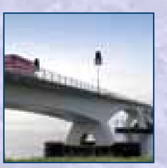
Outlook 2006





Dutch State Treasury Agency

Outlook 2006

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Preface

The primary objective of the Dutch State Treasury Agency (DSTA) is to finance the Dutch state debt at the lowest possible cost given a prudent degree of risk. For this purpose, it applies a risk management strategy. As part of a periodic evaluation, a comprehensive reassessment of this strategy will take place in 2006. The outcome of the reassessment will form the basis for the DSTA's risk management policy during the period 2007-2010. A thorough evaluation of the debt managers' objectives, tools and measurements will be an important part of this exercise.

Over the years, the DSTA has adapted to changing market conditions by introducing new elements into its issues and auction methods. New products are being taken on board on condition that they serve the objectives of the DSTA and to the extent that they adequately meet market demand.
The introduction of the 30-year DSL in April 2005 and the switch facility that was offered alongside the issue is a good example. The DSTA will reopen the 30-year bond in 2006. In addition, the DSTA will revive the 30-year bond that was issued in 1993. This will be achieved through issuing a new bond with the same characteristics in combination with a strip and destrip facility. Index-linked bonds will not be part of the funding strategy.

With respect to its cash management, the DSTA is presently looking into financial products such as European Commercial Paper and tri-party repos. European Commercial Paper might add to the efficient management of short-term liquidity, whereas tri-party repos could further reduce the DSTA's credit risk exposure in money market operations.

The support of the Primary Dealers and the Single Market Specialists complements the DSTA's issuing strategy. Their activities in the primary and secondary markets for both bonds and bills are monitored regularly to help safeguard the objectives of transparent and liquid markets for Dutch securities. The DSTA has a strong preference for maintaining a long-term relationship with its Primary Dealers. However, to leave a fair chance to new interested parties and to preserve the right incentives, the membership of the Primary Dealers is evaluated on an annual basis.

Specific attention was paid to the organisational set-up of the DSTA as well as to the IT-environment this year. Further improvements have been made in order to add to the flexibility and functionality of the DSTA. This in turn should enable us to adapt to new developments in good time.

Erik Wilders
Agent of the Dutch State Treasury Agency

Contents

Economic prospects and financial markets

Global economic performance continues to be strong. The Dutch economy is expected to gain momentum in 2006 as a result of the global outlook in combination with the initial effects of past reform measures. Government measures to jolt the labour market and improve the competitive position of Dutch businesses are beginning to bear fruit. 2005 was an enervating year for fixed-income markets. The yield curve in the US became almost completely flat due to gradual increases in the short-term interest rate.
The flattening in Europe was the result of a decline in long-term interest rates.

1.1 Global and European economic outlook

global growth around 4%

The world economy is expected to reach an average growth rate of 4% this year and just over 4% in 2006. Compared to 2004, economic performance in 2005 weakened slightly, partly because of a significant increase in oil prices. In 2006, oil prices are expected to stabilise and financial prospects in the corporate sector are looking up. The continuing strong performance of emerging markets such as China will also contribute to growth. A risk to the positive developments is formed by the lingering threats of terrorist attacks and by global imbalances.

consumers and businesses drive US performance

In 2005, economic performance in the United States remained robust, underpinned by strong income growth and improving labour market conditions. The catastrophic effects of Hurricane Katrina were felt, but the impact on aggregate output remained modest. As Katrina exacerbated the rise in oil prices, there is likely to be an indirect impact from the hurricane on the economy. Overall, the momentum of economic expansion in the US is solid. In 2006, increases in both private consumption and corporate investments will continue to drive performance. Private consumption is projected to benefit from higher employment. Corporate investments are expected to thrive on increased profitability, high capacity utilisation, and the historically low cost of capital, that prevails despite gradual increases in the short-term interest rate in order to reduce inflationary pressures. Economic performance will have a favourable impact on the budget deficit, which is expected to fall from 4.3% of GDP last year to about 3.5% of GDP in 2006.

China and Middle East boost growth

Prospects for the Asian economy continue to be bright with growth averaging close to 7% next year. China remains the strongest performer with an expected GDP growth of over 8% in 2006. India is also showing excellent growth rates driven by strong demand from the Middle East. It is estimated that Japan will grow at a pace of about 2% annually this year and next. To improve its fiscal position, Japan is expected to further tighten its budgetary policy in 2006.

better prospects for the euro zone...

In the euro zone, economic activity in 2006 is projected to pick up to reach a growth rate of about 2%, compared to just over 1% in 2005. Low growth in 2005 can be explained by a prolonged appreciation of the euro and by the large increase in oil prices. Confidence indicators also remain subdued. As a consequence, the EU budget deficit will breach the 3% reference value in 2005. For 2006, driving forces behind the anticipated upturn will be the favourable global economic developments and historically low interest rates, as well as the fading out of the impact of the euro appreciation and an expected stabilisation of the price of oil. As a result, an increase in corporate investments is expected. The budget deficit is estimated to improve slightly to an average level of 3% of GDP in 2006. The labour market's response will lag behind, but a slight reduction in the unemployment rate may occur already next year.

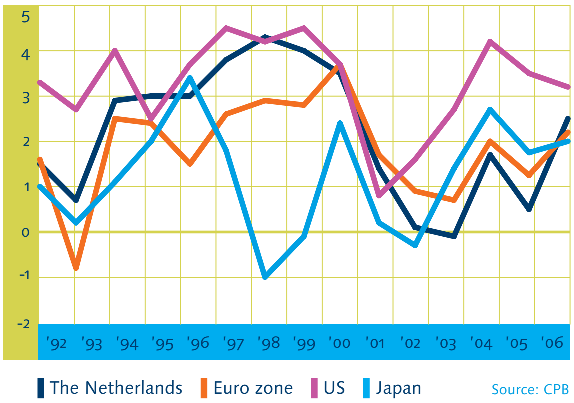
...are expected to reduce the deficit and improve the labour market performance

1.2 The Dutch economy

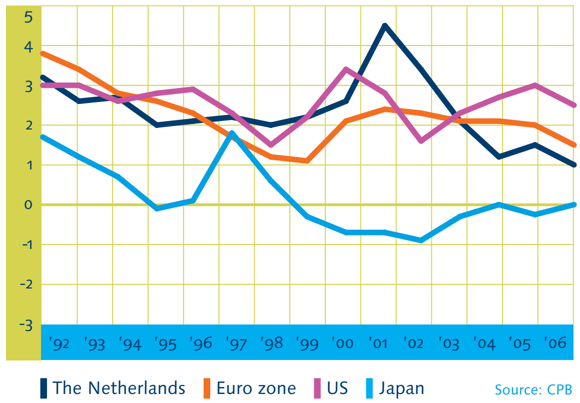
gaining momentum in 2006...

Implementation of the structural reform plans over recent years has put the Dutch economy in a good position to benefit from the continued strong global growth in 2006. After a minor setback in 2005, which was caused by a temporary reduction in purchasing power, a strong euro and excessively high oil prices, the Dutch economy is expected to gain momentum in 2006. The upturn will primarily be driven by the export sector, aided to a large

Volume growth of GPD, 1992-2006 (%)



Inflation, 1992-2006 (%)



extent by an improvement in the competitive position of Dutch businesses. As a result, it is estimated that economic growth next year will exceed 2%.

...after prolonged downturn...

Over the period 2001-2003 the Dutch economy experienced a severe economic downturn. The slowdown was mainly caused by a reduction in export growth, which in turn was the result of both external shocks and the strong relative increase in unit labour costs at the end of the 1990s. With the downturn, labour productivity growth weakened further as a result of labour hoarding. When wages failed to adjust, unit labour costs rose even more and the competitive position deteriorated vastly. The downturn was amplified, moreover, by negative wealth effects caused by a decline in the stock market and the fact that strong increases in house prices had come to a halt.

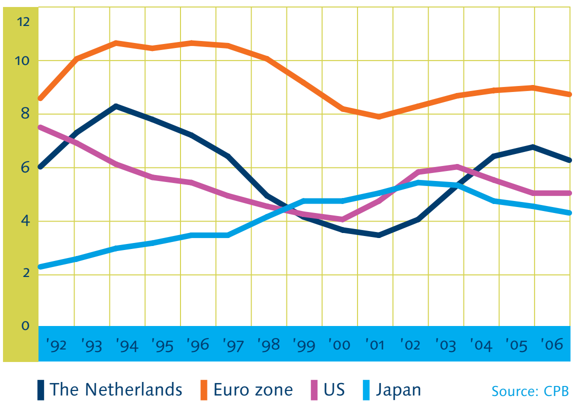
...thanks to structural reforms

In response to the weakened economic position, the Dutch government embarked on a wide range of reforms aimed particularly at jolting the labour market. Both increased labour participation and higher productivity growth were needed to put economic growth back on track. As a stimulus to labour participation, all exit routes out of the labour market were scrutinised and eligibility for them was tightened. To motivate both new and continued participation, inactivity traps were reduced and day care facilities improved. Wage moderation has also had a positive impact on labour market performance. Measures have been introduced to stimulate businesses. In 2006, taxes on new corporate capital will be abolished and the corporate profit tax rate will be reduced to 29.6% (compared to almost 35% in 2003). Furthermore, the government's aim is to cut the administrative burden on the business sector by 25% by the end of 2007; about 10% of this has been achieved at the end of 2005.

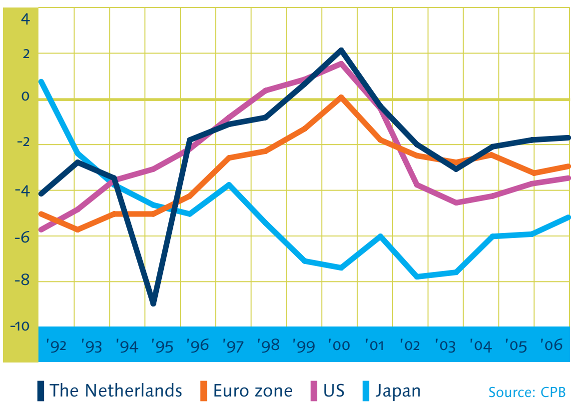
new health insurance and life-cycle scheme in 2006

Two reform schemes deserve particular attention. The first is the change in the tax treatment of early retirement and life-cycle saving, aimed at stimulating the labour market and particularly at encouraging older workers to remain in the labour market longer. The second is the implementation of the new health insurance system in 2006. The system is aimed at rendering health care more efficient. In the new system insurers will have an essential part in buying health care, which will stimulate competitiveness between healthcare suppliers. The compulsory public health insurance and private health insurance systems will be merged into a new, privately administered, basic health insurance system for curative healthcare. Participation in the scheme is mandatory and subject to a flat fee plus a contribution that is a function of earned income.

