



# BELGIUM

March 2020

## 2020 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; STAFF SUPPLEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BELGIUM

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 2020 Article IV consultation with Belgium, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 26, 2020 consideration of the staff report that concluded the Article IV consultation with Belgium.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 26, 2020, following discussions that ended on February 20, 2020, 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 March 13, 2020.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Belgium.

The documents listed below have been or will be separately released.

### Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services  
PO Box 92780 • Washington, D.C. 20090  
Telephone: (202) 623-7430 • Fax: (202) 623-7201  
E-mail: [publications@imf.org](mailto:publications@imf.org) Web: <http://www.imf.org>  
Price: \$18.00 per printed copy

**International Monetary Fund**  
**Washington, D.C.**



## IMF Executive Board Concludes 2020 Article IV Consultation with Belgium

FOR IMMEDIATE RELEASE

**WASHINGTON, DC – March 31, 2020** the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation<sup>1</sup> with Belgium.

Economic activity held up well over the last year, with 2019 growth reaching 1.4 percent, supported by robust domestic demand. The labor market also improved, with the unemployment rate falling to a record-low of 5.4 percent. However, given the rapidly unfolding global coronavirus outbreak, growth is projected to decline substantially this year and to gradually recover to 1.3 percent over the medium term. The outlook is clouded by unusually high uncertainty and risks are firmly on the downside as the Covid-19 pandemic represents a new and urgent challenge for policymakers.

Belgium has been without a full-fledged government since December 2018, which has constrained its ability to address long-standing structural challenges stemming from high public and rising private debt burdens, an aging population, slowing productivity growth, and climate change.

### Executive Board Assessment<sup>2</sup>

In concluding the Article IV consultation with Belgium, Executive Directors endorsed the staff's appraisal as follows:

**Economic activity has held up relatively well over the last year, but the outlook is clouded by unusual uncertainty and risks.** Growth was resilient and job rich in 2019, while the unemployment rate reached a historical low, in part reflecting previous reforms. Nonetheless, the inability to form a new government has paralyzed policymaking, while the public finances have deteriorated. The coronavirus outbreak is expected to reduce growth this year, and the outlook is highly uncertain and subject to risks, including more widespread and damaging effects of the coronavirus, escalating trade tensions, a sharper euro-area growth slowdown, and prolonged domestic political gridlock.

**Policies should focus on addressing the coronavirus outbreak in the near term and rebuilding resilience and addressing structural challenges in the medium run.** The immediate policy priority is to contain the spread and damaging effects of the coronavirus through targeted temporary support measures to affected firms and individuals, while ensuring that the healthcare system has adequate resources to address the crisis. Should banks face difficulties related to losses due to the impact of the coronavirus, if needed, the authorities

---

<sup>1</sup> 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.

<sup>2</sup> 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>.

could also support financial intermediation by considering additional temporary measures on capital relief. A new government should use its fresh mandate to implement comprehensive reforms to address remaining medium-term structural challenges: high public and rising private debt, an aging population, slowing productivity growth, and climate change.

**Belgium will need a credible medium-term consolidation to build fiscal buffers against future shocks and safeguard sustainability.** Under the baseline scenario, the deficit will continue to widen, and public debt will remain high in the medium run and be on a rising trajectory in the long run, due to population aging pressures. To safeguard fiscal sustainability and build buffers against future shocks, the new government needs to put in place a credible medium-term consolidation strategy aiming to reach structural fiscal balance by 2024. Avoiding a further deterioration in the structural balance this year (net of emergency measures to address the coronavirus outbreak) and aiming for a structural adjustment of ½ percent of GDP during 2021–24 could balance near and long-term considerations.

**Growth-friendly spending reforms should underpin the medium-term adjustment.** A sustained medium-term effort to reduce primary spending while improving its efficiency can support deficit targets and reorient the budget toward more growth-friendly areas. Reforms should focus on containing medium-term healthcare costs, bolstering the sustainability of the pension system, improving the targeting and labor-market incentives of social benefits, strengthening the efficiency of subsidies, and reducing duplication in the public administration. Complementary tax base-broadening reforms could create space to lower the labor tax wedge in the medium run.

**Additional reforms to boost labor-force participation, especially for vulnerable groups, are needed.** Despite recent reforms, Belgium’s labor-force participation rate remains among the lowest in Europe, especially for the young, low-skilled, non-EU born, and women. Efforts should thus focus on active labor-market policies and training programs targeted at vulnerable groups and should be followed by further reforms to bolster female labor-force participation, mobility, and labor-market flexibility. These can also help strengthen Belgium’s external position, which is weaker than implied by fundamentals.

**Complementary product-market reforms can help boost productivity growth.** Reversing the declining trend in productivity growth is essential to support higher standards of living and safeguard fiscal sustainability. Thus, reform efforts would need to focus on reducing red tape for startups, lowering regulatory barriers to competition in key sectors, supporting access to venture capital for innovative firms, and boosting public investment in infrastructure, fiscal space permitting. A comprehensive policy strategy is needed to fulfill the government climate change commitments and take advantage of the opportunities from the transition to a green economy.

**The authorities should continue to bolster the resilience of the financial sector over the medium run.** Staff welcomes the recent macroprudential measures addressing risks stemming from easy credit and rising corporate and household debt as well as the more recent decision to release the countercyclical capital buffer in response to the coronavirus crisis. Looking forward, they should stand ready to continue to support the banking sector as needed and revisit the framework for macro-prudential decision-making to ensure the ability to deploy macro-prudential policies effectively and timely. Efforts should continue to improve reporting, bank resolution, and deposit insurance frameworks. The authorities should also encourage banks to rationalize costs, strengthen governance, and adapt business models to prepare for the challenges of digitalization.

## Belgium: Selected Economic Indicators (2017–20)

	2017	2018	2019 Est.	2020 Proj.
<b>Real economy</b>				
Real GDP	2.0	1.5	1.4	0.8
Domestic demand	1.2	2.2	1.5	1.1
Foreign balance 1/	0.7	-0.7	-0.1	-0.2
Exports, goods and services	5.3	1.2	1.0	1.6
Imports, goods and services	4.4	2.1	1.2	1.9
Potential output growth	1.4	1.3	1.3	1.2
Output gap (in percent)	0.2	0.4	0.5	0.1
<b>Employment</b>				
Unemployment rate (in percent)	7.1	6.0	5.4	5.6
Employment growth	1.6	1.4	1.5	0.3
<b>Prices</b>				
Consumer prices	2.2	2.3	1.2	1.1
GDP deflator	1.7	1.5	1.6	1.3
<b>Public finance</b>				
Revenue	51.2	51.4	50.3	50.0
Expenditure	51.9	52.1	51.9	52.3
General government balance	-0.7	-0.7	-1.7	-2.3
Structural balance	-1.3	-1.5	-2.0	-2.3
Primary balance	1.6	1.4	0.2	-0.6
General government debt	101.8	100.0	99.0	99.5
<b>Balance of payments</b>				
Goods and services balance	1.4	-0.2	0.0	0.2
Current account	1.2	-1.0	-1.2	-1.0
<b>Exchange rates</b>				
Euro per U.S. dollar, period average	0.8	0.9	0.9	...
NEER, ULC-styled (2005=100)	98.7	98.3	98.0	...
REER, ULC-based (2005=100)	98.5	97.8	97.4	...
<b>Memorandum items</b>				
Nominal GDP (in billions of euros)	446.4	459.8	473.6	484.0
Population (in millions)	11.4	11.4	11.5	11.5

Sources: Haver Analytics, Belgian authorities, and IMF staff projections.

1/ Contribution to GDP growth.



# BELGIUM

## STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

March 13, 2020

### KEY ISSUES

**Context:** Belgium has been without a full-fledged government since December 2018, which has made it difficult to make progress toward addressing long-standing challenges stemming from high public and rising private debt burdens, an aging population, slowing productivity growth, and climate change. The global coronavirus pandemic represents a new and urgent challenge.

**Outlook:** Growth was resilient in 2019, reaching 1.4 percent. However, in view of the rapidly unfolding coronavirus outbreak, growth is projected to decline to 0.8 percent this year, recovering gradually to 1.3 percent in the medium term. The fiscal deficit has deteriorated and is expected to reach 2.3 percent of GDP in 2020 and around 3 percent in the medium term. Uncertainty around the outlook is unusually high, and risks are firmly on the downside, including more widespread and economically damaging effects of the coronavirus, renewed trade tensions, a weaker-than-expected European outlook, and prolonged domestic political gridlock.

**Policies:** Containing the spread and effects of the coronavirus through targeted fiscal and financial support measures is an urgent policy priority. Looking forward, Belgium must find a way to re-ignite reforms to strengthen the economy's resilience to shocks and support inclusive, and sustainable growth, including by:

- Building fiscal buffers and placing both the debt and the deficit on a firmly downward path through a credible and sustained spending-based medium-term consolidation effort aiming to contain aging costs, improve spending efficiency, and reorient the budget toward growth-enhancing areas.
- Increasing labor-market participation rates, especially for vulnerable groups and women, complemented by additional structural reforms to increase labor market flexibility and boost productivity growth. A comprehensive policy strategy in support of climate targets is also key to enhance the economy's long-term sustainability.
- Guarding against broader financial sector risks and continuing to bolster the resilience of the financial sector over the medium run.

Approved By  
**Ms. Detragiache (EUR),**  
**Ms. Gonzalez (SPR)**

Discussions took place in Brussels from February 10–20, 2020. The staff team comprised D. Velculescu (head), L. Kemoe, R. Vermeulen (all EUR), J. M. Fournier (FAD), and was assisted at headquarters by K Cerrato and Z. Jin. A. de Lannoy and D. Cools (OED) participated in the discussions. Staff met with S. Wilmès (Prime Minister), P. Wunsch (Governor of the National Bank of Belgium), A. De Croo (Minister of Finance), D. Clarinval (Minister of Budget), the Minister-Presidents of Wallonia and Flanders, leaders of the main political parties, other senior government officials, representatives from the private sector, and trade unions.

## CONTENTS

<b>CONTEXT</b>	<b>4</b>
<b>RECENT DEVELOPMENTS</b>	<b>4</b>
<b>OUTLOOK</b>	<b>7</b>
<b>POLICY DISCUSSIONS</b>	<b>9</b>
A. Rebuilding Fiscal Buffers and Safeguarding Sustainability	9
B. Raising Potential Output	13
C. Safeguarding Financial-Sector Stability	17
<b>STAFF APPRAISAL</b>	<b>21</b>
<b>BOXES</b>	
1. Political Fragmentation and Policy Uncertainty	5
2. Initial Considerations on Climate-Mitigation Efforts in Belgium	16
3. Assessing Belgium’s Position in the Credit Cycle	20
<b>FIGURES</b>	
1. Political Fragmentation and Policy Uncertainty	6
2. Macroeconomic Context	32
3. Fiscal Context	33
4. Competitiveness	34
5. Structural Barriers to Growth	35
6. Housing Market Vulnerabilities	36
<b>TABLES</b>	
1. Selected Economic Indicators, 2018–25	24
2. Balance of Payments, 2018–25	25

3. General Government Statement of Operations, 2018–25	26
4. General Government Consolidated Balance Sheet, 2010–18	27
5. Financial Soundness Indicators for the Banking Sector, 2010–19	28
6. Main Recommendations from the 2017 FSAP Mission	29

**ANNEXES**

I. Main Recommendations of the 2019 Article IV Consultation and Authorities' Response	37
II. External Sector Assessment	38
III. Risk Assessment Matrix	39
IV. Benchmarking and Prioritizing Spending Reforms in Belgium	40
V. Debt Sustainability Analysis	48

## CONTEXT

**1. Belgium has been without a full-fledged government for more than a year.** Following the fall of the Michel government coalition in December 2018, the May 2019 election further widened the political divide between the Flemish and Walloon regions, resulting in a heightened political fragmentation of parliament. This has made it difficult to find the necessary common ground to form a new government. Past experience suggests that government formation could take time—it required 1½ years in 2010–11—with potentially negative consequences for consumer and market confidence, and thus for domestic activity (Box 1).

**2. In this context, there has been no progress toward addressing Belgium’s long-standing challenges** (Annex I). While the previous government advanced a number of structural reforms supporting employment and growth and contained the fiscal deficit,<sup>1</sup> policymaking has been virtually paralyzed since end-2018. Budgets for 2019 and 2020 were not approved, and key measures under the planned jobs deal were not implemented. This has not been conducive to addressing Belgium’s remaining challenges stemming from high public and rising private debt burdens, an aging population, slowing productivity growth, and climate change.

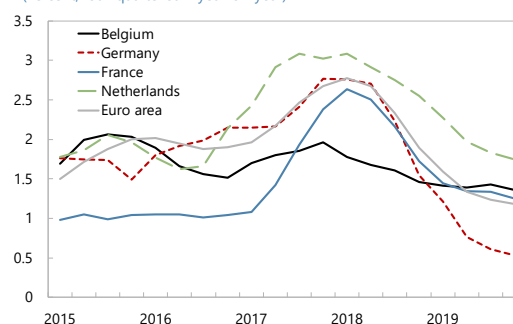
**3. The global coronavirus pandemic represents a new and urgent challenge.** The virus has spread rapidly across the globe in recent weeks and months, leading to wide-spread economic disruptions and loss of human life. Belgium has also been affected more recently, with over 300 cases as of March 12. Financial market volatility has been elevated, with the main stock index having declined by about 23 percent since end-February. The rising rate of increase of cases domestically, together with the economy’s trade openness, make Belgium highly vulnerable to the negative consequences of this shock, which could be magnified by the lack of a full-fledged government at this critical time.

## RECENT DEVELOPMENTS

**4. Growth remained resilient in 2019, and the labor market continued to improve**

(Figure 1). Following revisions to the National Accounts data, growth was revised up historically, reaching an average of 1.7 percent over 2014–18. In 2019, growth remained robust, reaching 1.4 percent, supported by private consumption and investment, even as public investment normalized and exports slowed due to weak external demand. The 2019 outturn was above the euro-area average. Growth remained job-intensive, with strong job creation and unemployment falling to a record-low of 5.4 percent, in part reflecting previous labor

**Output Growth Rates**  
(Percent, four-quarter sum year-on-year)



Source: IMF WEO.

<sup>1</sup> See Box 1 of [IMF Country Report No. 19/74](#).



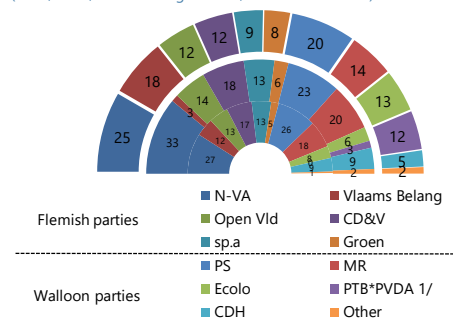
market reforms. Financial conditions were relatively loose, with private-sector credit growth averaging 5.5 percent last year. Inflation declined to 1.2 percent in 2019, driven by declining energy and food prices, while core inflation picked up slightly to 1.5 percent.

### Box 1. Political Fragmentation and Policy Uncertainty

**The 2019 election outcome deepened the political divide between the regions, complicating the formation of a new government.** Traditional center parties lost ground to far right party

Vlaams Belang in Dutch-speaking Flanders and to the green party Ecolo in French-speaking Wallonia, as well as to far-left party PTB/PvdA across the regions. Though regional governments have been formed within four months from the elections, federal-government formation negotiations have proven difficult and inconclusive, reflecting the heightened political fragmentation in the new parliament. As a result, Belgium has been governed by a caretaker government since December 2018.

**Distribution of Seats in Parliament Across Parties**  
(2010, 2014, and 2019 legislatures, from inside to out)



Source: Belgium Ministry of Interior.

1/ Crosses the language divide (not strictly a Walloon party).

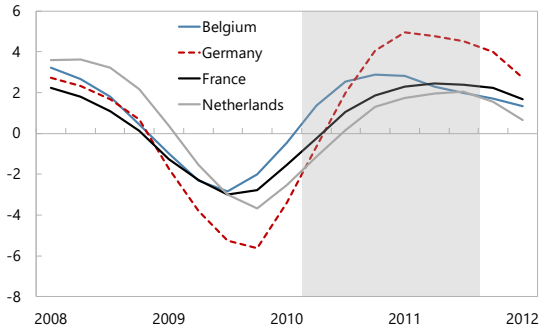
**Can the experience of the 2010–11 political gridlock provide any lessons for the current situation?** The last time Belgium was governed by a caretaker government was in 2010–11, when government formation took more than 540 days, following the collapse of the Leterme government in April 2010 and the June 2010 elections. The political gridlock came at a critical juncture, as the euro area debt crisis was still ongoing, compounding Belgium's vulnerabilities. While the impact of the political gridlock is difficult to isolate from external and other factors, some key lessons from this past episode are:

- **Output growth:** During the 2010–11 period without a government, growth appears to have decelerated faster from its peak than in peer countries, mainly on account of declining private consumption, as consumer sentiment weakened. Business investment and confidence, however, were less affected by political developments. Consumer confidence has also been trending downward in the current period of political gridlock, but the deceleration of output has so far been less pronounced than in peers.
- **Market confidence:** Belgium's sovereign bond spreads widened sharply in 2010–11, as the ongoing political uncertainty compounded heightened concerns about high-debt economies during the euro-area crisis. This is also reflected in a measure of the domestic component of Belgium's bond spread,<sup>1</sup> which widened during the time of the political gridlock but narrowed subsequently. During the current period, Belgium's spreads have remained at low levels. Nonetheless, prolonged political uncertainty in combination with negative shocks could put upward pressure on them.
- **Fiscal policy:** Over the 2010–11 period (including the subperiod under a caretaker government), Belgium's structural primary balance deteriorated by 0.4 percent of GDP, more than in neighboring countries (the euro area tightened fiscal policy on average). The current fiscal situation is markedly worse than in 2010–2011 and, with higher aging pressures than experienced during 2010–11 and a caretaker government without majority in parliament (unlike the previous 2010–11 episode), a much sharper deterioration is expected over the medium term in the absence of reforms.

<sup>1</sup> The domestic component is estimated using a VAR analysis of sovereign-bond spreads in 14 European countries. See IMF [Country Report No. 12/56](#).

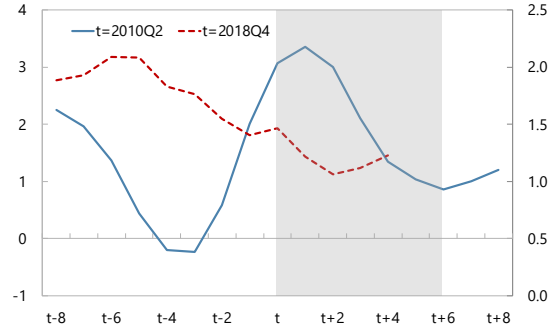
**Figure 1. Belgium: Political Fragmentation and Policy Uncertainty**

**Output Growth**  
(Percent, 4-quarter y-o-y)



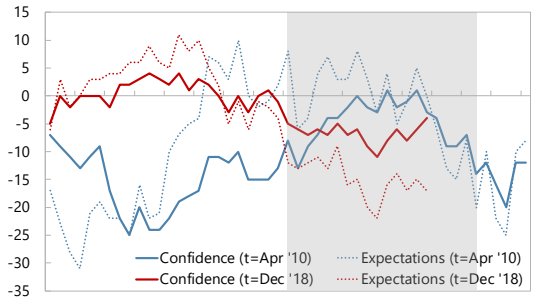
Source: IMF WEO.

**Private Consumption Growth**  
(Percent, 4-quarter y-o-y)



Source: IMF WEO.

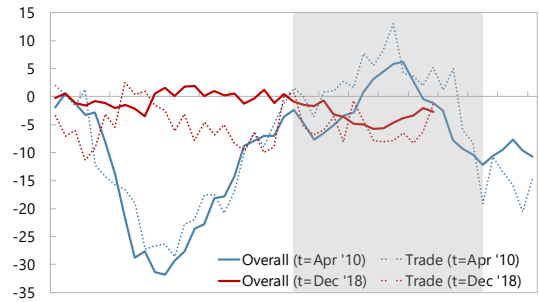
**Household Confidence 1/**  
(Balance, seasonally-adjusted)



Source: NBB (Haver).

1/ Overall indicator and expectations for the next 12 months; t in quarters.

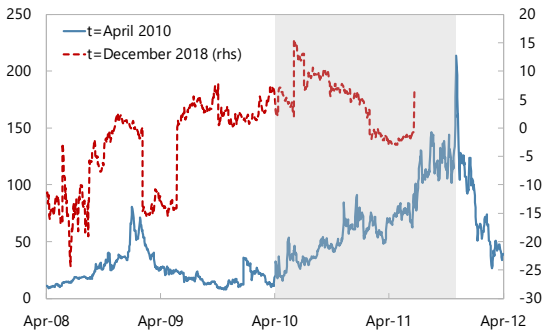
**Business Confidence 1/**  
(Balance, seasonally-adjusted)



Source: NBB (Haver).

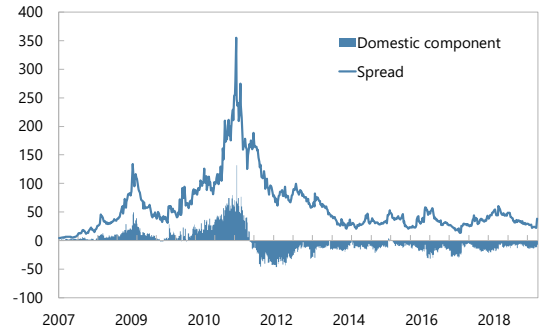
1/ Indicator for all sectors and for the trade sector; t in quarters.

**Bond Spreads**  
(Basis points over France)



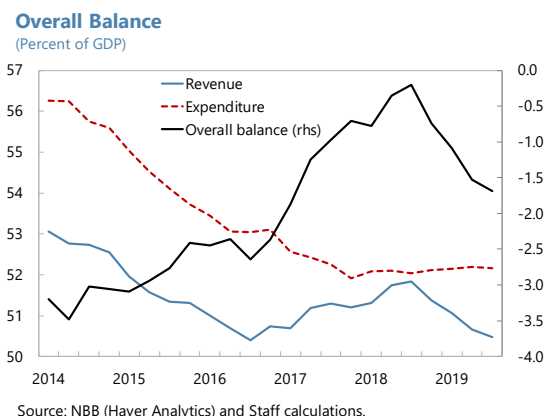
Source: Bloomberg.

**Domestic Component of Bond Spread**  
(Basis points over German 10-year Bund)



Sources: Bloomberg and IMF staff estimates.

**5. The public finances, however, deteriorated sharply** (Figure 2). Following a period of sustained consolidation since the global financial crisis, the fiscal deficit widened to an estimated 1.7 percent of GDP last year from 0.7 percent in 2018. This was primarily driven by a 1 percent of GDP fall in tax revenues, largely due to lower personal income taxes (PIT) related to the tax-shift reform and to a normalization in corporate income tax (CIT) receipts. Public spending remained broadly unchanged, as rising social benefits were largely offset by lower capital and interest spending. At close to 100 percent of GDP, public debt remained among the highest in the euro-zone.



