenses on financing the state debt,
- in the state debt and liquidity management system currently in place, the Supreme Audit Office of the Slovak Republic appreciates as a positive element the establishment of the Debt and Liquidity Management Committee,
- as for the performance of its principal tasks, ARDAL‘s operations in the audited period are consistent with the goals set by the Slovak government in the approved State Debt Management Strategy until 2006, and ARDAL has performed state debt management, state budget liquidity and financing of the state‘s needs in a transparent manner, and at the same time the expenses were rational and the risks relating to the state debt and liquidity management were minimized.

Milestones in 2005 and 2006

January 2005 - Launch of trading by an electronic auction system
The Debt and Liquidity Management Agency assumed the responsibility for organizing auctions of government securities early in 2005 and from the beggining it introduced an electronic system for receiving bids, evaluating them and reporting results to the bidders and to the financial market.

12 January 2005 – Moody´s Agency upgraded Slovakia‘s rating
The international rating agency Moody‘s Investors Service upgraded the rating of Slovakia‘s long-term foreign-currency debt from A3 to A2 and the rating of short-term foreign-currency debt from P-1 to P-2. Moody‘s also upgraded the rating of outstanding medium-term Government Bonds in the local and foreign currency from A3 to A2.

28 February 2005 – Reducing key interest rates
The Bank Council of the National Bank of Slovakia at its session decided to cut interest rates to 2.00 percent per annum for overnight sterilization trades, 4.00 percent per annum for overnight refinancing trades and 3.00 percent per annum for fortnight repo tenders. This decision cut the key interest rates in the Slovak Republic to all-time lows.

4 May 2005 – Launching a new issue of Government Bonds
In May 2005, the Ministry of Finance of the Slovak Republic through the Debt and Liquidity Management Agency launched on the market a new issue of 7-years zero-coupon bonds maturing in May 2012. The total value of bonds no. 2005 was SKK 40 billion.

11 October 2005 – Fitch Agency upgraded Slovakia‘s rating
The international rating agency Fitch Ratings upgraded the rating of the Slovak Republic‘s long-term foreign-currency debt from A- to A. The agency also upgraded the rating of Slovakia‘s short-term foreign-currency debt from F2 to F1 and upgraded the country‘s ceiling rating from A+ to AA-. The agency also confirmed the unchanged rating of Slovakia‘s long-term debt in Slovak koruna of A+. The outlook of Slovakia‘s ratings was set as stable.

25 November 2005 – Slovak Republic joined ERM II System
After seven years of a floating exchange rate, the koruna joined the ERM II band within which it should remain for two years as one of the Maastricht criteria for the euro introduction. Slovak finance minister Ivan Mikloš together with the National Bank of Slovakia‘s governor Ivan Šramko made an agreement on the conditions of introducing the euro with the European Central Bank and finance ministers of the other EMU countries on 24 November 2005. Under the agreement, the Slovak koruna/euro exchange rate is rather loose: it may „oscillate“ from 32.69 to 44.22 koruna per euro and its mid-rate is anchored at 38.455 koruna per euro. The koruna may depreciate or appreciate from the central parity by as much as 15 percent.
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15 December 2005 – Approving the Slovak Republic‘s budget
National Council of the Slovak Republic approved the draft 2006 state budget with a deficit of SKK 57.468 billion. The budget called for the total revenues in the year of SKK 272.717 million and total expenses of SKK 330,185 million. The deficit of the public finance calculated by the ESA 95 methodology in 2006 excluding the cost of pension reform should reach 2.9 percent of the expected gross domestic product.

19 December 2005 – Standard & Poors Agency upgraded Slovakia‘s rating
The international rating agency Standard & Poor‘s Ratings Services upgraded ratings of the Slovak Republic. It upgraded the rating of Slovakia‘s long-term debt from A- to A and the rating of the country‘s short-term debt from A-2 to A-1 with a stable outlook.

1 March 2006 – Increasing key interest rates
The Bank Council of the National Bank of Slovakia at its session decided to increase interest rates to 2.50 percent per annum for overnight sterilization trades, 4.50 percent per annum for overnight refinancing trades and 3.50 percent per annum for fortnight repo tenders. This decision brought to an end the period of the lowest key interest rates in Slovakia‘s history.

27 March 2006 - Slovakia issued a bond on European market the Ministry of Finance of the Slovak Republic through the Debt and Liquidity Management Agency launched on the European market a bond with a 15-years maturity, in the nominal amount of EUR 1 billion and with a fixed interest rate coupon of 4 percent per annum.

8 May 2006 - Launching a new issue of government bonds
In May 2006, Ministry of Finance of the Slovak Republic through the Debt and Liquidity Management Agency launched on the market a new issue of 20-years bonds with a fixed coupon. It was the first time ever that Slovakia issued a bond with a 20-years maturity. The total value of the bond issue no. 2007 was SKK 40 billion.

31 May 2006 – Increasing key interest rates
The Bank Council of the National Bank of Slovakia at its session decided to increase interest rates to 3.00 percent per annum for overnight sterilization trades, 5.00 percent per annum for overnight refinancing trades and 4.00 percent per annum for fortnight repo tenders.

17 June 2006 - General election
The general election was won by the opposition party Smer - Sociálna demokracia (Smer-SD) with 29.14 percent of votes. The SDKÚ-DS party of prime minister Mikuláš Dzurinda with 18.35 percent of votes fared surprisingly well. The election turnout was 54.67 percent of eligible voters, the lowest ever in the history of general elections in Slovakia.

4 July 2006 – New Slovak government
President Gašparovič appointed a new government headed by Smer-SD chairman Robert Fico. After nearly eight years this brought to an end the government led by Mikuláš Dzurinda (SDKÚ-DS).

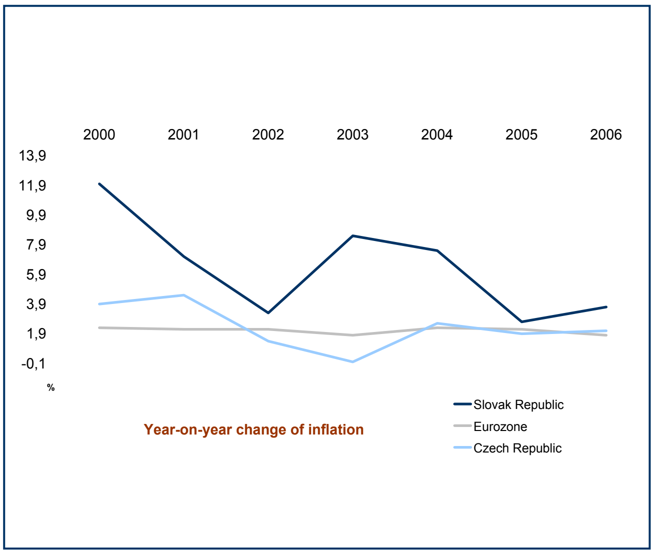
11 August 2006 – Increasing key interest rates
The Bank Council of the National Bank of Slovakia at its session decided to raise interest rates to 6.00 percent per annum for overnight refinancing trades and 4.50 percent per annum for fortnight repo tenders.