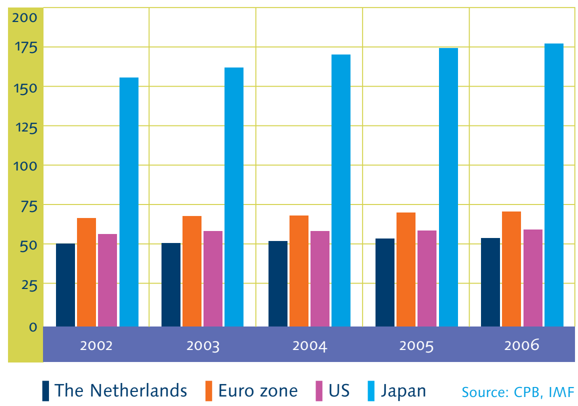
Unemployment, 1992-2006 (% of labour force)



Budget balance, 1992-2006 (% of GPD)
The Netherlands, Euro zone (EMU balance), US and Japan



Government debt, 2002-2006 (% of GDP)
The Netherlands, Euro zone (EMU debt), US and Japan



Past reform measures are beginning to bear fruit. The labour market is gradually showing signs of greater flexibility and wage increases are well contained. Contrary to past developments, Dutch unit labour costs are now falling in line with what we see in other countries in the euro zone. These initial results set the stage for stronger export growth and greater corporate sector profitability which, in turn, should trigger additional business investments. Corporate investments are expected to grow strongly in 2006. In addition, the unemployment rate should start to show a modest decline. As most reforms take time to become fully effective, results will become increasingly visible in the years to come.

buoyant growth in corporate investments

full impact of reforms in years to come

Both the economic cycle and the structural rigidities have left their mark on the fiscal position. The budget balance deteriorated from a surplus of more than 2% of GDP in 2000 to a deficit of 3.2% of GDP in 2003. The deterioration was confined by strong fiscal discipline. Fiscal discipline in combination with higher growth is expected to result in a deficit of below 2% in 2005 and 2006. Effective consolidation together with the anticipated economic recovery will even create room for additional expenditure targeted at enhancing the purchasing power of Dutch consumers. However, further fiscal adjustment over the medium term is necessary, particularly to cope with the effects of an ageing population.

some budgetary room to manoeuvre

1.3 Financial markets

flattening of the yield curve...

2005 was an enervating year for fixed-income markets. The yield curve in the US became almost completely flat, due to gradual increases in the short-term interest rate in order to reduce inflationary pressures. The flattening in Europe was the result of a decline in long-term interest rates to the lowest levels since World War II.

...in US...

In the US, the Federal Reserve Bank increased the rate from 1% in June 2004 to 4% in November 2005 in response to rising inflationary pressures. Within the same period, US long-term interest rates remained more or less stable at 4%. The talk of 2005 was the low level of rates in relation to the short end, referred to by Greenspan as a 'conundrum'. For example, the spread between 2-year and 10-year US treasury bonds declined from 240 to 11 basis points between January 2004 and August 2005, mainly as a result of a higher yield on the 2-year treasury bond.

...and in Europe...

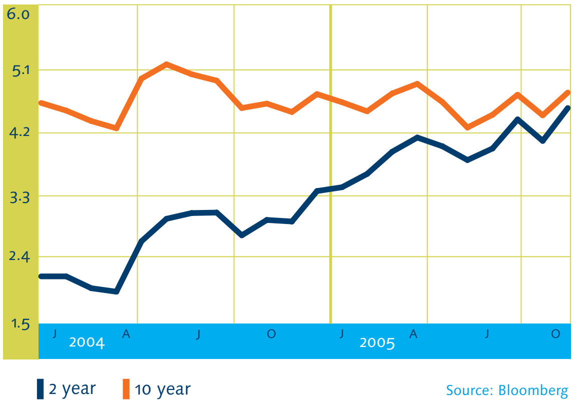
In Europe, money markets focused on the European Central Bank (ECB), which left the main refinancing rate unchanged. At the start of the year, the spread between the overnight and 12-month Euribor amounted to 25 basis points, which reflected a risk premium and a small chance of a possible interest rate hike. In the course of the year, the money market yield curve flattened. Despite rather hawkish language from ECB officials, the yield curve even became inverted in the middle of the year owing to doubts about the economic recovery. After August 2005, money market curves steepened sharply as a result of higher headline inflation induced by soaring oil prices and a depreciation of the euro. ECB officials in the meantime warned about the strong growth in monetary aggregates and inflationary pressures.

Long-term interest rates in Europe declined to the lowest levels in fifty years. For instance, the new Dutch 10-year DSL reached 3.025% in September 2005, whereas the German reference Bund briefly yielded less than 3%. As a consequence, the European yield curve flattened considerably in the past year-and-a-half. The yield between the 10-year and the 2-year bond dropped by 100 basis points to around 70 basis points. Likewise, the sizeable demand for ultra-long bonds pushed the spread between the newly issued 30-year and the 10-year DSL to below 40 basis points.

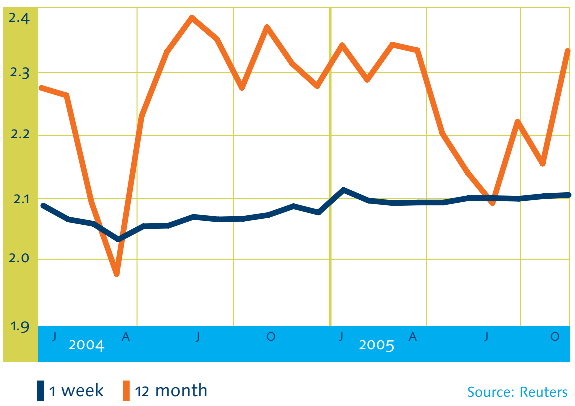
...due to inter alia accounting and pension/insurance regulations

The recent behaviour of interest rates around the world would have been difficult to predict. Yet there are some structural and temporary factors that partly explain recent developments. As a temporary factor, the worldwide trend in accounting and pension/insurance regulations for more 'marked-to-market' valuations of balance sheet positions is likely to have depressed long-term interest rates worldwide. The general reading of markets was that the new rules trigger a matching of long-term liabilities. The 30/10 spread was not only subject to actual behavior of institutional investors but also to speculation by trading accounts on changing behaviour of those influenced by the new rules. For example, the (rumour of the) delay of the Dutch supervision rules for pension funds (FTK) caused some volatility in the spread between 30-year and 10-year bonds (see also box 1). More structural factors that go some way towards explaining low interest rates are the considerable reserve flows from Asian and Middle Eastern central banks, demographic trends towards a large concentration of people just under retirement age and the maturing of the European bond market (see also box 2).

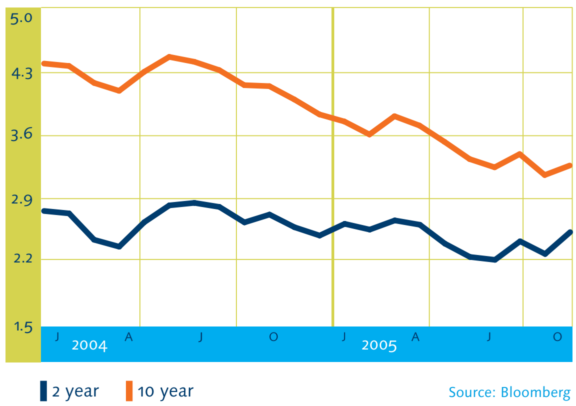
The US capital market, Swap rate 2 year and 10 year, January 2004 up to October 2005



The European money market, Euribor 1 week and 12 month, January 2004 up to October 2005



The European capital market, Swap rate 2 year and 10 year, January 2004 up to October 2005



- CPB, 2005, Macro Economische Verkenning 2006.
- IMF, 2005, World Economic Outlook.

Box 1 Postponement of the Financial Assessment Framework

The Dutch Central Bank (DNB), which is the supervisory authority for the pensions sector, announced in September 2005 that it has postponed the implementation of the new supervisory regime by one year.
This means that the Financial Assessment Framework (FTK) will be fully effective as from 1 January 2007 onwards, although pension funds have been able to voluntarily adopt the new rules since October 2004.
The rationale for the delay is that parliament as yet has to decide on some elements of the Pensions Act (Pensioenwet), which will legislate on financial supervision. The delay will give pension funds ample time to prepare for a careful implementation of the Financial Assessment Framework in 2007.

The assessment framework for insurance companies was postponed awaiting the results of the discussion concerning Solvency II.

Box 2 Explaining the low level of interest rates

Greenspan's conundrum has not yet been completely resolved and interest rates have confirmed their reputation as one of the most unpredictable macroeconomic variables. For instance, since 1982 the Wall Street Journal has interviewed a number of economists annually about their interest rate expectations. In the latest survey, which covers 2005, interviews were conducted with 56 economists and 55 of them incorrectly projected an increase in interest rates on the 10-year US treasury bond between December 2004 and 31 July 2005. Since the start of the survey, only one third of the interviewees have correctly projected the direction of interest rate movements, which is a poor result when compared to tossing a coin[1].

In retrospect, one macroeconomic development that might explain recent low interest rates is a rising saving glut[2]. In past years, savings ratios have grown faster than investment ratios, which resulted in a low real interest rate equilibrium. Middle Eastern and Asian countries are experiencing large savings surpluses. Savings in Middle Eastern countries were boosted by high oil revenues. In addition, some rapidly growing Asian countries have not yet succeeded in channelling their large domestic savings efficiently into investments, despite the transformation from a labour-intensive to a more capital-intensive economy. For example, China has a tremendous savings ratio of approximately 50% of GDP and an investment ratio of about 45% of GDP, resulting in a current account surplus of 5% of GDP. The US is the main absorber of Middle Eastern and Asian excess savings. The IMF projects that investment growth in the US will reach 7% annually between 2004 and 2006. In other western economies the expected rate of return on investments seems low. In these countries investment rates in terms of GDP have been declining, despite the favourable conditions under which investment opportunities could be financed. In the coming years, the downward pressure of excess savings from oil-producing countries and Asian countries might diminish. Middle Eastern countries could adapt their lifestyle to their higher wealth, and, of course, oil prices might decline. In countries such as China, a more efficient allocation of domestic savings to credit for consumers and (small) businesses is likely to develop.

Also, the changing demographic structure of western countries due to the ageing of populations might partly explain historically low interest rates. The life-cycle hypothesis predicts that countries will generate a large amount of savings if they have a large proportion of people currently of working age who are preparing for retirement. Countries with a lot of youngsters and people over 65, on the other hand, will dissave. This, therefore, suggests that there will be a high level of savings in many western countries as many are on the brink of a large increase in the old-age dependency ratio. However, the total effect of population ageing seems ambiguous. Firstly, the pace of ageing differs greatly from one country to another, so the aggregate impact of this phenomenon on global savings may be small. Secondly, the empirical evidence about the validity of the life-cycle pattern in savings is mixed. For instance, the elderly tend to dissave less than projected by this theory, presumably as a result of bequest motives.

If we focus on European interest rates, a few other factors are also relevant. The introduction of the euro has eliminated exchange rate premiums within Europe. Furthermore, the ECB has succeeded in creating a strong reputation for credibility during the past seven years. This has pushed inflation risk premiums downward. Current low (core) inflation rates seem to have depressed expectations about future short-term interest rates. This depresses current long-term interest rates according to the expectations theory. Finally, the European government bond market has evolved into a deep and liquid bond market with a corresponding decline in liquidity premiums. This too has resulted in a lower cost of capital.

