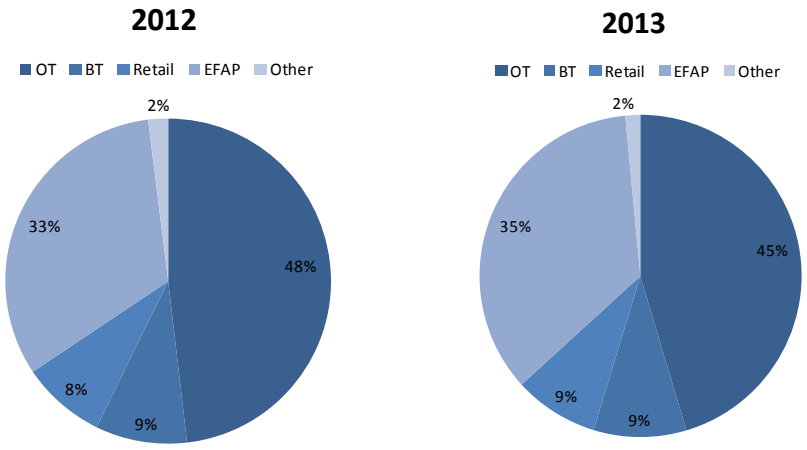
2. Financing of the Portuguese Government Debt Market

2.1. The Portuguese Government Debt Management Strategy

The issuance and management of government debt is subject to the principles set out in the Public Debt Law (Law No. 7/98, 3 February). It must ensure the funding required to cover the budgetary execution and should be conducted with the objectives of minimising direct and indirect costs in a long-term perspective and guaranteeing a balanced distribution of the various annual budgets, preventing excessive temporal clustering of redemptions and exposure to excessive risks.

The structure of the direct government debt stock at the end of 2013 reflects the continued increase in the weight of EFAP loans, which accounted for 35% of total debt (33% at end-2012). Besides the EFAP, the retail debt segment also increased its relative weight, moving from 8 to 9%, with the launch of a new product in 2013 – the *CTPM* –, whose amount subscribed came to more than EUR 600 million (see box "New Retail Instrument CTPM").

Graph 13 – Debt stock structure by type of instrument



Source: IGCP

2013 was also important in the planning of a strategy to return to the medium- and long-term debt market, which is expected to be consolidated in 2014. The financing strategy followed in 2013 encompassed the following main elements: i) intensifying efforts to promote Portuguese public debt with financial intermediaries and international investors; ii) monitoring the flow of buying and selling in the secondary market by investors and market operators, in order to assess the best windows of opportunity for the issuance of medium- and long-term debt under sustainable conditions; iii) promoting greater involvement of international real money investors in Portuguese government debt in order to reduce volatility and increase confidence in financing capacity; iv) strengthening the dialogue with rating agencies to improve the information provided, which may contribute to the promotion of a positive cycle of reviews in the short term; v) pre-financing in 2014 in order to reduce market uncertainties about Portugal's financing capacity and create a positive momentum in OT spreads; vi) promoting, where market conditions prove favourable, exchange offers and OT buybacks; vii) expanding the subscriber base of retail products and increasing this source of funding.

The year 2013 was marked by the return of "buy & hold" investors to the OT market. This situation was particularly visible in primary market operations, such as in the tap of OT 4.35% 16 Oct 2017 on 23 January 2013 and in the 10-year issue of OT 5.65% 15 Feb 2024 on 7 May. In June there was some volatility coupled with the rise in rates that led some real money investors to reduce exposure to Portugal as a result of the tapering by the Fed and the political crisis in Portugal. With the clarification of the political situation and following the successful outcome of

the 10th review of the troika, the interest of real money investors in Portugal re-emerged and OT rates picked up once again.

BOX: PERFORMANCE EVALUATION OF PARTICIPANTS IN THE PORTUGUESE GOVERNMENT DEBT MARKET

Taking into account the standardisation process of access to international financial markets, it is important to look at the contribution of primary dealers as a primary market distribution channel and suppliers of reference prices and liquidity in the secondary market, as they are key players in the standardisation of the secondary market, namely in terms of volatility.

