Dutch State Treasury Agency
Ministry of Finance

Outlook
2013

Outlook

2013

The Dutch economy has always been heavily dependent on trade. The collection of pictures in this Outlook show various buildings that were traditionally part of a Dutch city's trading infrastructure. Many of the photographs depict so-called 'waaggebouwen'. Literally translated, this means 'weighing buildings'. Merchants were obligated to weigh their produce, such as milk or cheese, at a city's official weighing building before offering it for sale. In this way, the weighing buildings supported fair and efficient trade. Merchants paid a small fee for the weighing service, which can be regarded as an early form of VAT charge. Most of the buildings shown stem from the seventeenth century, the Netherlands' 'Golden Age', when the United Provinces amassed huge wealth from international trade.

Preface

Reflecting on the past year, I could once again start this foreword by observing that 2012 brought us a challenging market environment, periods of turbulence, large swings in sentiment, etcetera. As much as I hate to repeat myself, this has been, more or less, my opening statement in the Outlooks of the past five years. This environment of increased uncertainty and volatility has, for now, become the new normal. I hope to have a more original and optimistic opening message for you next year.

In the Netherlands, there is a broad political consensus that consistent, reliable and responsible economic and budgetary policies are essential to retain the trust of financial markets in times of uncertainty. After the elections in September 2012 and one of the shortest periods of coalition negotiations in Dutch parliamentary history, a Coalition Agreement was drafted by the new government. The Agreement contains the basic outline of government policies over the next four years.

The new government will continue the Netherlands' strong tradition of budgetary responsibility. Reducing the budget deficit, in line with the requirements under the Stability and Growth Pact, remains one of the essential priorities for the coming years. However, the focus will not exclusively lie on policies with a short-term effect: measures that will help safeguard the long-term viability of public finances will be addressed. Hence the decision to improve the flexibility of the labour market, to addresses inefficiencies in the housing market, and to accelerate the increase in the retirement age.

The latest economic projections internalising the effects of the Coalition Agreement show that the DSTA will have an external funding need in 2013 of approximately € 90 billion. Taking into account the prolonged economic uncertainty, flexibility will continue to be key. In the past year, we have responded by extending our toolbox of funding instruments. For instance, we issued our first 20-year DSL, as well as our long-awaited USD bonds.

Looking forward, the DSTA will reduce the call on the capital market in 2013 to € 50 billion. This will help to preserve sufficient liquidity in the money market. By aiming for an outstanding amount of money market securities of € 30 billion, the money market should be able to fulfill its role as a buffer in case of unexpected changes in funding needs.

Generally speaking, however, it will once again be business as usual for the DSTA. We will issue new 3-, 5- and 10-year DSLs, the outstanding amount in the current on-the-run DSLs will be increased to at least their benchmark sizes, off-the-run DSLs will be reopened, and the DTC calendar will follow the usual pattern, with auctions twice a month.

Since the DSTA works hard to maintain its predictable and consistent reputation, I hope this Outlook 2013 will contain very few, if any, surprises.

Erik Wilders

Agent of the Dutch State Treasury Agency

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1 The economy, the budget and financial markets

1.1

Economic outlook

For the Dutch economy, 2012 was something of a bumpy ride. While a positive growth rate of 1% was realised in 2011, growth turned negative in the second half of 2011. Although quarterly growth rates turned positive again in the first two quarters of 2012, the economy slipped back in the third quarter. According to the first estimate by Statistics Netherlands, in the third quarter the economy declined by an unexpectedly large quarterly rate of 1.1%.

The subdued economic performance by the Netherlands can be ascribed in part to the measures taken by the government to improve the budgetary position, but mainly to the ongoing euro area debt crisis and uncertainty related to the economic outlook. These factors have undermined consumer- and business confidence and reduced household wealth. Declining eal disposable incomes, an increase in unemployment and tight credit conditions have also had negative effects on household spending and investment. Despite the economic slowdown in the Netherlands' most important trading partners in the euro area, the export sector is expected to make a slight positive contribution to GDP growth in 2012.

The most recent projections by the CPB (the national but independent official forecaster) – dated 18 September 2012 – show that economic growth is expected to return to positive territory next year, with an expected growth rate of 0.75%. Again, the driving force is expected to be the export sector, supported by an anticipated increase in business investment.

Table 1.1 – Key projections for the Netherlands

	2011	2012	2013
Gross Domestic Product (% change)	1.0	-0.50	0.75
Private consumption (% change)	-1.0	-1.00	0.00
Gross fixed investments (% change)	10.2	-2.75	3.25
Government expenditures (% change)	-0.6	-0.75	-0.75
Exports (% change)	4.3	4.25	4.25
- of which produced domestically	3.8	-0.25	3.25
- of which re-export	4.7	8.25	4.75
Imports (% change)	4.1	3.50	2.75
Unemployment (% labour force)*	4.4	5.25	5.75
Labour productivity (% change)	1.0	-1.25	2.00
Inflation (CPI % change)	2.3	2.25	2.00

* European definition
Source: CPB (projections of 18 September 2012). Next update: 19 December 2012

Figure 1.1 below shows the changing composition of GDP growth in 2006-2014 based on forecasts by the European Commission. In the years leading up to the 2008 financial crisis, growth was clearly consumption-driven. Household deleveraging in subsequent years meant that domestic demand was a drag on growth in the years after 2009, and it is expected to remain weak until 2014.

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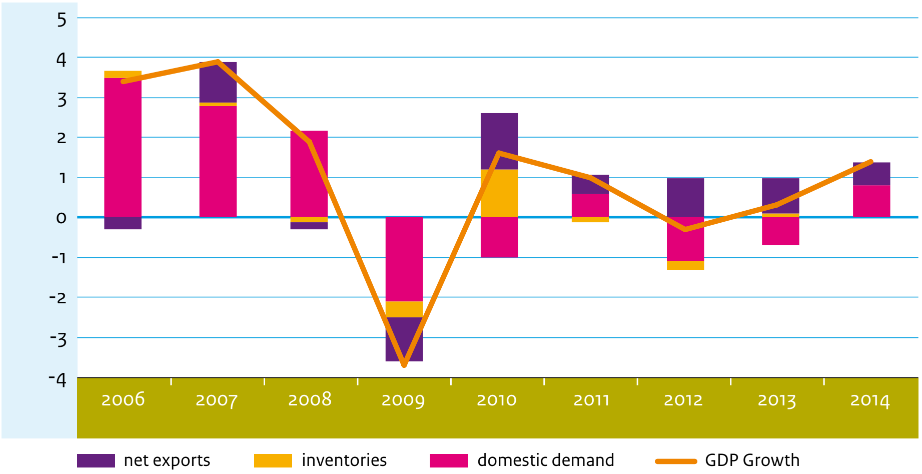
Figure 1.1 – Composition of GDP growth 2006-2014



Source: Autumn Forecast, European Commission

Private consumption
The decline in household consumption by 1% is one of the main reasons for the negative GDP growth in 2012. Households are in the process of deleveraging in order to bring down relatively high residential mortgage debt levels (111% of GDP), while tax increases, public spending cuts by the government and wage moderation efforts put downward pressure on consumers' disposable income. Consumer confidence is low, taking into account the uncertain economic climate.

While inflation is expected to decrease from 2.25% in 2012 to 2%, wage developments are expected to be insufficient to keep up with higher price levels. Consequently, the CPB projects median purchasing power to decline by 0.75% in 2013. As a result of these factors, the CPB expects zero growth for private consumption in 2013.

Investment
With both private and public demand under pressure, and consumer confidence remaining weak, the effect on investments is clearly visible. The construction sector is experiencing especially difficult times given the weakness in residential and commercial real estate. Investments are the most volatile component of GDP growth. After a growth rate of 10.2% in 2011 and a decline of 2.75% in 2012, the CPB expects investment to increase by 3.25% in 2013.

Government expenditure
Following the strong commitment of the Dutch government to continue along the path of deficit reduction, a number of consolidation measures were taken in 2012,comprising both increases in tax rates and cutbacks in spending. Overall, government expenditures declined by 0.75% in 2012, and are expected to decline by the same percentage in 2013. Section 2 provides more information on the budgetary outlook.

Exports
Since the Dutch economy is strongly outward-oriented, the export sector is consistently an important contributor to GDP. Net exports was the only positive contributor to GDP growth in 2012, with exports and imports increasing year-on-year by 4.25% and 3.5%, respectively. Import growth was relatively more subdued due to weak domestic demand. The growth of exports was lower than in previous years as a result of weaker demand in other EU countries, which account for a large share (of approximately 80%) of Dutch exports. On the other hand, the depreciation of the euro vis-à-vis other major currencies in 2012 helped support exports to countries outside the euro area. The CPB forecasts export growth of 4.25% for 2013, while import growth is expected to slow to 2.75%.

The current account surplus is mainly attributable to a surplus in the trade of goods, which accounts for about 80% of the total balance. So-called re-exports (imports which leave the country again after being processed) account for about half of the positive goods balance. This reflects the Netherlands' locational competitive advantage as a trade gateway to Europe, and its ability to a generate significant income from small value-added margins on a large volume of goods. At the same time, an income model that relies strongly on re-exports is vulnerable to fluctuations in the volume of world trade.

Domestically produced exports are dominated by agricultural products, food products, chemical products, machinery and transport equipment. Export growth of domestically produced goods has lagged considerably behind the growth of re-exports.

Another factor behind the Netherlands' current account surplus is its stock of natural gas reserves. The trade balance is supported by both gas exports and the reduced need for energy imports. The cumulative effect is an improvement of the current account by approximately 2.5% of GDP.

In recent years, the primary income balance, i.e. the net earnings on the Netherlands' large international asset position (which amounts to just under 50% of GDP), has also made a positive contribution to the current account. In this way, current account surpluses of the past are reflected in today's current account.

The robust performance of the export sector over the past few years is related to the competitiveness of the Dutch economy. In the World Economic Forum Competiteviness Index 2012-2013, The Netherlands occupies a fifth position, moving up two places compared to last year and overtaking Germany and the US. Strong points of the Netherlands as mentioned by the WEF are its highly productive and innovative companies, well-educated labour force, highly competitive market and advanced infrastructural facilities, including the large international seaport of Rotterdam and international airport Schiphol. As a result, the Netherlands has been able to consistently maintain a sizable trade surplus for more than three decades.

