REPUBLIC OF CROATIA
MINISTRY OF FINANCE

ANNUAL DEBT REPORT AND PUBLIC DEBT MANAGEMENT STRATEGY

2006

REPUBLIC OF CROATIA

MINISTRY OF FINANCE

ANNUAL DEBT REPORT AND PUBLIC DEBT MANAGEMENT STRATEGY

CONTENT

1. Legal and Institutional Framework for Public Debt Management 5
2. Public Debt Outstanding and projections of trends 6
3. Central Government Debt according to type of instruments. 11
   3.1. Treasury bills 13
   3.2. Treasury Bonds 15
4. Domestic Debt and international Bonds Debt Service Projections. 18
5. Credit Ratings of the Republic of Croatia 20
6. Exchange rate 22
7. 2007 Debt Management Strategy 23
   7.1. The Goal of Borrowing and Public Debt Management 23
   7.2. Basic Guidelines 23
8. Issuance Calendar 28

1. LEGAL AND INSTITUTIONAL FRAMEWORK FOR PUBLIC DEBT MANAGEMENT

The legal and institutional framework for Public Debt Management is set by the State Budget Act (96/2003). The act defines the coverage of public debt, the objectives of public debt management, the conditions and authorities for borrowing as well as the reporting obligations.

The State Budget Implementation Act of the Republic of Croatia, which is adopted each year for the following budgetary year, determines the amount of new borrowing, as well as obligations for current payments of the national debt.

State Budget Act defines the term 'national debt' as the debt of the consolidated budget of the Republic of Croatia, that is the general government debt (including the central consolidated budget and the consolidated budgets of local and regional self-government units).

Public Debt is defined as the debt of the consolidated budget of the Republic of Croatia with issued guarantees.

Objectives of public debt management:

- Ensuring the financial needs of the government, including the settlement of due obligations
- Achieving the lowest medium-term and long-term financing cost, along with an acceptable level of risk
- Promoting the development of domestic capital market

For the purpose of improving public debt management, along with technical and financial aid of the EU within the CARDS, the World Bank and the IMF programmes, many reforms have been implemented in recent years:

- The reorganisation of the Sector for public debt management has been carried out (front office, back office and middle office)
- A new, modern records and debt management information system has been introduced
- An electronic platform for T-Bill auctions has been introduced
- Advanced training of employees responsible for debt management has been conducted
- Deepening of the domestic market (building up of the long-term kuna yield curve)

2. PUBLIC DEBT OUTSTANDING AND PROJECTIONS OF TREND

Table 1. General government debt

GENERAL GOVERNMENT DEBT end of period. HRK million	2002	2003	2004	2005	2006
1. Domestic general government debt	**32,012.3**	**35,314.4**	**42,721.0**	**56,046.5**	**61,045.2**
1.1 Domestic debt of the Republic of Croatia	23,320.0	28,160.8	37,223.7	50,559.5	54,235.7
Treasury bills	5,632.7	6,548.1	9,022.5	12,533.4	12.662.2
Money market instruments	0.1	0.3		0.9	
Bonds	15,887.9	17,422.0	23,080.1	30,716.0	34.847.8
Croatian National Bank Loans	0.5	1.4	3.3	1.4	
Bank loans	1,798.8	4,189.1	5,117.8	7,307.8	6.725.7
1.2 Domestic debt of the extra-budgetary funds	7,659.1	6,247.5	3,911.2	3,935.0	5.168.2
Money market instruments	-	-	-	-	-
Bonds	4,108.1	3,418.2	1,726.0	-	-
Bank loans	3,551.0	2,829.3	2,185.1	3,935.0	5.168.2
1.3 Domestic debt of local government	1,033.1	906.1	1,586.2	1,551.9	1.641.3
Money market instruments	30.2	16.9	6.6	40.7	29.3
Bonds	-	-	204.4	196.4	263.0
Bank loans	1,002.9	889.2	1,375.1	1,314.7	1.349.0
2. Foreign general government debt	**40,538.4**	**45,832.8**	**50,266.6**	**45,377.8**	**41,540.5**
2.1 Foreign debt of the Republic of Croatia	37,388.3	41,048.8	42,095.7	36,433.6	32.486.1
Money market instruments	-	-	-	-	-
Bonds	28,694.2	32,144.8	32,899.3	27,112.3	22.843.0
Loans	8,694.1	8,904.1	9,196.4	9,321.2	9.643.0
2.2 Foreign debt of the extra-budgetary funds	2,755.4	4,463.2	7,925.3	8,725.8	8.902.7
Money market instruments	-	-	-	-	-
Bonds	-	-	-	-	-
Loans	2,755.4	4,463.2	7,925.3	8,725.8	8.902.7
2.3 Foreign debt of local government	394.6	320.8	245.7	218.5	151.7
Money market instruments	-	-	-	-	-
Bonds	-	-	-	-	-
Loans	394.6	320.8	245.7	218.5	151.7
3. Total (1+2)	**72,550.7**	**81,147.2**	**92,987.7**	**101,424.3**	**102,585.8**
Addendum: Issued guarantees of the Republic of Croatia	15,578.8	15,326.6	12,134.5	12,383.8	14,092.5
1. Domestic	7,423.8	6,796.5	4,542.2	5,268.5	7.252.3
2. Foreign	8,155.0	8,530.1	7,592.3	7,115.3	6.840.2
Total debt of HBOR	3,816.1	4,954.0	5,745.6	7,135.5	7.654.2
Total issued guarantees of the Republic of Croatia	**19,394.9**	**20,280.6**	**17,880.1**	**19,519.3**	**21,746.7**
GRAND TOTAL:	**91,945.3**	**101,427.8**	**110,868.0**	**120,943.5**	**124,332.5**
BDP	**181,231.0**	**198,422.0**	**212,826.0**	**229,031.0**	**246,760.0**
GENERAL GOVERNMENT DEBT (% in BDP)	**40.03%**	**40.90%**	**43.69%**	**44.28%**	**41.57%**
PUBLIC DEBT (% in BDP)	**50.73%**	**51.12%**	**52.09%**	**52.81%**	**50.39%**

The table 1 below illustrates the evolution of the general government debt of the Republic of Croatia over the past five years.

Contents and scope of facts in the preceding table are defined under the term "general government" and include the debt:

1. Of the central government, as well as former extra-budgetary funds
2. Of Croatian Motorways (Hrvatske autoceste) and Croatian Roads (Hrvatske ceste)
3. Of government funds and agencies (DAB, HFP)
4. Government guarantees issued to users outside the sector "general government"
5. Of 53 local administrative and self-government bodies
6. The direct debt of the Croatian Bank for Reconstruction and Development (HBOR

The stated scope includes the direct debt of HBOR, excluding all government guarantees issued to HBOR (the above stated has been carried out to avoid any possible double counting, since in numerous cases the Ministry of Finance guarantees the HBOR's borrowing and lending.

The total general government debt at the end of 2005 came to HRK 101.4 billion, the total domestic and foreign guarantees of the Republic in Croatia (including HBOR) to HRK 19.5 billion, which accounts for a grand total in public debt of the Republic of Croatia to the amount of HRK 120.9 billion, representing 52.8% of the nominal GDP for the year 2005.

At the end of 2006, the total general government debt came to 102,5 billion kuna, the total issued domestic and foreign guarantees of the Republic of Croatia (including HBOR) to HRK 21.7 billion, which accounts for a grand total in public debt of the Republic of Croatia to the amount of HRK 124.3 billion, representing 50.3% of the estimated nominal GDP for the year 2006.

In the year 2005, the general government debt increased in relation to the year 2004 by HRK 8.4 billion, as a result of increasing the domestic debt component, while over the same period the foreign debt decreased by HRK 4.9 billion. The same trend continued in 2006, when the domestic debt increased by HRK 5.0 billion, while the foreign debt decreased by HRK 3.8 billion, which resulted in increasing the general government debt by HRK 1.2 billion. Hence, slowing down of the general government debt is visible, which is the actual objective of the strategy for public debt management. Domestic general government debt at the end of 2006 is higher than the foreign debt, representing 59.5% of the total general government debt.

