



BELGIUM

2012 ARTICLE IV CONSULTATION

March 2012

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with Belgium, the following documents have been released and are included in this package:

- **Staff Report** for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 13, 2011, with the officials of Belgium on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 24, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Staff Statement** of March 9, 2012 updating information on recent developments.
- **Public Information Notice (PIN)** summarizing the views of the Executive Board as expressed during its March 9, 2012 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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BELGIUM

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

February 24, 2012

KEY ISSUES

Context: The high public debt and strong interlinkages between the banks and the sovereign continue to pose risks. Although the political deadlock was overcome and the new federal government has begun to address long-standing issues in the economy, uncertainty about the evolution of the euro area crisis and slow growth across Europe weigh on the outlook. Growth is projected to stagnate in 2012 and to be weak in 2013, with risks slanted to the downside. The authorities' strategy aims to achieve fiscal sustainability over the medium-term, contain risks in the financial sector, and increase employment and growth.

Fiscal policy: The vulnerability of Belgium's sovereign debt to market pressures makes credible medium-term fiscal consolidation a priority. The 2012 budget includes sizable consolidation measures and the government is committed to take additional measures as needed with the aim of reaching structural balance by 2015. In light of the weak growth prospects, automatic stabilizers should be allowed to operate freely around the consolidation path.

Financial sector policy: Important steps were taken to address the financial sector distress in 2011, but vulnerabilities remain. While most banks have maintained market access throughout the crisis, they should continue to build up capital to deal with possible adverse market dynamics. There is a need to further strengthen banking supervision and to implement the Basel III and Solvency II regulatory frameworks. The Belgian experience has also underscored the need for an effective approach to crisis management and a cross-border resolution framework in Europe.

Structural reform: The government has initiated labor market and pension reforms, in order to raise the employment rate. Boosting growth is important for sound public finances and requires pushing ahead with reforms in labor and product/services markets, including a reconsideration of the automatic wage indexation. A job-friendly tax reform could increase trend growth.

Approved By
**Ajai Chopra and
 Martin Mühleisen**

Discussions took place in Brussels during November 30–December 12, 2011 and January 24–27, 2012. The staff team comprised Mr. De Vrijer (head), Ms. Ohnsorge and Mr. Weber (all EUR), Mmes. Erbenova and Nedelescu (both MCM), and Mr. Acosta-Ormaechea (FAD). Messrs. Kiekens and De Lannoy (OED) participated in the discussions.

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THE MACROECONOMIC SETTING

A. Worsening Euro Area Crisis and New Political Start

Impact of euro area crisis

1. As the euro area crisis unfolded, Belgian sovereign bond spreads have come under pressure. Since mid-2010, co-movement with sovereign bond markets of the three euro area program countries, Italy, and Spain has pushed up Belgian sovereign bond spreads. The high public debt, the large exposure of the banking sector to the three program countries, Italy, and Spain, and the increase in government contingent liabilities as a result of bank restructuring contributed to heightened sensitivity of Belgian sovereign bond yields to foreign factors.

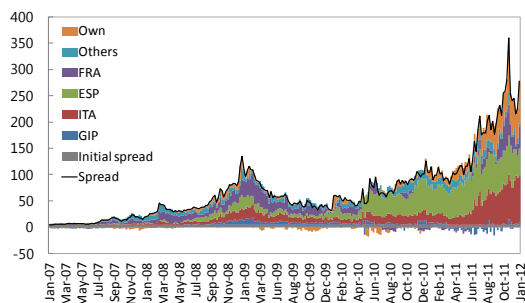
2. Domestic political events and financial developments compounded the

pressures from euro area financial markets.

A VAR analysis of sovereign bond spreads in fourteen European Union countries suggests that specific domestic factors also contributed to the rise in the Belgian government bond spread.¹ As it became increasingly clear that a caretaker government would remain in place for an extended period and market concerns increased about Dexia and the concomitant risks to public finances, domestic pressures on the spread intensified during 2011. The rise in the domestic factor came to a halt after a fiscal consolidation plan was agreed in November 2011, which paved the way for the creation of a new government.

Belgium: Contribution to Government Bond Spread

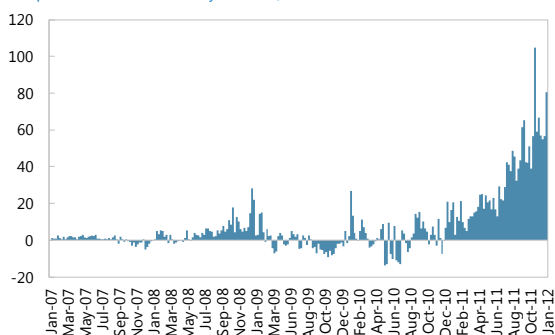
(Basis points above German 10-year Bund)



Sources: Bloomberg; and IMF staff estimates.

Belgium: Domestic Factor of Government Bond Spread

(Basis points above German 10-year Bund)



Sources: Bloomberg; and IMF staff estimates.

¹ The approach is described in more detail in the Selected Issues Papers, chapter 1.

3. Drying up of liquidity in euro area financial markets since the summer of 2011 eventually led to the breakup of Dexia Group (Box 1).

Since late 2010, the intensifying euro area crisis made Dexia’s accelerated deleveraging, as implied by its 2008 restructuring plan, impossible without taking substantial losses. Access to secured wholesale funding was squeezed by falling collateral values. In late-June and early-July 2011, banks’ CDS spreads began rising significantly and bank equity prices fell (Figure 1). Despite a significant reduction in short-term liabilities from €260 billion in 2008 to €96 billion by June 2011, Dexia remained heavily reliant on wholesale funding while its recourse to ECB funding had to be renewed.² Margin calls on interest rate swaps, a lack of unencumbered collateral, and panic of both wholesale and retail depositors in early October 2011 eventually set in motion an intervention by the public authorities in Belgium, France, and Luxembourg. Dexia’s business model of predominantly municipal government lending differed significantly from that of other Belgian banks. While the latter

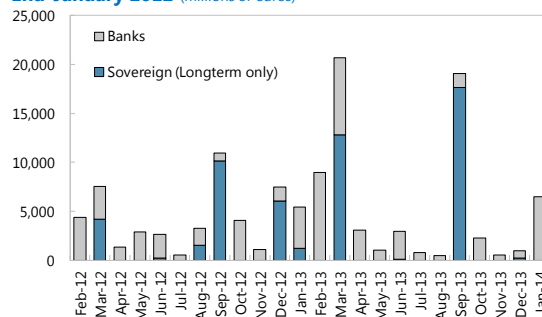
² By the time of its 2008 bail-out, 43 percent of Dexia’s balance sheet was financed by short-term instruments. Despite major restructuring, the reliance on short-term wholesale funding still stood at a significant one-fourth of Dexia’s total funding needs in June 2011. While its reported capital adequacy appeared healthy compared to peers (with core Tier 1 ratio at 12.1 percent at end-2010 and 10.4 percent under the stressed scenario in the EBA July 2011 stress test), a large part of its assets enjoyed zero risk-weighting with risk-weighted assets only at 21 percent of total assets—at the extreme end in the peer group of global systemically important banks.

have not been directly affected by Dexia’s resolution, it has been accompanied by the bankruptcy of some of Dexia’s shareholders.

4. Financial market volatility has continued since the breakup of Dexia.

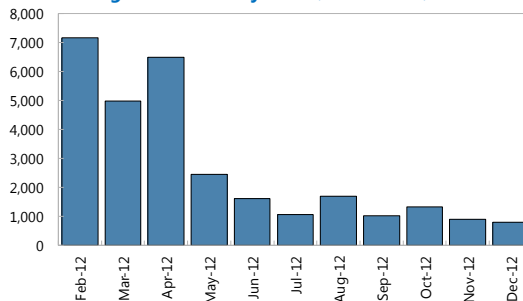
In the run-up to the euro summit in December 2011, Belgium’s five-year sovereign CDS spread soared above 400 basis points but has subsequently come down below 250 basis points at end-January 2012. Spreads will likely remain under pressure for some time in light of the high public debt, financial sector vulnerability to market turmoil in the euro area, and the close interlinkages between the banking sector and the Belgian sovereign. Banks hold substantial amounts of

Sovereign and Banks: Amounts Due on Existing Debt at End-January 2012 (millions of euros)



Source: NBB, Bloomberg, and staff calculations.

Maturity Profile of Government Treasury Bills Outstanding at end-January 2012 (millions of euros)



Sources: Bloomberg.

Box 1. The Resolution of Dexia

The breakup of Dexia Group (SA) was announced on October 10, 2011. The group was split into three parts:

- Dexia SA's Belgian operations were nationalized by the sale of the group's share holdings in Dexia Bank Belgium (DBB) to the Belgian state for an amount of €4 billion (1.1 percent of Belgian GDP). Dexia SA retains an earn-out right to benefit from any gains should DBB be resold within five years. Service agreements have been put in place with other units of Dexia to ensure operational continuity during a transition period while former intragroup funding exposures will be unwound gradually.
- In France, an agreement was reached on February 10, 2012 between the *Caisse des Dépôts et Consignations* (CDC), the *Banque Postale*, and the French state to secure the financing of the public sector. This agreement has two key elements: a) setting up a joint venture between CDC and *Banque Postale* to commercialize new financing of local authorities; and b) the creation of a new credit establishment held by the French State (31.7 percent), CDC (31.7 percent), *Dexia Crédit Local* (DCL, 31.7 percent) and *Banque Postale* (4.9 percent). This new credit establishment will be the parent company of Dexia Municipal Agency (DMA), a covered bond vehicle dedicated to the financing of the local public sector. DCL would continue operating under a banking license.
- Negotiations are currently underway for the sale of other parts of Dexia SA, including *Dexia Banque Internationale à Luxembourg* (DBIL), to be acquired by a foreign investment group (90 percent of the stake) and the Grand Duchy of Luxembourg (10 percent of the stake), and *Denizbank* in Turkey. Other parts of Dexia, including *CrediOp* in Italy, *Kommalkreditbank* in Germany, and *Sabadell* in Spain will be sold later, depending on market conditions.
- The *funding* of Dexia SA and of DCL would be guaranteed by the governments of Belgium (60.5 percent), France (36.5 percent), and Luxembourg (3 percent) in a several guarantee of up to €90 billion over a period of 10 years. So far, the European Commission has provided a

temporary approval for a guarantee of up to €45 billion of financing with maturities of up to three years while the restructuring plan is being finalized. Belgium's share in this temporary guarantee amounts to €27 billion (about 7½ percent of GDP). The implementation of the guarantee will enable Dexia SA to reduce the amount of its central bank financing and that from DBB.

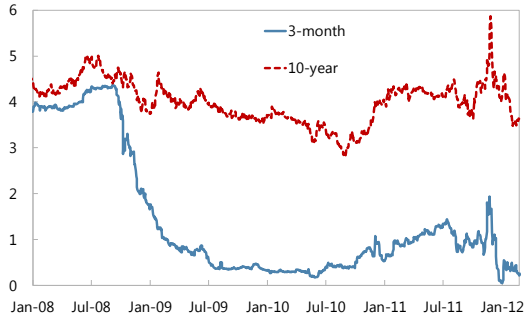
In Belgium, the resolution of Dexia has caused collateral damage with fiscal repercussions. Two shareholder entities became insolvent as a result of impairments on their Dexia participation and will be liquidated in an orderly fashion, while other shareholders will require recapitalization. Based on current estimates, the eventual fiscal cost may be up to ¾ percent of GDP:

- *Communal Holding*, the municipal financing vehicle with a 14 percent stake in Dexia SA, has become insolvent. It will be liquidated at a loss of some €0.8 billion shared by Belgium's Regions, the federal government, and DBB.
- *Arco Group*, an investment group of a workers' union with a membership of 11 percent of the workforce and a 14 percent stake in Dexia SA, has been issued a government guarantee for its individual members' capital of about 1.5 billion (net of proceeds from asset sales). Arco Group will also be liquidated.
- *Ethias*, a mutual insurance company with a balance sheet of 7 percent of GDP and a 5 percent stake in Dexia, incurred losses. Funding difficulties resulted in €180 million in public sector support in a bond issue in January 2012.

The actual and contingent sovereign liabilities arising from the resolution of Dexia are substantial for Belgium, but the immediate impact on the general government debt is small. Current Eurostat rules suggest that the immediate fiscal impact of Dexia's resolution is an increase in general government debt by the purchase price of DBB (1.1 percent of GDP) to the extent that funds need to be raised in debt markets. The sovereign guarantees for Dexia SA's and DCL's funding remain contingent liabilities unless guarantees are called and as long as Dexia SA is recognized as a financial institution.

Figure 1. Belgium: Financial Indicators

Government Interest Rates
(Percent)



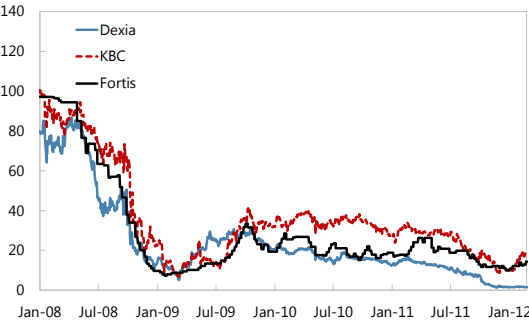
Source: Bloomberg.

Sovereign 10-Year Yield Spread
(Basis points)



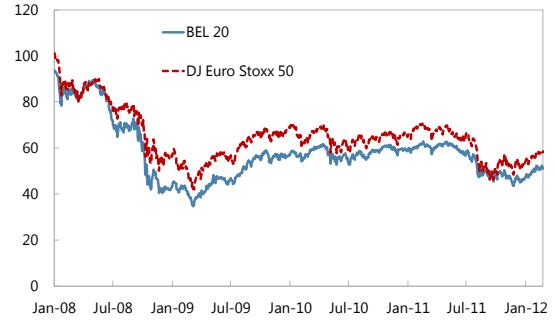
Sources: Bloomberg; and IMF staff calculations.

Equities
(2007 = 100)



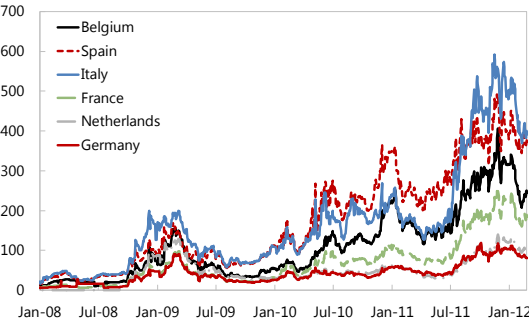
Sources: Bloomberg; and IMF staff calculations.

Stock Indices
(2007 = 100)



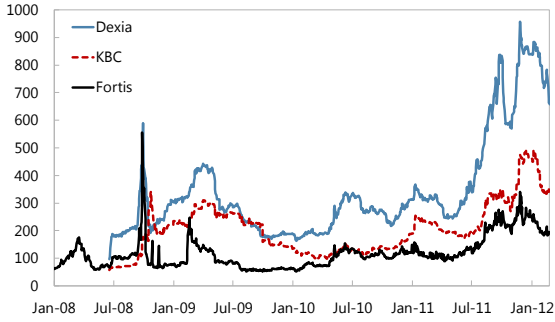
Sources: Bloomberg; and IMF staff calculations.

USD SR 5Y CDS Spreads
(Basis points)



Source: Bloomberg.

CDS Spreads
(Basis points)



Source: Bloomberg.

government securities and loans to the public sector, while the state has provided important capital support and guarantees to financial institutions resulting in a rise in contingent fiscal liabilities. Recent downgrades of the Belgian sovereign rating by all major rating agencies invoked the intimate ties between the financial sector and the sovereign, and market perception of the two is likely to remain attuned. Rollover needs (mainly sovereign) in February and March are sizable (€24½ billion, or 6½ percent of GDP). Another spike in rollover needs (€13 billion) will occur in September 2012.

Political breakthrough

5. After more than 540 days under a caretaker government, a new federal coalition government assumed office on December 6, 2011. The new government program includes a state reform, a fiscal consolidation plan, and an entitlement reform. The Sixth Reform of the State substantially increases the degree of fiscal federalism by devolving additional spending responsibilities to subnational governments and reforming their funding (Box 2). In particular, the reform grants autonomy over personal income tax revenues amounting to 2.9 percent of GDP to the Regions and Communities. At the same time, the reform devolves additional spending authority of 4.4 percent of GDP to sub-national governments to cover new responsibilities, including on labor market and employment policies, long-term care, and child benefits.

A 10-year transfer arrangement ensures the financing of the Walloon and Brussels-Capital Regions.

6. The state reform could strengthen the efficiency of government operations.

First, while the reform has no immediate impact on the overall general government balance, it strengthens the federal government's finances both in terms of smaller net spending responsibilities and more predictable budgeting. The revenue transfers to Regions and Communities cover only part of the devolved spending responsibilities, and the uncertainty of funding the devolved spending responsibilities with fluctuating revenues is now borne by Regions and Communities. Second, the devolution of especially long-term care and labor market policy responsibilities will better align incentives for containing costs.

Box 2. The Sixth Reform of the State

A Sixth Reform of the State was agreed in

October 2011. The reform is expected to come into effect in 2014 and contains two main elements: political reform and enhanced fiscal decentralization. Some short-term fiscal saving measures were also included such as a 5 percent ministerial pay cut. In a political agreement, a Flemish-speaking part is broken out of the bilingual electoral district of Brussels-Halle-Vilvoorde and voters in this part are no longer allowed to vote for candidates from Brussels. From 2014, federal and regional elections will take place at the same time in a five-year cycle (instead of the previous four-year cycle). Regions are given the right to initiate popular consultations on regional issues.