1 Mitchell, K. and Pearce D.K. , 2005, Professional Forecasts of Interest Rates and Exchange Rates: Evidence from the Wall Street Journal's Panel of Economists.

2 See B.S. Bernanke, The Global Saving Glut and the US Current Account Deficit, April 2005. Dooley M.P. , Folkerts-Landau, D., and Garber, P.M., 2005, Savings Gluts and Interest Rates: The Missing Link to Europe, Working Paper 11520, IMF.

Funding policy in 2006

For 2006, the basis amount-at-risk amounts to 44 billion euros. Past issuing has resulted in capital market redemption of approximately 26 billion euros for 2006. It is expected that the outstanding amount in the money market will need to be raised by 2 to 3 billion euros next year. Taking into account an estimated deficit of about 8 billion euros, the call on the capital market is expected to be between 28 and 35 billion euros in 2006.

The Dutch State will issue nominal bonds with maturities of 3, 10 and 30 years. In addition, restricted use will be made of swaps in order to achieve the required amount-at-risk. The DSTA will work together with its 13 Primary Dealers and 7 Single Market Specialists to attain this risk profile. Their performance in the primary and secondary markets is evaluated periodically. After a successful period as a Single Market Specialist, Dresdner Bank has been selected as a Primary Dealer for 2006.

Total borrowing requirement (in billions of euros)	2005	2006
Composition		
Capital market redemptions	26,8	25,7
Money market end of previous year	17,4	18,1
Deficit (projected)	6,0	8,0
Total	**50,2**	**51,8**
Funding		
Capital market	32,1	31,5
Money market	18,1	20,3
Total	**50,2**	**51,8**

Projections based on Budget Memorandum 2006

2.1 Risk management

basis amount-at-risk of 9% of GDP

The main control variable within the Dutch State's current framework for risk management is the basis amount-at-risk. The basis amount-at-risk in any year consists of the redemption on the debt plus the amount of interest rate swaps on which the interest rate is reset. The objective is to keep this amount constant at 9% of GDP. The budget deficit is not part of the basis amount-at-risk.

Maintaining a constant basis amount-at-risk over time ensures that the uncertainty for the budget of a possible change in interest rates is kept within limits. Since the basis amount-at-risk is linked to GDP, the risk to the budget in terms of GDP remains stable over time. Given the GDP estimates, the basis amount-at-risk amounts to 46 billion euros in 2006 and 48 billion euros in 2007.

risk management reappraisal for 2007 and further

The objectives for risk management will form part of the reappraisal of the risk management framework that will be conducted in 2006.
The reassessment might change the perception of how risk is best defined and of the level of risk that is deemed acceptable. Until the reassessment is completed, the Dutch State will adhere to a basis amount-at-risk of 9% of GDP for 2007 and the years ahead.

in 2006 basis amount-at-risk translates into 44 billion euros

Past bond issuances have resulted in capital market redemptions of almost 26 billion euros in 2006. In addition, it is expected that by the end of 2005 the outstanding amount in the money market will be approximately 18 billion euros. The recent buy-back of 2 billion euros has been included in this estimation. Furthermore, the current swap portfolio contributes approximately 1/2 billion euros to the amount-at-risk. In short, the basis amount-at-risk in 2006 is expected to reach a level of 44 billion euros, slightly less than 9% of 2006 GDP. This is largely due to budgetary windfalls towards the end of 2005, which have translated into a lower outstanding amount on the money market than previously estimated. The buy-back of 2 billion euros has only partially offset this downward adjustment.

uncertainties in money market funding at the end of the year

It is difficult to precisely regulate issuance in the money market. Towards the end of any given year, it is no longer possible to change capital market issuance. Should the budget balance deviate from earlier projections, this will therefore immediately translate into changes in the call on the money market.

Basis amount-at-risk (in billions of euros)	2005	2006
Redemptions		
Capital market redemptions	24,8	25,7
Money market end of previous year	17,4	18,1
Swaps	-0,1	0,3
Total	**42,1**	**44,1**
GDP (projected)	494,9	512,4
Basis amount-at-risk % GDP	**9%**	**9%**

The impact on the basis amount-at-risk of unforeseen fluctuations in the money market can be mitigated by conducting interest rate swaps. In practice, the basis risk amount will be in the vicinity of 9% of GDP. Fine-tuning via swaps in the last weeks of the year is difficult and not considered necessary.

swaps are used

Swaps also play a role in achieving the amount-at-risk further ahead. For example, swaps were used in 2005 to swap the new 30-year bond back to 10 years. This was done from a risk management perspective as it was deemed most optimal within the current risk management objective of low cost at a prudent degree of risk. Swaps stay at the disposal of the Dutch State and may be used for this purpose in the coming years.

basis amount-at-risk in 2007 about 48 billion euros

Looking ahead to 2007, the goal is a basis amount-at-risk of 48 billion euros (9% of estimated GDP). Capital market redemption in that year will be around 27 billion euros. The Dutch State aims for an outstanding amount in the money market of approximately 20 billion euros by the end of 2006. In this case, there will be little need for fine tuning, so that the net annual effect of swaps on the amount-at-risk in 2007 will need to be small.

2.2 Primary Dealer and Single Market Specialist groups in 2006

the DSTA selects 13 Primary Dealers...

Since 1999, the Dutch State works with a group of 13 banks to facilitate the issuance of DSLs and DTCs. These banks are the so-called Primary Dealers (PDs) with which the DSTA has developed a long-term relationship to support the Dutch State in its issuances. Annually, the Primary Dealers have to submit a business plan. Their selection is valid for the next calendar year. Being a Primary Dealer entails both rights and obligations.

...who have rights...

Primary Dealers have the exclusive right to buy DSLs from the DSTA. They can conclude swaps with the State and are entitled to use the repo and strip facilities. Furthermore, Primary Dealers receive compensation, the size of which depends on both the volumes acquired on the primary market and the volumes traded on the designated electronic platform. This compensation takes the form of a non-competitive bid, i.e. the right to buy additional bonds up to 3 days after the auction, at the weighted average price of the auction. Primary Dealers are automatically registered in the DTC-Register (see page 22).

Primary Dealers for 2006 in alphabetical order
ABN Amro
Barclays Capital
BNP Paribas
Calyon
Citigroup
Credit Suisse First Boston
Deutsche Bank
Dresdner Bank
Fortis Bank
HSBC France
ING Bank
Morgan Stanley
Société Générale

Single Market Specialists for 2006 in alphabetical order
CDC IXIS CIB
Dexia Bank
Goldman Sachs
JP Morgan Chase
KBC Bank
Rabobank
Royal Bank of Scotland

...and obligations

In return, Primary Dealers are obliged to distribute and promote DSLs and to stimulate the liquidity in the secondary market, e.g. by quoting prices on a designated electronic platform. In this way, the DSTA aims to provide the market with a transparent mid-price. Furthermore, a Primary Dealer must provide monthly information on his activities in the secondary market. From 2006 onward, a harmonised reporting format will be used by all Primary Dealers to report to debt managers in the euro zone countries.

Dresdner Bank selected as PD for 2006

The table above lists the Primary Dealers for 2006. There is one newcomer in the group: after a successful period as a Single Market Specialist for DTCs, Dresdner Bank has been selected as a Primary Dealer.

JP Morgan Chase selected as SMS for 2006

Apart from 13 Primary Dealers, 7 banks support the DSTA as Single Market Specialists (SMSs). Together, these 20 banks are active in the primary and secondary market for DTCs. They have been entrusted with promoting and distributing DTCs since 2001. All 20 banks are registered in the DTC-Register in which the rights and obligations are spelled out. Single Market Specialists are also obliged to report to the Dutch State. As for Primary Dealers, the reporting format was harmonised in all euro zone countries with effect from 2006 onwards. A newcomer in the group of Single Market Specialists in 2006 is JP Morgan Chase.

2.3 Developments in primary and secondary markets

the DSTA values transparency in the primary market...

The Dutch State sells DSLs to Primary Dealers via tap auctions. In the case of landmark new issues, loans are sold directly to end investors via a Dutch Direct Auction (DDA), see also box 3. DTCs are distributed to both Primary Dealers and Single Market Specialists via regular single-price (Dutch) auctions. The DSTA is committed to maximum transparency in primary transactions. This objective is achieved through the available auction techniques, the dissemination of auction results and the quarterly publication of the State's issuance calendars. The Dutch State firmly believes that transparency and continuity have a favourable impact on its borrowing costs.

The DSTA periodically evaluates the performance of the Primary Dealers and Single Market Specialists. This evaluation is based inter alia on the volumes of securities purchased at the auctions. The top 5 most active participants in the DSL and the DTC primary markets are published every six months.

Top 5 Primary Dealers for DSLs based on primary issuance, 2005
Fortis
ABN Amro
Barclays Capital
ING
CSFB

Top 5 Primary Dealers and Single Market Specialists for DTCs based on primary issuance, January-October 2005
ABN Amro
Société Générale
BNP Paribas
HSBC CCF
Calyon

...and in the secondary market

Although the Dutch State recognises the importance of properly functioning secondary markets in achieving low borrowing costs, its role in the secondary markets is limited. The role of the State can only be as facilitator, for example in bringing the outstanding volume of new bonds to at least 10 billion euros and in issuing bonds with maturities that are in demand. Primary Dealers are contracted to promote the liquidity of the secondary market and to quote two-way tradable prices on a designated electronic platform. This provides a transparent mid-price for end investors. The designated platform is Amsterdam MTS; the mid-price is fixed each day at 11:00 hrs CET. One of the most important responsibilities of the Dutch State is to provide reliable information on strategy and borrowing requirements and to disclose that information in a fair and transparent way.

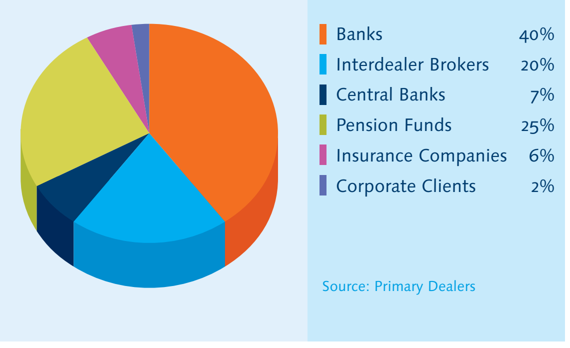
strong demand from pension funds...

Primary Dealers as well as Single Market Specialists provide the DSTA each month with secondary market trade reports that contain information on traded volumes of Dutch securities. During the first nine months of 2005, the largest players in the secondary DSL market were banks and pension funds. Apart from actively trading DSLs, banks also hold large amounts of the securities for their ALM portfolios. The dominant position of pension funds in the real money realm is striking and has grown quickly in recent years from just 18% in 2003 to 25% currently. This development may be attributed to the rising demand from pension funds for long-term fixed-income securities. Interest in the new long-term issue can also be seen in the data that the DSTA receives from electronic bank-to-customer (BtoC) trading platforms, which show relatively high trading volumes for the new 2037 DSL. In the secondary DTC market during the first nine months of 2005 the largest volumes were traded by banks, central banks and pension funds. The share of pension funds in the secondary DTC market is notably smaller than in the secondary DSL market, since pension funds focus mainly on the long end. Absolute trading volumes for DTCs are lower than for bonds, due to the buy and hold nature of short-term fixed-income products.