The level of public debt in the Republic of Croatia is a consequence of the relatively high initial debt level, resulting from the process of transition and assumption of part of the debt of former Yugoslavia. It is also the result of the high government spendings during the war and post-war reconstruction. In the beginning, a large part of the domestic debt was created by issuing bonds for the frozen foreign exchange deposits and so called "big bonds" which financed the restructuring of companies. Through the assumption of part of the debt of former Yugoslavia and regulating the obligations toward the London and Paris Club, the share of the foreign debt increased in the total public debt.

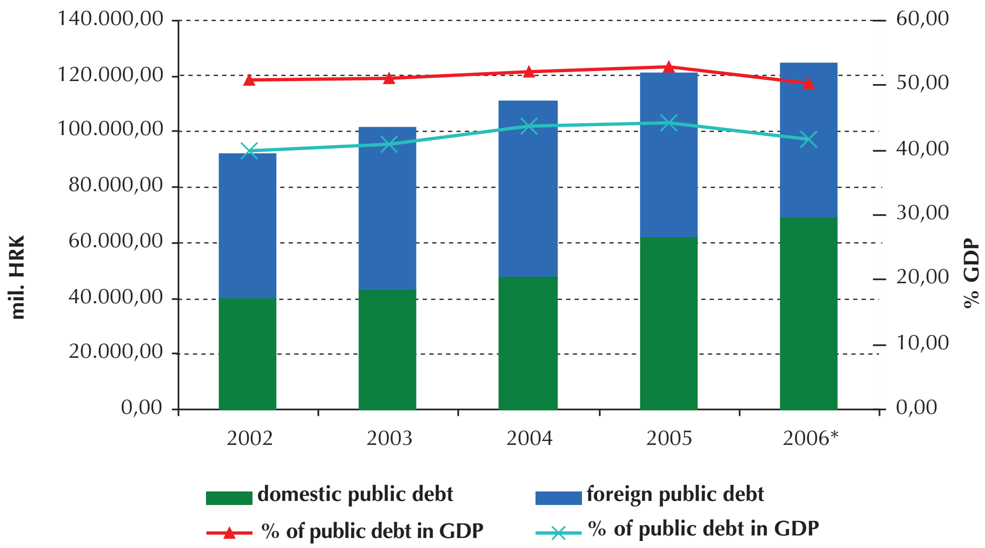

Figure 1. Public debt trend (mil. HRK and % BDP)

Within the period considered, the structure of the public debt has been considerably changed: the share of the foreign component in the total public debt has decreased from 56.6% at the end of 2002, to 44.8% at the end of 2006. The decrease of the foreign debt share in the total public debt is a result of the emphasized orientation toward the domestic capital market, with an objective of reducing the growth trend of the total foreign debt of the Republic of Croatia.

Thereby, a strong development of the domestic financial market has been confirmed in recent years, presenting an attractive alternative to foreign financial markets thanks to its depth, available maturities, and favourable yields.

The main objectives of public debt management strategy are further reduction of public debt growth and decrease of risks connected to public debt, mainly the exchange rate risks, increased transparency of the issuance policy and further development of domestic capital market.

As regards to the currency structure of the central government debt at the end of 2006, the prevailing debt is denominated in euro (54%), whereas the debt denominated in kuna amounts to 33% of the total central government debt. The foreign currency borrowing share has decreased in the recent years, whereas the debt share denominated in kuna has increased, due to a stronger orientation toward the domestic capital market and the development of the long-term yield curve in the national currency. Redemption of due bonds to the amounts of EUR 800 million (2005 and 2006) and JPY 50 billion (2004 and 2006), and payment of due obligations toward the London and Paris Club, influenced a significant decrease of debt component in foreign currency.