**6. The current account deficit is estimated to have reached 1.2 percent of GDP in 2019** (Figure 3). The trade balance stayed around zero, while the income balance surplus was insufficient to offset the deficit due to current transfers. The external-balance assessment (EBA) model yielded a current account norm of 2.4 percent of GDP in 2019, implying a preliminary estimated current account gap of 3.5 percent below the norm. Unit labor costs (ULCs) increased in recent years, as wage growth picked up following earlier wage moderation, and productivity growth stagnated. Consequently, the ULC-based real effective exchange rate (REER) appreciated by 2.7 percent since 2016, compared to a 1.5 percent appreciation of the nominal effective exchange rate, while the export market share stabilized at a low level. Based on preliminary data and EBA model results, the 2019 external position is estimated to have been weaker than medium-term fundamentals and desirable policy settings would imply, subject to large statistical and model uncertainty (Annex II).<sup>2</sup>

## OUTLOOK

**7. Growth is expected to decline to 0.8 percent this year due to the coronavirus outbreak.** The outbreak is expected to affect both supply (through supply chains and a reduction of services, including transportation and tourism) and demand (through confidence and delayed purchases and investments) and shave off some 0.5 percent of growth this year. Domestic demand will be significantly affected in the first half of the year, as individuals reduce private consumption and firms postpone investment (in addition to an expected investment moderation from the peak achieved in previous years and in response to ongoing macro-prudential measures). Both exports and imports are also expected to remain subdued in the first two quarters of the year, with third quarter tourism also affected as individuals cancel planned travel. As a result, quarterly growth in the first half of the year is projected to stagnate relative to an average of 0.4 percent in the second half of 2019, with a gradual recovery envisaged toward the second half of 2020. Inflation is projected to stay subdued at around 1.1 percent this year. The baseline scenario is based on current policies and assumes a normalization of the political situation during 2020.

<sup>2</sup> The BoP data was revised multiple times, including in 2017, April and October 2019, resulting in CA revisions exceeding 1 percent of GDP each time.

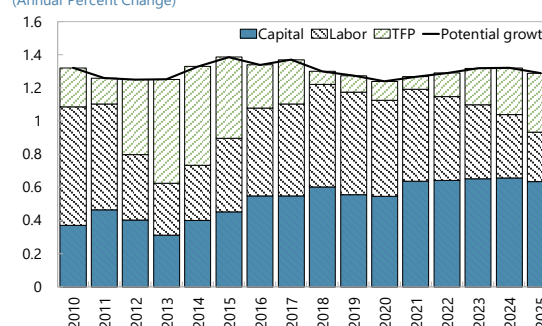
Belgium: Selected Economic Indicators, 2018–25								
	2018	2019	2020	2021	2022	2023	2024	2025
Real GDP (change in percent)	1.5	1.4	0.8	1.2	1.3	1.3	1.3	1.3
Private consumption	1.5	1.1	1.0	1.5	1.6	1.5	1.5	1.5
Public consumption	0.9	1.6	1.7	1.2	1.3	1.3	1.4	1.5
Gross fixed investment	4.0	3.1	0.9	2.0	1.8	2.3	2.5	1.8
Exports of goods and services	1.2	1.0	1.6	3.9	3.9	3.8	3.5	3.5
Imports of goods and services	2.1	1.2	1.9	4.3	4.3	4.1	3.9	3.7
CPI (year average)	2.3	1.2	1.1	1.2	1.6	1.8	1.8	1.8
Output gap (percent of potential GDP)	0.4	0.5	0.1	0.0	0.0	0.0	0.0	0.0

Sources: Haver Analytics, Belgian authorities, and IMF staff calculations.

**8. Over the medium run, growth is projected to stabilize at its potential rate of around 1.3 percent.** Potential growth is expected to be supported by stable capital accumulation and continued employment growth, reflecting recent labor-market reforms. Total factor productivity growth is set to rebound from recently low levels but will contribute to medium-term growth only modestly in the absence of additional structural reforms.

#### Potential Growth Decomposition

(Annual Percent Change)



Source: IMF staff calculations

**9. The outlook remains clouded by unusual uncertainty and downside risks** (Annex III). Domestic and global projections are particularly difficult to make in the context of a rapidly changing situation related to the coronavirus outbreak and are magnified by uncertainty regarding behavioral responses (including panic) to the unfolding crisis. Thus, risks remain firmly on the downside, related to more prolonged and disruptive effects due to the coronavirus outbreak, weaker-than-expected global and European growth, trade tensions due to rising protectionism and uncertainty about the final Brexit arrangement,<sup>3</sup> a sharp rise in risk premia, and a further build-up of financial vulnerabilities. Continued policy uncertainty and paralysis associated with further delays in the formation of a new government could weigh on confidence and activity in the near term and on potential growth in the long run. On the flipside, a successful conclusion of the formation process could see a freshly mandated government accelerate reforms that can support growth.

#### Authorities' Views

**10. The authorities broadly shared staff's views on the outlook and risks.** At the time of the mission, they generally expected slightly higher growth in the near-term (1.2–1.4 percent), as somewhat stronger domestic demand should offset a weaker external contribution. Over the medium run, the National Bank of Belgium (NBB) saw growth remaining below its potential level of 1.3 percent, largely due to subdued investment and continued loss of export market share. The authorities agreed with staff's assessment of risks and noted their continued efforts to prepare for a no-deal Brexit, while monitoring emerging risks from the coronavirus closely.

<sup>3</sup> For a discussion of Belgium's exposure to the UK, see Box 2 of [IMF Country Report No. 19/74](#).

## POLICY DISCUSSIONS

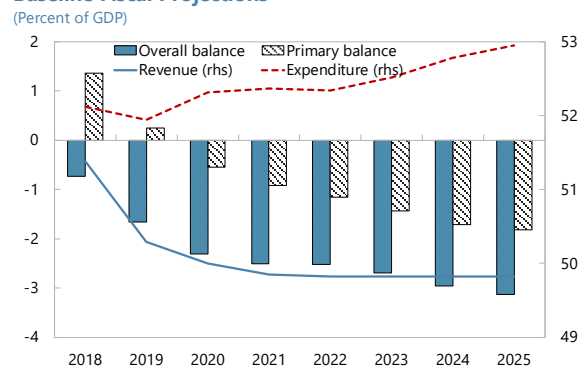
**11. Belgium is at a difficult crossroads: political gridlock paralyzes policymaking, while rising risks and medium- and long-term challenges put a premium on reforms.** The cost of policy inaction rises over time and is compounded by emerging risks, such as the coronavirus outbreak. In the near term, the policy priority should be to contain the spread and damaging effects of the coronavirus through targeted temporary fiscal and financial support measures. A new government should use its fresh mandate to implement a comprehensive package of reforms to strengthen the economy's resilience to future shocks and support higher, more inclusive growth. A policy mix focused on addressing high and rising fiscal risks through a growth-friendly medium-term fiscal consolidation, while continuing to monitor macro-financial risks and reinvigorating growth-enhancing structural reforms could help tackle vulnerabilities while supporting growth:

- *Rebuilding fiscal buffers and safeguarding sustainability:* A credible, sustained, and growth-friendly medium-term consolidation strategy is needed to put the deficit and debt on a firm downward path by containing aging costs, improving spending efficiency, and reorienting the budget toward growth-friendly areas.
- *Achieving higher, more inclusive, sustainable growth:* Additional reforms to increase participation in the labor market, especially for vulnerable groups, are needed, and should be followed by further labor-market reforms to strengthen work incentives, including for women, foster mobility, and improve flexibility, along with complementary reforms to reduce red tape, boost competition in key sectors, and support financing of innovative firms, will be key to support long-term growth. A comprehensive and coordinated policy strategy in support of climate targets is also needed.
- *Guarding against broader financial sector risks and continuing to bolster the resilience of the financial sector over the medium run:* Elevated private-sector leverage warrants continued close monitoring and readiness to use macroprudential policies. Efforts should continue to improve reporting, bank resolution, and deposit insurance frameworks.

### A. Rebuilding Fiscal Buffers and Safeguarding Sustainability

**12. The fiscal deficit is projected to widen to around 3 percent of GDP in the medium run.** In 2020, the deficit is expected to reach 2.3 percent of GDP, on account of lower revenues due to the pre-legislated CIT and employers' social contributions reductions and rising aging-related social spending. Over the medium run, interest savings associated with lower interest rates will be insufficient to offset rising primary spending, driven by growing pension and health costs and a resumption of full-benefit indexation after recent freezes and cuts. This is

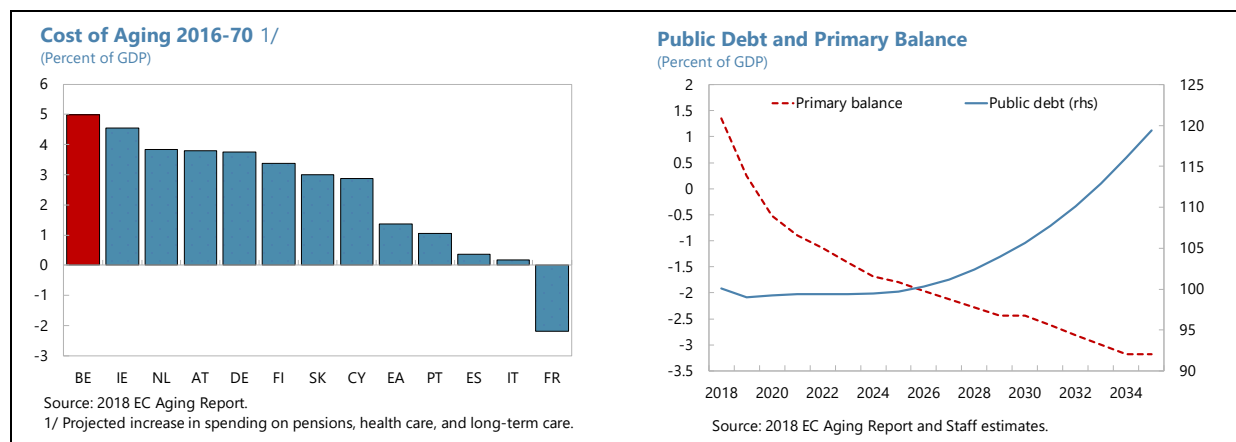
**Baseline Fiscal Projections**



Source: IMF Staff projections.

expected to bring the deficit to just above 3 percent of GDP by 2025 (relative to the MTO of balance), representing a structural deterioration of the overall and primary balances of 1.2 and 1.8 percent of GDP, respectively. There are risks that the deficit could be even higher, given calls for hiking minimum pensions, lowering VAT rates for electricity, and the potential for overspending on regional investment programs without offsetting budgetary measures.

**13. In the long run, public debt under the baseline scenario is on a rising trajectory.** Over the medium run, public debt remains high (100 percent of GDP) and its dynamics, while currently supported by the negative interest-growth differential, are vulnerable to shocks, particularly a macro-fiscal or contingent liability shock (Annex III). More worryingly, in the long run, baseline debt is projected to be on a rising trajectory due to large and increasing pension and long-term care costs due to population aging and generous benefit indexation.<sup>4</sup> Thus, while Belgium's ample access to markets at currently low interest rates allows for some fiscal space to deal with shocks, Belgium's fiscal space is at risk when fiscal rules (and long-term considerations) are taken into account.<sup>5</sup>



**14. The policy priority should be to contain the damaging effects of the coronavirus through targeted temporary support measures.** The caretaker authorities have recently taken targeted measures to support affected firms and individuals, including to facilitate access to temporary unemployment, redistribute and defer direct tax payments, provide financial support to the self-employed, and suspend penalties for delays by suppliers of the public sector. They should continue to monitor the situation closely and take further temporary measures as needed, including to bolster capacity and resources for the health system by making full use of the (recently increased) health envelope and continue to support vulnerable groups and firms affected by the outbreak, while allowing automatic fiscal stabilizers to work.

<sup>4</sup> Aging-related costs are projected to increase by 1.4 percent of GDP during 2025–35 (as in the 2018 EC Aging Report). Other primary spending and revenue components are constant relative to GDP after 2025. Real growth is constant at 1.3 percent, inflation at 2 percent, and the effective interest rate converges gradually to its steady-state level of 4.3 percent by 2040.

<sup>5</sup> See [IMF WP No. 20/1](#), which finds that public debt remains the most important predictor of crises regardless of interest-growth differentials.

**15. A credible medium-term consolidation strategy is essential to build fiscal buffers and restore long-term sustainability.** Once a new government is formed, the authorities should design and implement a medium-term consolidation strategy that carefully balances near-term and long-term sustainability concerns. With the output gap closed but the coronavirus outbreak still developing, targeting a broadly neutral structural stance this year (net of emergency temporary measures related to the coronavirus outbreak), followed by an average annual structural adjustment of around 0.6 percent of GDP during 2021–24 could help attain the MTO by 2024 and put debt on a firm declining path in the medium and long term.<sup>6,7</sup> This will still require a fiscal effort of around 0.4 percent of GDP this year to finance tax reductions and spending increases not related to the coronavirus emergency, and around 0.6–0.7 percent of GDP per year in 2021–24 relative to the baseline. The flat adjustment in structural terms under the baseline this year is appropriate, given the potential but temporary needs due to the coronavirus risk as well as the uncertainty regarding the time needed to form a new government and take structural adjustment measures (assumed in the second half of the year, when the economy recovers). Preserving policy credibility will be essential, including by specifying (and pre-legislating, to the extent possible) future medium-term reforms to safeguard medium-term deficit and debt sustainability objectives.

<b>Belgium: Fiscal Projections</b> (Percent of GDP)							
	2019	2020	2021	2022	2023	2024	2025
<b>Baseline forecast</b>							
Revenue	50.3	50.0	49.8	49.8	49.8	49.8	49.8
Expenditure	51.9	52.3	52.4	52.3	52.5	52.8	53.0
Fiscal balance	-1.7	-2.3	-2.5	-2.5	-2.7	-3.0	-3.1
Primary balance	0.2	-0.6	-0.9	-1.2	-1.4	-1.7	-1.8
Structural balance	-2.0	-2.3	-2.5	-2.5	-2.7	-3.0	-3.1
Change in structural balance	-0.5	-0.4	-0.2	0.0	-0.2	-0.3	-0.2
Gross government debt	99.0	99.5	99.6	99.6	99.6	99.7	100.0
<b>Recommended policies (illustrative scenario)<sup>1</sup></b>							
Revenue	50.3	50.0	49.8	49.8	49.8	49.8	49.8
Expenditure	51.9	52.0	51.4	51.0	50.5	50.1	50.1
Fiscal balance	-1.7	-2.0	-1.6	-1.1	-0.7	-0.3	-0.2
Primary balance	0.2	-0.2	0.0	0.2	0.6	0.9	1.0
Structural balance	-2.0	-1.9	-1.4	-0.9	-0.3	0.0	0.0
Change in structural balance	-0.5	0.0	0.5	0.5	0.5	0.4	0.0
Fiscal effort	...	0.4	0.7	0.5	0.7	0.6	...
Gross government debt	99.0	99.3	98.9	97.8	96.2	94.0	91.6
Source: IMF staff calculations.							
<sup>1</sup> Assumes that the fiscal adjustment is expenditure-based.							

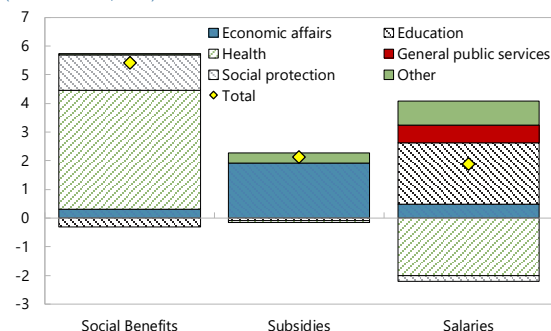
<sup>6</sup> The illustrative scenario is focused on recommended fiscal reforms. Structural reforms could further support growth, helping counterbalance the effects of the consolidation on growth over the medium term and further enhance sustainability in the long run.

<sup>7</sup> Staff's analysis of the optimal fiscal stance for Belgium broadly supports this recommendation. See accompanying Selected Issues Paper "The appropriate fiscal stance: restoring buffers to be able to offset future shocks."

## 16. Growth-friendly spending reforms should underpin the medium-term fiscal adjustment.

At over 52 percent of GDP at end-2018, Belgium's public spending was the third largest in Europe. Staff's analysis indicates that spending on social benefits, subsidies, and the wage-bill exceeds that of peers, suggesting scope to rationalize and improve its efficiency (Annex IV). This can not only support the adjustment, but also help reorient the budget toward more growth-friendly areas, such as public investment, skill upgrading, and support for the integration of vulnerable groups in the labor market (see Section B). Moreover, as noted above, substantial aging-related costs pose an additional long-run challenge that must be addressed. In this context, efforts should focus on the following areas:

**Contribution to Spending Gap vis-à-vis EU14**  
(Percent of GDP, 2017)



Sources: Eurostat and IMF staff calculations.

- Health care:* Healthcare spending is high relative to peers and is expected to rise further with population aging. While in the near term it will be essential to ensure that the health system has adequate resources to deal with the coronavirus emergency, in the medium run, a strategy is needed to contain costs by strengthening overall cost controls through binding spending ceilings, promoting preventive healthcare, and focusing reimbursements on generic medicines.
- Pensions:* Building on previous pension reforms, the new government should consider further measures to limit aging costs over the medium and long run, including by accelerating the pace of increase in the effective retirement age (now 61.1 compared to the OECD average of 64.6) and linking the minimum retirement age to gains in life expectancy (e.g. by introducing a sustainability factor linked to life expectancy), as well as revisiting the mechanism governing real increases in pension and other social benefits, which are generous by international standards.
- Other social benefits:* While in the near term, temporary and targeted measures will be essential to support individuals affected by the coronavirus outbreak, including as a result of sickness, loss of employment, etc., once the situation normalizes, there is scope to improve the targeting of social benefits while protecting the most vulnerable, including by reforming the unemployment system to strengthen incentives to return to work, tightening controls on sickness and disability benefits, which have increased rapidly in recent years, and better targeting family benefits, including to support women's participation in the labor force.
- Subsidies:* With spending on subsidies, especially exemptions, having increased to levels well above peers, there is scope to improve their efficiency, including for R&D, where evidence suggests that overlapping schemes lead to decreasing returns.<sup>8</sup> The company-car scheme, which is costly and adds to pollution, should also be revisited.
- Wage bill:* Reforms should focus on reducing fragmentation and duplication in the public administration, while streamlining the civil service, particularly at the subnational level.

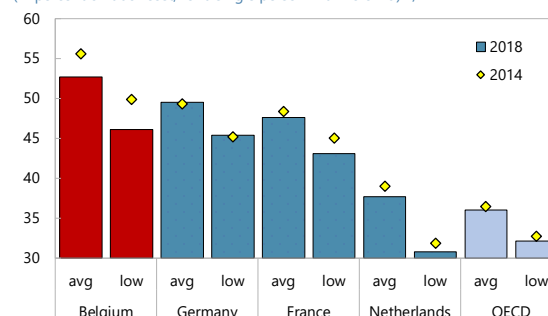
<sup>8</sup> See European Commission, [Country Report Belgium 2019](#), [OECD \(2019\), In-Depth Productivity Review of Belgium](#), [OECD \(2020\), Economic Surveys Belgium](#), and Dumont (2019), [FPB Working Paper 04-19](#).



**17. Further tax reforms could provide space to reduce the labor tax wedge in a budget neutral way.** Belgium's tax burden remains among the highest in Europe, even after recent reforms. To create space to lower the labor tax wedge and support employment and growth in the medium run, reforms should focus on broadening tax bases and reducing exemptions. For example, tax expenditures have proliferated over time, eroding efficiency.<sup>9</sup> Value-added tax expenditures are particularly high and could be reduced by harmonizing rates to improve efficiency. Moreover, the taxation on capital could be further simplified to restore neutrality between: (i) salary and dividends payments (e.g., by increasing dividend withholding taxes), (ii) distributed profits and retained earnings (e.g., by considering a personal capital gains tax or a deemed-distribution tax),<sup>10</sup> (iii) rental and other forms of income (e.g., by taxing actual rental income net of expenses), and (iv) different asset classes (e.g., by reducing tax privileges for savings accounts and life insurance).<sup>11</sup>

**Average Tax Wedge By Labor Income**

(In percent of labor cost, for a single person with no child) 1/



Source: OECD Tax Statistics.

1/ Low income: 67 percent of average earnings.

### **Authorities' Views**

**18. The authorities agreed with the need to put the deficit and debt on a sustained downward path.** The caretaker authorities noted that the lack of a parliamentary majority makes it difficult to take consolidation measures in the near term, although, after the mission, they notified the urgent measures taken in response to the coronavirus outbreak. They concurred that the new government should implement a credible medium-term strategy to bring the deficit toward the MTO and reduce debt, while noting that some flexibility with regards to investment may be necessary, given Belgium's important needs for infrastructure and green investments. The NBB stressed the importance of a relatively more ambitious structural adjustment in the near term to boost credibility and ensure adherence to European rules. Interlocutors agreed that the adjustment should be largely expenditure-based, aiming to improve spending efficiency and increase labor-force participation, including for older workers.

## **B. Raising Potential Output**

**19. A fragmented labor market and low productivity growth are constraining Belgium's long-term potential** (Figure 4). Despite past reforms, Belgium's employment and labor-force participation rates remain among the lowest in Europe, particularly for the young, old, low-skilled, non-EU born, and women, reflecting limited flexibility of the labor market, obstacles to

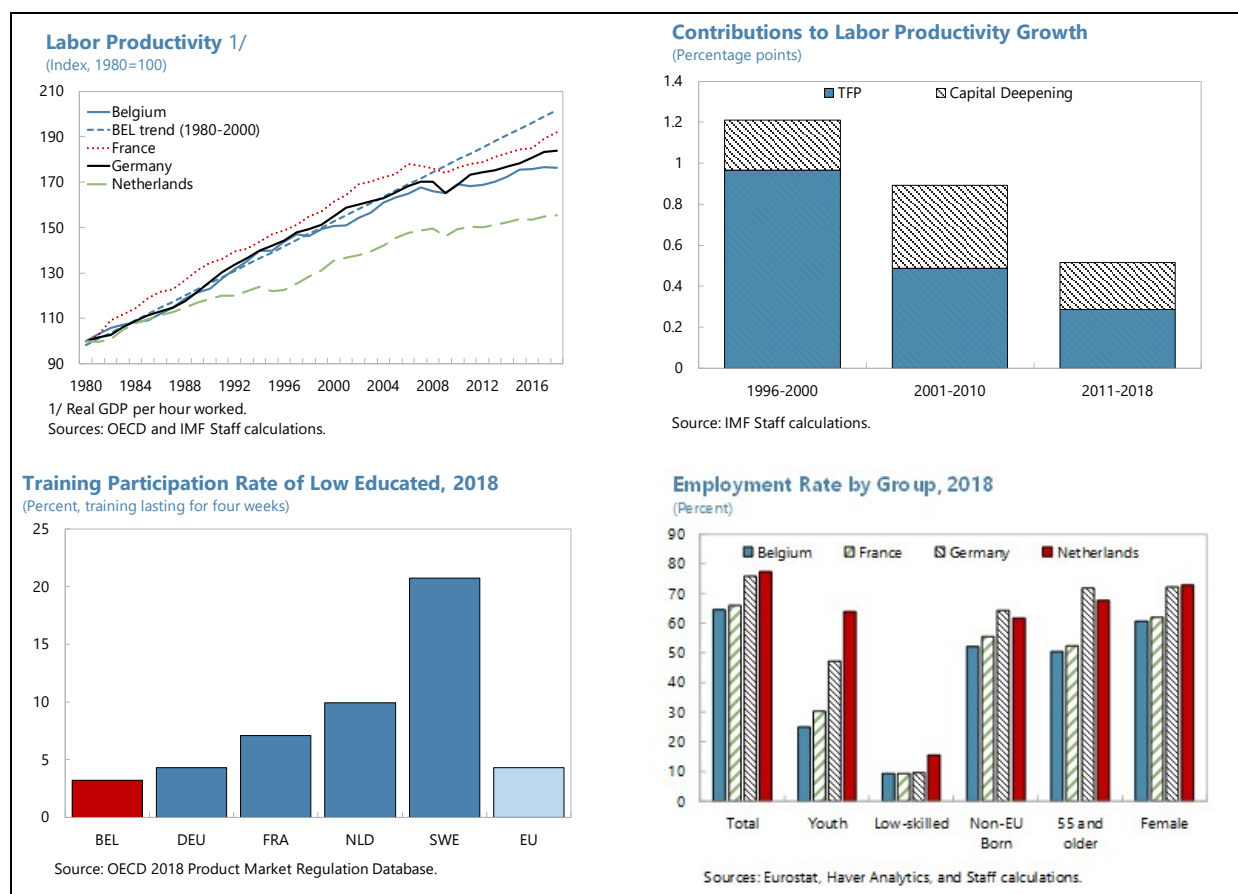
<sup>9</sup> Tax expenditures were 6.3 percent of GDP in 2016. See 2017 Tax Expenditure Report, Federal Ministry of Finance.