Table 1.2 – Top 10 most competitive economies

	2012-2013	Score
1	Switzerland	5.72
2	Singapore	5.67
3	Finland	5.55
4	Sweden	5.53
5	The Netherlands	5.50
6	Germany	5.48
7	United States	5.47
8	United Kingdom	5.45
9	Hong Kong SAR	5.41
10	Japan	5.40

Source: Global Economic Forum Competitiveness Index 2012-2013

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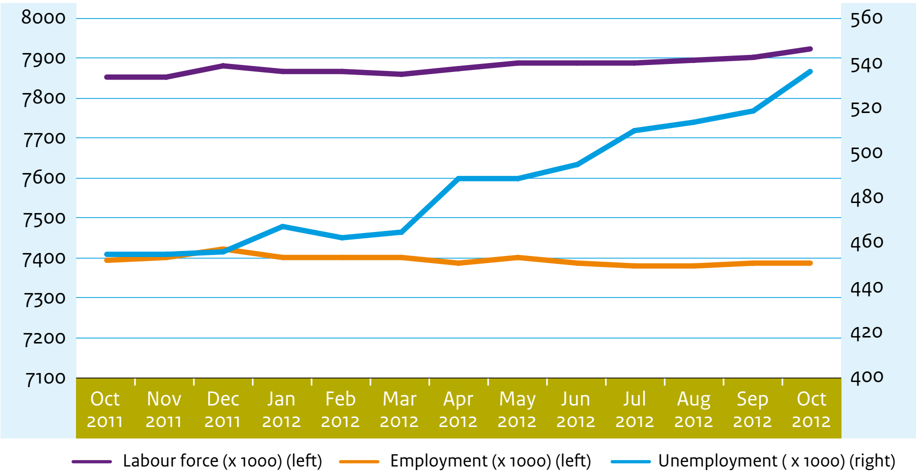
Labour market

The Dutch labour market continues to perform relatively well in comparison with other European countries. The unemployment rate inched up to an average of 5.25% (according to the European definition) this year, and is expected to increase to 5.75% of the labour force in 2013. Interestingly, the main reason for the uptick in the unemployment rate so far has been the growing supply of labour, as can be seen from the figure below. As social benefit schemes are made less generous and the impact of austerity measures is increasingly felt, more people have decided to actively seek work. This holds for the young as well as older people who anticipate that their future pension benefits may be less generous due to the effects of the crisis.

Whereas unemployment increased by 81.000 persons in the year to October 2012, the labour force increased by 69.000 persons in the same period. Although employment has remained stable during 2012, employment growth is expected to become negative in the coming months.

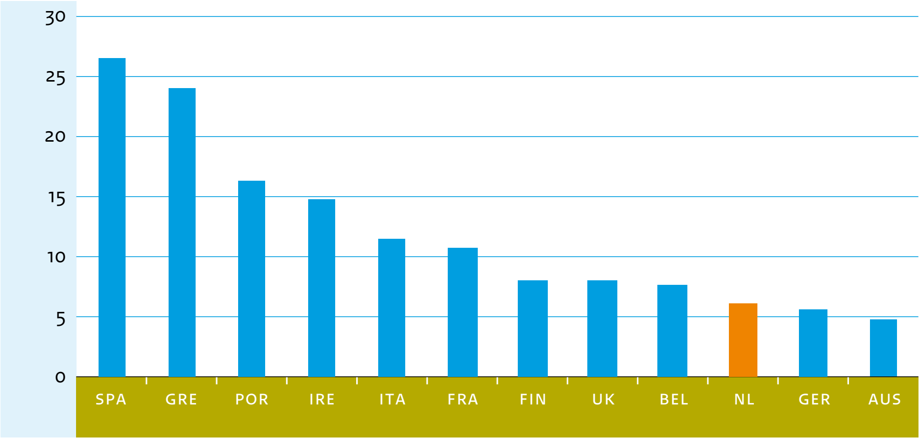
Figure 1.2 – Labour market developments in the Netherlands (seasonally adjusted)



Source: National Statistics (CBS), statistics based on national definition

According to the Autumn Forecast by the European Commission, the Netherlands will have the third-lowest unemployment rate in the EU, after Germany and Austria, in 2013.

Figure 1.3 – Unemployment rates in selected EU countries (% of labour force)



Source: Eurostat (EU definition)

Impact of the new coalition agreement on long-term economic growth

The policy measures announced in the Coalition Agreement of the new Liberal/Labour government are expected to have a small negative impact on the medium-term growth prospects of the Dutch economy. Mainly as a result of the austerity measures included in the Agreement, the average annual economic growth rate for the 2013-2017 period is expected to be reduced by 0.25 percentage points relative to the baseline scenario, although the impact of the measures will generally be felt after 2013. As a result, output in 2017 will be approximately 1.25% lower than it would have been in absence of the measures.

The payoff is expected in the longer run. Structural labour market reforms, such as a modernization of the Unemployment Insurance Act and reform of the law on the termination of employment, are expected to enhance potential growth. Besides the favourable budgetary impact, reform of the housing market should contribute to increasing labour mobility. Wage moderation in the public sector, which is expected to spill over into the private sector, will benefit the export sector by mitigating the growth in unit labour costs. Other measures announced by the new government that will strengthen potential growth include a gradual increase in the retirement age to 67 in 2021 (from 65 now) and a reduction in the regulatory burden on businesses to support entrepreneurship.

1.2 Budgetary Outlook

Resignation of minority government

The year 2012 was eventful from a budgetary policy perspective. Disagreement over a new round of consolidation measures, deemed necessary to bring the EMU-deficit to below 3% of GDP in 2013 as mandated by the EU's budgetary rules, resulted in the withdrawal of support of the minority VVD (Liberals)/CDA (Christian Democrats) government by the PVV (Freedom Party) on 23 April 2012. This lead to the resignation of the government on the same day.

Both in order to maintain the Netherlands' strong track record of budgetary discipline and to underline commitment to the EU's budgetary rules, a broad new coalition of five political parties immediately initiated renewed budgetary negotiations. Within two days, the parties reached agreement on consolidation measures amounting to 2% of GDP (€ 12 billion) for 2012-2013 and growth-enhancing structural reforms. Independent CPB calculations confirmed that the combined effect of the measures contained in this 'Spring Agreement' would produce a deficit of 2.7% of GDP in 2013.

Budget for 2013

Following the parliamentary elections in September 2012, which resulted in a majority for a VVD (Liberals) – PvdA (Labour) coalition in parliament, these two parties commenced negotiations to form a new government. As a matter of priority, they focused on producing a budget for 2013. On 1 October, the two parties announced they had reached agreement on a definitive budget for 2013, based largely on the budgetary measures in the Spring Agreement. Although a few of the measures in the Spring Agreement were amended (for instance, the commuter tax was scrapped, while the insurance tax was increased), the aim of the packages was the same: reduction of the budget deficit to below 3% in 2013. Calculations by both the CPB and the European Commission have since confirmed that this goal will be met, based on current projections. The most important measures in terms of their budgetary impact in 2013 are the increase in the VAT rate from 19% to 21% (effective per October 2012), an increase in the insurance tax from 9.7% to 21%, and the extension of the public-sector wage freeze.

Budget for 2013-2017

In the Netherlands, a coalition agreement between parties forming a new government typically contains the general outlines of their policy plans for the entire four-year governing horizon, including a multi-annual budget. The plans are subsequently sent to the CPB, which makes an independent analysis of their economic and budgetary effects. This medium-term framework adds to the stability of the policy environment and clearly signals a new government's budgetary stance over the medium term, reducing uncertainty for consumers, businesses and the financial markets.

After one of the shortest periods of coalition negotiations in Dutch parliamentary history, VVD and PvdA reached agreement on a package of policy measures for the 2013-2017 period on 29 October 2012. The package has a strong focus on improving the sustainability of public finances, and also includes a number of structural reforms intended to increase the economy's potential growth.

In their coalition agreement, the two parties committed themselves to a reduction in public expenditures of € 12.9 bln over the 2013-2017 period. The largest savings will be realized by reducing social security outlays (€ 3 bln), healthcare expenditures (€ 5 bln), costs of public administration (€ 2.5 bln) and development aid (€ 1 bln). Approximately € 3.9 bln in new spending is reserved for new policy initiatives, including investments in education, R&D, sustainable energy and the police force. Government revenues will be raised by € 7 bln. In total, the package will lead to a consolidation of € 16 billion (2.3% of GDP) in 2013-2017. The CPB has calculated that the effect of the policy package will be to reduce the ex-post EMU deficit (i.e.

the deficit that will result after the impact of the measures on GDP has been taken into account) by 1.3 percentage points to 1.4% in 2017. The structural EMU deficit is expected to improve from an earlier estimate of 2.9% of GDP in 2017 to 1.2% of GDP in 2017.

Long-term sustainability

Equally important is the favourable impact of the Coalition Agreement on the long-term sustainability of public finances. The measures included in the Coalition Agreement will lead to an improvement in so-called 'sustainability gap' of 2.1 percentage points of GDP. The sustainability gap measures the difference between the structural primary balance and the primary balance required for long-term stabilisation of government debt. This gap takes into consideration the budgetary impact that present policies and institutional arrangements – for instance concerning ageing-related spending – have on long term debt. The CPB projects an improvement of the sustainability gap from minus 1.3% of GDP to plus 0.8% in 2017. Measures that are expected to improve the long-term sustainability of public finances include savings in health care, a reduction in the deductibility of mortgage payments, and the acceleration of the increase in the retirement age (to 67 in 2021 and linked to life expectancy thereafter).

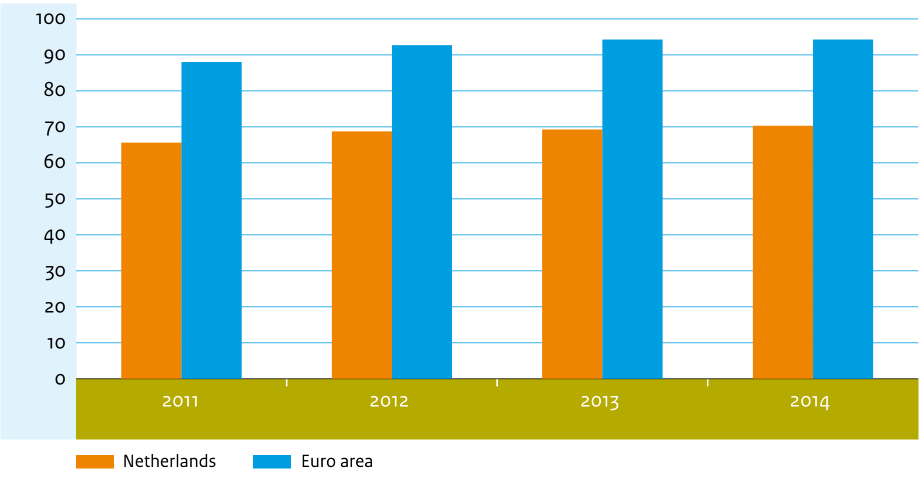
Table 1.3 – Effect of Coalition Agreement on EMU deficit 2013-2017 (% of GDP)

	2013	2014	2015	2016	2017
EMU balance - base case	-2.7	-3.0	-2.7	-2.9	-2.8
Size of budgetary measures	0.1	0.5	1.4	1.9	2.3
Net budgetary impact of measures	0.1	0.3	0.7	1.0	1.4
EMU deficit incl. net impact of measures	-2.6	-2.7	-2.0	-1.9	-1.4

Source: CPB
New projections from the Finance Ministry will be available in early December (after the cut-off date of this Outlook).

The CPB's calculations show that after a projected peak at 71.7% of GDP in 2014, EMU-debt is expected to gradually decrease to 70.8% of GDP in 2017. The European Commission is slightly more optimistic, and expects the debt to reach 70.3% of GDP in 2014. For comparability reasons, the graph below is based on the EC figures.

Figure 1.4 – EMU debt 2011-2014 (% of GDP)



Source: Autumn Forecast 2012, European Commission

Box 1.1 – Rules of the Dutch fiscal framework

One of the major features of the Dutch fiscal framework is that it is trend-based and has multi-annual expenditure ceilings. The basics of this framework have been in place since 1994. Its essence is that the budget balance is allowed to fluctuate with the economic cycle, within the room for manoeuvre allowed under the European budgetary rules. The fiscal framework centers around four main rules:

1. **A strict separation between revenues and expenditures.**
   Windfalls on the revenue side cannot be used for additional spending, and when revenues fall short of expectations, cutbacks on expenditures are not required. Two reasons for introducing this strict separation are the cyclical nature of revenues and the pro-cyclical bias inherent in politics.