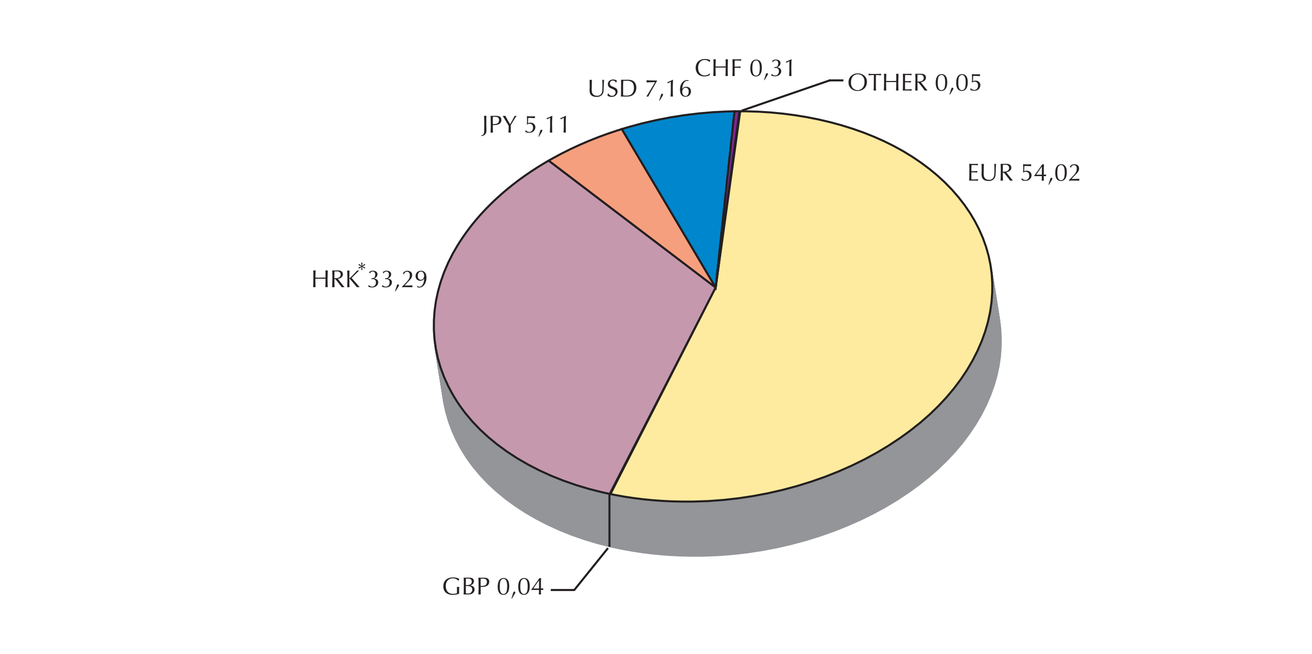

Figure 2. Central government debt, currency structure, end of 2006

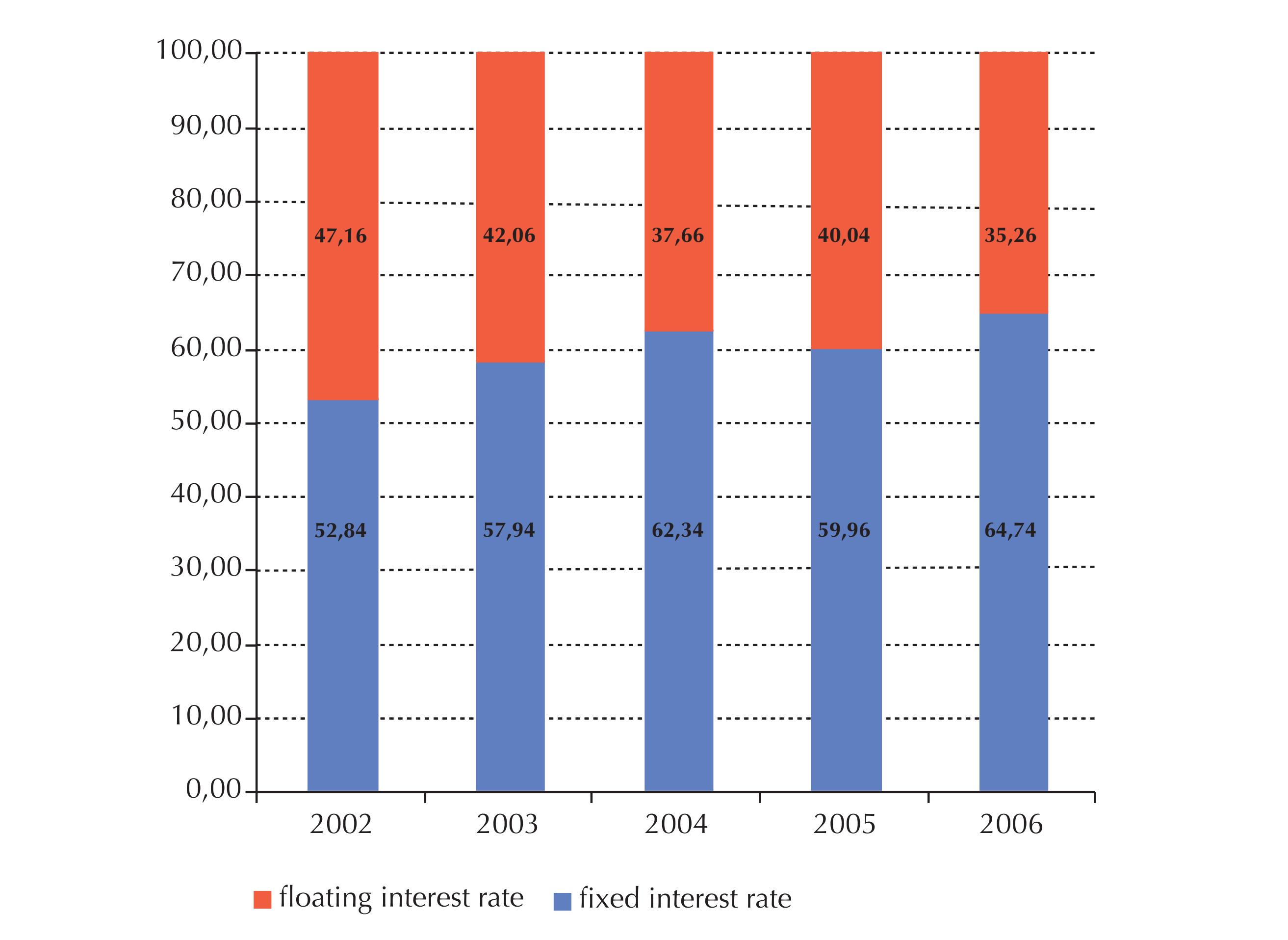

Figure 3. Public Debt structure according to interest rate type

The increase in borrowing, through issuing bonds with a fixed interest rate, led to an increase in debt share of the Public Debt with a fixed interest rate, which at the end of 2006 came to 64.74%, and at the same time to a decrease of debt share with a floating interest rate. The debt share with a variable interest rate was further decreased in 2006, first of all owing to payment of due obligations toward the London Club, repayment of obligations toward the Paris Club, as well as loan payments to international financial institutions.

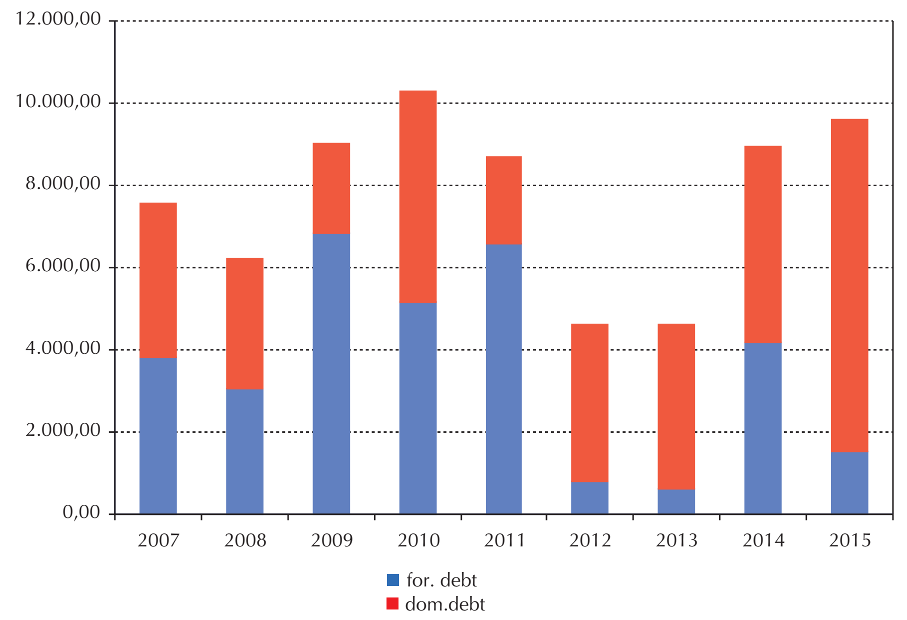

Figure 4. Central government debt amortization 2007-2015, mil. HRK

When managing public debt, it is important to ensure the smooth repayment profile in the forthcoming period. Borrowing orientation toward the domestic capital market shall contribute to reducing of exposure to exchange rate risks and at the same time encourage the domestic capital market development by creating a benchmark yield curve.

3. CENTRAL GOVERNMENT DEBT ACCORDING TO TYPE OF INSTRUMENTS

	2003		2004		2005		2006	
	mil. HRK	%	mil. HRK	%	mil. HRK	%	mil. HRK	%
Domestic market debt	**14,43**	**20,85%**	**24,94**	**31,44%**	**37,02**	**42,56%**	**43,05**	**49,64%**
1. bonds	7,88	11,39%	15,92	20,07%	24,49	28,15%	30,39	35,04%
2. treasury bills	6,55	9,46%	9,02	11,37%	12,53	14,40%	12,66	14,60%
Other debt	**54,78**	**79,15%**	**54,38**	**68,56%**	**49,97**	**57,44%**	**43,67**	**50,36%**
1. domestic	13,73	19,84%	12,28	15,48%	13,54	15,57%	11,18	12,89%
2. foreign	41,05	59,31%	42,10	53,08%	36,43	41,88%	32,49	37,47%
Central government total debt	**69,21**	**100,00%**	**79,32**	**100,00%**	**86,99**	**100,00%**	**86,72**	**100,00%**

Table 2. Central government debt according to type of instruments

In the central government debt structure there has been a considerable increase of the domestic market debt component (bonds and treasury bills), whose share in the total central government debt grew from 20.85% at the end of 2003 to approximately 50% at the end of 2006. The government orientation toward borrowing through issuing long-term or short-term securities in domestic market, enables realization of the budget determined financing, with a reduced dependency on foreign capital markets, and without a significant increase of foreign public debt. With an aim of further encouraging the domestic financial market development, the Ministry of Finance created long-term bonds denominated in kuna, as an additional instrument for investments by institutional investors, followed by an expected participation of a retail segment, broadening to the utmost the investor base for government bonds on the domestic capital market.

