NEWS letter

Centre International pour le Crédit Communal

March 2006, Number 4

The Newsletter contains important information about the affiliated institutions. Among other items, Newsletter contains articles on interesting developments, new products, cooperative ventures and summaries of annual reports. Contributions to the Newsletter are very welcome and should be submitted on disk (preferably in Word for Windows), by e-mail or by fax. Please direct questions and comments regarding the Newsletter to the secretariat.
Tel.: +31 70 3 750 814 or 3 750 820.
E-mail: centre@bng.nl

Contents

Staff Meeting on April 7

Special attention in this edition of the Newsletter to the upcoming events of the International Centre for Local Credit: the Staff Meeting which will be organized by Bank Nederlandse Gemeenten in The Hague on April 7, and the Centre Conference, hosted by Dexia Credit Local on November 16 and 17 in Paris. Both meetings give the opportunity to strengthen the ties between the member institutions.

If representatives of your institution have not applied already for attending the Staff Meeting, I recommend strongly that they will do so as soon as possible, as the topic 'Asset and Liability Management under IFRS' has a great impact for all member institutions.

In the coming months much attention will be given to the website of the Centre in order to make it a tool for intensifying contacts between the member institutions. A contract was signed with a site developer to make a up-to-date website, which will give much more possibilities for the member institutions to present theirselves as well. We 'll keep you informed!

By Pim Vermeulen
Secretary General of the
Centre International pour
le Crédit Communal

Asset & liability management under IFRS to be discussed on Staff Meeting in April 2006

On April 7, Bank Nederlandse Gemeenten will host the ICLC Staff Meeting on the effects of the accounting rules of IFRS on the Asset & Liabilities Management of the member institutions. After an introductionary lecture by Mr. Michel van der Lof, partner at Ernst & Young and a specialist in IAS 39, it is time for the experiences two member institutions have in this respect. Mr. John Reichardt, managing director at BNG, will discuss the way BNG deals with IFRS concerning ALM, while Mr. Ove Bjerkan, head Accounting, middle office and IT of Norges Kommunalbank will present the implications for the communal banks in the Nordic countries.

Since 2005 (most) European banks apply the International Financial Reporting Standards in their accounting. Banks from outside the European Union will switch on a later date, as is the case with Norges Kommunalbank, where IFRS will be implemented from 2007 onwards.

The most striking change of IFRS, compared with most of the local GAAP is the obligation to enter derivatives into the balance sheet at fair value and to present the changes in these fair values in the profit & loss account. But there are many other important issues that might have a huge impact on the profit and loss figures: the rules for recognition or derecognition of assets and liabilities on the balance sheet, the fair value treatment of the 'available for sale assets', the way to handle pension or option plans, the rules concerning impairment of goodwill, an so on.

As a result of this, volatility in profit and loss and in the balance sheet were expected to rise.

In this respect, it is interesting to see what the impact of the change to IFRS on the reported company results has been so far. An analysis of Ernst & Young of the IFRS disclosures of the 20 largest European banks* reveals a mixed picture. Most reports note, that the overall impact is low.

Bank Nederlandse Gemeenten, The Hague

Another common message is, that IFRS has not changed the way banks conduct business, as cash flows are not impacted by accounting changes. In the opinion of Ernst & Young, this ignores the potential impact that IFRS has in areas, such as regulatory capital, and possibly credit ratings, which both have the potential to affect cash flow. We might infer from Ernst & Young's conclusions that banks appear to be succesful in finding ways to fight volatility under IFRS and observe that that banks are not likely to admit they had to change their business because of accounting rules.

Concerning the overall quantitative impact of the transition from local GAAP to IFRS, most reports indicate that the impact of this transition is moderate; but it all seems to be in the same direction: down in reported equity, profit, earnings per share, Tier-1 capital and return on capital.