2. **An expenditure framework and ceilings.**
   To ensure sound public expenditures, the government subjects itself to an expenditure framework that fixes the overall level of expenditures during the entire government term. The government is only allowed to allocate additional funds to one policy area when the necessary means are compensated elsewhere.

3. **The income framework.**
   A framework is also provided for the income side. Changes in tax rates during the term of government are limited. A windfall cannot be spent on new policies and a setback does not necessitate cutbacks. Full automatic stabilisation is used for the income side. Windfalls are credited and setbacks are debited to the EMU-balance.

4. **Commitment to European rules.**
   Whenever the budget balance does not develop according to the requirements of the Stability and Growth Pact, additional adjustments must be made.

1.3

Financial market developments

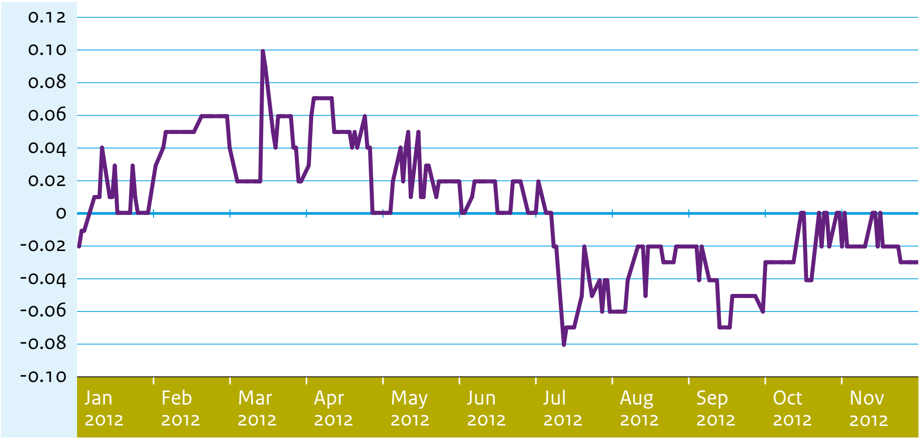
The year 2012 confirmed that the 'green shoots' that were taken as early signs of economic recovery in 2011 have proven to be largely illusory. Growth projections for many developed countries, especially in Europe, were repeatedly lowered over the course of the year. A negative growth rate is now expected for the euro area on aggregate in 2012. Stock markets seem largely indifferent to these adverse developments in the real economy, as the main indices are now about 5% higher than at year-end 2011. Central banks across the developed world remain highly accommodative, bringing official rates near zero percent and deploying a growing array of unconventional measures.

This chapter will focus on developments in three areas that are especially relevant for the purposes of this Outlook: the declining yields of Dutch debt instruments in the financial markets, the effects of the financial and European debt crisis on the Dutch pension assets, and the situation in the Dutch housing market, where prices have been declining gradually but steadily over the past four years.

Declining yields of Dutch debt instruments

After having declined substantially in 2011, bond yields of highly rated sovereigns have continued their downward trajectory this year. Dutch yields reached historic lows in 2012 as Dutch debt continues to benefit from its AAA-safe haven status. The 10-year Dutch bond yield started the year at 2.3% and reached a level of 1.6% end-November, after having touched a historical low of 1.53% in June. At many times throughout the year, the DSTA was able to issue T-bills at negative yields. From the second half onwards, negative yields in DTC auctions were the 'new normal'. The DSTA managed to issue foreign currency CP at firmly negative yields.

Figure 1.5 – 3-month DTC yields



Spreads of 10-year DSLs over their German benchmark Bund reached a peak of 80 bp following the resignation of the government in April 2012. However, spreads declined equally swiftly after a broad political agreement on reducing the budget deficit for 2013 was reached within days of the government's resignation. Since then, spreads have shown a declining trend, hovering around 20-25 bp over German Bunds at the end of November, which is around 15 bp lower than the spread at the beginning of the year.

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Figure 1.6 – Spread of 10-year DSL over reference German Bund yield (bp)

Pension developments

Since the start of the financial crisis, coverage ratios of Dutch pension funds have dropped, mainly as a result of the crisis (low interest rates and declining equity and real estate prices), but also because of increases in life expectancy. Since the third quarter of 2011, the coverage ratio of most funds dropped below the minimum required level of 105%. The supervisor DNB (the Dutch central bank) has implemented a number of changes in the discount rate that pension funds can use when calculating their liabilities. The most important change is that as of 30 September 2012, liabilities longer than 20 years are calculated using an ultimate forward rate (UFR). Insurers have been using such a method since 30 June 2012. For liabilities longer than 20 years, the discount rate is calculated by a gradual extrapolation of forward rates towards a maximum level of 4.2%. For liabilities between 20-60 years, the extrapolation method takes into account actual market rates with a decreasing weight.

Applying the UFR helps mitigate the detrimental effect of the current low long-term interest rates in the markets on pension funds' coverage ratio, and makes coverage ratios less sensitive to financial market developments. However, more must be done before Dutch pension funds can regain a healthy position and recover from their underfunded positions. Many pension funds have already decided to forego indexation of pension outlays, reducing the purchasing power of (future) pensioners. In addition, funds may try to further repair their coverage ratio by increasing contributions and/or by cutting the nominal rights of future pensioners. To prevent sharp increases in contributions or cuts in benefits, pension funds are allowed to spread benefit cuts over time. More specifically, underfunded pension funds may limit reductions in pension entitlements, but are in that case required to cut back on the level of ambition of their pension scheme. The largest pension fund in the Netherlands (ABP, for government employees and teachers) announced that it is likely to reduce nominal benefits by 0.5% in 2013.

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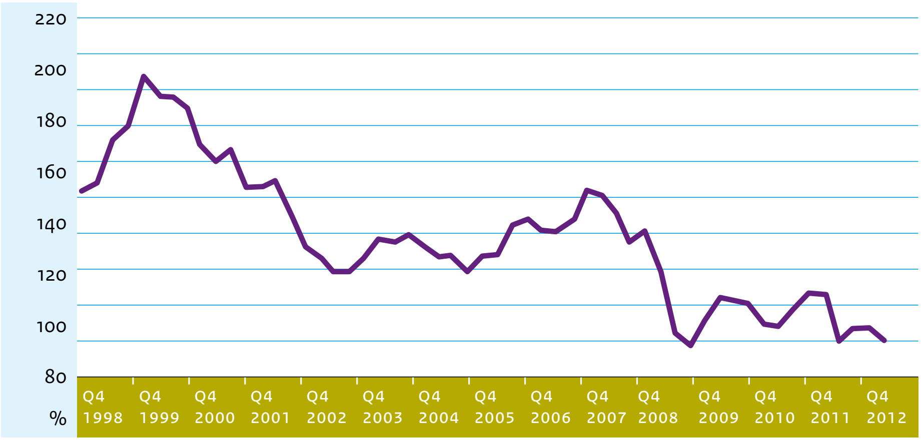
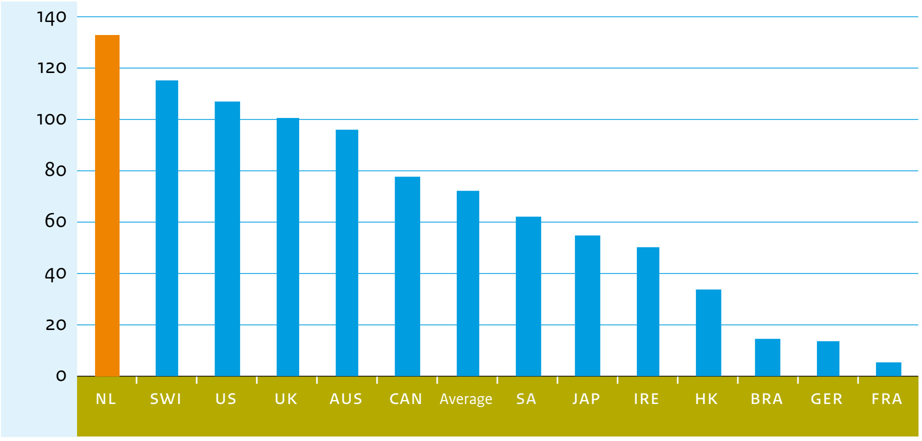
Figure 1.7 – Average funding ratio of pension funds



Source: DNB

Despite the decline in the coverage ratio over the last few years, the absolute level of pension assets in the Netherlands remains high. As the figure below illustrates, Dutch pension assets are, expressed as a percentage of GDP, the highest amongst the world's major economies.

Figure 1.8 – Pension assets (% of GDP)

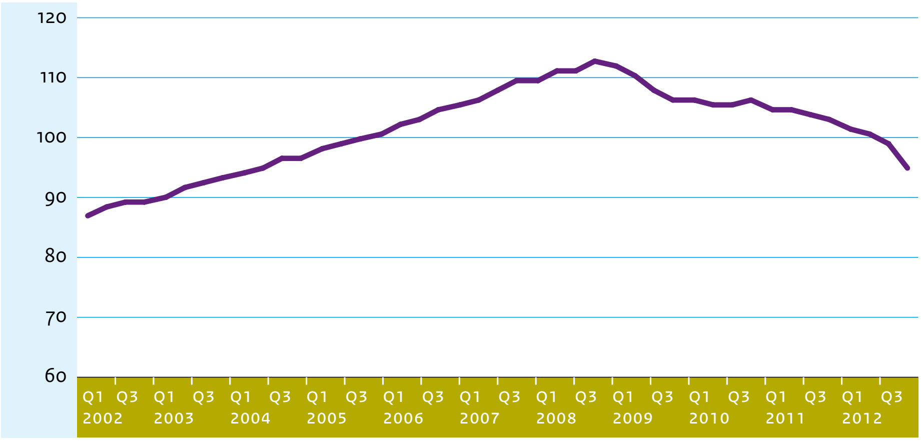


Source: Towers Watson Global Pension Assets Study 2012

Developments in the housing market

Dutch house prices have been declining gradually since house prices peaked in the first half of 2008. The main causes of the downward price trend were the effects of the economic recession on consumer confidence and household wealth, and a more conservative lending climate among mortgage lenders. Uncertainty about the future tax deductibility of mortgage payments also dampened demand from potential buyers. According to Statistics Netherlands (CBS), house prices have on average decreased by around 15.5% since the peak in 2008. This decline follows an extended period of price increases (see figure below).

Figure 1.9 – House price index (2005 = 100)



Source: CBS

The number of transactions has also decreased sharply (by around half) over the 2008-2012 period. The weakness of the housing market meant that government faced a delicate balancing act regarding housing market policy, which needed to address various objectives simultaneously:

- The government wished to support the housing market in the short term so as to avoid exacerbating cyclical weakness.
- At the same time, many experts stressed the importance of encouraging households to pay down mortgage debts more quickly to help bring down loan-to-value ratio's, which are relatively high in the Netherlands and present a source of vulnerability, both for household and for banks.
- From a budgetary perspective, cutting back on the generosity of the deductibility of mortgage interest payments presents a logical step towards deficit reduction, since this subsidy has put increasing pressure on public finances (the cost to the budget reached € 12.7 billion, or 1.6% of GDP in 2012).