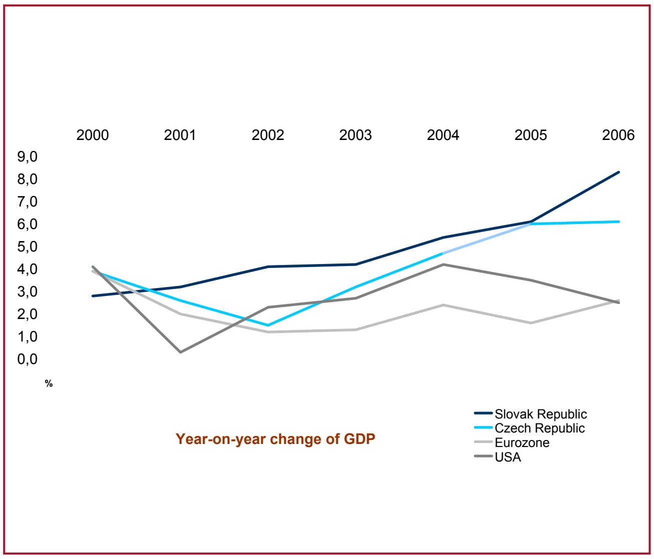
29 September 2006 - Increasing key interest rates
The Bank Council of the National Bank of Slovakia at its session decided to raise interest rates to 3.25 percent per annum for overnight sterilization trades, 6.25 percent per annum for overnight refinancing trades and 4.75 percent per annum for fortnight repo tenders.

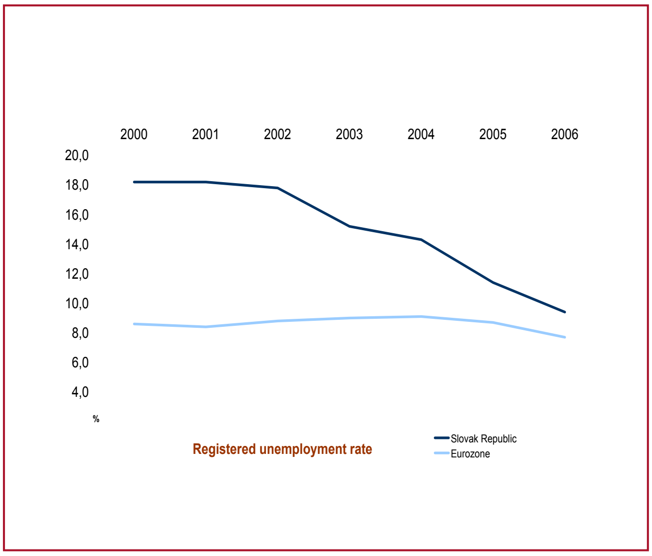
17 October 2006 - Moody's Investors Service Agency upgraded Slovakia's rating
The rating agency Moody's Investors Service upgraded the rating of Slovakia's Government Bonds in the local and foreign currency from A2 to A1.

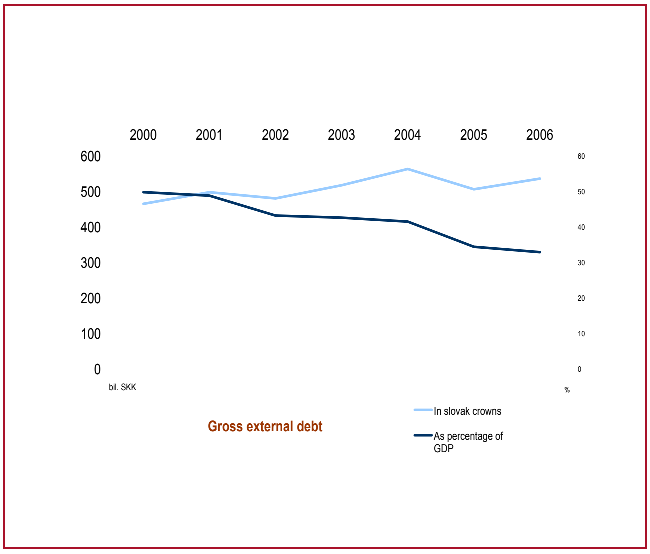
12 December 2006 – Approving Slovak Republic's budget
The Parliament passed the 2007 State Budget Act submitted by the government. 85 of the 150 MPs present voted for it. 65 MPs voted against it and nobody abstained from the vote. The state budget plans a deficit of SKK 38.368 billion, revenues of SKK 310.471 billion and expenses of SKK 348.857 billion. The public finance deficit should reach 2.9 percent of GDP.

