



II

ANNUAL REPORT 2002



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2 OTHER BCL FINANCIAL ACTIVITIES

2.1 Monetary policy operations

In the Grand Duchy, the BCL is in charge of the execution of the monetary policy formulated by the ECB for the whole euro area.

To implement monetary policy decisions the BCL carries out a certain number of open market operations with its counterparties -credit institutions- forming the Luxembourg financial centre.

Open market operations are divided into:

- main refinancing operations -MRO- which are conducted through weekly standard tenders and have a maturity of two weeks,
- longer-term refinancing operations -LTRO- which are executed through monthly standard tenders and have a maturity of three months.

In 2002, 86.8% of the banking liquidity was provided through MROs.

The BCL ensures the implementation of the Eurosystem's minimum reserves requirements. This system, introduced on 1st January 1999, day of the official euro launch, is applicable to all the banks of the Luxembourg financial centre, whatever their legal form or geographic origin.

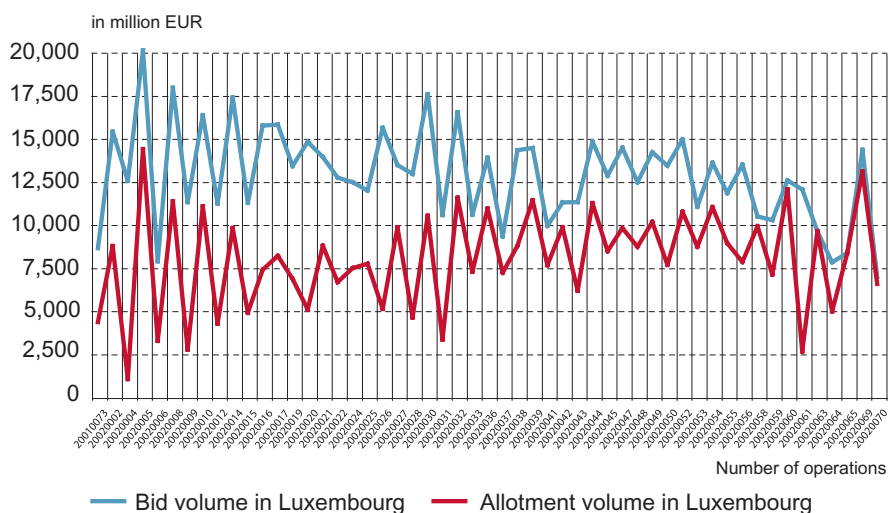
The minimum reserve requirement for banking institutions aims at stabilising interest rates in the money market and, if necessary, may create or increase a structural liquidity deficit.

- The main refinancing operations

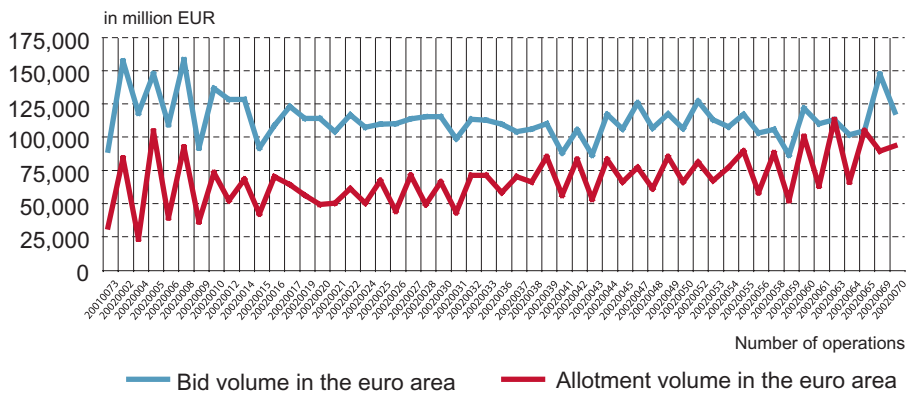
Since 28 June 2000, the MROs of the Eurosystem are conducted as variable rate tenders, using the multiple rate auction technique. The ECB sets the minimum bid rate for these operations, thereby signalling the monetary policy stance.

The background for this decision was the severe overbidding problem which occurred under the fixed rate tender procedure until June 2000. In 2002, the allotment ratio (i.e. the ratio between the amount allotted in the tender and the total amount of bids) averaged 59.3%.