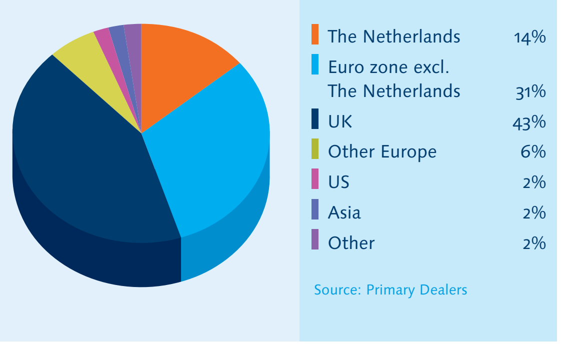
...and from UK

Geographically speaking, the distribution in the secondary DSL market is almost identical to that in the secondary DTC market for the first nine months of 2005. The largest share of Dutch securities is traded in the United Kingdom. This can be explained partly by the fact that many banks trade out of London.

Client type distribution in the secondary market for DSLs, January-September 2005



Geographical distribution in the secondary market for DSLs, January-September 2005



Other geographical regions with high trading activity in Dutch securities are the Netherlands and the euro zone in general. Since the introduction of the euro, the share of the secondary market that is concentrated in the Netherlands has steadily declined. Relative to previous years, trading in the United Kingdom, the United States and Asia has risen somewhat, especially in DTCs.

2.4 Issuance in 2006

capital market target range of 28 to 35 billion euros in 2006

The target range for capital market issuance in 2006 is set at 28 to 35 billion euros. This range is based on the level of redemptions, the desired volume in the money market and the projected budget deficit in 2006.

cash deficit level...

The cash deficit in 2005 affects the overall funding need in 2006 through its impact on the money market volume by end-2005. The deficit in 2006 feeds through directly to the overall funding need in 2006. Since the cash deficit is uncertain and the volume on the money market needs to be kept at an appropriate level, a target range rather than a point estimate is used to indicate the likely call on the capital market. The anticipated upturn in the Dutch economy gives reason to believe that there is a slight possibility of a lower outcome.

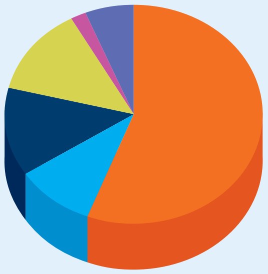
...and money market changes set the range

The level of capital market redemption in 2006 is approximately 26 billion euros. The most recent forecasts indicate a cash deficit of 8 billion euros for 2006. This means that the call on the capital market would amount to 34 billion euros. Money market funding will need to be raised by 2 to 3 billion euros, at the expense of capital market issuance. After taking account of the money market, the estimated level of capital market issuance comes to 31 to 32 billion euros. This is translated into a range of 28 to 35 billion euros.

issuance of new 3-year and 10-year bonds...

Most of the capital market issuance will be covered by the issuance of two new bonds with maturities of 3 and 10 years. Both bonds will reach an outstanding amount of at least 10 billion euros in 2006. Furthermore, the Dutch State will continue issuance at the long end of the curve. The 30-year bond that was issued in 2005 will be re-opened in 2006. In addition, a new bond will be issued with the same maturity and coupon date as the 30-year bond that was introduced in 1993. The most important difference between the 1993 bond and the new bond will be the level of the coupon. The new bond will have a coupon that reflects current interest rates, which means that it will be substantially below the 7.5% coupon of the bond issued in 1993. A strip facility

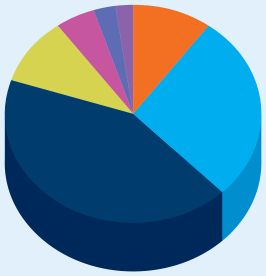
Client type distribution in the secondary market for DTCs, January-September 2005



Banks	56%
Interdealer Brokers	10%
Central Banks	13%
Pension Funds	13%
Insurance Companies	2%
Corporate Clients	6%

Source: Primary Dealers & Single Market Specialists

Geographical distribution in the secondary market for DTCs, January-September 2005



The Netherlands	10%
Euro zone excl. The Netherlands	28%
UK	42%
Other Europe	10%
US	5%
Asia	3%
Other	2%

Source: Primary Dealers & Single Market Specialists

...and reopening of 30-year bond and revival of the 2023...

will be created for investors so that it is possible to carve the new bond out of the old one. Both the new bond and the strip facility will improve liquidity in this specific maturity and will create a new benchmark point at the long end of the curve (see also section 3.2 on revival of the 2023).

...leave room for extra capital market issues

Taken together, the issuance of two new bonds, the re-opening of the 30-year bond and the revival of the bond issued in 1993, are sufficient to exceed the lower end of the target range for the capital market. At the same time, these plans leave some room for additional capital market issues. Additional issuance will be announced through the press releases, such as the quarterly calendars for DSLs and DTCs.

DSL calendar 2006				
Month of issuance	**Announcement (Wednesday)**	**Issuance (2nd Tuesday)**	**Payment (Friday)**	**DSL**
January	4	10	13	3-year
February	8	14	17	2023
March	8	14	17	3-year
April	5	11	14	
May	3	9	12	
June	7	13	16	
July	5	11	14	
August	no issuance			
September	6	12	15	
October	4	10	13	
November	8	14	17	
December	6	12	15	

December is a reserve date.
A 10-year bond will be issued in March or April via a DDA.

DTC calendar 2006					
Issuance (1st & 3rd Monday)	**Payment (Wednesday)**	**DTC 3-month**	**DTC 6-month**	**DTC 9-month**	**DTC 12-month**
03-01-06	05-01-06	31-03-06	30-06-06		**15-12-06**
16-01-06	18-01-06	28-04-06			15-12-06
06-02-06	08-02-06	28-04-06	**31-07-06**		
20-02-06	22-02-06	31-05-06		29-09-06	
06-03-06	08-03-06	31-05-06	**31-08-06**		
20-03-06	22-03-06	30-06-06		15-12-06	
03-04-06	05-04-06	30-06-06	29-09-06		**30-03-07**
18-04-06	20-04-06	31-07-06			30-03-07
02-05-06	04-05-06	31-07-06	**31-10-06**		
15-05-06	17-05-06	31-08-06		15-12-06	
05-06-06	07-06-06	31-08-06	**30-11-06**		
19-06-06	21-06-06	29-09-06		30-03-07	
03-07-06	05-07-06	29-09-06	15-12-06		**29-06-07**
17-07-06	19-07-06	31-10-06			29-06-07
07-08-06	09-08-06	31-10-06	**31-01-07**		
21-08-06	23-08-06	30-11-06		30-03-07	
04-09-06	06-09-06	30-11-06	**28-02-07**		
18-09-06	20-09-06	15-12-06		29-06-07	
02-10-06	04-10-06	15-12-06	30-03-07		**28-09-07**
16-10-06	18-10-06	31-01-07			28-09-07
06-11-06	08-11-06	31-01-07	**30-04-07**		
20-11-06	22-11-06	28-02-07		29-06-07	
04-12-06	06-12-06	28-02-07	**31-05-07**		
18-12-06	20-12-06	30-03-07		28-09-07	

Shaded areas: due to (national) holidays the issuance is on Tuesday and the payment is on Thursday.
Bold typeface: new programmes.

Box 3 Dutch Direct Auction

The Dutch Direct Auction (DDA) is an issuance method developed by the DSTA in close cooperation with the Primary Dealers. It was first used in 2003 to introduce a new 5-year benchmark. The main objective of the DDA is to involve the end investor in primary market issuance. To achieve this goal, the DDA combines the best of both worlds. An appeal to the skills of the Primary Dealers' sales forces ensures that the investor community is addressed directly before and during the auction (a feature of syndicated deals). The method of allocating at a uniform price, which is typically used in Dutch Auctions, was chosen to avoid the winner's curse. Finally, the allocation algorithm makes no distinction between countries or types of real money investors, thereby assuring a level playing field.

One of the advantages of the DDA is that large amounts can be placed at once, which ensures instant secondary market liquidity. This proved very useful when the new 30-year benchmark was issued in April 2005. Since the Dutch State had been absent in the ultra-long segment for 7 years, issuing a small amount could have hampered both secondary market performance and price discovery. Through the DDA, the DSTA raised more than 5 billion euros in just a few hours. The auction started at 10:00 hrs CET on 19 April, at which time investors could submit their bids via the Primary Dealer of their choice. The DDA is designed so that Primary Dealers can only view bids entered on behalf of their own clients, implying that the DSTA is the sole book runner. During the auction, numerous subscriptions were entered by more than 200 investors. By noon, subscriptions amounted to a total of 17 billion euros, which prompted the DSTA to close the book. Of the total amount, 80% was allocated to real money investors. Real money investors include pension funds, insurance companies, asset managers and central banks. They have priority in allocation over trading accounts, although the DSTA can raise the allocation to trading accounts to as much as 20% in order to safeguard liquidity in the secondary market.

Because of the potential market impact of a large chunk of 30-year supply, the DSTA agreed with Primary Dealers that a 'switch' facility would apply. This facility allowed investors to switch from alternative government

Box 3 Dutch Direct Auction (continued)

bonds with comparable maturity into the new DSL. The absence of such a facility could have led to disturbances in the bond market given that some investors sell alternative bonds to hedge or to fund the new DSL. Enabling investors to switch directly into the new DSL should reduce price volatility. Actual price changes during pricing of the new DSL were minor, underscoring the usefulness of the offered facility.

The second DDA in 2005 occurred in June when the new 10-year benchmark was introduced. Again, the book expanded quickly. This time the DSTA had the ability to limit bids more aggressively than in previous auctions with the aim of smoothening the process and ensuring allocation to as many investors as possible. Ultimately, the cut-off price was at the tightest level of the spread guidance. The DSTA exercised its right to increase the allocation to trading accounts to ensure liquidity in the secondary market. Real money investors still received 86% of the overall allocation.

During the last three years, the DDA was used five times. The auction has worked satisfactorily for both the DSTA and the investor community. Over the years, the rules were adapted slightly to match the changing behaviour of participants and to stay on track leading to the goal of involving the end investor. The DSTA will continue to strive for further improvements to its auctioning methods.