<sup>10</sup> See De Mooij et al., 2017, [IMF Country Report 17/70](#).

<sup>11</sup> See European Commission, [Country Report Belgium 2019](#).

labor mobility, and skills mismatches.<sup>12</sup> While Belgium’s labor-productivity level is relatively high, its growth rate has slowed over the last two decades, averaging around 0.9 percent, less than half its historical trend. This is primarily due to a decline in total factor productivity (TFP) growth, reflecting not only common trends across advanced economies (e.g. the shift from manufacturing to services, weaker technology diffusion across firms, and population aging), but also Belgium-specific factors, such as weak business dynamism, restrictions to competition in product and service markets (among the highest relative to peers), low public investment, and ineffective R&D spending.<sup>13</sup>

**20. Additional labor market reforms are needed to boost labor-force participation and inclusiveness and boost flexibility.** In the near term, efforts should focus on providing temporary support to individuals and firms affected by the coronavirus outbreak. Once the situation normalizes, the authorities should continue efforts to integrate vulnerable groups through active labor-market policies and more effective training and dual-learning programs. Over the medium run, the new government should implement further reforms to: (i) bolster female labor force participation by revamping parental leave policies (where Belgium has scope to align with peers) and reducing tax disincentives for secondary earners; (ii) strengthen work incentives by reforming

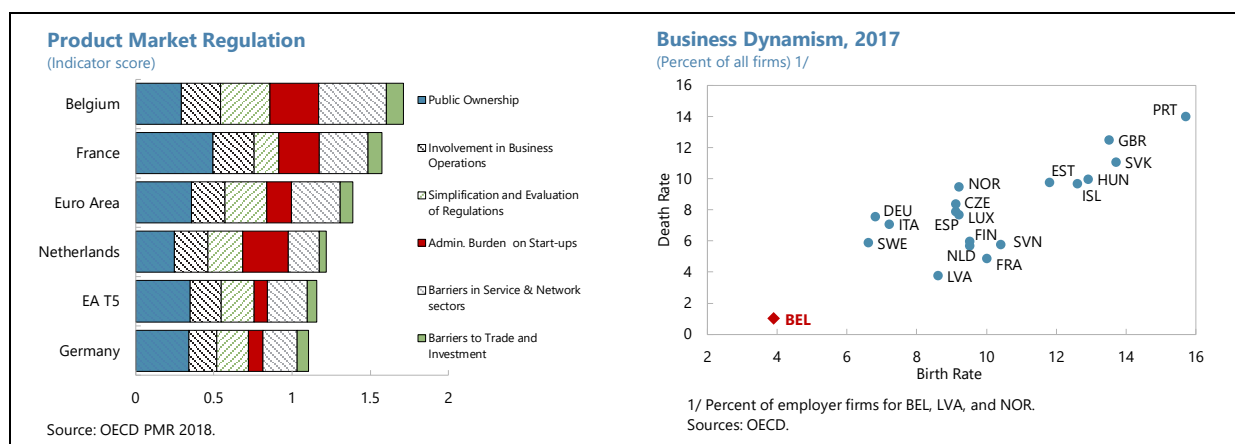


<sup>12</sup> Also see Piton and Rycx, 2020, [NBB Working Paper No 381](#).

<sup>13</sup> Also see [OECD \(2019\), In-Depth Productivity Review of Belgium](#).

the unemployment- benefit system (options that could be considered include increasing degressivity, limiting the duration of benefits, and bringing replacement rates closer in line with peers); (iii) support labor mobility by improving public transport across regions and reducing real-estate regulatory and tax barriers (e.g. by shifting from real-estate transaction to recurrent property taxes);<sup>14</sup> and (iv) boost flexibility by aligning wages with productivity at the firm level (including via opt-outs and reducing the weight of seniority in compensation) and increasing the flexibility of collective dismissals.

**21. Complementary medium-term reforms are also needed to support business dynamism, boost competition, and green the economy.** Following measures to widen the scope of the insolvency law, facilitate out-of-court restructuring, and streamline firm-incorporation requirements in 2018, new measures strengthening the competition authority were adopted in mid-2019. Building on these and the common ground across party-lines, the existing or new authorities should intensify reform efforts to: (i) further reduce red tape for start-ups and ease regulatory restrictions in retail trade and distribution and professional services; (ii) support innovation by reducing tax incentives for safe assets, making use of the Belgian growth fund to support venture funding of innovative firms,<sup>15</sup> and improving the efficiency of R&D tax incentives (see paragraph 16); and (iii) increasing investment in infrastructure, fiscal space permitting.<sup>16</sup>



**22. The new government should prepare a comprehensive and coordinated policy strategy to address climate change and take advantage of the opportunities from the transition to a green economy.** Belgium has ambitious medium and long-term objectives for reducing emissions of greenhouse gases. However, progress has been limited, and current policies will be insufficient to attain the targets. Among policy options that could be considered by the new government, in collaboration with regional governments and EU institutions, are: (i) feebates or regulations to incentivize emissions reductions; (ii) introducing carbon taxes in an equitable manner, the revenues

<sup>14</sup> At 2.3 percent of GDP in 2017, real-estate transaction duties are among the highest in the EU. Also see European Commission, [Country Report Belgium 2019](#).

<sup>15</sup> See Box 4 of [IMF Country Report No. 19/74](#).

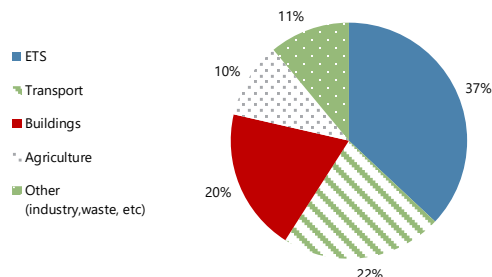
<sup>16</sup> Also see [IMF Country Report No. 18/72](#).

from which could be used to compensate vulnerable households and boost green investment; and (iii) extending the emissions-trading system (ETS) to cover more sectors (Box 2).

**Box 2. Initial Considerations on Climate-Mitigation Efforts in Belgium**

**Under the 2015 Paris Agreement, Belgium committed to reduce emissions of greenhouse gases by 80–95 percent by 2050.** Under the new Green Deal, these targets could become even more ambitious and frontloaded (reductions by 50 percent by 2030). So far, Belgium has lagged behind its targets. In part, this reflects that only 37 percent of its emissions are priced via the EU Emissions Trading System (ETS). The remaining 63 percent is not subject to any explicit carbon price and is concentrated in the transport and the buildings sectors, followed by agriculture and others.

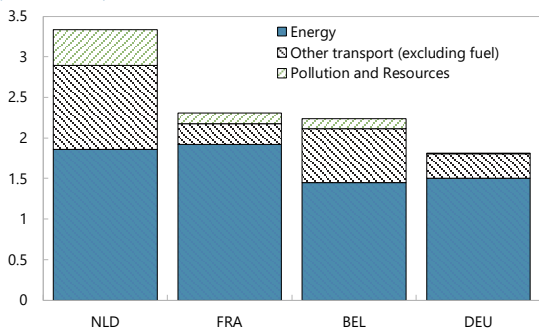
**Emissions**  
(Percent of total CO2 emissions)



Source: European Commission.

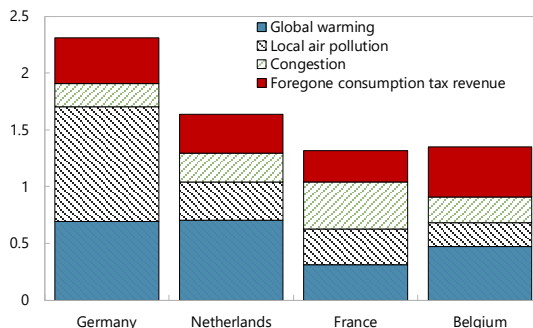
**Belgium’s main policy tools to reduce emissions are fuel excise taxes on road transportation, and, to a lesser extent, other transport taxes.** Nonetheless, at 2¼ percent of GDP, Belgium’s overall environmental tax burden (relative to GDP) is relatively low compared to peers, and below the EA average. Belgium also uses a relatively lower level of environmental subsidies (1.4 percent of GDP) than peers.

**Environmental Taxes, 2017**  
(Percent of GDP)



Source: European Commission, Eurostat.

**Energy Subsidies, 2017**  
(Percent of GDP)

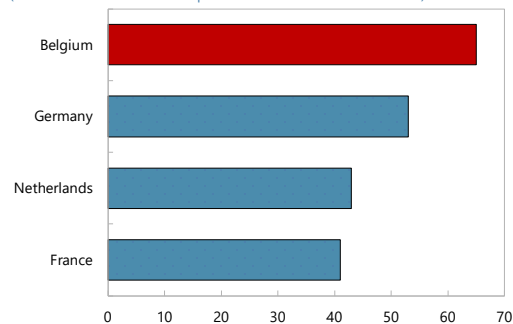


Source: IMF Country-level Subsidy Estimates Database, 2018.

**Belgium has room to accelerate its efforts to facilitate the transition toward a low-carbon economy.**

According to the OECD’s carbon pricing-gap measure (capturing how much economies fall short of pricing carbon emissions in line with a carbon-price benchmark value), Belgium’s gap (65 percent) is the highest among peers. As suggested in the IMF October 2019 Fiscal Monitor, among the policy options that could be considered to reduce this gap are: (i) “feebates” (systems of fees and rebates on products or activities with above or below-average emission intensity) or regulations (e.g. emission-rate and energy-efficiency standards); (ii) carbon taxes, which are among the most efficient tools to incentivize a shift to cleaner energy consumption (already in use in several European countries), the revenues from which could be used to compensate vulnerable households and boost investment in green technologies; and (iii) extending the ETS to cover more sectors (e.g. industry).

**Carbon Pricing Gap, 2015**  
(Percent deviation of carbon price from OECD benchmark value)



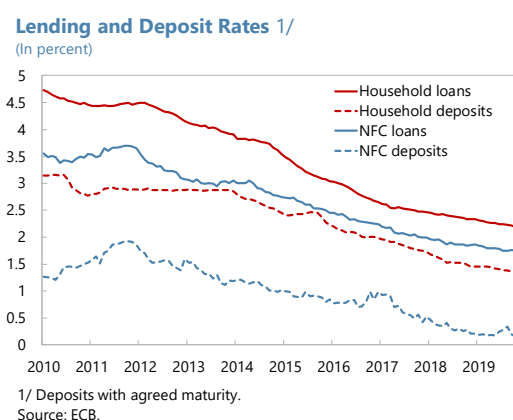
Source: OECD.

## Authorities' Views

**23. The authorities agreed that boosting labor force participation and productivity growth is critical to lift potential growth and support fiscal sustainability in the medium run.** They emphasized the employment gains from past reforms but recognized that more needs to be done to integrate vulnerable groups in the labor market and address skills mismatches. They pointed to positive results for improving access to venture capital, including through the Belgian Growth Fund, but acknowledged that further efforts are needed to reduce red tape and regulations. They also concurred with the need for a clear strategy to achieve emission reduction targets, noting the importance of strong coordination both across regions and with European partners and institutions.

## C. Safeguarding Financial-Sector Stability

**24. While resilient, the financial sector faces new challenges.** The post-crisis deleveraging, de-risking and reorientation on the domestic market has strengthened banks' resilience, while capital and liquidity buffers have been bolstered.<sup>17</sup> Likewise, insurance companies have increased solvency ratios and reduced exposures to guaranteed rates. However, low interest rates have put pressure on profitability, leading banks to ease credit standards and insurers to reallocate assets toward corporate and mortgage-lending products.<sup>18</sup> Should low interest rates persist, this could rekindle concerns about adequate pricing of risks and future loan performance, as well as about the sustainability of business models of smaller banks that have less options to diversify and less resources to adapt to digitalization.<sup>19</sup> The coronavirus outbreak adds to the challenges, should individuals and firms face difficulties in repaying their loans.



**25. Strong credit growth has pushed up leverage, particularly for households.** Household debt increased to 61 percent of GDP and 105 percent of disposable income by end-September 2019, due to strong mortgage lending.<sup>20</sup> Credit-growth to firms also continued robustly last year (5.1 percent), albeit slower than its rate of 7.6 percent in 2018. Belgium's non-financial corporate

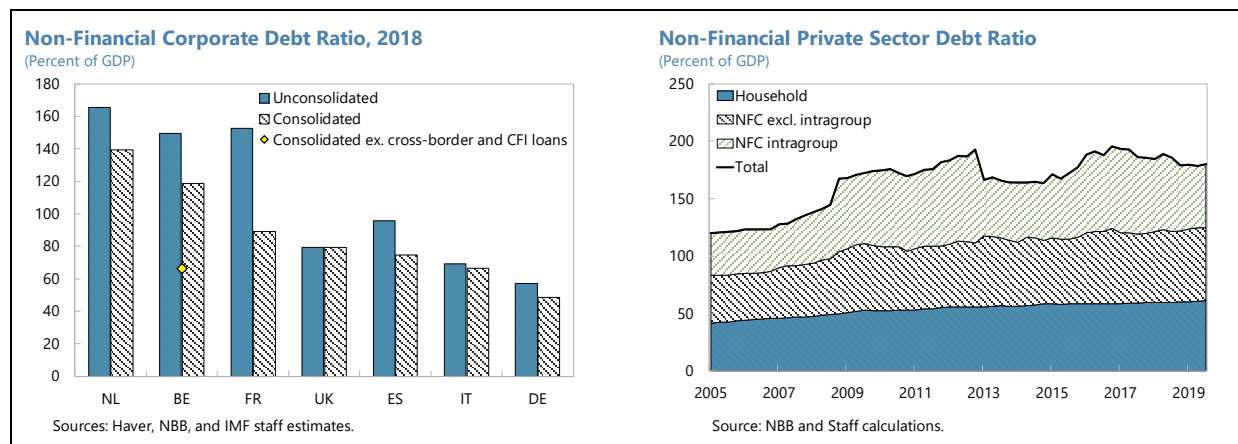
<sup>17</sup> At 18.3 percent, bank capital adequacy ratios are well-above the regulatory requirements and resilient to stress (see [2018 EBA stress tests results](#) and [IMF Country Report No. 18/67](#)).

<sup>18</sup> Some banks have offset the decline in interest margins by expanding lending activities outside the euro area, while hedging exposures.

<sup>19</sup> See the NBB's [Financial Stability Report 2019](#) and [Annual Report 2018](#); and [ESRB \(2019\), Vulnerabilities in the residential real estate sectors of the EEA countries](#).

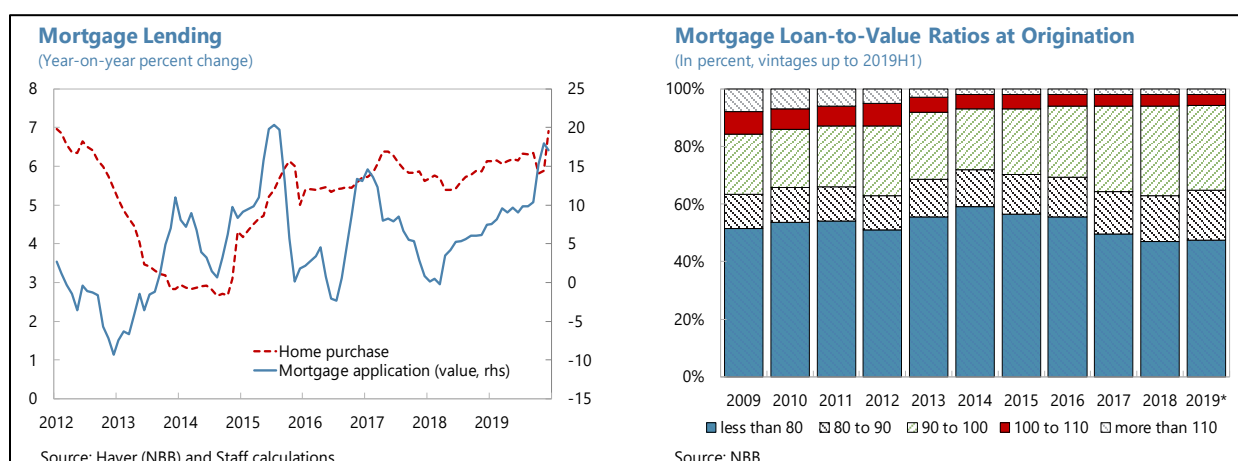
<sup>20</sup> The marked pickup in mortgage applications in 2019Q4 relates to the phasing out of the income-tax deduction for homeowners in Flanders.

debt has remained around 120 percent of GDP on a consolidated basis, and 64 percent of GDP when adjusting for intragroup loans.<sup>21</sup> In line with the National Bank of Belgium (NBB), staff assesses that bank credit to the non-financial private sector relative to GDP in 2019 was above its trend (Box 3).



**26. In this context, housing-market vulnerabilities continued to build during 2019**

(Figure 5). House-price growth has been modest, but valuations remain stretched, with price-to-rent and price-to-income ratios still well-above their historical averages and estimated equilibrium values.<sup>22</sup> The share of new mortgage loans with high loan-to-value ratios (LTV > 90 percent) and/or debt-service-to-income ratios (DSTI > 30 percent) has steadily increased in the past years, exposing banks to credit risk in case of a sharp house-price correction. While sizable household financial assets (close to 170 percent of GDP) mitigate risks, assets may not be evenly distributed across households, and new households (with typically lower assets) account for a sizeable share of new loans (43 percent in H12019), of which almost half had an LTV ratio exceeding 90 percent. The coronavirus outbreak could thus have a material impact on bank asset quality.



<sup>21</sup> See Box 5 of [IMF Country Report No. 19/74](#).

<sup>22</sup> The ECB estimates that prices are overvalued by about 15 percent, while the NBB estimates an overvaluation of 5.3 percent at end-2019:Q2.

**27. To address these vulnerabilities, the supervisory authorities have taken additional macroprudential measures over the last year.** Following measures taken in 2018 to increase risk weights on banks' mortgage loans,<sup>23</sup> in June 2019, the NBB activated the countercyclical capital buffer (CCyB), at a rate of 0.5 percent, allowing banks until July 2020 to comply. In October 2019, the authorities issued supervisory expectations setting limits on the share of high-risk mortgage loans that banks and insurers can issue,<sup>24</sup> following the ESRB's 2019 recommendation to address housing-market risks.

**28. The authorities should remain vigilant and stand ready to take additional measures as needed to address near-term risks related to the coronavirus.** The supervisory authorities should continue to monitor risks closely, especially given the rapidly evolving coronavirus outbreak. In this regard, their most recent decision to release the CCyB is welcome, as it can help free up capital buffers that can be used to absorb any potential loan losses and thus help to preserve financial stability during the current coronavirus crisis. Should banks face difficulties related to losses associated with the impact of the coronavirus, if needed, they could also support financial intermediation by considering additional temporary measures on capital relief. The authorities could also encourage banks to undertake loan restructuring as appropriate based on prudent risk management standards and in line with existing guidelines.

**29. Staff welcomed progress in implementing other FSAP recommendations** (Table 6).<sup>25</sup> Looking forward, efforts should continue to: (i) stand ready to use macroprudential policies as needed and revisit the framework for macro-prudential decision-making to ensure the ability to deploy macro-prudential policies effectively and timely (e.g. by granting the NBB the power to implement directly cyclical macroprudential policies without the need for prior approval by the Minister of Finance or government); (ii) complete the technical standards on the reporting of intra-group transactions, risk concentration, and capital adequacy for financial conglomerates; (iii) ensure the feasibility and effectiveness of bank-resolution strategies, including by maintaining a sufficient and consistent allocation of MREL as needed; and (iv) strengthen deposit insurance by legislating the segregation of the Guarantee Fund from the government funds, once the new government is formed. Finally, the authorities should encourage banks to continue to rationalize costs (e.g. related to staffing and dense branch networks), strengthen governance, and adapt their business models to support profitability and prepare for the challenges related digitalization and a potentially prolonged period of low interest rates.<sup>26</sup>

<sup>23</sup> The measures increased the implied risk weight of mortgage loans from 10 to 18 percent on average.

<sup>24</sup> The NBB set LTV thresholds for new loans at 80/90 percent for buy-to-let/owner-occupied housing and a limit of 5 percent for new loan volumes with high LTV and high DSTI or debt-to-income ratios (>50 and >9 percent) Mortgage lenders are expected to comply or explain.

<sup>25</sup> See [IMF Country Report No. 18/67](#).

<sup>26</sup> See NBB's [Financial Stability Report 2019](#).

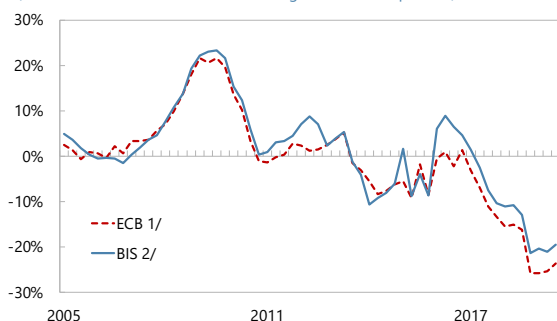
### Box 3. Assessing Belgium’s Position in the Credit Cycle

**Identifying excessive credit growth is critical to prevent a build-up of systemic risk.**<sup>1</sup> The Basel Committee introduced the credit-to-GDP gap in 2010 to guide macroprudential policy decisions regarding the counter-cyclical capital buffer (CCyB). The credit gap measures the deviation of the credit-to-GDP ratio from its long-term trend, with widening positive gaps signaling growing imbalances that, left unaddressed, could result in a credit boom-bust.

**For Belgium, standard BIS/ECB measures imply a large negative credit gap, while the NBB’s measure points to a positive credit gap since late 2017.** Using BIS’s standardized HP-filter methodology based on total credit to the non-financial private sector and related ECB measure excluding external credit, Belgium’s credit-gap estimates hover around -19 to -24 percent (end-September 2019). The NBB’s measure, which employs the same methodology but includes only resident-bank credit to the non-financial private sector, yields a positive credit gap of 1.5 percent at end-September 2019, down from a peak of 2 percent in June, driven by credit to non-financial corporates (NFCs).

#### Standardized Credit to GDP Gap

(Deviation of credit-to-GDP from its long-term trend in percent) 1/

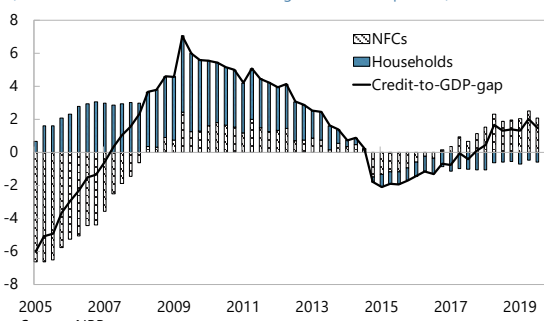


Sources: ECB and BIS (Haver Analytics).

1/ Credit to the non-financial private sector (BIS); excluding external credit (ECB).

#### Adjusted Credit to GDP Gap and Decomposition

(Deviation of credit-to-GDP from its long-term trend in percent) 1/



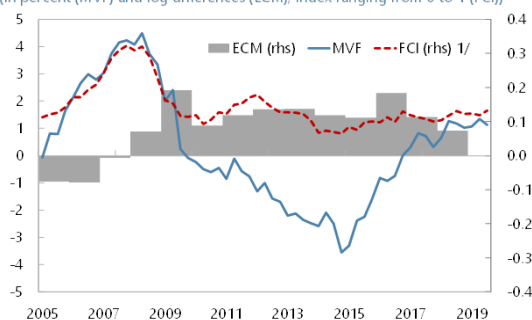
Source: NBB.