The negative impact is not necessarily caused by the new standards being more prudent. Much of the negative impact is due to the recognition and measurement requirements for items such as derivatives, pension obligations and equity based compensation, which used to be off balance under local GAAP. In almost all cases, according to Ernst & Young, companies reported a significant decrease in equity, due to the requirement to recognize pension fund deficits. The impact of some, however also could have been positive, depending on the point in the business cycle or the level of asset process. In other words, the effect is an increase in volatility instead of a structurally more prudent way of accounting. In other cases, however, standards are more prudent than the local GAAP. Financial service fees are now recognized as part of the effective yield on an instrument, and therefore, defer revenue

* Ernst & Young, IFRS – The Implications for European Banks, September 2005.

recognition. The loan impairment rules now require discounting of expected future cash flows. The change to tangible asset impairment testing rules require more conservative discounting of cash flows in determination recoverable amounts. Most of the companies reported an increase in loan impairment provisions and a re-measurement of financial assets to take account of deferring fees and commissions, therefore resulting in a decrease of equity, some companies reported a decrease in equity due to the revised 'Day one' profit rules.

The confusion and controversy surrounding IAS 32 (Financial instruments: disclosure and presentation) and IAS 39 (Financial instruments: recognition and measurement) implementation has lead to a variety of different approaches to reporting the impact of the revised financial instruments accounting standards. Adding to this confusion is the EU carve-out version of IAS 39, the key differences being that the EU version does not allow companies to choose to fair value liabilities and the removal of certain paragraphs relating to interest rate margin hedging of a portfolio of core deposits.

It is clear that the IFRS rules have its impact on the policy and decisions concerning Asset & Liability management. That is where the Staff Meeting will concentrate on. Minimizing volatility in the profit and loss account and in equity will in many cases have been one of the starting points in determining a new steering model for ALM purposes. Evaluation of hedging strategies in this respect and against the background of the wish to do business as usual will have been part of the workload. Although every bank have had his own specific problems to solve, the quest for the right hedging strategy, and the decisions that had to be made to get there will be recognizable for many institutions and might hand over useful ideas to others.

Dexia Credit Local host of XXXVth Conference of the International Centre for Local Credit in November

Autumnal Paris will be the setting of the 35th Conference of the International Centre for Local Credit, which will be held on November 16 and 17, 2006.

Host is Dexia Credit Local. For Dexia, this year marks the 10th anniversary of the Dexia Group. Attention to this event is paid on page 5 of the Newsletter. Members will be invited to join the activities on November 15, in the Opéra.

Centre of the conference activities will be the brand new Park Hyatt Hotel in the Rue de la Paix. This hotel will accommodate the guests and has the facilities for the conference meetings.

Central theme of the conference is *Financing local government in a changing environment.*

In the morning programme of November, 16, the environment of the public sector will be the main topic.

On the programme are analyses and presentations of the relevant changes in the macro-economic environment, in which both banks and governments are doing their jobs. The present orientation towards market mechanism, level playing field etc., emerging sectors as biotech and health will be part of the presentation and subject to discussion.

Within this changing environment, the changing role of the public sector is one of the main topics of the afternoon programme. Experiences with the changing roles, but also items like ageing population, migration to the cities and the way the local government has to deal with these developments are on the agenda. The role of the public sector banks in this changing world will be due to changes as well; the change from lenders to partners will be the closing item of the first afternoon session.

After a short break, the developments in the way of financing by government and by the institutions will be the main topic.

On the morning of November 17, Dexia intends to give the floor to high financial and political experts representatives and organize the whole morning as a debate between the (non ICLC)-speakers and the audience.

Lending to municipalities in Portugal

Caixa Geral de Depósitos Lisbon

Credit has been one of the Portuguese municipalities' main sources of revenue for sustaining their endeavours to develop social and cultural infrastructures, as a complement to the funding supplied by the Community Structural Fund and the Social Cohesion Fund or exclusively on their own initiative.

The respective funding or private loans under Community Framework Support have benefited from subsidies provided by the ERDF itself in addition to subsidies from the Portuguese state and in the case of Community Framework Support I (89/93) and Community Framework Support II (93/97) also from Caixa Geral de Depósitos, which was chosen to manage the global subventions especially created by the European Commission to support municipal investment in Portugal, provided, on a fifty-fifty basis, by the European Investment Bank and Caixa.

The Local Finance Law (Law no. 42/98 of 6 August) determines the criteria for establishing municipalities' shares of state budget revenues and defines the rules for allocating the amounts in question to each municipality, via the General Municipal Funds – in which all municipalities share – and Municipal Cohesion Funds, which are only allocated to municipalities with lower social development indices.