The key elements of enhanced fiscal decentralization are devolution of responsibilities to the regional and community levels of government and increased tax autonomy:

- *Devolution of responsibilities to Regions and Communities:* Regions will be responsible for a significant share of labor market policies (€4 billion) and policies on tax exemptions for mortgages, energy savings, and service vouchers (€2 billion). Communities will become responsible for child allowances (€6 billion), old-age care (€3 billion) and some other health care expenditures (€1 billion). In total, the new responsibilities of Regions and Communities amount to some €16 billion (4.4 percent of GDP).
- *Greater tax autonomy for Regions.* Since 1989, the Regions have had the right to add surcharges or give rebates on the personal income tax (PIT). Their PIT revenues depended on a grant financed by and shared according to regional proceeds from PIT collected at the national level and these surcharges/rebates. Following the Sixth Reform of the State, Regions will be authorized to set their own schedule of regional PIT rates and brackets in addition to a federal PIT schedule. Competencies for defining the tax base and tax collections remain at the federal level. The deviation in the tax progressivity of the regional PIT schedule from the federal one is limited to €1,000 per tax payer. Regional personal income tax revenues will accrue to the Regions alone. Assuming constant existing tax brackets, federal and regional personal income tax revenues will be calibrated such that PIT revenues of the Regions represent €10.7 billion (2.9 percent of GDP, or about one quarter of current PIT revenues).
- *Revised system of transfers to Regions:* To finance two specific new competencies (labor market policy and responsibilities for defining tax exemptions), Regions will receive a transfer of 90 percent of the budget envelopes for employment policies and 60 percent of the fiscal expenditure budget, the remaining 40 percent being part of the amount transferred as revenues from greater tax autonomy. In addition, Regions will receive a “solidarity transfer” of 80 percent of the difference between the Region’s share in the population and in PIT revenues. A transitional transfer mechanism will ensure that there are no losses for the Regions from the new system in the starting year. The transfer amount is fixed in nominal terms for the first ten years, and then reduced by 10 percent per year. Finally, the Brussels-Capital Region will benefit from a permanent transfer of 0.1 percent of GDP to cover exceptional financing needs.
- *Revised funding of Communities:* Instead of being allocated shares of VAT revenues, Communities will receive a budget transfer according to the number of pupils (€14 billion) and according to distribution keys based on demographics to cover their new spending responsibilities. In addition, they will receive an appropriation under the Regional fiscal allocation (€8 billion). A transitional transfer mechanism similar to that for Regions is foreseen.
- *Contribution of Regions and Communities related to the pensions of their civil servants.* Regions and Communities will pay a contribution for their civil servants’ pensions paid by the federal government. This contribution will increase gradually to 8.86 percent of wages.

7. However, the reform remains to be set into a rules-based, multi-year budgetary framework, in line with the EU Directive on Requirements for Budgetary Frameworks on the Member States approved in April 2011. Given that the system of inter-governmental transfers is complex, it is important that the

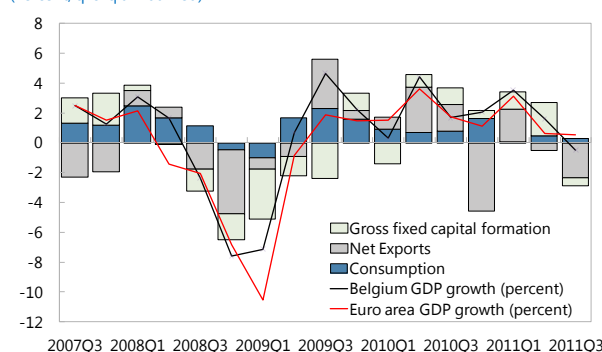
transparency of the transfer system be improved, including through the regular publication of comprehensive data on all transfers between each level of government. This would also clarify the making of choices on inter-governmental burden sharing in the current fiscal consolidation.

B. A Stalling Recovery Slides into Recession

8. Growth momentum has slowed since early 2011. A rebound in investment in 2010 and 2011:Q1 was supported by solid export growth. As confidence weakened, however, growth began to falter in 2011:Q2, in tandem with a marked slowdown in the rest of the euro area. With activity declining in the second half of the year, real GDP growth is estimated at 1.9 percent in 2011, above the euro area average (1.6 percent).

Contributions to GDP Growth

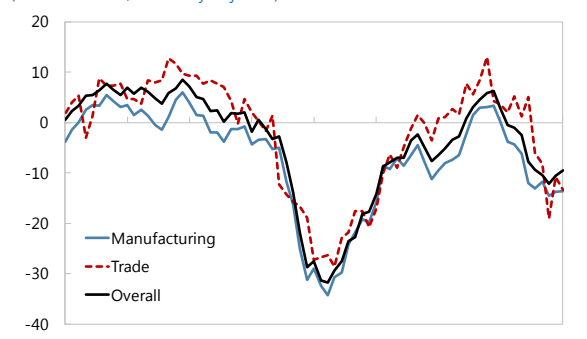
(Percent, q-o-q annualized)



Sources: Haver Analytics; and IMF staff calculations.

Business Confidence Survey

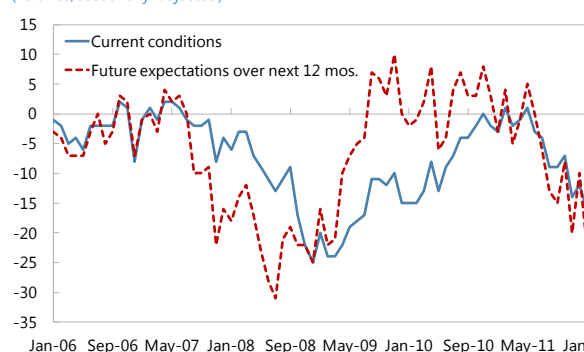
(Percent balance, seasonally-adjusted)



Source: Haver Analytics.

Consumer Confidence Survey

(Balance, seasonally-adjusted)



Source: Haver Analytics.

9. The labor market has so far remained resilient, partly because of a series of employment support programs.

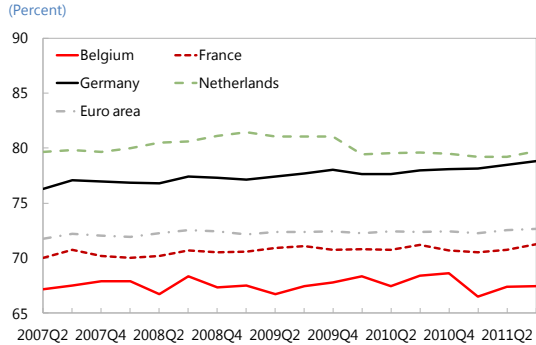
The unemployment rate receded to 7.3 percent in November 2011 from its peak of

8.5 percent in March 2010 (Figure 2). During the crisis, a wider group of workers was granted access to subsidized employment schemes. As a result, a by OECD standards high share of the labor force is now covered by these schemes at a fiscal cost of more than 1 percent of GDP. While this has supported

Figure 2. Belgium: Developments in Unemployment and Inflation, 2005–11

Labor force participation remains low by EU standards.

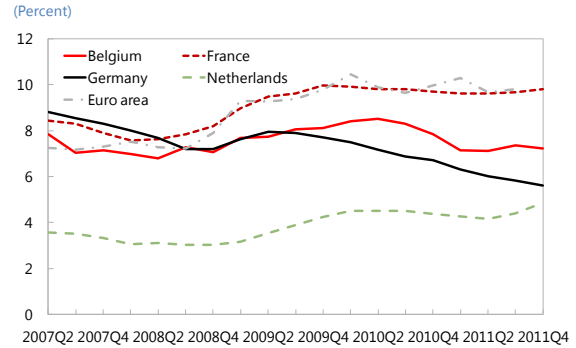
Labor Force Participation Rates



Sources: Haver Analytics; and IMF staff calculations.

The unemployment rate has fallen, partly due to subsidized employment schemes.

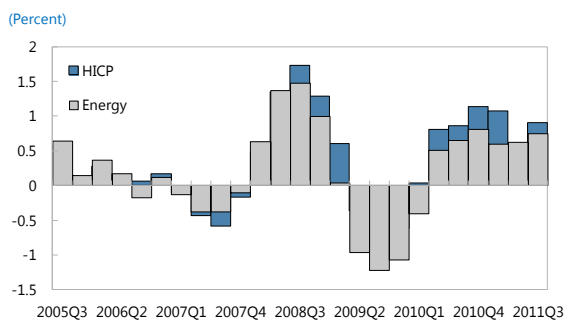
Unemployment Rates



Sources: Haver Analytics; and IMF staff calculations.

Energy price inflation has remained high...

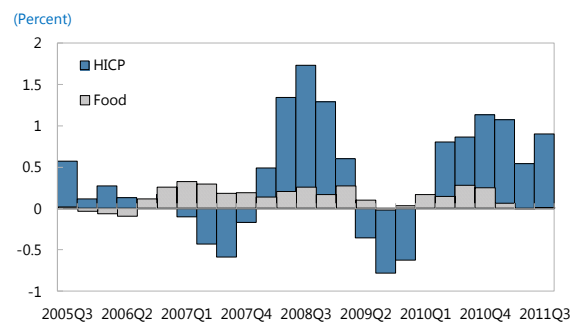
Role of Energy Price in Explaining the BEL-EA Difference in Inflation



Sources: WEO; IMF Dabatase; Haver Analytics; and IMF staff calculations.

...but food price inflation declined since end-2010.

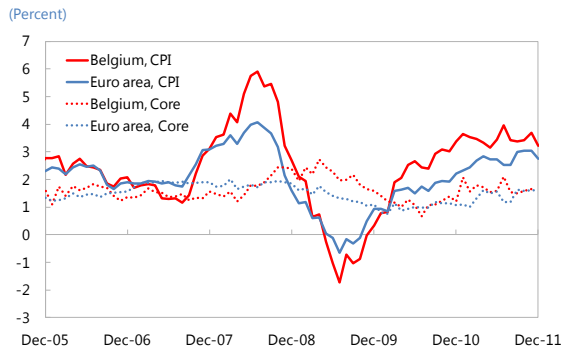
Role of Food Price in Explaining the BEL-EA Difference in Inflation



Sources: WEO; IMF Dabatase; Haver Analytics; and IMF staff calculations.

Inflation has remained around 3½ percent,

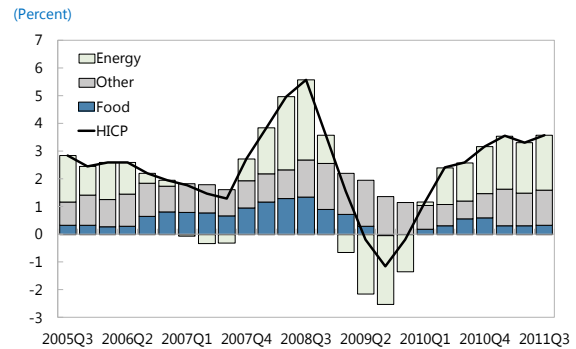
Headline and Core Inflation



Sources: WEO; IMF Dabatase; Haver Analytics; and IMF staff calculations.

...with rising core inflation offsetting declining food inflation.

Contributions to Inflation



Sources: WEO; IMF Dabatase; Haver Analytics; and IMF staff calculations.

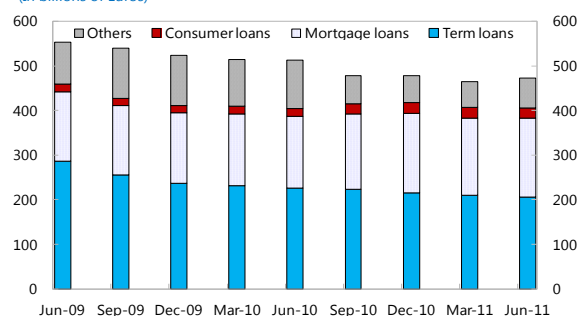
employment, it also hinders the reallocation of labor and new labor market entry. The long-term unemployment rate has fallen marginally to 3¾ percent, but remained above that in the Netherlands (1½ percent) and Germany (2¾ percent), and the labor force participation rate remained low at 66.9 percent in 2011:Q3.

10. Annual consumer price inflation has remained around 3½ percent throughout much of 2011, mostly due to energy prices that rose faster than in other EU countries. The sensitivity of Belgian inflation to energy prices reflects the relatively high energy dependency of the economy as well as rigidities in energy markets, and is amplified by second-round effects induced by Belgium's automatic wage indexation mechanism. The automatic wage indexation mechanism for public sector employees and social benefits will be triggered in early 2012. The wage and benefit increase of 2 percent will represent a considerable burden on the budget (estimated at ½ percent of GDP) and further weaken wage cost competitiveness.

11. Private sector lending stabilized as bank deleveraging slowed during 2011. As the larger global banks have sought to regain home market share, credit standards in Belgium for households and corporates have not changed much in 2011. This has helped stabilize private sector lending. Lending to households, especially mortgage lending, has resumed since mid-2010. Lending to nonfinancial corporates, however, remained

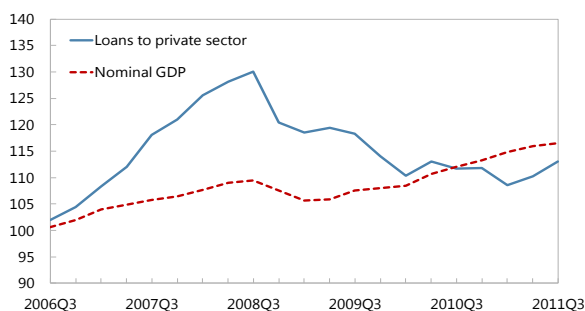
weak as large enterprises continued to substitute bond issuance for bank lending and the deterioration in the economic outlook dampened credit demand.

Loans and Advances to Non-Credit Institutions
(In billions of Euros)



Source: NBB

Loans to Private Sector and Nominal GDP
(2006=100)



Sources: Haver Analytics; and IMF staff calculations.

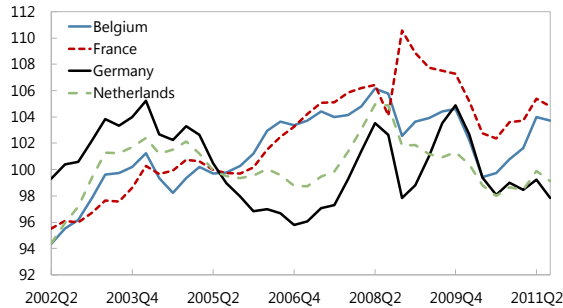
12. The recent tendency of inflation and nominal unit labor costs to increase more than in Belgium's main trading partners is a concern for competitiveness. While estimates based on CGER methodologies suggest that the real exchange rate is broadly in equilibrium, the real effective exchange rate based on consumer prices has appreciated somewhat (by 1¼ percent) since its post-crisis trough in mid-2010. Relatively high inflation, the automatic wage indexation, and a modest 1 percent increase in labor productivity have contributed to a 3 percent real appreciation in

terms of unit labor costs since mid-2010. As a result, wage-cost competitiveness vis-à-vis Belgium’s main trading partners has deteriorated somewhat. There is a risk that second-round effects of high past energy price inflation will further widen the competitiveness

gap with key trading partners, limiting export growth going forward. The current account surplus has shrunk during the first nine months of 2011 to virtual balance despite strong export growth to Asia partially offsetting weaknesses in Europe.

Real Effective Exchange Rates, Based on ULC

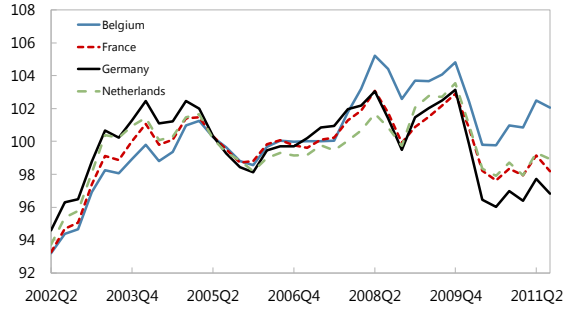
(2005=100)



Source: IFS.

Real Effective Exchange Rates, Based on CPI

(2005=100)



Source: IFS.

Estimation of Competitiveness Margin Using CGER Methodologies 1/

(Exchange rate level relative to equilibrium, minus indicates undervaluation)

Methodology	
Macroeconomic balance approach	1.6
External sustainability approach	-1.0
Equilibrium real exchange rate approach	0.1
Memorandum items:	
Current account balance (percent of GDP)	
2010	1.5
2017	1.6
CA Norm 2/	1.4

Source: IMF staff estimates.

1/ CGER (Consultative Group on Exchange Rate Issues). Values between -10 and +10 mean the real exchange rate is close to balance. IMF, 2008, "Exchange Rate Assessments: CGER Methodologies", estimates based on data available in August 2011.

2/ Based on macroeconomic balance approach.

OUTLOOK AND RISKS

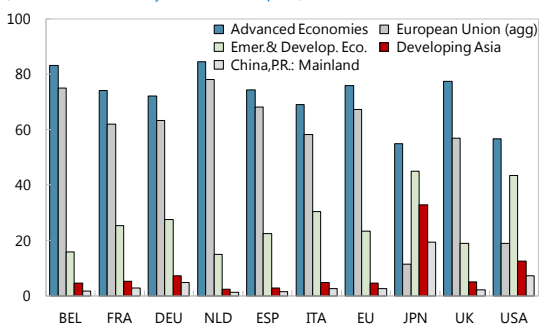
13. Belgium is a highly open economy undertaking most of its trade and FDI with a limited number of countries. With an export-to-GDP ratio of 79 percent, Belgium is among the most open economies in Europe and also globally. Its exports are highly

concentrated with three quarters of total merchandise exports accounted for by the European Union (EU), close to two thirds of which go to Germany, France and the Netherlands. Imports are also largely sourced from the neighboring countries. At 93 percent

of GDP, Belgium has one of the highest stocks of foreign direct investment (FDI) in the European Union, which is predominantly owned by entities in France, the Netherlands, and Luxembourg.³ Similarly, Belgium's FDI abroad (74 percent of GDP) is high by EU standards and is also concentrated in the same three countries.

Comparison of Main Export Destinations, 2010

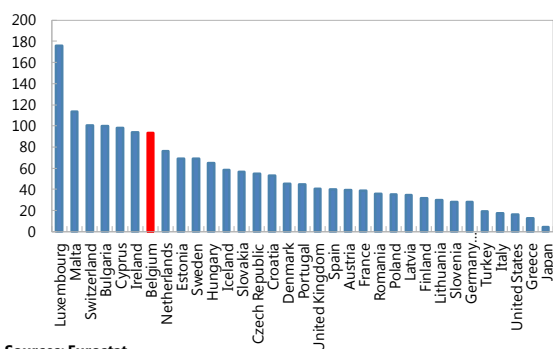
(Percent of total country merchandise exports)



Sources: IMF DOTS; and IMF staff calculations.