Macroeconomic Overview



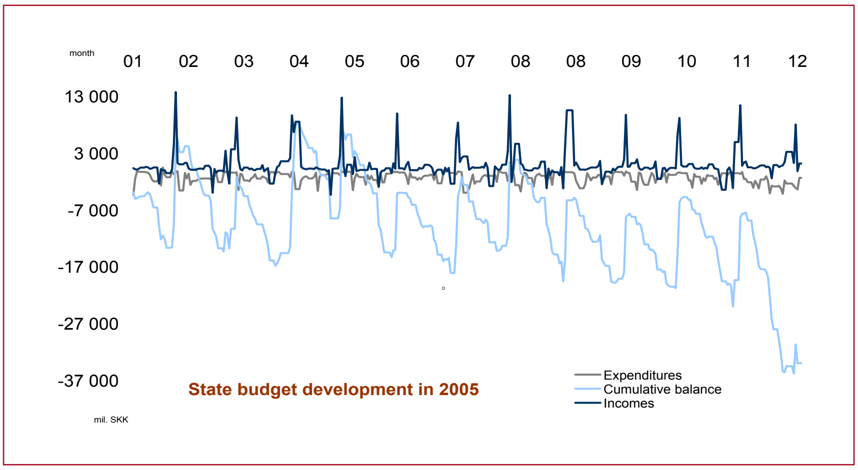


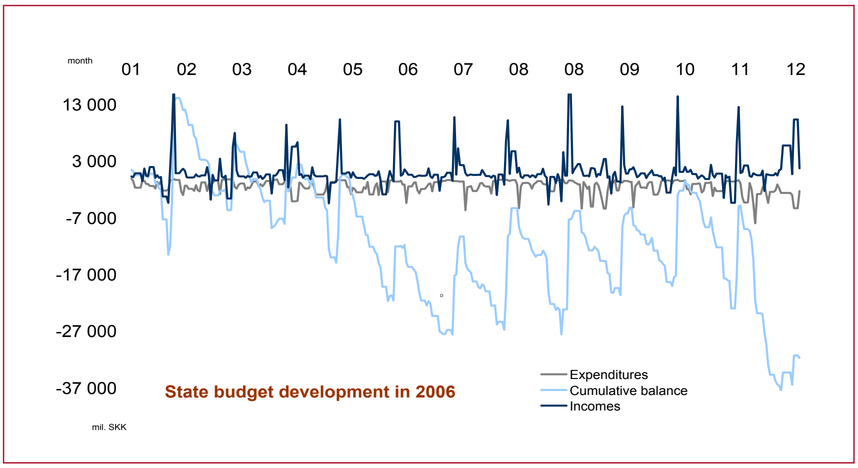


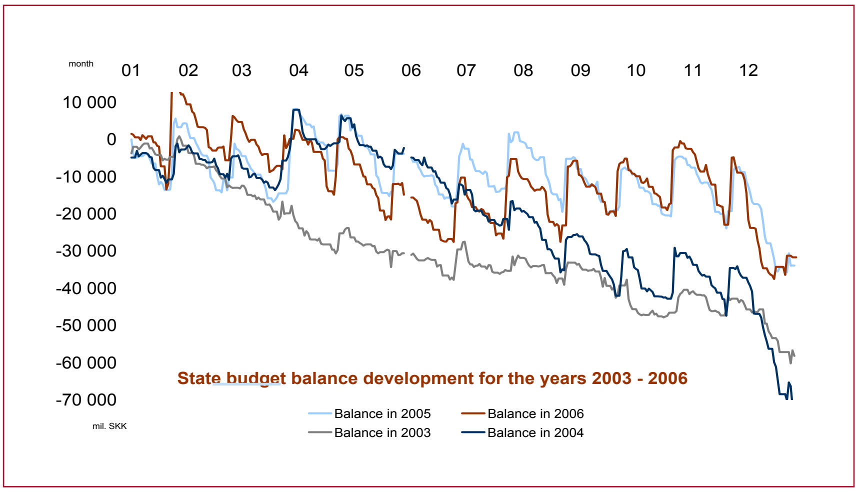


Agency	Rating of Slovakia‘s long-term debt	Date of issue
Standard&Poor‘s	A strong capacity to perform financial liabilities	19.12.2005
Moody‘s	A1	17.10.2006
FITCH	A strong capacity to perform financial liabilities	11.10.2005

Government Budget Development in 2005 and 2006







In both years Slovakia‘s actual government deficit was much lower than originally planned in the budget. The deficit as of 31 December 2005 was SKK 33.886 billion (2005 planned deficit was SKK 61.526 billion). The deficit as of 31 December 2006 was SKK 31.678 billion (2006 planned deficit was SKK 57.468 billion).
A temporary mismatch between the state budget‘s revenues and expenses was covered by financial resources accumulated for repaying the government debt, and partly by financial resources obtained by issuing Government Treasury Bills, financial resources obtained on the interbank market and financial resources from the State Treasury‘s refinancing system.

Liquidity Management

Parties Involved in Liquidity Management

The liquidity management system is controlled by and composed of three entities described below:

State Treasury – is a state budgetary organization whose mission is to maintain client accounts in accordance with Act 291/2002 on the State Treasury and on Amending and Supplementing Some Laws, make domestic and cross-border payments, control expenses from the state budget and to make payments from the state budget.

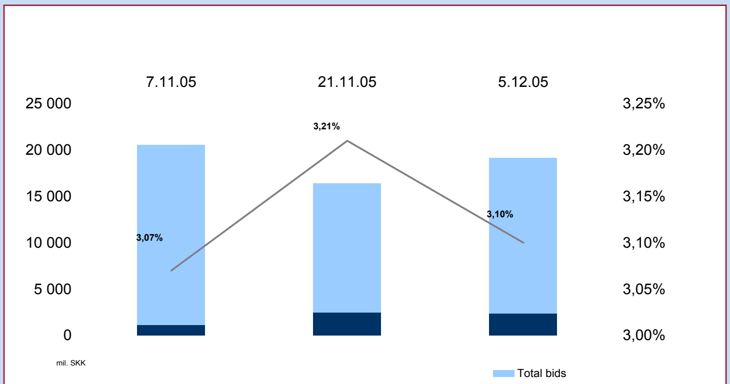
Ministry of Finance of the Slovak Republic (State Debt Client) – is responsible for managing liquidity, state budget and debt on a sole account of the state. On this account the ministry issues government securities, receives loans and makes transactions on the financial market and credits/debits such transactions.

ARDAL – is a state budgetary organization responsible for ensuring operations relating to state liquidity and debt management for the Ministry of Finance of the Slovak Republic (State Debt Client) on a sole account of the state and for managing related risks. ARDAL also efficiently manages the State Treasury's liquidity in the local currency on the State Treasury's sole account and related risks. The liquidity management of both organizations is considerably facilitated by the refinancing system between the Ministry of Finance of the Slovak Republic and the State Treasury.

ARDAL in association with the Ministry of Finance of the Slovak Republic have prepared a document which clearly defines the method of exchanging accounting documents and preparing the budget for the State Debt Client.

Government Treasury Bills with a face value of SKK 5,820 million were issued in 2005. Accepted interest rates ranged from 3.07 percent per annum to 3.21 percent per annum. The accepted interest rates remained between the BRIBOR and BRIBID rates throughout the year. The average interest rate (weighted amounts and maturities) on the Government Treasury Bill portfolio issued in 2005 was 3.14 percent per annum.

No auctions of Government Treasury Bills were made in 2006 as the State Treasury had enough disposable resources for financing the deficit.



Overview of State Treasury Bills auctions results in 2005

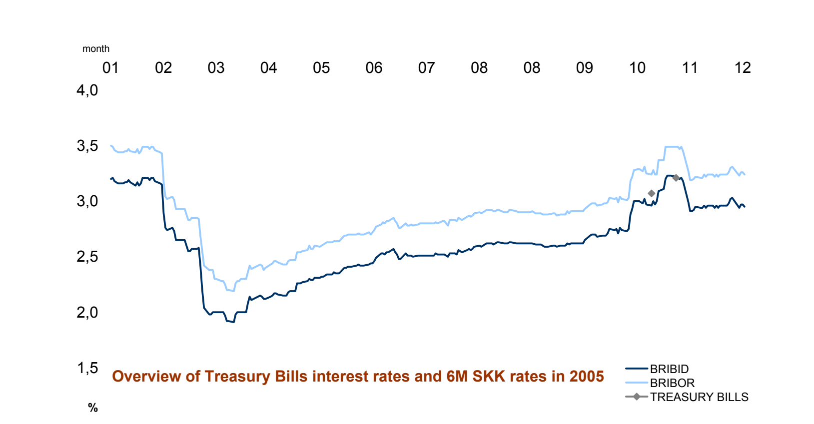
After 2004 – the year of transition when client accounts were moved from the National Bank of Slovakia to the State Treasury and when ARDAL's main task was liquidity management on the sole account in two financial institutions, year 2005 was much simpler as regards liquidity management. For this reason, ARDAL focused mainly on the efficiency of liquidity management in order to get the maximum yield from short-term surplus resources of the State Treasury and the State Treasury's financial resources were used primarily to cover the state debt and the state budget.