GRAPH 1 MRO 2002 - BID AND ALLOTMENT VOLUME IN LUXEMBOURG

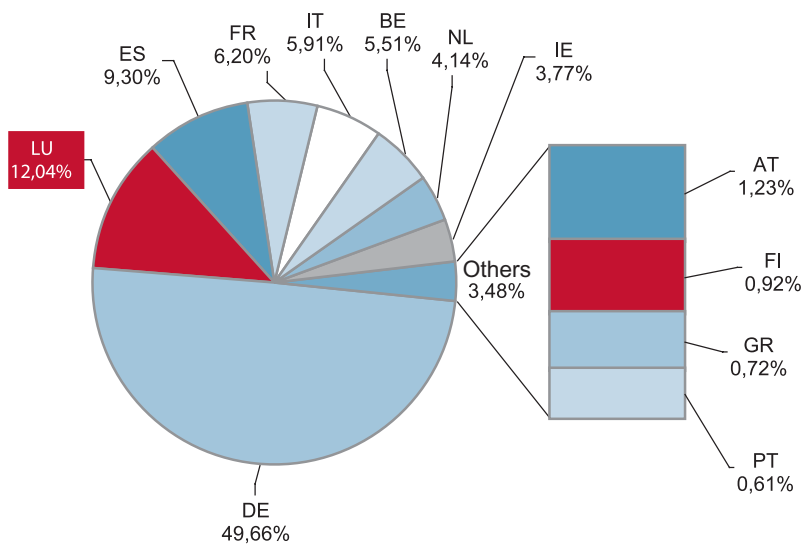


GRAPH 2 MRO 2002 - BID AND ALLOTMENT VOLUME IN THE EURO AREA



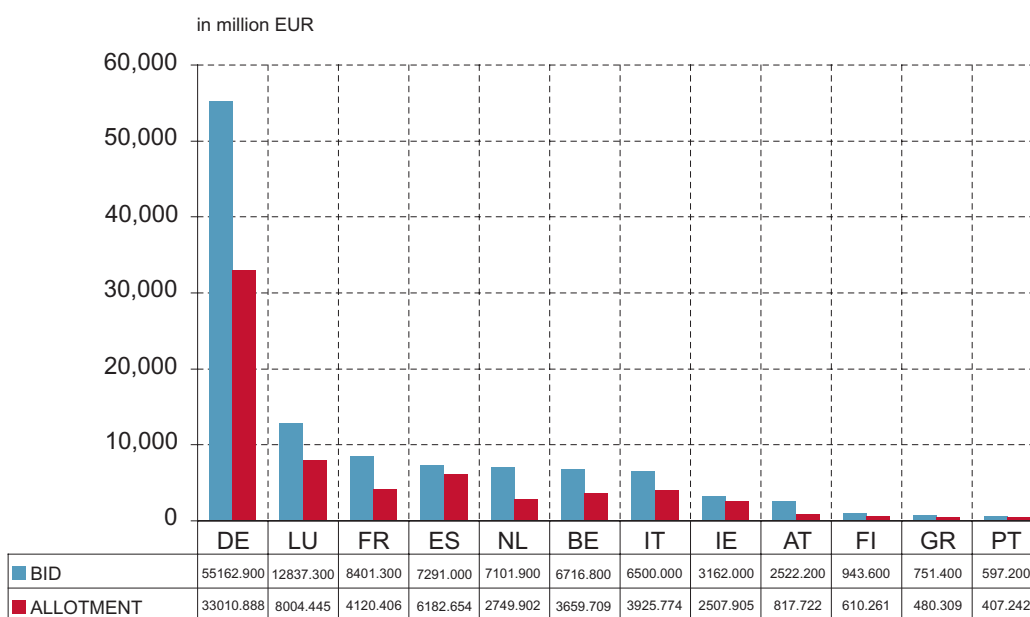
With regards to the allotment volume in the whole euro area, Luxembourg ranked, on average, on the second place. Overall, Luxembourg ranked in the second place in 2002 as it did in 2001 behind Germany, leading to the conclusion that Luxembourg is an important financial place in monetary markets.

GRAPH 3 MRO 2002 - AVERAGE ALLOTMENT VOLUME IN THE EURO AREA



Compared to 2001, the average percentage allotted to Luxembourg in 2002 increased from 9.9% to 12%.

GRAPH 4 MRO 2002 - AVERAGE BID AND ALLOTMENT VOLUME IN THE EURO AREA

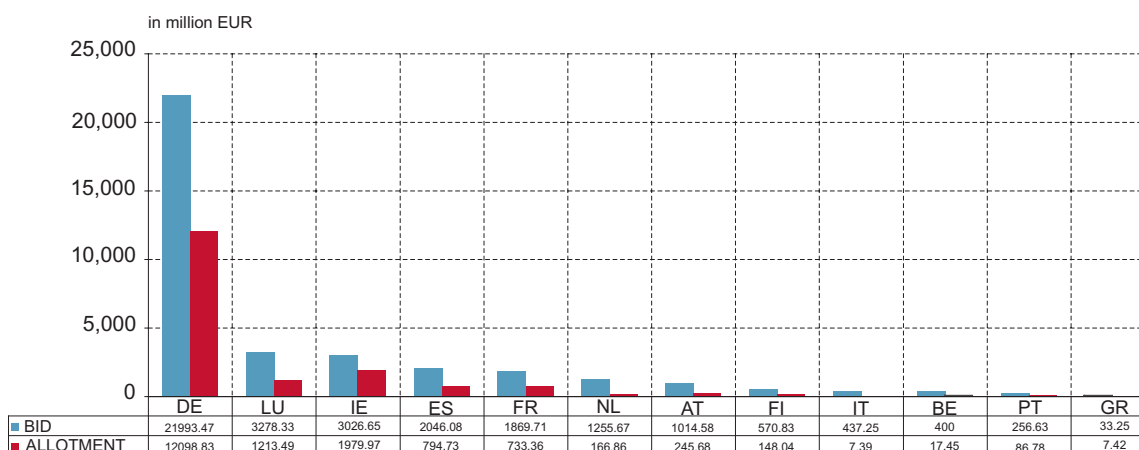


Compared to 2001, the average number of participating counterparties in MROs decreased from 21.4 to 18.2. This situation was also observed in the whole euro area (from 404.4 to 306.8). The decrease of the number of counterparties can be explained by the mergers and acquisition phenomenon in the banking sector.

- The longer-term refinancing operations

With regards to the allotment volume in the whole euro area, Luxembourg on average ranked on the second place in 2002. Overall, Luxembourg ranked on the third place for the year 2002. The average number of counterparties remained stable at 10.8.

GRAPH 5 LTRO 2002 - AVERAGE BID AND ALLOTMENT VOLUME IN THE EURO AREA



As in 2001, the Governing Council decided to allot 20 billion euros for each LTRO during the first half

of 2002. In June 2002, the Governing Council decided to shift the allotment volume to 15 billion euros for LTROs of the second half of 2002. This decision was taken regarding the development of autonomous factors, especially the impact of cash changeover. The revised amount took into account the banking need for liquidity for the second half of 2002.