The same law defines the limits of municipal indebtedness on the basis of 2 (two) criteria: the annual volume of transfers from the state budget to municipalities and the volume of the preceding year's investment expenditure by the municipality itself, whose annual financial liabilities on medium and long term loans may not exceed 25 per cent and 20 per cent respectively.

Owing to the state's need to control public expenditure and reduce the budget deficit to the levels set out in the European Union's Stability and Growth Pact and notwithstanding the low levels of local activity and expenditure vis-à-vis public administration and the economy in general, as shall be examined in light of data provided by the National Association of Portuguese Municipalities, the said indebtedness ratios have been reduced by 50 per cent since June 2002 and are expected to remain at this level at least up until the time of the state budget for 2006.

The number of employees (136,500), in turn, represented 2.9 per cent of the active working population.

Together with the referred to 50 per cent reduction in debt ratios, the state's 'rectificatory' budget for 2002 also determined zero growth in municipal indebtedness, whose annually defined plafond (€213.1m in 2005) is only allocated on a pro rata basis among the municipalities which have complied with the new ratios and in accordance with their share of municipal funds.

However, starting 2004, loans to ensure the domestic component of public expenditure in Community Framework Support approved projects and ratified by a ministerial ruling, were excluded from the said limits.

In light of such restrictions, there has been a considerable fall in lending to municipalities over the last few years, affecting net income generated by the sector. CGD, notwithstanding, remains the undisputed leading bank in this segment in Portugal, with a market share of 60 per cent.

Reference should be made to the fact that lawmakers in Portugal created legal mechanisms to allow the market to operate transparently and openly, in a fully competitive regime when, in 1991, they enforced a requirement for public consultations with a minimum number of 3 (three) credit institutions/banks in respect of the terms on offer, prior to the approval of all and any loans by the municipal executive and decision-making bodies.

It should also be pointed out that the municipalities have endeavoured to obviate the severe restrictive measures on lending in their search for ever increasingly creative and complex solutions. These include factoring, leasing, renting, loan assignments and the anticipation/securitisation of future revenues, particularly rents from low-cost housing. Such endeavours have been accompanied by Caixa Geral de Depósitos and other banks.

Levels of Municipal Activity in 2002

	GDP	*Public Administration*
Total revenues (€7,634.1m)	5.9%	12.7%
Total expenditure (€7,357.9m)	5.8%	11.9%
Total investment (€2,884.0m)	2.2%	58.2%

Dexia at a glance

Dexia was born of the alliance in 1996 of two major players in local public finance in Europe : Crédit Communal de Belgique and Crédit Local de France. These two institutions, together with Banque Internationale de Luxembourg (BIL), were united in 1999 into one company under the name of Dexia. Today, the group is ranked among the top fifteen banks in the eurozone based on market capitalization.

Its main core business is dedicated to financing public facilities and providing financial services to local governments, Dexia has built its expertise in Belgium and France where its market share is of 80% and 42%, respectively, thanks to continuous financial and technological innovation. It is active mainly in Europe, North America and the Asia-Pacific region and its presence is growing in other parts of the world.

The company acts as a financial adviser, arranger and lender in direct and project financing transactions in the infrastructure, energy and environmental sectors. It serves the financing needs of governments of all size, as well the health sector, low-income housing and the social economy.

To meet the specific capital market needs of the largest public sector issuers, Dexia has developed a specialized offer to give them efficient access to the markets, particularly through bonds issues, securitization vehicles and other creative solutions.

Dexia operates through its American subsidiary, Financial Security Assurance (FSA), to provide financial guarantees in the framework of municipal bond issues, financing of public infrastructure projects and asset-backed securities (ABS). FSA is a major player in each of its markets worldwide.

On January 1st, 2006, the Board of Directors of Dexia, who was chaired by François Narmon until then, has appointed Pierre Richard as Chairman of the Board of Directors and Axel Miller as Managing Director and Chairman of the Group Management Board.

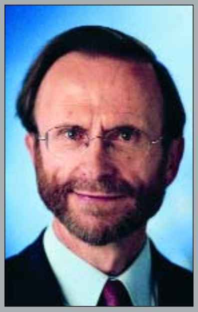
A new structure for the operational organization of the Dexia Group was also set up on January 1st, 2006. It is built on the following lines :

- a Group Management Board of 5 members, among whom Axel Miller (chairman) and Jacques Guerber (vice-chairman);
- a 12-member Group Executive Committee composed of the 5 members of the Group Management Board and the 7 group divisions Managing Directors. Bruno Deletré has been appointed, Group Managing Director, Head of the Public & Project Finance & Credit Enhancement division;
- Gérard Bayol has been appointed Chairman of the Executive Committee of the operational entity Dexia Crédit Local and Philippe Valletoux vice-chairman.