The group of primary dealers increased to 19 in 2013, with the entrance of Banco BPI, SA. The performance of the following operators deserves special mention:

Table 1 – Best performing Primary Dealers in 2013

1	Morgan Stanley & Co International
2	Caixa Banco de Investimento, SA
3	Banco Espirito Santo, SA
4	Barclays Bank, plc
5	Société Générale

Source: IGCP

The group of Treasury Bill Specialists (EBT) did not change in 2013. We highlight the performance of the following EBT:

Table 2 – Best performing Treasury Bill Specialists in 2013

1	Caixa Geral de Depósitos, SA
2	Société Générale
3	Banco Espirito Santo, SA
4	Millenniumbcp
5	Crédit Agricole

Source: IGCP

In 2014, a similar strategy should be developed with the necessary flexibility, through the combination of various instruments throughout the year, always with the goal of reducing cash requirements and securing the required funding. Ideally, advantage should be taken of windows of opportunities in the market, expected early in the year, to resolve funding in 2014 in order to start executing the pre-funding of 2015, thus creating favourable conditions for a transition to the sustainable funding of financial markets.

2.2. BORROWING REQUIREMENTS

On a public account basis, the State's net borrowing requirements in 2013 amounted to about EUR 11.1 billion, EUR 7.7 billion of which represent the budget deficit of the State's subsector in public accounts and close to EUR 4 billion was allocated to the net purchase of financial assets, (especially loans to other public entities within General Government, namely state-owned enterprises).

Throughout 2013, money from the fund to support the recapitalisation of the private banking system was used in the capital increase of Banif, in a total of EUR 1.1 billion. The State further cashed privatisation proceeds of approximately EUR 1.5 billion, resulting from the privatisation of ANA and CTT.

At the end of 2013 there was still a portion of EUR 6.4 billion captive in *Banco de Portugal* to strengthen financial stability. Excluding this amount, the balance of funding available for the following fiscal years stood at about EUR 3.6 billion.

Table 3 – State borrowing needs and sources in 2012 and 2013

(EUR million)	2012	2013
1. NET BORROWING REQUIREMENTS	**18,034**	**11,148**
Budget deficit	8,896	7,665
Net purchase of financial assets (except privatisation revenues and the strengthening of financial stability)	6,846	3,843
Strengthening of financial stability	4,500	1,100
Privatisation revenues (-) *	2,208	1,459
2. REDEMPTION AND CANCELLATIONS (Funded Debt)	**36,819**	**34,945**
Saving Certificates + Treasury Certificates	2,229	923
Short-term euro-denominated debt	17,985	21,615
Medium- and long-term euro-denominated debt	16,485	13,145
Non-euro-denominated debt	429	61
Swap capital flows (net)	-309	-798
3. GROSS BORROWING REQUIREMENTS (1. + 2.)	**54,853**	**46,093**
4. SOURCES OF FUNDING	**64,606**	**56,090**
Balance of financing from previous Budgets	7,674	9,755
Debt issuance of the year's Budget	56,933	46,335
Debt issuance in Complementary Period	0	0
5. BALANCE OF FINANCING FOR FORTHCOMING BUDGETS (4. - 3.)	**9,755**	**9,994**
Deposits dedicated to strengthen financial stability	3,500	6,400
Balance of financing available for forthcoming Budgets	6,255	3,594
p.m. Discrepancies	2	-3
p.m. DEBT ISSUANCE IN THE CIVIL YEAR (Funded Debt)	**56,933**	**46,335**
Relative to the Budget of the previous year (Complementary Period)	0	0
Relative ot the year's Budget	56,933	46,335

* The revenue from the privatisation of BPN (EUR 40 million) was received in 2012, but was only applied in debt redemptions in 2013. Likewise, part of the revenues from the privatisation of CTT (around EUR 120 million) was received in 2013, but will only be applied in debt redemptions in 2014.