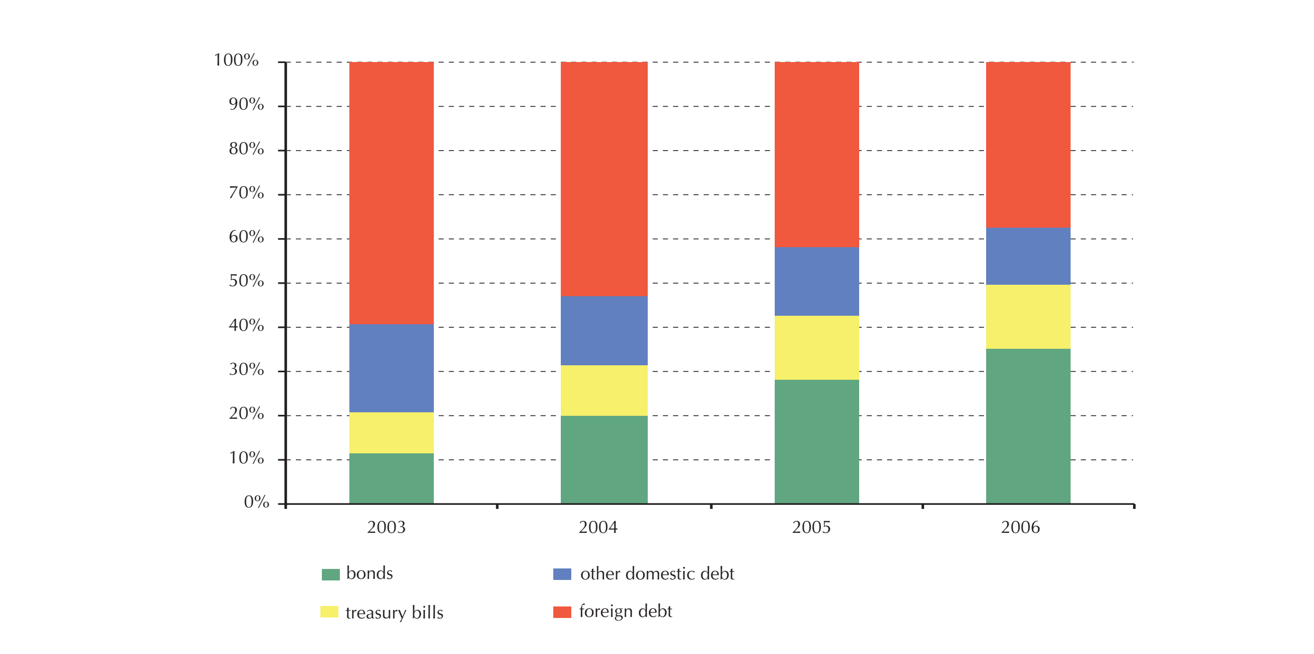

Figure 5. Central government debt structure according to type of instruments

Toward the end of 2006, the total central government debt included the bonds (35.04%) and treasury bills (14.6%), whereas the remaining domestic debt of 12.89% related to syndicated loans and rehabilitation bonds. The foreign debt share decreased from 59.31% at the end of 2003 to 37,47% (end of 2006), and in the most part related to international bonds and project loans of international financial institutions.

3.1. Treasury Bills

In the recent years the trend of budgetary financing in domestic capital market through issuing long-term debt securities, as well as short-term treasury bills, has become increasibly noticeable.

Treasury bills are short-term securities auctioned by the Ministry of Finance at a unique price. Submitted offers are ranked conforming to the offered discount price, starting from the highest to the lowest. In the process of offers acceptance, the Ministry of Finance establishes the lowest acceptable discount price, and conforming with that price determines a unique selling price for the whole series of treasury bills.

Ministry of Finance issues treasury bills of 91, 182 and 364 days maturities.

36 auctions of treasury bills were held in 2006 with a total of 89 issues, of which 32 issues with maturity of 91 days, 21 issues with maturity of 182 days and 36 issues with maturity of 364 days.

In 2006. a total of HRK 14.3 billion T- Bills were issued, and 13.7 billion of treasury bills were redeemed.

The largest interest at auctions is shown for treasury bills with the longest maturity date, which is why at the end of 2006 the share of 364 days treasury bills reached 96.4% of the total amount of the outstanding treasury bills of the Ministry of Finance.

Figure 6. illustrates movement of interest rates on treasury bills issued by the Ministry of Finance, which at the end of 2006 came to 3% for 91 days maturity, 3,5% for 182 days maturity and 3,9% for 364 days maturity.

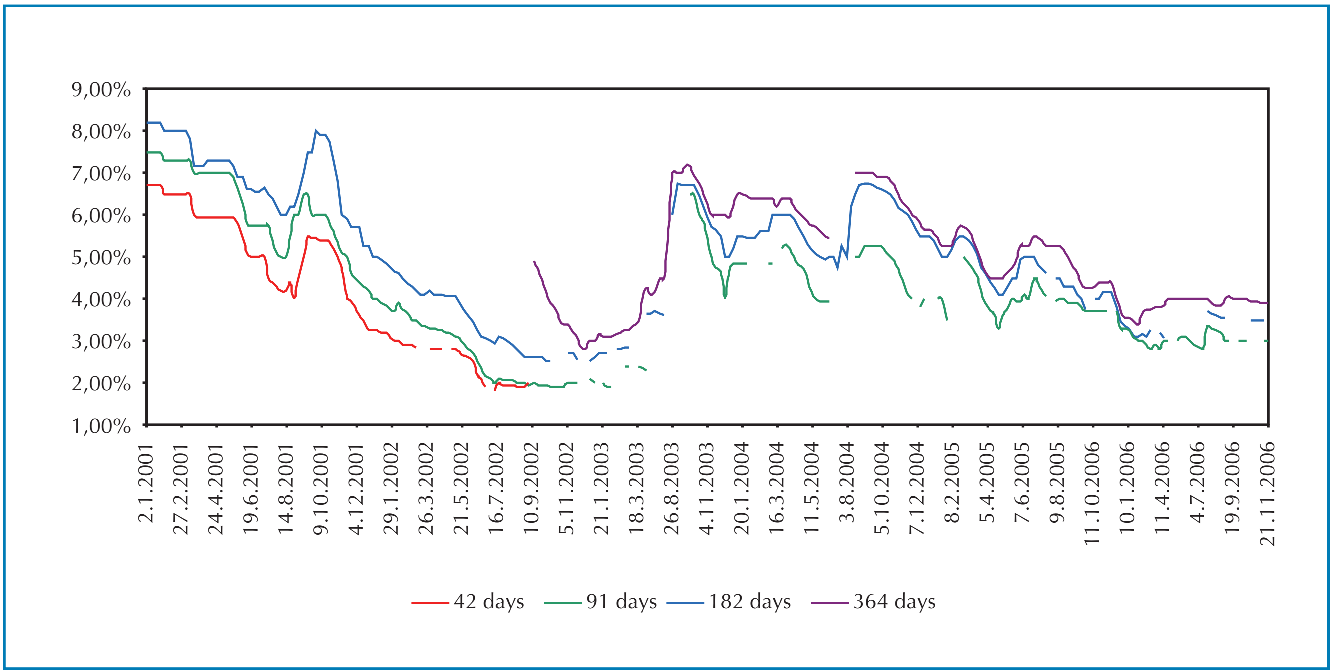

Figure 6. Treasury bills interest rates

Figure 7. illustrates the relation between the total amount of bids and the amount of issued treasury bills at auctions of the Ministry of Finance. Within the monitored period a trend of increased demand for treasury bills was observed, especially so at the beginning of 2006, when the bids total was six times higher than the issued amount.