Research and new developments

In 2006, a reappraisal of the risk management framework will be conducted to establish a framework for the period 2007-2010. In this context, the objectives that are central to debt management, particularly the measurements to identify risks and costs, as well as relevant external factors and scenarios will be investigated in detail. As part of the reassessment, the possibilities for developing a capital market benchmark will also be taken into consideration.
A restructuring of the divisional set-up of the DSTA will guarantee optimal flexibility of the organisation and the best possible use of a new IT system. As regards MTS, its recent acquisition by Euronext and Borsa Italiana might change the organisation of the local markets, but it is expected to have little impact on the daily activities of the end user of the electronic trading platform AMS. The Agency is looking into possible benefits of working with European Commercial Paper and tri-party repos. After extensive research on this matter, the Agency has come to the conclusion that issuing index-linked bonds is not presently an attractive option for the Dutch State. In 2006, the DSTA will reopen the 30-year bond issued in 2005. But more important, it will revive the bond issued in 1993 by offering a strip facility.

3.1 Risk management after 2006

objective of lowest cost at acceptable risk

The main objective for most European and other debt managers is to issue at the lowest possible cost and at an acceptable level of risk. Risk is generally defined as fluctuations in interest expenditure. To limit the risk to the budget, debt managers should issue primarily at the longer end of the curve. However, given that the yield curve normally slopes upwards, this strategy would be contrary to the low-cost objective, which favours issuance at the short end. A variety of approaches has been adopted to balance the two objectives. Examples include a cost-at-risk analysis or an asset and liability approach. Parallel to the main objective, other considerations may be taken into account, such as the broadening of the investor base and the promotion of liquidity.

implementation of asset and liability approach remains complex

In recent years, much attention has been paid to the asset and liability approach. The underlying thought is that (financial) institutions can avoid large fluctuations in their profits and losses by matching assets with liabilities. From a government point of view, the asset and liability approach is attractive because it could mitigate the effect of temporary shocks on the budget. For the public, this would reduce uncertainty with respect to after-tax income and wealth, leading to more efficient decision-making processes. Research into the asset and liability approach for the government typically concentrates on three areas. These concern looking at the debt portfolio as a hedge (i) for the economy as a whole, (ii) for the budget, or (iii) merely for the financial assets and liabilities. In all areas, research has generated valuable insights, but the actual implementation of an asset and liability approach for the government sector remains complex. It is probably against this background that the IMF and the World Bank have concluded that 'the main objective of debt management should be to ensure that government's financing needs and its payment obligations are met at the lowest possible cost over the medium term, consistent with a prudent degree of risk.'

reassessment of risk management framework for 2007-2010

In line with the common objectives of debt management, the Dutch State aims to finance its debt at the lowest possible cost given a prudent degree of risk. To determine the right balance between the risk and cost objective, risk management guidelines for the period 2003-2006 were established in 2002. In 2006, the current risk management guidelines will be evaluated and an extensive analysis will be conducted to establish the framework for 2007-2010.

concept of amount-at-risk for 2003-2006

The current measurement used to assess the interest rate risk associated with the funding of the state debt is referred to as the amount-at-risk. This is the amount on which interest rates have to be reset in any given year, expressed as a percentage of GDP. On the basis of several scenarios that provided insight into the link between costs and risks, the Dutch State selected for the period 2003-2006 a target value of 9% of GDP.

An obvious advantage of expressing budgetary risk as a percentage of GDP is that it remains constant throughout the years. If the state debt as a percentage of GDP increases or decreases, the debt profile is adapted in order to keep the relative risk constant. If issuance policy permits, this adjustment is done by altering the size and composition of the loans. Alternatively, swaps can be used to fine-tune the amount-at-risk. Application of the framework together with the increase in both the absolute and relative level of debt in recent years has resulted in an extension of the maturity of the state debt. The renewed activity in the ultra-long segment in 2005 fits in well with the lengthening of the portfolio.

An essential element of a well functioning framework is a regular check on the assumptions on which the framework is based. This is especially important as the external environment is dynamic. That is why a framework is traditionally developed for a period of four years, after which it is reassessed. As part of the reappraisal, the DSTA will scrutinise the objectives that are central to debt management. In addition, it will examine whether it is desirable to modify the measurements used to identify risk and costs. Naturally, the external factors that are relevant to the debt management strategy, such as structural developments in the interest rate environment, will be taken into account. Furthermore, scenario analysis will be an essential part of the reassessment. Finally, benchmarking will be looked at as an important element of further improvement of the debt management strategy. In 2002, the DSTA already implemented a benchmark for the money market. With the upcoming reassessment the possibilities for developing a capital market benchmark will be considered.

several factors will be addressed in the reassessment

3.2 New financial instruments

Revival of the 2023

reopening of 30-year bond and revival of the 2023

In line with the objective of continuity, the Dutch State will continue to be active in the long-term maturity segment in the coming years. In doing so, it aims to create a liquid curve along the entire spectrum. For 2006 the DSTA plans both the reopening of the 30-year bond that was introduced in 2005 and the improvement of the liquidity of the bond maturing in 2023. The latter will be achieved through a combination of a new bond and a strip and destrip facility.

strip and destrip facility

The new issuance and the strip and destrip facility have a number of significant aspects. Firstly, a new bond will be introduced which has the same characteristics as the original 30-year bond introduced in 1993 with redemption in 2023. The only difference will be the coupon. The original 2023 bond has a 7.5% coupon. The new 2023 bond will have a lower coupon to reflect current market conditions. Together with this new bond, a strip and destrip facility will be made available. This facility will enable investors to carve the new 2023 bond out of the original 7.5% 2023 bond.

Investors who use the strip facility will end up with a line of coupon strips (I/O's). This is a result of the difference between the coupon for the original 2023 bond and the coupon for the new 2023 bond. To resolve this matter, the Dutch State will also issue zero-coupon bonds (P/O's) redeeming in 2023. Investors can then link their excess coupon strips to the zero-coupon bonds and thus create the new bond. Apart from issuing the P/O, the DSTA will build in the possibility to buy back the excess I/O's.

The issuance of the P/O and the possibility of buying back the I/O's create an arbitrage relationship between the new and the original bond. The arbitrage relationship creates a pool of liquidity and avoids large adverse price effects to the coupon strips and thus to the original 2023. The improved liquidity is expected to create a new benchmark point on the long end of the Dutch curve. Whether or not this strategy will be repeated depends on, among other things, investors' appetite for the new issue of the 2023 bond. After 2006, the Dutch State may consider using a comparable strategy to raise liquidity in the 2028 bond, which was issued in 1998.

European Commercial paper

the DSTA investigates ECP...

Currently, the DSTA investigates the cost savings that can potentially be achieved by issuing European Commercial Papers (ECPs) with maturities of up to 3 months. An ECP is a short-term note with standardised documentation. ECPs are issued in a programme. In general, ECP maturities range from 1 day to 2 years. Several currency denominations are possible.

...in order to achieve a more efficient management of short-term liquidity

The main purpose of the programme is more efficient management of short-term liquidity. As the ECP market has in recent years developed into a fully fledged market, the presumption is that the DSTA can broaden its investor base by issuing ECPs on a regular basis. The programme will exist alongside the regular DTC programme. As a result, the focus of the ECP programme will be on the very short end of the range. The benefit to investors is the availability of a transparent tailor-made product with the highest possible creditworthiness. Transparency is guaranteed by the standardised documentation. The possibility of different maturities and currency denominations will ensure flexibility. Other countries' experiences show that investors discount the favourable characteristics of ECPs in the yield on ECPs, which might enable the DSTA to improve the efficiency of its cash management.

Tri-party repos

to further reduce its credit risk...

In order to further reduce its credit risk exposure in money market operations, the DSTA is currently also looking at the possibility of working with the tri-party repo instrument. A traditional repo is a transaction where the cash provider lends money at an agreed interest rate and maturity and the cash taker provides securities as collateral. Hence it is a secured transaction. The third party involved administrates the collateral. The third party is often a clearing and settlement institution.

...the DSTA is exploring the experiences with tri-party repos

The DSTA works towards a negative cash balance but, due to large intra-year cash flows, short-term surpluses cannot be completely avoided. The DSTA could use these short-term surpluses as a cash provider in tri-party repos. In order to obtain a complete overview of the costs and benefits involved with tri-party repos, the DSTA is currently exploring the experiences of cash providers, cash takers and institutions that operate as third parties. The experience of cash providers, especially other debt managers, is particularly important. The potential demand from cash takers is also under scrutiny, as are the services offered by the collateral manager.

Index-linked bonds

the DSTA has investigated index-linked bonds...

A funding instrument that the DSTA has investigated extensively is the index-linked bond. A number of countries have issued index-linked bonds. They were issued, for instance, as a result of the increased demand for real assets, or because the issue fitted in well with portfolio considerations. Some countries have used index-linked bonds to underline the government's objective of bringing down inflation. The extent to which issuing index-linked bonds is appealing depends on many factors and is ultimately country-specific.

The Dutch State has looked at index-linked bonds from several angles. Three of these angles were investigated in detail. These were the risk of index-linked bonds to the budget, the cost-effectiveness of index-linked bonds and the (prospective) demand for index-linked bonds from the pension fund sector.

When issuing index-linked bonds, interest expenditures in the budget will vary substantially with inflation. As such, sensitivity of interest expenditures to inflation fits in well with the Dutch expenditure framework that is designed to fluctuate one-on-one with inflation. However, interest payments already move over-proportionally with inflation given that the initial impact of inflation is on the stock of debt that is refunded. This is generally much larger than the flow of interest expenditures. For example, if the funding requirement is 50 billion euros and interest payments are 10 billion euros, a percentage point increase in inflation would raise interest payments not by 1% but by 5%. From this perspective, the issuance of index-linked bonds is neither necessary nor desirable.

...with respect to the risk to the budget...

Apart from this, issuing index linked bonds could be attractive as it may constitute a hedge against inflation risk in the budget as a whole, i.e. including both revenues and expenditures. If, in the absence of index-linked bonds, the budget is positively correlated to inflation, the introduction of such bonds could stabilise the budget in the aftermath of an inflationary shock. As suggested by intuition, there is on average a marginally positive relationship between the budget and the inflation rate. In the long run, index-linked bonds could thus form a hedge against the risk of inflation. The hedge is far from perfect, however. In the short run, the link between inflation and the budget is ambiguous, which suggests that the introduction of index-linked bonds involves extensive basis risk as it can either exacerbate or mitigate the impact of inflationary shocks on the budget.

Given the basis risk that is involved with the issuing of index-linked bonds, a risk-return analysis is appropriate. Within a risk-return framework a funding instrument (or portfolio of instruments) that entails the same amount of risk as another instrument but at a lower cost is a superior instrument. Likewise, a funding instrument that is as costly but less risky than another instrument is superior to that other instrument. From this point of view, the DSTA has concluded that issuing index-linked bonds is presently not an attractive option. Combinations of the current funding instruments are superior when it comes to meeting the State's objective of cost-efficient funding subject to a certain degree of risk. This conclusion is, of course, subject to new developments and could change if the risk-return trade-off of index-linked bonds relative to other funding instruments were to improve.

...the cost-effectiveness...

...and the demand from the pension funds

Finally, the (prospective) demand for index-linked bonds from the pension fund sector was examined. Many argue that international regulations that focus on marked-to-market evaluation of balance sheet positions induce pension funds to extend duration so as to match assets with liabilities. Long-term index-linked bonds could be a suitable instrument for this purpose. Thus far, demand for index-linked bonds from the sector has varied and has been driven predominantly by diversification arguments.