In 2006 the ARDAL fulfilled a goal set in 2005 – reducing the number of clients represented by ARDAL in trading on the money market from two to one. From 1 March 2006 onwards, ARDAL has been trading in the local currency on the money market only on behalf of the Ministry of Finance of the Slovak Republic. This is possible thanks to the so-called refinancing system established between the State Treasury and the Ministry of Finance of the Slovak Republic which allows the ministry to buy from the State Treasury its surplus liquidity in the Slovak koruna on a daily basis. ARDAL in the name of the Ministry of Finance of the Slovak Republic currently trades deposits, makes REPO trades or sale and buy back trades (so called reverse trades), currency conversions and currency swaps. By creating and managing the sole position, ARDAL has appreciably reduced possible risks arising out of trade settlements both on the part of banks and ARDAL.

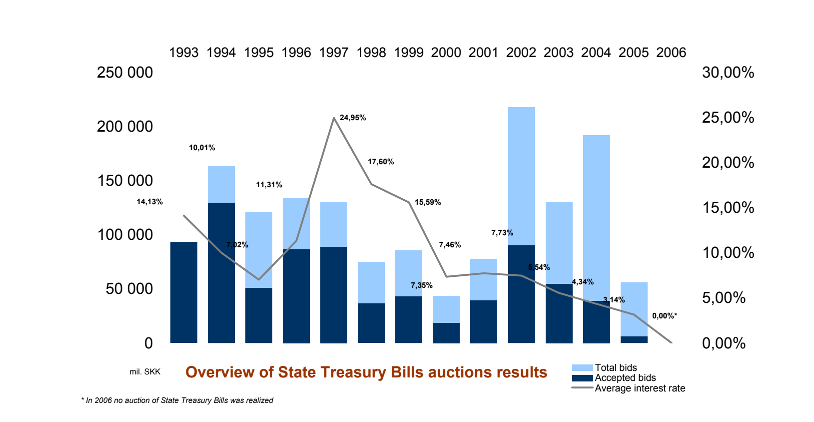
The State Treasury modified the entire financial planning system in 2006 and implemented a new module for processing historic data on transactions on client accounts. As a result it was necessary to modify also financial plans which the State Treasury provides to ARDAL. The State Treasury gradually improved the quality of data necessary for a daily liquidity management, notably it now supplies much more accurate data on the following two weeks.

The above changes have resulted in considerably improved conditions for liquidity management, particularly for short-term investment of disposable resources in the local currency in 2-weeks' sterilization tenders through commercial banks. One of ARDAL's objectives in 2006 was to balance the management of the Ministry of Finance of the Slovak Republic's koruna liquidity position on a weekly basis and to get higher yields from surplus liquidity than it got in the previous year. This also allowed ARDAL to use short-term financial resources of the State Treasury not only for covering deficits but also to cover debts of the Slovak Republic to a larger extent than it did in the previous year.

Owing to the improving conditions for liquidity management, ARDAL plans to launch operations of a modified and considerably expanded auction system in 2007. The system is designed to satisfy the refinancing needs of the Ministry of Finance of the Slovak Republic by using auctions of primary issues of Government Treasury Bills, REPO trades in Government Bonds and Treasury Bills and sell and buy-back trades in Government Bonds and Treasury Bills.



Overview of Treasury Bills interest rates and 6M SKK rates in 2005



Overview of State Treasury Bills auctions results

In 2005, ARDAL already normally operated on the interbank market but could not make standard interbank trades with the National Bank of Slovakia. ARDAL therefore could not take part in sterilization repo tenders of the National Bank of Slovakia and since 1 March 2005 was excluded from primary auctions of Treasury Bills of the National Bank of Slovakia and from secondary trading in National Bank of Slovakia Treasury Bills. ARDAL therefore had to deposit temporarily disposable funds on the interbank market and in commercial banks, which resulted in a higher credit risk.
The National Bank of Slovakia even did not allow ARDAL to draw an intraday credit limit which contributes to a trouble-free settlement of interbank trades on the whole interbank market in the local currency. It is normal practice in the EMU countries that organizations responsible for procuring resources for covering government debt and for liquidity management may draw an intraday credit from the central bank. This state persisted until 2006.
In 2005 and 2006, ARDAL made largely short-term intrabank deposits in the name of the State Treasury and the Ministry of Finance of the Slovak Republic (State Debt Client) in accordance with limits approved for individual local and foreign commercial banks. The only way to appreciate disposable financial resources in the National Bank of Slovakia is to deposit them to the so-called State Treasury's appreciation account maintained in the National Bank of Slovakia which, however, has a cap on the amount of interest-bearing funds and the interest on this account does not correspond to market conditions.

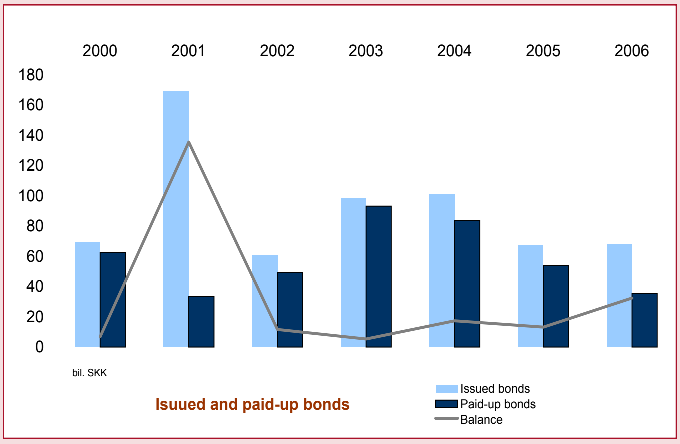
Debt Management

ARDAL continued to take advantage of the synergic effect in state debt and liquidity management which allows to bridge temporarily adverse conditions on the market and/or to benefit from good market conditions by issuing Government Bonds for refinancing the state on the best market conditions. In 2005, ARDAL used low interest rates on the capital market for fixing the future costs of longer maturities in a period before an anticipated increase in the key interest rates by issuing Government Bonds in the amount larger than was the minimum amount necessary at that time. The funds procured at the auctions were then lent on the interbank market and carried interest on the market conditions. This issuance policy and active management of funds procurement allowed ARDAL to improve the indicators of average maturity and duration in accordance with the approved State Debt Management Strategy until 2006.

Interest rates on longer maturities increased in 2006 until July and then slightly decreased until September. ARDAL issued Government Bonds primarily in the first and last quarters of 2006 and the total face value of the bonds issued in 2006 was smaller than originally planned. The state‘s financial needs were increasingly financed by resources procured from the State Treasury and the market.