Source: *DGO* and IGCP

2.3. FINANCING ACTIVITY

The net issuance of debt in 2013 amounted to EUR 11.4 billion. In comparison to the previous year, it is important to highlight the positive net contribution of Savings Certificates, which in 2012 had registered a negative contribution of about EUR 1.7 billion, while in 2013 it made a positive contribution of EUR 455 million. The positive contribution of Treasury certificates in excess of EUR 560 million should also be noted. BT once again proved a major source of financing with a net issuance of about EUR 1.3 billion. The remaining positive contribution comes from loans under the EFAP which, as mentioned earlier, replaced part of the financing in the medium- and long-term market.

Table 4 – Composition of net funded financing in 2013

(EUR million)	Issuance	Redemptions	Net
EURO-DENOMINATED DEBT	**42,927**	**35,682**	**7,245**
CA – Savings Certificates	1,339	884	455
CT – Treasury Certificates	599	38	561
CEDIC	4,127	4,405	-278
CEDIM	463	42	421
BT – Treasury Bills	16,505	15,236	1,269
OT – Fixed rate	11,970	13,091	-1,121
EFSF	6,600	0	6,600
EFSM	0	0	0
Other short-term debt	1,324	1,974	-650
Other medium- and long-term debt	0	11	-11
NON- EURO-DENOMINATED DEBT	**3,408**	**61**	**3,347**
IMF	3,401	0	3.401
Other debt	7	61	-61
SWAPS (NET)		**-798**	**798**
TOTAL	**46,335**	**34,945**	**11,390**

Note: Issuance of *CA* and *CT* include values related with issuance occurred in 2012 that were only deposited in 2013, but excludes issuance that occurred in2013 that was only deposited in 2014. This justifies minor discrepancies when compared with the issuance amount considered to compute the debt outstanding as of end-2013 in table 14.
Source: IGCP

Additional data on market funding and via EFAP is shown below.

Funding under the EFAP

In relation to funding via EFAP, the nominal value of disbursements in 2013 was approximately EUR 10 billion, with an average maturity of around 15 years and an estimated average rate of 2.84%.

Table 5 – Summary of amounts disbursed under the EFAP in 2013

Entity	Nominal value (EUR million)	Average Maturity (years)	Estimated all-in-cost (%)	Amount disbursed (EUR million)
EFSF (1)	6,600	18.7	1.99%	6,567
IMF (2)	3,397	7.2	4.49%	3,388
Total	**9,997**	**14.8**	**2.84%**	**9,955**

(1) The interest rate on EFSF loans made since May 2012 is variable and indexed to the cost of its pool of funding. The estimated IRR for these loans takes into consideration the financing programme provided by the EFSF and the implicit evolution of interest rate forwards.
(2) The base interest rate on IMF loans (in SDR) is refixed every week based on the basket consisting of Eurepo 3m, US Tbills 3m, UK Tbills 3m and JP Tbills 3m. A spread is added to this rate that varies over time between 100 and 400 basis points, depending on the amount of funding made available by the IMF and the time elapsed since the beginning of the Programme. The IRR for the entire period of the loan was estimated based on the interest-rate and exchange-rate forwards as well as on the estimated timing of future expenditures.
Source: IGCP

OT Issuance

Continuing the process begun in 2012 to recover access to international financial markets, in 2013 IGCP held a tap of OT 4.35 16 OCT 2017 in January, issued a new10-year OT 5.65 15 FEB 2024 in May, and conducted an OT exchange in December:

On 23 January IGCP held a tap of OT 4.35 16 OCT 2017 in the amount of EUR 2.5 billion, in which demand exceeded EUR 12 billion through close to 300 orders, mostly from international investors. The amount issued was largely allocated to real money investors, with 60% having been allocated to asset managers. In geographical terms, the allocation was diversified with the highest allocation going to the US and UK (33% and 29%, respectively).

On 7 May, IGCP issued a new 10-year bond, OT 5.65 15 FEB 2024, with an amount of EUR 3 billion. Demand exceeded EUR 10 billion and 369 investors participated in the operation, in which the issuance rate was fixed at mid-swaps plus 400 basis points. The amount issued was also largely allocated to real money investors, with 51% having been allocated to asset managers and 12% to insurers and pension funds. In geographical terms the distribution of the issuance was also very diverse, with 27% of the allocation remaining in the UK, 16% in the US, 14% in domestic investors and 10% in Scandinavian investors.