3.3 Organisation of the DSTA

Since the introduction of the euro in 1999, the DSTA's environment has changed considerably. Competition among debt managers in the euro zone has become far greater and debt management is consequently more of a challenge. Rapid developments in products and issuance methods require a continuous evolution of the debt management strategy and of its execution if an organisation is to remain at the forefront. At the same time, demands as

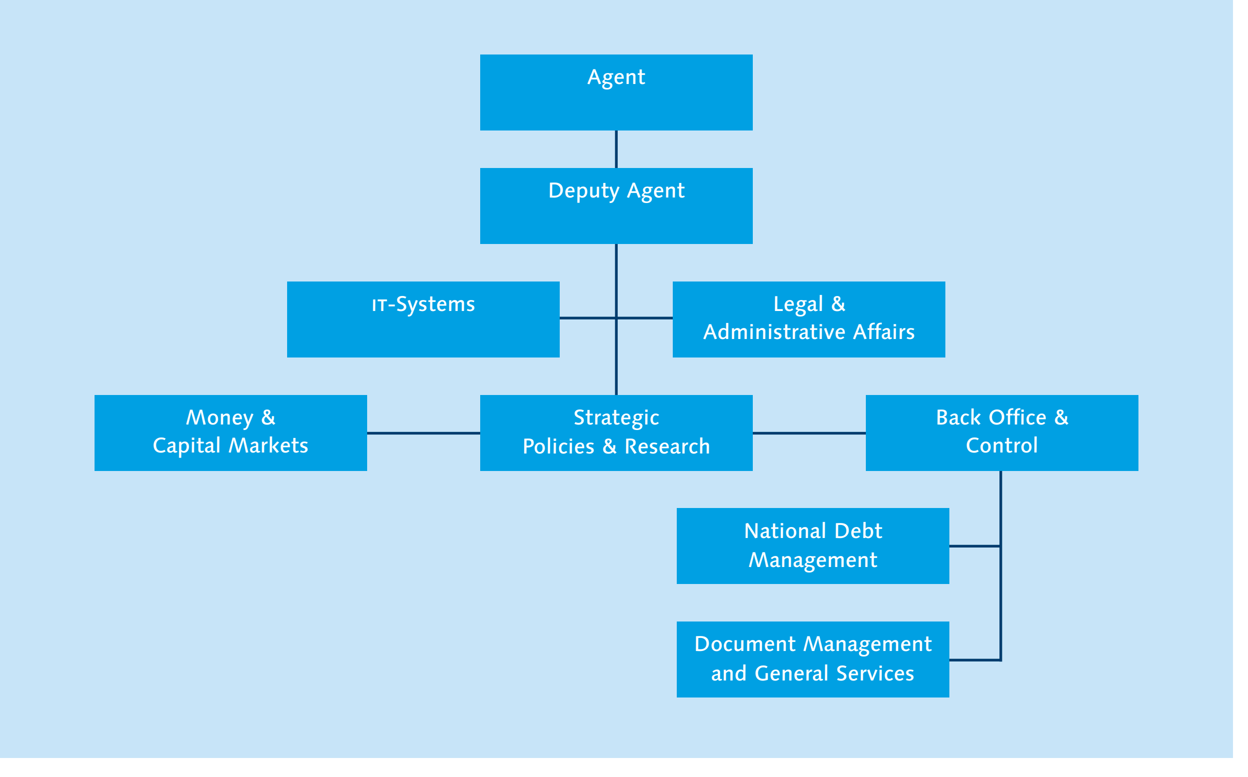
adaptation of IT

regards efficiency, transparency and accountability are high. A flexible and dynamic organisation is required for optimal performance in this rapidly changing and demanding environment. To this end, an upgrade of the DSTA's IT facilities was called for. Straight Through Processing (STP) for the front, middle and back offices is the aim. With this in mind, an integrated system became fully operational on 1 July 2005.

The above-mentioned developments, including the introduction of the new IT system, have influenced the operational processes and cooperation between the divisions of the DSTA and thereby created a need for a different divisional set-up. The Financial & Economic Affairs department will be integrated into the National Debt Management department and certain tasks will be transferred from the front office (Money & Capital Markets) to become the responsibility of the National Debt Management division. Within this division additional emphasis will be put on risk management. The number of employees will fall by about 10% in the next 2 years. The new structure will become fully functional as of 1 January 2006.

reorganisation of divisional set-up

The new organisation chart is as follows:



3.4 Change of control at MTS S.p.A.

quotation and auctioning platform

The Amsterdam MTS System (AMS) is an electronic platform for interdealer trading in Dutch State Loans and Dutch Treasury Certificates. In order to enhance transparency, Primary Dealers and Single Market Specialists are obliged to quote prices (bid and ask) for at least 5 hours each day for DSLs (only Primary Dealers) and DTCs (Primary Dealers and Single Market Specialists). These prices are fixed daily and published in the financial press. AMS also provides a tap functionality for DSLs.

In 1988, MTS S.p.A. (MTS) was established to improve transparency and liquidity in Italian government bond trading. In 1997, MTS was privatised and the concept was gradually exported to all other euro zone countries including the Netherlands. MTS owns share capital in several local MTS organisations and fully owns EuroMTS. AMS is owned by MTS (30%), the Dutch State (5%) and its 13 Primary Dealers (each 5%).

acquisition will affect organisation but not the end-user

On 1 July 2005, a majority of the shareholders of MTS accepted Euronext and Borsa Italiana's joint offer to acquire a controlling stake in MTS. For this purpose, Euronext and Borsa Italiana will incorporate a joint venture that will acquire at least 51% of MTS by subscribing to a capital increase. With this acquisition, Euronext and Borsa Italiana want to become more active in the fixed-income securities market. This acquisition gives them an indirect stake in AMS. The change of ownership might alter the organisation of the local markets, but it is expected to have little impact on the daily activities of the end user of the electronic trading platform AMS.

Annexes

1 Forms of Dutch debt

The Dutch State Treasury Agency (DSTA) issues short-term and long-term debt.

- *DTCs*

Dutch Treasury Certificates (DTCs) are issued with maturities of 3, 6, 9 and 12 months. Issuance takes place on the first and third Monday of each month.

- *DSLs*

Dutch State Loans (DSLs) are currently issued with maturities of 3, 10 and 30 years. A 30-year bond was issued in 2005, and before that in 1993 and 1998. Issuance of DSLs occurs on the second Tuesday of each month. Also, several times a year bonds are issued via the Dutch Direct Auction (DDA).

2 Characteristics of Dutch government securities

More than 90% of Dutch state debt consists of DSLs. The remainder is funded in the money market

The table shows that the average remaining term to maturity of the outstanding DSL portfolio has increased in 2005, partly due to the issue of the 30-year DSL. Over time, the average remaining term to maturity has fallen. The DSTA's policy is to fund as short as possible on condition that the amount of risk to the budget remains acceptable. While adhering to this policy, the debt position has allowed migration to the shorter end of the market. The average coupon has also decreased significantly over time. This can be partly attributed to shorter funding. The downward trend in interest rates in recent years is, however, the main reason for the diminished average coupon.

3 Issuance techniques

DSLs and DTCs are issued entirely electronically. This helps to create a more efficient and transparent primary market. Specific issuing techniques for DSLs and DTCs differ.

- *DSLs*

DSLs are issued either via a tap auction or via a Dutch Direct Auction (DDA).

In a tap auction the bond is opened for subscription at 10:00 hrs CET. The DSTA then announces the price at which it is willing to sell on the AMS electronic trading platform. Depending on the incoming volume of bids at the quoted price, the DSTA may revise the price or close the auction at any time. Primary Dealers can subscribe at the quoted price for a minimum amount of 25 million euros or higher amounts in multiples of 5 million euros.

In 2003, the DSTA introduced a new auction technique – the Dutch Direct Auction (DDA). The DDA is characterised by a uniform price. Because of the uniform price there is no 'winner's curse', where the eager bidder ends up paying a price higher than other awarded bidders. Another difference between the tap auction and the DDA auction is that in the DDA, the DSTA aims to place the bond directly with end-investors. In the DDA therefore, the DSTA favours real money accounts, i.e. end-investors. This means that at the cut-off rate real money accounts have priority over trading accounts such as banks and hedge funds. In order to ensure liquidity, the DSTA reserves the right to allocate 20% of the issue to trading accounts.

Key figures of bonded debt

	1995	2000	2001	2002	2003	2004	31-10-2005
Average remaining maturity	6.9	6.3	6.2	6.1	6.0	5.6	6.2
Average coupon	7.6	6.1	5.7	5.7	5.2	4.8	4.4

In a DDA the bond is opened for subscription at 10:00 hrs CET. The initial spread guidance is already announced the day before subscription opens. During the auction day Primary Dealers can subscribe and the spread guidance can be adjusted until 15:00 hrs CET, at which time the spread guidance becomes final. The auction closes at 17:00 hrs CET at the latest. The DSTA may decide to close the book early if necessary to guarantee adequate allocation. Primary Dealers can subscribe at any price within the spread guidance for a minimum amount of 1,000 euros. The Dutch State Treasury Agency can exercise its right to limit bids to avoid the book becoming inflated.

- *DTCs*

DTCs are sold at uniform-price auctions, which are also known as 'Dutch auctions', using the Bloomberg Auction System (BAS). Primary Dealers and Single Market Specialists can place bids, yields and quantities in the system up to a pre-announced time. After that time, it is decided what volumes will be placed at what returns. Parties who have placed bids below the cut-off rate are usually granted their bid in full. Bids at the cut-off rate are rewarded in part or in full depending on the remaining amount allotted. The entire allocation is allotted at the same price. Because of the uniform price system, the winner's curse is avoided.

In the interest of a balanced market, the DSTA has the right to restrict the amount allotted to any subscriber to only 40% of the total issue. This prevents the amount auctioned from being allotted largely or entirely to a single participant.

DTC-auctions start at 10:30 hrs CET and close at 11:30 hrs CET. Each bid must have a volume of at least 10 million euros and it must be in multiples of 10 million. Subscribers can revise or withdraw their bids at any time up to the closure of the auction.

4 Facilities

- *Repurchase facility*

The repurchase facility enables affiliated institutions to sell the State positions in bonds that were issued before 1996 where the outstanding amount is less than 2.5 billion euros. The repurchase facility was introduced in 2002 to guarantee the marketability and liquidity of such bonds for investors. As of mid-2005 the outstanding volume of these loans had decreased to about 10% of the total volume that was issued. In line with the aim of concentrating as much of the debt as possible in 'liquid' bonds, the DSTA has since 1999 only issued bonds that reach a total volume of at least 10 billion euros after multiple issues.

- *Repo-facility*

In creating the repo-facility the DSTA's aim was also to improve the liquidity of DSLs and DTCs. The repo-facility allows Primary Dealers to borrow DSLs and DTCs at any time from the DSTA on condition that the DSLs and DTCs have not yet reached an outstanding volume of 10 billion euros. Primary Dealers pay a premium of 25 basis points for this facility. This facility is exclusively available to Primary Dealers (DSLs and DTCs) and Single Market Specialists (DTCs only).