In September 2002, the Governing Council also discussed the possibility of suppressing the LTRO. This measure was proposed in a public consultation held at the ECB on 8 October 2002 with some other technical measures in order to improve the efficiency of the operational framework of monetary policy. These operations meeting Eurosystem counterparties requirements in liquidity management, the Governing Council decided to maintain the LTRO and to keep the allotment volume at 15 billion euros per auction in 2003.

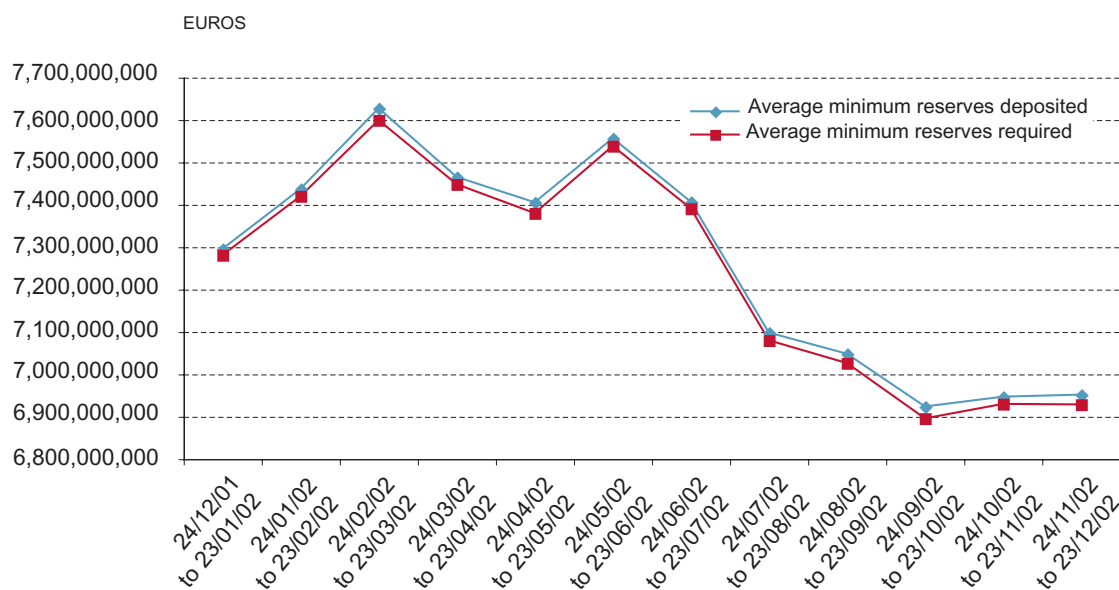
- Fine-tuning operations

Following the introduction of the fiduciary euro, autonomous factors -especially banknotes- in the euro area showed a high degree of volatility. In order to re-establish the liquidity situation the ECB executed two fine-tuning operations on 4 and 10 January, 2002. On 18 December 2002 the ECB also launched a fine-tuning operation in order to reduce market tensions resulting from the underbidding in the last refinancing operation during the minimum reserves period.

- The minimum reserves system

In 2002, the average amount of minimum reserves held by credit institutions in Luxembourg was estimated at 7.3 billion euros.

GRAPH 6 DEVELOPMENT OF THE AVERAGE REQUIRED AND DEPOSITED MINIMUM RESERVES



The deposited amounts are remunerated at the average MRO rate of the ECB during the maintenance period.

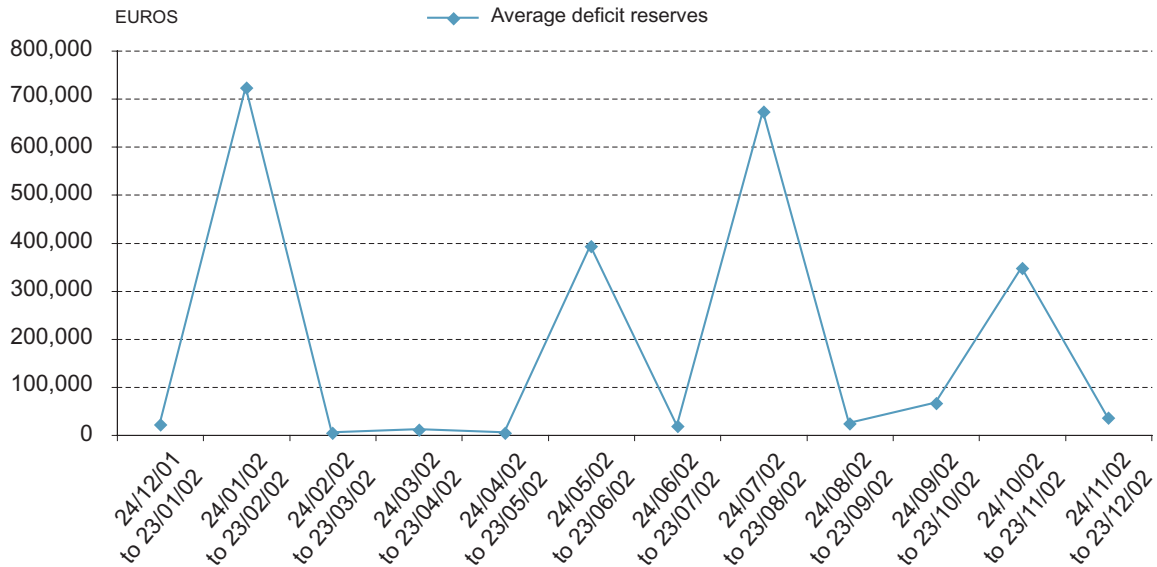
Evolution of the remuneration rate in 2002

Period	1	2	3	4	5	6	7	8	9	10	11	12
Rate (%)	3.34	3.30	3.28	3.30	3.30	3.33	3.32	3.29	3.28	3.28	3.28	3.06

In 2002, the rates at which minimum reserves were remunerated passed from 3.34% to 3.06%.