Several policy measures have been taken in support of the housing market in the short term, such as the reduction of the real estate transactions tax from 6% to 2% and a temporary increase of the maximum mortgage level for which public insurance can be purchased.

To address more structural, long-term problems, the maximum loan-to-value ratio for new mortgages has been reduced. The full deductibility of mortgage payments will be limited in two ways. First, for new mortgages, interest payments will only be tax-deductible if the mortgage loan is fully repaid during 30 years. This should encourage households to pay down their mortgage debt. Second, for both new and existing mortgages, the highest tax rate at which interest payments can be deducted will be reduced by 0.5 percentage points each year, from the current 52% to 38%.

Although it has risen in the course of 2012, the percentage of mortgage loans that is in arrears or non-performing remains relatively low. There are several reasons for this. First, unemployment, which is one of the main causes of mortgage payment difficulties, has remained relatively low in the Netherlands throughout the crisis (see previous section). Second, mortgage lenders have full recourse against borrowers' assets, so that homeowners have a strong incentive to a keep up with their mortgage payments. Third, mortgages are always means-tested, meaning that the maximum mortgage loan is always set in proportion to household income. Fourth, the high level of gross mortgage debts gives an incomplete picture of the financial position of Dutch households. Against these liabilities are large assets in the form of liquid personal savings, stocks and other financial assets, as well as retirement savings. In terms of household income, household debt (including mortgage debt) accounted for 270% of annual income at the end of 2011, while household assets sum to 738% of income, leaving a net asset position of 468% of household income. These figures exclude households' pension savings which totaled € 1117 bln. Finally, the interest rate sensitivity of mortgages is low due to the high share of fixed-income mortgages, so that households are relatively insulated (at least in the medium term) from possible adverse interest rate movements in the future.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2 Funding and issuance

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2.1

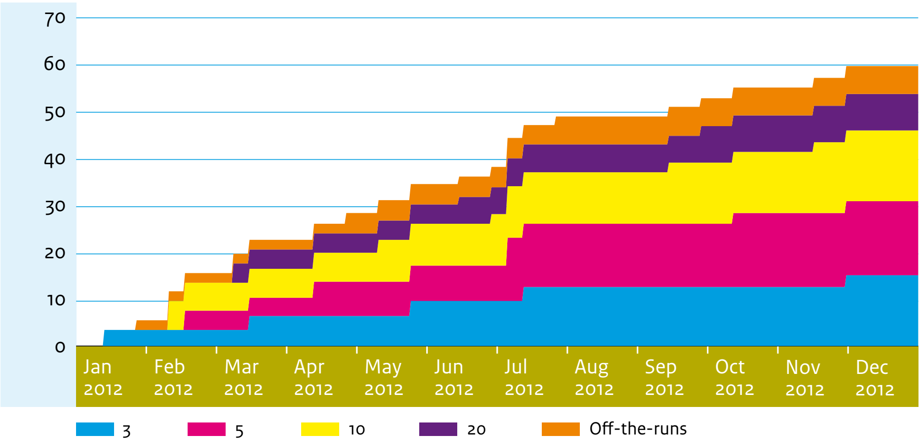
Looking back on funding in 2012

This paragraph reflects on the execution of the funding plan in 2012. Against the backdrop of the financial instability in the capital markets the DSTA managed to secure its funding needs at relatively low costs. This can mainly be attributed investors' flight to the quality of Dutch State Loans.

Capital market issuance in 2012

After three consecutive years of issuing approximately € 50 bln per year, the DSTA decided to increase its call on the capital market to € 60 bln in 2012. The increase was driven by two factors: a desire to reduce the size of the money market and an increase in the budget deficit. Due to the higher capital market target, the DSTA launched four new DSLs, of which three were issued via a DDA. By also reopening off-the-run bonds and tapping benchmarks to their committed outstanding amounts, € 60.4 bln was raised in the capital markets in 2012. Figure 2.1 depicts the development of the amount issued over the different maturity buckets.

Figure 2.1 – DSL issuances in 2012 by maturity (years)



* 5-year also includes reopenings of the DSL 2.50% 15 January 2017

The DSTA kicked off the year with a new 3-year benchmark bond in January, the DSL 0.75% 15 April 2015, which was launched through a regular tap auction. After the initial tap of € 3.6 bln, the bond was reopened four times in 2012 to achieve a total outstanding amount of € 15.0 bln, in line with the committed benchmark volume.

In February, the first DDA of the year was held for the launch of the new 10-year benchmark, the DSL 2.25% 15 July 2022. An initial amount of € 6.0 bln was issued. The new 2022 DSL was reopened four more times through tap auctions to reach its current outstanding amount of € 15.3 bln.

One month after the launch of the new 10-year benchmark, the DSTA issued a 20-year bond for the first time in its history. The DSL 2.50% 15 January 2033 filled the gap in the refinancing profile between the DSLs maturing in 2028 and 2037. The initial issuance size of € 4.2 bln was increased to € 8.0 bln through two subsequent reopenings. The bond will be reopened again early next year to increase its volume to at least € 10 bln (see next section).

The final euro-denominated bond issued through a DDA was the new 5-year benchmark, the DSL 1.25% 15 January 2018, in July. After one reopening, the current outstanding amount is € 8.6 bln. Through a number of further reopenings, this amount will be raised to at least € 15 bln in the first half of 2013.

Table 2.1 summarises the three euro-denominated DDA issuances in 2012. In general, the current yield of the DSLs issued is lower than it was at the time of their first issuance, ensuring a good performance for buy-and-hold investors who purchased the bonds in the DDA. Furthermore, spreads vis-à-vis the relevant German reference bonds have tightened for two of the three DSLs. Only the new 20-year DSL has widened by a few basis points (by late November) compared to the German benchmark.

Table 2.1 – Results of DSL issuance via DDA (as at 28 November 2012)

DDA	2.25% 15 Jul 2022	2.50% 15 Jan 2033	1.25% 15 Jan 2018
Reference Bond	DBR 4 Jan 2022	DBR 4 Jul 2034	DBR 4 Jan 2018
Date of Issuance	7 Feb 2012	6 Mar 2012	3 Jul 2012
Total DDA-Allocation	€ 6.0 bln	€ 4.2 bln	€ 6.0 bln
Investors	43% Real Money/ 57% Other	33% Real Money/ 67% Other	65% Real Money/ 35% Other
Issuance Yield	2.359%	2.736%	1.305%
Issuance Spread over reference bond	+ 47 bps	+ 17 bps	+ 60 bps
Current Yield	1.880%	2.580%	0.98%
Current spread over reference bond	+ 40 bps	+ 22 bps	+ 33bps
Current outstanding volume	€ 15.3 bln	€ 8.0 bln	€ 8.6 bln

Since DSL redemptions fall in January and July and the majority of auctions fall in the first half of the year, frontloading is a logical and sensible funding strategy for the DSTA. In the seven months of 2012 preceding the summer break, the DSTA issued 76% of its total capital market funding goal of € 60 bln.

Box 2.1 – Permanent buyback program

In March 2012, the DSTA announced the start of a pilot DSL buyback program for the DSL 5% 15 July 2012. The goal was to further improve the DSTA's cash management operations. Because of the size of DSL redemptions and coupon payments – which cumulate on 15 January and 15 July – pre-financing is desirable. Buying back a bond in advance improves cash management in two ways. Firstly, it reduces the necessary accumulation of surplus cash positions just prior to the dates of the cash outflow. Secondly, it reduces redemption peaks. On 24 October 2012, after a positive evaluation of the pilot program, the DSTA decided to make the buyback program permanent.

As the goal of the buyback instrument is to improve cash management, it will focus on bonds with short residual maturities. Under the buyback program the DSTA can, in calendar year t, buy back bonds which will mature in year t or t+1 and refinance them with money market instruments that also redeem in t+1, albeit on different dates. To ensure that the liquidity of the eligible bonds remains sufficiently high, the maximum amount that may be bought back will be capped by the requirement that the outstanding volume of a bond must always be at least € 10 bln. Furthermore, the bonds will continue to be available via the repo facility that the DSTA offers its Primary Dealers.

In contrast to the issuance of DSLs, bond buybacks will not be performed through pre-announced auctions. Instead, the DSTA will determine whether, and to what extent, to enter the secondary market on a day-by-day basis. Buybacks will be performed bilaterally with Primary Dealers. DSLs that have been bought by the DSTA will be cancelled immediately.

Up-to-date information on the net outstanding volume of DSLs is available on www.dsta.nl.

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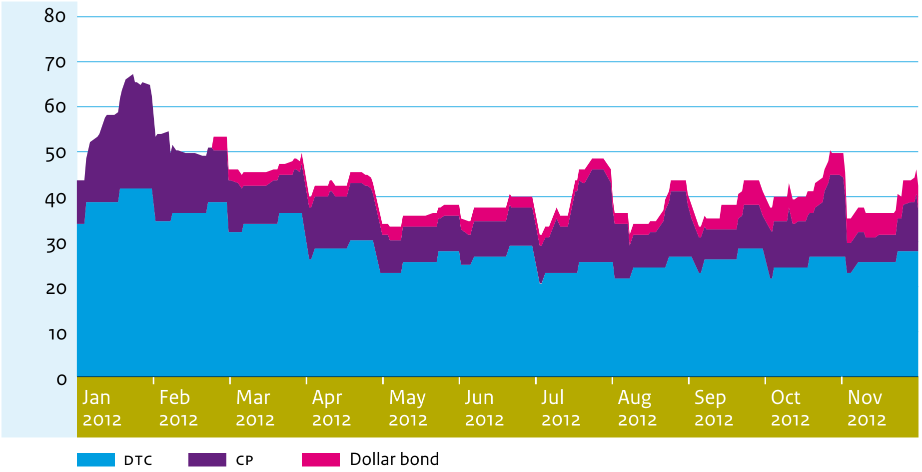
Money market issuance in 2012

For the DSTA, the money market acts as a buffer. To ensure a more balanced ratio between money and capital market funding, the DSTA aimed to lower the outstanding money market volume in 2012 compared to 2011.

Various instruments are deployed by the DSTA to optimise the management of money market funding. Traditionally, Dutch Treasury Certificates (DTCs), which are issued twice a month, have been the money market cornerstone instrument for the DSTA. Commercial Paper (CP) adds flexibility, since maturities can be tailored to specifically suit both investors and the DSTA. Figure 2.2 gives an overview of the outstanding amount (in euro) of DTCs and CP throughout 2012. Since the DSTA is committed to a clear and transparent capital market issuance program, it decided that any opportunistically issued USD-denominated bond would impinge on the planned end-of-year money market volume. This explains why the two USD Dutch State Bonds that were issued in 2012 are included in figure 2.2. Collateral received, deposits and repo's are not included in this overview.