Thirdly, IGCP announced an exchange offer buying three OT maturing in June 2014, October 2014 and October 2015 as consideration, of equal nominal value, of OT maturing in October 2017 and June 2018. This operation allowed the reduction of commitments for 2014 and 2015, with refinancing moving to 2017 and 2018.

Table 6 – OT exchange offer

Date	Bond	Position	Exchange offer YTM	Nominal value (EUR million)	Final outstanding
03-Dec-13	OT 4.75 16 JUN 2014	Purchase	2.12%	837	4,607
03-Dec-13	OT 3.6 15 OCT 2014	Purchase	2.75%	1,640	6,190
03-Dec-13	OT 3.35 15 OCT 2015	Purchase	3.33%	4,165	9,242
				6,642	
03-Dec-13	OT 4.35 16 OCT 2017	Issuance	4.68%	2,676	11,258
03-Dec-13	OT 4.45 15 JUN 2018	Issuance	4.96%	3,966	10,853
				6,642	

Source: IGCP

The different sources of funding enabled IGCP to accumulate levels of liquidity and apply part of this in several bilateral buybacks throughout the year, with a view to reducing the commitments relating to debt redemption in 2014.

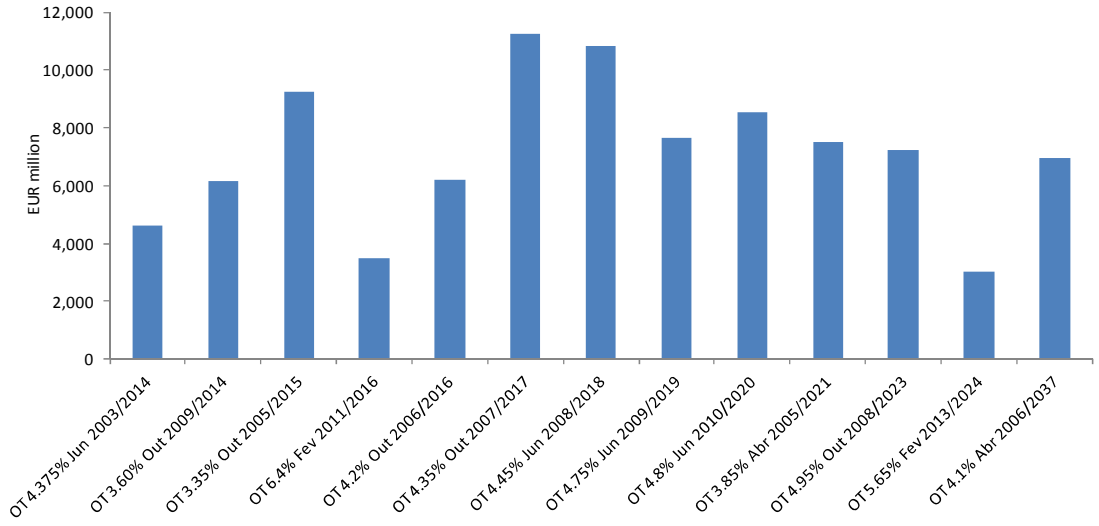
Table 7 – BT and OT buybacks in 2013

Security	Amount (EUR million)
BT buybacks	
BT 17 JAN 2014	265
BT 18 APR 2014	450
BT 18 JUL 2014	50
BT 19 SEP 2014	55
BT 20 DEC 2013	106
BT 21 FEB 2014	481
BT 23 MAY 2014	325
OT buybacks	
OT 3.6 15OCT2014	30
OT 4.375 16JUN2014	559
OT 5.45 23SEP2013	261
Total	**2,582**

Source: IGCP

After these operations, the total OT outstanding at end-2013 presented the following amortisation profile:

Graph 14 – Composition of OT curve at end-2013



Source: IGCP

EMTN Programme

Throughout 2013, the EMTN programme was updated. No operations were carried out under it, but it is currently ready to be used as an alternative source of funding.