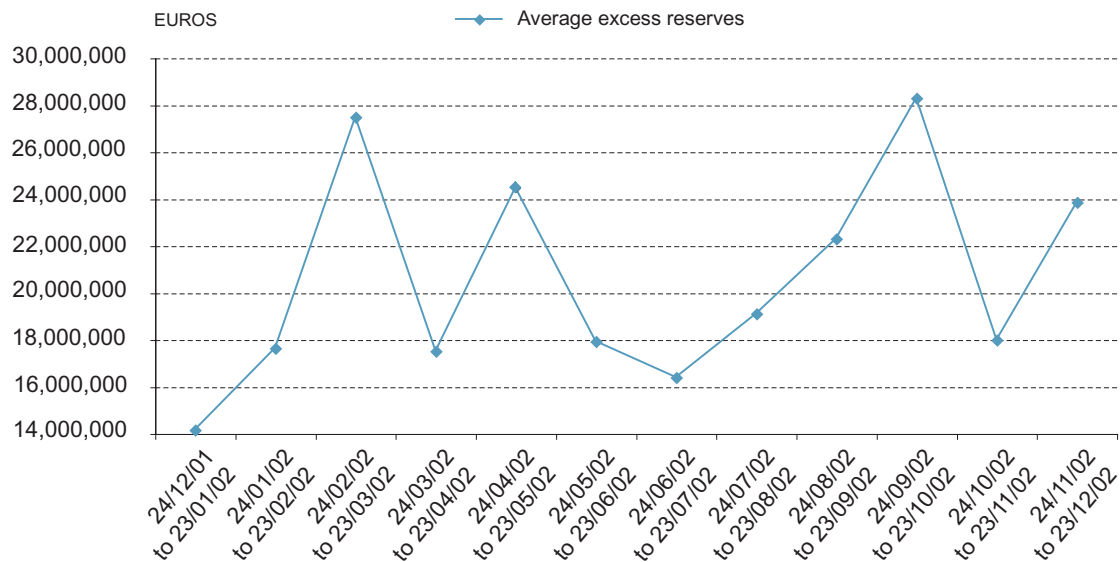
It is noteworthy that 17 sanctions for not respecting minimum reserve requirements have been paid in 2002 in comparison to 16 in 2001.

GRAPH 7 DEVELOPMENT OF AVERAGE DEFICIT RESERVES



Penalties for not respecting minimum reserve requirements remained at a high level during the whole year.

GRAPH 8 DEVELOPMENT OF AVERAGE EXCESS RESERVES



Excess of minimum reserves -that are not remunerated- remained at a high level during the whole year.

2.2 Foreign exchange reserves management by the BCL

According to the Statute of ESCB, the BCL, as a full member of the System, had to contribute to the ECB's capital. As a result, it transferred an amount of € 74.6 m in foreign exchange assets, corresponding to 0.1492% of the ECB's capital. The ECB's foreign exchange reserves are managed in a decentralised way by NCB's including the BCL since September 1999. On 31 December 2002, the total market value (accrued interest included) owned by the BCL corresponded to € 78.6 million. One of the objectives of the foreign exchange reserves management of the ECB is to make sure that, if necessary, the ECB has sufficient liquidities available to intervene in the foreign exchange markets.

Security and liquidity are therefore basic requirements for the management of these reserves. The tactical benchmark is set up by taking the strategic benchmark into account for each currency. It reflects the ECB's medium term preference as regards revenue and risk with reference to market conditions.

A modification of the tactical benchmark may affect different risk categories (e.g. modified duration or liquidity risk). The modified maturity of the tactical benchmark may differ from the modified maturity of the strategic benchmark in the context of fluctuation margins announced in advance by the ECB.

In the management of this portfolio, the first task of the BCL is to invest the foreign exchange reserves on behalf of the ECB within the foreseen fluctuation margins and fixed risk limits and to maximise revenue. The amount of gold assets managed actively is set by the ECB, taking into account strategic considerations as well as market conditions.

2.3 The management of BCL's assets

The management of the BCL's own assets is performed in accordance with ECB principles. The investment policy underlying the management of the assets is based on the following criteria:

- cautious investment approach;
- fundamental macroeconomic analysis;
- organisation of the portfolio scheme;
- choice of the investment decisions;
- thorough control and well calculated risk-taking.

The BCL's investment policy aims at achieving the following goals: generate regular high incomes and provide in the long term a lasting return on investment by taking into account various considerations such as capital security, stability of the securities and liquidity subject to investment.

For that reason and with respect to the principle of equal risk distribution, the BCL implements a proactive, progressive and matching investment policy based on modern portfolio theory.

The bulk of BCL's own assets is invested in fixed income securities denominated in euro. Yet, the BCL's strategic orientation allows a diversification to other categories of assets.

The investment policy committee has to define the investment policy of the BCL's financial resources. Taking into account goals and constraints on an annual basis, the committee sets a strategic orientation for the portfolio management by defining an appropriate framework for the investment policy and the determination of the strategic benchmark oriented towards revenue collection and performance calculation. The management committee is in charge of the tactical allocation and defines the main thrust of investment. The tactical benchmark is set up according to the strategic benchmark, taking into account fluctuation margins. The attention is put on the tactical investment strategy in the short term.

Given that the portfolios are exclusively invested in euro, investment decisions are made by taking into account:

- the interest rate risks (average portfolio duration, yield curve position);
- the risk degree of markets (chosen sectors, portfolio asset selection according to a given security and, to a lesser extent, to the geographic distribution by country).