Alex Miller

Bruno Deletré

Gérard Bayol



Pierre Richard

Contacts

Christophe Chouleur, *Deputy Senior Manager Group Communications*
Jean-Pierre Deleva, *Group communication*
Marie-Alice Lallemand Flucher, *Head of Communication, Dexia Crédit Local*

Beginning with this newsletter, we will publish on a regular base economic forecasts from one of the member institutions. The first in this serie is the recent forecast by DekaBank. If you are interested to publish your forecast in the next newsletter, please have contact with the ICLC secretariat for deadlines etc.

DekaBank, Economics Department, *January 22, 2006, updated February 24, 2006*

Regions in focus

USA

In the fourth quarter of 2005 the US economy showed a mere 1.6% growth, which can be attributed primarily to the stagnation of private consumption. In the wake of the successful discount campaigns conducted by automobile manufacturers towards the end of the summer their sales collapsed at the beginning of the quarter, which weakened consumption temporarily.

However, the figures for December show that it has now recovered and returned to previous levels. The growth of employment in December proved somewhat disappointing, with an increase of only 108,000 new jobs.

However, the week in which the data were gathered was exceptionally cold, which may have given the figures a downward bias. Nevertheless, the growth of household incomes in the near future should be so dynamic that consumption will also recuperate. The mood of the corporate sector remains positive: although the ISM purchasing managers' index for the manufacturing sector has fallen, at over 54 points it remains quite clearly in the expansive range. The ISM index for the non-manufacturing sector is stable at around 60 points; this signals dynamic growth and leads us to suppose that the US economy will remain on its robust expansion path in the foreseeable future.

The slowdown in the rate of inflation at the end of 2005 was due primarily to the fall in the price of gasoline and must therefore be regarded as temporary. We expect another substantial rise in the price of gasoline in the first months of 2006, which will push up the annual rate of inflation to around 4%.

In addition there will be a gradual increase in the rate of core inflation in the first half of the year. This will be a clear indication that the tightening of monetary policy has so far had little impact on the rise of consumer prices. Although the minutes of the Fed's meeting and its statement on the latest interest-rate decision have been interpreted by the markets as a sign that an end to the cycle of interest-rate hikes is now in sight, we maintain our forecast and expect the Fed to raise key rates to a level of 5% by May in steps of 25 basis points.

Euro Zone

In the fourth quarter of 2005, euro zone growth did not meet expectations. However, the positive trend reflected by indicators of market sentiment confirms that future prospects are good. Moreover, the increase in value-added tax planned in Germany for 2007 will have a stimulating impact by providing an incentive for consumers to bring forward their purchases.

In 2005 exports were the main pillar supporting growth and the dynamic development of the global economy will provide a further stimulus for German exports in the first half of 2006.

In 2007, however, the German economy will suffer a substantial slump. On the one hand, the increase in demand for goods as a result of the expected increase in value-added tax will disappear; on the other hand, the weaker growth of the global economy will dampen domestic growth.

At its press conference in January the ECB left the door wide open for further interest-rate hikes in the future. In view of the stable economy everything points to a rise in key rates of 25 basis points in March. We expect rates to be raised again in August to a level of 2.75%.

United Kingdom

By the end of 2005 the service sector had staged a recovery but for the manufacturing sector there is still no light at the end of the tunnel. Both employment and the supply of labour have increased and average earnings are rising at a rate of around 4%, which means that private consumers are in a position to step up their expenditures. However, without the support of ever-rising housing prices the growth rate of the British economy will be lower than in the past decade. Only in the course of 2007 will it be possible to close the output gap.

We do expect the Bank of England to lower interest rates in May 2006, as inflation is quite close to the BoE's target and will probably weaken.

Japan

Japan's economic situation has been steadily improving and the country is now on course to move onto a sustained higher growth path, as the GDP growth of 5,5% (qoq;ann.) showed. This development has been driven primarily by domestic demand. It is evident that not only has corporate sentiment improved, but both investment plans and profit expectations now point to robust investment activity in the next few quarters.