5 Clearing and settlement

The DSTA is affiliated with Euroclear Nederland, which is the central securities custody institution in the Netherlands. Debt instruments are delivered to Euroclear and Clearstream from the Euroclear Nederland issue account by book entry only. The DSTA is also affiliated with SWIFT (Society for Worldwide Interbank Financial Telecommunication).
In addition to these links, the DSTA is a member of a 'Closed User Group' together with Euroclear Nederland and De Nederlandsche Bank. SWIFT is used to confirm transactions to counterparties and for communications with Euroclear, Clearstream, Euroclear Nederland and De Nederlandsche Bank.

- *Collateral in connection with swaps*

The Dutch government has been using interest rate swaps since the beginning of 2001. Collateral is required in order to minimise credit risk for the State. The counterparty to the State is obliged to furnish collateral if the interest rate swap has a positive value. Acceptable collateral includes government securities issued by creditworthy governments in the eurozone, the United Kingdom and the United States. Cash in euros is also acceptable. The value of all swaps and the collateral that was put up is determined on a weekly basis. Interest is paid if cash collateral is furnished. Settlement of this return takes place on the last working day of the month.

- *Withholding tax*

Many countries levy withholding tax on income from securities held abroad. Because such income is generally also taxed in the country where the security is held, this frequently involves double taxation. To prevent double taxation, the Netherlands has entered into tax treaties with many countries in order to provide a tax exemption on dividends and interest in the country where the security is held, i.e. tax is only levied in the country of residence. Such treaties cover the various sections of the central government as well as local government bodies and institutions that are 100% owned by the State. The DSTA therefore falls within the scope of these treaties. This means that the DSTA is exempt from taxation on transactions involving securities held in a country where withholding tax is levied. In order to qualify for exemption, the DSTA submitted the necessary applications to the countries concerned via the settlement institutes, and exemption has been granted.

- *Lapsed interest and repayments*

Private investors holding K certificates should collect their interest and principal within the contractually agreed period. Failure to do so means that the right lapses. If that happens, investors should apply to the DSTA for ex gratia payment, stating their reasons for exceeding the agreed payment period.

- *Dematerialisation*

In 2003 agreements were reached with Euroclear Nederland to replace the conventional CF certificates, K certificates and global notes placed in the custody of Euroclear Nederland. The conversion of these physical securities into book entries in the name of the 'Affiliated Institutions of Euroclear Nederland' means that the government debt is almost entirely dematerialised. A very small proportion of the government debt still consists of classical K certificates that are kept at home by their holders. Since the government has not issued any K certificates since 1987, even this exception will soon be a thing of the past.

The Securities Giro Act offers investors the opportunity to ask for their participation in the giro circuit to be terminated. Following on from the dematerialisation, the obligation to terminate is limited to a registration by name. As proof of the registration, the investor receives a statement of account. Interest and redemption will be automatically transferred to the investor.

6 Taxation

Investors in government debt are taxed. For private investors, income tax is the most important. Since the introduction of the new tax system on 1 January 2001, the return on financial assets has been taxed by assuming that these assets yield a fixed net return of 4%. The real return (e.g. capital gains) and the costs involved in acquiring the assets are irrelevant.

The income tax is levied on three sources of income ('boxes'). Box 3 concerns income from savings and investments. A 30% tax rate applies to the return on all income earned in box 3. The return in any year is assumed to be 4% over the average of the savings and investments on 1 January and 31 December. It should be noted that only net savings and investments are counted. Investments in government debt, in whatever shape or form, are valued at their market price. If assets are financed by liabilities, only the net value is taken into account. This also means that interest paid on the liabilities used to finance financial assets cannot be deducted separately. The 4% rate covers the net value of all benefits and costs, i.e. receipts such as interest receipts and capital gains on stock, as well as costs such as capital losses and interest payments. Depending on the composition of the household (e.g. households with children) a portion of the savings and investments is exempt from taxation. Married couples and unmarried couples living together can file together and choose who accounts for the box 3 savings and investment components. For example, they can each account for half of their investments. Other allocation methods are also possible, as long as the total of all savings and investments is accounted for. Exemptions may also be transferred from one partner to another.

The interest payments to holders of Dutch government bonds residing outside the Netherlands are not taxed at the source. In accordance with the tax-treaties, taxation is only levied in the country of residence.

7 Statutory framework and accountability

The Dutch State Treasury Agency acts on behalf of the Minister of Finance, who is empowered by law to contract loans on behalf of the government. Policy details relating to the amount of debt and the funding thereof are contained each year in the annual Appropriation Bill IX A. This is part of the Budget Memorandum that concerns the National Debt and is put before Parliament on the third Tuesday of September. This Bill also contains the authorisation to service the government debt with respect to both the estimated interest payments and the redemptions. The Appropriation Bill IX A and the subsequent amendments during the financial year require parliamentary approval. As a rule, the Bill is passed by Parliament in the month of December preceding the start of the new budgetary year.

Parliament is informed regularly on the implementation of the Budget with respect to the National Debt and on any windfalls or additional expenses due to interest rate changes or changes in the borrowing requirement. An update on the implementation during the year is reported as part of the Budget Memorandum (which is put before Parliament at the same time as the Appropriation Bill IX A on the third Tuesday of September). The developments regarding implementation during the new budget year are communicated in the Spring Memorandum of that year (June) and the Autumn Memorandum (December). The relevant budget memoranda and bills put before Parliament are open to public scrutiny.

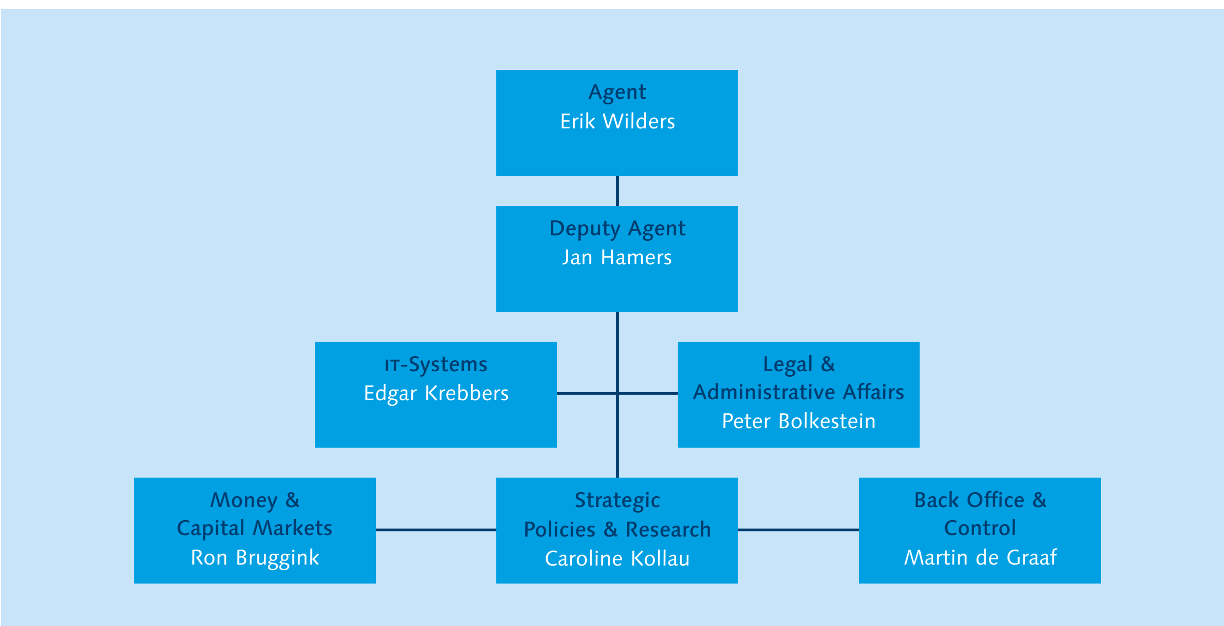
Since the Budget Memorandum 2002, interest payments have been budgeted and reported on an accrual basis. This is in accordance with the European System of Accounts (ESA 1995). In addition, since the Budget Memorandum 2002, the Memorandum has complied with a new system of budgeting and reporting. With this system, the Dutch government wants to emphasise the relationship between objectives, means and results of government policies.

The preparation of the funding policy and its actual implementation are the responsibility of the Dutch State Treasury Agency.

8 Organisation chart

The Dutch State Treasury Agency is one of the 5 directorates of the Treasury of the Ministry of Finance. The other 4 directorates are: Financial Markets, Foreign Financial Relations, Financing, and Financial and Economic Policy. The Treasury itself is one of the 5 Directorates-General of the Ministry of Finance. The other 4 Directorates-General are: Budget, Tax & Customs Policy & Legislation, Tax & Customs Administration, and the Central Directorates.

The Dutch State Treasury Agency is organised according to the chart below:



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Statistical information

1 Interest costs of Central Government debt in 2004, 2005 and 2006

In millions of euros

	2004	2005	2006
Interest cost			
Interest cost on fixed debt	9,176	9,028	8,815
Interest cost on floating debt			
Interest cost on DTCs	588	483	657
Interest cost on other short-term borrowing	66	70	79
Buyback premium	14	50	-
Total interest cost	**9,845**	**9,631**	**9,551**
Interest received			
Net interest received on EURIBOR swaps	94	64	68
Received interest on floating debt			
Received interest on Central Bank account	-	1	1
Received interest on short-term lending	39	60	23
Net interest received on EONIA swaps	5	-	-
Buyback discount	-	-	-
Total interest received	**139**	**125**	**92**
Net interest cost	**9,706**	**9,506**	**9,459**

Interest cost in 2004 is based on realised cost.
The results for 2005 are preliminary and run up to 31 October.
Interest cost for 2006 is based on the 2006 budget for National Debt.