FDI position in reporting economy, 2009

(Percent of GDP)



Sources: Eurostat.

14. Belgian growth co-moves strongly with GDP growth in its main trading partners. In an Ordinary Least Square (OLS) regression of Belgian quarter-on-quarter real GDP growth on contemporaneous quarter-on-quarter growth of the four largest euro zone

³ Thirty percent of this FDI stock present in Belgium is in financial intermediation. The recent breakup of Dexia is likely to impact the overall stock of FDI.

members (Germany, France, Italy, and Spain), more than 50 percent of the variation in Belgian GDP growth can be explained by those four countries' growth rates—about twice as much as, on average, in other euro area countries. In principle, this co-movement could be due to Belgium being hit by common shocks as its main trading partners, the spillovers of domestic shocks from the main trading partners to Belgium, or the spillovers from Belgium to its main trading partners (which is less likely, given Belgium's economic size).

Table 1-1. OLS regression Belgium growth (q-on-q) (1960Q3 - 2011Q3)

Variable	Coefficient	Std. Error	Prob.
BEL (-1)	0.32	0.06	0.00
DEU	0.14	0.04	0.00
FRA	0.08	0.04	0.04
ITA	0.16	0.04	0.00
ESP	0.13	0.04	0.00
Constant	0.10	0.05	0.06
Durbin-Watson	2.11	Adj. R2	0.53
Number of obs.	203		

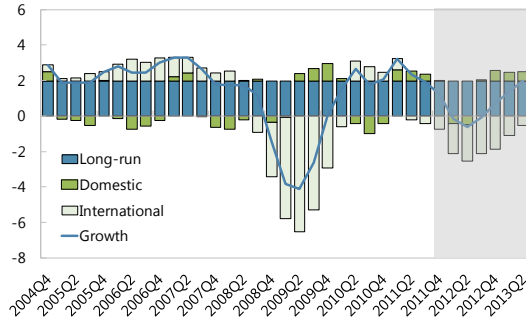
15. Belgian growth is largely explained by foreign shocks, reflecting the openness and interconnectedness of the economy. A multi-country VAR analysis of quarter-on-quarter real GDP growth, which decomposes growth into a long-run, a dynamic domestic, and a dynamic foreign component, suggests that Belgium's GDP growth is largely dominated by spillovers from domestic shocks in other economies.⁴ Long-run growth is

⁴ The decomposition and forecasts under this scenario are constructed using the VAR approach described in Poirson and Weber (2011) and explained in more detail in the Selected Issues Papers, chapter 1.

estimated at just below 2 percent. About three quarters of the long-run growth and of the variance of the dynamic component are related to long-run growth in other economies. The VAR estimates suggest that a sharp slowdown in domestic demand growth—by half a standard deviation—in euro area program countries and, more importantly, Italy and Spain, could reduce Belgian growth by $\frac{3}{4}$ percent in 2012 and $\frac{1}{2}$ percent in 2013. The response in this adverse scenario is stronger than in France and Germany, but in line with the response in the Netherlands.

Growth Contribution: Belgium

(Percent)



Sources: IMF WEO; OECD; and Poirson and Weber (2011).

16. Domestic fiscal consolidation will compound the impact on growth of fiscal consolidation abroad. Belgium's main trading partners—France, the Netherlands, and Germany—are projected to tighten their structural fiscal balances by an average of 1 percent of GDP in 2012 and $\frac{1}{2}$ percent in 2013. Staff estimates that trading partner fiscal consolidation will reduce Belgian growth by about $\frac{1}{4}$ percent in 2012–13.⁵ Belgium's high trade openness to countries planning relatively large consolidation efforts implies that spillovers to Belgian growth are about twice the average spillover size in the sample. Belgium itself is also set on a fiscal consolidation path. Domestic fiscal consolidation would reduce growth by another $\frac{1}{4}$ percent in 2012 and $\frac{3}{4}$ percent in 2013, assuming a fiscal multiplier of 0.4. The outward spillover or the envisaged Belgian fiscal consolidation is small, reducing main trading partner growth by less than 0.05 percent.

⁵ The model allows for carryover effects from fiscal changes in the previous period. Estimates are based on the cyclically adjusted revenue and expenditure changes of 20 countries which cover about 70 percent of world GDP and more than 80 percent of Belgian exports. For a detailed description see the Selected Issued Papers, chapter 1.

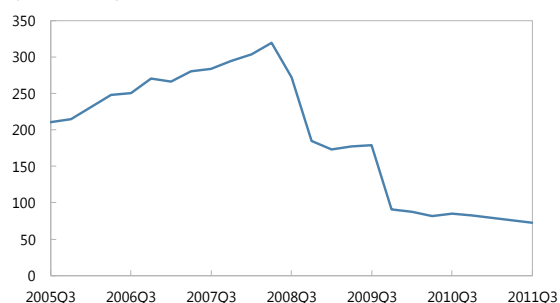
	Fiscal Contribution to Growth ¹								
	(In percentage points)								
	2011			2012			2013		
	Total growth impact	Of which:		Total growth impact	Of which:		Total growth impact	Of which:	
		domestic effect	spillover effect		domestic effect	spillover effect		domestic effect	spillover effect
Belgium	-0.4	-0.2	-0.1	-0.6	-0.3	-0.3	-0.8	-0.7	-0.2
of which:									
- current year	-0.2	0.1	-0.2	-0.5	-0.4	-0.1	-0.5	-0.4	-0.1
- carry over prev. year	-0.2	-0.3	0.1	-0.2	0.1	-0.2	-0.4	-0.3	-0.1
PPP weighted average	-0.2	-0.1	0.0	-0.3	-0.3	-0.1	-0.4	-0.3	-0.1
Simple average	-0.5	-0.4	-0.1	-0.7	-0.5	-0.1	-0.4	-0.3	-0.1

Source: IMF staff estimates.

1/ Financial sector support recorded above-the-line was excluded for the calculation of growth impact for Ireland (2.5 percent of GDP in 2009 and 5.3 percent of GDP in 2010) and the US (2.5 percent of GDP in 2009, 0.4 percent of GDP in 2010, and 0.1 percent of GDP in 2011 and 2012). Financial sector support is not expected to have a significant impact on demand. For Russia only non-oil revenues are assumed to have an impact on growth. Values need not add up due to rounding.

17. Deleveraging has diminished Belgian banks' exposure abroad significantly since end-2008, although substantial exposures remain to a few countries. As a consequence of deleveraging and the split of Fortis along national lines, claims abroad of BIS-reporting Belgian banks dropped from their peak of 300 percent of Belgian GDP at end-2008 to about 72 percent at end-September 2011.⁶ Thus, the foreign exposure of the Belgian banking sector has fallen from one of the highest in the euro area

Belgium: Banking Sector Claims Abroad 1/
(Percent of GDP)



Sources: Bank for International Settlements.

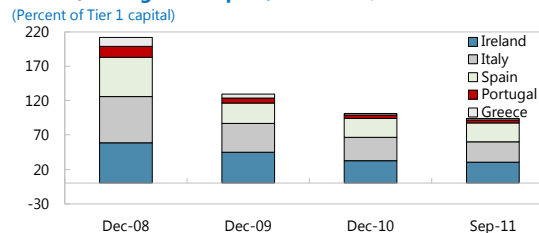
1/ Claims abroad on ultimate risk basis.

⁶ The split of Dexia along national borders in October 2011, will result in a further reduction of the banking sector claims abroad in 2011:Q4.

to the euro area average, and well below the current levels of France and the Netherlands (110 percent and 164 percent of GDP, respectively). The largest remaining asset exposures are claims on France, the Czech Republic, the U.K., and the U.S. Evidence of deleveraging in Emerging Europe is mixed (Box 3).

18. Banks retain significant exposure to countries with weak growth prospects, fragile sovereign debt markets, and stressed financial markets. On a consolidated basis, BIS-reporting Belgian banks retained at end-September 2011 exposures to Italy, Spain,

Consolidated Claims of Belgian Banks on Greece, Italy, Ireland, Portugal and Spain, 2008-11 1/
(Percent of Tier 1 capital)



Source: Bank for International Settlements.

1/ Amounts outstanding based on consolidated foreign claims of reporting banks on an ultimate risk basis.

Note: The Belgian banking sector data exclude ING Belgium and BNP Paribas Fortis, classified respectively under the exposures of Dutch and French banks, and only include data from Dexia Bank Belgium and not other subsidiaries of Dexia Group.

Box 3. Deleveraging in Financial Markets—the Belgian Experience

Following the 2008 financial crisis, the largest Belgian financial groups have engaged in major restructuring programs, aimed at reducing the risk profile of their activities. The execution of the restructuring plans has resulted in significant balance sheet transformation, on both the liabilities and asset side. The recast of strategic plans included the sale and run down of non-core activities and, as a result, a reduction of funding needs.

Banks’ balance sheets and risk-weighted assets have steadily declined since 2007, by about 25 and 38 percent, respectively. The retrenchment has been more significant in the exposures to credit institutions and corporates, while exposures to retail clients and non-credit institutions (including local authorities) have decreased to a lesser extent.^{1/} The overall exposure to central governments has been largely maintained, although it entailed some structural changes.

Deleveraging Process in the Belgian Banks, 2007-11
(Consolidated end-of-period data, in euro billion)

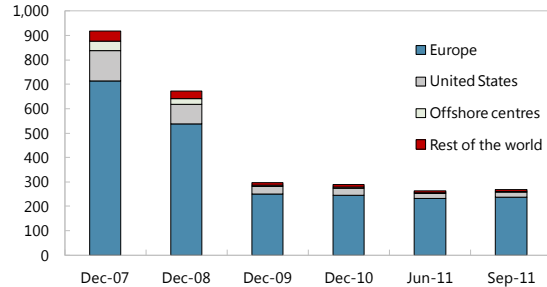
	2007	2008	2009	2010	Sep-11	% Change
Total assets	1,578.4	1,422.1	1,190.5	1,151.1	1,184.7	-24.9
Loans and advances	987.0	768.7	692.6	702.5	721.2	-26.9
Credit institutions	320.8	213.2	156.1	195.8	211.3	-34.1
Corporate	313.5	290.7	244.4	197.8	193.7	-38.2
Retail	276.2	208.0	237.4	254.0	264.3	-4.3
Central governments	16.4	13.1	14.4	11.3	6.6	-59.8
Non-credit institutions	60.1	43.5	40.3	43.6	45.3	-24.6
Debt securities	295.9	298.7	264.7	231.9	214.7	-27.4
Credit institutions	80.2	63.7	53.1	36.8	27.2	-66.1
Corporate	70.2	71.7	49.1	45.0	37.6	-46.4
Central governments	136.6	156.7	156.7	143.4	142.4	4.2
Non-credit institutions	8.9	6.6	5.8	6.7	7.5	-15.7
Risk weighted assets	583.5	491.7	407.5	372.5	361.3	-38.1

Source: NBB.

Note: "Non-credit institutions" covers inter alia loans to financial institutions other than banks and to local authorities.

The deleveraging process took place mainly abroad, while exposures to resident counterparties have increased from €352 billion (end-2007) to about €420 billion (September 2011). The external exposures to both Europe and the United States have decreased sharply during 2008 and 2009. In this period, the Belgian financial groups deleveraged by disposing of asset portfolios (legacy assets, debt securities, and non-strategic loans) and of some foreign subsidiaries.^{2/} In 2010-11, the reduction of foreign exposures has slowed as asset disposal became more difficult under worsening market conditions.

Belgian Banks' Principal Foreign Exposures, 2007-11 1/
(Billions of Euros)

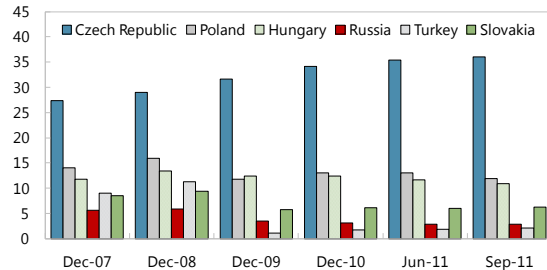


Source: BIS Consolidated Banking Statistics.

1/ Amounts outstanding based on consolidated foreign claims of reporting banks on an ultimate-risk basis.

The main exposures of Belgian banks to Emerging Europe decreased by about 8 percent, but the deleveraging in individual countries shows a mixed picture. The exposure to the Czech Republic has increased, while exposures to Turkey and Russia have declined markedly and those to Poland and Hungary decreased to a lesser extent. These differences reflect the relative importance of different foreign operations in terms of strategic market position, earning power, and development perspectives for the parent group.

Belgian Banks Main Exposures on Emerging Europe, 2007-11 1/
(In billions of Euros)



Source: BIS Consolidated Banking Statistics.

1/ Amounts outstanding based on consolidated foreign claims of reporting banks on an ultimate-risk basis.

As deleveraging in Emerging Europe is deemed to continue, the process entails risks for both the banks and the host markets where they operate.^{3/}

Under current market circumstances, the sale of foreign subsidiaries may become challenging and less profitable, despite leading to a capital relief effect (through a reduction in risk weighted assets). Moreover, reducing lending in some host markets, which offer substantially higher margins and growth opportunities, may further affect the profitability at the group level and may require changes in business models.

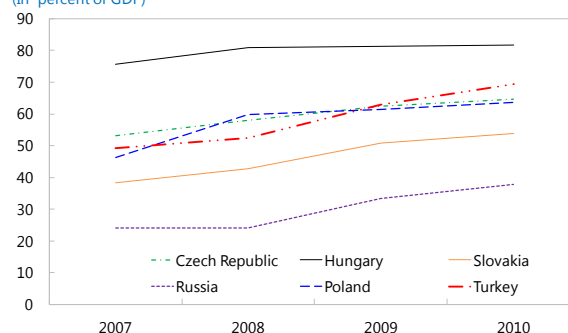
Box 3. Deleveraging in Financial Markets—the Belgian Experience (continued)

For the host emerging markets, deleveraging of foreign subsidiaries may negatively influence the supply of credit in the future. So far, evidence from markets where Belgian banks have deleveraged does not indicate a reduction in the level of financial intermediation. This could be explained by the substitution of the credit supply by other banks operating in these markets. In the longer term, reduced parent funding to foreign subsidiaries may lead to more conservative credit underwriting practices and to a more sustainable business model based on increased reliance on local savings. In the process of changing hands, the host countries' supervisors will need to be satisfied with the ownership structure, governance, and financial strength of the potential investors.

1/ In the case of corporates, the decrease of the exposures may also be explained by a lower credit demand following the financial crisis.

2/ A substantial part of the reduction of external assets in 2008 is attributed to Fortis, where the Dutch part of the financial group (Fortis Bank Netherlands) and an important part of the legacy portfolio have been carved out.

Selected European Countries: Domestic Credit, 2007-10
(In percent of GDP)



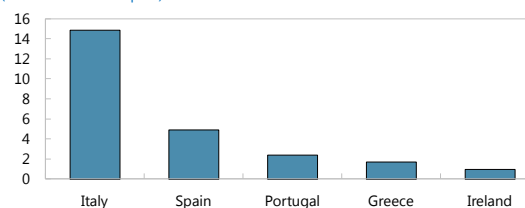
Sources: International Financial Statistics, IMF, and Economist Intelligence Unit.

3/ Announced restructuring plans indicate further disposals of subsidiaries in Emerging Europe.

4/ In Turkey, subsidiaries of the Belgian banks account for 3.4 percent of total banking sector assets, while in Russia for only 0.3 percent. In the Czech Republic, Hungary, and the Slovak Republic, Belgian banks account for much greater market shares of 20.2 percent, 11.4 percent, and 10.4 percent, respectively.

and the three euro area program countries of €52.9 billion (94 percent of Tier 1 capital of the banking system), of which exposures to sovereigns were €14 billion (25 percent of bank Tier 1 capital). The exposures to the Greek sovereign amounted to €1 billion (1.7 percent of bank Tier 1 capital) after the 55 percent average impairment booked by the banks as of 2011:Q3.

Consolidated Claims of Belgian Banks on Public Sectors in Greece, Italy, Ireland, Portugal and Spain, September 2011 1/
(Percent of Tier 1 capital)



Source: Bank for International Settlements.

1/ Amounts outstanding based on consolidated foreign claims of reporting banks on an ultimate risk basis.

Note: The Belgian banking sector data exclude ING Belgium and BNPP Fortis, classified respectively under the exposures of Dutch and French banks, and only include data from Dexia Bank Belgium and not other subsidiaries of Dexia Group.

19. The strong interplay between the banking sector and the Belgian sovereign is a source of vulnerability. The total exposure of the banking sector to the government (including exposures to local authorities) stood at €111.3 billion (of which €66.7 billion in debt securities holdings and €44.6 billion in loans) or about 9 percent of banking sector assets as of September 2011. Therefore, sovereign downgrades could put significant strains on the banking sector as it could trigger additional impairments and an increase in funding costs.⁷ At the same time, the Belgian state holds significant participations in the three largest banks and has provided extensive guarantees, with new contingent liabilities for Dexia currently reaching up to 7½ percent of GDP while previously issued guarantees related to KBC, Fortis, and Dexia amount to another 8 percent of GDP.

20. Uncertainty about the evolution of the euro crisis and slow growth in Europe weigh on the outlook for Belgium. Weakening business confidence and a worsening outlook are expected to depress investment activity. Fiscal tightening and increased uncertainty would further dampen domestic demand. As a result, real GDP growth is projected to stall in 2012, and to resume gradually from 2013 to almost 2 percent over

the medium term. Unemployment is expected to rise with the weak growth. Potential growth is projected to revert to its trend rate of about 1½ percent over the medium term as the output gap gradually closes (Box 4). The relatively high inflation in 2010–11 is being propagated by the automatic wage indexation and sizable nominal wage increases would keep inflation above 2 percent in 2012. Thereafter, inflation is set to return within the ECB's target range.