In November the core inflation rate rose for the first time since October 2003. Moreover, there are further indicators, in particular the volume of credit granted, which clearly reflect the gradual progress the government's reflationary policies have achieved. In he months to come the Bank of Japan must convince the markets that a transition from its policy of quantitative easing of the monetary reins to a pure zero-rate policy does not signify a change in the way monetary policy will function. With effect from the second quarter of 2006 at the earliest, we expect the BoJ to begin to gradually reduce the supply of liquidity to the minimum reserve volume. The zero-rate policy is only likely to come to an end in the first half of 2007.

Emerging Markets

In central Europe economic prospects for 2006 are good, thanks to buoyant growth, moderate inflation and stable currencies. After only three months in power Poland's new PiS minority government has brought about change in the Minstry of Finance and Zyta Gilowska has raised hopes of a more robust budget policy. In Ukraine the controversial Gasprom deal has had parliamentary repercussions: the motion of no confidence against Prime Minister Juri Jechanurow was approved by a majority and according to the opinion polls the outcome of the resulting general election in March is wide open. In spite of the growing number of infections reported in Turkey, we do not expect the spread of avian influenza to have any serious economic impact.

In Brazil and Mexico weak growth in the second half of 2005 and good inflation prospects will make it possible to continue the cycle of interest-rate cuts. Economic recovery has been underpinned by a more expansive monetary policy and increasing government expenditure. Thanks to the sustained high prices of raw materials Latin America as a whole will enjoy high current-account surpluses in the months to come, which considerably reduces the danger of a liquidity crisis at election time. In Asia both South Korea and India have joined China as engines of growth, which will contribute to greater economic stability in the region as a whole.

MARKETS

Bonds

The yields on 10-year government bonds in the USA have risen substantially since the beginning of the year. The raising of the FED-funds rate to a level of 5% has already been factored in most prices. Nevertheless, we still believe that capital market yields will have risen significantly by the middle of the year. The reason for this is that the American economy will prove more robust and the need for interest-rate hikes will be greater than the market's expectations that have been factored into prices.

In recent weeks yields on the capital market in the euro zone have no longer followed the increased factoring of expected interest-rate hikes at the short end of the interest rate curve, with the result that the curve has flattened. However, we still consider the real yields on the euro-zone bond market to be too low, especially in comparison with the equity market. An alignment of the yields of both asset classes should lead in the medium term to rising equity prices and a slight rise in bond yields. In February the spread on the Emerging Markets Bond Index Global (EMBIG) sank to an all-time low of 200 basis points. New issues launched by Brazil, the Philippines, Turkey and Hungary were well received.

Many newly industrialising countries have already covered their financing needs for 2006. We believe there will be further upgrades by the rating agencies this year. In the next three months we expect EMBIG spreads to move sideways.

Currencies

The growing uncertainty in the final phase of the Fed's cycle of interest-rate hikes has resulted in a marked depreciation of the US dollar. At the same time as the Fed has been issuing rather soothing minutes of its meetings, the publication of favourable economic data for the euro zone have added oil to the fire of the ECB's rhetoric in favour of interest-rate hikes. We assume that if, as we expect, the cycle of interest-rate hikes comes to an end, the US dollar will lose a vital support. In the medium term, moreover, the attention of the markets will be focused increasingly upon the imbalances in the US economy, so that we maintain our expectations of a dollar depreciation. Our 3-month EUR-USD forecast is 1.16 USD.

Commodities

At the beginning of 2006 the weak phase on the oil market promptly came to an end. Participants on the oil market have been plunged into a state of uncertainty by both the dispute between Russia and Ukraine over gas and the renewed escalation in the dispute with Iran over atomic energy. In a market environment that is already strained, doubts with regard to the reliability of Russia as an oil exporter and fears of delivery failures on the part of Iran could very quickly result in renewed hefty price hikes.

Changes in management DekaBank

From January 1, 2006, Franz S. Waas (44) is the new president of the management board of DekaBank. He was member of the management board of HSH Nordbank AG, and responsible for the activities on the domestic and foreign capital markets, and for the acivities concerning private equity.

Also from January 1, 2006 Mr. Oliver Behrens (41) has been appointed as member of the management board. He was global head for structured products as well for money market product and short-term fixed interest loans. Dr. Peter Mathis, representative for DekaBank in the executive committee of the International Centre for Local Credit, has resigned.