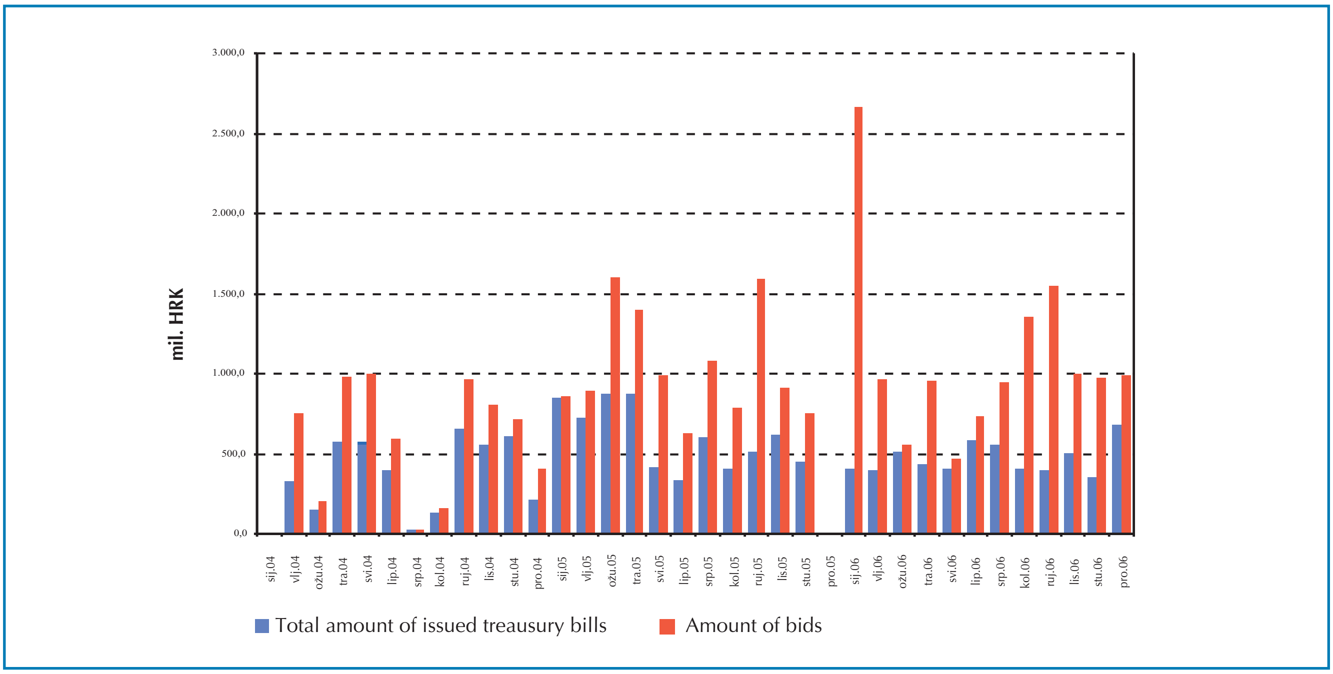

Figure 7. Auction results for treasury bills

3.2. Treasury Bonds

When analysing and determining financing sources for meeting the borrowing requirements of the State Budget, the orientation toward domestic capital market is continued, with an aim of reducing the growth trend of the total foreign debt of the Republic of Croatia. The debt strategy implemented in 2005 contributed considerably to the stated indicator stabilisation and resulted in nominal reduction of the government sector share in the total foreign debt for more than 4 billion kuna when compared to 2004. By continuing this policy in 2006, an additional reduction of the government sector foreign debt was achieved to the amount of 3,8 billion kuna. Thereby, a strong development of the domestic financial market has been confirmed, presenting an attractive alternative to foreign financial markets thanks to its depth, available maturities and favourable yields.

Through issuing of bonds denominated in kuna during the past 3 years (total issuance of 13,5 billion kuna with due date of 1 billion in 2008, 3 billion in 2010, 4,0 billion in 2013 and 5,5 billion in 2015), a benchmark long-term yield curve has been established in national currency.

At the same time five international bonds were redeemed (in July 2004, 300 million DEM, in December 2004, 25 billion JPY, in March 2005, 500 million EURO, in February 2006, 25 billion JPY, and in March 2006, 300 million EURO), as well as three issues domestic bond (in July 2004, 222 million EURO, in September 2004, 200 million EURO and in December 2005, 225 million EURO).

Bond	Date of issue	Currency	Amount (million)	Interest rate	Maturity date
domestic bonds					
Series 02 D-08	14.12.2001.	EUR	200	6,875%	14.12.2008.
Series 03 D-12	23.5.2002.	EUR	500	6,875%	23.05.2012.
Series 04 D-08	28.5.2003.	HRK	1.000	6,125%	28.05.2008.
Series 05 D-14	10.02.2004.	EUR	650	5,500%	10.02.2014.
Series 06 D-07	07.07.2004.	EUR	400	3,875%	07.07.2007.
Series 07 D-19	29.11.2004.	EUR	200	5,375%	29.11.2019.
Series 08 D-10	08.03.2005.	HRK	3.000	6,750%	08.03.2010.
Series 09 D-15	14.07.2005.	EUR	350	4,250%	14.07.2015.
Series 10 D-15	15.12.2005.	HRK	5.500	5,250%	15.12.2015.
Series 11 D-13	11.07.2006.	HRK	4.000	4,500%	11.07.2013.
international bonds					
London Club Series A	31.07.1996.	USD	311,9	USD 6m LIBOR + 81,25 bp	31.7.2010.
Samurai II 2007	11.07.2000.	JPY	40.000	3,000%	11.07.2007.
Euro-EUR III 2011	06.03.2001.	EUR	750	6,750%	14.03.2011.
Euro-EUR IV 2009	11.02.2002.	EUR	500	6,250%	11.02.2009.
Samurai IV 2008	26.06.2002.	JPY	25.000	2,150%	26.06.2008.
Euro-EUR V 2010	24.02.2003.	EUR	500	4,625%	24.2.2010.
Samurai V 2009	26.06.2003.	JPY	25.000	1,230%	26.06.2009.
Euro-EUR VI 2014	15.04.2004.	EUR	500	5,000%	15.04.2014.

Table 3. Review of outstanding bonds of the Republic of Croatia on 31-12-2006

Bond	Date of issue	Currency	Amount (million)	Interest rate	Due date
domestic bonds					
HZZO Series I	19.07.2000.	EUR	222	8,500%	19.07.2004.
DAB Series I	19.12.2000.	EUR	105	8,000%	19.12.2003.
DAB Series II	19.12.2000.	EUR	225	8,375%	19.12.2005.
Series 01 D-04	20.09.2001.	EUR	200	6,500%	20.09.2004.
international bonds					
London Club Series A	31.07.1996.	USD	545,8	USD 6m LIBOR + 81,25 bp	31.7.2010.
London Club Series B	31.07.1996.	USD	604	USD 6m LIBOR + 81,25 bp	31.7.2006.
Euro-USD 2002.	06.02.1997.	USD	300	7,000%	27.02.2002.
Euro-DEM 2004	01.07.1997.	DEM	300	6,125%	16.07.2004.
Matador 2001.	04.03.1998.	ESP	15.000	6,500%	26.03.2001.
Euro-EUR I 2006	23.02.19991	EUR	300	7,375%	10.03.2006.
Samurai I 2004	14.12.1999.	JPY	25.000	4,000%	14.12.2004.
Euro-EUR II 2005	28.03.2000.	EUR	500	7,000%	28.03.2005.
Samurai III 2006	06.02.2001.	JPY	25.000	2,500%	23.02.2006.

Table 4. Review of redeemed bonds of the Republic of Croatia for the period from 2001 until 31-12-2006

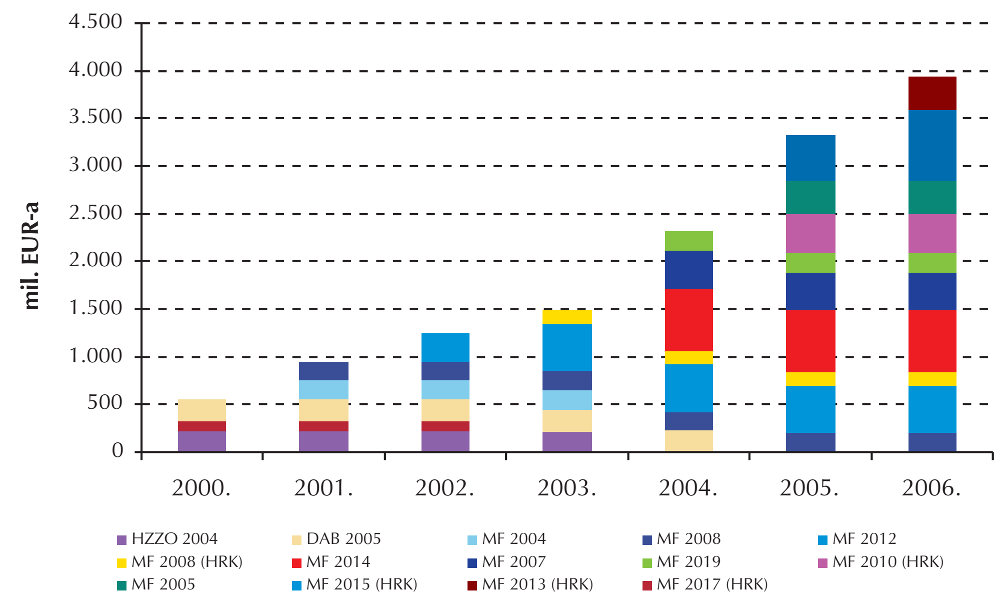

Figure 8. Review of domestic bonds listed at the Zagreb Stock Exchange

All issued bonds of the Republic of Croatia were listed in the first quotation ("Official market") of the Zagreb Stock Exchange, which at the end of 2006 listed a total of ten bonds issued by the Republic of Croatia.