BT Issuance

The development of BT yields did not show a well-defined trend. Despite the market environment, a total of EUR 20.0 billion in BT was issued throughout the year.

Table 8 – BT auction rates in 2013 (competitive)

Auction month	Maturity (months)				
	3m	6m	9m	12m	18m
January	0.67%			1.61%	1.96%
February	0.74%			1.28%	
March	0.76%				1.51%
April	0.74%			1.39%	
May		0.81%		1.23%	
June		1.04%			1.60%
July		1.05%		1.72%	
August	0.77%			1.62%	
September	1.08%				2.29%
October	1.16%		1.71%		
November	1.08%			1.49%	

Source: IGCP

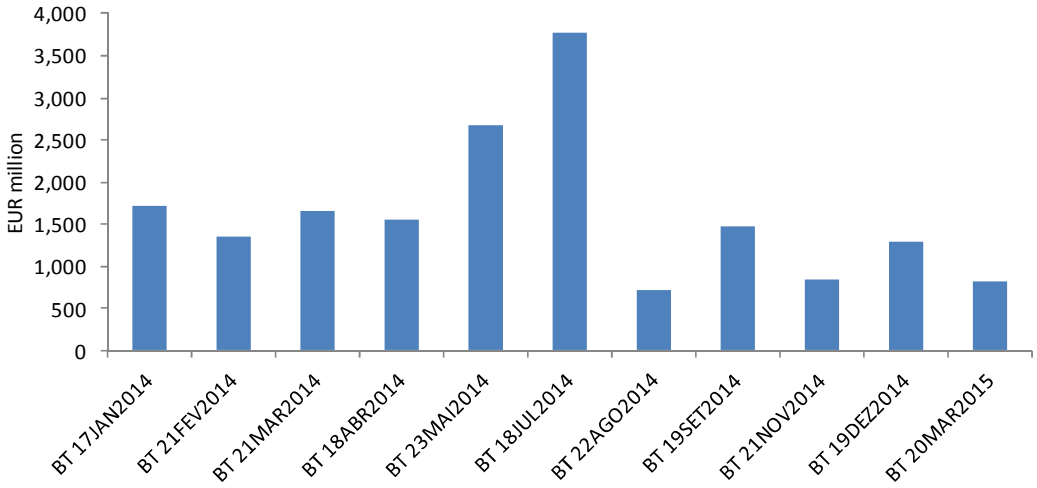
Table 9 – Amount placed in BT auctions in 2013 (competitive and non-competitive)
Net of premiums and discounts

Auction month	Maturity (months)					
	3m	6m	9m	12m	18m	Total
January	313			1,425	1,269	3,007
February	393			1,488		1,882
March	321				1,498	1,819
April	295			1,985		2,280
May		612		1,647		2,258
June		609			1,267	1,876
July		355		1,267		1,622
August	312			716		1,029
September	549				802	1,351
October	525		1,220			1,745
November	328			838		1,166
Total	3,037	1,576	1,220	9,366	4,835	**20,035***

*Besides this amount, EUR 2,000 million were issued in favour of *FRDP*.
Source: IGCP

The profile of short-term debt at year-end was dispersed across various maturities, which makes it possible to keep a programme that allows investors the roll-over of their investments.

Graph 15 – Composition of BT curve at end-2013



Source: IGCP

CA/CT Issuance

In 2013, for the first time since 2008, both the issuance of *CA* and *CT* was higher than the respective redemptions, which led to an increase in the outstanding amounts of both products. This situation was the result of a strong commitment by IGCP in retail products, which had lost importance over the last few years as a source of funding of the Republic. As such, in the fourth quarter of the year IGCP launched the *CTPM*, whose increasing rates over a five-year period seek investors for a longer investment period than traditional savings certificates (*CA*).

Developments in *CA* resulted in a net increase of EUR 462 million. Net subscriptions of *CT*, in turn, amounted to EUR 610 million. Thus, at end-2013, the outstanding amounts of *CA* and *CT* stood at EUR 10 billion and EUR 2 billion, respectively.