The amount of the Slovak government debt maturing in 2005 was approximately SKK 125 billion. It was refinanced by term deposits from the State Treasury in the amount of SKK 70 billion (funds for pension reform transferred from the National Bank of Slovakia to the State Treasury) and financial resources procured by issuing Government Bonds with a face value of SKK 67.196 billion.

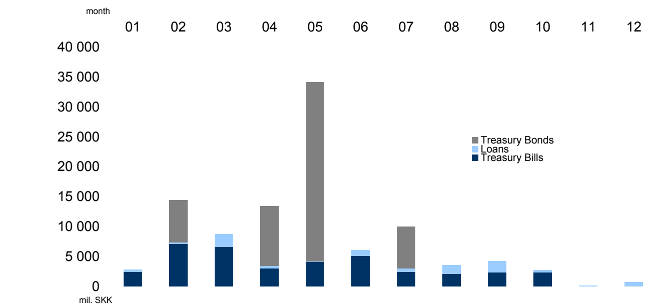
The financial liabilities of the Slovak Republic maturing in 2006 actually amounted to SKK 90.5 billion, and therefore by early termination of term deposits from the State Treasury (funds for pension reform) in the amount of SKK 60.0 billion ARDAL repaid a total principal amount of SKK 150.5 billion. The debt was refinanced by short-term resources borrowed from the State Treasury in the mount of SKK 80 billion and the remainder was procured by issuing bonds. The issued local-currency bonds totaled SKK 33.2 billion. A benchmark EUR-denominated bond has a face value of EUR 1 billion.



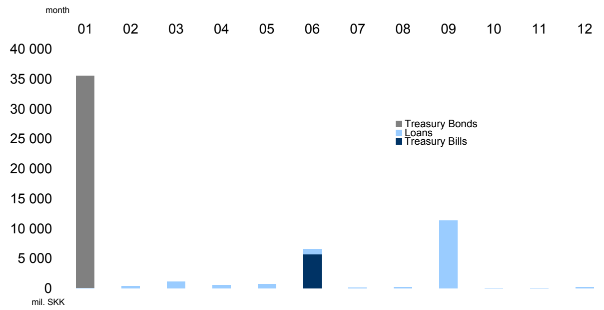
Isuued and paid-up bonds

The open Government-Bond lines were joined in 2005 by a new issue of Government Bonds with zero coupon and 7-years maturity. The maturity of the Government Bond was set on the basis of the profile of maturities of the Slovak Republic‘s debt. A total of 23 auctions were made on the local capital market throughout 2005, selling Government Bonds with an aggregate face value of SKK 67.196 billion. The average interest rate generated in the auctions in 2005 weighted by the face value sold (ignoring the time) was 2.952 percent per annum, which was an all-time low. One new issue of Government Bonds was launched in 2006. It was the first issue of Slovak Government Bonds with a fixed interest rate coupon and a 20-years maturity. 19 auctions were made on the local capital market throughout 2006, selling Government Bonds with a combined face value of SKK 33,196 million. The average interest rate generated in the auctions in 2006 weighted by the face value sold (ignoring the time) was 4.064 percent per annum.

In 2005, ARDAL assumed from the National Bank of Slovakia the complete organization of auctions of Government Securities and replaced the previously used manual system of bid collection, bid evaluation and reporting results to the bidders and the financial market by an electronic system. The electronic auction system was developed in association with company Reuters.



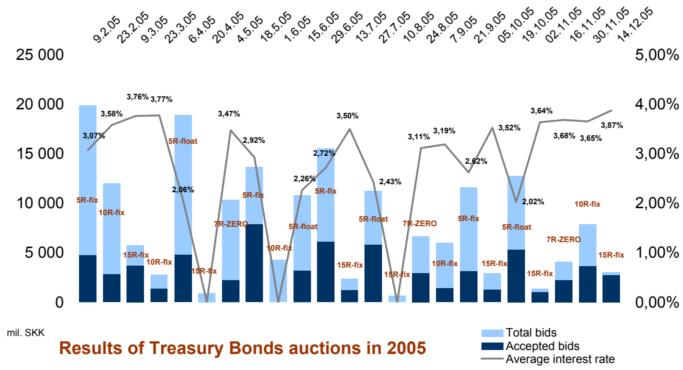
Maturity structure of State debt in 2005



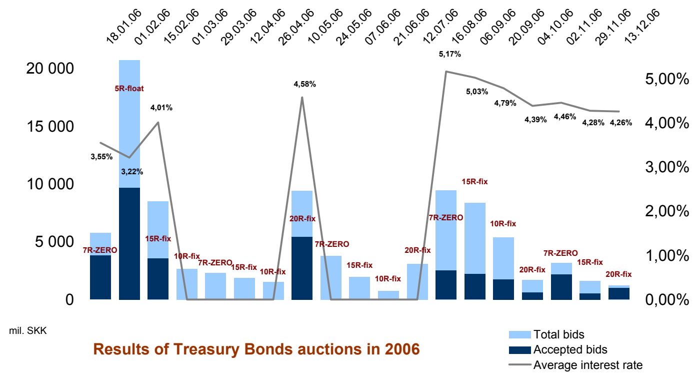
Maturity structure of State debt in 2006

The principal amount of government debt repaid in 2005 totalled SKK 124.952 billion, of which mature Government Bonds accounted for SKK 54 billion, Government Loans for SKK 9.324 billion, mature loans from the interbank market and the State Treasury for SKK 24.080 billion and mature Government Treasury Bills accounted for SKK 37.548 billion. The majority of these repayments were made in the first half of 2005. Interest and discount paid on Government Securities and Loans totaled SKK 22.818 billion.

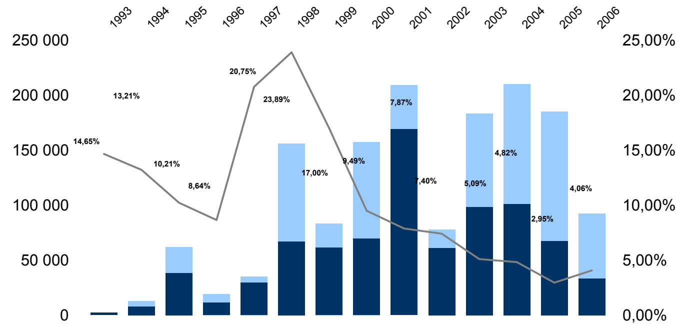
The principal amount repayments made in 2006 totaled SKK 56,796 million (of which Government Bonds accounted for SKK 35,400 million, loans for SKK 15,671 million and Government Treasury Bills for SKK 5,724 million), whereas interest paid on Government Bonds, Government Treasury Bills and Loans totaled SKK 19,391 million.