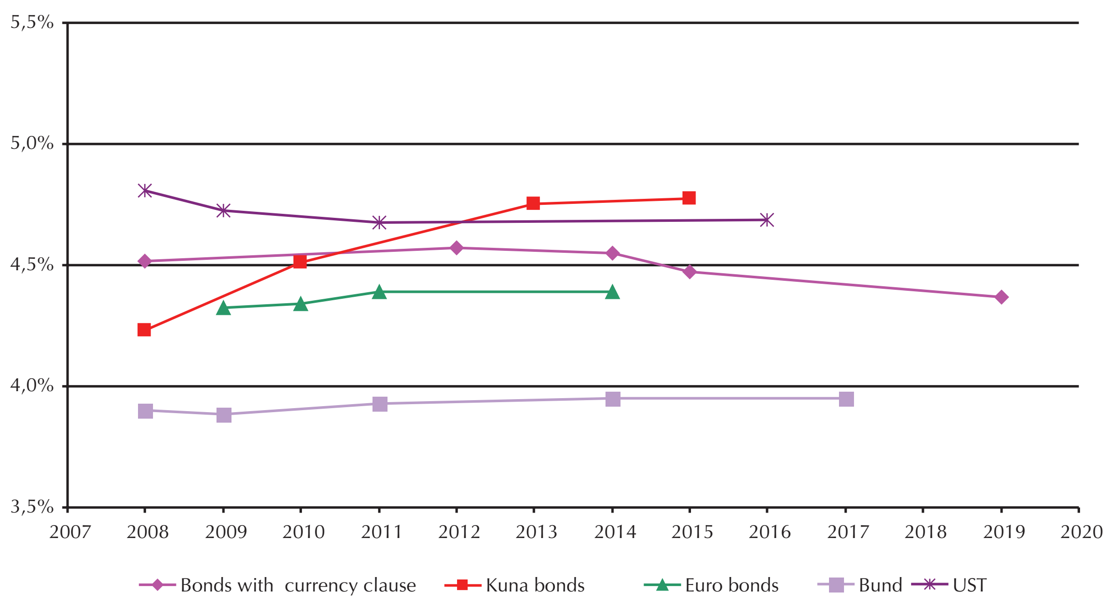

Figure 9. Yield curve of Croatian bonds, 29/12/2006

4. DOMESTIC DEBT AND INTERNATIONAL BONDS DEBT SERVICE PROJECTIONS

Table 5. Projection of debt service of domestic debt

(HRK mil.)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Amortization	**3.529,68**	**2.938,44**	**2.109,58**	**5.127,58**	**2.207,15**	**3.791,97**	**4.000,00**	**4.774,30**	**8.070,78**	**0,00**	**0,00**	**0,00**	**1.469,02**
Big bonds I	0,00	0,00	0,00	0,00	1.895,42	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Big bonds II (RB,SB)	64,56	68,97	73,60	78,45	84,69	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Big bonds III (PBZ)	58,39	62,73	67,28	72,20	77,49	41,06	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series I (RB, SB)	148,30	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series II (PBZdm)	23,94	25,12	26,44	27,76	29,16	15,13	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series III (PBZk)	60,60	65,00	69,78	74,92	80,43	42,53	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series IV (PBZk5)	32,76	34,45	36,21	37,97	39,96	20,71	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series V - A (DUB)	4,11	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series V - B (DUB)	198,98	213,15	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 02 D-08	0,00	1.469,02	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 03 D-12	0,00	0,00	0,00	0,00	0,00	3.672,54	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 04 D-08 (HRK)	0,00	1.000,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 05 D-14	0,00	0,00	0,00	0,00	0,00	0,00	0,00	4.774,30	0,00	0,00	0,00	0,00	0,00
Bonds - Series 06 D-07	2.938,03	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 07 D-19	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	1.469,02
Bonds - Series 08 D-10 (HRK)	0,00	0,00	0,00	3.000,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 09 D-15	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	2.570,78	0,00	0,00	0,00	0,00
Bonds - Series 10 D-15 (HRK)	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	5.500,00	0,00	0,00	0,00	0,00
Bonds - Series 11 D-13 (HRK)	0,00	0,00	0,00	0,00	0,00	0,00	4.000,00	0,00	0,00	0,00	0,00	0,00	0,00
Critical loan	0,00	0,00	1.836,27	1.836,27	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Interest repayment	**1.975,99**	**1.793,90**	**1.606,54**	**1.432,06**	**1.282,25**	**1.049,71**	**919,55**	**608,26**	**476,97**	**78,96**	**78,96**	**78,96**	**78,96**
Big bonds I	86,67	86,67	86,67	86,67	86,67	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Big bonds II (RB,SB)	25,49	21,01	16,31	11,38	4,55	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Big bonds III (PBZ)	26,30	21,96	17,41	12,49	7,12	1,47	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series I (RB, SB)	7,05	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series II (PBZdm)	7,05	5,88	4,63	3,23	1,84	0,37	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series III (PBZk)	27,25	22,77	18,00	12,93	7,42	1,54	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series IV (PBZk5)	9,70	8,01	6,32	4,48	2,57	0,51	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series V - A (DUB)	0,22	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Banks reorganization - Series V - B (DUB)	25,41	11,24	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 02 D-08	100,99	100,99	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 03 D-12	252,52	252,52	252,52	252,52	252,52	126,26	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 04 D-08 (HRK)	61,25	30,63	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 05 D-14	262,59	262,59	262,59	262,59	262,59	262,59	262,59	131,29	0,00	0,00	0,00	0,00	0,00
Bonds - Series 06 D-07	113,85	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 07 D-19	78,96	78,96	78,96	78,96	78,96	78,96	78,96	78,96	78,96	78,96	78,96	78,96	78,96
Bonds - Series 08 D-10 (HRK)	202,50	202,50	202,50	101,25	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bonds - Series 09 D-15	109,26	109,26	109,26	109,26	109,26	109,26	109,26	109,26	109,26	0,00	0,00	0,00	0,00
Bonds - Series 10 D-15 (HRK)	288,75	288,75	288,75	288,75	288,75	288,75	288,75	288,75	288,75	0,00	0,00	0,00	0,00
Bonds - Series 11 D-13 (HRK)	180,00	180,00	180,00	180,00	180,00	180,00	180,00	0,00	0,00	0,00	0,00	0,00	0,00
Critical loan	110,18	110,18	82,63	27,54	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Total	**5.505,66**	**4.732,35**	**3.716,12**	**6.559,63**	**3.489,40**	**4.841,68**	**4.919,55**	**5.382,56**	**8.547,75**	**78,96**	**78,96**	**78,96**	**1.547,98**

Table 6. Projection of debt service of international bonds of the Republic of Croatia