Investment decisions are taken on the basis of technical and fundamental analysis, as well as on quantitative assessments. The management committee's role is to define reference factors that guide the management of the bank's assets, to follow the investments up, to review the strategy and the



realised performance. Standard external benchmarks allow a regular comparison of performance.

The cautious investment approach takes into account:

- the analysis of the different (country) economies and international financial markets;
- the allocation decision of the assets under management by appreciating the investment returns on the different international markets;
- the definition of a clear strategy;
- the capital value preservation of the assets under management by a policy of risk diversification and the maintenance of a particular quality demand of investment;
- the applying of strict risk control measures.

“Liquidity Portfolio”

The first goal of this operational portfolio is to provide liquidity to face up to cash-flow fluctuations. The instruments used are mainly short-term interbank deposits, CDs, commercial papers, transfer and retrocession operations and the purchase of variable rate bonds.

“Investment Portfolios”

The main goal of this investment portfolio is to maximise yield while taking into account particular demand as regards risk, revenue and liquidity. As of 31 December 2002, the total market value (accrued interest included) represented € 1 221.6 million.

TABLE 1 ASSETS ALLOCATION AS OF 31 DECEMBER 2002

Maturity	Portfolio
0-1 year	51%
1-3 years	21%
3-5 years	14%
5-10 years	14%

In 2002, a big part of the BCL's own funds has been invested in long-term bonds, given that market conditions for that kind of investment were favourable. Around the end of the year, however, the underlying duration of the portfolio has been reduced.

It is worth noting that the securities included in this portfolio are largely diversified according to the geographic location and credit risk of the issuer. Counterparties and credit risk limits are regularly set up and checked by the risk management team.

“Outright Portfolio”

Several securities of this investment portfolio are used for outright transactions. Outright open market transactions refer to operations where the Eurosystem buys or sells assets outright in the market (spot or forward). Outright open market operations are executed only for structural and fine-tuning purposes, i.e.:

- for these open market operations which the Eurosystem carries out primarily in order to manage the structural liquidity situation in the market;
- for these open market operations which the Eurosystem carries out on a non-regular basis in order to face unexpected liquidity fluctuations.

“Pension Fund Portfolio”

The management of this fund is described further under chapter VIII, section 2.4.

“Institutional Portfolios”

The BCL provides discretionary asset management services to public institutional clients and other central banks.

2.4 Banknotes and circulation of fiduciary money

In 2002, the introduction of euro coins and banknotes in Luxembourg was a great success thanks to the excellent cooperation of all those involved and to its acceptance by the public. For the BCL, 2002 also represented a normalisation concerning the management of fiduciary money. Because of the return of the Luxembourg coins and banknotes and of the legacy currencies of the other participating Member States, the first quarter was busy. The level of activity, however, has stabilised to a more sustained rhythm in comparison to the situation prevailing before the introduction of the euro coins and banknotes. This is due to the increased volume of coins and banknotes that have to be processed and the supplementary efforts to be made for the organisation of the production.

As the other NCBs of the Eurosystem, the BCL has assumed its responsibilities for the organisation of the production and the management of the quality of the euro banknotes. In order to facilitate the management of the quality of the banknotes and to reduce the number of specialised printing works, the ECB has put in place a pooled production scheme which is nevertheless implemented in a decentralised manner. According to this scheme, the needs of the participating NCBs are aggregated by the ECB and the production of one denomination is afterwards assigned to at most two NCBs. In 2002, the BCL was responsible for, according to a strict delivery schedule, the production of 30 million 100-euro banknotes, for seven different NCBs, among which was of course the BCL. The production of these banknotes has been entrusted to the specialized printing works of Setec Oy established in Finland near Helsinki.

2.4.1 Evolution of the circulation of currency

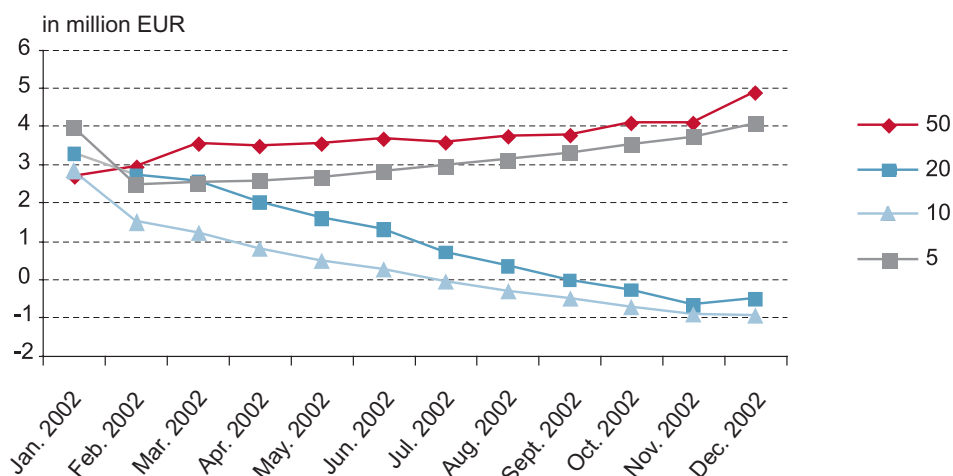
2.4.1.1 Euro coins and banknotes

The volume of euro coins and banknotes put into circulation by the BCL does not necessarily correspond to the volume effectively in circulation in Luxembourg, i.e. those used in the payment systems in Luxembourg. The reason therefore is the migration of euro banknotes and coins inside the euro area.