21. Risks to the outlook are slanted to the downside. The Belgian financial system remains vulnerable to financial market turmoil in the euro area and the risk of negative feedback loops between the sovereign and financial sector endures. Shocks to either the sovereign or the banks could significantly increase funding costs for both and thereby trigger a decline in credit and growth, although high household wealth may provide a buffer to the transmission of foreign shocks to domestic sovereign stress. A sharper slowdown in key trading partners also poses downside risks. Belgium's high degree of trade openness and concentration of exports make it vulnerable to cyclical developments in Europe.

⁷ Results of the 2011 EBA EU Capital Exercise reveal that KBC's net direct exposure to the Belgian sovereign amounted to €21 billion (168 percent of Tier 1 capital) as of end-September 2011, of which €14 billion is held as available for sale in the banking book and €0.7 billion in the trading book, i.e., subject to mark-to-market valuation.

Box 4. Potential Output Estimates for Belgium

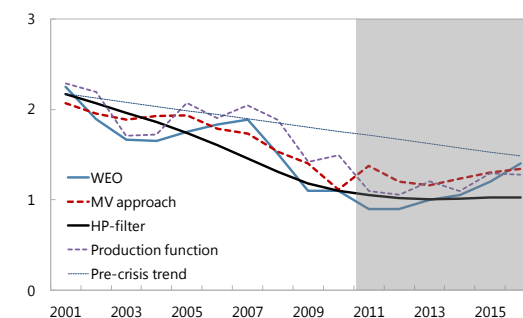
History suggests that financial crises tend to be followed by lower output potential. This can be attributed to the effects on growth via several channels, such as: (i) a decline in labor force participation; (ii) increases in structural unemployment; (iii) lower capital to labor ratios; and (iv) limited access to finance for capital investments hampering total factor productivity. However, relocation of resources can also have a beneficial impact on potential growth, if inefficient activities are being replaced by more efficient usage of resources.

Estimating the level of potential output is especially difficult in the aftermath of a recession. Estimates of potential output are always subject to considerable uncertainty, since potential output is not directly measured. In the immediate aftermath of a recession, this uncertainty is increased even further. The frequently employed filtering techniques are subject to end-point problems and are therefore less suited for computing output gaps at the end of the sample period.

Results from three different methods are employed to assess prospects for potential output growth. A standard Hodrick-Prescott (HP) filter, a production function approach and a multivariate approach (MV) provide similar indications about Belgian potential output growth. While the HP filter is a univariate approach and uses only the information derived from output, the production function approach derives the output potential from capital, labor and TFP trends, which, in turn, are determined using a HP filter. The multivariate approach instead models the joint behavior of output, unemployment, capacity utilization, inflation, and inflation expectations. The approach uses Bayesian techniques, to infer the levels of potential output and the NAIRU that would be consistent with Belgian data.^{1/}

Potential GDP growth is likely to recover to close to 1½ percent by 2016. Potential growth has fallen from almost 2 to about 1 percent according to all estimates, although over different horizons. According to the production function approach, the drop is largely due to lower capital usage. Employment losses have also contributed with ¼ percentage points to the reduction in output potential. Total factor productivity had been on a declining trend already prior to 2008. The multivariate approach suggests the fastest recovery in potential output growth, while the HP filter yields the lowest estimate with only 1 percent by 2016. Potential output growth of 1½ percent by 2016 is consistent with a linear extrapolation of the potential growth trend from 1996 to 2007. The trend implies a gradual decline of potential growth from 2 percent in 2007 to 1½ percent by 2016.

Belgium - Potential Output Growth (percent)

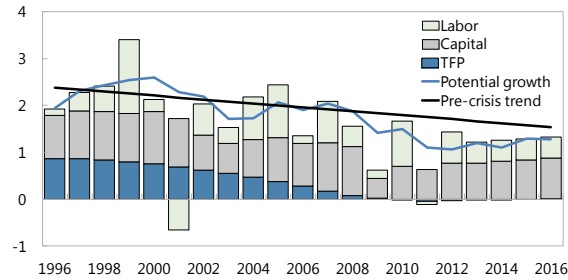


Sources: IMF staff estimates, production function estimate based on 4-year moving average; pre-crisis trend based on the linear trend from the potential growth of the production function approach from 1996 to 2008.

The output gap has narrowed rapidly from 2009 to 2011, but is estimated to widen again in 2012–13, and to close by 2017. As actual output growth recovered in 2010 and 2011, the output gap started narrowing. However, the demand shock expected for the latter half of 2011 and 2012 is likely to lower output growth substantially, while potential output is likely to be less affected. Only when actual GDP growth is expected to regain strength from 2014 would the output gap start to close again and potential output start to recover driven by higher capital accumulation.

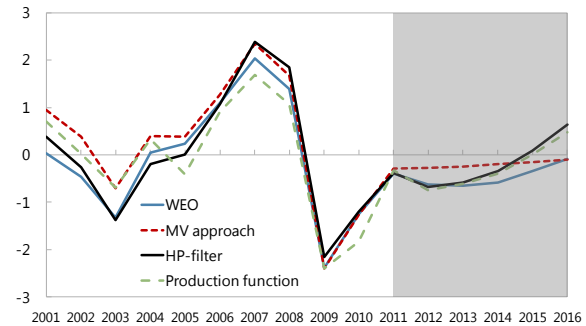
Box 4. Potential Output Estimates for Belgium (continued)

Contribution to Potential Growth
(Percent)



Source: IMF staff estimates.
Note: Potential growth reflects the 4-year moving average (hence may not sum to contributions in individual years); pre-crisis trend based on the linear trend from the potential growth of the production function approach from 1996 to 2008.

Output Gap
(Percent)

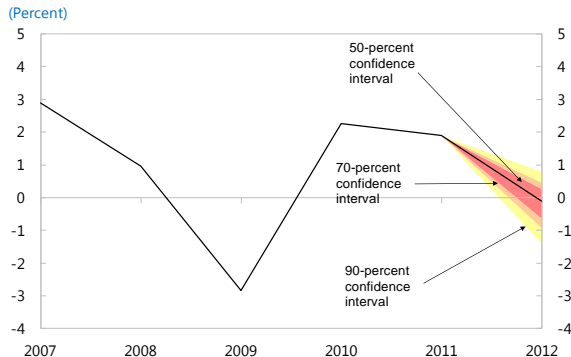


Sources: WEO; and IMF staff estimates.

¹/ Details of the approach can be found in Jaromir Benes, Marianne Johnson, Kevin Clinton, Troy Matheson, Petar Manchev, Roberto Garcia-Saltos, Douglas Laxton, 2010 "Estimating Potential Output with a Multivariate Filter," IMF Working Papers 10/285, International Monetary Fund. A prior on the growth rate of potential output of 1.9 is applied to the estimation, which is consistent with average historical output growth values since 1980 and a steady state growth assumption of 1.6 percent. The estimation is performed on quarterly data from 1995 onwards.

In contrast, a comprehensive resolution of the European financial and sovereign crisis could strengthen confidence and renew the growth momentum.

Real GDP Growth: Risks to the Forecast



Source: WEO and IMF staff estimates.

22. As Belgium’s population ages, maintaining potential growth at its current trend rate of 1½ percent over the longer term will be a challenge. The long-term potential growth rate of the Belgian economy is expected to continue to decline, notably due

to population aging. The old age dependency ratio is expected to rise sharply from 26 percent in 2010 to 42 percent in 2060 and remain around that level for the following twenty years. The European Commission’s 2009 Aging Report estimates that population aging could reduce potential real GDP growth by some ¾ percentage point.⁸ In addition, population aging would raise fiscal expenditures by 5½ percent of GDP between 2010 and 2060.⁹ This calls for sustained structural adjustment in order to preserve long-term fiscal sustainability.

⁸ European Commission’s 2009 Aging Report and High Council of Finance’s 2010 Annual Report.

⁹ High Council of Finance’s 2011 Annual Report.

Authorities' views

23. The authorities broadly agreed with staff's outlook for 2012, but were somewhat more optimistic about 2013.

They considered that as the government makes progress with fiscal consolidation, confidence would be bolstered and domestic demand rebound. The authorities expected employment growth to be more resilient than

projected by staff as the planned labor market reforms would encourage job search and creation. They agreed that risks are tilted to the downside and were aware of the potentially damaging interaction between the sovereign and the financial sector. They emphasized that their policy strategy was designed to reduce these risks.

POLICY DISCUSSIONS

A. Policy Challenges

24. Given the uncertain situation in the euro area and the risks facing the economy, the discussions focused on the need for Belgium to address long-standing challenges.

The new government's program appropriately aims at achieving fiscal sustainability over the medium term, containing risks in the financial sector, and increasing employment and growth.

- A credible medium-term fiscal consolidation plan is needed to preserve market confidence in sovereign debt, address rising aging costs, and begin to reduce the public debt to the 60 percent of GDP limit under the Stability and Growth Pact (SGP) over the longer term, in line with the EU Fiscal Compact. Reducing the fiscal deficit below 3 percent of GDP in 2012 and achieving structural balance by 2015 are appropriate goals. The sizable fiscal consolidation package for 2012-13 is

an important down payment. The consolidation should focus on structural measures, notably entitlement reforms, which do less damage to near-term growth. Automatic stabilizers should be allowed to operate to cushion the impact of the slowdown.

- In the financial sector, the authorities were aware of the need to be vigilant in view of remaining risks and remain mindful of the strong interplay between the banking system and sovereign risks. Steps should be taken to enlarge bank capital buffers, if needed to be provided by the state, to enhance confidence in the banks and to cope with risks stemming from potentially worsening market conditions. The authorities should continue to further strengthen banking supervision, and implement the Basel III and Solvency II regulatory frameworks. Strong safety nets and close cooperation between the

relevant authorities are necessary in the current environment of market volatility.

- The government program includes a number of labor market and pension reforms that are important first steps toward achieving the authorities' objective of increasing the employment rate by 5 percentage points by 2020, from the current low level of 68 percent, to boost

potential growth and achieve long-run fiscal sustainability. Reform of pension and unemployment benefits as well as tax incentives should aim at strengthening labor market participation and employment of population groups that are currently only weakly attached to the labor market.

B. Credible Medium-Term Fiscal Consolidation

25. Fiscal consolidation in 2011 was less than expected as a result of financial sector support and a cyclical drop in revenues. The restructuring of Dexia entailed fiscal support of some 0.2 percent of GDP to several entities. In addition, tax revenues deteriorated in the fourth quarter of 2011 as economic activity weakened. The fiscal deficit remained at 4 percent of GDP in 2011, above the target of 3.6 percent of GDP. The stock of general government debt rose to 98.6 percent of GDP at end-2011, partly as a result of the nationalization of the Belgian subsidiary of Dexia Group (Dexia Bank Belgium, DBB).

26. Sizeable fiscal measures are expected to bring the overall deficit below 3 percent of GDP in 2012. Given the vulnerability of Belgium's sovereign debt to market pressures, the authorities were keenly aware of the need to adhere to their Stability Program target of reducing the overall deficit below 3 percent of GDP in 2012. The 2012 budget contains fiscal consolidation measures of 2½ percent of GDP, including an

expenditure freeze announced in early January 2012 which will be replaced by structural measures in the February budget review. The consolidation measures are, however, partially offset by the automatic wage and benefit indexation in early 2012. In addition, the increase in the number of pensioners projected for 2012 is expected to raise outlays on pension benefits by ¼ percent of GDP. Overall, the structural consolidation effort amounts to some 1½ percent of GDP, bringing the 2012 deficit to 2.9 percent of GDP. Half of the fiscal savings are from revenue measures, especially taxes on various savings vehicles. Should growth fall substantially below the baseline projection, automatic stabilizers should be allowed to operate freely, as long as government market access is not jeopardized. This would avoid a spiral of fiscal consolidation and weakening economic growth, in turn undermining public debt sustainability.

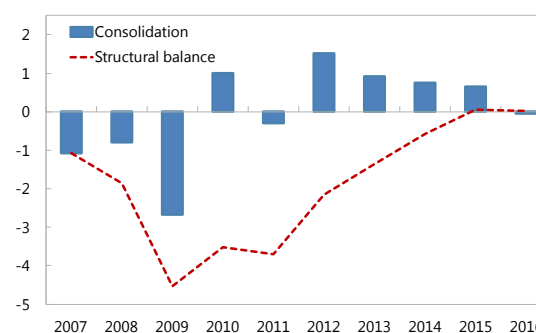
Fiscal savings measures, 2012 (percent of GDP)	
Revenues	1.3
Tax revenues	1.0
of which:	
Notional interest tax deductibility	0.4
Tax on movable property	0.2
Nontax revenues	0.2
Expenditures	0.7
of which:	
Health care	0.2
Other	0.6
TOTAL	2.5

Source: Belgian authorities and IMF staff estimates.

27. Additional consolidation measures will be necessary after 2012 to achieve the authorities' goal of structural balance by 2015. Staff recognizes the difficult trade-off between maintaining investor confidence in Belgian sovereign debt and supporting economic activity. Given the limited fiscal space, it is appropriate to aim for achieving a structurally balanced budget by 2015 while letting automatic stabilizers operate freely around the consolidation path, in order to sustain activity. Since the structural deficit in 2012 would remain above 2 percent of GDP, an additional structural consolidation effort will be required over 2013-15. The new government's program already includes measures of some ½ percent of GDP that will become effective in 2013. These include increased excise taxes on polluting cars, as well as expected revenue gains from combating fiscal fraud and rising employment as a result of labor market reforms. The revenue impact from the latter may not materialize as planned if the current weak patch of the economy extends through 2013.

Structural Balance

(Percent of GDP)



Sources: NBB; and IMF staff estimates.

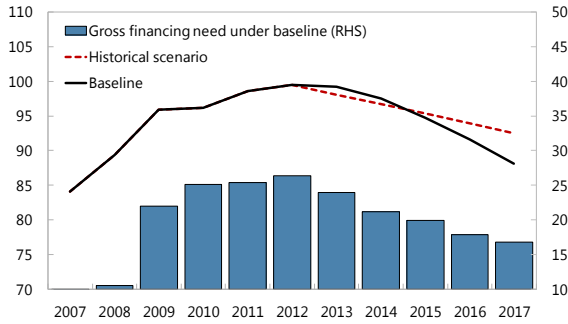
28. Even modest changes in the economic environment would rapidly push the public debt ratio above 100 percent.

Under the baseline scenario, if the consolidation plan is fully adhered to, public debt rises to about 99 percent of GDP in 2012–13 before declining to about 88 percent by 2017 (Figure 3 and Table 4). A 1¼ percent of GDP increase in the primary deficit, a 1 percent interest rate increase, or a 1 percent slowdown in growth would raise general government debt above 100 percent of GDP in 2013 or 2014. In addition, there are substantial contingent liabilities of the federal government from bank support. The funding guarantee approved by the European Commission to Dexia SA and *Dexia Crédit Locale* in December 2011 and the contingent liabilities related to previously issued guarantees to KBC, Fortis, and Dexia amount to 15½ percent of GDP. If half of these contingent liabilities came due in 2012, the stock of general government debt would rise to 106 percent of GDP in 2012 and remain above GDP until 2015.

Figure 3. Belgium: Public Debt Sustainability: Bound Tests

Baseline and Historical Scenarios

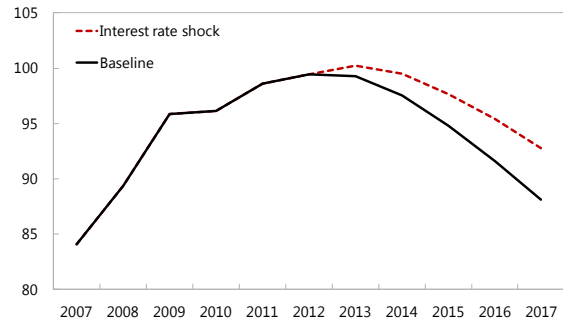
(Percent of GDP)



Sources: Belgian Debt Agency; and IMF staff calculations.

Interest Rate Shock

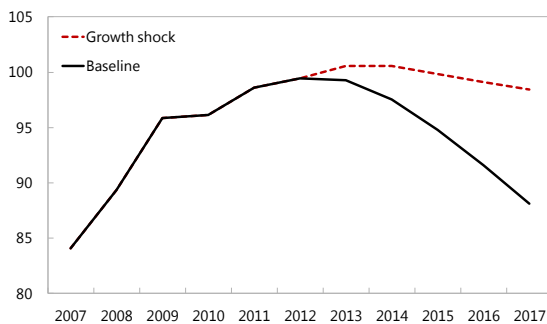
(Percent of GDP)



Sources: Belgian Debt Agency; and IMF staff calculations.

Growth Shock

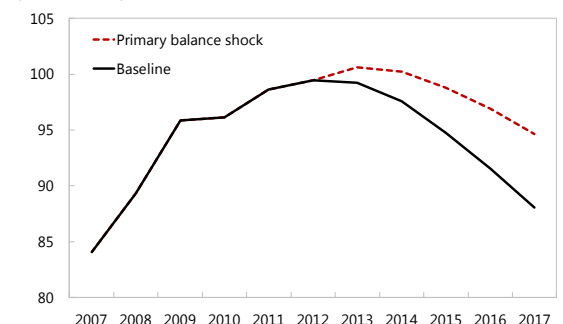
(Percent of GDP)



Sources: Belgian Debt Agency; and IMF staff calculations.

Primary Balance Shock

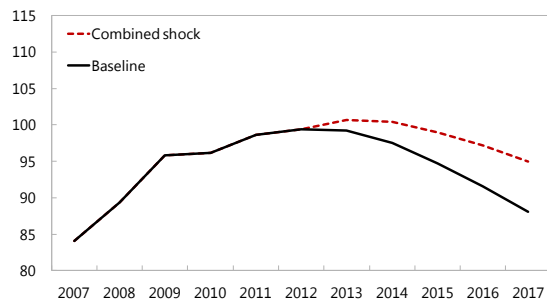
(Percent of GDP)



Sources: Belgian Debt Agency; and IMF staff calculations.