1/ Domestic bank credit (including securitized loans) to the non-financial private sector (HP filter consistent with BIS methodology).

**Alternative credit-gap estimates developed by the IMF suggest a modest positive credit gap at end-2019.** While the Basel credit-gap methodology has been widely used, it has limitations, including: (i) an inability to take into account financial deepening or liberalization; (ii) a tendency for large credit booms to inflate the trend; and (iii) statistical problems related to HP filters. IMF (2020) propose two complementary structural approaches: (i) a multivariate filtering (MVF) method that jointly estimates the cyclical component of credit and other macroeconomic variables; and (ii) a model-based method (ECM) that estimates the credit trend based on long-term fundamentals using panel regressions.<sup>2</sup> Using the same credit definition as the NBB, the MVF approach yields a small positive gap of 1.1 percent (Sept. 2019), while the model-based empirical approach yields a somewhat larger positive gap of 7.3 percent (2018). The NBB’s financial condition index (FCI) capturing various dimensions of macroprudential risks in a single indicator<sup>3</sup> comoves closely with the estimated MVF credit gap and confirms that cyclical systemic risks have lingered in Belgium in 2019.

#### Credit Gaps and Financial Condition Index (FCI)

(In percent (MVF) and log differences (ECM); index ranging from 0 to 1 (FCI))



Source: Baba and others (2020) and NBB.

1/ Broad-based composite indicator of domestic financial conditions.

<sup>1</sup> See Drehman and others, 2011; Drehman and Juselius, 2012; IMF, 2011; IMF 2013, and Lund-Jensen, 2012.

<sup>2</sup> See IMF Working Paper No. 20/6

<sup>3</sup> The FCI is a broad-based composite indicator of domestic financial conditions covering credit growth, real estate, private sector debt, banking sector and financial market conditions, see Cordemans, N., Tielens, J., and Ch. Van Nieuwenhuize (2019).



### **Authorities' Views**

**30. The authorities concurred with staff's assessment and policy recommendations.** They shared the view that low interest rates, digitalization, and private sector leverage pose challenges for the banking sector, although they stressed that risks were mitigated by strong bank and household balance sheets, limited house price misalignment, and a recent normalization in loan pricing following supervisory scrutiny. This being said, they agreed with the need to continue to closely monitor risks and indicated their intention to take additional measures if warranted. The NBB noted their commitment to follow up on the completion of remaining FSAP recommendations.

## **STAFF APPRAISAL**

**31. Economic activity has held up relatively well over the last year, but the outlook is clouded by unusual uncertainty and risks.** Growth was resilient and job rich in 2019, while the unemployment rate reached a historical low, in part reflecting previous reforms. Nonetheless, the inability to form a new government has paralyzed policymaking, while the public finances have deteriorated. The coronavirus outbreak is expected to reduce growth this year, and the outlook is highly uncertain and subject to risks, including more widespread and damaging effects of the coronavirus, escalating trade tensions, a sharper euro-area growth slowdown, and prolonged domestic political gridlock.

**32. Policies should focus on addressing the coronavirus outbreak in the near term and rebuilding resilience and addressing structural challenges in the medium run.** The immediate policy priority is to contain the spread and damaging effects of the coronavirus through targeted temporary support measures to affected firms and individuals, while ensuring that the healthcare system has adequate resources to address the crisis. Should banks face difficulties related to losses due to the coronavirus, the supervisory authorities could support financial intermediation by considering additional temporary measures on capital relief. A new government should use its fresh mandate to implement comprehensive reforms to address remaining medium-term structural challenges: high public and rising private debt, an aging population, slowing productivity growth, and climate change.

**33. Belgium will need a credible medium-term consolidation to build fiscal buffers against future shocks and safeguard sustainability.** Under the baseline scenario, the deficit will continue to widen, and public debt will remain high in the medium run and be on a rising trajectory in the long run, due to population aging pressures. To safeguard fiscal sustainability and build buffers against future shocks, the new government needs to put in place a credible medium-term consolidation strategy aiming to reach structural fiscal balance by 2024. Avoiding a further deterioration in the structural balance this year (net of emergency measures to address the coronavirus outbreak) and aiming for a structural adjustment of ½ percent of GDP during 2021–24 could balance near and long-term considerations.

**34. Growth-friendly spending reforms should underpin the medium-term adjustment.** A sustained medium-term effort to reduce primary spending while improving its efficiency can support deficit targets and reorient the budget toward more growth-friendly areas. Reforms should focus on containing medium-term healthcare costs, bolstering the sustainability of the pension system, improving the targeting and labor-market incentives of social benefits, strengthening the efficiency of subsidies, and reducing duplication in the public administration. Complementary tax base-broadening reforms could create space to lower the labor tax wedge in the medium run.

**35. Additional reforms to boost labor-force participation, especially for vulnerable groups, are needed.** Despite recent reforms, Belgium's labor-force participation rate remains among the lowest in Europe, especially for the young, low-skilled, non-EU born, and women. Efforts should thus focus on active labor-market policies and training programs targeted at vulnerable groups and should be followed by further reforms to bolster female labor-force participation, mobility, and labor-market flexibility. These can also help strengthen Belgium's external position, which is weaker than implied by fundamentals.

**36. Complementary product-market reforms can help boost productivity growth.** Reversing the declining trend in productivity growth is essential to support higher standards of living and safeguard fiscal sustainability. Thus, reform efforts would need to focus on reducing red tape for startups, lowering regulatory barriers to competition in key sectors, supporting access to venture capital for innovative firms, and boosting public investment in infrastructure, fiscal space permitting. A comprehensive policy strategy is needed to fulfill the government climate change commitments and take advantage of the opportunities from the transition to a green economy.

**37. The authorities should continue to bolster the resilience of the financial sector over the medium run.** Staff welcomes the recent macroprudential measures addressing risks stemming from easy credit and rising corporate and household debt as well as the more recent decision to release the countercyclical capital buffer in response to the coronavirus crisis. Looking forward, they should stand ready to continue to support the banking sector as needed and revisit the framework for macro-prudential decision-making to ensure the ability to deploy macro-prudential policies effectively and timely. Efforts should continue to improve reporting, bank resolution, and deposit insurance frameworks. The authorities should also encourage banks to rationalize costs, strengthen governance, and adapt business models to prepare for the challenges of digitalization.

**38. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.**

## Proposed Decision

The Executive Board endorses the thrust of the staff appraisal in the report for the 2020 Article IV consultation with Belgium.

It is expected that the next Article IV consultation with Belgium will take place on the standard 12-month cycle.

Table 1. Belgium: Selected Economic Indicators, 2018–25

	Est.		Projections					
	2018	2019	2020	2021	2022	2023	2024	2025
	(Percent change, unless otherwise indicated)							
<b>Real economy</b>								
Real GDP	1.5	1.4	0.8	1.2	1.3	1.3	1.3	1.3
Domestic demand	2.2	1.5	1.1	1.6	1.6	1.6	1.7	1.6
Private consumption	1.5	1.1	1.0	1.5	1.6	1.5	1.5	1.5
Public consumption	0.9	1.6	1.7	1.2	1.3	1.3	1.4	1.5
Gross fixed investment	4.0	3.1	0.9	2.0	1.8	2.3	2.5	1.8
Stockbuilding 1/	0.3	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance 1/	-0.7	-0.1	-0.2	-0.3	-0.3	-0.3	-0.4	-0.3
Exports, goods and services	1.2	1.0	1.6	3.9	3.9	3.8	3.5	3.5
Imports, goods and services	2.1	1.2	1.9	4.3	4.3	4.1	3.9	3.7
Household saving ratio	11.8	12.5	12.6	12.6	12.4	12.3	12.4	12.5
Potential output growth	1.3	1.3	1.2	1.3	1.3	1.3	1.3	1.3
Potential output growth per working age person	1.0	1.2	1.2	1.2	1.3	1.3	1.3	1.3
Output gap (in percent)	0.4	0.5	0.1	0.0	0.0	0.0	0.0	0.0
<b>Employment</b>								
Unemployment rate (in percent)	6.0	5.4	5.6	5.5	5.5	5.5	5.4	5.4
Employment growth	1.4	1.5	0.3	0.5	0.6	0.6	0.6	0.6
<b>Prices</b>								
Consumer prices	2.3	1.2	1.1	1.2	1.6	1.8	1.8	1.8
GDP deflator	1.5	1.6	1.3	1.4	1.5	1.6	1.7	1.7
	(Percent of GDP; unless otherwise indicated)							
<b>Public finance</b>								
Revenue	51.4	50.3	50.0	49.8	49.8	49.8	49.8	49.8
Expenditure	52.1	51.9	52.3	52.4	52.3	52.5	52.8	53.0
General government balance	-0.7	-1.7	-2.3	-2.5	-2.5	-2.7	-3.0	-3.1
Structural balance	-1.5	-2.0	-2.3	-2.5	-2.5	-2.7	-3.0	-3.1
Structural primary balance	0.6	-0.1	-0.6	-0.9	-1.2	-1.4	-1.7	-1.8
Primary balance	1.4	0.2	-0.6	-0.9	-1.2	-1.4	-1.7	-1.8
General government debt	100.0	99.0	99.5	99.6	99.6	99.6	99.7	100.0
<b>Balance of payments</b>								
Goods and services balance	-0.2	0.0	0.2	0.3	0.1	-0.1	-0.2	-0.2
Current account	-1.0	-1.2	-1.0	-0.9	-1.1	-1.2	-1.3	-1.2
<b>Exchange rates</b>								
Euro per U.S. dollar, period average 2/	0.8	0.9	...	...	...	...	...	...
NEER, ULC-styled (2005=100) 2/	98.7	97.6	...	...	...	...	...	...
REER, ULC-based (2005=100) 2/	98.4	96.5	...	...	...	...	...	...
<b>Memorandum items</b>								
Gross national savings (in percent of GDP)	24.5	24.3	24.4	24.5	24.5	24.5	24.6	24.8
Gross national investment (in percent of GDP)	25.5	25.5	25.4	25.5	25.6	25.7	25.9	26.0
Nominal GDP (in billions of euros)	459.8	473.6	484.0	497.1	511.2	526.5	542.8	559.2
Population (in millions)	11.4	11.5	11.5	11.6	11.6	11.7	11.8	11.8

Sources: Haver Analytics, Belgian authorities, and IMF staff projections.

1/ Contribution to GDP growth.

2/ As of December 2019.

Table 2. Belgium: Balance of Payments, 2018–25

	2018	Est. 2019	Projections					
			2020	2021	2022	2023	2024	2025
	(In percent of GDP)							
<b>Balance on current account</b>	-1.0	-1.2	-1.0	-0.9	-1.1	-1.2	-1.3	-1.2
Balance on goods and services	-0.2	0.0	0.2	0.3	0.1	-0.1	-0.2	-0.2
Balance of trade (f.o.b., c.i.f.)	119.8	118.2	116.6	117.1	118.5	119.6	120.3	120.7
Exports of goods and services	82.6	81.6	80.6	81.0	81.8	82.5	82.9	83.2
Exports of goods	59.8	59.1	58.4	58.6	59.3	59.8	60.1	60.3
Exports of services	22.8	22.5	22.2	22.3	22.6	22.8	22.9	22.9
Imports of goods and services	-82.7	-81.6	-80.4	-80.7	-81.7	-82.6	-83.2	-83.4
Imports of goods (f.o.b.)	-60.0	-59.1	-58.3	-58.5	-59.2	-59.9	-60.3	-60.4
Imports of services	-22.8	-22.5	-22.1	-22.2	-22.5	-22.8	-22.9	-23.0
Income, net	0.6	0.2	0.2	0.3	0.3	0.3	0.4	0.4
Current transfers, net	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5
<b>Balance on capital account</b>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Balance on financial account</b>	-1.6	-1.2	-1.0	-0.9	-1.1	-1.2	-1.3	-1.2
Direct investment, net	1.9	2.2	2.4	2.6	2.8	3.0	3.2	3.4
Portfolio investment, net	-0.7	0.5	0.2	0.0	-0.8	-1.4	-1.9	-2.1
Financial derivatives, net	0.9	-0.2	-0.2	-0.3	-0.1	0.0	0.0	-0.1
Other investment, net	-4.0	-3.8	-3.6	-3.4	-3.2	-2.9	-2.7	-2.5
Reserve assets	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Errors and omissions, net	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Haver Analytics, Belgian authorities, and IMF staff projections.

**Table 3. Belgium: General Government Statement of Operations, 2018–25**

	Est.		Projections					
	2018	2019	2020	2021	2022	2023	2024	2025
	(In percent of GDP)							
<b>Revenue</b>	51.4	50.3	50.0	49.8	49.8	49.8	49.8	49.8
Taxes	30.9	29.9	29.6	29.6	29.6	29.6	29.6	29.6
Personal income tax	12.1	11.7	11.7	11.7	11.7	11.7	11.7	11.7
Corporate income tax	4.4	3.9	3.7	3.6	3.6	3.6	3.6	3.6
Taxes on property	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
VAT	6.9	6.8	6.8	6.8	6.8	6.8	6.8	6.8
Excise	2.7	2.6	2.7	2.7	2.7	2.7	2.7	2.7
Other taxes	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Social contributions	15.5	15.5	15.4	15.4	15.4	15.4	15.4	15.4
Actual social contributions	13.3	13.3	13.2	13.2	13.2	13.2	13.2	13.2
Imputed social contributions	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Other revenue (incl. grants)	5.0	5.0	5.0	4.9	4.9	4.9	4.9	4.9
<b>Expenditure</b>	52.1	51.9	52.3	52.4	52.3	52.5	52.8	53.0
Expense	48.7	48.6	49.0	49.0	48.9	49.0	49.2	49.5
Compensation of employees	12.3	12.2	12.3	12.3	12.2	12.2	12.2	12.2
Use of goods and services	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1
Interest	2.1	1.9	1.8	1.6	1.4	1.3	1.3	1.3
Subsidies	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6
Grants	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Social benefits	24.6	24.8	25.2	25.4	25.6	25.8	26.0	26.2
Other expense	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Net acquisition of nonfinancial assets	3.4	3.3	3.3	3.4	3.4	3.5	3.6	3.5
Gross operating balance	2.7	1.7	1.0	0.9	0.9	0.8	0.6	0.4
<b>Net lending/borrowing</b>	-0.7	-1.7	-2.3	-2.5	-2.5	-2.7	-3.0	-3.1
<b>Memorandum items</b>								
Primary balance	1.4	0.2	-0.6	-0.9	-1.2	-1.4	-1.7	-1.8
Structural fiscal adjustment	-0.2	-0.5	-0.4	-0.2	0.0	-0.2	-0.3	-0.2
Structural fiscal primary adjustment	-0.4	-0.7	-0.5	-0.4	-0.2	-0.3	-0.3	-0.1
Gross government debt	100.0	99.0	99.5	99.6	99.6	99.6	99.7	100.0
Real growth of primary expenditure	2.3	1.4	1.9	1.7	1.7	1.9	1.9	1.5

Sources: Haver Analytics, Belgian authorities, and IMF staff projections.

**Table 4. Belgium: General Government Consolidated Balance Sheet, 2010–18**

	2010	2011	2012	2013	2014	2015	2016	2017	2018
	(In percent of GDP)								
Net financial worth	-82.3	-84.2	-92.2	-88.6	-96.6	-93.2	-91.6	-85.9	-84.6
Financial assets	26.4	27.4	28.8	30.0	34.0	33.2	35.9	34.7	34.0
Currency and deposits	4.9	5.0	4.7	4.4	4.3	4.2	4.6	4.5	4.1
Securities other than shares	0.6	0.5	0.5	0.4	0.3	0.3	0.4	0.4	0.5
Loans	6.0	6.4	7.7	8.1	9.1	8.7	8.8	8.7	8.6
Shares and other equity	10.4	10.5	11.2	12.1	15.0	14.7	16.5	15.8	15.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.5
Other accounts receivable	4.6	4.9	4.8	4.9	5.3	5.3	5.7	5.3	5.3
Liabilities	108.7	111.6	121.0	118.6	130.6	126.4	127.6	120.6	118.6
Special Drawing Rights	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Securities other than shares	89.0	90.5	99.0	95.9	105.1	101.9	103.5	98.0	96.3
Loans	15.2	16.7	17.5	18.4	20.9	19.8	19.3	18.0	17.4
Shares and other equity	0.0	0.0	0.0	0.0	0.1	0.2	0.0	0.0	0.0
Insurance technical reserves	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.6
Other accounts payable	3.9	4.0	4.0	3.9	4.1	4.1	4.4	4.2	4.0

Sources: Haver Analytics and IMF staff calculations.

Table 5. Belgium: Financial Soundness Indicators for the Banking Sector, 2010–19<sup>1</sup>

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019Q3
<b>Earnings and profitability</b>										
Return on assets	0.5	0.0	0.1	0.3	0.5	0.6	0.6	0.6	0.5	0.6
Return on equity	10.7	0.7	3.0	5.9	7.7	10.1	9.1	8.7	8.0	8.7
Net interest income to total income	68.3	71.2	71.6	62.6	70.2	67.7	66.0	61.2	63.5	63.4
Interest margin	1.2	1.2	1.3	1.2	1.6	1.8	1.8	1.6	1.6	1.6
Average yield on assets	2.8	2.9	2.9	2.6	2.7	2.6	2.4	2.1	2.1	2.1
Average cost of funding	1.6	1.7	1.7	1.4	1.1	0.8	0.6	0.5	0.5	0.5
Noninterest income to gross income	31.7	28.8	28.4	37.4	29.8	32.3	34.0	38.8	36.5	36.6
<i>Of which: Net fee and commission income</i>	25.6	26.8	28.3	27.7	25.8	26.7	25.1	24.3	24.6	24.1
(Un)realized capital gains booked in P&L	-0.2	-3.9	0.2	6.0	-0.3	5.3	6.7	3.7	5.4	2.6
Cost/income ratio	66.0	67.3	73.4	62.4	61.2	58.6	58.4	58.2	61.3	60.7
<b>Structure assets</b>										
Total assets (in percent of GDP)	323.2	310.2	278.7	251.0	249.0	236.5	266.1	227.3	225.9	242.5
<i>Of which (in percent of total assets):</i>										
Loans to credit institutions	17.0	15.2	12.4	12.3	9.1	8.5	7.5	6.8	6.7	7.4
Debt securities	20.1	18.5	18.4	18.9	19.6	18.0	16.4	14.4	13.3	12.0
Equity instruments	0.5	0.4	0.6	0.4	0.6	0.7	0.4	0.4	0.4	0.4
Derivatives	11.6	14.6	11.5	6.8	8.4	6.4	5.8	4.4	3.5	4.6
Loans to customers	44.0	44.4	48.1	53.9	54.1	56.4	55.4	59.4	62.3	59.6
<i>Of which: Belgian residents (in percent of loans)</i>	64.0	69.7	72.0	69.4	69.2	69.2	71.0	70.7	71.6	71.0
Other EMU residents (in percent of loans)	19.0	16.9	15.0	15.7	16.2	16.1	15.1	15.0	15.1	14.9
Rest of the world (in percent of loans)	17.0	13.4	13.0	14.9	14.5	14.7	13.9	14.2	13.3	14.2
Mortgage loans (in billions euros) 2/	178.5	183.9	188.3	190.8	202.4	216.1	229.7	227.4	241.5	254.7
Consumer loans (in billions euros) 2/	23.7	23.2	24.0	26.9	17.2	19.7	24.8	26.2	24.8	27.2
Term loans (in percent of loans)	42.3	40.0	39.3	40.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Reverse repo operations (in percent of loans)	7.3	4.2	3.3	3.1	1.7	1.5	1.0	1.1	0.5	0.6
<b>Funding and liquidity (in percent of total assets)</b>										
Debts to credit institutions	15.4	11.2	11.0	10.7	9.1	8.5	10.3	9.0	8.6	9.8
Bank bonds and other debt securities 3/	10.9	8.8	10.6	10.1	9.3	9.1	9.3	9.6	8.9	8.0
Customer deposits	46.0	46.5	49.3	54.7	58.5	61.0	58.4	62.2	63.9	62.7
<i>Of which: Sight deposits 4/</i>	13.7	12.6	15.1	18.1	24.2	28.4	26.4	30.3	31.1	31.0
Saving deposits 5/	16.2	16.0	18.9	21.0	19.9	20.8	25.6	26.07	27.1	26.3
Term deposits 4/	8.5	9.6	9.2	9.6	8.9	8.1	6.2	5.7	5.7	5.3
Retail deposits 5/	26.1	26.5	30.6	34.8	33.5	35.1	35.6	37.7	39.2	37.8
Repo's	5.0	5.2	2.3	2.7	2.3	1.7	0.2	0.1	0.0	0.1
Liquid assets 6/	32.5	34.3	36.4	36.8	32.8	32.2	32.5	31.7	29.2	29.3
<b>Asset quality</b>										
Sectoral distribution of loans (in percent of total assets)										
Credit institutions	17.0	15.2	12.4	12.3	9.1	8.5	6.1	6.8	6.5	7.2
Corporate (until 2013) / Non financial corporations (as of 2014)	17.2	16.4	16.3	18.5	20.6	22.0	21.4	22.7	24.8	23.4
Retail (until 2013) / Households (as of 2014)	22.1	22.9	26.3	29.4	25.5	27.4	27.5	29.6	29.9	28.9
Central governments (until 2013) / General government (as of 2014)	1.0	0.8	0.8	1.0	4.4	4.3	4.1	4.3	4.4	3.9
Non-credit institutions (until 2013) / Other financial corporations (as of 2014)	3.8	4.3	4.7	5.0	3.5	2.7	2.4	2.9	2.9	3.0
Non-performing loans (NPL) as percent of gross loans 6/	2.8	3.2	3.2	3.1	2.7	2.6	2.4	2.1	1.9	1.9
Provisions and write-offs as percent of NPL 6/	53.0	49.4	53.0	54.1	57.1	54.3	55.7	57.2	61.6	57.8
<b>Capital adequacy</b>										
Regulatory capital to risk-weighted assets	19.3	18.5	18.1	18.7	17.3	18.7	18.8	19.0	18.8	18.3
Regulatory Tier 1 capital to risk-weighted assets	15.5	15.1	15.8	16.4	15.1	16.0	16.2	17.0	16.5	16.2
Capital to assets	5.0	4.6	5.8	6.4	6.6	6.5	7.1	7.1	7.2	6.6
NPL net of provisions as percent of Tier 1 capital 6/	12.2	14.2	13.4	12.3	12.0	12.9	10.7	7.9	6.5	7.2
Net open position in foreign exchange to capital	3.3	1.4	2.1	2.1	3.4	2.6	2.1	1.6	1.9	1.7

Sources: National Bank of Belgium.

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

2/ Only loans to households as of 2014

3/ Excluding saving certificates as of 2014

4/ Deposits booked at amortized cost only.

5/ Only household deposits as of 2014

6/ Unconsolidated data.