	Currency	Amount in orig. currency	Amount in USD*	2007	2008	2009	2010	2011	2012	2013	2014
London Club Series A	USD	857.796.000	857.796.000	77.981.454	77.981.454	77.981.454	77.981.454	0			
- coupon: 6m LB+13/16				18.079.513	13.258.309	8.437.106	3.615.903	0			
Samurai bond / II	JPY	40.000.000.000	336.429.310	340.611.708							
- coupon: 3%				10.218.351							
EURO bond	EUR	750.000.000	987.525.054	0	0	0	0	887.399.966			
- coupon: 6,75%				59.899.498	59.899.498	59.899.498	59.899.498	59.899.498			
EURO bond	EUR	500.000.000	658.350.036			591.599.977					
- coupon: 6,25%				36.974.999	36.974.999	36.974.999					
Samurai bond / IV	JPY	25.000.000.000	210.268.319		212.882.318						
- coupon: 2,15%				4.576.970	2.288.485						
EURO bond	EUR	500.000.000	658.350.036				591.599.977				
- coupon: 4,625%				27.361.499	27.361.499	27.361.499	27.361.499				
Samurai bond / V	JPY	25.000.000.000	210.268.319			212.882.318					
- coupon: 1,23%				2.618.453	2.618.453	1.309.226					
EURO bond	EUR	500.000.000	658.350.036								591.599.977
- coupon: 5,0%				29.579.999	29.579.999	29.579.999	29.579.999	29.579.999	29.579.999	29.579.999	29.579.999
Repayment	**USD**			**414.410.764**	**288.249.773**	**946.599.809**	**736.331.490**	**987.525.054**	**0**	**0**	**658.350.036**
Interest rate repayment	**USD**			**206.450.471**	**189.276.003**	**180.901.265**	**133.640.035**	**99.575.443**	**32.917.502**	**32.917.502**	**32.917.502**
Total repayment (capital + interest)	**USD**			**620.861.235**	**477.525.776**	**1.127.501.074**	**869.971.525**	**1.087.100.497**	**32.917.502**	**32.917.502**	**691.267.538**
Status at the end of the year	**USD**			**3.617.056.162**	**3.328.806.389**	**2.382.206.581**	**1.645.875.090**	**658.350.036**	**658.350.036**	**658.350.036**	**0**

*mean rate of exchange HNB, on 31.12.2006.
6m USD LIBOR 5,37 (29.12.2006.)

5. CREDIT RATINGS OF THE REPUBLIC OF CROATIA

The Republic of Croatia was given evaluations of credit rating by three leading rating agencies: Moody`s Investors Service, Standard & Poor`s (S&P), Fitch Ratings. In addition, Republic of Croatia was also given evaluation by the Japanese Rating Agency R&I, specialised for rating evaluation of securities' issuers in Japan.

Initial evaluations by agencies S&P, Moodys's and Fitch Ratings were assigned to the Republic of Croatia in January 1997, and the Japanese Rating Agency R&I assigned their ratings to the Republic of Croatia in 1998.

The stated agencies verify the assigned credit rating every year.

In December 2004, for the first time after seven years, the Rating Agency Standard & Poor's upgrated Croatia's credit rating for long-term debt in foreign currency from BBB- to BBB. The credit rating increase followed strong reforms and structural changes, as well as stabilisation of the foreign debt levels of public and private sectors.

In 2006 there was a change in evaluation of credit rating by the agency Rating and Investment Information (R&I).

On 10th November 2006, after eight years, Rating and Investment Information upgraded Croatia's credit rating for long-term debt in foreign currency from BBB to BBB+.

Long-term debt	**Moody's**	**FITCH**	**Standard&Poor's**	**Rating and Investment Information**
Long-term debt in foreign currency	Baa3	BBB-	BBB	BBB+
Long-term debt in domestic currency	Baa1	BBB+	BBB+	NR
Outlook	STABLE	STABLE	STABLE	STABLE
Short-term debt	**Moody's**		**FITCH**	**Standard&Poor's**
Long-term debt in foreign currency	P-1		F3	A-3
Long-term debt in domestic currency	NR		NR	A-2

Table 7. Review of investment credit rating of the Republic of Croatia

State	**Moody's (long-term debt in foreign currency)**	**Standard and Poor's (long-term debt in foreign currency)**
Bulgaria	Baa3	BBB+
Czech Republic	A1	A-
Croatia	Baa3	BBB
Hungary	A2	BBB+
Poland	A2	BBB+
Romania	Baa3	BBB-
Slovakia	A1	A

Table 8: Comparison of credit ratings at the end of 2006

6. EXCHANGE RATE

The exchange rate between kuna and euro at the end of 2006 came to 7,35 HRK/EUR and was nominally 0,4% stronger than the exchange rate at the end of 2005, when it came to 7,38 HRK/EUR.

The exchange rate between kuna and USD grew stronger by 10,5%, in 2006 that is, from the level of 6,23 HRK/USD on 31st December 2005, it reached 5,58 HRK/USD on 31st December 2006, as a reflection of USD decline toward euro on the global market.

	31. 12. 2005.	31. 12. 2006.
HRK/EUR	7,376	7,345
HRK/USD	6,234	5,578
HRK/JPY	5,308	4,692

Table 9. Foreign exchange rate, end of year

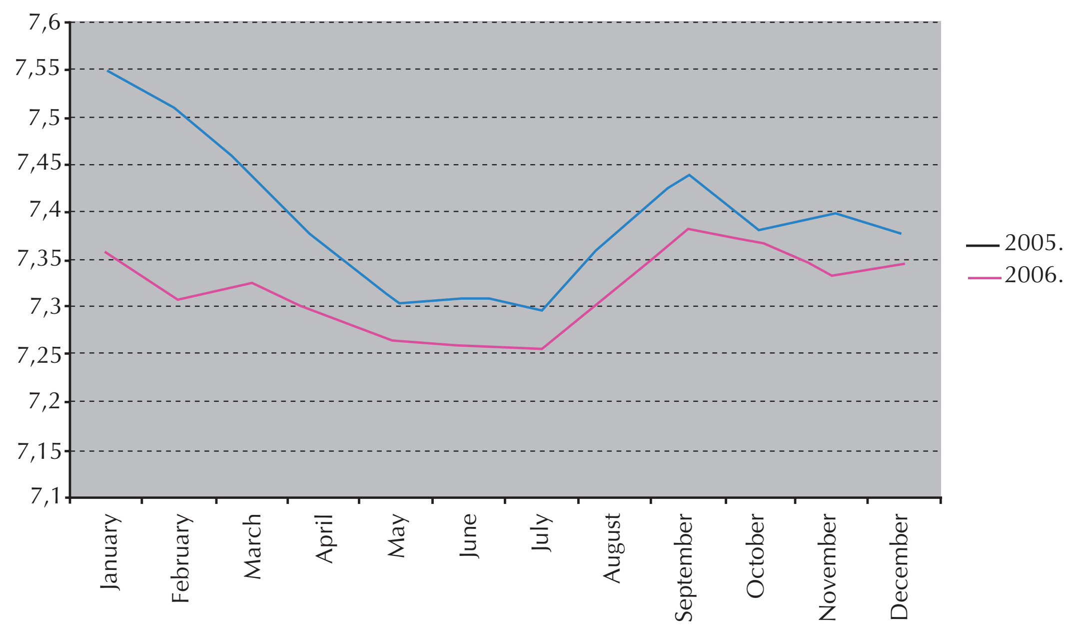

Figure 10. Mean rate of exchange between Croatian kuna and euro, the end of month

7. 2007 DEBT MANAGEMENT STRATEGY

7.1. The Goal of Borrowing and Public Debt Management

The primary goal of borrowing and public debt management is providing for financial requirements of the state budget while minimising, over the medium to long term, the financing cost at a prudential level of risk.

An additional objective is the development of the domestic government securities market. A developed market represents the basic precondition for an efficient debt management, i.e., for an efficient borrowing costs and liquidity management, as well as diversification of the debt portfolio.

7.2. Basic Guidelines

The basic guidelines of the Ministry of Finance in debt management are the following:

- Prudential debt management
- Transparent and predictable borrowing and debt management
- Promoting liquidity and a wide circle of investors into government securities, and development of an efficient infrastructure at the domestic capital market.

Prudential Debt Management

During the monitored medium-term period, debt management will focus on the fulfilment of two groups of objectives: optimizing the structure and reducing the risk of government debt portfolio, as well as improvement of trading and development of infrastructure on the domestic government securities market. Optimizing the structure of the government debt portfolio primarily relates to its currency and maturity structure.