Combined Shock 1/

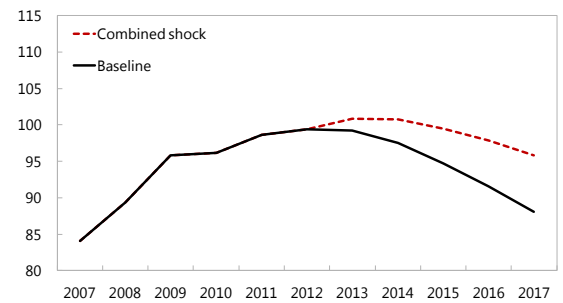
(Percent of GDP)



Sources: Belgian Debt Agency; and IMF staff calculations.
 1/ Permanent 1/2 standard deviation shocks applied to real interest rate while permanent 1/4 standard deviation shocks applied to growth rate, and primary balance.

Combined Shock 1/

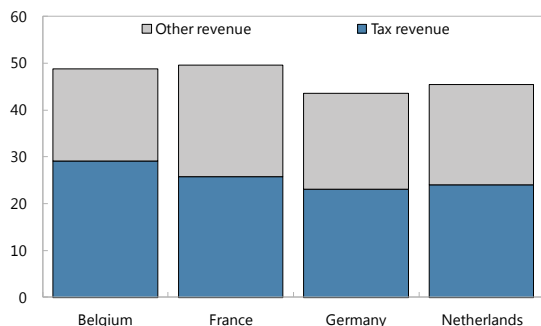
(Percent of GDP)



Sources: Belgian Debt Agency; and IMF staff calculations.
 1/ Permanent 1 percent shock applied to real interest rate while permanent 1/4 standard deviation shocks applied to growth rate, and primary balance.

29. The additional consolidation effort should be centered on containing expenditures through entitlement reform and streamlining public sector employment, as well as on broadening the tax base. With a revenue-to-GDP ratio near 50 percent, and above that in the Netherlands and Germany, additional saving efforts should now focus on the expenditure side, especially further entitlement reform that will also boost potential growth.

General Government Revenues, 2010
(Percent of GDP)



Sources: World Economic Outlook, Haver Analytics.

- Additional pension reforms are needed to contain rising aging-related costs. A national dialogue should be started to prepare a comprehensive pension reform. The average effective retirement age—at 59 years one of the lowest in the OECD in 2009—needs to be raised closer to the official retirement age (65 years).¹⁰ The government has already decided to gradually raise the minimum age for early retirement from 60 to 62 years by 2016.

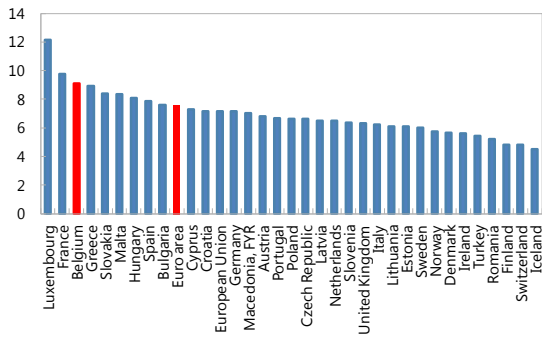
¹⁰ An increase in the effective retirement age by one year is estimated to yield structural savings of ½ percent of GDP.

Additional measures could comprise removing fiscal indicatives for pre-pension benefits; further raising the early retirement threshold; counting spells of unemployment to a lesser degree towards pension benefits; and introducing actuarially neutral discounts on pensions granted before the official retirement age of 65 to compensate for the longer benefit and shorter contribution periods.

- Reducing the real growth norm for health care spending from 4½ percent to 2 percent would strengthen incentives for tighter expenditure control. This could be accomplished through efficiency improvements, and by strengthening cost-saving incentives for health care providers and customers, including by aligning pharmaceutical reimbursement reference prices to those of generic products and by increasing co-pay.
- Public sector employment is among the highest in the European Union as a share of total employment, resulting in a relatively high government wage bill. One-third of public servants are expected to retire by 2020, providing an opportunity to reduce wage costs by not replacing a sizable number of them at all levels of government.

Employment in Public Administration, 2010 Q2

(Percent of total employment)



Sources: Eurostat.

- On the revenue side, considerable scope remains to reduce federal and regional tax exemptions (see below). This could help offset the fiscal impact of reducing the labor tax wedge and rebalance the relative weight of tax revenues towards indirect taxes.

30. The consolidation effort should be set into a strengthened institutional framework. A rules-based fiscal framework for the general government would add credibility to the consolidation effort and the preservation of fiscal sustainability in the long term. A structural balance fiscal rule, in line with the EU Directive on Requirements for Budgetary Frameworks and the draft Treaty on Stability, Coordination, and Governance in the Economic and Monetary Union (Fiscal Compact), should include a provision that unforeseen additional revenues be assigned to public debt reduction. A transition period will be necessary as Belgium's consolidation strategy aims at reducing the structural fiscal deficit below the general Fiscal Compact ceiling of 0.5 percent of GDP by 2015. Full implementation of the government's medium-

term consolidation strategy would reduce the public debt ratio by more than 10 percentage points by 2017, in line with the debt targets under the Fiscal Compact.

31. A multi-year perspective, based on realistic revenue assumptions and an in-depth expenditure review, would help prioritize spending programs. Such a rules-based, multi-year framework for the general government would need to be complemented with a burden-sharing agreement between the different levels of government, including spending caps for each level. Close coordination between the regions and municipalities should help ensure adherence to the overall fiscal targets committed to at the European level. A burden-sharing agreement will become increasingly important as the state reform takes effect in 2014 and the degree of fiscal federalism widens.

Authorities' views

32. The authorities broadly concurred with staff's view. They reiterated their strong commitment to reduce the deficit below 3 percent of GDP in 2012, and confirmed that durable measures of sufficient magnitude (about ½ percent of GDP) would be identified to this end during the February budget review. Further budget reviews in 2012 would provide an opportunity to monitor progress against the budget targets and take further measures, if needed. The authorities also agreed that additional consolidation would be needed to achieve structural balance by 2015, but

stressed that medium-term consolidation would also need to include options to raise revenue. They considered reinforcing the

C. Safeguarding Financial Stability

33. After a notable improvement in 2010, the conditions of the banking sector weakened again in 2011 following the resurgence of the financial crisis in the euro area. In 2010, banks returned to profitability with net profits reaching €5.6 billion against a €1.2 billion loss in 2009 and their Tier 1 capital adequacy ratio increasing to 15.5 percent on aggregate (Figure 4). The deleveraging has been considerable. By September 2011, the sector's balance sheet had declined by 25 percent (€394 billion) from its pre-crisis value at end-2007.¹¹ Renewed sovereign distress in 2011 and unfinished restructuring coupled with the need to fund legacy assets affected major banks significantly through higher funding costs, widening funding gaps, impairment of sovereign assets, as well as more difficult asset disposals. System-wide, capital ratios remained well-above the regulatory norm and credit quality indicators were generally stable, although in some sectors impairments are on the rise.

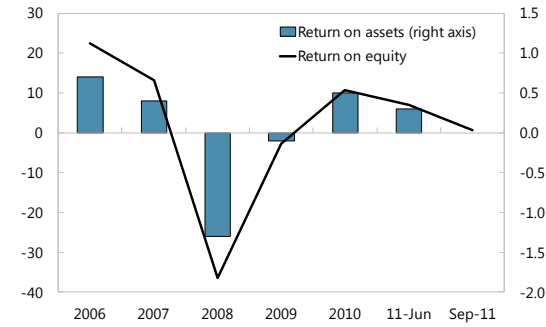
¹¹ The increase in the total balance sheet on a consolidated basis in 2011:Q3 was mainly the result of the strong decline in long-term interest rates, which pushed up the market value of interest rate derivatives and—as a counterpart—the amounts of collateral posted against these market values.

institutional fiscal framework as important, notably the adoption of a fiscal rule engaging all levels of government.

34. Notwithstanding the prompt resolution of Dexia, the authorities need to remain alert to potential spillovers and execution risks. While the actions undertaken so far proved stabilizing, they came at the cost of a significant rise in the state's contingent liabilities. The dismantling of the international Dexia Group is a complex process, entailing substantial operational and financial implications for the entities of the group in a difficult market context. Important steps have been taken to unwind former intra-group exposures and to build management and operational capacity in DBB. Going forward, the execution of Dexia's restructuring plan will require continued vigilance, intensive supervisory and government oversight, and coordination among all relevant authorities to prevent contagion and minimize future fiscal costs. The authorities should work with relevant foreign counterparts in implementing appropriate supervisory treatment for Dexia Group. The other entities which suffered losses on Dexia's shareholdings following its resolution should be handled in a manner that reduces additional fiscal implications for the state.

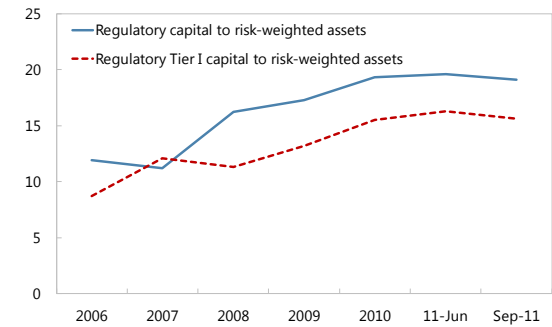
Figure 4. Belgium: Selected Financial Sector Indicators, 2006–12

Bank Profitability
(Percent)



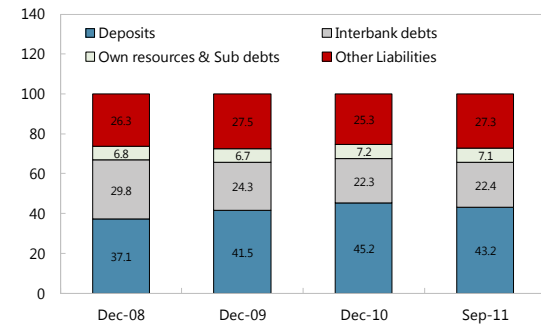
Source: NBB

Bank Capital Ratios
(Percent)



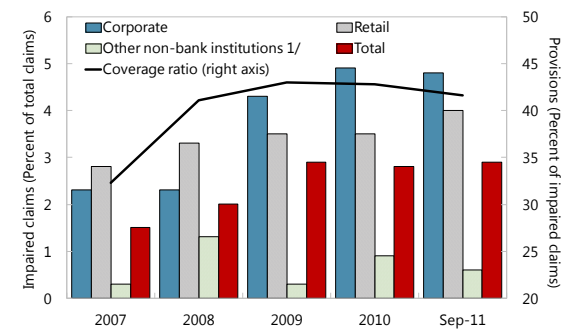
Source: NBB

Funding Structure of Credit Institutions
(Percent of total liabilities)



Source: NBB.

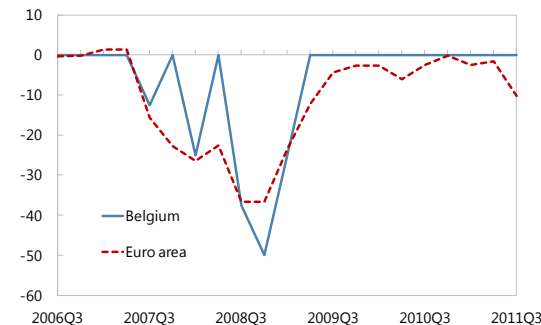
Credit Quality Indicators



Source: NBB

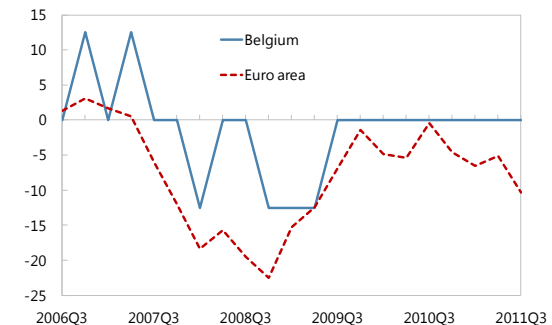
1/ Exposures on non-bank financial institutions and local authorities.

Lending Criteria, Non-Financial Corporate Sector
(Percent)



Source: NBB.

Lending Criteria, Residential Mortgages
(Percent)



Source: NBB.

35. Future progress with financial sector restructuring is subject to heightened uncertainty.

BNP Paribas Fortis and KBC have advanced with their restructuring, but continue to be reliant on public support and their ability to maintain the planned pace of deleveraging through further asset disposals is challenged by difficult market conditions. Continued efforts will be needed to improve their operational efficiency and reduce operating expenses, given the revenue pressures stemming from limited growth prospects of the Belgian market, continued deleveraging, high funding costs, and adverse developments in some foreign subsidiaries. Going forward, it is important for the authorities to insist on strong capital buffers when the state capital would be repaid.¹² Absent this recapitalization, public support may need to be maintained beyond the dates initially envisaged.

36. Banks should continue to build up capital to deal with possible adverse market dynamics and maintain funding access.

The authorities should take steps to ensure that banks have strong capital buffers, in line with forthcoming Basel III capital requirements, that are achieved as far as possible by increasing capital rather than slowing down credit. Reinforced capital buffers, if needed to be provided by the state, are essential to enhance confidence in the banks and to cope with risks

¹² According to the restructuring plan approved by the European Commission in 2009, KBC should reimburse the state aid by end of 2013 to avoid incurring costly penalties.

stemming from potentially worsening market conditions.

37. The resolution of Dexia again showed the importance of cross-border cooperation in the areas of supervision and resolution.

At this juncture, it is important to strengthen the dialogue with foreign supervisors, including within the respective supervisory colleges. Increased supervisory cooperation should lead to acquiring a more thorough understanding of international groups' activities, risks (including contagion risks within the groups), and governance, and enable a more intrusive oversight and timely corrective action or resolution, if necessary. Moreover, the authorities might need to review the resolution framework in light of EU-wide developments.

38. The new supervisory architecture in place since April 2011 should improve coordination of micro- and macro-prudential policies.

The prudential supervision of financial institutions has been integrated into the central bank, while the Financial Services and Markets Authority (FSMA) is assigned the task of ensuring the smooth operation of markets and the protection of consumers of financial services. All bank and insurance supervision staff were taken over by the National Bank of Belgium (NBB) which now should continue with the challenging task of organizing the supervisory function in a manner that enables to reap the synergies with the traditional roles of the

central bank. Staff welcomes the authorities' plans to further strengthen resources devoted to prudential supervision. Progress has been made in developing the macroprudential toolkit to identify and mitigate systemic risks, while further steps in enhancing the macroprudential framework should be guided by the recent recommendations of the European Systemic Risk Board.¹³ Limiting intra-group exposures of Belgian banks from end-2012 and proposed covered bonds legislation would enable banks to shore up liquidity and tap new sources of wholesale funding at critical moments. Moreover, enhanced supervisory oversight over smaller banks would be necessary as competitive pressures on the domestic market will intensify.

39. Strong financial safety nets are important in the current environment of elevated market volatility and uncertainty.

The reserves of the deposit guarantee scheme amounted to €2 billion at end-2011, implying a coverage ratio of around ½ percent of eligible deposits (at the lower end in an international comparison). The introduction of risk-based contributions to the deposit guarantee system¹⁴ and the setting up of a

¹³ Recommendation of the European Systemic Risk Board of 22 December 2011 on the macro-prudential mandate of national authorities (ESRB/2011/3) http://www.esrb.europa.eu/pub/pdf/ESRB_Recommendation_on_National_Macroprudential_Mandates.pdf?87d545ebc9fe76b76b6c545b6bad218c

¹⁴ In June 2011, the Constitutional Court canceled the article establishing the uniform deposit guarantee contribution by all banks (Law of December 23, 2009), following the claim of a mid-sized bank that the fee was disproportionately affecting

(continued)

financial stability fund¹⁵ in 2012 are welcome. Going forward, the authorities should ensure that the newly designed deposit guarantee scheme has adequate resources, a sufficient degree of autonomy and strong governance arrangements in line with best international practice, while taking account of potential synergies with other resolution mechanisms. To facilitate effective policy actions, it is equally important to establish a formal framework for cooperation and information exchange on financial stability issues among the relevant national authorities, drawing from past experience with the Financial Stability Committee.¹⁶

40. The insurance sector has improved its profitability in 2010, but remains vulnerable to sovereign risk. Since

government and corporate bonds account for a large share of total investments of insurance companies, the sector is highly sensitive to the increase in risk premiums in euro area bond markets. The solvency margin remained more

institutions funded with retail deposits compared to riskier institutions relying on wholesale funding. The new legislation on the deposit guarantee system was passed in December 28, 2011 and entered into force in 2012.

¹⁵ New legislation has been passed establishing the requirement for banks to pay a financial stability contribution calculated as a percentage of total liabilities net of own capital and deposits.

¹⁶ The former Financial Stability Committee (FSC) was replaced in July 2010 by the Committee for Systemic Risks and System-relevant Financial Institutions (CSRSFI), which was put in charge of the prudential supervision of systemic financial institutions during the transition to a new supervisory architecture which entered into force in April 2011. The latter is yet to be replaced by a formalized framework reflecting the new supervisory layout.

than twice the required regulatory minimum and the authorities expect the implementation of Solvency II requirements to be smooth. The resolution of Dexia has imposed losses on Ethias, one of the largest insurance companies and a former shareholder in Dexia,¹⁷ which may demand further public support. The progress with the preparations for Solvency II implementation should be closely monitored by NBB.

Authorities' views

41. The authorities agreed on the need to be alert to risks in the financial sector and considered that completing the restructuring of the financial sector remains a priority. The authorities were committed to enhanced oversight as well as close

cooperation with relevant foreign authorities so as to maintain financial stability. They recognized the importance of robust capital buffers in the financial sector and will continue to closely monitor implementation of Basel III and Solvency II standards. The authorities underlined that important progress has been achieved in strengthening financial sector supervision and welcomed the FSAP Update scheduled for end-2012 as an opportunity to engage in in-depth discussions on financial sector issues, including in the areas of supervisory standards compliance, conglomerate supervision, crisis management and resolution framework, and macroprudential policy.

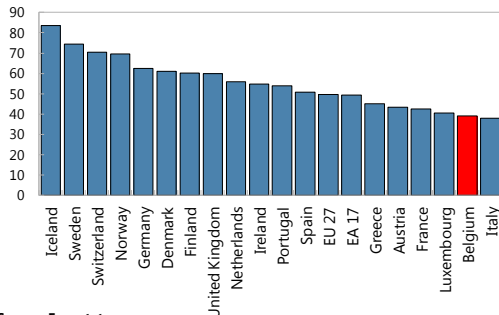
¹⁷ According to the restructuring plan approved by the European Commission, Ethias has divested of its stake of 5 percent in Dexia SA. The fulfillment of this commitment has been achieved by transferring the participation in Dexia SA to its parent company, Ethias Finance SA, which was recapitalized by the federal and regional governments for €180 million.