In 2002, the total volume of euro banknotes put into circulation by the BCL amounts to 23.78 million banknotes (frontloading excluded) and thus increased by 158% in comparison to the volumes frontloaded. At the end of July 2002, the volume of the 10-euro banknotes put into circulation by the BCL became negative, i.e. credit institutions, which are BCL clients, deposited more banknotes than they have withdrawn from the BCL. This phenomenon can be explained by the fact that tourists and cross border workers massively brought this denomination to pay their everyday transactions in Luxembourg. The same situation appeared as from the end of September for the 20-euro denomination.

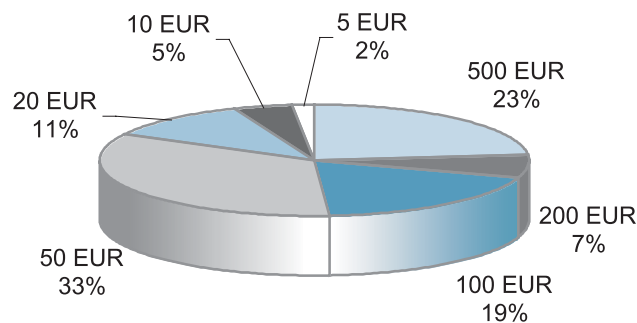
The graph below illustrates the divergent evolution in the volume of the denominations mainly used in everyday transactions:

GRAPH 9 EVOLUTION OF THE NUMBER OF CERTAIN EURO BANKNOTE DENOMINATIONS PUT INTO CIRCULATION BY THE BCL



In comparison with the whole euro area, the BCL has increased its contribution to the total volume of banknotes put into circulation by the Eurosystem, passing from 0.22% in January to 0.47% in December 2002. In Luxembourg and in the euro area, the first months of 2002 have been characterised by a massive demand of lower denominations for settling everyday transactions. Subsequently, a renewed interest for higher denominations, also used for hoarding purposes, became apparent and this development can be seen as a sign of trust in the new currency. The total value of euro banknotes put into circulation by the Eurosystem amounts to 358.54 billion euro at the end of 2002 and the following total value breakdown per denomination was as follows:

GRAPH 10 BREAKDOWN OF THE VALUE OF EURO BANKNOTES PUT INTO CIRCULATION BY THE EUROSYSTEM PER DENOMINATION

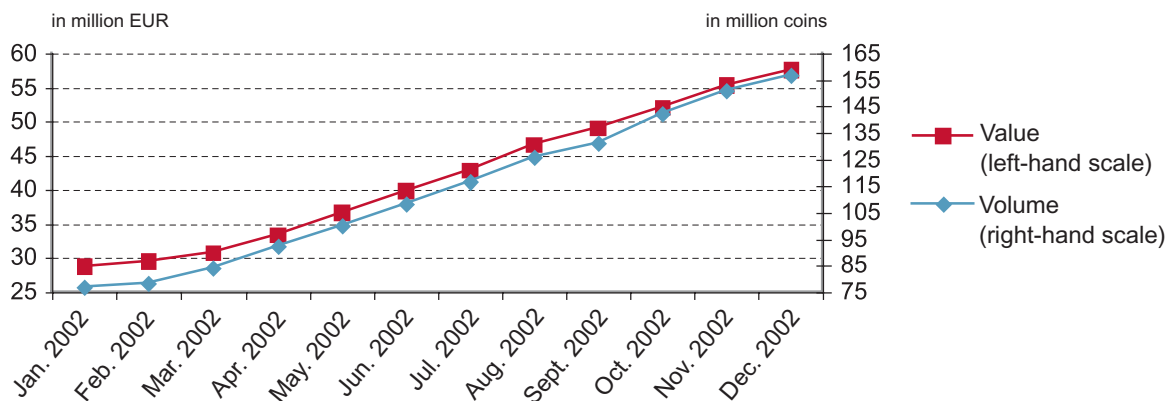


The value of banknotes put into circulation by the Eurosystem during 2002 has increased by 167% in comparison to the situation as of 31 December 2001 (frontloading), that is to say an increase of more than 225 billion euro.

The Luxembourg euro coins have also been subject to an important demand of the Luxembourg and foreign public. After a frontloading of 69.69 million coins at the end of 2001, 157.07 million Luxembourg coins were in circulation at the end of 2002 representing a total value of 57.65 million euro. This volume represents a weight of 764 tons of coins, which statistically represents 356 coins per inhabitant or a weight of 1.73 kg coins per inhabitant. The Luxembourg euro coins have been subject to an important demand coming from collectors from the entire world.

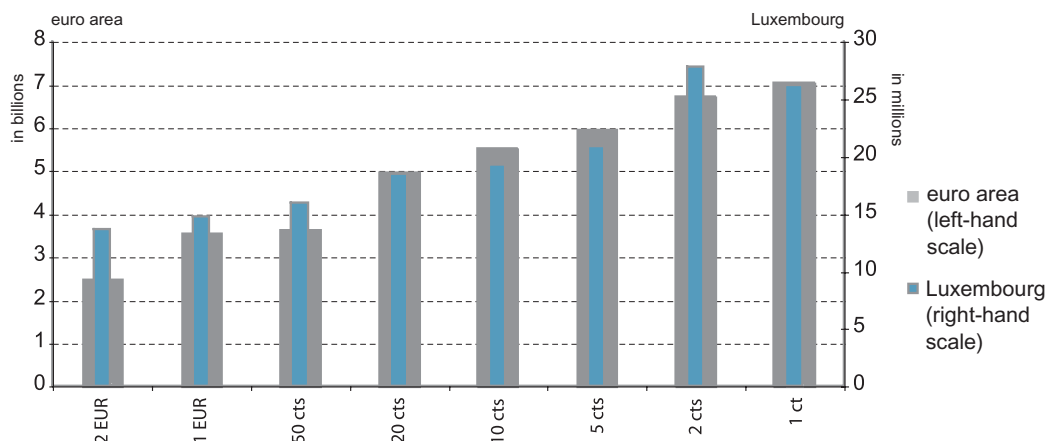
The average monthly volume of coins in circulation amounts to 113.71 million. The following graph shows the evolution of the volume and the value of Luxembourg euro coins in circulation in 2002. The demand for Luxembourg coins has kept increasing, the difference between the volume and the value having slightly increased.