2 Changes in long-term debt in 2005

In thousands of euros

Position as at 31 December 2004		**197,090,910**
New issues in 2005		
Public bonds	30,310,192	
Private placements	-	
	add	30,310,192
Redemptions in 2005		
Regular redemptions		
Public bonds	24,136,052	
Private placements	16,049	
Early redemptions		
Public bonds	60,328	
Private placements	25,303	
	less	24,237,732-
Position as at 31 October 2005		**203,163,370**

3 Issuance of bonds for the 2004 and 2005 borrowing requirement

In billions of euros

Month of issuance	ISIN-code	Bond issued	Issue	Raised amount	Yield
2004					
January	NL0000102119	3% NETH 2004 per 15 July 2007	first issuance	3.4	2.99%
February	NL0000102101	2.75% NETH 2003 per 15 January 2009	reopening	1.8	3.33%
March	NL0000102119	3% NETH 2004 per 15 July 2007	reopening	2.3	2.66%
	NL0000102325	3.75% NETH 2004 per 15 July 2014	first issuance	5.1	3.98%
April	NL0000102101	2.75% NETH 2003 per 15 January 2009	reopening	1.5	3.28%
May	NL0000102119	3% NETH 2004 per 15 July 2007	reopening	1.6	3.09%
June	NL0000102325	3.75% NETH 2004 per 15 July 2014	reopening	1.8	4.42%
July	NL0000102119	3% NETH 2004 per 15 July 2007	reopening	2.3	3.02%
September	NL0000102325	3.75% NETH 2004 per 15 July 2014	reopening	3.1	4.11%
October	NL0000102119	3% NETH 2004 per 15 July 2007	reopening	2.5	2.71%
	NL0000102309	3% NETH 2004 per 15 January 2010	first issuance	6.3	3.23%
November	NL0000102325	3.75% NETH 2004 per 15 July 2014	reopening	1.8	3.93%
			Total	**33.5**	
2005					
January	NL0000102150	2.5% NETH 2005 per 15 January 2008	first issuance	2.6	2.63%
February	NL0000102309	3% NETH 2004 per 15 January 2010	reopening	2.5	2.99%
March	NL0000102150	2.5% NETH 2005 per 15 January 2008	reopening	2.3	2.62%
April	NL0000102309	3% NETH 2004 per 15 January 2010	reopening	1.7	2.94%
	NL0000102234	4% NETH 2005 per 15 January 2037	first issuance	6.0	4.07%
May	NL0000102150	2.5% NETH 2005 per 15 January 2008	reopening	2.2	2.39%
June	NL0000102309	3% NETH 2004 per 15 January 2010	reopening	1.5	2.54%
	NL0000102242	3.25% NETH 2005 per 15 July 2015	first issuance	6.0	3.21%
July	NL0000102150	2.5% NETH 2005 per 15 January 2008	reopening	1.7	2.28%
September	NL0000102242	3.25% NETH 2005 per 15 July 2015	reopening	2.3	3.17%
October	NL0000102150	2.5% NETH 2005 per 15 January 2008	reopening	1.5	2.49%
			Total	**30.3**	

4 Concluded interest rate swaps

Position as at 31 December, in millions of euros

Start date	End date	Nominal amount	Fixed interest rate[1] (%)	Floating interest rate[2] (%)	Type[3]
2001	2011	3000	5.20733	2.198	receive
2002	2012	700	5.28993	2.169	receive
2003	2013	200	4.21525	2.197	receive
2004	2008	3998	3.2444	2.1932	pay
31 Oct. 2005	2035	6010	4.1567	2.2823	receive
	2014	1050	3.7061	2.1756	pay
	2015	4000	3.7865	2.1690	pay
	2016	375	3.6933	2.1610	pay

1 For the fixed interest rate the average interest rate is presented.
2 The floating rate is reset every half year on the basis of the 6-month Euribor interest rate prevailing at that time.
3 Receiver swaps are swap contracts in which the Dutch State receives a long-term fixed interest rate and pays a short-term floating interest rate. Payer swaps are swap contracts in which the Dutch State pays a long-term fixed interest rate and receives a short-term floating interest rate.

5 Key figures of individual bonds in 2005

In thousands of euros

Movements in 2005	Total 31-10-05	Issues	Redemptions	Total 31-10-05	ISIN-code
A Public Bonds					
7.75 pct DSL 1995 due 1 March 2005	11,049,360	-	11,049,360	-	NL0000102184
7.00 pct DSL 1995 due 15 June 2005	582,693	-	582,693	-	NL0000102200
6.75 pct DSL 1995 due 15 November 2005	626,750	-	-	626,750	NL0000102218
4.00 pct DSL 2002 due 15 July 2005	12,504,000	-	12,504,000	-	NL0000102663
8.50 pct DSL 1991 due 2006	436,647	-	6,733	429,914	NL0000101954
6.00 pct DSL 1996 due 15 January 2006	12,329,020	-	-	12,329,020	NL0000102226
3.00 pct DSL 2003 due 15 July 2006	12,899,000	-	-	12,899,000	NL0000102697
8.75 pct DSL 1992 due 15 January 2007	181,310	-	7,543	173,767	NL0000101996
8.25 pct DSL 1992 due 15 February 2007	325,295	-	14,838	310,457	NL0000102028
8.25 pct DSL 1992 due 15 September 2007	580,586	-	14,635	565,951	NL0000102051
5.75 pct DSL 1997 due 15 February 2007	13,637,194	-	-	13,637,194	NL0000102267
3.00 pct DSL 2004 due 15 July 2007	12,216,000	-	-	12,216,000	NL0000102119
5.25 pct DSL 1998 due 15 July 2008	11,118,031	-	-	11,118,031	NL0000102291
2.50 pct DSL 2005 due 15 January 2008	-	10,222,000	-	10,222,000	NL0000102150
3.75 pct DSL 1999 due 15 July 2009	12,088,000	-	-	12,088,000	NL0000102416
2.75 pct DSL 2003 due 15 January 2009	10,366,430	-	-	10,366,430	NL0000102101
7.50 pct DSL 1995 due 15 April 2010	544,705	-	15,201	529,504	NL0000102192
5.50 pct DSL 2000 due 15 July 2010	10,227,366	-	-	10,227,366	NL0000102580
3.00 pct DSL 2004 due 15 January 2010	6,327,486	5,794,000	-	12,121,486	NL0000102309
5.00 pct DSL 2001 due 15 July 2011	13,620,000	-	-	13,620,000	NL0000102606
5.00 pct DSL 2002 due 15 July 2012	10,487,000	-	-	10,487,000	NL0000102671
4.25 pct DSL 2003 due 15 July 2013	14,223,000	-	-	14,223,000	NL0000102689
3.75 pct DSL 2004 due 15 July 2014	11,709,846	-	-	11,709,846	NL0000102325
3.25 pct DSL 2005 due 15 July 2015	-	8,283,765	-	8,283,765	NL0000102242
7.50 pct DSL 1993 due 15 January 2023	8,241,489	-	-	8,241,489	NL0000102077
5.50 pct DSL 1998 due 15 January 2028	8,886,814	-	-	8,886,814	NL0000102317
4.00 pct DSL 2005 due 15 January 2037	-	6,010,427	-	6,010,427	NL0000102234
• 3 1/2 pct Grootboek	472	-	42	430	NL0000002707
• 3 pct Grootboek	10,266	-	477	9,789	NL0000004802
• 2 1/2 pct Grootboek	23,920	-	859	23,061	NL0000006286

Movements in 2005				
	Total 31-10-05	**Issues**	**Redemptions**	**Total 31-10-05**
A Public bonds				
Total public bonds	195,242,681	30,310,192	24,196,380	201,356,493
B Private placements				
Total private placements	1,848,229	-	41,352	1,806,877
Total	**197,090,910**	**30,310,192**	**24,237,732**	**203,163,370**

6 Annual interest payments and repayments of principal, 2006-2037

In millions of euros, according to the long-term debt position as at 31-10-2005

	Interest payments	Redemptions
01-11 to 31-12-2005	93	6,352,007
2006	8,974	25,728
2007	7,775	26,982
2008	6,532	21,374
2009	5,691	22,495
2010	4,950	22,913
2011	3,982	13,803
2012	3,289	10,849
2013	2,736	14,391
2014	2,119	11,752
2015	1,677	8,330
2016	1,405	53
2017	1,402	368
2018	1,372	59
2019	1,368	59
2020	1,364	54
2021	1,360	47
2022	1,358	75
2023	1,352	8,250
2024	733	2
2025	733	29
2026	733	2
2027	733	-
2028	733	8,887
2029	244	-
2030	244	-
2031	244	-
2032	244	-
2033	241	-
2034	241	-
2035	241	-
2036	241	-
2037	241	6,010

Highlights of DSTA Outlook 2006

- Basis amount-at-risk: € 44 bln
- Target range for capital market funding: € 28-35 bln
- Instruments to be used: 3-year, 10-year, 30-year nominal bonds
- Revival: new bond maturing in 2023, and opening of strip & destrip facility
- Primary Dealers: Dresdner Bank is a newcomer
- Risk management framework: reassessment for 2007-2010

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DSL calendar 2006

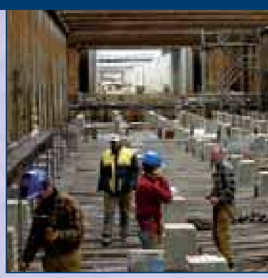
Month of issuance	Announcement (Wednesday)	Issuance (2nd Tuesday)	Payment (Friday)	DSL
January	4	10	13	3-year
February	8	14	17	2023
March	8	14	17	3-year
April	5	11	14	
May	3	9	12	
June	7	13	16	
July	5	11	14	
August	no issuance			
September	6	12	15	
October	4	10	13	
November	8	14	17	
December	6	12	15	

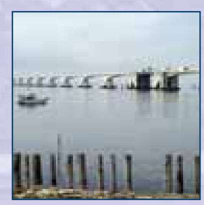
December is a reserve date.
A 10-year bond will be issued in March or April via a DDA.

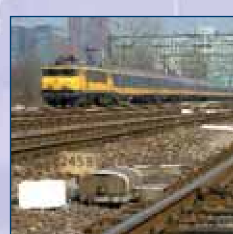
DTC calendar 2006

Issuance (1st & 3rd Monday)	Payment (Wednesday)	DTC 3-month	DTC 6-month	DTC 9-month	DTC 12-month
03-01-06	05-01-06	31-03-06	30-06-06		**15-12-06**
16-01-06	18-01-06	28-04-06			15-12-06
06-02-06	08-02-06	28-04-06	**31-07-06**		
20-02-06	22-02-06	31-05-06		29-09-06	
06-03-06	08-03-06	31-05-06	**31-08-06**		
20-03-06	22-03-06	30-06-06		15-12-06	
03-04-06	05-04-06	30-06-06	29-09-06		**30-03-07**
18-04-06	20-04-06	31-07-06			30-03-07
02-05-06	04-05-06	31-07-06	**31-10-06**		
15-05-06	17-05-06	31-08-06		15-12-06	
05-06-06	07-06-06	31-08-06	**30-11-06**		
19-06-06	21-06-06	29-09-06		30-03-07	
03-07-06	05-07-06	29-09-06	15-12-06		**29-06-07**
17-07-06	19-07-06	31-10-06			29-06-07
07-08-06	09-08-06	31-10-06	**31-01-07**		
21-08-06	23-08-06	30-11-06		30-03-07	
04-09-06	06-09-06	30-11-06	**28-02-07**		
18-09-06	20-09-06	15-12-06		29-06-07	
02-10-06	04-10-06	15-12-06	30-03-07		**28-09-07**
16-10-06	18-10-06	31-01-07			28-09-07
06-11-06	08-11-06	31-01-07	**30-04-07**		
20-11-06	22-11-06	28-02-07		29-06-07	
04-12-06	06-12-06	28-02-07	**31-05-07**		
18-12-06	20-12-06	30-03-07		28-09-07	

Shaded areas: due to (national) holidays the issuance is on Tuesday and the payment is on Thursday.
Bold typeface: new programmes.







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