D. Kick-starting Structural Reforms

42. The government is taking the first steps in tackling long-standing labor market distortions in order to increase the employment rate (for 20–64 year olds) by 5 percent by 2020. By thus increasing the Belgian employment rate close to the euro area average, trend output growth could eventually be increased by about ½ percent per year. The reforms aim in particular at increasing activity of the young and of older workers, and should help reduce the large regional dispersion in unemployment (Box 5). Specific measures include greater degressivity in unemployment benefits; limiting the availability of unemployment benefits to first time labor market entrants; stricter enforcement of job search requirements for workers up to 60 years; a gradual limitation of pre-pension benefits for older workers; and a stepwise increase in the minimum age for early retirement from 60 to 62 years by 2016. Many of the agreed reforms are to be implemented gradually, which mutes the immediate impact on employment incentives and makes it important to guard against implementation risks.

2010 Activity Rates, 55–64 Year-Olds

(Percent)



Source: Eurostat.

43. Boosting potential growth and achieving fiscal sustainability may require additional reforms of the labor market and the tax regime. Reforms should focus on further raising the activity rate, increasing wage flexibility, and strengthening tax incentives to job creation.

- While social benefit levels are such that replacement rates are not out of line with OECD averages, access to these benefits is broad.¹⁸ Eligibility requirements for unemployment, pre-pension, and early retirement benefits could be further tightened while enhancing efforts to increase job search activities. Unemployment benefits could be phased out after a fixed period of time. In addition, incentives in the administration of unemployment benefits could be better aligned, in order to intensify the monitoring of search activities and increase sanctions on inadequate efforts. It would help to shift resources from employment subsidies towards enhanced

¹⁸ According to the *OECD's Belgium Economic Survey 2011*, net replacement rates of unemployment benefits and pension benefits are broadly in line with OECD practices. Until the recent reforms, unemployment benefits declined less over time than in many other OECD countries but net replacement rates started lower. Pension benefits for civil servants remain more generous than for private sector employees. The Sixth Reform of the State pledges to align civil servants' pension benefits to the general pension benefit system. For details, see the Selected Issues Paper, chapter 3.

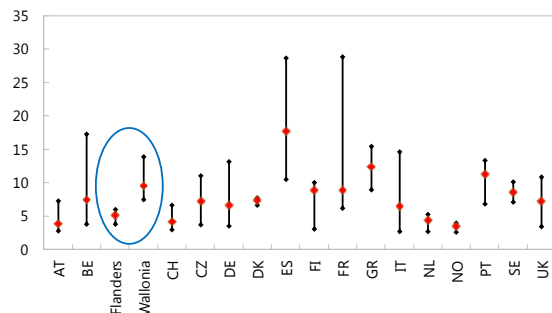
Box 5. Belgium: The Regional Dimension of Unemployment

The dispersion of unemployment rates is, by EU standards, exceptionally large in Belgium.

In 2010, unemployment rates in Belgium ranged from 3.8 percent in West-Flanders to 17.3 percent in Brussels. Only Spain and France, both about twenty times Belgium's size by area, have a greater regional dispersion of unemployment rates.

Regional Unemployment Rates, 2010

(NUTS 2 level, percent)



Source: Eurostat.

High unemployment rates are concentrated in French-speaking Wallonia and Brussels and in provinces with formerly large mining sectors and steel industry.

The highest unemployment rates are in provinces which used to be dominated by mining industries. Furthermore, reportedly nine out of ten jobseekers in Wallonia and Brussels do not speak Dutch, which is a major obstacle to finding a job in Flanders and in Brussels. Other impediments to geographical mobility exist as well, including a fairly high rate of home ownership coupled with large transaction costs when people want to move.

Regional disparities in the implementation of the unemployment benefit system may contribute to diverging labor market incentives.

For example, in 2007, Wallonia and Brussels imposed half as many sanctions (2.51 and 2.02 sanctions per hundred unoccupied job seekers, respectively) as Flanders (6.92 sanctions per hundred unoccupied job seekers). This relative ranking was reversed in 2010.

search assistance and training, especially in regions with high unemployment.

- The automatic wage indexation mechanism should be abolished or at least significantly reconsidered to increase flexibility in sectoral wage negotiation, improve wage cost competitiveness, and avoid second-round effects of energy price volatility and potential increases in indirect taxation. Increasing the scope for tailor-made sectoral wage negotiations would have a positive impact on competitiveness and job creation, reduce pressures to downsize staffing in sectors that are hit by

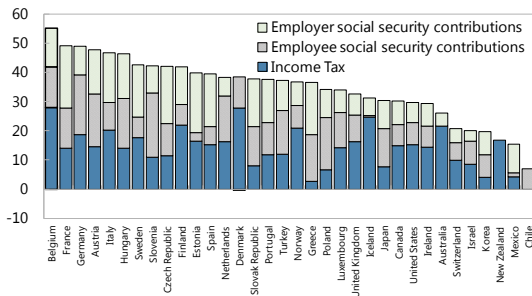
the recession, and limit pressures on the budget.

- The high labor tax wedge has created disincentives to work and, as a result, labor participation and hours worked are well below the EU average.¹⁹ The tax wedge on labor should be reduced to boost labor demand while increasing the differential between wages and unemployment benefits to enhance incentives for job search activities. To compensate for the

¹⁹ The OECD estimates that a 10 percentage point reduction in the tax wedge can increase employment over time by 3.7 percentage point in an average OECD country.

lost revenue, the VAT tax base could be broadened, tax expenditures could be streamlined, the collection of environmental taxes could be raised to reach EU-15 levels, and the immovable property tax could be revised.²⁰

OECD Countries: Total Tax Wedge in 2010 /1
(Percent)



Source: OECD, Taxing Wages Database.
1/ For a single individual worker without children, at the income level of the average worker.

44. Competition policy should be strengthened further. In the energy sector, barriers to entry could be further reduced and regulatory oversight should be strengthened to limit any rents and bring energy prices closer to the levels in neighboring countries. The EU Services Directive has been transposed

²⁰ The VAT revenue ratio in Belgium (defined as total VAT revenue relative to its potential base) was 0.49 at end-2008, significantly below the EU-15 average (0.55) and comparator countries such as Germany (0.55) and the Netherlands (0.6), reflecting the impact of exemptions and reduced VAT rates. The revenue from the immovable property tax stood at 1.2 percent of GDP at end-2008, much below the level observed in France (2.4 percent of GDP) and other major OECD countries such as the United Kingdom (3.5 percent of GDP) and the United States (3.1 percent of GDP). Outdated assessment of immovable property values largely explains the relatively lower yield of immovable property taxes in Belgium. See also the Selected Issues Paper, chapter 2.

into national legislation but further steps are needed to achieve its full implementation.

Authorities' views

45. The authorities regarded the planned labor market reforms as important actions to increase employment and growth. They were confident that the measures would increase employment but acknowledged that progress would have to be carefully monitored. Additional reforms could be considered in coming years to raise the effective retirement age close to the official age. Stepped up activation policies would also be important. These should include efforts by firms to increase employment of older workers, and expanded and more efficient job search assistance. The authorities will keep the automatic wage indexation system under examination. They cautioned, however, that addressing this issue now would jeopardize support for the ongoing labor market and pension reforms, and hence be counterproductive. The authorities agreed that a reduction in labor taxation could help boost employment and growth. They concurred with the possibility to increase environmental taxes and to reduce tax expenditures but cautioned that immovable property taxes are levied at the local authority level and that coordinating tax efforts between different levels of government would be challenging.

STAFF APPRAISAL

46. The high public debt and strong interlinkages between the banks and the sovereign continue to pose risks while the outlook is clouded by slow growth across Europe. A recession in Belgium is already underway since the third quarter of 2011, and real GDP is expected to stagnate in 2012 with a slow recovery in 2013. Downside risks to the outlook are significant as the open Belgian economy and large financial sector remain vulnerable to turmoil in the euro area. This makes the Belgian sovereign's refinancing costs and the banking sector susceptible to shocks while the risk of negative feedback loops between the sovereign and financial sector endures. High household wealth may provide an implicit buffer conditional on domestic investors' willingness to replace foreign demand for Belgian debt.

47. The new federal government has begun to address the risks and long-standing problems facing the Belgian economy, but full implementation of its program is crucial. The government program appropriately aims at achieving a structurally balanced budget by 2015, completing the restructuring of the financial sector, and raising the low employment rate by 5 percent by 2020. The near-term measures are important first steps towards achieving these objectives. In particular, the program includes a sizable fiscal consolidation package, and wide-ranging labor market and pension

reforms. Over the medium term, further action is needed to deal with rising aging costs while reducing the high public debt, including by bringing the low effective retirement age close to the legal retirement age of 65 years.

Sustained job creation and boosting growth are indispensable for sound public finances and require pushing ahead with reforms in labor and product/services markets. A job-friendly tax reform could raise trend growth.

48. Resuming credible fiscal consolidation remains a priority. In light of the vulnerability of Belgium's sovereign debt to market pressures, it is essential to reduce the deficit in 2012 below the Stability Program's ceiling of 3 percent of GDP. The 2012 budget, together with a partial spending freeze, contains sizeable fiscal savings measures. It is important that the ad hoc spending freeze is replaced at the time of the February budget review by structural measures of sufficient magnitude to enable reaching the deficit target. In this connection, the costly automatic wage and benefit indexation should be reconsidered against other spending priorities. Should growth fall significantly below current projections, the automatic stabilizers should be allowed to operate to buffer the downturn as long as financial market access is not jeopardized

49. After 2012, additional consolidation efforts will be required to achieve structural balance by 2015.

With revenues already at almost 50 percent of GDP, measures should focus on the expenditure side, especially further pension reforms that would further raise the effective retirement age; measures to contain the growth rate of health care spending; and curtailing public sector employment by not replacing a sizable share of retiring public servants at all levels of government. In light of the weak growth prospects in the next few years, automatic stabilizers should be allowed to operate freely around the consolidation path. The consolidation effort should be set into a rules-based framework for the general government and be based on a renewed burden-sharing agreement between all levels of government. This will become increasingly important as the Sixth Reform of the State takes effect in 2014 and the degree of fiscal federalism widens.

50. The Belgian financial system is at a critical juncture.

The financial sector remains highly vulnerable to sovereign and financial market turmoil in the euro area and the interplay with its own sovereign has further intensified. Further deleveraging is challenged by difficult asset disposals, while profits are likely to come under pressure from intensifying competition on the domestic market and the worsening economic outlook.

51. Remaining risks need to be addressed in a proactive manner.

The

restructuring of Dexia Group needs to continue under intense oversight in a way which limits contagion and fiscal costs, and in close cooperation between relevant Belgian and foreign authorities. Building strong capital buffers remains an important priority in view of the financial sector's vulnerability to spillovers from the turmoil in European markets. Given the difficult market context, the authorities should stand ready to provide necessary backstop if private capital cannot be tapped. Staff welcomes the measures taken to strengthen supervisory resources and to develop the macroprudential toolkit. It is important to finalize the legislative process for the newly designed deposit guarantee scheme taking account of potential synergies with other resolution mechanisms. Prompt progress with enacting relevant covered bond legislation is desirable. The Belgian experience has also underscored the need for an effective approach to crisis management and a cross-border resolution framework in Europe.

52. The labor market and pension reforms initiated by the government are welcome steps toward raising employment and growth.

Nevertheless, further steps may be needed to achieve the government's ambitious employment goals. Eliminating or at least significantly reforming the automatic wage indexation would benefit competitiveness and job creation. Initiation of a national dialogue would help pave the way for a comprehensive pension reform, which should be complemented by a compact

between the social partners that would facilitate employment for older workers. Unemployment benefits could be phased out after a fixed period to strengthen job search incentives. To help the unemployed more effectively to find a job, resources could be shifted to enhanced search assistance and training

53. Competition policy should be strengthened further and a job-friendly tax reform could boost growth and help restore fiscal sustainability. Barriers to

entry in the energy sector could be reduced while strengthening the sector's regulation. In the services sector, the EU Service Directive still needs to be fully implemented. Given the lack of fiscal space, any reduction in the high labor taxes would have to be offset by an increase in tax revenues that are less detrimental to more labor-intensive growth. A burden-sharing agreement for fiscal consolidation may help forge the political consensus needed to embark on such a reform.

54. It is recommended that the next Article IV consultation with Belgium be held on the standard 12-month cycle.

Table 1. Belgium: Selected Economic Indicators, 2007–17

	2007	2008	2009	2010	Projections						
					2011	2012	2013	2014	2015	2016	2017
(Percentage change from the previous period; unless otherwise indicated)											
Real economy											
Real GDP	2.9	1.0	-2.8	2.3	1.9	-0.1	0.8	1.3	1.6	1.8	1.9
Private consumption	1.7	1.9	0.8	2.5	0.6	0.2	0.8	1.1	1.3	1.6	1.7
Public consumption	2.0	2.4	0.8	0.2	0.7	-0.3	0.1	0.4	0.6	1.1	1.4
Gross fixed investment	6.0	2.0	-8.1	-0.7	4.5	-0.5	1.1	2.6	3.1	3.5	3.8
Business investment	8.2	4.2	-9.3	-1.6	7.2	-0.6	1.7	3.6	4.1	4.3	4.7
Dwellings	-1.1	0.9	7.2	-1.8	6.5	2.3	0.1	0.0	0.0	0.8	1.2
Public investment	3.3	-2.7	-9.2	1.6	-1.6	-1.3	0.1	1.0	1.5	2.1	2.4
Stockbuilding 1/	0.1	-0.3	-0.7	0.0	1.5	-0.1	0.0	0.0	0.0	0.0	0.0
Foreign balance 1/	0.2	-0.8	-0.7	1.2	-0.4	0.1	0.1	0.1	0.1	0.0	-0.1
Exports, goods and services	5.2	1.7	-11.2	9.9	4.7	-0.8	3.2	4.2	4.6	4.6	4.4
Imports, goods and services	5.5	3.1	-10.7	8.7	5.3	-0.9	3.2	4.3	4.6	4.9	4.7
Household saving ratio (in percent)	16.4	17.0	18.3	16.4	16.8	17.5	17.1	16.7	16.5	16.1	15.9
Potential output growth	1.9	1.5	1.1	1.1	0.9	0.9	1.0	1.1	1.2	1.4	1.5
Output gap (in percent)	2.0	1.3	-2.4	-1.3	-0.3	-1.3	-1.5	-1.3	-0.9	-0.5	-0.1
Employment											
Unemployment rate	7.5	7.0	7.9	8.3	7.3	8.0	8.6	8.8	8.9	8.6	8.3
Employment	1.7	1.8	-0.1	0.8	1.2	-0.3	0.2	0.6	0.9	1.1	1.2
Prices											
Consumer prices	1.8	4.5	0.0	2.3	3.5	2.2	1.9	1.9	1.9	1.9	2.0
GDP deflator	2.3	2.2	1.2	1.8	2.7	2.3	1.8	1.8	2.0	2.0	2.2
ULC (in whole economy)	2.1	4.5	3.8	0.0	2.8	3.4	1.3	1.8	2.1	2.1	2.0
(Percent of GDP; unless otherwise indicated)											
Public finance											
Revenue	48.0	48.6	48.0	48.8	48.4	49.8	49.8	49.8	49.8	49.8	49.8
Expenditure	48.3	49.9	53.8	52.9	52.5	52.8	52.1	51.1	50.3	50.2	49.9
General government balance	-0.3	-1.3	-5.8	-4.1	-4.0	-2.9	-2.2	-1.2	-0.4	-0.2	0.0
Structural balance	-1.1	-1.9	-4.5	-3.5	-3.7	-2.2	-1.4	-0.6	0.0	0.0	0.0
Primary balance	3.5	2.5	-2.2	-0.7	-0.4	0.9	1.5	1.9	2.4	2.2	2.1
General government debt	84.1	89.3	95.9	96.2	98.6	99.4	99.3	97.6	94.8	91.6	88.1
Balance of payments											
Trade balance	1.5	-2.2	0.3	0.8	-0.3	0.7	0.9	1.1	1.4	1.5	1.6
Current account	1.6	-1.6	-1.7	1.5	0.0	-0.1	0.6	1.0	1.4	1.5	1.6
Terms of Trade (percent change)	0.6	-3.6	3.6	-2.1	-1.5	0.1	0.0	0.1	0.0	0.1	0.0
Exports, goods and services (volume, percent change)	4.9	-1.8	-11.3	8.4	4.7	-0.8	3.2	4.2	4.6	4.6	4.4
Imports, goods and services (volume, percent change)	5.6	-1.8	-12.3	7.4	5.3	-0.9	3.2	4.3	4.6	4.9	4.7
Memorandum items:											
Nominal GDP (billions of euros)	336	346	340	354	371	379	389	401	415	431	449
Population (millions)	10.6	10.7	10.8	10.8	10.9	11.0	11.1	11.1	11.2	11.3	11.3
Sources: Data provided by the Belgian authorities, and IMF staff projections.											
1/ Contribution to GDP growth.											