Table 6. Belgium: Main Recommendations from the 2017 FSAP Mission

Recommendation	Timing*	Status
<b>Systemic risk analysis</b>		
<p>Enhance the risk analytical framework by: (i) incorporating bank stress testing to the toolkit for systemic risk assessment and macroprudential policy; (ii) extending the horizon of insurance stress tests; (iii) intensifying monitoring of insurers' mortgage loan portfolios and related underwriting standards; (iv) in cooperation with the FSMA, further developing the shadow banking monitoring framework; (v) enhancing the coverage and quality of commercial real estate data. (NBB)</p>	ST	<p>(i) The NBB has worked on the redevelopment of its credit risk and net interest income models (which mainly apply to SIs) and conducted—for the second time—a top-down stress test for 11 of its LSIs. (ii) The European Insurance and Occupational Pensions Authority (EIOPA) is still working on formalizing methodologies for performing stress tests for insurance, including multi-period stress tests. This work will serve as a basis for the NBB to develop its own policy. (iii) The NBB and FSMA have further developed their shadow banking monitoring framework to address data gaps and allow for more granular analysis of the relevant entities in the subsector of the OFIs. The FSMA also initiated regulation making swing pricing, anti-dilution levies and redemption gates available as additional liquidity management tools for all Belgian investment funds. An update of the joint NBB-FSMA report on asset management and shadow banking was published in January 2020. (iv) The NBB has explored various data sources covering CRE investments and bank exposures (it subscribed to one in March 2019). Collaboration with banks and market participants will continue in 2020 with a view to close remaining data gaps.</p>
<b>Prudential policy, supervision, and oversight</b>		
<p>Approve promptly the new macroprudential measure proposed by the NBB and enhance the NBB's ability to implement cyclical macroprudential tools in a timely manner. (MoF)</p>	ST	<p>The macroprudential measure enacted by royal decree in May 2018 runs until May 2020. As risks are still present on banks' balance sheets, the NBB intends to prolong this measure for one year. The notification processes with the ECB and relevant European institutions are ongoing and are expected to be finalized by March 2020. Against a background of increasing systemic vulnerabilities and in line with the ESRB guidelines and recommendations, the NBB has activated the CCyB, and issued supervisory expectations regarding credit standards for new mortgage lending (LTV, DTI, DSTI) that also apply to insurers.</p>
<p>Continue to strengthen bank supervision by: (i) ensuring the reliability and consistency of internal models and (ii) proactively assessing loan classifications to ensure prudent provisioning practices. (NBB/SSM)</p>	C	<p>(i) The NBB actively participated in the SSM's TRIM (Targeted Review of Internal Models) project for Significant Institutions. On-site inspections took place in Belgian banks to conform to the scope and methodology defined for TRIM. Obligations and limitations included in the decisions taken by the Supervisory Board will be followed up in due time. The same quality is expected for the internal models of Less Significant Institutions active in Belgium. The NBB is also actively pleading for a compliant implementation of the Basel 3.5/IV. (ii) In 2019, the NBB implemented two EBA guidelines on the disclosure and management of NPEs. The NBB also contributed to the drafting of the EBA guidelines on loan origination and monitoring (to be published in 2020) and participated in the ECB credit underwriting standards project. Furthermore, the Banking Law was amended to require banks to take account of total indebtedness of entities to which they extend credit.</p>

<b>Table 6. Belgium: Main Recommendations from the 2017 FSAP Mission (Continued)</b>		
<b>Recommendation</b>	<b>Timing*</b>	<b>Status</b>
Adjust to insurers' evolving risk profiles by: (i) seeking to address the sector's increasing liquidity risk, (ii) continuing to analyze the business growth of reinsurance operations; and (iii) engaging with the industry to gradually improve the quality of insurers' capital. (NBB)	ST	(i) A new article of the Insurance Law has been introduced allowing the NBB to suspend lapses for a period of time or to spread them over time, in case of a run on insurance companies. (ii) The NBB has increased its capacity to monitor and assess reinsurance operations with last year's increase in resources for insurance supervision (budget and staff). Specific attention will continue to be given to insurance groups considering filing for a Belgian license (including in the Brexit context). (iii) [No further measures were implemented after an analysis of the insurance industry showed that there are no Belgian insurers with a high reliance on low-quality capital instruments.]
Enhance FC supervision by: (i) setting supervisory expectations for FC governance and risk management; and (ii) enhancing monitoring of intra-group transactions at FC level and the risk of regulatory arbitrage between insurance and banking sectors. (NBB/SSM)	ST	(i) The ECB has developed a first draft of the FC supervisory guidance for joint supervisory teams (JSTs), that will be included in the SSM Operational Guidance. The guidance provides the JSTs a hands-on framework on how to assess the FC corporate governance and risk management. (ii) Draft technical standards on the reporting of intra-group transactions and risk concentration are being finalized (expected to be sent to the European Commission in the first quarter of 2020), while draft implementing technical standards on the reporting of FC capital adequacy are under preparation.
Enhance SWIFT oversight by (i) aiming at complementing the NBB's use of moral suasion in the oversight of SWIFT with additional regulatory and supervisory powers; (ii) broadening membership in the SWIFT Oversight Forum; and (iii) improving information sharing on SWIFT oversight and assurance reports. (NBB)	ST	(i) The NBB submitted to the G10 SWIFT Oversight Group (OG) several options for complementing the current moral suasion approach, and the OG chose to maintain the status quo. The tool of onsite inspections has been added to the moral suasion methodology and has become a standard oversight tool since its adoption by the OG in December 2019. (ii) The extended set-up of the Forum has become fully operational as of 2019, with in-person meetings taking place every year. (iii) New reporting and outreach activities initiated last year have been continued, while an additional outreach activity on SWIFT oversight, the Customer Security Program, and the role of supervisory authorities in the program is planned in 2020Q1 (in Asia, jointly with MAS, to reach out to non-G20 authorities).
<b>Financial safety net and crisis management</b>		
Ensure the feasibility of resolution strategies for banking groups with systemically important subsidiaries (SRM) and prioritize resolution planning for the two less significant institutions with the highest share of insured deposits. (NBB)	MT	Resolution plans (including a binding MREL requirement) for all LSIs were adopted. Solo MREL is in the process of being set for Belgian subsidiaries of systemic importance under the remit of the SRB. Internal MREL should be set in the cycle 2020 (under the revised framework of the BRRD2). The NBB demonstrated its capacity to implement a resolution scheme during a dry run exercise organized by the SRB in December 2019.

**Table 6. Belgium: Main Recommendations from the 2017 FSAP Mission (Concluded)**

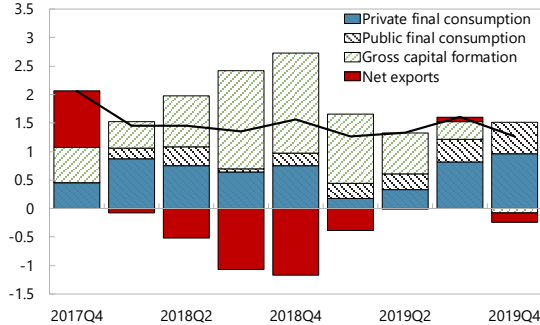
Recommendation	Timing*	Status
Strengthen the DIS by (i) publicly committing to shortening the DIS pay-out period to seven days by 2019; (ii) establishing credit lines with the MoF; and (iii) segregating the Guarantee Fund from government funds. (MoF)	ST	(i) A new DGS law allows for a gradual reduction of the repayment period to seven working days (until December 31, 2023). The transitional period serves to draw up and test the necessary procedures for a short time limit for repayment. (ii) In 2019, the Guarantee Fund finalized the manual of procedure which describes in detail in what manner the it can make use of the credit line with the Deposit and Consignment Office (part of MoF) in case of a payout. (iii) A draft bill aiming at the segregation of the Guarantee Fund's available financial means from the government funds will be submitted to the new government as soon as it is formed.
<b>AML/CFT</b>		
Ensure adequate transparency of beneficial ownership of legal persons and arrangements. (MoF)	MT	Legal entities incorporated in Belgium, and trustees of foreign legal arrangements administered in Belgium, are required to submit beneficial ownership (BO) information to a centralized publicly accessible register administered by the MOF. The register is fully operational.
*C=continuous; I=immediate (within one year); ST=short term (within 1–2 years); MT=medium term (within 3–5 years)		

**Figure 2 Belgium: Macroeconomic Context**

Growth has been steady, driven by investment and, increasingly, private consumption...

**Real Growth by Component**

(In percent, y-o-y)

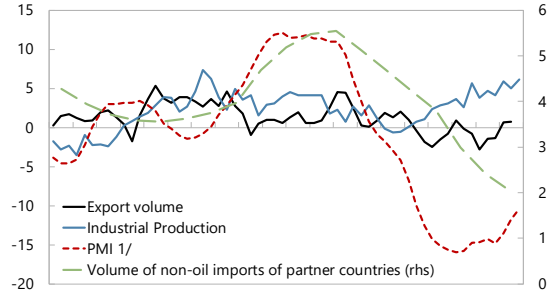


Source: Haver Analytics; and IMF staff calculations.

...reflecting a muted impact of weak external demand on industrial production.

**Exports and Industrial Production**

(3-month moving average, change in percent from the previous year)

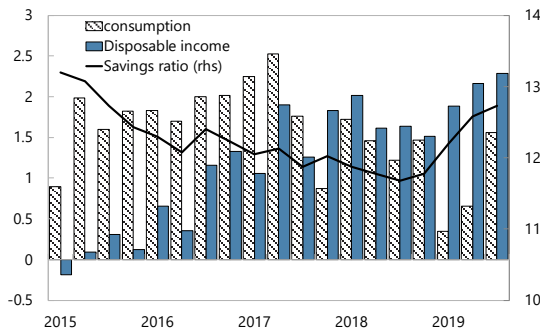


Sources: Haver Analytics, IMF WEO, and IMF staff calculations.  
1/ Average of manufacturing PMI in DE, FR, and NL, weighted by export share.

Consumption has lagged disposable income, with the saving ratio rising...

**Household Consumption and Drivers**

(Moving 4q-volumes, annual percent change)

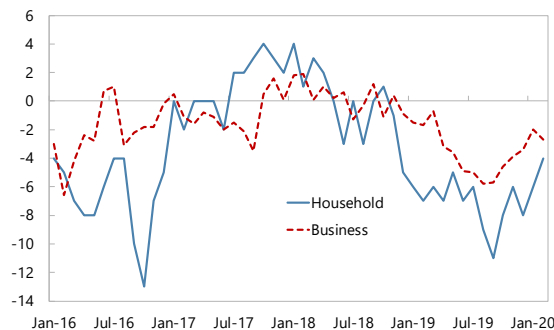


Source: Haver Analytics and IMF Staff calculations.

...while confidence has been subdued until recently.

**Business and Household Confidence**

(Percent point difference between positive and negative responses)

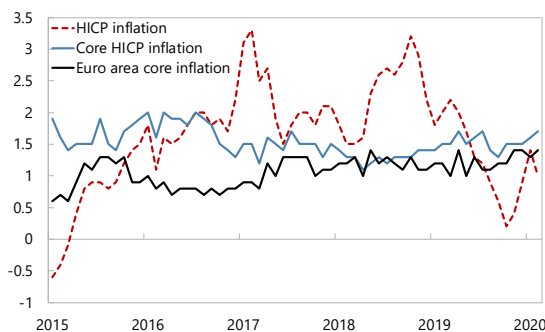


Source: National Bank of Belgium.

Lower fuel and food prices brought headline inflation down, while core remains subdued and steady.

**Annual Inflation**

(Percent)



Source: Eurostat (Haver Analytics).

Unemployment has fallen to a historical low, while employment has reached new highs.

**Employment and Unemployment Rates**

(Percent of population; percent of active population)

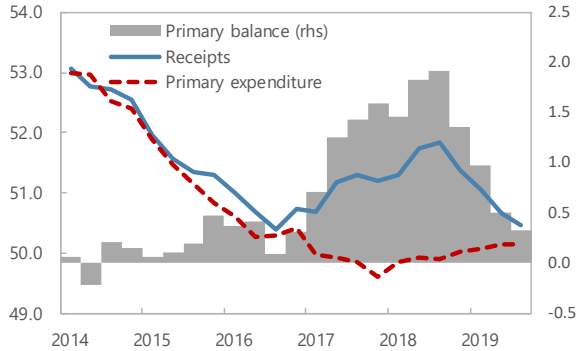


Source: NBB.

**Figure 3. Belgium: Fiscal Context**

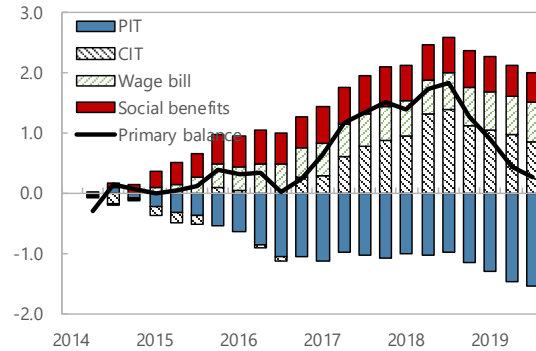
The primary surplus declined sharply as revenues reversed recent gains and primary expenditure picked up.

**Primary Balance**  
(Percent of GDP)



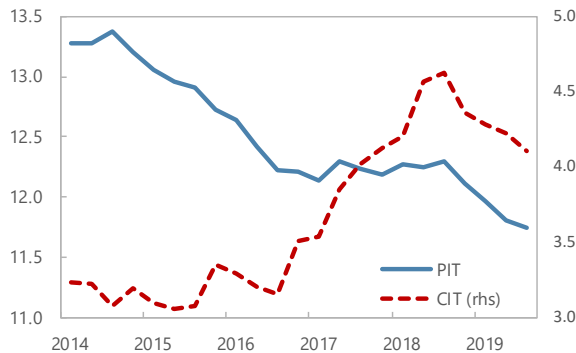
The fiscal easing since late 2018 is primarily driven by lower direct tax receipts.

**Fiscal adjustment**  
(Cumulative change in percent of GDP)



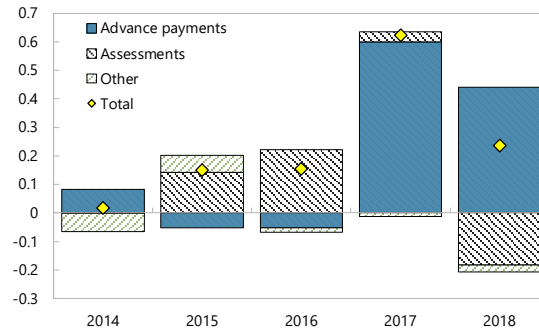
PIT receipts declined following the tax shift, while the one-off boost to CIT receipts over 2017-18 is coming to an end

**Revenue trends**  
(Percent of GDP)



...as the increase in advance payments is offset by lower tax assessments.

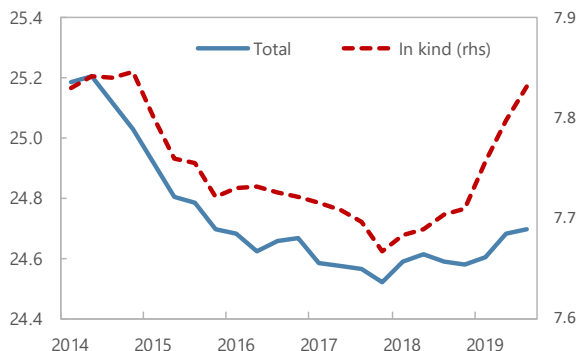
**CIT Revenue**  
(Annual change in percent of GDP)



Source: NBB and Staff calculations.

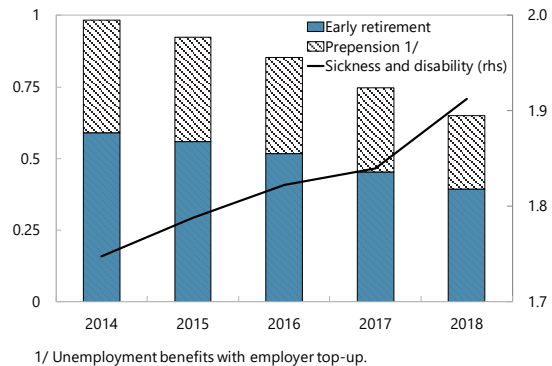
The increase in primary expenditure is largely driven by a spick up in social benefit spending, particularly in kind.

**Social benefit spending**  
(Percent of GDP)



Tightening access to early retirement has led to an increase in sickness and disability spending.

**Sickness and Disability and Early Retirement Spending**  
(Percent of GDP)



1/ Unemployment benefits with employer top-up.

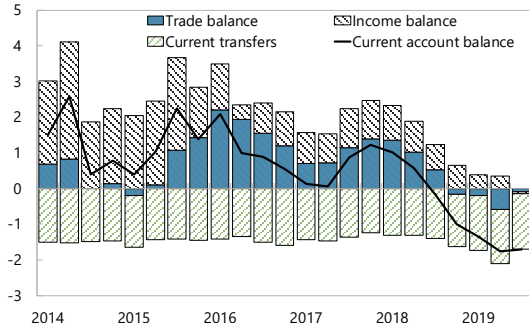
Source: NBB (Haver Analytics), Belgian authorities, and Staff calculations.

**Figure 4. Belgium: Competitiveness**

The current account surplus turned into deficit, driven by deteriorating trade and income balances.

**Current Account**

(Percent of GDP)

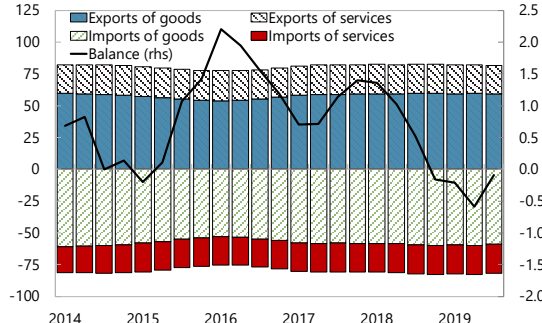


Source: Haver Analytics and Staff calculations.

Higher imports, mainly of goods, and lower services exports more than offset higher goods exports.

**Trade Balance**

(Percent of GDP)

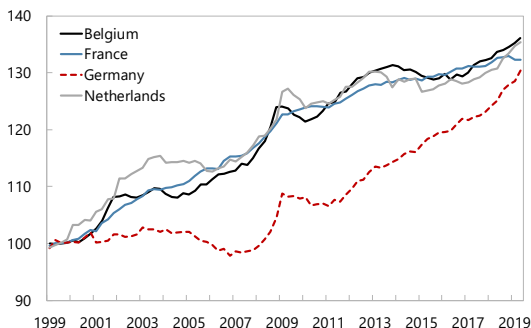


Source: Haver Analytics and Staff calculations.

Unit labor costs have increased in line with peers but remain above Germany...

**Evolution of Unit Labor Costs**

(Index 1999=100)

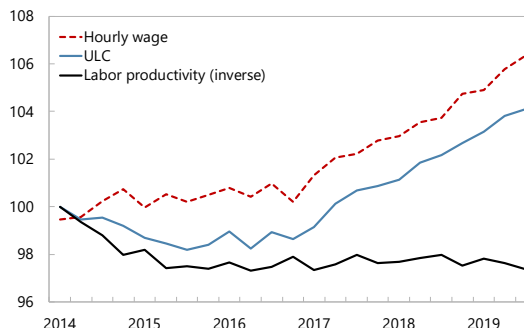


Sources: Eurostat (Haver Analytics) and IMF staff calculations.

...driven by a rebound in wages following years of moderation, and stagnant labor productivity growth.

**Evolution of Unit Labor Costs and Components**

(Index, 2014=100)

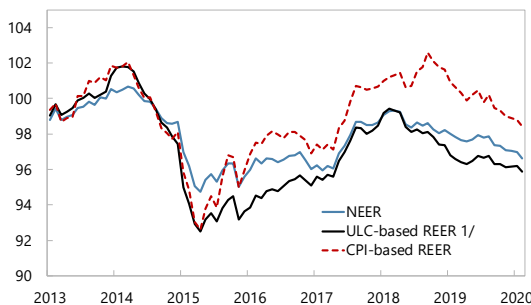


Source: Haver Analytics and IMF

Nominal and real exchange rates have declined recently but remain above 2017 levels.

**Exchange Rates**

(Index, 2005=100)



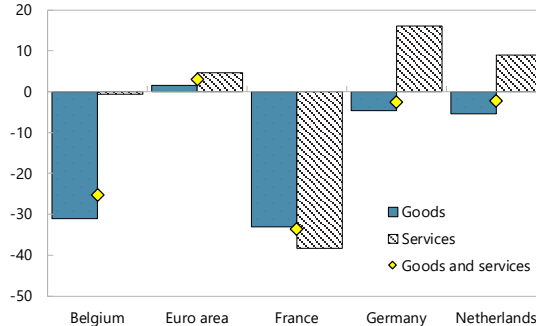
Source: IMF staff calculations.

1/ ULC-based REER calculated based on ULCs in manufacturing sector.

Belgium lost export market share, particularly in goods, since the early 2000s, though it stabilized more recently,

**Cumulative Change in Export Market Share**

(Percent, 2000-18)

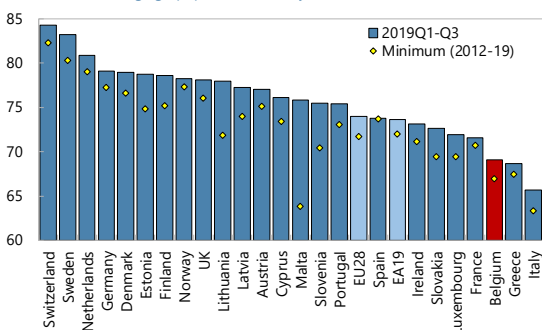


Source: WEO and Staff calculations.

**Figure 5. Belgium: Structural Barriers to Growth**

Unfavorable demographics and low labor force participation weigh on labor supply.

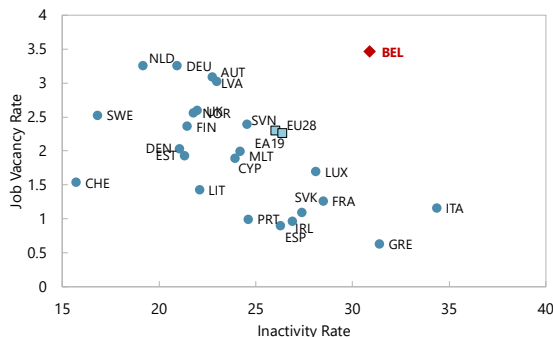
**Labor Force Participation Rate**  
(Percent of working age population, 15-64 years)



Sources: Eurostat and IMF staff calculations (Haver Analytics).

This coincides with the highest job vacancy rate in the euro area, pointing to labor market frictions.

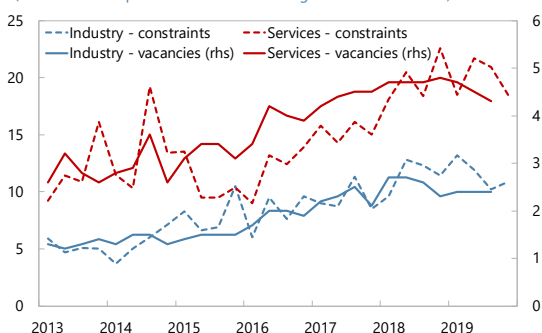
**Job Vacancies and Inactivity**  
(Percent, 2019Q1-Q3)



Sources: Eurostat and IMF staff calculations (Haver Analytics).

Frictions include skills mismatches and barriers to labor mobility, compounding supply constraints.

**Job Vacancies and Labor Supply Constraints**  
(Percent of total post and of firms indicating labor as a constraint)

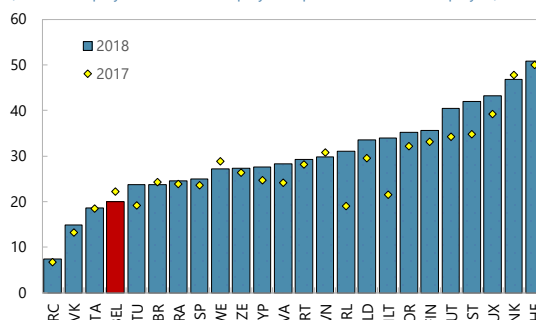


Sources: Eurostat and European Commission.

Reflected in one of the lowest transition rates in Europe.

**Total Transition Rate**

(From unemployed/inactive to employed in percent of total unemployed)

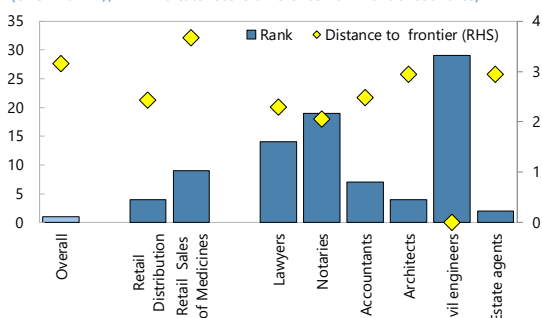


Sources: Eurostat and Haver Analytics.