Figure 2.2 – Outstanding amounts of money market instruments and USD bonds,
January – November, € bln

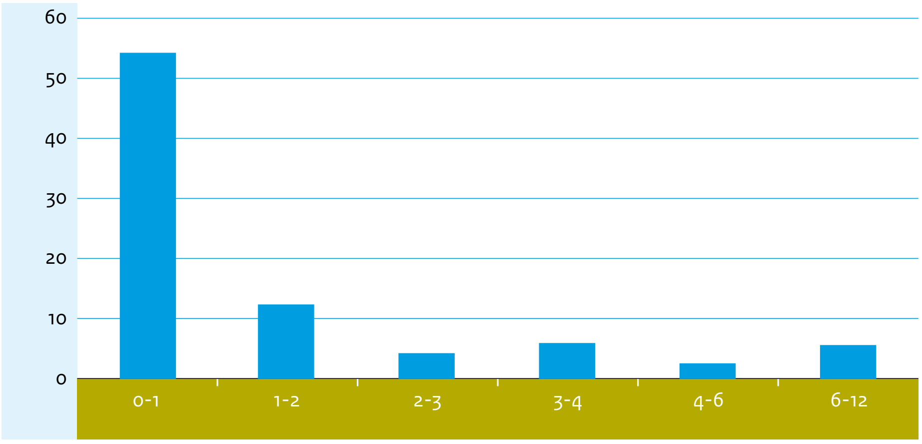


Between January and November 2012, a gross amount of € 54 bln was issued though DTCs. This is substantially lower than in previous years. This can be explained by a combination of three factors: a lower money market target (as explained previously), a strong increase in the amount of collateral received, and the issuance of two USD-denominated bonds.

Following policy decisions by the ECB, the front end of the Dutch curve entered negative yield territory in 2012. Although negative yield auctions were first held in December 2011, the trend became more persistent after the ECB cut its deposit rate to 0% in July. Despite the negative yields, DTCs remain popular among investors, as evidenced by the high bid-to-cover ratios in auctions. Although the issuance of DTCs has been more limited than in previous years, liquidity is still high: bid-offer spreads for DTCs are among the tightest in the euro area.

As in previous years, the DSTA's CP program has two issuance peaks matching the redemptions and coupon payments of DSLs: in the beginning of the year and in July. Given the demand among investors for high-quality USD paper, the majority of the CP issued by the DSTA was in USD. Strong market appetite allowed the DSTA to swap the majority of these issuances back to negative levels in euro. CP is a cash management fine-tuning instrument, as is illustrated by the fact that the majority of CP issued had a maturity of up to 1 month (figure 2.3).

Figure 2.3 – Issued amounts of Commercial Paper in euro equivalent (bln) per maturity bucket (in months)



USD bond issuance in 2012

A milestone for the DSTA in 2012 was the launch of its inaugural US Dollar Dutch State Bond (DSB). The USD DSB 1.00% 24 February 2017 was launched via a customised DDA. A target amount of USD 2 bln was announced. During the auction, the initial spread guidance of +9/+12 bps over the 5 year USD mid-swap was tightened to +9/+10 bps. Due to the large demand and good quality names in the book, a ticket size of USD 3.27 bln was allocated at a spread of +9 bps, with a total book size just above USD 5.2 bln.

The DSTA followed up on the success of this first USD launch with a 3-year US Dollar Dutch State Bond in early September. The USD DSB 0.25% 12 September 2015 was the largest USD issuance by a euro area sovereign since 2009. It also had the lowest coupon ever paid on a benchmark issuance in the USD market by a SSA issuer. The book grew quickly to USD 7 bln, and after just under three hours the DSTA closed the book. The bond was issued at the tightest end of the +5/+8 bps (over mid-swap) spread guidance and an amount of USD 3.5 bln was printed.

Aside from obtaining a funding advantage, the goal of issuing dollar bonds is also to introduce the Dutch name to more investors and to familiarise them with the DDA process. Both goals were met. The 5- and the 3-year USD issuances resulted in 25 bps and 16 bps costs saving after hedging costs, respectively. Investors from more than 30 countries participated in the two deals and the distribution to investors outside the Euro Area was larger than in the regular DSL DDAs. To avoid FX exposure, all USD cash flows are hedged through a Cross Currency Swap back into euros.

The DSTA regards a USD bond as an addition to its existing euro program. The extent to which USD bonds will be issued in the future is uncertain. Their use will mainly depend on the size of the funding need in the money market. In any case, a precondition for the issuance of a USD bond is that a funding advantage vis-à-vis the euro DSL curve can be obtained.

Box 2.2 – Deviations from the benchmark

In 2011, the DSTA undertook an evaluation of its risk management strategy that was implemented in 2008. At the same time, an analysis was done of whether and how the existing risk framework should be continued or modified. On the basis of this analysis, the 7-year constant maturity portfolio was maintained as the DSTA's benchmark.

However, one innovation was introduced. As of 2012, deviations from the risk profile as prescribed by the benchmark are allowed. Two considerations called for introducing this opportunity. First, given the current market circumstances (i.e. relatively low interest rates), deviations from the benchmark offer a possibility of lowering interest costs in the long run. Second, and more importantly, deviations that act to lengthen the average maturity of the DSTA's portfolio enhance fiscal stability, since interest costs are locked-in for a longer period of time if long issuances are not swapped back to a 7-year constant portfolio.

In the short run, however, deviations typically lead to higher interest costs. Instead of paying the 7-year swap rate, a longer maturity DSL rate is paid. To ensure that debt management policy does not unduly interfere with the deficit reduction goals set by the government, deviations are subject to strict requirements. The two most important ones are:

- i deviations may not result in an increased volatility of the budget. Consequently, deviations are allowed only if they extend the average maturity of the DSTA's portfolio,
- ii deviations must fit within annual budgetary projections for interest expenditures.

The DSTA has used this option on several occasions. More information is available in the Annual Accounts (as sent to parliament).

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2.2

Funding plan for 2013

The borrowing requirement in any year is the sum of the ultimate volume of the money market in the preceding year, capital market redemptions and the expected cash deficit.

Based on the latest projections of the cash balance in the budget, the 2012 end-of-year money market volume is expected to stand at € 49.3 bln. As a result of an increase of the budget deficit during the year, this is approximately € 10 bln higher than anticipated at the start of the year. The money market consists primarily of outstanding Dutch Treasury Certificates, Commercial Paper and deposits. However, over the course of 2012, cash collateral received on swaps with a positive mark-to-market value has become an increasingly important source of funding. As a result, outstanding DTC volumes have declined over the course of 2012 (see previous section).

The total projected borrowing requirement for 2013 is broken down as follows:

- Capital market redemptions, for a total amount of € 31.8 bln
- An expected end-of-year money market volume (including collateral) of € 49.3 bln
- An estimated cash deficit of € 15.2 bln

Altogether, this results in a projected total borrowing requirement for 2012 of € 96.3 bln.

Usually the funding need in any year is completely matched by issuance in the money and capital market. In 2013, however, due to the introduction of Treasury Banking for local governments (see Box 2.3), part of the funding need will be covered from within the general government. Inflows from local governments in 2013 are expected to reduce the DSTA's external funding need by approximately € 6 bln. Normally, incoming and outgoing flows related to Treasury Banking are accounted for in the cash balance. This means that approximately € 90 bln needs to be funded in the money- and capital market.

Of this amount, the DSTA has decided to fund approximately € 50 billion in the capital market by issuing of DSLs. The remaining amount will be financed in the money market, resulting in an estimated volume at year-end 2013 of approximately € 40 bln.

Table 2.3 – Borrowing requirement and funding in 2013 (€ bln)

Borrowing requirement 2013	
Capital market redemptions	31.8
Money market ultimo 2012#	49.3
Cash deficit	15.2
Total	**96.3**
Expected inflow from local governments	6.0
Total external funding requirement	**90.3**

Funding	
Capital market	50
Money market ultimate 2013#	40.3
Total Funding	**90.3**

Including cash collateral received

Box 2.3 – Treasury Banking for local governments

In addition to being the debt management office in the Netherlands, the DSTA also fulfills important central treasury functions for large parts of the government.

In the context of what is called 'Treasury Banking' (in Dutch: Schatkistbankieren) a large number of (semi) public organisations and schools have a banking relationship with the Ministry of Finance.

All entities participating in the system of Treasury Banking are independent in the execution of their payment transactions. However, any financial assets they have should be held with the Ministry of Finance on a current account and/or as deposits. Most organisations can also apply for a current account credit facility and/or are able to borrow from the Ministry for their investments.

This bundling of cash flows promotes the efficiency of the treasury, averting simultaneous borrowing and lending within the general government. All organisations continue to use their commercial banks for the execution of their daily payment transactions.

Starting in the second half of 2013, local governments will participate in the system of Treasury Banking. Taking into account a transitional arrangement for existing investments, local governments will only be able to invest their excess liquidity with the Ministry of Finance. Local governments will not be able to borrow from the treasury.

The goal of this measure is threefold:

1 A lower level of government debt.
2 A more efficient organisation of the treasury function within the government.
3 A further reduction of market risk and counterparty exposure of local governments.

The level of government debt (EMU-debt) is defined by Eurostat as the gross consolidated debt of the central and local governments. According to the definition, mutual financial assets and liabilities cancel each other out. Excess liquidity that local governments have invested outside the government sector – for instance, deposits held at a bank or long term portfolios invested via asset management firms – do not diminish the level of government debt, whereas assets held within the government sector work to reduce the level of government debt.

By bringing local governments into the central treasury, it is expected that an estimated € 6 billion (1% of GDP) will be consolidated in 2013. In the long run, this measure should diminish EMU-debt by around 3% of GDP. Every inflow into the treasury in the context of Treasury Banking lowers the (external) borrowing requirement of the DSTA.

Declining funding need requires a lower call on the capital market

In 2012, the issuance of DSLs was increased from the level in the three preceding years, in which approximately € 50 bln had been issued annually, to around € 60 bln. As announced at the time, the DSTA intended to maintain this higher level of capital market funding for at least a few years. This would allow the money market volume to decline gradually.

Over the course of 2012 two developments occurred that substantially reduced the funding need for 2013. First, the introduction of Treasury Banking for local governments is expected to result in an inflow of € 6 bln next year, followed by smaller inflows in the years following. Second, two issuances of USD denominated bonds have mitigated the money market volume at the end of 2012. Together, these factors have reduce the funding need for next year by approximately € 11 bln.

Taking into account this lower funding need, keeping the capital market issuance in 2013 at the same level as in 2012 would excessively reduce outstanding volumes of DTCs and Commercial Paper (CP) in the money market. This may harm liquidity in DTCs and may also reduce the role CP can play as the most flexible money market instrument for cash management purposes.

In general, the money market fulfills an important buffer function for the DSTA. This buffer function will be especially important in the coming years, since a growing part of the money market consists of cash collateral received from Primary Dealers. This is potentially a volatile source of funding. In 2012 the amount of collateral received increased to a level of € 12.7 bln (at the end of October), representing quite a sizeable part of the end-of-year volume of the money market. In case more cash collateral would be received, the room for issuance of DTCs and CP would shrink further.

Hence, the amount of capital market funding in 2013 must be calibrated such that a sufficient volume of the various money market instruments can be guaranteed in all plausible collateral scenarios. By reducing issuance on the capital market to € 50 bln in the coming years, it is anticipated that the money market volume (excluding cash collateral) will hover around to the targeted volume of € 30 bln.

Capital Market issuance in 2013

In 2013 the DSTA intends to fund roughly € 50 bln on the capital market by issuing new 3-, 5- and 10-year DSLs. Furthermore, the outstanding amount in the current on-the-run 5- and 20-year DSLs will be increased to at least their benchmark sizes. The remaining funding need will be covered by the reopening of off-the-run DSLs.