GRAPH 11 VOLUME AND VALUE OF THE LUXEMBOURG EURO COINS IN CIRCULATION



In comparison with the euro area, Luxembourg contributes to 0.39% of the total number of coins put into circulation by the participating Member States, whilst Luxembourg contributes to 0.46% of the total value issued by all the issuing authorities of the euro area. The average value of Luxembourg euro coins put into circulation amounts to 36.7 cent in comparison to an average of 31.1 cent for the euro area coins. The following graph shows the comparison of the volume of the different coin denominations put into circulation by Luxembourg to the corresponding volume in the euro area.

GRAPH 12 COMPARISON OF THE VOLUME OF CIRCULATION OF THE DIFFERENT EURO COIN DENOMINATIONS IN LUXEMBOURG TO THAT OF THE EURO AREA

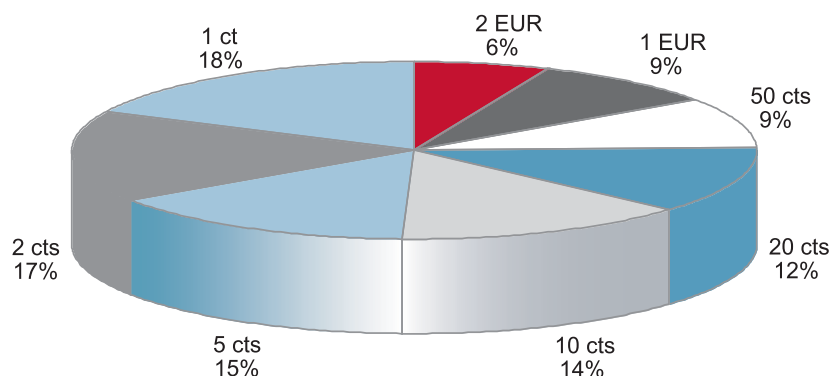


Concerning the Luxembourg coins, the 2-cent denomination is the most widespread. The classification according to the volume in descending order is as follows: 2 cent, 1 cent, 5 cent, 10 cent, 20 cent, 50 cent, 1 euro, 2 euro.

The demand for Luxembourg coins for the three higher denominations is higher than that of the euro area. The other denominations are slightly underneath the European average.

The total value of euro coins put into circulation by the Eurosystem has reached 12.43 billion euro at the end of 2002 and the total volume of coins amounts to 39.953 billion. The following graph shows the breakdown of this volume of the euro area according to following denominations:

GRAPH 13 BREAKDOWN PER DENOMINATION OF THE VOLUME OF COINS OF THE EURO AREA IN CIRCULATION



2.4.1.2 Luxembourg coins and banknotes

The withdrawal of the legacy currencies has been initiated a long time before the introduction of the euro coins and banknotes and has been completed systematically by the end of March 2002 due to the good cooperation of all people involved in Luxembourg. In 2002, the total value of Luxembourg currency (coins and banknotes altogether, numismatic and commemorative coins included) still in circulation and not yet exchanged moved from 3.48 billion to 505.77 million Luxembourg francs, i.e. a decrease by 85%. The average monthly value for last year amounts to 702.03 million Luxembourg francs, against 4.09 billion in 2001. The circulation of the 5 000-Luxembourg-franc-banknote has the most strongly decreased, that is to say by 96.1% and that of the 1 000-franc-banknote has decreased by 80%. The denomination of 100 Luxembourg francs has only decreased by 40.7%. These figures show that collectors prefer the lower denominations. The following table shows the evolution of the outstanding Luxembourg banknotes for the five last years:

TABLE 2 EVOLUTION OF THE OUTSTANDING LUXEMBOURG BANKNOTES FOR THE FIVE LAST YEARS

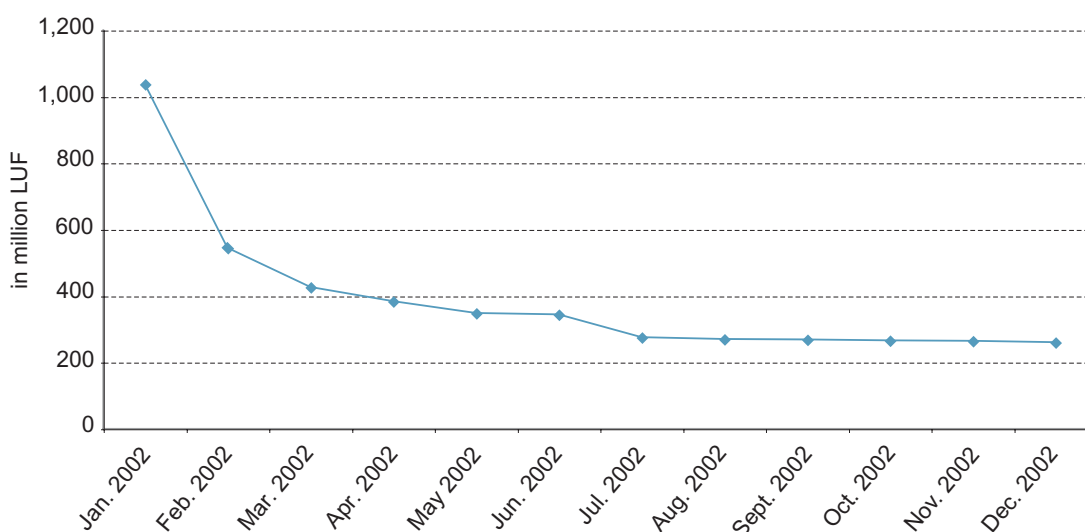
end of period	5,000 LUF	1,000 LUF	100 LUF	withdrawn LUF banknotes abroad	total
1998	3,194,890,000	1,090,562,000	185,821,900		4,471,273,900
variation*	-8.7%	-15.1%	-4.3%		-10.1%
1999	3,190,680,000	853,482,000	168,913,800	-159,980,000	4,053,095,800
variation*	-0.1%	-21.7%	-9.1%		-9.4%
2000	3,054,750,000	676,114,000	153,731,500	-168,910,000	3,715,685,500
variation*	-4.3%	-20.8%	-9%		-8.3%
2001	2,398,720,000	435,327,000	141,357,900	-198,966,000	2,776,438,900
variation*	-21.5%	-35.6%	-8.1%		-25.3%
2002	93,855,000	83,749,000	83,781,100	0	261,385,100
variation*	-96.1%	-80.8%	-40.7%		-90.6%