Another key impediment to growth is excessive regulation of retail and service sectors.

**Sectoral Indicators for Retail and Services Sectors**

(OECD Rank 1; PMR indicator score difference from frontier countries)

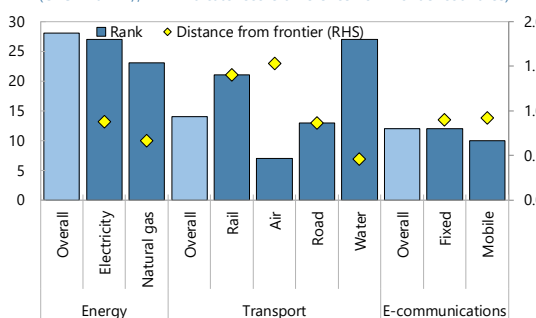


1/ Ranked from high (1) to low (34) regulatory burden out of 34 OECD countries. Sources: OECD and IMF staff calculations.

Likewise, regulatory barriers in network industries except energy are well-above the euro area average and peers.

**Sectoral Indicators for Network Sectors**

(OECD Rank 1; PMR indicator score difference from frontier countries)



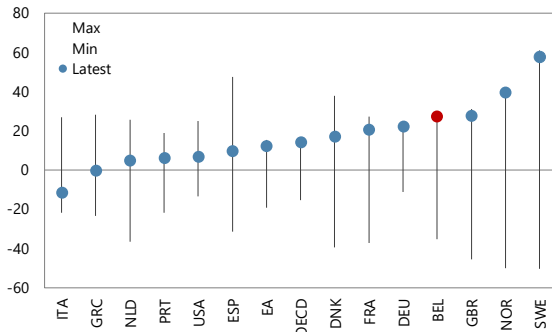
1/ Ranked from high (1) to low (34) regulatory burden out of 34 OECD countries. Sources: OECD and IMF staff calculations.

**Figure 6. Belgium: Housing Market Vulnerabilities**

The housing price-to-rent ratio remains at historically high levels...

**Price-to-Rent Ratio**

(Percent deviation from historical mean; 1995Q1-2019Q3)

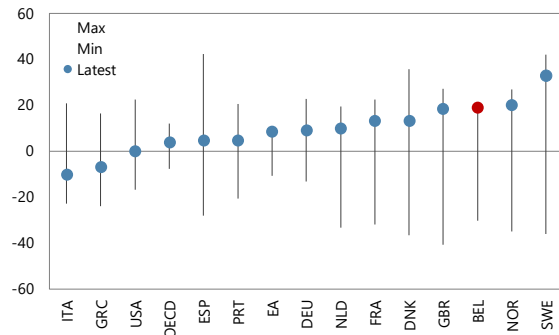


Source: OECD and IMF staff calculations.

...as so does the housing price-to-income ratio.

**Price-to-Income Ratio**

(Percent deviation from historical mean; 1995Q1-2019Q3)

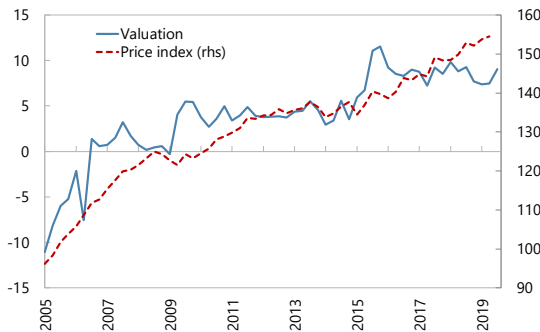


Source: OECD and IMF staff calculations.

Nevertheless, some models suggest only a modest overvaluation.

**House Price and Valuation Developments**

(Percent deviation from estimated equilibrium price; Index, 2005=100)

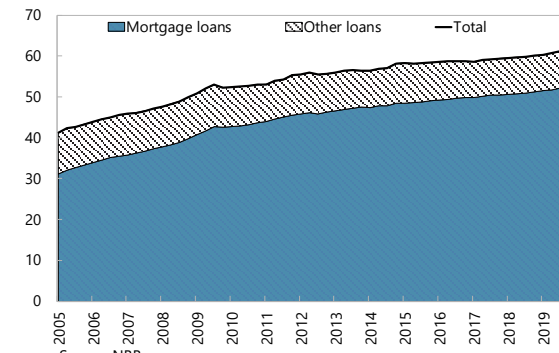


Source: NBB estimates, Haver, and Staff calculations.

Mortgage lending has been driving up household debt.

**Household Debt Ratio**

(Percent of GDP)

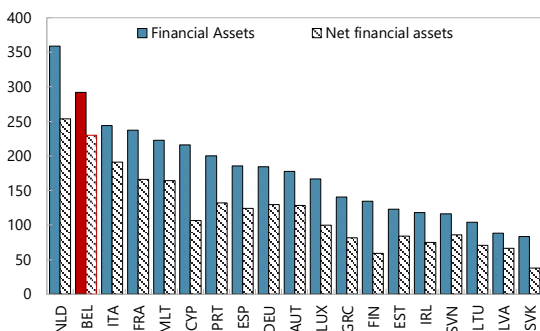


Source: NBB.

Large financial assets mitigate the risks associated with household debt.

**Household Financial Assets, 2019Q3**

(Percent of GDP)

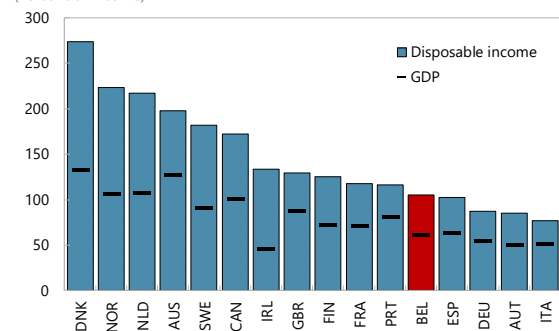


Source: ECB.

Household debt as a share of income is relatively low.

**Household Debt, 2018**

(Percent of Income)



Source: Haver Analytics and Staff calculations.



## Annex I. Main Recommendations of the 2019 Article IV Consultation and Authorities' Response

Fund Recommendations	Policy Actions
<b>Fiscal policy</b>	
Pursue gradual fiscal consolidation to attain the MTO based on reforms to make public spending more efficient and reforming the pension system.	Federal budgets for 2019–20 were not approved, with fiscal policy guided by the 1/12th rule on current spending. The budget deteriorated in 2019. No new efficiency-enhancing spending or pension reforms have been initiated.
Additional measures to safeguard revenues and promote economic efficiency should be pursued.	No new revenue measures have been adopted.
<b>Structural reforms</b>	
Enhance labor force participation and address the fragmentation of the labor market by implementing the Jobs Deal reform, including the unemployment system, closing educational gaps, improving training and lifelong learning, and reducing barriers to mobility.	Selective measures under the 2018 Jobs Deal to stimulate hiring and training in professions facing shortages have been adopted, but the unemployment benefit reform has been delayed.
Better link wages to productivity by revising the wage-setting framework.	An agenda for the reform of the salary system linking pay to skills and productivity rather than seniority has been agreed with social partners, but no reform has been initiated yet.
Further streamline and harmonize regulations, increase investment in infrastructure, improve the efficiency of R&D spending, and strengthen competition in services	The mandate and functioning of the competition authority have been strengthened. An investment strategy for the next decade under the National Pact for Strategic Investment (NPSI) is being developed.
<b>Financial sector policy</b>	
Stand ready to tighten macroprudential conditions further should risks intensify.	In 2019, the NBB: (i) activated the countercyclical capital buffer (CCyB) at a rate of 0.5 percent; and (ii) issued supervisory expectations regarding credit standards in banks' and insurers' mortgage lending.
Continue to implement FSAP recommendations	See Table 6.

## Annex II. External Sector Assessment

<p><b>Overall Assessment:</b> Based on preliminary data and EBA model results, the external position in 2019 is estimated to have been weaker than medium-term fundamentals and desirable policies would imply. The external deficit is projected to deteriorate modestly in the medium term relative to 2018, as the trade deficit widens. Despite a projected decline in the NIIP, its still large and positive value mitigates vulnerabilities associated with the high external public debt.</p> <p><b>Potential Policy Responses:</b> Steady fiscal consolidation, structural reforms—in the near term focused on supporting labor force participation and linking wages to productivity, followed by reforms to improve the business environment, simplify regulations, and strengthen competition in services and regulated professions—can help bring the external position more in line with fundamentals.</p>						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP remains strong at 49 percent of GDP at 2019Q3, up from 41 percent at end-2018, reflecting the continued positive net financial wealth of households. Gross foreign assets were large at 452 percent of GDP, inflated by intragroup corporate treasury activities. Gross foreign assets of the banking sector stood at 85 percent of GDP, down considerably from the pre-crisis peak. External public debt was 70 percent of GDP, predominantly denominated in euros. Target 2 balances averaged –€27.4 billion (–5.8 percent of GDP) in 2019, up from –€9.9 billion in 2018.</p> <p><b>Assessment.</b> Belgium’s large gross international asset and liability positions are inflated by the presence of corporate treasury units, which do not appear to create macro-relevant mismatches. Based on the projected current account and growth paths, the NIIP-to-GDP ratio is expected to decline going forward. The large and positive NIIP and its trajectory do not raise sustainability concerns.</p>					
	2019:Q3 (% GDP)	NIIP: 48.5	Gross Assets: 452.1	Debt Assets: 162.2	Gross Liab.: 403.6	Debt Liab.: 171.7
<b>Current Account</b>	<p><b>Background.</b> Since the global financial crisis, the CA balance has averaged 0.4 percent of GDP over 2010–18.<sup>1</sup> The relative stability in the CA masks significant movements in the trade and primary income balances, reflecting large operations of multinationals. In 2018, the CA registered a deficit of 1 percent of GDP for the first time since 2012, driven by lower primary income outflows related to the operations of multinational enterprises and unusually large R&amp;D imports by one firm. The CA deficit is estimated to have widened slightly in 2019 to 1.2 percent of GDP and is projected to remain around 1.2 percent of GDP over the medium term, with a small deterioration in the trade balance—as import growth outpaces export growth, given the large foreign content of exports and robust domestic demand—partially offset by a gradual improvement in the income balance as interest rates normalize over the medium term. Data have been subject to large historical revisions.</p> <p><b>Assessment.</b> Preliminary EBA model estimates yield a CA gap of –3.5 percent of GDP for 2019, based on a cyclically adjusted CA balance of –1.1 percent (relative to an estimated norm of 2.4 percent). This is within the range estimated by staff for the CA gap of between –4.5 to –2.5 percent of GDP, which applies a standard range for the CA gap of ±1 percent of GDP.</p>					
	2019 (% GDP)	Actual CA: –1.2	Cycl. Adj. CA: –1.1	EBA CA Norm: 2.4	EBA CA Gap: –3.5	Staff Adj.: 0.0
<b>Real Exchange Rate</b>	<p><b>Background.</b> The REER (both ULC- and CPI-based) appreciated by nearly 20 percent during 2000–09. Over the past decade the REER has been more volatile, with wage moderation contributing to a 6 percent depreciation of both the ULC- and CPI-based REER in 2014–15, which has since been largely reversed. In 2019, the ULC- and CPI-based REER depreciated by 1.9 and 1.5 percent relative to the 2018 average.</p> <p><b>Assessment.</b> Preliminary EBA model estimates point to an REER overvaluation of between 9 and 17 percent, based on the CPI-based REER index and level models; the REER overvaluation resulting from the staff CA gap model is 8.3 percent, using an elasticity of 0.42. Staff assesses the REER to be overvalued in the range of 6 to 11 percent, using standard error bands.</p>					
	<p><b>Background.</b> Gross financial outflows and inflows were on an upward trend during the pre-crisis period as banks expanded their cross-border operations. Since the crisis, these flows have shrunk and become more volatile as banks have deleveraged. Short-term external debt accounted for 29 percent of gross external debt at end-2019:Q3. The capital account is open.</p> <p><b>Assessment.</b> Belgium remains exposed to financial market risks, but the structure of financial flows does not point to specific vulnerabilities. The large and positive NIIP reduces the vulnerabilities associated with high external public debt.</p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> The euro has the status of a global reserve currency.</p> <p><b>Assessment.</b> Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</p>					
	<p><b>Background.</b> The euro has the status of a global reserve currency.</p> <p><b>Assessment.</b> Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The euro has the status of a global reserve currency.</p> <p><b>Assessment.</b> Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</p>					
	<p><b>Background.</b> The euro has the status of a global reserve currency.</p> <p><b>Assessment.</b> Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</p>					

<sup>1</sup> The Belgian CA numbers underwent major revisions in 2015, 2016, 2017, and 2019, complicating the comparison with previous external sector assessments.

## Annex III. Risk Assessment Matrix

Source of Risk and likelihood	Impact if realized/transmission channel	Policy response
<p><b>High</b></p> <p><b>Weaker-than-expected global growth.</b> Other risks and idiosyncratic factors in the U.S., Europe, China, and other large emerging markets feed off each other in a synchronized and prolonged slowdown:</p> <ul style="list-style-type: none"> <li>• Europe: Weak foreign demand or an unanticipated Brexit outcome delays investment, reduces private consumption, and strains banks. With limited policy space, the region enters a prolonged period of anemic growth and low inflation.</li> </ul>	<p><b>High</b></p> <p>Weak growth in partner countries would negatively impact Belgian exports and discourage export-related investment. A protracted growth slowdown could lower potential growth, raise structural unemployment, and complicate fiscal adjustment.</p>	<p><i>Build fiscal buffers and implement reforms to improve productivity and raise potential growth. Should the shock materialize, utilize available fiscal space, while designing a credible medium-term consolidation strategy.</i></p>
<p><b>High</b></p> <p><b>Rising protectionism and retreat from multilateralism.</b> In the near term, escalating and unpredictable trade actions and an inoperative WTO dispute settlement system under threat imperil the global trade system. Additional actions or the threat thereof, including investment restrictions reduce growth directly and through adverse confidence effects. In the medium term, geopolitical competition, protracted tensions, and fraying consensus about the benefits of globalization lead to further fragmentation, with adverse effects on investment, productivity, growth, and stability.</p>	<p><b>High</b></p> <p>An increase in protectionism could result in a loss in external demand and make fiscal and structural reforms more difficult.</p>	<p><i>Boost competitiveness through labor and product market reforms.</i></p>
<p><b>High/Medium</b></p> <p><b>Sharp rise in risk premia that exposes financial vulnerabilities.</b> An abrupt reassessment of market fundamentals triggers widespread risk-off events that expose financial vulnerabilities that have been building in a period of low interest rates and a search for yield. Risk asset prices fall sharply, leading to significant losses in major financial institutions. Higher risk premia generate debt service and refinancing difficulties; stress on leveraged firms, households, and vulnerable sovereigns; and capital outflows.</p>	<p><b>Medium</b></p> <p>Tighter financial conditions could weigh on confidence and further strain leveraged firms, households, and the sovereign. Debt service risks are mitigated by comfortable asset positions. Banks and insurers are exposed to a sudden interest rate shock given maturity mismatches and home bias in bond portfolios. Financial market stress elsewhere in Europe could have spillover effects.</p>	<p><i>To reduce shock exposure and enhance resilience, monitor risks closely and utilize macro-prudential tools proactively. Once the shock materializes, Euro area monetary policy is first line of defense against liquidity stress, supported by activation of backstops and resolution mechanism.</i></p>
<p><b>High</b></p> <p><b>More severe Covid-19 pandemic</b> causes widespread and prolonged disruptions to economic activity directly, through global trade and supply chain spillovers, and via confidence effects on financial markets and investment</p>	<p><b>High</b></p> <p>Supply chain disruptions, weaker external demand, and confidence effects would negatively affect exports, investment, and growth. The impact could be mitigated through trade diversion.</p>	<p><i>Utilize available fiscal space to contain immediate effects, while designing a medium-term consolidation strategy. Encourage contingency planning by firms that source inputs from affected or at-risk jurisdictions</i></p>
<p><b>High</b></p> <p><b>Domestic political uncertainty</b> related to the protracted formation of a federal government following the 2019 elections.</p>	<p><b>High</b></p> <p>Political uncertainty could weigh on confidence and domestic demand, while impeding needed fiscal and structural adjustment. The cost of policy inaction will rise as fiscal and structural imbalances are left unaddressed.</p>	<p><i>Reignite reforms even as the speed depends on political developments, while seeking consensus on priorities for the next government.</i></p>

## Annex IV. Benchmarking and Prioritizing Spending Reforms in Belgium<sup>1</sup>

### 1. This annex benchmarks spending in Belgium against European peers and analyzes its efficiency to identify areas where medium-term consolidation efforts could be concentrated.

The analysis builds on previous work by IMF (2015, 2016) and NBB (2017), extending it using a cross-classification of public spending by economic area and by function of government (COFOG), which allows for a more precise identification of areas where Belgium spends more than its peers.<sup>2</sup> To assess the efficiency of Belgium's public spending relative to peers, this paper uses both non-parametric and stochastic methods for three functions: health, education, and social protection (Box IV.1).

### 2. Social benefits, subsidies and compensation of employees account for the bulk of the spending gap between Belgium and EU peers.

Overall, Belgium spends close to 6 percent of GDP more than its EU peers. This is due to a 9.4 percent of GDP gap in the above-mentioned three spending areas, which is partly compensated by lower spending on goods and services, investment, and other outlays. Regarding the areas where Belgium spends more than peers:

**Gap in Major Spending Categories Between Belgium and EU14 (Percent of GDP)**

	Total Expenditure	General Public services				Economic affairs			Health 1/			Education			Social protection					
		Total	Exec.&Legis. Organs, Fiscal, Financial & External affairs	Basic research	Public debt transactions	Total	General econ., commercial and labour affairs	Transportation	Total	Outpatient services	Hospital services	Total	Pre-primary and primary education	Secondary education	Total	Sickness and disability	Pensions	Family and children	Unemployment	Social exclusion
<b>Total</b>	<b>5.8</b>	<b>1.0</b>	<b>0.4</b>	<b>0.5</b>	<b>0.7</b>	<b>2.2</b>	<b>2.5</b>	<b>0.4</b>	<b>0.9</b>	<b>0.6</b>	<b>0.6</b>	<b>1.5</b>	<b>0.5</b>	<b>0.8</b>	<b>0.4</b>	<b>0.6</b>	<b>-0.7</b>	<b>0.3</b>	<b>0.4</b>	<b>0.2</b>
Social benefits	5.4	0.0	0.0	0.0	0.0	0.3	0.3	0.0	4.2	1.4	3.2	-0.3	-0.2	-0.2	1.2	0.8	-0.3	0.5	0.3	-0.1
Subsidies	2.1	0.0	0.0	0.0	0.0	1.9	1.9	0.0	-0.1	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Compensation of employees	1.9	0.6	0.5	0.2	0.0	0.5	0.2	0.3	-2.0	-0.6	-1.6	2.1	0.6	1.0	-0.2	-0.2	-0.1	-0.2	-0.1	0.1
Investment	-0.5	0.2	0.0	0.2	0.0	-0.3	0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	0.1	0.0	0.0	0.0	0.0	0.0
Consumption of goods and services	-1.9	0.1	0.0	0.0	0.0	-0.1	0.1	0.0	-1.3	-0.5	-1.1	0.0	0.0	0.0	-0.3	-0.2	-0.2	0.0	0.0	-0.2
Other spending	-1.2	0.2	-0.1	0.1	0.7	-0.2	-0.1	0.1	0.3	0.4	0.1	-0.2	0.3	0.1	-0.4	0.2	-0.1	0.0	0.2	0.3

■ Higher than peers by more than 25 percent      ■ Lower than peers by 0-5 percent  
■ Higher than peers by 5-25 percent      ■ Lower than peers by 5-25 percent  
■ Higher than peers by 0-5 percent      ■ Lower than peers by more than 25 percent

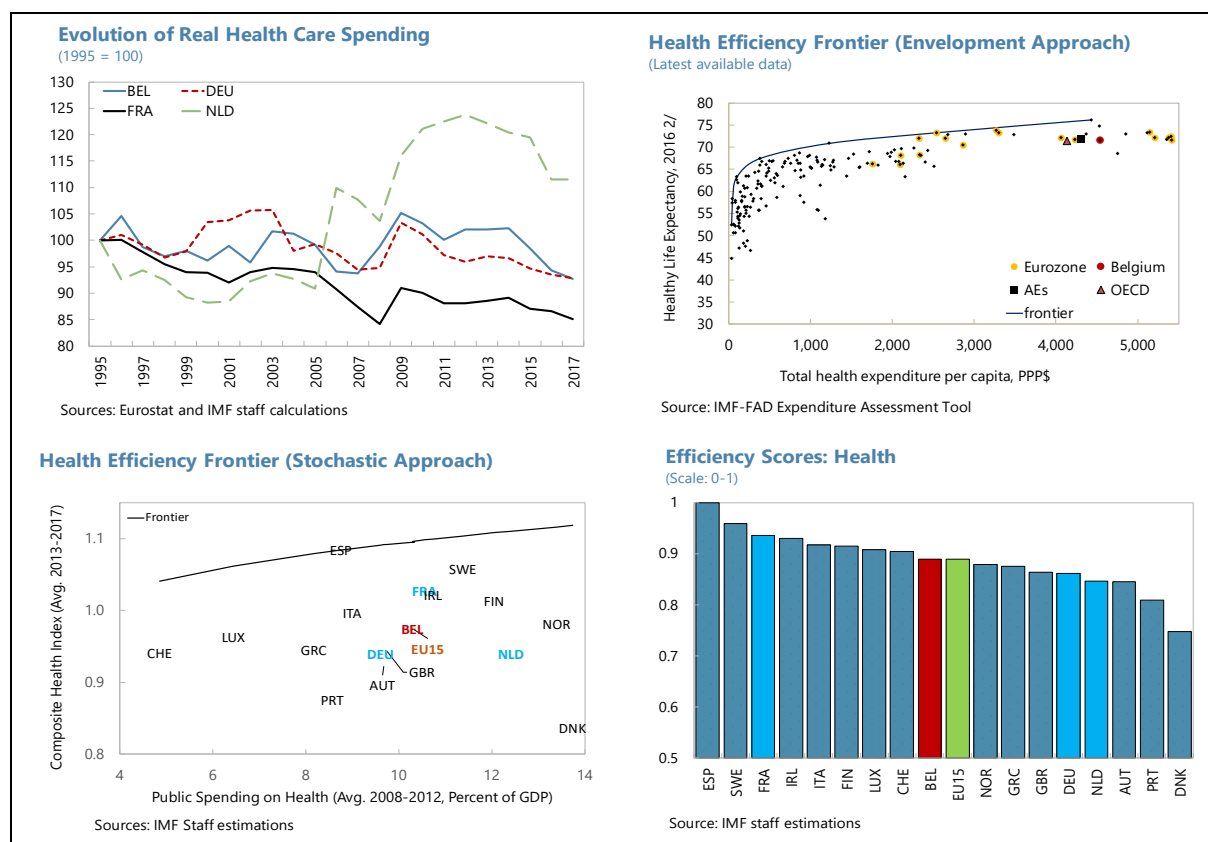
Sources: Eurostat and IMF Staff calculations  
 1/ Unlike in many European countries, Belgian hospitals are classified outside the general government. Spending on health care, as a consequence, recorded as social transfers, creating a positive gap in social benefits between Belgium and peers, and a negative gap in other outlays. Comparison between Belgium and EU peers is, therefore, more appropriate at the level of total health spending.

<sup>1</sup> Prepared by Laurent Kemoe (EUR).

<sup>2</sup> Advanced EU peers (referred to as EU14 or EU peers) include: Austria, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.

