Selected parts of the document approved by the Government at its session on 22 May 2002

Part I

Draft

RESOLUTION

of the Government of the Czech Republic

of ……………………No….

Revision of the Strategy for Dealing with the Exchange Rate Effects of the Foreign Exchange Revenues of the State

The Government

I. approves

1. an amended method for dealing with the exchange rate effects of the foreign exchange revenues of the state, contained in Part III of this document (hereinafter referred to as the "Method"), which relates to the amended items of Government Resolution No. 74 of 16 January 2002 under item I/2 of this Resolution and to the task assigned under item II/2/b) of the said resolution;

2. the following amendment to Government Resolution No. 74 of 16 January 2002 on the Strategy for Dealing with the Exchange Rate Effects of Capital Inflows from Privatisation of State Property and from Other Foreign Exchange Revenues of the State:

a) item I/6 of the Resolution is hereby repealed and replaced with the following wording:
The Minister of Finance will leave the funds acquired from the de-blocking of Russian debt on the CNB's foreign exchange account in the full amount until 31 May 2002. The conversion of these funds into Czech koruna will be performed as laid down in the Method under item 3,

b) item I/7 of the Resolution is hereby repealed and replaced with the following wording:
The Czech National Property Fund will gradually deposit on a non-interest-bearing foreign exchange account at the Czech National Bank until 31 December 2007 an amount with a koruna equivalent of CZK 25 billion. The terms and conditions of maintenance of this account will correspond to the mechanism referred to in the Method under item 1,

c) item I/8 of the Resolution is hereby repealed and replaced with the following wording:
The remaining foreign exchange resources of the National Property Fund or the State (both the existing resources and those acquired in the future) which will need to be converted to koruna will be directly converted from the Czech National Property Fund or the State into the CNB's foreign exchange reserves. The Czech National Bank will directly convert the foreign exchange revenues under the conditions set forth in the Method under items 2 and 3,

d) items I/5, II/2/a) and II/2/b) of the Resolution are hereby repealed.

Part III

Revision of the Strategy for Dealing with the Exchange Rate Effects of the Foreign Exchange Revenues of the State

The main reason for revising the strategy is that some tasks of the state recorded in the original Government resolution are performed specifically by the Czech National Property Fund, whose activities are governed by a special legislative act. Some of the other revisions are only technical in nature. Only these amendments are given below – the original text is not repeated.

<u>Draft amended method</u>

1. The National Property Fund will deposit on a non-interest-bearing foreign exchange account at the CNB an amount originating from the State's foreign exchange revenues with a koruna equivalent of CZK 25 billion, which is derived from the current level of the State's commitments to the CNB, i.e. a CZK 22.5 billion state guarantee associated with banking sector consolidation plus CZK 2.4 billion as the unresolved part of the CNB's receivable from the NBS. The target amount on the account will be achieved as follows:

   Option 1
   in the course of *the second half* of 2002 (and possibly in subsequent years) by the depositing of at least 20% of each privatisation revenue received *after 1 June* 2002, as corresponds to the current possibilities of the NPF's amended budget, mainly because of the postponement of the privatisation of Český Telecom ***or***
   Option 2
   immediately in the course of *2002,* i.e. including the revenues from the privatisation of Transgas a.s., and possibly in subsequent years, by the depositing of at least 20% of each privatisation revenue received *in 2002*, on condition that a restriction of the NPF's current budget expenditures is approved.

   The money will be deposited on the aforementioned non-interest-bearing account up until 31 December of 2007, when the State's commitments to the CNB associated with banking sector consolidation fall due. If the CNB's receivable from the State continues, this money can subsequently be used only to cover the State's commitments to the CNB. This money can be used to cover the State's commitments to the CNB only on condition that Article 18 (2) of Act No. 171/1991 Coll., on the Powers of the Authorities of the Czech Republic in Matters regarding the Transfer of State Assets to Other Persons and on the National Property Fund of the Czech Republic, is supplemented accordingly.

2. Privatisation revenues in foreign currencies which the National Property Fund is unable to keep on its foreign exchange account with the central bank will be converted directly into the CNB's foreign exchange reserves. If necessary, the same mechanism will also be applied to the conversion of the State's other foreign exchange revenues.

3. The CNB will convert foreign currency into Czech koruna using an exchange rate derived from the market exchange rate announced by the CNB for the day on which the conversion is effected, depending on the converted volumes and depending on time. The exchange rate which the CNB will apply for conversions of the revenues of the National Property Fund and the State in 2002 will:

- in the case of the *NPF*'s revenues be reduced by 3% for the conversion of the first CZK 30 billion, by 6% for conversions from CZK 30 billion to CZK 80 billion, and by 9% for conversions exceeding CZK 80 billion,

- in the case of the *State*'s revenues be reduced by 3% for the conversion of the first CZK 20 billion and by 9% for conversions exceeding CZK 20 billion.

  If the preferential total (i.e. State and NPF) limit of CZK 50 billion for conversions with the rate reduced by 3% or CZK 100 billion with the rate reduced by 6% is not exhausted in 2002, these limits will remain in effect until they are exhausted in the subsequent period. Conversely, if the direct conversions exceed CZK 100 billion in 2002, in each of the following years conversions will only be performed with the largest reduction of the rate. At the same time, however, this largest reduction will decrease by 2% a year, i.e. to 7% in 2003, 5% in 2004, 3% in 2005, 1% in 2006 and 0% in 2007.

4. Item I/5 of the original Resolution, which assumed that Česká exportní banka would ensure its prospective needs for financing foreign currency assets through a transaction with the State as stated in the – original – Method, is repealed, as, owing to delayed collection of funds of National Property Fund, the assumed transaction did not occur. As the ČEB's necessary borrowing transaction is money neutral and hence does not affect the koruna's exchange rate, the Ministry of Finance and the Czech National Bank agree to implement a ČEB bond issue according to the current need in an amount of USD 350 million and with a maturity of 7 years.

Removal of task from Government Resolution No. 74/2002, under item II/2/b)

Under this item the Minister of Finance was charged with the following task: "to immediately check the situation and prospective solution of the Ministry of Finance's guarantee for České dráhy, s.o. (Czech Railways) in respect of the European Investment Bank and to submit a proposal to the Government for covering this guarantee using the foreign exchange revenues of the State".

Regarding this item we state the following:

The guaranteed loans amount to approximately EUR 946 million of principal, i.e. approximately CZK 89 billion, maturing progressively up until the year 2020. From 2002 until 2007, on average EUR 90.5 million a year, i.e. almost CZK 3 billion, will have to be paid from the state budget as a result of this state guarantee. An overview of ČD's loan instalments and likely drawings on guarantees is given in Annex 1.

One solution allowing sterilisation of the effects of the conversion of privatisation revenues on the koruna's appreciation would be to hedge the exchange rate risk of ČD's future loan instalments by means of a "transformation" guaranteed by Českomoravská záruční a rozvojová banka, a.s., as was done to hedge the foreign currency instalments on EIB loans and instalments on Mufis loans granted for municipal infrastructure financing.