* in comparison to the precedent year

- in LUF

It can be noted that the global circulation volume of Luxembourg notes has decreased by 94.2% between the end of 1998 and the end of 2002. The flow back of the notes takes the form of an asymptotic curve. The monthly evolution is shown in the following graph:

GRAPH 14 EVOLUTION OF THE CIRCULATION OF THE LUXEMBOURG NOTES IN 2002



As to the circulation of Luxembourg notes in the other countries of the euro area, it can be seen that the article 52 mechanism (free of charge exchange in other euro area countries and repatriation to the issuing central bank) has extensively been used until end of March 2002, official deadline for this mechanism. The monthly average value of Luxembourg notes repatriated by the other central banks of the euro area amounts to approximately 47.5 million Luxembourg francs.

As to the value of coins in circulation, there has been a decrease of not yet exchanged coins of 68.4% in 2002 and the amount still in circulation was 2 of 10.08 million Luxembourg francs at the end of December 2002. The withdrawal scenario of Luxembourg coins was jointly put in place by the Belgian and Luxembourg authorities and was operational in October 2001 in order to perform a common withdrawal, which avoided the obligation to separate Luxembourg and Belgian coins.

At the end of 2002, a total volume of 940 331 Luxembourg notes and 65 865 183 coins was still not presented for exchange and represented a global value of 471.46 million Luxembourg francs.

2.4.2 Management of fiduciary money

The first three months of the year were characterised by the flow back of the legacy currency which was either to be repatriated to the issuing central bank or to be sorted.

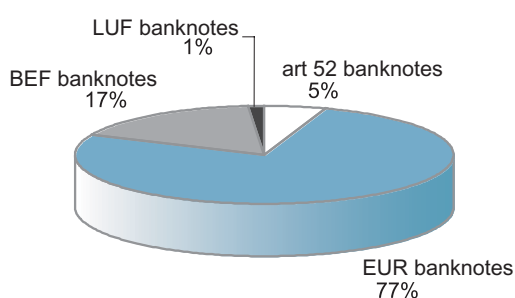
On the basis of article 52 of the ESCB statutes, the BCL exchanged the notes of the other euro area countries free of charge until end of March. In this context, the cash department received and repatriated some 3.8 million notes representing a total value of 225 314 million euro.

In 2002, the BCL exchanged more than 12 million Belgian notes for a counter-value of 468.41 million Belgian francs, which was below the amount of 579 million euro estimated to be in circulation in Luxembourg ahead of the cash changeover, according to the theoretical key. In these operations, the BCL acted as an agent of the BNB. The BCL has been authorised by the BNB to entirely destroy the 12 million Belgian legacy notes withdrawn in Luxembourg.

The number of Luxembourg notes returned to the BCL by the financial institutions came close to 885 000. As to the euro notes returned to the BCL, their number was approximately 54 million so that the circulation volume was in average 2.1 times at transit in the counters of the bank.

These volumes represented more or less 2 000 different lodging operations managed and registered by the cash department.

GRAPH 15 LODGING OPERATIONS BY TYPE OF NOTE



Three quarters of the lodged notes in 2002 were euro notes, 17% were Belgian notes and only a small amount were Luxembourg notes because of their highly reduced volume before the cash changeover.

As to the withdrawal operations of euro notes, they exceeded the number of 4 200 in 2002. The public also took advantage of the services offered by the BCL through its public counter for the exchange of notes and coins. More than 12 600 operations were handled at the public counter.

After the technical switch of the sorting machines for processing the euro notes, more than 39 million notes have been treated. The sorting machines do not only operate authenticity tests, but also soiling



tests. Considering denominations altogether, nearly 750 000 notes were destroyed for unfitness for circulation. The reject/destruction rate is of course low in this first year of the circulation of the euro.

In the field of counterfeit monitoring, the BCL has cooperated with the ECB and the national authorities in the analysis of the discovered counterfeits.

2.4.3 Numismatic issues

The euro has generated a great interest for numismatic collections of the legacy currencies as well as of the new euro notes and coins. In Luxembourg, the following numismatic products have been put into circulation in 2002:

- the "12 countries cube": produced by the BCL, was in CD-format and contained the first euro coin issues of the 12 participating countries
- the "12 countries album", was a luxurious edition of the first euro coins of the 12 participating countries
- the "2002 yearly set" displayed the first Luxembourg euro coins with the year 2002
- the silver coin "Court of Justice", issued in December 2002, was the first Luxembourg commemorative coin in euro and commemorated the 50th anniversary of the Court of Justice of the European Communities. This coin has a face value of 25 euro and is minted in sterling silver. Its diameter is 37 mm and its weight 22,85 g. It has legal tender only in Luxembourg.