Managing director Kommunekreditt Norges AS retires

On January 1, 2006, Mr. Bjarne Jensen, managing director of Kommunekreditt Norge AS, went into retirement. He was managing director since the start of Kommunekreditt in 1993. His place has been taken by Mr. Anulf Arnøy. Mr. Arnøy (49) has been vice chairman of the board of directors of Kommunekreditt since 1999. Since 1991, he is active at Eksportfinans ASA, Norway's third biggest lending institution and 100 % owner of Kommunekreditt. He had a number of leading jobs; the latest is executive vice president and leader of the export lending department in 2004 and 2005. He is member of the executive board of Eksportfinans since 1999, and from 2005 on also deputy for the president end CEO of Eksportfinans.

Address

Centre International pour
le Crédit Communal
P.O. Box 30305
2500 GH The Hague
The Netherlands
tel.:+31 70 3750 814/820
fax:+31 70 3750 406
www.centre-international.com
e-mail: Centre@bng.nl

Dexia Study shows important role of local government in European Union

By using five indicators (expenditure, investments, taxes, budget and debt), Dexia Bank made an inquiry into the financial position of the local governments of the European Union between 1999 and 2004. Furthermore, the main topics for 2005 were highlighted.

In the 25 countries of the European Union, 90.500 local governments exist. Their expenses amounted in 2004 1,315 billion Euro, that is 12.7 per cent of the European GDP. They confirm their role as the largest public investor category, as they are responsible for almost two thirds of the total public investments.

Taking the local budgets of the 15 'old' member states into consideration, Dexia reports an increase in current expenditure in 2004 with 3.7 percent to 1,259 billion euro. Main reasons for this increase are the expenses for health care and social welfare. In the period 1999-2004 the average annual increase amounted to 4.5 per cent, well above the average 1.9 per cent growth of the GDP, and the 2.0 per cent increase of the expenses of the total public sector.

In the United Kingdom, Ireland and Greece, a substantial rise in local investments were an important factor, due to the ambition to upgrade the quality of public facilites (UK) and under the influence of substantial European subsidies (Greece, Ireland). The development of local expenses in the Netherlands, Portugal, Germany and Austria lagged behind the EU average.

For 2005, Dexia expects that expenditure of local government in the UK will have been solid again. France and Portugal will also have seen a substantial rise, due to transfer of tasks and municipal elections. Italy on the other hand, will have seen hardly an increase due to the boundaries set by the internal stability pact.

The investments in the EU-15 in 2004, though, showed just a moderate increase, 1.5 per cent to 149 billion Euro. Leader is Greece, as a result of the investments on behalf of the Olympic Games in Athens. In seven countries investments declined. The development of the investments is influenced by the increasing role of Public-Private-Partnerships, notably in Spain and Austria. The 10 'new' member states did better, with an increase of 3.4 per cent in 2004. Investment needs will remain substantial, Dexia reports.

As in 2004, 2005 will have seen substantial investments in public transport in the United Kingdom. Therefore investment level will remain high over there.

Tax income in EU-15 rose in 2004 with 5,3 percent to an amount of 467 billion Euro. Between 1999 and 2004 the average increase was 4.8 per cent.Transfer of taxes as replacement for state grants or as compensation for new tasks , as specifically was the case in Spain, are the main reason. In this context, the Dutch government made a remarkable decision to skip from 2006 on part of the taxation power of municipalities on real estate and replace it by a increase of the general grant by the state.

The budget of the local governments in EU-15 are almost in balance. In 2004 the deficit amounted to 22 billion Euro, 0.22 per cent GDP. In Italy deficit showed a sharp rise in 2004, as a result of increasing regional expenditure for health care in combination with with the development in local income, that almost came to a standstill. GDP The deficitin the EU-10 was almost negligible.

The total debt of the local public sector in the EU-15 at the end of 2004 was 572 billion Euro, 5.8 per cent of the total GDP and 9 per cent of the total public debt of the member states. In Austria, the Netherlands, France and United Kingdom, local debt declined in the period 1999-2004. In the EU-10 indebtness of local government rose substantially, but is still lower than in the EU-15. Many member states of the EU have rules to prevent local government from having excessive high budget deficits and/or debts.