Table 2. Belgium: Balance of Payments, 2007–17

	2007	2008	2009	Prel.	Projections						
				2010	2011	2012	2013	2014	2015	2016	2017
Balance on current account	1.6	-1.6	-1.7	1.5	0.0	-0.1	0.6	1.0	1.4	1.5	1.6
Balance on goods and services	1.5	-2.2	0.3	0.8	-0.3	0.7	0.9	1.1	1.4	1.5	1.6
Balance of trade (f.o.b., c.i.f.)	0.2	-3.2	-1.4	-1.0	-1.7	-0.7	-0.5	-0.4	-0.2	-0.1	0.0
Exports of goods and services	81.3	82.4	70.4	78.1	81.9	79.5	80.0	81.1	82.5	83.9	85.0
Exports of goods	65.1	65.0	52.6	59.6	63.9	62.0	62.4	63.3	64.3	65.4	66.2
Exports of services	16.2	17.4	17.8	18.5	18.0	17.5	17.6	17.9	18.2	18.5	18.7
Imports of goods and services	79.8	84.6	70.1	77.3	82.2	78.7	79.1	80.1	81.2	82.4	83.3
Imports of goods (f.o.b.)	64.9	68.2	54.0	60.5	65.6	62.6	62.9	63.7	64.6	65.6	66.3
Imports of services	14.9	16.4	16.1	16.7	16.6	15.8	15.9	16.1	16.3	16.6	16.7
Income, net	1.5	2.3	0.0	2.4	2.2	0.9	1.5	1.7	1.8	1.8	1.8
Current transfers, net	-1.4	-1.8	-1.9	-1.8	-1.9	-1.8	-1.8	-1.8	-1.8	-1.8	-1.8
Balance on capital account	-0.4	-0.5	-0.4	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Balance on financial account	-1.5	2.2	2.0	-1.4	0.8	0.3	-0.4	-0.8	-1.2	-1.4	-1.5
Direct investment, net	2.9	-5.3	11.1	4.9	1.9	1.8	1.7	1.7	1.7	1.7	1.7
Portfolio investment, net	-8.9	10.0	9.1	-0.1	2.3	0.1	-0.9	-1.4	-1.8	-2.0	-2.1
Other investment, net	4.2	-3.6	-18.3	-6.5	-3.3	-1.5	-1.2	-1.0	-1.0	-1.0	-1.0
Reserve assets	-0.3	0.2	-0.2	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions, net	0.5	-0.3	0.2	0.3	-0.4	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Belgian authorities; and IMF staff projections.

Table 3. Belgium: General Government Accounts, 2007–17

(In percent of GDP, unadjusted for working days; unless otherwise indicated)

	2007	2008	2009	Pre.	Projections						
				2010	2011	2012	2013	2014	2015	2016	2017
Revenue	48.0	48.6	48.0	48.8	48.4	49.8	49.8	49.8	49.8	49.8	49.8
Tax revenue 1/	43.2	43.5	42.7	43.2	43.7	44.7	44.7	44.7	44.7	44.7	44.6
Nontax revenue	4.8	5.1	5.2	5.5	4.7	5.1	5.1	5.1	5.1	5.1	5.1
Expenditure	48.3	49.9	53.8	52.9	52.5	52.8	52.1	51.1	50.3	50.2	49.9
Primary expenditure	44.4	46.1	50.1	49.5	48.8	48.9	48.3	47.9	47.4	47.6	47.7
Current	41.7	43.3	46.8	46.6	45.9	46.1	45.6	45.1	44.7	44.8	44.9
Of which: social benefits	22.3	23.3	25.4	25.1	24.6	25.5	25.0	24.8	24.7	24.8	25.0
Capital	2.8	2.7	3.4	2.8	2.9	2.8	2.8	2.8	2.8	2.8	2.8
Interest payments	3.9	3.8	3.7	3.5	3.7	3.9	3.8	3.3	2.9	2.6	2.3
Balance	-0.3	-1.3	-5.8	-4.1	-4.0	-2.9	-2.2	-1.2	-0.4	-0.2	0.0
Structural balance	-1.1	-1.9	-4.5	-3.5	-3.7	-2.2	-1.4	-0.6	0.0	0.0	0.0
Primary balance	3.5	2.5	-2.2	-0.7	-0.4	0.9	1.5	1.9	2.4	2.2	2.1
Structural primary balance	2.8	2.0	-0.8	0.0	0.0	1.7	2.4	2.7	3.0	2.6	2.3
Cyclical balance	1.0	0.6	-1.2	-0.6	-0.2	-0.7	-0.8	-0.7	-0.5	-0.3	-0.1
Debt	84.1	89.3	95.9	96.2	98.6	99.4	99.3	97.6	94.8	91.6	88.1
Memorandum items (in percent):											
Real primary expenditure growth	2.6	4.6	5.7	0.9	0.5	0.1	-0.4	0.4	0.6	2.1	2.1
Output gap	2.0	1.3	-2.4	-1.3	-0.3	-1.3	-1.5	-1.3	-0.9	-0.5	-0.1
GDP growth	2.9	1.0	-2.8	2.3	1.9	-0.1	0.8	1.3	1.6	1.8	1.9

Sources: Belgian authorities, and IMF staff projections.

1/ Includes social contributions.

Table 4. Belgium: Public Sector Debt Sustainability Framework, 2008-17
(Percent of GDP, unless otherwise indicated)

	Actual				Projections						Debt-stabilizing primary balance 9/
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	
Baseline: Public sector debt 1/ o/w foreign-currency denominated	89.3	95.9	96.2	98.6	99.4	99.3	97.6	94.8	91.6	88.1	-1.3
Change in public sector debt	5.3	6.5	0.3	2.5	0.8	-0.2	-1.7	-2.8	-3.2	-3.5	
Identified debt-creating flows (4+7+12)	-0.6	7.5	6.9	-1.1	0.8	-0.2	-1.7	-2.8	-3.2	-3.5	
Primary deficit	-2.5	2.2	0.7	0.4	-0.9	-1.5	-1.9	-2.4	-2.2	-2.1	
Revenue and grants	48.6	48.0	48.8	48.4	49.8	49.8	49.8	49.8	49.8	49.8	
Primary (noninterest) expenditure	46.1	50.1	49.5	48.8	48.9	48.3	47.9	47.4	47.6	47.7	
Automatic debt dynamics 2/ Contribution from interest rate/growth differential 3/ Of which contribution from real interest rate Of which contribution from real GDP growth	1.3	5.1	-0.3	-0.5	1.7	1.3	0.2	-0.4	-1.0	-1.4	
Contribution from exchange rate depreciation 4/ Other identified debt-creating flows Privatization receipts (negative) Recognition of implicit or contingent liabilities Other (specify, e.g. bank recapitalization)	0.0	-0.1	0.0	0.0	...	...	...	...	...	...
Residual, including asset changes (2-3) 5/	5.9	-0.9	-6.6	3.6	0.0	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	183.8	199.8	197.2	203.8	199.6	199.3	195.9	190.2	183.8	177.0	
Gross financing need 6/ in billions of U.S. dollars	10.5	22.0	25.1	25.4	26.4	24.0	21.2	19.9	17.9	16.7	
Scenario with key variables at their historical averages 7/					99.4	98.1	96.7	95.3	93.9	92.5	0.9
Key Macroeconomic and Fiscal Assumptions Underlying Baseline											
Real GDP growth (in percent)	1.0	-2.8	2.3	1.9	-0.1	0.8	1.3	1.6	1.8	1.9	
Average nominal interest rate on public debt (in percent) 8/	4.7	4.1	3.8	4.1	4.0	3.9	3.4	3.1	2.8	2.6	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.5	2.8	2.0	1.4	1.7	2.1	1.6	1.1	0.8	0.3	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-6.6	7.2	-9.5	1.8	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.2	1.2	1.8	2.7	2.3	1.8	1.8	2.0	2.0	2.2	
Growth of real primary spending (deflated by GDP deflator, in percent)	4.6	5.7	0.9	0.5	0.1	-0.4	0.4	0.6	2.1	2.1	
Primary deficit	-2.5	2.2	0.7	0.4	-0.9	-1.5	-1.9	-2.4	-2.2	-2.1	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - p(1+g) - g + ae(1+r))/(1+g+p+gp)]$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $ae(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 5. Belgium: Key Financial Market Indicators, 2009–11

	2009Q4	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2011Q4
Financial institution equity indices 1/									
Dexia	4.9	4.0	3.4	3.2	2.9	2.8	2.4	1.7	0.5
Fortis	37.0	37.7	31.3	28.5	27.6	30.1	33.3	26.6	17.3
KBC	32.3	33.7	33.2	33.9	29.9	28.7	27.4	20.5	12.8
ING	7.5	7.1	6.8	7.3	7.6	8.5	8.5	6.3	5.7
Credit default swap spreads 2/									
Dexia	183.5	185.2	264.3	287.1	264.2	320.7	284.6	575.1	742.7
Fortis	60.6	70.5	109.8	114.3	115.4	114.5	113.1	190.7	244.6
KBC	150.6	114.6	123.6	128.5	152.6	227.3	187.8	274.7	383.9
ING	65.0	74.6	108.0	111.0	127.0	120.2	103.3	170.3	215.3
Stock indices 1/									
BEL 20	2,494.6	2,552.5	2,526.0	2,515.4	2,632.8	2,662.8	2,663.6	2,268.3	2,077.0
Euro stoxx 50	2,874.0	2,850.8	2,743.1	2,715.9	2,817.8	2,932.9	2,864.9	2,381.6	2,278.0
Interbank interest rates 3/									
Overnight	0.4	0.3	0.3	0.5	0.6	0.7	1.1	1.0	0.8
three-month	0.7	0.7	0.7	0.9	1.0	1.1	1.4	1.6	1.5
Government interest rates 3/									
three-month	0.4	0.3	0.3	0.4	0.7	0.9	1.2	1.0	0.9
10-year	3.6	3.7	3.4	3.1	3.6	4.2	4.2	4.1	4.5
Money market risk spread 4/									
	33.0	36.1	41.1	45.9	30.7	24.2	25.2	51.7	57.2

Sources: Bloomberg; and Datastream.

1/ Equity index, period average.

2/ Basis points; 5-year EUR SR CDS spreads, period average.

3/ Percent.

4/ Basis points; three-month interbank rate minus three-month Treasury Bill.

Table 6. Belgium: Financial Soundness Indicators of the Banking Sector, 2006–11 1/

	(Percent)					
	2006	2007	2008	2009	2010	2011 2/
Earnings and profitability						
Return on assets	0.7	0.4	-1.3	-0.1	0.5	0.0
Return on equity	22.4	13.2	-36.5	-2.7	10.7	0.7
Net interest income to total income	47.9	50.3	75.0	79.1	68.3	70.7
Interest margin	1.0	1.1	1.0	0.8	1.2	1.3
Average yield on assets	4.6	5.3	5.0	2.8	2.8	2.9
Average cost of funding	3.60	4.20	4.00	2.00	1.60	1.70
Noninterest income to gross income	52.1	49.5	24.9	20.9	31.7	29.3
<i>Of which:</i> Net fee and commission income	25.1	27.9	35.1	30.1	25.6	27.5
(Un)realised capital gains booked in P&L	14.6	14.3	-19.9	-14.5	-0.2	-3.6
Cost/income ratio	55.7	61.1	86.1	77.7	66.0	68.6
Structure assets						
Total assets (as share of GDP)	4.5	4.7	4.1	3.5	3.2	3.2
<i>Of which</i> (in percent of total assets)						
Loans to credit institutions	20.1	20.3	15.0	13.1	17.0	17.8
Debt securities	22.5	18.8	21.0	22.3	20.1	18.1
Equity instruments	3.6	3.3	1.1	0.8	0.5	0.4
Derivatives	4.5	7.6	15.7	11.3	11.6	14.3
Loans to customers	41.6	42.2	39.1	45.0	44.0	43.0
<i>Of which:</i> Belgian residents (in percent of loans)	43	43	53	59	64	67
Other EMU residents (in percent of loans)	29	30	20	19	19	18
Rest of the world (in percent of loans)	28	27	28	22	17	15
Mortgage loans (in billion euro)	190	208	132	158	179	185
Consumer loans (in billion euro)	15	17	17	17	24	23
Term loans (in percent of loans)	46.1	40.1	47.8	44.0	42.3	41.6
Reverse repo operations (in percent of loans)	16.9	10.5	10.1	7.3	7.3	4.5
Funding and liquidity (in percent of total assets)						
Debts to credit institutions	29.2	27.4	19.4	14.1	15.4	12.8
Bank bonds and other debt securities	11.2	11.3	8.7	12.6	10.9	9.4
Customer deposits	39.1	37.9	40.2	46.8	46.0	47.5
<i>Of which:</i> Sight deposits 3/	11.1	11.8	10.9	13.2	13.7	12.7
Saving deposits 3/	10.2	8.5	9.2	14.1	16.6	16.4
Term deposits 3/	10.6	11.5	11.7	8.9	8.5	8.9
Retail deposits	20.4	17.8	18.2	23.8	26.1	25.8
Repo's	4.2	3.5	6.4	7.1	5.0	7.4
Liquid assets 4/	27.0	23.6	28.6	31.5	32.5	35.2
Asset quality						
Sectoral distribution of loans (in percent of total assets)						
Credit institutions	20.1	20.3	15.0	13.1	17.0	17.8
Corporate	18.3	19.9	20.5	20.5	17.2	16.4
Retail	18.3	17.5	14.6	19.9	22.1	22.3
Central governments	0.8	1.0	0.9	1.2	1.0	0.6
Non-credit institutions	4.1	3.8	3.1	3.4	3.8	3.8
Non-performing loans (NPL) as percent of gross loans 4/	1.7	1.4	1.7	2.7	2.8	2.8
Provisions + writeoffs as percent of NPL 4/	51	41	67	51	53	50
Capital adequacy						
Regulatory capital to risk-weighted assets	11.9	11.2	16.2	17.3	19.3	19.1
Regulatory Tier I capital to risk-weighted assets	8.7	12.1	11.3	13.2	15.5	15.6
Capital to assets	3.3	4.1	3.3	4.5	5.0	4.7
NPL net of provisions as percent of Tier I capital 4/	10.9	9.2	6.5	13.8	12.2	12.6
Net open position in foreign exchange to capital	4.9	3.3	6.6	4.7	3.3	2.1

Sources: NBB.

1/ Consolidated data. Data are based on the IAS/IFRS reporting Scheme.

2/ Data for the first nine months of 2011. The flow data are annualised.

3/ Deposits booked at amortised cost only.

4/ Unconsolidated data.

Table 7. Belgium: Financial Soundness Indicators of the Non-Banking Sectors, 2006–11

(Percent)

	2006	2007	2008	2009	2010	2011 2/
Insurance sector 1/ 2/						
Solvency ratio	252.6	222.6	223.3	230.0	214.0	196.0
Profitability						
Return on equity (percent, annualised)	20.8	31.7	-27.5	6.3	9.9	0.3
Life						
Premiums (billions of euros)	20.4	21.9	19.5	18.6	18.9	13.4
Technical result/premiums (percent)	4.9	4.4	-18.8	4.0	4.2	0.3
Non-life						
Premiums (billions of euros)	9.3	9.3	9.7	9.2	9.5	7.4
Combined ratio (percent)	101.7	102.1	100.2	103.8	104.5	101.6
Technical result/premiums (percent)	12.7	13.8	1.8	7.1	7.4	7.8
Corporate sector 3/						
Total debt as a percentage of equity	60.5	59.9	59.9	50.4	51.2	...
Profitability (return on equity)	9.6	9.8	11.4	7.8	7.1	...
Debt service coverage ratio	152.5	162.8	278.2	196.2	176.3	...
Household sector						
Debt (percent of GDP) 4/ 5/	45.9	47.8	50.1	53.9	55.5	54.3
Interest burden (percent disp. income) 5/	2.1	2.9	3.0	1.9	1.5	1.7
Financial savings ratio (percent of GDP) 4/ 5/	2.1	2.9	2.6	6.4	5.8	4.9
Savings rate 4/ 5/	15.7	16.4	16.8	18.4	16.2	16.7
Real estate sector						
House price inflation 6/						
Houses	12.3	9.9	4.5	-0.3	5.0	3.6
Apartments	11.3	7.4	3.5	1.9	6.7	1.9
Mortgage loans as percent of total loans 7/	34.0	32.7	24.3	30.3	37.3	38.2
Of which: domestic households 7/	17.6	16.5	14.7	14.1	16.6	18.1
Variable rate mortgages (percent of total new loans) 8/	7.4	1.2	2.9	34.0	37.6	15.3

Source: NBB, Stadim, Mineco, UPC.

1/ Unconsolidated data.

2/ Provisional data for the first 9 months of 2011. Projections for 2011 for GDP, disposable income and savings rate.

3/ Data for 2010 based on a sample of already available annual accounts in the Central Balance Sheet Register.

4/ For 2011, debt and financial savings ratio as at the end of September.

5/ Projections for 2011 for GDP, disposable income and savings rate.

6/ For 2011, growth between the average for the first nine months of 2011 and the average for the full year 2010.

7/ For 2011, situation at the end of September.

8/ For 2011, data for the first nine months.

Attachment I. Belgium: Risk Assessment Matrix

Nature/Source of Main Threats	Overall Level of Concern	
	Likelihood of Severe Realization of Threat in the Next 1-3 Years and Channel of Vulnerability (high, medium, or low)	Expected Impact if Threat is Realized (high, medium, or low)
1. Sharp slowdown in Eurozone.	<p>Medium</p> <ul style="list-style-type: none"> Belgium has strong trade and financial links with Eurozone member countries. Historically, these have explained about half of real GDP growth. 	<p>High</p> <ul style="list-style-type: none"> A slowdown of similar magnitude as in 2009 could reduce Belgian growth to $-3\frac{1}{2}$ to -4 percent. The impact would be more severe than in 2009 because, in light of the high public debt, there is no policy room to buffer a sharp downturn.
2. Drying up of financial markets.	<p>Medium</p> <ul style="list-style-type: none"> Government rollover needs remain substantial with peaks in issuance expected in March and September. The threat to the banking sector has been reduced following the introduction of the ECB 3-year funding facility. 	<p>High</p> <ul style="list-style-type: none"> Sovereign rollover needs are high around €54 billion in 2012 and those of the three largest banks another €21 billion.
3. Energy price hike	<p>Low</p> <ul style="list-style-type: none"> The pass-through of global energy price shocks into Belgian inflation is higher than in other countries. Automatic wage indexation increases the pass-through of inflation shocks into wages and, hence, competitiveness. 	<p>Medium</p> <ul style="list-style-type: none"> Deteriorating competitiveness would dampen an incipient recovery.
4. Breakdown of coalition government	<p>Low</p> <ul style="list-style-type: none"> The coalition government consists of six parties across the political spectrum. The government has a two-year mandate. The next general election is scheduled for 2014. 	<p>Medium</p> <ul style="list-style-type: none"> New structural reforms initiatives would be put on hold. However, financial market stress constrains policy options of any government while public debt remains high.