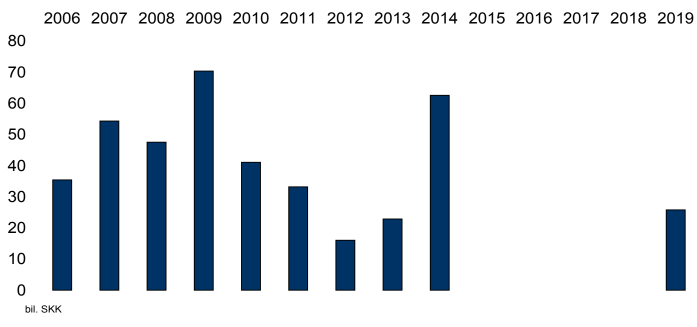
Results of Treasury Bonds auctions in 2005



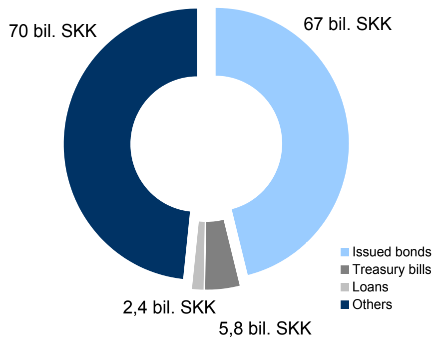
Results of Treasury Bonds auctions in 2006



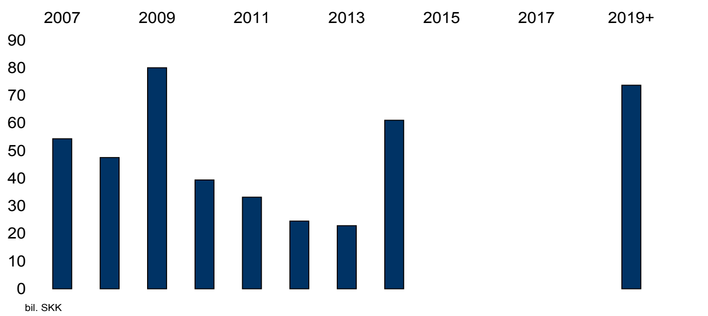
Results of Treasury Bonds auctions according to years



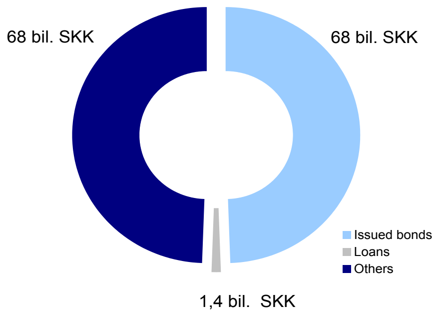
Bonds maturity structure as of 31.12.2005



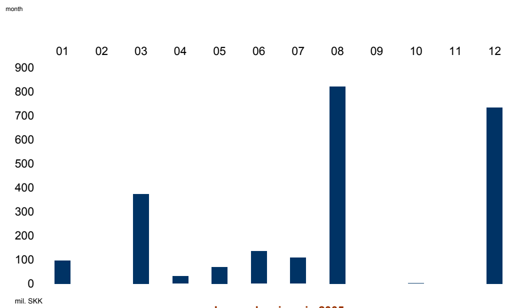
Due debt financing in 2005



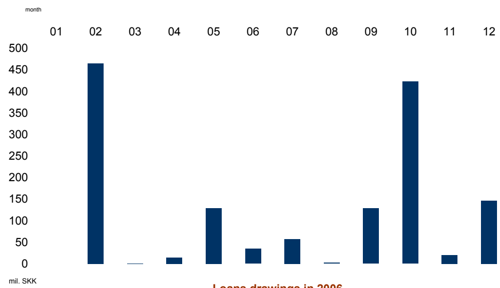
Bonds maturity structure as of 31.12.2006



Due debt financing in 2006



Loans drawings in 2005



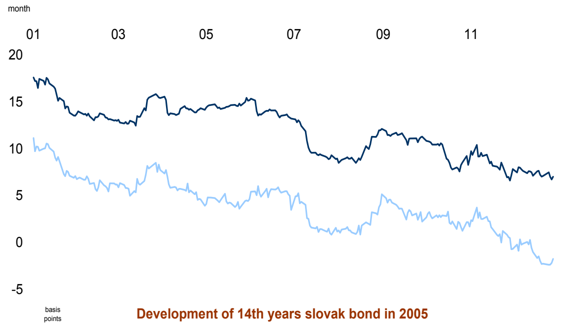
Loans drawings in 2006

Government Loan drawdowns in 2005 totalled SKK 2.370 billion (at the NBS exchange rate in effect on 31 December 2005). Liabilities arising from outstanding Government Loans stood at SKK 42.201 billion as of 31 December 2005 (at the NBS exchange rate in effect on 31 December 2005).

Government Loan drawdowns in 2006 totalled SKK 1,418 billion (at the NBS exchange rate in effect on 31 December 2006). Liabilities arising from outstanding Government and other Loans stood at SKK 27.293 billion as of 31 December 2006 (at the NBS exchange rate in effect on 31 December 2006).

In both years, ARDAL continuously analysed the loan portfolio in order to restructure it. To do so, ARDAL negotiated with several banks attemting to improve the financial conditions of a Government Loan in the event of an early repayment of existing disadvantageous loans. By repaying some loans before maturity, ARDAL cut interest payable which was higher than the cost of government refinancing and in some cases ARDAL eliminated exchange-rate risk.

Long term rates (10 years)



Development of 14th years slovak bond in 2005

EUROBOND

Despite the intention specified in the Government Debt Management Strategy until 2006 to launch one issue of a foreign Government Bond every year, Slovakia did not issue any foreign bond in 2005. The reason was financial resources for pension reform which were transferred from the National Bank of Slovakia to the State Treasury.
A Eurobond was issued on the European market as late as 2006. The issued bond had a 15-years maturity, by one year longer than that of equivalent issues of Hungary, Poland and the Czech Republic. The bond with a face value of EUR 1 billion carries a fixed interest coupon of 4 percent per annum. The conditions on the market were advantageous for that maturity, and this Slovak issue had the best spread in comparison with benchmark instruments. Spread from ASW mid was as little as 7 basic points , which is the smallest spread in all V4 countries and in all eastern Europe. During the ensuing months the spreads of Slovak Bonds remained stable, but owing to the booming economy and upgraded ratings the spreads then fell several points below mid ASW.

	Item	Balance in SKK ,000 as of 31.12.2005	Balance in SKK ,000 as of 31.12.2006
1.	Government Bonds	408 941 990	436 398 373
	Government Bonds denominated in SKK	352 169 000	349 965 200
	Government Bonds denominated in foreign currency	56 772 000	86 432 500
	Rehabilitation Government Bonds	990	673
2.	Government Treasury Bills	5 820 000	0
3.	Government Loans	14 791 288	13 734 252
4.	Loans assumed from rail companies ŽSR and Žsp, a.s	15 249 435	6 840 339
5.	Loans assumed from State Road Management Fund	11 701 963	4 776 282
6.	Other liabilities	692 202	2 258 978
7.	Loan from State Treasury	77 748 470	151 882 029
8.	Short-term loans from financial institutions	2 802 666	0
9.	SWAP transaction	31 792 320	0
10.	Risks from Government Guarantees	29 879 410	19 921 700
	Total government liabilities	**599 419 748**	**635 811 953**

Risk Management

Risk management is aimed to identify, analyse and control risks related to ARDAL‘s operations. Principal risks, which have been identified and currently are being analysed and monitored, comprise refinancing risk, liquidity risk, interest risk, credit risk and operating risk.
A framework risk-management document is the State Debt Management Strategy which defines the main indicators. This document is compiled for four years and is approved by the Slovak Government.