More specifically:

- *Reopening on-the-run DSLs* – The 5-year 1.25% DSL January 2018, first issued in July 2012, will be reopened three times in the first half of 2013. This will raise its outstanding volume by approximately € 7 bln, towards at least € 15 bln. The 20-year 2.5% 15 January 2033 will be reopened once in 2013, bringing the outstanding volume to at least € 10 bln in the first half of 2013.
- *New 3-year DSL* – A new 3-year bond will be launched in January 2013, by means of a regular tap. By subsequently reopening this bond, the outstanding volume will increase to at least € 15 bln before year's end. In line with the 2012 issuance, this new 3-year DSL will have its coupon date in April.
- *New 10-year DSL* – A new 10-year bond will be issued in February/March, by means of a DDA. Subsequent reopenings will increase the outstanding amount of this DSL to at least € 15 bln before the end of the year.
- *New 5-year DSL* – Later in the year, the DSTA will launch a new 5-year DSL by means of a DDA. The initial issuance and a subsequent reopening will raise the outstanding amount of this DSL to an indicative amount of € 7 bln at the end of the year. Further reopenings of this bond are scheduled for 2014.
- The remaining € 4 bln will be raised by reopening off-the-run DSLs.

The off-the-run facility will be continued into 2013. However, in 2013 only two off-the-run auctions are scheduled, on the fourth Tuesday of January and July. The target volume for each auction is approximately € 2 bln. The selection of DSLs to be reopened will be made on the regular Wednesday prior to the auction. Due to relatively large fluctuations in the redemption profile of the coming years, the selection of bonds will be driven predominantly by the DSTA's objective of achieving a more evenly spaced redemption profile. Therefore, bonds maturing in years in which total redemptions are relatively low have a higher probability of being reopened in the off-the-run facility.

With regard to the issuance of USD bonds, the DSTA's policy remains unchanged. The precondition for issuing debt in US dollars is that a funding advantage can be realized vis-à-vis a comparable bond issued in euros. Additionally, since the DSTA has determined that foreign currency funding will impinge on money market funding, maintaining a sufficient money market volume as described previously is an important constraint for USD issuance. Based on the sharp decline in outstanding DTCs experienced this year, additional issuances in USD are therefore uncertain at this time, taking into account the funding plan.

Table 2.4 summarises the DSL issuance described above. The DSL calendar can be found at the end of this section.

Table 2.4 – DSL issuance in 2013, indicative sizes, € bln

DSL	Indicative amounts
New 3-year DSL	15
New 10-year DSL	15
New 5-year DSL	7
On-the-run 5-year DSL	7
On-the-run 20-year DSL	2
Reopening off-the-run DSLs	4
Total DSL funding	**50**

DTC issuance

The DTC calendar follows the usual pattern, with auctions held on the first and third Monday of every month. At every auction, a 3-month programme will be tendered, in combination with a programme in the 6-, 9- or 12-month segment. As was the case this year, the focus of the second line will be on issuance in the 6-month segment to optimise the DSTA's ability to absorb unforeseen changes in the cash balance. Both the fluctuations in cash collateral received and the uncertain inflows from local governments in the context of Treasury Banking require flexible cash management. In addition, by issuing DTCs with relatively short maturities, the incidence of cash surpluses can be reduced, thereby mitigating credit risk.

Consequently, the auction calendar in 2013 follows the same pattern as this year. Issuance in 12-month programmes will take place in the beginning of the first and third quarter only. The second and fourth quarter will start with an auction of a 9-month DTC. In all other auctions, 3-month DTCs will be auctioned in combination with issuance in the 6-month segment.

All DTC-programmes to be auctioned will be announced on the Wednesday prior to the auction (T-5). The DTC calendar can be found at the end of this section. Unforeseen circumstances may lead to changes in the calendar. Quarterly issuance calendars will provide updates, if necessary. These will be published through regular press releases and are available on the DSTA's website.

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Indicative DSL calendar 2013

Month of issuance	Auction Date 2nd Tuesday	Details	Auction date 4th Tuesday	Details	DDA window
January	8	Tap new 3-year: DSL 15 April 2016	22	Off-the-run	
February	12	Tap 5-year: 1.25% DSL 15 January 2018	26	No tap	DDA new 10-year
March	12	Reopening new 3-year	26	Tap 5-year: 1.25% DSL 15 January 2018	
April	9	Tap	23	No tap	
May	14	Tap	28	Tap	
June	11	Tap	25	No Tap	DDA new 5-year
July	9	Tap	23	Off-the-run	
August	Reserve dates				
September	10	Tap	24	Tap	
October	8	Tap	22	No Tap	
November	12	Tap	26	Tap	
December	Reserve dates				

Indicative DTC calendar 2013

Auction date	Settlement date	3-month DTC-progamme	6-, 9-, 12-month DTC-programme
07-01-13	09-01-13	28-03-2013	30-12-2013
21-01-13	23-01-13	29-04-2013	28-06-2013
04-02-13	06-02-13	29-04-2013	31-07-2013
18-02-13	20-02-13	31-05-2013	30-08-2013
04-03-13	06-03-13	31-05-2013	30-09-2013
18-03-13	20-03-13	28-06-2013	30-09-2013
02-04-13*	04-04-13	28-06-2013	30-12-2013
15-04-13	17-04-13	31-07-2013	31-10-2013
06-05-13	08-05-13	31-07-2013	29-11-2013
21-05-13*	23-05-13	30-08-2013	29-11-2013
03-06-13	05-06-13	30-08-2013	30-12-2013
17-06-13	19-06-13	30-09-2013	31-01-2014
01-07-13	03-07-13	30-09-2013	30-06-2014
15-07-13	17-07-13	31-10-2013	31-01-2014
05-08-13	07-08-13	31-10-2013	28-02-2014
19-08-13	21-08-13	29-11-2013	28-02-2014
02-09-13	04-09-13	29-11-2013	31-03-2014
16-09-13	18-09-13	30-12-2013	31-03-2014
07-10-13	09-10-13	30-12-2013	30-06-2014
21-10-13	23-10-13	31-01-2014	29-04-2014
04-11-13	06-11-13	31-01-2014	30-05-2014
18-11-13	20-11-13	28-02-2014	29-04-2014
02-12-13	04-12-13	28-02-2014	30-05-2014
09-12-13#	11-12-13	31-03-2014	30-06-2014

Shaded areas indicate new programmes.

* Tuesday instead of Monday due to national holiday

\# Second Monday

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2.3

Collective Action Clauses (CACs) in newly issued DSLs

After the restructuring of Argentina's debt in 2003, the international community decided that collective action clauses (CACs) would be included in international debt issuances to facilitate international efforts for orderly restructurings in the event of a sovereign debt crisis. The objective of these provisions was to allow a majority of bondholders to recontract sovereign debt, without a minority of bondholders obstructing the process.

On 2 February 2012, a modified version of the Treaty Establishing the European Stability Mechanism (ESM) was signed by all 17 euro area Member States. Paragraph 3 of Article 12 of the Treaty states that as of 1 January 2013, CACs shall be included in all new euro area government debt securities with an original stated maturity of more than one year, in a way that ensures that the legal impact across Member States is identical. The Economic and Financial Committee (EFC) developed and approved the European model CACs. These were subsequently confirmed by the Heads of Government and States of euro area Member States on 11 March 2011 and by the European Council on 24-25 March 2011.The European model CACs can be found on the EFC's website[1].

The CACs shall distinguish two types of modifications of the borrowing conditions that can be made with approval of the majority of the bondholders in a bondholder meeting.
(1) A reserved matter modification, involving the modification of a bond's most important terms and conditions, such as a reduction in the principal or interest payable on a bond, or changes in the dates on which these payments must be made. These modifications require the highest level of bondholder consent.
(2) A non-reserved matter modification, involving the modification of a bond's less important terms and conditions (broadly speaking, any modification, amendment, supplement or waiver of the Trust Indenture or the terms and conditions of the bonds requiring the consent of holders that does not constitute a reserved matter) and requiring a lower level of bondholder consent.

Under the CAC, a modification may be proposed in relation to either a single bond, a so-called single-series modification, or to more than one bond at the same time, a so-called cross-series modification. Different approval thresholds apply to single-series and cross-series modifications. In all events, a proposed modification will require the issuer's consent. Modifications, if approved, are binding for all bondholders.

Following the EFC's decision, the borrowing conditions of all new issues of Dutch euro and dollar bonds, notes and other debt instruments with a maturity of more than one year will contain these harmonized CACs from 2013 onwards. In order to implement the CACs, a new Article referring to the CACs has been added to the general conditions of the borrowing conditions. The text of the CACs can be found on the website of the DSTA[2]. Please note that the original English text of the CACs is leading above its Dutch translation.

The introduction of the European model CACs will not affect any Dutch bonds issued prior to 1 January 2013. At its summit held on 24-25 March 2011, the European Council concluded that all euro area Member States should be allowed, under agreed conditions, to reopen debt issuances outstanding on the date of the CAC's mandatory introduction, in order to preserve market liquidity. Member States agreed that up to 45% of the total face amount of all central government issuance in 2013 may be raised via reopenings (i.e., in securities that do not include CACs). According to the DSTA's 2013 funding plan, the Netherlands will issue about 26% of its capital market funding, or € 13 bln, in bonds that do not contain CACs.

1 http://europa.eu/efc/sub_committee/cac/cac_2012/index_en.htm
2 www.dsta.nl/english/Subjects/CACs

3 Primary and secondary markets

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3.1

Looking Back: Primary Dealers and Single Market Specialists in 2012

Every year, the DSTA appoints Primary Dealers to promote and distribute DSLs and DTCs, and to contribute to the secondary market liquidity of Dutch sovereign securities. Single Market Specialists fulfill a similar task exclusively for DTCs. DSLs are sold to Primary Dealers through tap auctions held by the DSTA. New long-dated benchmark issuances are sold directly to end-investors by means of the Dutch Direct Auction (DDA), with the Primary Dealers acting as intermediaries. DTCs are distributed to both Primary Dealers and Single Market Specialists through regular single-price (Dutch) auctions.

Being a Primary Dealer (PD) entails both rights and obligations. PDs have the exclusive right to buy DSLs in tap auctions from the DSTA. Furthermore, they are entitled to use the DSTA's repo- and strips facilities. The repo facility is available to all DSLs and DTCs. All DSLs can be stripped and reconstituted with the DSTA at a PD's request. An overview of the amount of every DSL that has been stripped is available on the DSTA's website. On the condition that PDs sign the ISDA Master Agreement and meet the minimum requirements of the Credit Support Annex (CSA), they are also entitled to conduct swaps with the Dutch State. The CSA aims to mitigate the DSTA's credit risk.

Compensation in the DDA for all PDs is settled in the form of fees, the size of which depends on the volume of DSLs that a PD is able to place with end-investors. PDs can also receive compensation in the form of a non-competitive bid (non-comp), i.e. the right to buy additional bonds up to 3 days after a tap auction, at the weighted average price of the auction. To qualify for the non-comp, PDs must fulfill their quotation obligations on the secondary market (see section 3.3) and purchase at least 3% of the total nominal amount issued in the relevant tap auction. The maximum amount available for the non-comp is set at 15% of the total amount allocated in the auction. In 2012 (up to and including both taps in November), the total amount issued through the non-comp facility was € 3.1 bln, equal to 5.1% of the total DSL issuance.