Issuance of CEDIC/CEDIM

The outstanding of CEDIC and CEDIM amounted to EUR 4,7 billion at the end of 2013 (EUR 4,6 billion at the end of 2012), with a net contribution to financing of EUR 142 million.

BOX: EXTENSION OF THE MATURITIES OF THE EFSM AND EFSF LOANS

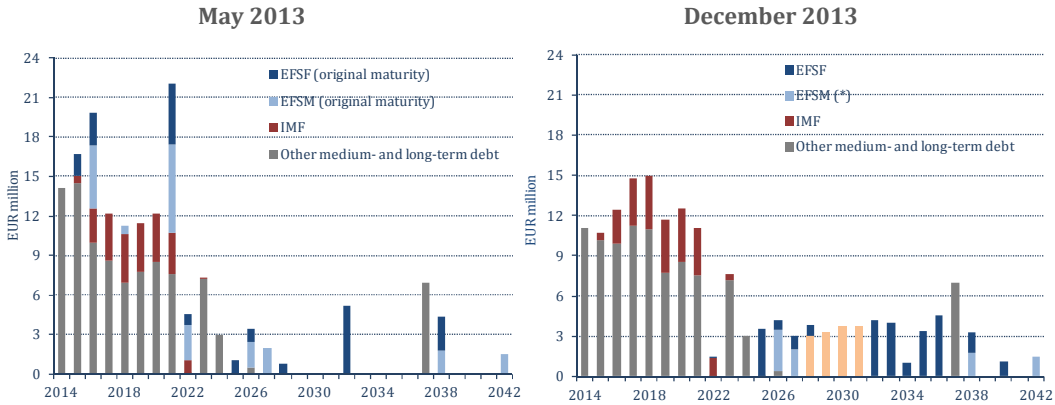
On 12 April 2013, Eurogroup and ECOFIN reached an agreement in principle for the extension of the weighted average maturity of loans granted to Portugal and Ireland under the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF) for a period of seven years. The aim of this agreement is to support these countries in the full return to the medium- and long-term debt market and thereby promote the successful and sustainable exit of the respective economic adjustment programmes. By contributing to a smooth repayment profile over time, avoiding peaks of refinancing needs, in particular during the transition period following the end of the respective programmes, the extension of maturities gave Portugal and Ireland more time to sustainably rebuild their investor base and to recover a more favourable status with rating agencies.

The EFSM agreement was formalised by ECOFIN on 21 June and translated into an extension of the average maturity of loans from 12.5 to 19.5 years. The procedure to extend the term of loans shall be fulfilled individually, close to the respective date of original amortisation and shall be refinanced by new loans. Despite the fact that the new final maturities have not yet been defined, it is not expected that Portugal will have to refinance any EFSM loan before 2026.

In the case of the EFSF, the respective Board of Directors approved the extension of the average maturity to 21 years on 24 June and formally approved the new repayment dates of each loan.

Taking into account the new dates of already approved EFSF loans and a simulation of the new maturities of EFSF loans to be agreed, the redemptions of medium- and long-term debt at the end of 2013 presented the profile shown in graph 16 below.

Graph 16 – Redemption profile of medium- and long-term debt before and after the extension of maturities of EFSM and EFSF loans



(*) The final maturity of the EFSM loans marked with orange bars has not been defined yet (extension of maturity will be implemented close to the respective date of original amortisation), but it is not expected that Portugal will have to refinance any EFSM loan before 2026.
Source: IGCP

BOX: NEW RETAIL INSTRUMENT *CTPM*

On 31 October 2013 (World Savings Day), IGCP launched a new debt instrument called Treasury Certificates Savings Plus (*CTPM*) to promote the medium-term savings of households. With this new product, private investors are now able to benefit from a higher return, bringing it closer to the profitability of public debt instruments traded in the wholesale market. The supply of Savings Certificates (*CA*) – instrument with guaranteed liquidity and risk-free interest rate – was thus complemented by this new instrument designed for investors with less need for liquidity, promoting the widening of the domestic investor base, essential to effectively ensure the State's financing needs.