Refinancing Risk and Liquidity Risk

ARDAL‘s mission is to issue Government Bonds in a way which ensures an even distribution of maturities of Government Securities, if possible diversification of the investor base in order to mitigate the refinancing risk on the local market, and extending and maintaining the duration of the Government Securities and Government Loans portfolio in the interval of 4 to 6 years.

Interest Risk

In accordance with recommendations from EU experts, the Slovak Government has approved the document Debt Management Strategy which sets the indicator of duration of the state‘s debt portfolio at around 4 years and the optimum ratio of fixed-interest securities to variable-interest securities. Experience of countries with a similar structure of state debt shows that the optimum composition of Slovakia‘s debt is 75 percent fixed-interest securities and 25 percent variable-interest securities.

Exchange Rate Risk

In accordance with recommendations from the EMU countries, ARDAL‘s objective is to launch at least one issue of a foreign Government Bond every year and to increase the state debt financing in foreign currencies at the expense of the local currency, but not to make transactions which would increase the exchange rate risk of the state. ARDAL‘s goal is to actively manage foreign-currency cash flows.

Credit Risk

In the event of depositing disposable funds and making derivative transactions in commercial banks, the state is exposed to an increased credit risk. Therefore a credit-limit-setting methodology has been prepared based mainly on ratings. The methodology and individual limits are approved by the Ministry of Finance of the Slovak Republic.

Operating Risk

ARDAL attempts to implement information systems and to improve working procedures in all basic processes in ARDAL‘s operations, thereby minimizing the risk of losses incurred due to operating risks. To identify and eliminate operating risks, ARDAL has approved internal processes and crisis scenarios in the event of internal and external risks.

Extending the Average Maturity of the Government Securities Portfolio and the Duration of the Government Securities Portfolio

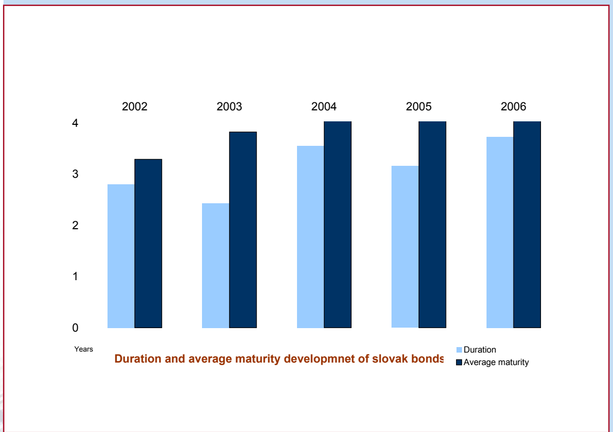
By distributing maturities over a longer period and by extending durations it is possible to eliminate the refinancing risks of the Slovak Republic‘s debt and to reduce its sensitivity to changing market interest rates, which will generally improve the conditions of refinancing the state debt and stabilize the costs (expenses).
A strategy from 2003 expected that by 2006 the average maturity of the Government Debt portfolio should be extended to 4 to 6 years and its duration should be 4 years. As of 31 December 2004, the Government Bond portfolio had the average maturity of 4.654 years and duration of 3.553 years. This clearly shows the preferences of Slovak investors as Slovakia did not launch any foreign issue in 2005. Issues with shorter maturities were sold first, whereas issues with 10- to 15-year maturities were sold in smaller volumes. For this reason, the average duration and the average time to maturity were shorter in 2005 than they were at the end of 2004.

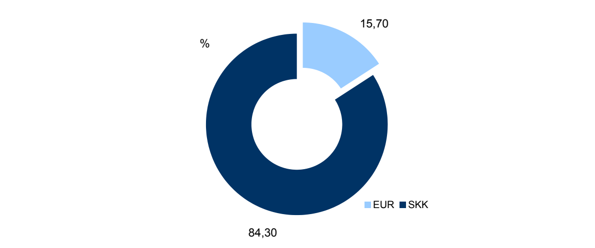
** The year-end average duration and maturity reflect also the repayment of a restructuring bond with a face value of SKK 35.4 billion maturing in January 2006. After this issue was repaid, the average maturity and average duration were longer than they were at year-end 2004.*

Year	2002	2003	2004	2005	2006
Duration	2.800	2.433	3.553	3.161*	3.729
Maturity	3.2900	3.824	4.654	4.554*	5.139

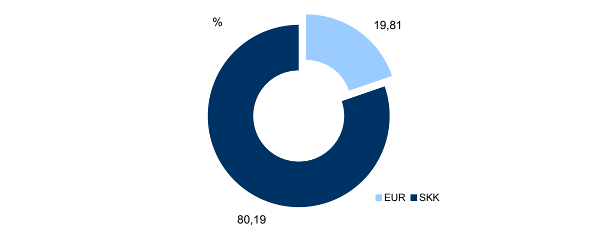
Gradual increase in the refinancing of the state debt in foreign currencies at the expense of the Slovak koruna

By launching a foreign issue in the amount of EUR 750 million in 2003 and EUR 1 billion in 2004, the Ministry of Finance of the Slovak Republic gradually implements the strategy of increasing the share of the state debt denominated in foreign currencies at the expense of debt in SKK. These issues were the main factor which shifted the initial 82 percent (SKK) to 18 percent (other currencies) ratio in 2003 to 78 percent (SKK) to 22 percent (other currencies) on 31 December 2004. As the funds for the pension reform were transferred to the State Treasury system and a decision was made to use these funds primarily for debt refinancing, no foreign Government Bonds were issued in 2005. After a foreign issue of Government Bond with a face value of EUR 750 million was repaid in May 2005, the ratio shifted to 86 percent (SKK) to 14 percent (EUR) as of 31 December 2005. After the Slovak Eurobond was issued in 2006, the ratio reversed to 79 percent (SKK) to 21 percent (EUR). As of 31 December 2006, the ratio of the state debt (bond portfolio) denominated in the Slovak koruna to the state debt in foreign currencies stood at 80 percent to 20 percent.