- **Social benefits:** The gap with peers is 5.4 percent of GDP, concentrated in *health* (4.2 percent), mainly outpatient and hospital services, and *social protection* (1.2 percent), principally sickness and disability, unemployment, and family and child benefits. However, the total gap is lower (2.2 percent of GDP) when considering that a large part of the gap in the health sector (3.2 percent) is due to transfers to hospitals that are classified outside the general government.
- **Subsidies:** Belgium spends 2.1 percent of GDP more than peers on *subsidies*, most of which (1.9 percent) is provided to support the economy;
- **Compensation of employees:** Spending on employees' compensation is 1.9 percent of GDP higher than the average of EU peers, due to a higher-than-average spending on *teachers' compensation* (2.1 percent gap in education) and, to a lesser extent, on other civil servants' compensation (0.6 percent in *General public services*, and 0.5 percent in *Economic affairs*).

**3. Belgium has some scope to improve pockets of inefficiency in health spending.** While health spending has been relatively flat in real terms over the last two decades, it is higher than in peers, and population aging is expected to add to costs in the long run.<sup>3</sup> According to the DEA approach, and controlling for private spending, Belgium's health spending efficiency is somewhat below the frontier, with outcomes broadly in line with other advanced economies and OECD countries, but spending above those. According to the SFA approach, which also controls for initial

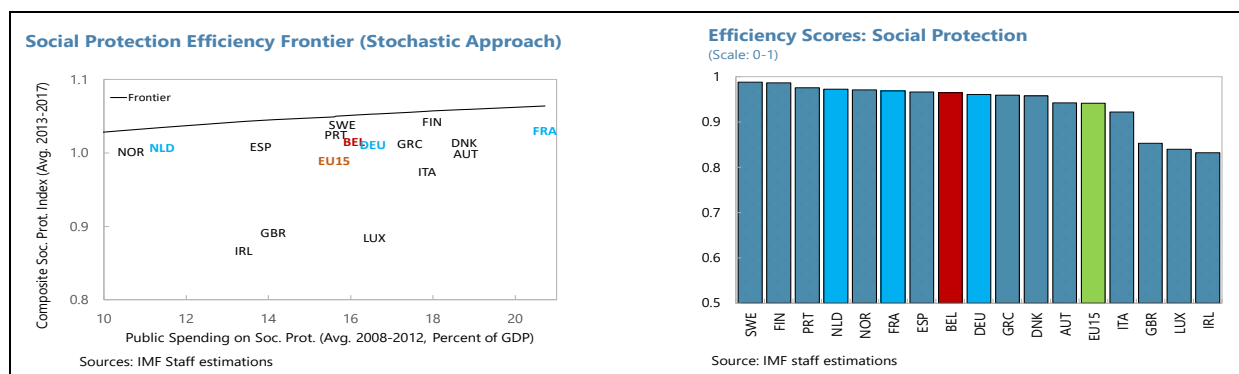


<sup>3</sup> Health spending was at 7.7 percent of GDP in 2017 and is estimated to increase by 2 percent on average per year during 2015–30 (OECD 2019), and by 1.6 percent of GDP between 2013–60 (EC 2015).

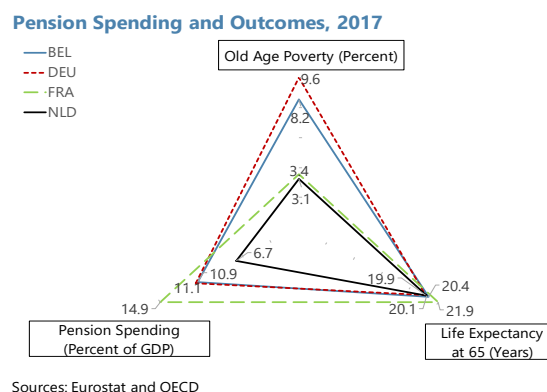
conditions and takes into account a composite of health outcomes, Belgium’s spending efficiency, while still below the frontier, is closer to its EU14 peer group.<sup>4</sup> Nonetheless, some pockets of inefficiency remain. According to the OECD (2017), more than half of emergency department visits in Belgium were unwarranted. The EC (2017) notes that avoidable hospitalizations for chronic conditions in Belgium are above the EU average. Thus, there could be scope to improve efficiency by fostering home care for some chronic conditions and supporting preventive healthcare (OECD, 2019). Making healthcare spending ceilings binding by strengthening cost controls (e.g. or focusing reimbursements on generic medicines) could also help contain pressures going forward.

**4. The efficiency of Belgium’s social protection spending could also be improved.<sup>5</sup>**

Belgium’s spending on social protection is above that of the EU14. Moreover, according to the SFA approach, after controlling for initial conditions, while Belgium’s spending efficiency is somewhat above the EU14, it appears less efficient in delivering social outcomes than selective EU peers.<sup>6</sup> This suggests scope for efficiency savings in some areas, which include:



- Pensions:** While total pension expenditure is somewhat below peers, outcomes are mixed, with relatively high old-age poverty (8.2 compared to less than 4 percent in France and the Netherlands) while life expectancy is close to peers. With population aging expected to add to pension costs in the long run, further pension reforms are needed to maintain sustainability, including revisiting the pace of increase of the effective retirement age and



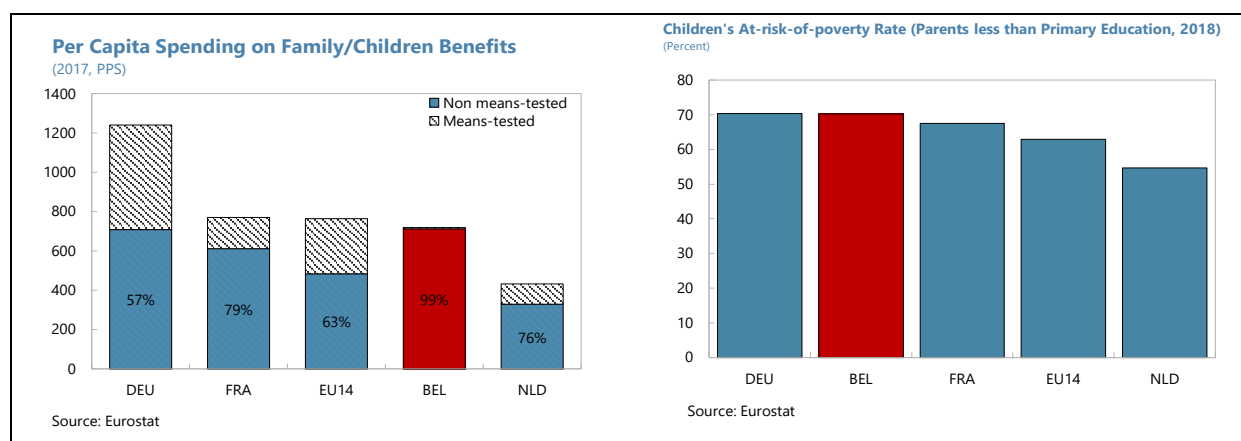
<sup>4</sup> Health performance is measured by a composite health index, which is a weighted average of six standardized health outcome indicators: life expectancy (weight: 0.2), Health adjusted life expectancy (0.2), infant mortality rate (0.2), perception of health status (0.2), satisfaction with the healthcare system (0.1), and hospital waiting times (0.1).

<sup>5</sup> In the efficiency analysis, spending on *sickness* in the *social protection* function of the COFOG classification is subtracted from total social protection and added to health spending. The results are robust to this treatment.

<sup>6</sup> The composite social protection outcome index is a weighted average of five standardized outcome indicators: the poverty rate of 16-64 year-olds (weight: 0.18), the income Gini after taxes and transfers (0.18), the old-age poverty rate (0.18), the long-term unemployment rate (0.18), children’s school enrollment rate (0.18) and the housing overburden rate (0.1).

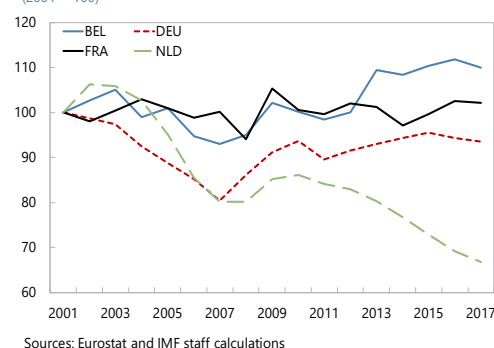
linking the minimum retirement age to gains in life expectancy. To contain automatic drift, the mechanism governing real increases in pension and other social benefits should also be revisited.

- **Family and child benefits:** Spending on these benefits is slightly above peers. However, the benefits are not means tested, unlike in peer countries, resulting in a relatively high poverty rate for children in vulnerable households, and a relatively low female labor-force participation rate.<sup>7</sup> Better targeting family benefits could help improve these outcomes.



- **Sickness and disability benefits:** Real spending on sickness and disability pensions increased by 10 percent since 2011, in part due to substitution effects following the tightening of early retirement schemes, which has exacerbated the gap relative to peers.<sup>8</sup> Tightening controls of spending in this area will be key to contain spending drift.

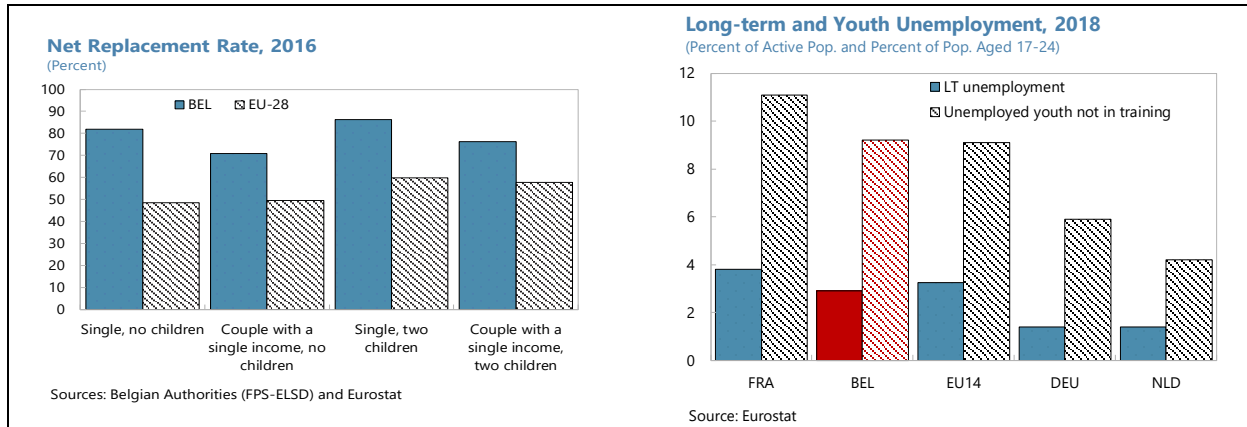
**Real Spending on Sickness and Disability Pension (2001 = 100)**



- **Unemployment benefits:** Unemployment benefit spending is somewhat higher than peers, reflecting generous replacement rates, low degressivity over time, and, exceptionally, unlimited duration. While this reduces the risk of poverty for the unemployed, it also contributes to high long-term unemployment (long-term unemployed account for some 55 percent of unemployment benefit recipients against an EU average of 26 percent) and a higher share of inactive youth. Reforming the unemployment system to strengthen incentives to return to work would support both the public finances and growth.

<sup>7</sup> Family benefits are not means-tested but other benefits (e.g. unemployment, housing benefits) depend upon the beneficiary's household type (number of children, single or couple, etc.).

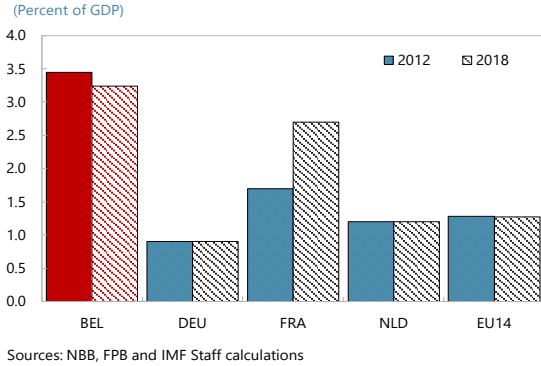
<sup>8</sup> The increase in the participation rate of older workers and the arduous nature of jobs supported by the service vouchers schemes may also explain part of the increase in claims for sickness and disability benefits.



**5. Subsidies, which are largely in the form of tax exemptions, could be made more efficient.**

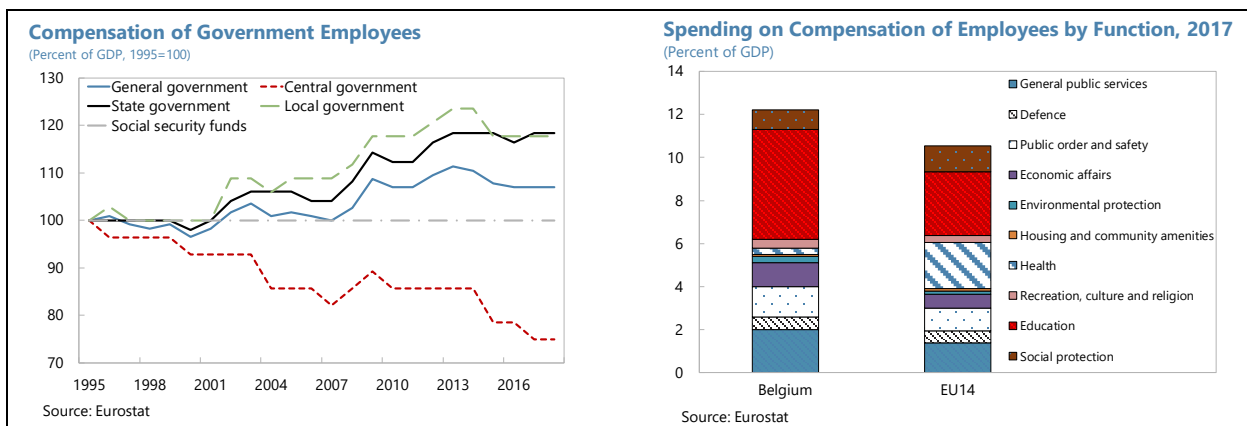
Subsidies are 2.5 times higher in Belgium than the average European level. A large part of subsidies is intended to encourage employment of low-skilled workers, which is key given their low labor force participation. However, tax incentives supporting business R&D remain among the highest worldwide, and the combination of various exemptions and deductions reduces their effectiveness (EC, 2019, OECD 201–20, and Dumont 2019). Widening the tax base by rationalizing them would not only help improve efficiency, but also support growth.

**Benchmarking Subsidies in Belgium Against peers**



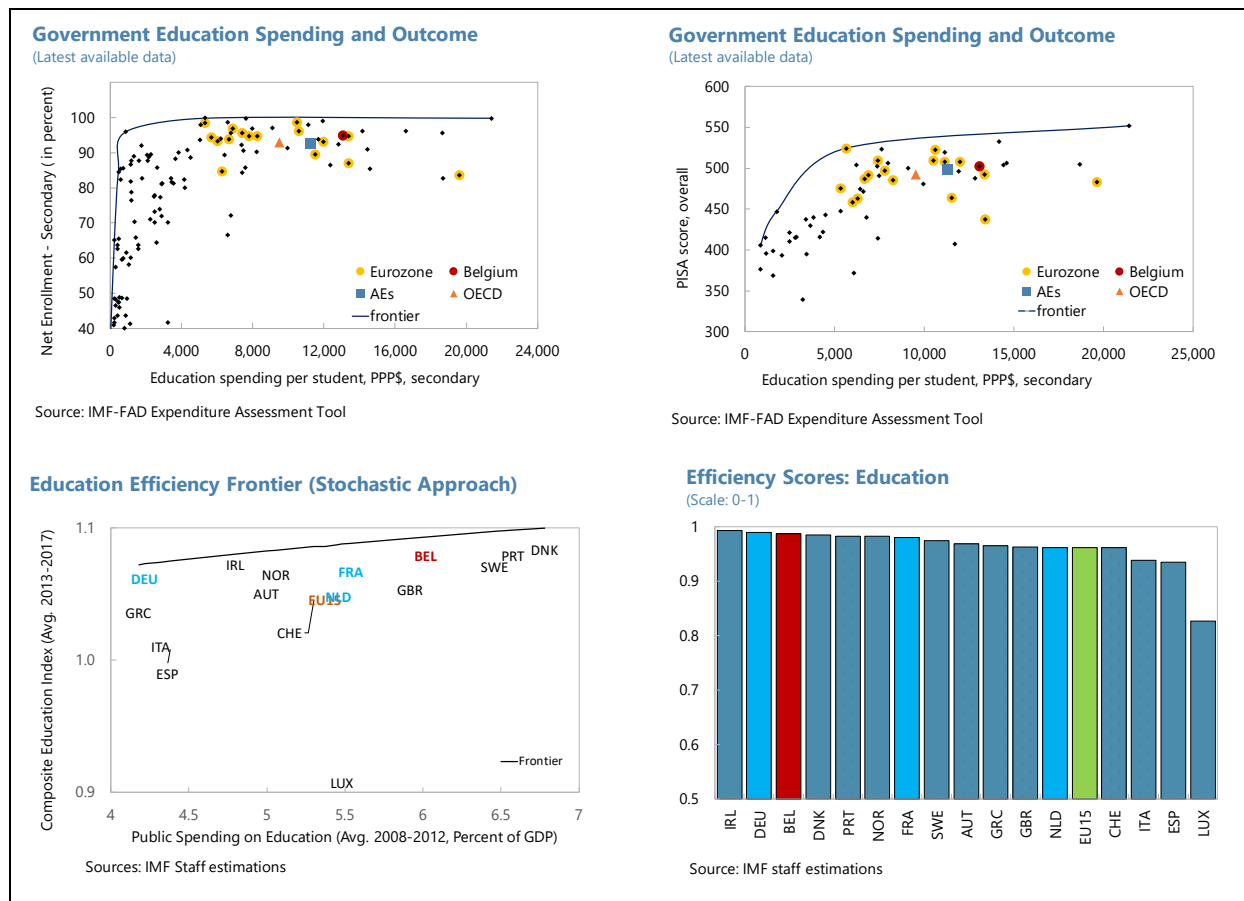
**6. Spending on compensation of employees could also help contribute to the consolidation effort.**

The federal government reduced its wage bill by 25 percent since 1995, but the total general government’s wage bill increased by almost 7 percent during the same period due to decentralization of powers to state and local governments (IMF, 2015). Spending on compensation of employees stands out in two areas:





- Education:** Teachers' compensation represents more than 40 percent of total compensation of employees in Belgium and is higher than the EU14 average, particularly in secondary education (1 percent of GDP gap) and primary education (0.6 percent gap), due to low student-teacher ratios. According to the DEA approach, Belgium's education spending is somewhat below the efficiency frontier, given outcomes broadly in line with advanced and OECD peers, but higher educational performance is weaker for socio-economically disadvantaged individuals and first- and second-generation immigrants. Thus, Belgium has some room to improve education-spending efficiency, including by aligning student-teacher ratios with peers, while providing incentives to attract strong teachers to regions with disadvantaged students and immigrants, and where grade repetition is high.<sup>9</sup>



- Public administration and transportation:** Belgium spends 1.1 percent of GDP more than peers on compensation of employees in these areas due to a relatively high and increasing level of employment, especially at the sub-national level. Reducing fragmentation and duplication in the public administration between Entities I and II, as well as within Entity II, and controlling the growth in the latter's employment (for instance through attrition) are necessary to help support the consolidation.

<sup>9</sup> Grade repetition is reported as a major cause of both poor performance and excessive spending in primary and secondary education (particularly in the French Community).

**7. In conclusion, Belgium has some room to rationalize and improve the efficiency of its public spending.** In particular, subsidies and the wage bill could be rationalized, while efficiency of spending could be further increased in health, education, and other social protection benefits. This analysis should be interpreted with care. First, efficiency frontiers are difficult to estimate and dependent on the choice of peer countries. Second, outcomes are imprecise, difficult to measure, and represent only a subset of public policies' targets. Finally, differences in levels of public spending reflect countries' social choices with respect to public versus private spending.

### Box 1. Efficiency Frontier Estimation Methodologies

This paper uses two main approaches to the estimation of public-spending efficiency:

- *A non-parametric method*, linking direct measures of inputs with direct measures of outputs. The efficiency frontier is derived using linear-programming techniques whereby a convex best-practice frontier is drawn by "enveloping" (linking) countries that produce the best output with a given amount of input (Data Envelopment Analysis, DEA).<sup>2</sup>
- *A parametric method*, which involves the estimation of an econometric model controlling for determinants of the output variable other than the input variable. The method used is the Stochastic Frontier Analysis (SFA), which specifies a production technology,  $f(X_i, \alpha)$  using inputs for country  $i$ ,  $X_i = (x_i^1, x_i^{-1})$ , to produce the optimal output:  $y_i^* = f(X_i, \alpha)$ . The model assumes that the government only achieved a fraction of  $y_i^*$ , namely  $y_i = f(X_i, \alpha)\varepsilon_i \exp(v_i)$ , where  $0 < \varepsilon_i \leq 1$  is the level of efficiency, and  $v_i$  is a random shock. Assuming  $k$  inputs, a log-linear production function, and defining  $\varepsilon_i = \exp(-u_i) \leq 1$ , the SFA estimates the following econometric model:  $\ln(y_i) = \alpha_0 + \sum_{j=1}^k \alpha_j \ln(x_i^j) + v_i - u_i$ .<sup>1</sup>

In each function, public spending in percent of GDP is used as input variable, and a composite index (weighted average of several standardized measures of output) is used as output indicator. Our SFA models control for private spending, the level of development, and other relevant determinants of the outcomes (e.g. demographics, etc.). The SFA model is also used to compute efficiency scores as one minus the proportional amount by which the output could be increased without additional spending.

<sup>1</sup> Greene, W. H. (2008), Parmeter, C. F. and Kumbhakar, S. C. (2014)

<sup>2</sup> See IMF (2017)

## References

- Dumont, M. (2019), *Tax Incentives for Business R&D in Belgium, Third Evaluation*, Federal Planning Bureau Working Paper 4-19
- European Commission (2017), *Belgium: Country Health Profile 2017*, State of Health in the EU, European Observatory on Health Systems and Policies, Brussels.
- European Commission (2019), *Country Report Belgium 2019*, Commission Staff Working Document, SWD (2019) 1000 final.
- Greene, W. H. (2008), *The Econometric Approach to Efficiency Analysis*. In Fried, H. O., Knox Lovell, C. A., and Schmidt, P., editors, *The Measurement of Productive Efficiency*. Oxford University Press, New York and Oxford
- IMF (2015), *Towards a Growth-Friendly Fiscal Consolidation in Belgium*, IMF Country Report No. 15/71
- IMF (2016), *Belgium—Making Public Expenditures More Efficient*, IMF Country Report No. 16/78.
- IMF (2017), *Expenditure Assessment Tool (EAT)*, Fiscal Affairs Department, Technical Notes and Manuals No 17/06”
- National Bank of Belgium (2017), *Public Sector Efficiency in Belgium*, NBB Economic Review, 2017.
- OECD (2017), *Tackling Wasteful Spending on Health*, OECD Publishing, Paris.
- OECD (2019), *Health Spending Projections to 2030*, OECD Health Working Paper No. 110.
- OECD (2019), *In-Depth Productivity Review of Belgium*, OECD Publishing, Paris
- OECD (2020), *OECD Economic Surveys: Belgium 2020*, OECD Publishing, Paris
- Parmeter, C. F. and Kumbhakar, S. C. (2014), *Efficiency Analysis: A Primer on Recent Advances*, Foundations and Trends in Econometrics, 7(3-4), 191-38

## Annex V. Debt Sustainability Analysis

1. **Public debt sustainability risks remain high over the medium run.** Under the baseline scenario, the public debt-to-GDP ratio is projected to increase marginally to 100 percent by 2025 under broadly unchanged policies and steady, but moderate, growth, while interest rates remain low. Gross financing needs are expected to be 14.7 percent of GDP in 2020 and to average around 15 percent over the medium term. The projected medium-term public debt path is sensitive to a real GDP growth shock, a combined macro-fiscal shock, and a contingent liability shock. In the long run, debt under the baseline scenario is on a rising trajectory due to growing aging costs.
2. **At end-2018, Belgium's public debt was equal to €460 billion, or 100 percent of GDP.** Around 85 percent of the debt was owed by the federal government; the remainder was owed by regions, communities, local authorities, social security, and other federal entities. All federal debt was denominated in euros, of which 9.4 percent was short-term debt and 9.7 percent carried a variable interest rate. The average weighted duration of federal debt was 9.6 years, up from 9.3 years at end-2017. The average weighted interest rate was 2.2 percent, down from 2.3 percent the previous year.