BELGIUM

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

February 24, 2012

Prepared By

European Department

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FUND RELATIONS

(As of January 31, 2012)

Missions: Brussels, November 30–December 12, 2011 and January 24–27, 2012.

Staff team: Mr. De Vrijer (Head), Ms. Ohnsorge, Mr. Weber (all EUR), Mmes. Erbenova and Nedelescu (MCM), and Mr. Acosta-Ormaechea (FAD).

Country interlocutors: The Prime Minister; the Vice-Prime Minister and Minister of Finance; the Vice-Prime Minister and Minister of Economy; the Minister for the Budget; the Minister of Employment; the Governor of the National Bank of Belgium; the Director of the Treasury; the Chairman of the Financial Services and Markets Authority; the Head of the Federal Planning Bureau; the Head of the Central Council for the Economy; the Head of the Competition Authority; staff of the Prime Minister and Vice-Prime Ministers' offices, the Federal Ministry of Finance, the Federal Ministry for the Economy, the Federal Ministry of the Budget, the Federal Ministry for Employment, the Federal Ministry of Pensions; the staff of the Public Borrowing Section of the High Finance Council; the health care administration; the regional ministries of the budget for Flanders, Brussels and Wallonia, respectively; the Minister of Finance of Brussels–Capital Region; the Minister of Finance of Flanders; the Minister of Finance of Wallonia; and representatives of labor unions, employer organizations, the financial sector, think tanks, and academia. Mr. Kiekens (Executive Director) or Mr. De Lannoy (Advisor to the Executive Director) attended the meetings.

Data: Belgium subscribes to the Fund's Special Data Dissemination Standard, and comprehensive economic data are available on a timely basis (Appendix II).

Membership Status

Joined: December 27, 1945; Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	4,605.2	100.00
Fund holdings of currency	3,193.61	69.35
Reserves tranche position	1,411.61	30.65
Lending to the Fund		
New Arrangements to Borrow	819.61	

SDR Department

	SDR Millions	Percent Allocation
Net cumulative allocations	4,323.34	100.00
Holdings	4,233.87	97.93

Outstanding Purchases and Loans

None

Latest Financial Arrangements

None

Projected Payments to the Fund

(SDR Million; based on existing use of resources and present holdings of SDRs)

		Forthcoming			
	2012	2013	2014	2015	2016
Principal					
Charges/Interest	0.19	0.18	0.18	0.18	0.18
Total	0.19	0.18	0.18	0.18	0.18

Implementation of HIPC Initiative

Not applicable

Implementation of Multilateral Debt Relief Initiative

Not applicable

Implementation of Post-Catastrophe Debt Relief

Not applicable

Exchange Arrangements

- Belgium's currency is the euro, which floats freely and independently against other currencies.
- Belgium has accepted the obligations under Article VIII and maintains an exchange system free of restrictions on payments and transfers for current international transactions, except for restrictions maintained solely for security reasons. These measures are established by European Union regulations and have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Article IV Consultation

Belgium is on the 12-month consultation cycle. The previous Article IV consultation was concluded on March 23, 2011. The associated Executive Board's assessment is available at <http://www.imf.org/external/np/sec/pn/2011/pn1143.htm> and the staff report (IMF Country report No. 11/81) at <http://www.imf.org/external/pubs/cat/longres.aspx?sk=24768.0>.

FSAP Participation**FSAP Assessment**

IMF Country Report No. 06/75

Summary: The report concluded that Belgium's financial system is resilient and benefits from a number of features that help stability. These include a traditionally cautious attitude toward risk by banks, large holdings of government securities, extremely low holdings of equity by banks, a stable source of funding benefiting from generous tax incentives, a high standard of banking supervision, and a stable macroeconomic policy framework. Overall, supervision showed a high degree of compliance with international standards. Near-term vulnerability appears low, reflecting the soundness of the dominant banking system, the generally benign financial environment, the strong financial condition of the corporate sector, and the relatively healthy financial position of the household sector. Financial institutions were found to withstand an adverse macroeconomic stress well, helped in part by the beneficial diversification in the *bancassurance* model.

The 2005 Mutual Evaluation Report on the Assessment of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) measures prepared by the Financial Action Task Force (FATF) indicates that Belgium's AML/CFT framework applicable to financial institutions is

comprehensive and broadly compliant with FATF standards in this area.

Notwithstanding the strengths of the Belgian financial sector, a number of issues emerged from the FSAP. The heavy exposure abroad, the open nature of the economy, and the importance of the Euroclear Group globally, made the domestic financial system potentially vulnerable to global economic developments and financial contagion. Risks remained and may increase with a downturn in the business cycle, increased cross-border operations, and deeper links with the global money centers. In line with the 2005 FSAP recommendations, the supervisory framework has been strengthened. The Banking, Finance, and Insurance Commission's (CBFA) management

committee has been streamlined and synergies between the CBFA and the National Bank of Belgium (NBB) have been further developed. Regular stress tests have helped promote a systematic dialogue between supervisory authorities and market participants, while detailed procedures for financial crisis management have been tested. Prudential supervision of the insurance sector has been upgraded and regulation of the pension funds sector reinforced.

Technical Assistance

None

Resident Representative

None

STATISTICAL ISSUES

Belgium's economic and financial statistics are adequate for surveillance purposes. The

National Bank of Belgium (NBB) regularly publishes a full range of economic and financial data and provides calendar dates of main statistical releases. On-line access to these comprehensive databases is facilitated by the NBB's data search engine, Belgostat. Belgium is a SDDS subscriber. Statistics for International Financial Statistics on banking institutions and monetary aggregates are prepared on a monthly basis and are timely.

Belgium adopted the European System of Integrated Economic Accounts 1995

(ESA95) in 1999. Revisions of national accounts started in November 2005 to comply with EUROSTAT requirements and prepare for the adoption of chain-linked national accounts statistics. Unlike in other countries, the NBB is responsible for compiling national accounts statistics. Quarterly accounts are published within a lag of three months. Both annual and quarterly accounts data are of good quality, with shortcomings mainly related to export and import deflators, which are based on unit values, rather than prices collected directly from exporters and importers.

General government revenue, expenditure, and balance on an accrual basis (ESA95) are published annually. The NBB publishes

monthly data on central government operations and quarterly data on general government operations since April 2007.

The overall quality and availability of financial indicators are good. The authorities

are providing quarterly updates of financial sector indicators (FSIs) in a timely manner. Key publicly accessible websites for macroeconomic data and analysis are:

National Statistical Portal

www.belgostat.be

National Statistics Institute

www.statbel.fgov.be

Institute for National Accounts

www.inr-icn.fgov.be

National Bank of Belgium

www.nbb.be

Federal Planning Bureau

www.plan.be

Banking, Finance, and Insurance Commission

www.cbfa.be

High Finance Council

www.docufin.be

Central Economic Council

www.ccecrb.fgov.be

Belgium: Table of Common Indicators Required for Surveillance
(As of January 17, 2012)

	Date of Latest Observation	Date Received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of Publication ⁶
Exchange Rates	2/16/12	2/16/12	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	12/11	1/12	M	M	M
International Investment Position	2010	2/11	A	A	A
Reserve/Base Money	12/11	1/12	M	M	M
Broad Money	12/11	1/12	M	M	M
Central Bank Balance Sheet	12/11	1/12	M	M	M
Consolidated Balance Sheet of the Banking System	12/11	1/12	M	M	M
Interest Rates ²	2/16/12	2/16/12	D	D	D
Consumer Price Index	1/12	2/12	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ —General Government ⁴	2011:Q3	1/12	Q	A	A
Revenue, Expenditure, Balance, and Composition of Financing ³ —Central Government	2011:Q3	1/12	Q	A	A
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	12/11	1/12	M	M	M
External Current Account Balance	2011:Q3	12/11	Q	Q	Q
Exports and Imports of Goods and Services	11/11	2/12	Q	Q	Q
GDP/GNP	2011:Q4	2/12	Q	Q	Q
Gross External Debt	2011:Q3	12/11	Q	Q	Q

1 Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

2 Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

3 Foreign, domestic bank, and domestic nonbank financing.

4 The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

5 Including currency and maturity composition.

6 Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA)



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 12/28
FOR IMMEDIATE RELEASE
March 20, 2012

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2011 Article IV Consultation with Belgium

On March 9, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Belgium.¹

Background

Growth momentum has slowed since early 2011. As confidence weakened, growth began to falter in tandem with a marked slowdown in the rest of the euro area. The labor market has so far remained resilient, partly because of a series of employment support programs. Annual average inflation remained around 3½ percent in 2011, and will trigger the automatic wage indexation mechanism for public sector employees in early 2012. Private sector lending stabilized as bank deleveraging slowed in 2011. The recent tendency of inflation and nominal unit labor costs to increase more than in Belgium's main trading partners is a concern for competitiveness.

As the euro area crisis unfolded, Belgian sovereign and bank spreads have come under pressure. Drying up of liquidity in euro area financial markets since the summer of 2011 eventually led to the restructuring of Dexia. Dexia's Belgian retail operations were broken out of the group and nationalized at a cost of 1 percent of GDP. The remainder of the group was provided with guarantees by the governments of Belgium, France, and Luxembourg. The

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

contingent liabilities arising from this operation and previous bank support, combined with an already high stock of public debt, contributed to rising bond yields and CDS spreads on Belgian sovereign debt during the financial market turmoil of late 2011.

Continued uncertainty about the evolution of the euro area crisis and slow growth in Europe weigh on the outlook for Belgium. Real GDP growth is expected to stall in 2012 and resume gradually from 2013. Risks to the outlook are slanted to the downside. They arise from the high public debt; from the financial sector's exposure to countries with weak growth prospects, fragile sovereign debt markets and stressed financial markets; from the strong interplay between the banking sector and the Belgian sovereign; and from Belgium's high degree of trade openness. The economy is thus vulnerable to financial turmoil across the euro area and to cyclical developments in Europe.

A new federal government was formed in December 2011. The new government program appropriately aims at achieving fiscal sustainability over the medium-term, containing risks in the financial sector, and increasing employment and growth. The Sixth Reform of the State substantially increases the degree of fiscal federalism by devolving additional spending responsibilities to subnational governments and reforming their funding. The 2012 budget includes a sizeable fiscal consolidation package of 2½ percent of GDP, in order to reduce the fiscal deficit below 3 percent of GDP in 2012. The authorities continue to strengthen banking supervision and are committed to implement the Basel III and Solvency II regulatory frameworks. The government program details structural reforms aimed at raising the employment rate (for 20–64 year olds) by 5 percentage points. Key measures include greater degressivity in unemployment benefits; stricter enforcement of job search requirements and a gradual limitation of pre-pension benefits for older workers; and a stepwise increase in the minimum age for early retirement from 60 to 62 years by 2016.

Executive Board Assessment

Executive Directors welcomed the new government's efforts to achieve fiscal sustainability over the medium term, contain financial sector risks, and increase employment and growth. Directors cautioned, however, that the euro area turmoil and the strong linkages between financial institutions and the sovereign continue to pose downside risks to the outlook. In this context, a steadfast and full implementation of the government's economic program remains crucial.

Directors stressed that medium-term fiscal consolidation is key to mitigating pressures in the sovereign debt market. They welcomed the sizable adjustment in the 2012 budget and the government's commitment to take additional measures as needed to achieve structural balance by 2015. With revenues at almost 50 percent of GDP, Directors agreed that the consolidation strategy should focus on expenditure containment, particularly in pensions, health care, and public sector employment. Most Directors noted that a rationalization of wage and benefit indexation could also generate budgetary savings. More broadly, Directors recommended a

rules-based framework and a burden-sharing agreement between all levels of government to strengthen the credibility of the consolidation effort. In light of weak growth prospects, most Directors recommended allowing automatic stabilizers to operate freely around the consolidation path, although a few Directors noted the importance of safeguarding the achievement of fiscal targets.

Directors welcomed the steps taken to address financial sector distress in 2011. They noted, however, that the financial system remains vulnerable to market pressures in the euro area and that the interplay with the Belgian sovereign has intensified. With greater domestic competition and a deteriorating economic outlook likely to depress profits, Directors argued that pushing ahead with the bank restructuring under way and strengthening capital buffers remain important priorities. Accordingly, they encouraged the authorities to stand ready to provide the necessary backstop if private capital cannot be tapped. Directors also stressed the need to strengthen bank supervision and implement the Basel III and Solvency II regulatory frameworks. They further agreed that Belgium's experience during the global financial crisis has underscored the need for more effective crisis management and cross-border resolution in Europe.

Directors welcomed the labor and pension reforms recently launched by the authorities as first steps toward raising employment and growth. Nevertheless, they noted that additional efforts are needed, in particular to increase the effective retirement age to its statutory level. Directors stressed the need to push ahead with reforms in labor and product markets, with most Directors noting that a reform of the wage indexation scheme would help boost competitiveness. Directors observed that a job-friendly tax reform could increase trend growth. With severely limited fiscal space, they considered that any reduction in the high labor taxes would have to be offset by an increase in indirect taxes revenues.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2011 Article IV Consultation with Belgium is also available.

Belgium: Selected Economic Indicators, 2007–12

	2007	2008	2009	2010	Prel. 2011	Proj. 2012
(Percent change; unless otherwise indicated)						
Real economy						
Real GDP	2.9	1.0	-2.8	2.3	1.9	-0.1
Private consumption	1.7	1.9	0.8	2.5	0.6	0.2
Public consumption	2.0	2.4	0.8	0.2	0.7	-0.3
Gross fixed investment	6.0	2.0	-8.1	-0.7	4.5	-0.5
Business investment	8.2	4.2	-9.3	-1.6	7.2	-0.6
Dwellings	-1.1	0.9	7.2	-1.8	6.5	2.3
Public investment	3.3	-2.7	-9.2	1.6	-1.6	-1.3
Foreign balance 1/	0.2	-0.8	-0.7	1.2	-0.4	0.1
Exports, goods and services	5.2	1.7	-11.2	9.9	4.7	-0.8
Imports, goods and services	5.5	3.1	-10.7	8.7	5.3	-0.9
Household saving ratio (in percent)	16.4	17.0	18.3	16.4	16.8	17.5
Potential output growth	1.9	1.5	1.1	1.1	0.9	0.9
Output gap (in percent)	2.0	1.3	-2.4	-1.3	-0.3	-1.3
Employment						
Unemployment rate (in percent)	7.5	7.0	7.9	8.3	7.3	8.0
Employment	1.7	1.8	-0.1	0.8	1.2	-0.3
Prices						
Consumer prices	1.8	4.5	0.0	2.3	3.5	2.2
GDP deflator	2.3	2.2	1.2	1.8	2.7	2.3
ULC (in whole economy)	2.1	4.5	3.8	0.0	2.8	3.4
(percent of GDP; unless otherwise indicated)						
Public finance						
Revenue	48.0	48.6	48.0	48.8	48.4	49.8
Expenditure	48.3	49.9	53.8	52.9	52.5	52.8
General government balance	-0.3	-1.3	-5.8	-4.1	-4.0	-2.9
Structural balance	-1.1	-1.9	-4.5	-3.5	-3.7	-2.2
Primary balance	3.5	2.5	-2.2	-0.7	-0.4	0.9
General government debt	84.1	89.3	95.9	96.2	98.6	99.4
Balance of payments						
Trade balance	1.5	-2.2	0.3	0.8	-0.3	0.7
Current account	1.6	-1.6	-1.7	1.5	0.0	-0.1
Terms of Trade (percent change)	0.6	-3.6	3.6	-2.1	-1.5	0.1
Exports, goods and services (volume, percent change)	4.9	-1.8	-11.3	8.4	4.7	-0.8
Imports, goods and services (volume, percent change)	5.6	-1.8	-12.3	7.4	5.3	-0.9

Sources: Data provided by the Belgian authorities, and IMF staff projections.

1/ Contribution to GDP growth.

Statement by the IMF Staff Representative
March 9, 2012

1. **This statement provides additional information on economic and financial developments in Belgium since the issuance of the Article IV consultation staff report.** The additional information does not change the thrust of the staff appraisal.
2. **Indicators point to weak domestic demand in the first quarter of 2012, in line with expectations.** Domestic orders as well as business confidence in construction and domestic trade continued to weaken in January and February. However, overall business confidence in February improved for the third month in a row, mirroring the recent improvement in German business confidence. The improvement followed a decline in September–November that was linked to a sharp drop in exports.
3. **Annual consumer price inflation in February was 3 ¾ percent.** The main drivers of inflation in February continued to be energy prices. The increase in consumer prices thus far remains below the threshold that triggers an automatic wage and benefit increase in the public sector. It is expected that the automatic wage indexation will take place in March.
4. **Several large banks have announced their 2011 results and they have been broadly in line with expectations.** Dexia Group announced substantial losses (€12 billion) for 2011, reflecting losses from asset disposals, including of Dexia Bank Belgium, and impairment on Greek sovereign debt. In contrast, KBC and ING Belgium announced net profits in 2011. Despite a doubling in net profits over 2010, ING Belgium decided not to distribute dividends in order to further strengthen its capital base. In the case of KBC, net profits were substantially smaller than in 2010, reflecting loan loss provisions on its exposure to Ireland and Hungary, and the impairment recorded on Greek sovereign debt. The bank distributed a small technical dividend to remain on track with its restructuring plan. In a further restructuring step, KBC sold its Polish subsidiary Kredyt Bank to Santander in a transaction that should raise KBC's Tier 1 capital by 0.8 percentage point (compared with 12.3 percent at end-December 2011).
5. **The authorities and Dexia SA's management are finalizing the restructuring plan that is to be submitted to the European Commission in late March.** So far, *Dexia Crédit Locale* has issued €41 billion in government guaranteed bonds, within the envelope of sovereign guarantees of €45 billion. The proceeds have been used to reimburse unsecured liabilities to Dexia Bank Belgium (recently renamed Belfius) and emergency liquidity assistance of the Belgian and French central banks, and to satisfy the funding needs of Dexia SA. As a result, the unsecured exposure of Belfius to Dexia SA has fallen substantially, thus almost eliminating a significant financial stability risk for Belgium arising from Dexia's restructuring.
6. **The government has made good progress towards meeting its funding needs.** By end-February, a quarter of the sovereign medium- and long-term funding needs for 2012 were met.