CTPM are issued with a 5-year term and a guaranteed fixed rate on the subscription date. The gross remuneration rates fixed for subscriptions made as from 31 October 2013 and guaranteed until their amortisation are as follows:

1st year	2nd year	3rd year	4th year	5th year
2.75%	3.75%	4.75%	5.00%	5.00%

In the 4th and 5th year, a premium equal to 80% of the average real GDP growth, if positive[6], will be added to this rate. Note that, unlike *CA*, the *CTPM* bear interest annually, there is no capitalisation of interest, and they may only be redeemed within one year of the subscription date. On the redemption date, the full amount invested is guaranteed.

The launch of this new product, along with the adoption of exceptional remuneration conditions in *CA* already introduced in September 2012, contributed to reverse the downward trend of the stock of retail instruments observed since 2008. Indeed, in 2013, the outstanding of *CA* and *CT* increased by EUR 1,072 million, which translated into an increase in the importance of this instrument in the stock of total debt of 0.3 percentage points (from 5.7 to 6.0%).

Table 10 – Stock of retail instruments in the State's direct debt

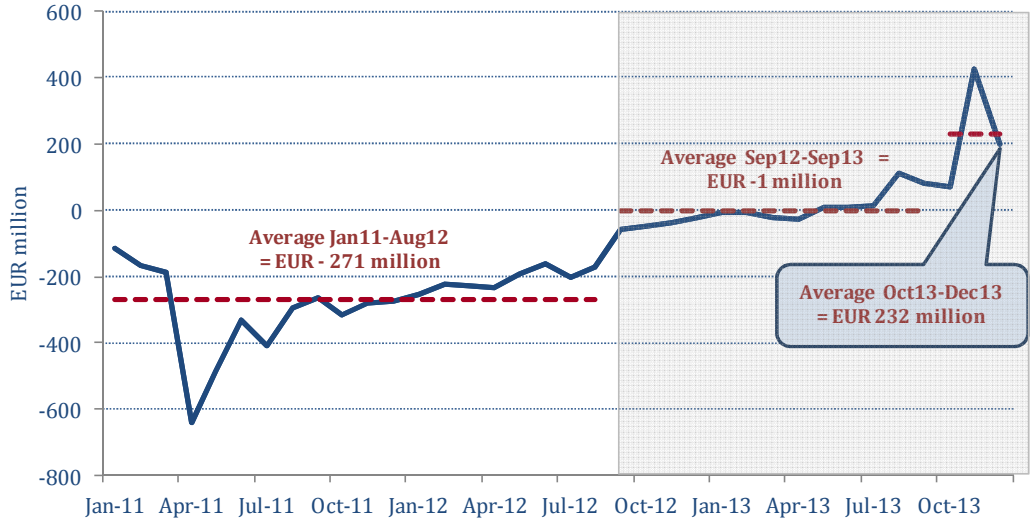
(EUR milion)	Dez-07	Dez-08	Dez-09	Dez-10	Dez-11	Dez-12	Dez-13
CA	18.049	17.197	16.869	15.469	11.384	9.669	10.132
CT				684	1.308	1.416	1.378
CTPM							648
Total CA+CT+CTPM	**18.049**	**17.197**	**16.869**	**16.153**	**12.692**	**11.085**	**12.158**
Direct government debt	112.804	118.463	132.747	151.775	174.895	194.466	204.252
% CA+CT	**16,0**	**14,5**	**12,7**	**10,6**	**7,3**	**5,7**	**6,0**

Source: IGCP

This development reflected the acceleration of *CA* subscriptions and new *CTPM* subscriptions in the fourth quarter, as well as a slowdown in redemptions of *CA* and *CT*, with net subscriptions of retail instruments assuming an average value of EUR 232 million in the last quarter of the year.

[6] Detailed information on the methodology for calculating the premium, as well as other specific features of the product, are available on IGCP's site

Graph 17 – Monthly net issuance of *CA* and *CT*



Source: IGCP