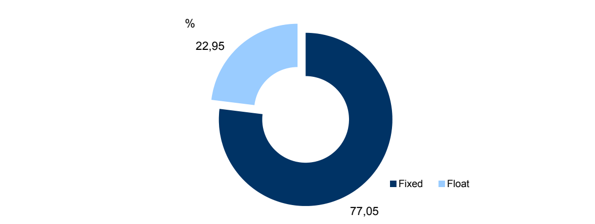




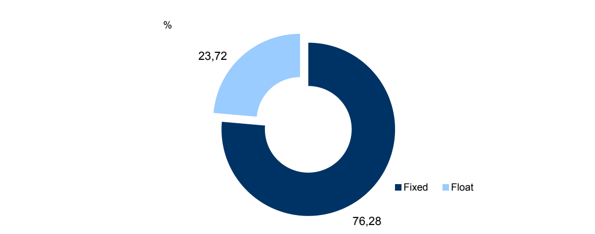
Currency structure of slovak bonds as of 31.12.2005



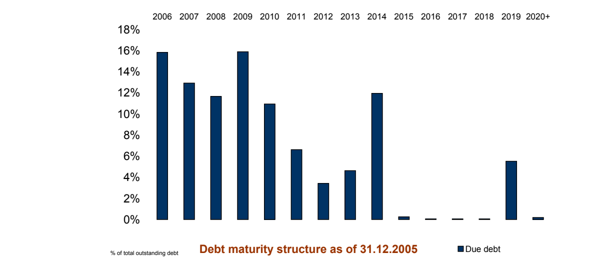
Currency structure of slovak bonds as of 31.12.2006



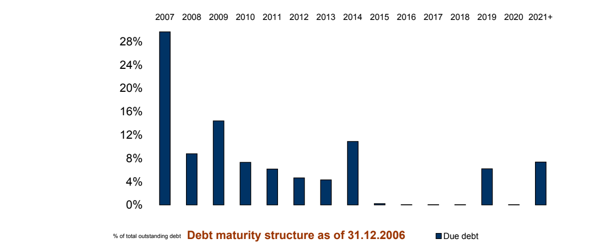
Coupon structure of slovak bonds as of 31.12.2005



Coupon structure of slovak bonds as of 31.12.2006



Debt maturity structure as of 31.12.2005



Debt maturity structure as of 31.12.2006

ARDAL's Objectives in the Next Years

- Completing the process of preparing an ISDA agreement (International Swaps and Derivatives Associacion) and signing it with financial institutions.
- Establishing an auction system for primary sales of Government Treasury Bills, repo and sell and buy back trades in them.
- Gradual expansion of operations with Slovak Bond issues denominated in the Slovak koruna and their primary sales also outside the Slovak territory.
- Taking part in the preparation of legislative changes relating to Slovakia's accession to the European Monetary Union, notably in the Bonds Act, Securities Act and in tax laws.

Dear readers,

It is my pleasure to submit to you operations report for the Debt and Liquidity Management Agency (DLMA) for years 2005 and 2006. Year 2006 was for our Agency the 3rd active year of operation in the area of government debt and liquidity management and therefore a time for quick look back at the Agency's activities during this period.

Whereas years 2003 and 2004 were a period of content, personnel and technical development, during years 2005 and 2006 DLMA has actively fulfilled the government debt management strategy, approved by the government in 2003 and pursue its main goal, which is effective covering of government debt and active management of the state's liquidity.

Year 2005 has fully shown financial contribution of the State Treasury system in the area of debt service cost reduction and reduced expenses for liquidity management, mainly through the use of funds from State Treasury. Increased flexibility of the state debt management allowed more flexibility in responding to changes on the financial markets, reducing thereby significantly additional expenses of the state budget. Primary market for the government securities became more standard, in particular from the international standpoint, due to the introduction of government securities electronic auction sales, started from January 2005.

State debt management strategy target indicators for 2003 to 2006 planned for year 2006 were completed already in year 2005. Average maturity of the government securities portfolio reached a figure of 5 years already in 2005 and in the same year the duration reached planned level within the 3.5 – 4 years band. We consider year 2005 as the most successful in terms of covering the state debt needs with securities, since the average weighted interest rate for state bonds issued in 2005 was only 2.95% p.a. Thanks to extremely successful year 2005 the average interest rate of the "live" portfolio of state bonds had, for the 1st time in the country's history, dipped below 5% p.a. Quality improvement of the debt and liquidity management, together with favourable macro-economic development of the Slovak economy and interest rate reduction, have resulted in savings achieved by the stated budget with respect to the debt servicing expenditures in 2006 totalling 6.6 bln Sk improvement against the budgeted amount.

During the 2nd half of 2005 our agency's operations were the subject of planned audit by the Supreme Audit Office of the Slovak Republic. The final audit report concluded: "In terms of meeting the primary objectives of the DLMA operations during the audited period the audit has shown that DLMA is fulfilling its goals set out by the government of the Slovak Republic in approved management strategy of the state debt in order to provide state debt management, liquidity of the state budget and financing of government needs in a transparent manner whilst maintaining rational expenses and minimisation of risks related to the management of state debt and liquidity".

In 2006 the interest rates have experienced a reverse trend, with significant increases of interest rates on the domestic, but also international European financial market. Despite this development DLMA had managed to maintain and slightly reduce the average interest expenses of the live securities portfolio to 4.84% p.a. DLMA brokered a bond issue for the Ministry of Finance of the Slovak Republic at approximately half the planned value (33.2 bln Sk). Reasons for this were unfavourable price movement on financial market, mainly during the summer months of year 2006. Less favourable situation on the financial markets allow the agency to utilise funds from the State Treasury not only to cover the ongoing budget deficit, but in comparison with previous year to cover also the country's debt to work larger extent.

In line with the state debt management strategy Slovakia issued in 2006, for the 1st time in history, government bond on the European market with 15-year maturity. Financial markets have received favourably positive development of the Slovak economy and the public finances condition with the historically lowest coupon of 0.07% p.a. In 2006 DLMA continued in restructuring of the state's loan portfolio, the agency managed to discharge less favourable loans and improve the terms of existing loans in an effort to reduce state budget expenses.

In 2006 we have met all indicators defined in the State Debt Management Strategy for year 2003-2006. Meeting of these goals resulted in reduce expenditure for debt servicing, stability of the state debt expenses budgeting and significant risk reduction of the state debt portfolio in the future. The practice has justified the strategy's goals defined in 2003. The agency's operational expenses in the context of overall savings and progressive change in the approach with respect to the state debt and liquidity management appear as negligible.

In the near future the agency's main task will be the preparation for introduction of Euro currency in the area of state debt, liquidity management and management and operations of the agency as a budget-funded organisation. In the area of debt management and international bond issues the agency has already been preparing for the common European currency for a number of years. In years 2007 and 2008 the key task will be prepare also the agency's information systems and to implement the Euro currency also in the area of securities settlement and other agency's transactions.

Dear readers,

in closing I would like to express my thanks to all business partners and colleagues here at the agency for their excellent co-operation and support over the past two years. Special thanks goes to agency employees, who played key role in achieving excellent results during this period.

Daniel Bytčánek