Prior to every DDA, three PDs are selected to execute the role of DDA advisor, for which they receive an advisory fee. Full details of the rights and obligations of the PDs can be found in the PD contract and conditions, available on-line at www.dsta.nl.

Ranking 2012

PDs and Single Market Specialists are evaluated periodically with respect to their primary market performance. Since 2012, the performance ranking is based on duration-weighted issuance. The weighting factors and corresponding maturities that were applied in 2012, and which will continue to apply in 2013, are explained in the next section. The top 5 performers in the DSL and the DTC primary markets in 2012 (up to 30 November) are shown below.

Top 5 Primary Dealers for DSLs, *January – November 2012*	
1	ING Bank
2	Rabobank
3	ABN Amro Bank
4	NATIXIS
5	Barclays Capital

Top 5 Primary Dealers and Single Market Specialists for DTCs, *January – November 2012*	
1	ING Bank
2	Commerzbank
3	Rabobank
4	Nomura
5	Citigroup

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3.2

Primary Dealers and Single Market Specialists in 2013

Primary Dealers (PDs) are selected annually for the upcoming calendar year based on a business plan they submit to the DSTA and their performance in the previous year(s). The appointment is effective for one year, starting on 1 January. Financial institutions interested in becoming a Single Market Specialist may apply throughout the year. This open application procedure also applies to Commercial Paper dealers.

The DSTA is proud to present its selection of 16 PDs for 2013. The composition of the PD group has changed slightly in comparison to 2012. There is one newcomer in the group, and one Primary Dealership has been terminated. The DSTA favours some extent of rotation among its group of PDs; this should help to stimulate PDs to remain competitive and improve their performance.

List Primary Dealers for 2013, *in alphabetical order*

ABN Amro Bank	Jefferies
Barclays Capital	NATIXIS
Citigroup	Nomura
Commerzbank	Rabobank
Deutsche Bank	Royal Bank of Canada
Goldman Sachs	Royal Bank of Scotland
HSBC France	Santander GB&M
ING Bank	Société Générale

Primary Dealer ranking method in 2013

While in previous years the ranking was based on nominal volumes purchased, a new duration-weighted ranking method was introduced in 2012. The DSTA believes that a weighted issuance ranking provides more incentives to PDs for achieving a balanced demand for DSLs across the different maturities. Furthermore, the weighted issuance method better reflects the performance and commitment of a PD vis-à-vis the DSTA, given that bonds with a higher duration entail more risk for a bank and face more challenging market circumstances than shorter-dated bonds. Since it is regarded as a success by both the DSTA and the PDs, the new ranking method will be continued in 2013. The weighting factors for a given remaining maturity are unchanged from 2012 and are shown below.

Table 3.1 – Weights for Dutch State Loans by maturity

DSL maturing	Weighting factor
Before 2015	1
In 2015 – 2016	2.5
In 2017 – 2019	5
In 2020 – 2023	8.5
In 2024 – 2034	13
In 2035 – 2042	18

In addition to PDs, the DSTA also appoints a number of Single Market Specialists. Single Market Specialists have the right to participate in the DTC auctions and have market making obligations in the secondary DTC market, together with the PDs. Including the 16 PDs, the promotion and distribution of DTCs is safeguarded by a group of 21 banks.


Grolsch

List of Single Market Specialists for 2013, *in alphabetical order*
BBVA
Crédit Agricole
Credit Suisse
DZ Bank
UBS

Commercial Paper dealers

Since 2007, the Commercial Paper (CP) program has played a substantial role in fulfilling the DSTA's money market funding needs. CP is used to satisfy short-term funding needs in a flexible and cost-efficient way, without interfering with the minimum required volume of the DTC program. Next to issuance in euros, CP is also issued in US Dollars, Swiss Francs, British Pounds and Norwegian Kroner, with the majority in US Dollars.

CP issuance is enabled by a panel of designated dealers, who are responsible for distributing the securities to end-investors. CP is not issued by means of auctions at predetermined dates, but rather on an 'if needed'-basis. Since issuance in broken dates is possible as well, CP has proven successful in attracting new investors with (temporary) excess liquidity. Indicative prices and maturities can be found on the pages of the DSTA on Bloomberg (DSTA06) and Reuters (DSTA06).

List of Commercial Paper dealers for 2013, *in alphabetical order*	
Barclays Capital	ING Bank
Deutsche Bank	Rabobank
Citigroup	Royal Bank of Scotland
Credit Suisse	UBS

3.3 Liquidity in secondary markets

The ability to rapidly exchange an asset into cash at minimum costs constitutes the asset's liquidity. It is commonly defined by three dimensions: market tightness, depth and resiliency. Tightness represents the spread between bid and offer prices, or the transaction costs in the market. Depth measures the size of trades that can be undertaken without influencing the market price. Lastly, resiliency reflects the time it takes for a market to return to normal after a large trade has been transacted.

The global stock market crash in October 1987, and more recently the credit crisis in 2008 and the financial crisis in the euro area, are reminders that market liquidity should not be taken for granted. The DSTA recognises the importance of liquidity in government bond markets. It has several instruments at its disposal specifically to secure and improve market liquidity in the secondary market.

First and most importantly, DSTA is committed to raise outstanding amounts of new 3-, 5- and 10-year DSLs to at least € 15 billion within 12 months of the first issuance. Second, the DSTA commits itself to annually issuing a new 3-year and a new 10-year government bond. This not only ensures a regular supply of new bonds, but also a sufficiently liquid curve out to ten years, which facilitates cross-curve trading. Third, off-the-run bonds are frequently reopened. Reopenings are not only a funding instrument for the DSTA, but also allow the DSTA to help alleviate the inventory problem of older bonds. If a relatively large proportion of bonds is in an inactive buy-and-hold portfolio, a regular fresh supply of these bonds will improve market liquidity.

Furthermore, PDs have quotation obligations to ensure that tradable prices for DTCs and DSLs are available at all times at the tightest possible spreads. The DSTA's market makers have the obligation to quote DSLs and DTCs for at least six hours a day on designated interdealer platforms. They are required to quote against the standard bid-offer spread or within one standard deviation of the average spread quoted by all PDs. Table 3.2 shows the quotation obligations for 2013.

Table 3.2 – Quotation obligations

	Standard b/o spread	Max b/o spread [1]	Minimum quantity
DTCs	4 basis points	4 basis points	€ 10 million
DSLs 1¼ years to 3½ years*	4 cents	Max (4c; π6h + σ6h)**	€ 10 million
DSLs 3½ years to 6½ years*	5 cents	Max (5c; π6h + σ6h)**	€ 10 million
DSLs 6½ years to 13½ years*	7 cents	Max (7c; π6h + σ6h)**	€ 10 million
DSLs 13½ years to 17½ years*	12 cents	Max (12c; π6h + σ6h)**	€ 10 million
DSLs over 17½ years*	20 cents	Max (20c; π6h + σ6h)**	€ 10 million

* remaining maturity
** π6h = average of the PDs 6 best hours quotes, σ6h= standard deviation
1 If the average of the PD quotes is wider than the standard bid-offer spread, the maximum bid-offer spread will be one standard deviation of the average spread of the six best hours quotation of all PDs that have quoted that DSL.

To fulfill their quotation obligation, PDs and SMSs may select a platform of their choice, as long as the platform meets a number of criteria. One of these is transparency: bid- and offer prices must be available to professional investors in real time at 'reasonable commercial terms'. For retail investors, prices must be available free of charge with a maximum delay of 15 minutes. Currently, PDs can fulfill their quotation obligations on MTS, BGC Brokers LP, ICAP Electronic Broking and Eurex Bonds GMBH.

Further supporting liquidity in the DSL and DTC markets is the repo facility that the DSTA makes available to PDs. The repo facility can be used by PDs to obtain DSLs (both off-the-runs and on-the-runs) and DTCs from the DSTA, for instance to cover short positions. This 'lender of last resort' facility does not come free of charge, however: PDs pay a premium of 25 basis points.

Finally, liquidity and tradability of DSLs is enhanced by a strip facility. PDs have access to this facility, allowing them to have a DSL stripped into separate coupon strips and one principal strip by the DSTA (the DSTA can also reconstitute stripped bonds). Information on the amount of DSLs that have been stripped is available in the Monthly report on the DSTA's website.

Bid-offer spreads are one of the indicators of liquidity in a given market. Figure 3.1 shows bid-offer spreads of 10-year bonds for the Netherlands and several other countries (Germany, France and Belgium). Over the course of 2012, the spread narrowed for every country. The bid-offer spread for the German bond is consistently the lowest. This can be explained by the absolute high volume of debt, its benchmark status in the euro area and the availability of the Bund future for hedging purposes. Given the relatively modest volume of outstanding Dutch bond issues, Dutch bid-offer spreads are both relatively narrow and relatively stable, and closest to Germany.

Figure 3.1 – 10-year bid-offer spread (in cents per € 100)

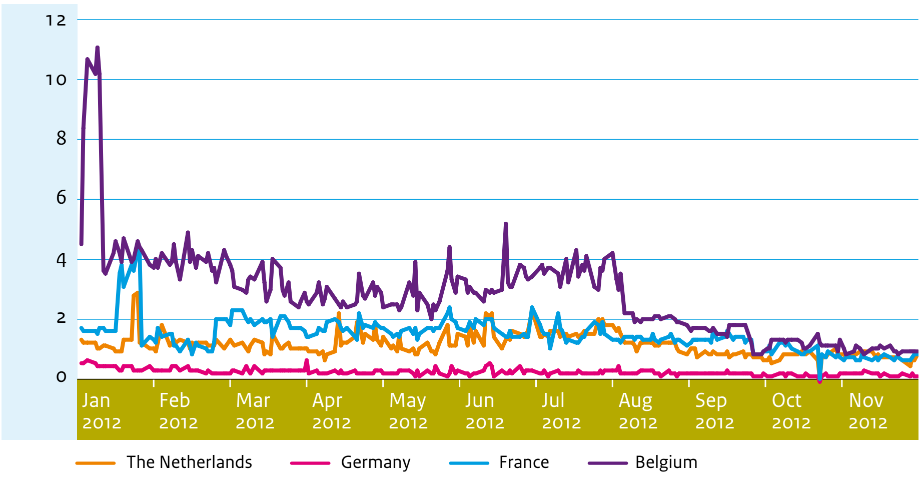
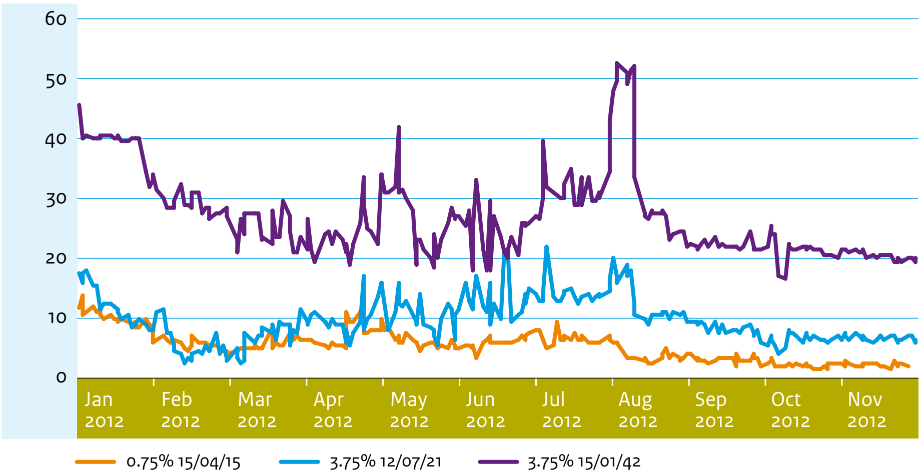


Figure 3.2 shows the development of the bid-offer spread during 2012 for three DSLs with different maturities. After a somewhat volatile first half of the year and a noticeable spike in early August, bid-offer spreads have stabilised at relatively low levels in the second half of 2012. During the year, the bid-offer spreads of the 3- and 10- year DSLs shown in the graph have remained relatively tight, while – as can be expected – the longest bond showed the highest volatility and consistently had the highest spread. Explanatory factors include the somewhat smaller outstanding size of this bond relative to the other two, and the tendency for a higher proportion of long-dated bonds to remain in 'hold-to-maturity' portfolios. Furthermore, market makers seek compensation for the higher interest rate sensitivity of the price of longer dated bonds vis-à-vis shorter dated bonds by increasing the spread. Bid-offer spreads across the different maturities declined towards year-end.