Optimizing the Structure of the Government Debt Portfolio with Regard to Currency Structure

A relatively high share of the central government debt denominated in foreign currency (67%) increases the exposure to currency risk, i.e., risk of increasing the burden of debt financing and debt level in the event of a depreciation of the domestic currency. High exposure to Euro (54% of debt) has a double effect: on the one hand, a relative stability of the kuna against the Euro decreases the currency risk and makes the Euro an attractive currency for borrowing. However, exposure to one currency considerably increases the negative impact of possible changes in the foreign exchange market. For this reason financing will be directed mostly to kuna sources so that the share of debt denominated in foreign currency would drop to approximately 40% until 2009, and borrowing of the Ministry of Finance during 2007 is primarily planned in kuna (except for loans of international financial institutions). Should, for purpose of more efficient risk management, a need arise for foreign borrowing or borrowing with a currency clause, it will, given the stability of the kuna and medium-term prospects of EU accession, be effected in the Euro.

Optimizing the Structure of the Government Debt Portfolio with Regard to Maturity Structure

The current term structure in which short-term debt accounts for 14.6% of the central government debt, with an average annual maturity of 3.57 years, does not raise a concern. However, to reduce the risk of refinancing it is necessary to reduce the relative share of short-term debt and retain the average debt maturity above 3 years. For this reason in 2007 borrowing will focus on instruments with a longer maturity, primarily on bonds with maturity of 5 and/or 10 years. The aim will be to adjust the maturity of new borrowing to unify the schedule of maturity of liabilities and equally distribute the burden of refinancing. In this respect, the aim will be to reduce the amount of debt with maturity in the next 12 months and debt with a floating interest rate to 33% of total debt. Also, attempts will be made to level the term structure of treasury bills in terms of an adequate share of individual terms of payment since treasury bills with a longer maturity prevail in the current term structure.

Transparent and Predictable Borrowing and Dept Management

The future borrowing requirements depend on the current debt status (interest payment and repayment maturity), the future trends of primary fiscal balance (surplus or deficit), debt management policy (forms, conditions, and payment terms of new borrowing) and on the privatization process, since the receipts from the privatization of companies in the state portfolio may be used for financing the deficit and thus reduce the need for borrowing.

According to the current debt status and projections of repayments until 2016, an annual maturity of approximately HRK 8 billion a year is expected. However, the schedule of projected repayments indicates a larger burden of repayments in the period between 2009 and 2011 and again at the end of the monitored period. The reason for this are the maturities of several bonds in the years indicated. It is most important to point out redemption in the same year of domestic and Euro bonds in 2010 and 2014 and repayment of two domestic bonds in 2015.

In the next medium-term period between 2007 and 2009, the requirements for borrowing will be at the average level of HRK 11.8 billion or 4.1 percent of GDP, and will be more evident during 2007 and 2009, primarily due to significant maturities of repayments of existing liabilities. Expenditures on interest payments will be at an average level of 1.6 percent of GDP with a slight drop of their share in GDP. A continuation of fiscal consolidation will result in a reduction of primary deficit, which will contribute to reducing borrowing requirements. On the other hand, the envisaged privatization schedule will have an opposite effect since the importance of capital revenue in financing of the deficit will decline.

The projected borrowing requirements will primarily be used on the domestic market, in accordance with the policy of reduced foreign borrowing. Foreign borrowing should be at the average level of 0.5 percent of GDP with a strong declining trend.

Table 10: Borrowing Requirements and Borrowing (2007-2009)

HRK million	2007	2008	2009
1. Primary surplus (-) / deficit (+)	-12	76	276
2. Interests	4.610	4.624	4.789
3. Repayments	8.742	7.054	9.701
4. Capital revenues	1.830	1.277	1.256
Receipts from sale of non-financial assets	320	267	246
Receipts from sale of stocks and other shares	1.510	1.010	1.010
5. Borrowing requirements (1. + 2. + 3. - 4.)	11.509	10.477	13.510
6. Borrowing	11.509	10.477	13.510
Foreign	1.751	1.760	838
Domestic	9.758	8.717	12.672

Note: Surplus / deficit defined according to GFS 1986 methodology

Promoting Liquidity and a Wide Circle of Investors into Government Securities and Development of an Efficient Infrastructure on the Domestic Capital Market

Further development of the capital market in Croatia can significantly be contributed to by the development of the domestic government securities market as its important component. On the other hand, development of that segment of the market will also contribute to a more efficient debt management thanks to a greater liquidity, transparency, and predictability. For this reason the activities of the Ministry of Finance in the medium term will focus on the realization of several operational goals related to the improvement of trading and development of infrastructure on the domestic government securities market.

Building the Reference Domestic Yield Curve

In the next medium-term period the Ministry of Finance intends to build a reference kuna yield curve from 3 months to 10 years, which will contribute to a reduction of costs of interests and easier setting of the price of other instruments on the market. In addition to the creation of an adequate term structure of treasury bills indicated above, the Ministry of Finance intends to place the future bond issues with the term of payment of 3, 5, 7, and 10 years by complementing the maturities necessary to build the curve. This means that the current maturities in 2007 will most probably be complemented by maturities of 2012 and 2017.

Implementation of auction for issuing Bonds

The practise of issuing Bonds in Republic of Croatia has been leaning on syndication of bigger bond issues, while auctions have been used for T- bills issue. However, the technique of auction is the standard practice in EU Member States for issuing of Government securities in the domestic market as it promotes its flexibility and liquidity. For that same reason, over the medium term, the Ministry of Finance plans to combine auctions and syndication for the issuance of Bonds in the domestic market; new Bonds will be issued through syndication while reopening will be auctioned.

Publication of issuance calendar and quarterly borrowing plans

With a view in increasing the transparency and predictability of the issuance of Government securities, the Ministry of Finance plans to publish each quarter a calendar detailing the amount of debt to be issued as well as the amount for the next month and indicative target for the two following ones. In addition, the Ministry of Finance plans to publish a yearly calendar indicating the dates of auctions and anticipated dates of syndicated issues.

Implementation of Primary Dealers System

The Ministry of Finance plans to initiate the implementation of a Primary Dealers during 2007. The selected Primary Dealers will have the monopoly of participation in auctions; Primary Dealers will also have the obligation to quote binding bid and ask prices in the secondary market. This will promote the liquidity in the market and contribute to the building-up of a reference yield curve and eventually to the reduction of the borrowing costs of the Ministry of Finance.

8. ISSUANCE CALENDAR

Calendar of issuing T-Bills in 2007.

Ordinal number	Date of auction	Indicative target (mil. HRK)
1	2. January	305*
2	9. January	559*
3	23. January	505*
4	13. February	464*
5	13. March	459*
6	20. March	250
7	27. March	545
8	3. April	300
9	10. April	400
10	24. April	300
11	8. May	500
12	22. May	400
13	5. June	500
14	12. June	500
15	3. July	500
16	17. July	450
17	24. July	500
18	31. July	400
19	7. August	350
20	28. August	350
21	4. September	350
22	11. September	400
23	18. September	300
24	2. October	500
25	9. October	400
26	16. October	450
27	23. October	400
28	30. October	500
29	6. November	450
30	20. November	300
31	11. December	500
32	18. December	450

* Issue already effective

Calendar of planned Bonds issue in 2007.

Ordinal number	Date of issuing	Indicative target (mil. HRK)
1	8. February	2.500*
2	6. July	3.500
3	25. September	3.000

* Issue already effective

PUBLISHER:
Ministry of Finance of the Republic of Croatia
Zagreb, Katančićeva 5

Editor:
Public Debt Management Department

Prepared by:
Public Debt Management Department

Technical editor:
aKD

Printing:
aKD

Edition:
50 copies

Those using data from the Annual Debt Report and Public Dept Management Strategy are requested to cite the source.

Available on the Internet:
www.mfin.hr

Zagreb, 2007.