Figure 3.2 – Bid-offer spreads in DSLs of different maturities (in cents per € 100)



Statistical information

1 Interest costs of Central Government debt

In millions of euros

	2011	2012	2013
Interest paid			
Interest cost on fixed debt	9,522	9,740	9,992
Interest cost on floating debt (DTC, CP and other short term borrowing	705	202	242
Total interest costs	**10,227**	**9,942**	**10,234**
Interest received			
Interest received on fixed debt (net interest received on EURIBOR swaps)	0	0	0
Interest received on floating debt*	262	214	113
Total interest received	**262**	**214**	**113**
Net interest costs	**9,965**	**9,729**	**10,121**
Net interest costs in % GDP	1.7%	1.6%	1.6%

* Including interest on the central bank account and the loans to ABN AMRO (formerly Fortis Bank Netherlands)
The results for 2012 are preliminary and based on the 2013 Budget Memorandum (September 2012)
Projections for 2012 are also based on the 2013 Budget Memorandum

2 Changes in long-term debt in 2012

In thousands of euros

Position as at 31 December 2011		**274.837.281**
New issues in 2012		
Public bonds (EUR + USD)	65,663,814	
Private placements	811	
	add	65,664,624
Redemptions in 2012		
Regular redemptions		
Public bonds	29,625,000	
Private placements	4,606,266	
Early redemptions		
Public bonds	1,586,691	
Private placements	15,882	
	less	35,833,840
Position as at 30 November 2012		**304,668,066**

3 Annual interest payments and repayments of principal, 2012-2042

In millions of euros, according to the long-term debt position as at 30-11-2012

	Interest payments	Redemptions
30-11 to 31-12-2012	37	82
2013	9,755	31,803
2014	8,838	31,610
2015	8,063	46,165
2016	7,030	13,471
2017	6,486	33,255
2018	5,367	26,838
2019	4,645	14,129
2020	4,078	15,137
2021	3,545	15,549
2022	3,039	15,337
2023	2,689	14,094
2024	1,911	22
2025	1,908	22
2026	1,907	23
2027	1,905	27
2028	1,903	24
2029	1,186	12
2030	1,185	10
2031	1,185	0
2032	1,185	16
2033	1,183	8,014
2034	983	0
2035	983	0
2036	983	0
2037	983	13,187
2038	455	0
2039	455	0
2040	455	0
2041	455	0
2042	455	12,126
total		**290,952**

4 Interest rate swaps

Position as at 30 November 2012, in millions of euros

Bucket (year of maturity)	Net nominal amount	Pay or receive* (net)
2012	176	Pay
2013	15,061	Pay
2014	15,449	Pay
2015	1,265	Pay
2016	34,439	Pay
2017	16,266	Pay
2018	22,601	Pay
2019	21,406	Pay
2020	15,022	Receive
2021	18,775	Receive
2022	21,823	Receive
2023	2,340	Receive
2026	1,610	Receive
2027	8,350	Receive
2028	3,707	Receive
2032	16	Receive
2033	2,208	Receive
2035	6,010	Receive
2036	1,825	Receive
2037	4,445	Receive
2042	10,586	Receive
2055	33	Receive
Net total	**29,913**	**Pay**

* 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 2012

In thousands of euros

Movements of public bonds in 2012	Total 31-12-2011	Issues	Redemptions	Total 30-11-2012	Isin code
2.50 pct DSL 2009 due 15 January 2012	14,361,000		14,361,000		NL0009041359
5.00 pct DSL 2002 due 15 July 2012	15,264,000		15,264,000		NL0000102671
1.75 pct DSL 2010 due 15 January 2013	15,043,000	495,000	1,585,000	13,953,000	NL0009331461
4.25 pct DSL 2003 due 15 July 2013	15,983,000			15,983,000	NL0000102689
1.00 pct DSL 2011 due 15 January 2014	15,104,000			15,104,000	NL0009690593
3.75 pct DSL 2004 due 15 July 2014	14,324,846	2,024,000		16,348,846	NL0000102325
2.75 pct DSL 2009 due 15 January 2015	15,488,940			15,488,940	NL0009213651
0.75 pct DSL 2012 due 15 April 2015		15,005,000		15,005,000	NL0010055703
3.25 pct DSL 2005 due 15 July 2015	15,109,765			15,109,765	NL0000102242
0.25 pct DSL USD 2012 due 12 September 2015		2,792,722		2,792,722	XS0749484217
4.00 pct DSL 2006 due 15 July 2016	13,311,467			13,311,467	NL0000102283
2.50 pct DSL 2011 due 15 January 2017	8,200,920	7,438,000		15,638,920	NL0009819671
1.00 pct DSL USD 2012 due 24 February 2017		2,511,619		2,511,619	XS0827695361
4.50 pct DSL 2007 due 15 July 2017	14,654,990			14,654,990	NL0006007239
1.25 pct DSL 2012 due 15 January 2018		8,561,425		8,561,425	NL0010200606
4.00 pct DSL 2008 due 15 July 2018	15,081,020			15,081,020	NL0006227316
4.00 pct DSL 2009 due 15 July 2019	14,056,398			14,056,398	NL0009086115
3.50 pct DSL 2010 due 15 July 2020	15,069,615			15,069,615	NL0009348242
3.25 pct DSL 2011 due 15 July 2021	15,493,985			15,493,985	NL0009712470
2.25 pct DSL 2012 due 15 July 2022		15,252,147		15,252,147	NL0010060257
3.75 pct DSL 2006 due 15 January 2023*	10,321,550	305,900		10,627,450	NL0000102275
7.50 pct DSL 1993 due 15 January 2023*	3,747,939		305,900	3,442,039	NL0000102077
5.50 pct DSL 1998 due 15 January 2028	12,143,814	885,000		13,028,814	NL0000102317
2.50 pct DSL 2012 due 15 January 2033		8,013,900		8,013,900	NL0010071189
4.00 pct DSL 2005 due 15 January 2037	12,043,427	1,144,000		13,187,427	NL0000102234
3.75 pct DSL 2010 due 15 January 2042	10,584,910	1,541,000		12,125,910	NL0009446418
2 1/2 pct Grootboek	18,286		1,375	16,911	NL0000006286
3 1/2 pct Grootboek	331		32	299	NL0000002707
3 pct Grootboek	6,777		284	6,492	NL0000004802
	265,413,980	**65,969,714**	**31,517,591**	**299,866,102**	

* The redemption mentioned contains 305,900,000 euro as the result of the conversion of the 3.75% to the 7.5% bond.

6 Short-term debt and eonia swaps in 2012

In millions of euros, movements in 2012

Key figures of T-bills	Total 31-12-11	Issues	Expirations	Total 30-11-12	ISIN-code
DTC 2012-01-31	7,380	-	7,380	-	NL0009798743
DTC 2012-02-29	6,890	-	6,890	-	NL0009822022
DTC 2012-03-30	6,970	2,990	9,960	-	NL0009755867
DTC 2012-04-27	4,020	3,300	7,320	-	NL0009853787
DTC 2012-05-31	1,100	2,160	3,260	-	NL0010022190
DTC 2012-06-29	5,290	3,250	8,540	-	NL0009822030
DTC 2012-07-31	-	3,260	3,260	-	NL0010059978
DTC 2012-08-31	-	3,470	3,470	-	NL0010065983
DTC 2012-09-28	2,210	4,170	6,380	-	NL0009979855
DTC 2012-10-31	-	3,620	3,620	-	NL0010136495
DTC 2012-11-30	-	5,160	5,160	-	NL0010159554
DTC 2012-12-27	-	6,550	-	6,550	NL0010054045
DTC 2013-01-31	-	4,780	-	4,780	NL0010200341
DTC 2013-02-28	-	3,590	-	3,590	NL0010228938
DTC 2013-03-28	-	2,150	-	2,150	NL0010244349
DTC 2013-04-29	-	2,110	-	2,110	NL0010278354
DTC 2013-05-31	-	1,170	-	1,170	NL0010278958
DTC 2013-06-28	-	2,220	-	2,220	NL0010220794
	33,860	**53,950**	**65,240**	**22,570**	

Commercial paper	Total 31-12-11	Issues	Expirations	Total 30-11-12
ECP EUR	2,250	6,252	8,502	-
ECP USD	5,834	60,849	58,717	7,965
ECP GBP	1,502	23,148	24,477	173
ECP CHF	-	51	51	-
ECP NOK	-	3,079	3,079	-
	9,585	**76,527**	**94,251**	**8,138**

Other short-term debt (mainly deposits)	Total 31-12-11	Issues	Expirations	Total 30-11-12
borrow	1,375	171,751	167,161	5,965
lend	-	90,583	90,283	300
	1,375	**81,168**	**76,878**	**5,665**

Eonia swaps (position as at 30 November 2012)

Bucket (year of maturity)	net nominal amount	pay or receive (net)
2012	10,390	Receive
2013	25,340	Receive
	35,730	**Receive**

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DE
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SCHUITJE VAART
RONDVAARTEN

The cut-off date for data in the Outlook 2013 is
30 November 2012, unless otherwise specified

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Highlights of the DSTA Outlook 2013

- Targeted capital market funding in 2013: approx. € 50 bln
- Expected money market volume at year's end (including collateral) approx. € 40 bln
- During the year, the borrowing requirement and funding plan will be updated regularly.
- Quarterly issuance calendars in March, June and September.
- Traditional auction dates: second and fourth Tuesday of month
- Off-the-run facility continued (two auctions, in January and July).
- DTC auctions: first and third Monday every month; two programmes per auction
- Three new DSLs in 2013: 3-year, 5-year and 10-year
- On-the-run 5-year DSL: three reopenings in 2013 to reach target volume of € 15 bln
- On-the-run 20-year DSL: one reopening in 2013 to reach a volume of at least € 10 bln
- Commercial paper in Euros, US Dollars, British Pounds, Swiss francs and Norwegian kroner, maturities up to 1 year.
- A total of 6 auctions in the first of quarter 2012:
  - Launch and reopening of new 3-year: DSL 15 April 2016
  - Two reopenings of on-the-run 1.25% DSL 15 January 2018
  - New 10-year DSL, window for issuance: February/March
  - Off-the-run facility in January
- DDA window for new 5-year: June/July

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