### Baseline Scenario and Realism of Projections

3. **In the baseline scenario, the ratio of public debt to GDP declines gradually over the medium term under the assumption of continued primary surpluses, moderate growth, and low real interest rates.** In the long run, however, debt is projected to increase under the baseline scenario, as a result of rising aging costs.
  - **Macroeconomic assumptions.** Growth declines to 0.8 percent this year and gradually recovers to 1.3 percent over the medium term, broadly in line with potential growth, while the output gap remains closed. Inflation rises to close to 2 percent by 2025.
  - **Fiscal assumptions.** The fiscal deficit widens to 2.3 percent in 2020 due to weaker revenues and social benefit spending drift. The deficit widens to 3.1 percent over the medium term under the assumption of broadly unchanged policies. With a small positive output gap closing, the structural deficit moves in step, while the primary deficit widens to 1.8 percent by 2025.
  - **Debt levels and gross financing needs.** Belgium's high level of government debt calls for using the higher scrutiny framework.<sup>1</sup> Government gross debt has increased significantly since 2007, reflecting large fiscal stimulus and substantial support to the banking sector. After peaking at 107.0 percent of GDP in 2014, debt has declined gradually to an estimated 99 percent in 2019. It is projected to increase to 100 percent by 2025. Gross financing needs average 15 percent of GDP over the medium term.

<sup>1</sup> For advanced economies that (i) have a current or projected debt-to-GDP ratio above 60 percent; or (ii) have current or projected gross financing needs-to-GDP ratio above 15 percent; or (iii) have or are seeking exceptional access to Fund resources; teams are required to use an extended set of tools to identify and assess specific risks to debt sustainability. For these "higher scrutiny" cases, teams are also required to produce a standardized summary of risks in a heat map and prepare a write-up to discuss risks, including any country-specific considerations.

- **Realism of baseline assumptions.** The median forecast errors for real GDP growth (0.11 percent), the primary balance (-0.31 percent), and inflation (0.33 percent) are all relatively small, measured over the period 2010–18.
- **Heat map.** Risks from the debt level are deemed high, given that the relevant 85 percent threshold is breached under baseline and all stress test scenarios. While Belgium’s gross financing needs are below the benchmark of 20 percent of GDP in 2019 and the medium term, its external financing requirement, at 85 percent of GDP in 2019, is significantly above the upper threshold, and the share of debt held by foreigners is relatively high at 53 percent of total.<sup>2</sup>

## Stress Tests

### 4. **Stress tests suggest that debt levels are sensitive to a real GDP growth shock and a combined macro-fiscal shock. Debt would increase significantly under a financial sector contingent liability shock.**

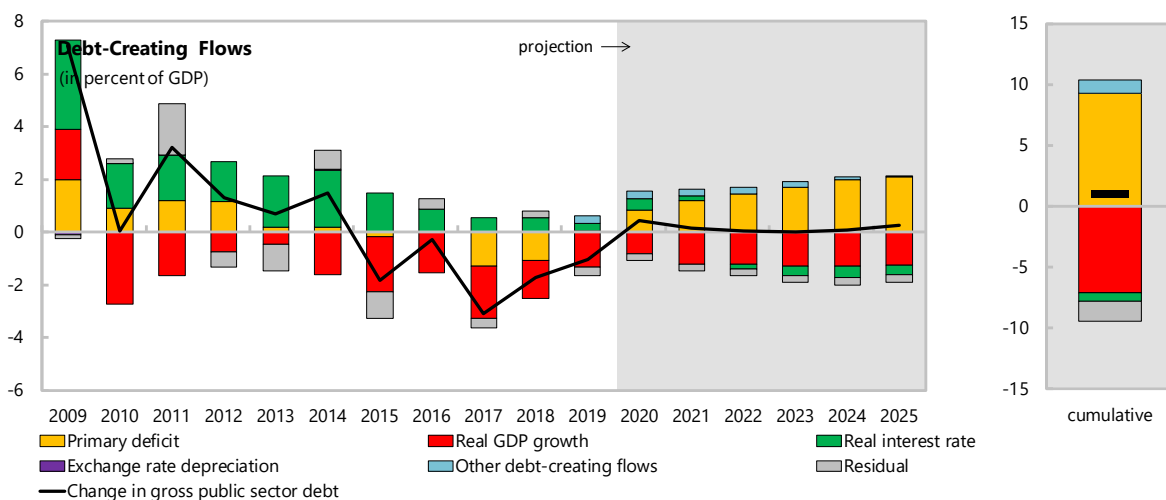
- **Growth shock.** Under this scenario, real GDP growth is reduced by one standard deviation in 2021–22, i.e., 0.7 percentage points each year relative to the baseline scenario. The assumed decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth). Under this scenario, the debt-to-GDP ratio increases to 102.6 percent of GDP in 2022 and remains broadly stable thereafter.
- **Interest rate shock.** This scenario examines the implications for debt sustainability of an increase in interest rates by 562 basis points (calibrated based on a historical high in interest rates observed in 1995) starting in 2021. The debt-to-GDP ratio increases more rapidly, reaching about 105 percent in 2025. Gross financing needs are 3 percentage points of GDP higher in 2025 relative to the baseline scenario.
- **Exchange rate shock.** This scenario assumes 13 percent depreciation in the real exchange rate in 2021. This shock results in small effects relative to the baseline.
- **Primary balance shock.** This scenario examines the implications of a revenue shock and a rise in interest rates leading to a cumulative 0.8 percentage points of GDP deterioration in the primary balance (one standard deviation shock) in 2021–22. This shock leads to a modest deterioration in the debt-to-GDP ratio relative to the baseline scenario.
- **Combined macro-fiscal scenario.** This scenario aggregates shocks to real growth, the interest rate, the exchange rate, and the primary balance while avoiding double-counting the effects of individual shocks. Under this scenario, debt stands at 108.5 percent of GDP and gross financing needs equal about 18 percent of GDP at the end of the projection period.
- **Contingent liability shock.** In this scenario, non-interest expenditures in 2021 increase by the equivalent of 10 percent of banking sector assets, and growth slows by 1 standard deviation for two years (2021–22). Debt increases to 122 percent of GDP in 2021 and increases marginally over the medium term, reaching 125 percent in 2025.

<sup>2</sup> Belgium has one of the strongest net international investment positions in the euro area, and a substantial portion of the external financing needs of non-financial corporations stems from intragroup lending.

**Figure 1. Belgium: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario**  
(in percent of GDP unless otherwise indicated)

	Debt, Economic and Market Indicators <sup>1/</sup>										As of March 02, 2020		
	Actual		Est.		Projections								
	2009-2017 <sup>2/</sup>	2018	2019	2020	2021	2022	2023	2024	2025				
Nominal gross public debt	103.7	100.0	99.0	99.5	99.6	99.6	99.6	99.7	100.0		Sovereign Spreads		
Public gross financing needs	12.0	14.5	14.1	14.7	13.9	16.8	15.1	16.3	14.0		EMBIG (bp) <sup>3/</sup> 40		
Real GDP growth (in percent)	1.2	1.5	1.4	0.8	1.2	1.3	1.3	1.3	1.3		5Y CDS (bp) 16		
Inflation (GDP deflator, in percent)	1.5	1.5	1.6	1.3	1.4	1.5	1.6	1.7	1.7		Ratings Foreign Local		
Nominal GDP growth (in percent)	2.7	3.0	3.0	2.2	2.7	2.8	3.0	3.1	3.0		Moody's Aa3 Aa3		
Effective interest rate (in percent) <sup>4/</sup>	3.2	2.1	2.0	1.8	1.6	1.4	1.3	1.3	1.4		S&Ps AA AA		
											Fitch AA- AA-		

	Contribution to Changes in Public Debt										cumulative	debt-stabilizing primary balance <sup>9/</sup>
	Actual		Est.		Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025			
Change in gross public sector debt	1.0	-1.7	-1.0	0.5	0.2	0.0	0.0	0.1	0.2	1.0		
Identified debt-creating flows	0.9	-2.0	-0.7	0.7	0.4	0.3	0.3	0.3	0.5	2.6		
Primary deficit	0.5	-1.1	0.0	0.8	1.2	1.4	1.7	2.0	2.1	9.3		
Primary (noninterest) revenue and grants	50.9	51.1	50.0	49.7	49.6	49.5	49.5	49.5	49.5	297.5		
Primary (noninterest) expenditure	51.3	50.0	50.0	50.6	50.8	51.0	51.3	51.5	51.6	306.7		
Automatic debt dynamics <sup>5/</sup>	0.5	-0.9	-1.0	-0.4	-1.0	-1.4	-1.6	-1.7	-1.6	-7.8		
Interest rate/growth differential <sup>6/</sup>	0.5	-0.9	-1.0	-0.4	-1.0	-1.4	-1.6	-1.7	-1.6	-7.8		
Of which: real interest rate	1.7	0.6	0.3	0.4	0.2	-0.2	-0.4	-0.5	-0.4	-0.7		
Of which: real GDP growth	-1.2	-1.4	-1.3	-0.8	-1.2	-1.2	-1.3	-1.3	-1.3	-7.1		
Exchange rate depreciation <sup>7/</sup>	0.0	0.0	0.0	...	...	...	...	...	...	...		
Other identified debt-creating flows	0.0	0.0	0.3	0.3	0.3	0.3	0.2	0.1	0.1	1.1		
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Stock-flow adj. and debt management	0.0	0.0	0.3	0.3	0.3	0.3	0.2	0.1	0.1	1.1		
Residual, including asset changes <sup>8/</sup>	0.0	0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-1.7		



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as  $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+grt)]$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = 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).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

7/ The exchange rate contribution is derived from the numerator in footnote 5 as  $ae(1+r)$ .

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

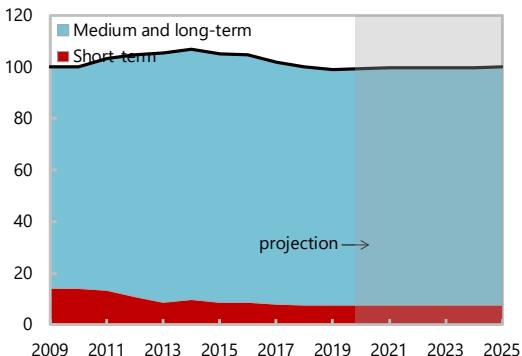
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

**Figure 2. Belgium: Public DSA—Composition of Public Debt and Alternative Scenarios**

**Composition of Public Debt**

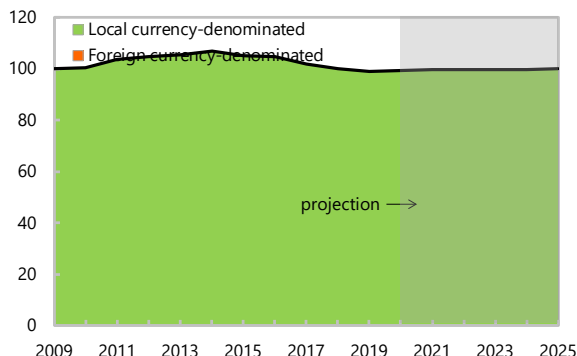
**By Maturity**

(in percent of GDP)



**By Currency**

(in percent of GDP)

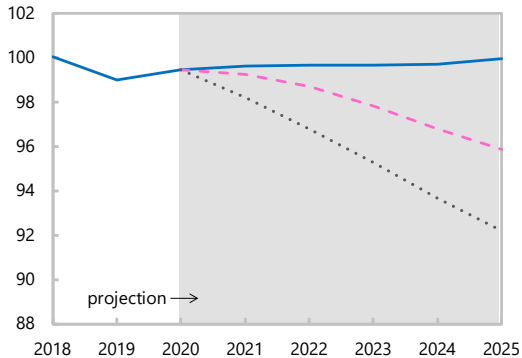


**Alternative Scenarios**

— Baseline      ..... Historical      - - - Constant Primary Balance

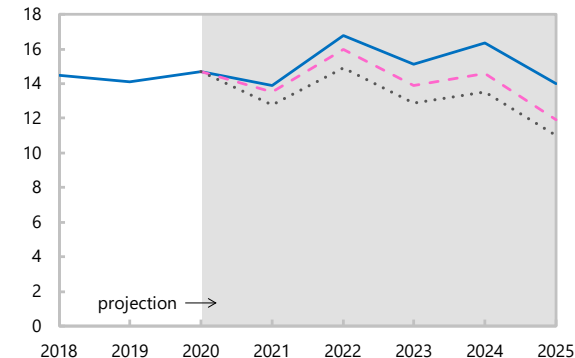
**Gross Nominal Public Debt**

(in percent of GDP)



**Public Gross Financing Needs**

(in percent of GDP)



**Underlying Assumptions**

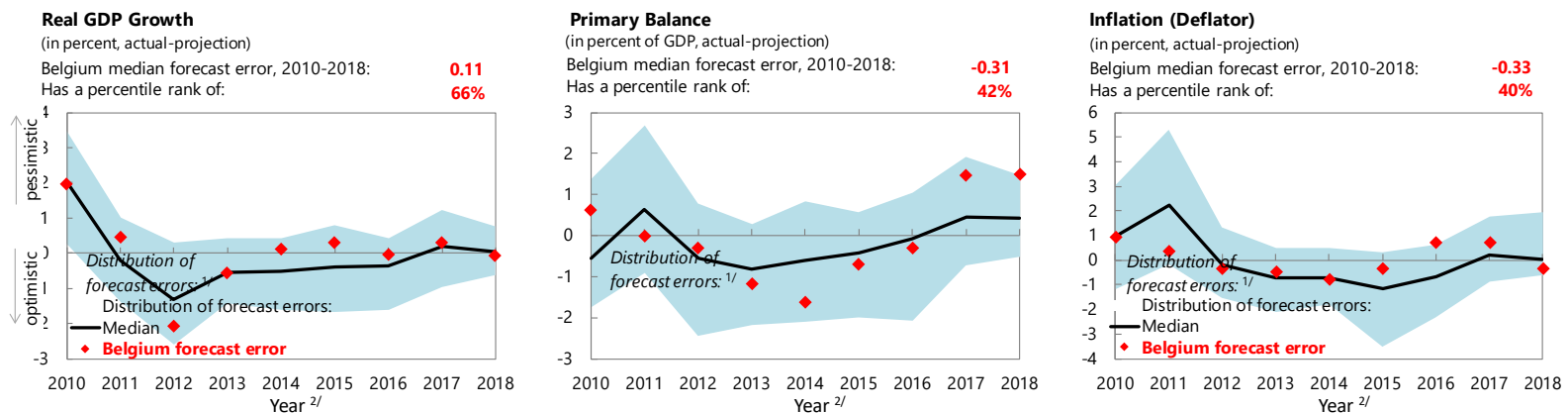
(in percent)

	2020	2021	2022	2023	2024	2025
<b>Baseline Scenario</b>						
Real GDP growth	0.8	1.2	1.3	1.3	1.3	1.3
Inflation	1.3	1.4	1.5	1.6	1.7	1.7
Primary Balance	-0.8	-1.2	-1.4	-1.7	-2.0	-2.1
Effective interest rate	1.8	1.6	1.4	1.3	1.3	1.4
<b>Constant Primary Balance Scenario</b>						
Real GDP growth	0.8	1.2	1.3	1.3	1.3	1.3
Inflation	1.3	1.4	1.5	1.6	1.7	1.7
Primary Balance	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Effective interest rate	1.8	1.6	1.4	1.3	1.3	1.4
<b>Historical Scenario</b>						
Real GDP growth	0.8	1.6	1.6	1.6	1.6	1.6
Inflation	1.3	1.4	1.5	1.6	1.7	1.7
Primary Balance	-0.8	-0.1	-0.1	-0.1	-0.1	-0.1
Effective interest rate	1.8	1.6	1.6	1.6	1.7	1.8

Source: IMF staff.

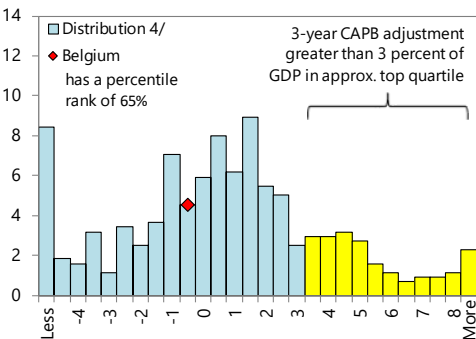
**Figure 3. Belgium: Public DSA—Realism of Baseline Assumptions**

**Forecast Track Record, versus all countries**

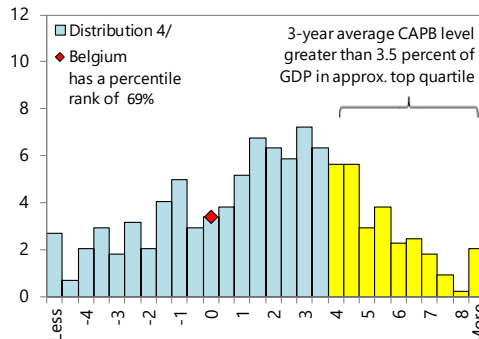


**Assessing the Realism of Projected Fiscal Adjustment**

**3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)**  
(Percent of GDP)

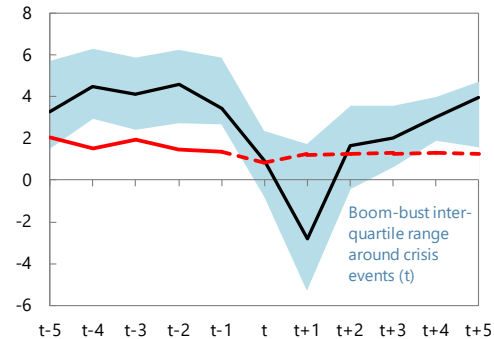


**3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)**  
(Percent of GDP)



**Boom-Bust Analysis<sup>3/</sup>**

**Real GDP growth**  
(in percent)



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

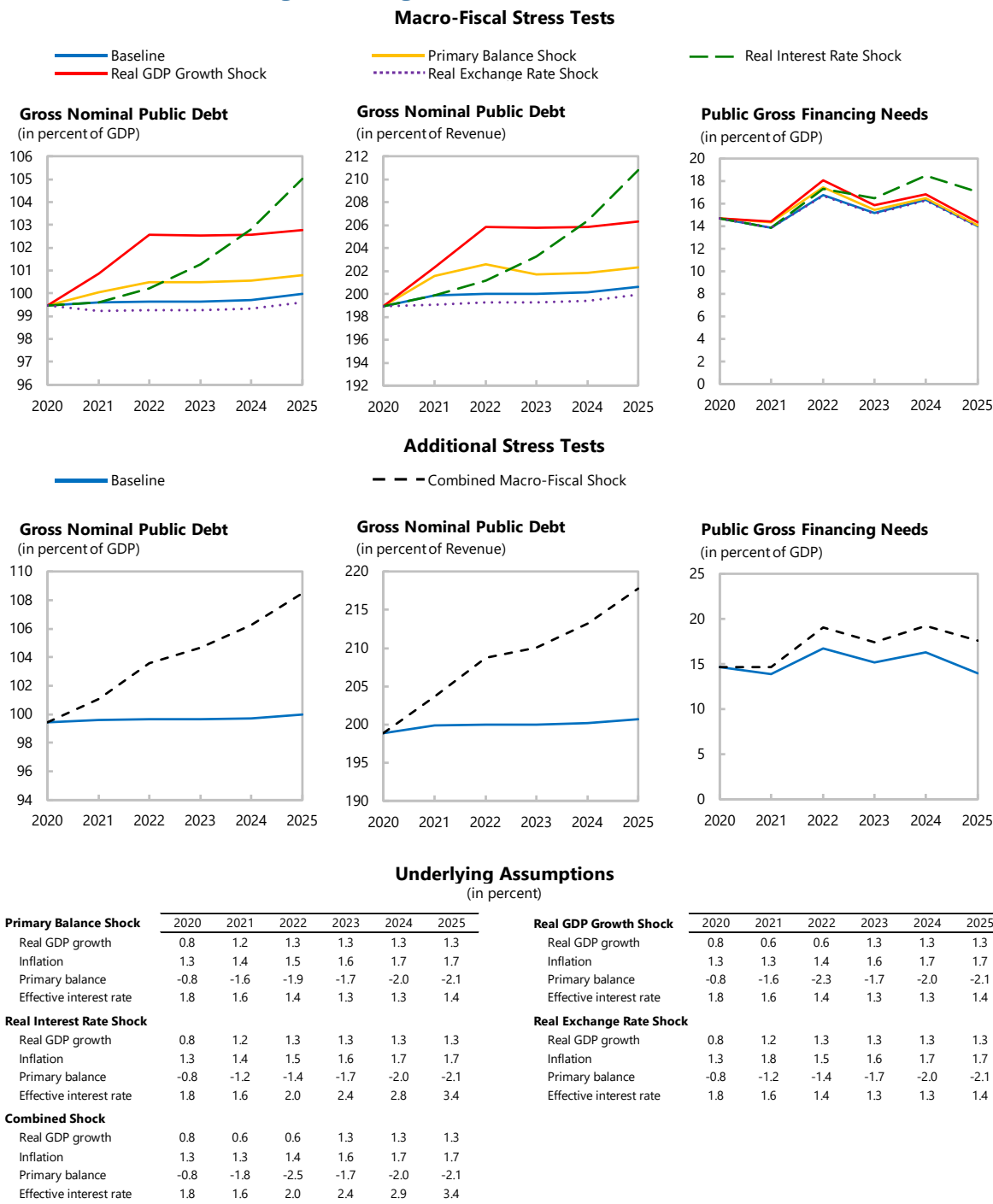
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Belgium has had a positive output gap for 3 consecutive years, 2017-2019. For Belgium, t corresponds to 2020; for the distribution, t corresponds to the first year of the crisis.

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.



**Figure 4. Belgium: Public DSA—Stress Tests**



Source: IMF staff.

**Figure 5. Belgium: Public DSA Risk Assessment**

**Heat Map**

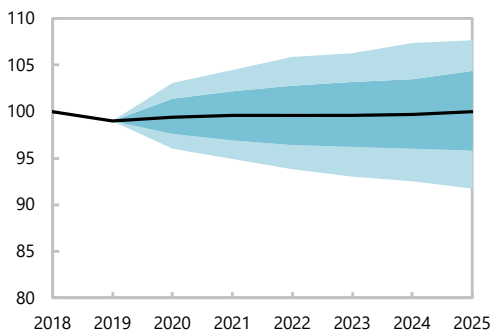
Debt level <sup>1/</sup>	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs <sup>2/</sup>	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile <sup>3/</sup>	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

**Evolution of Predictive Densities of Gross Nominal Public Debt**

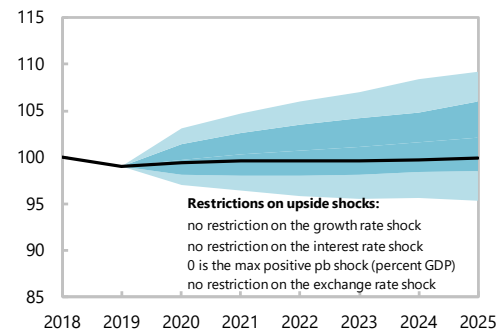
(in percent of GDP)

— Baseline      Percentiles:    ■ 10th-25th    ■ 25th-75th    ■ 75th-90th

**Symmetric Distribution**

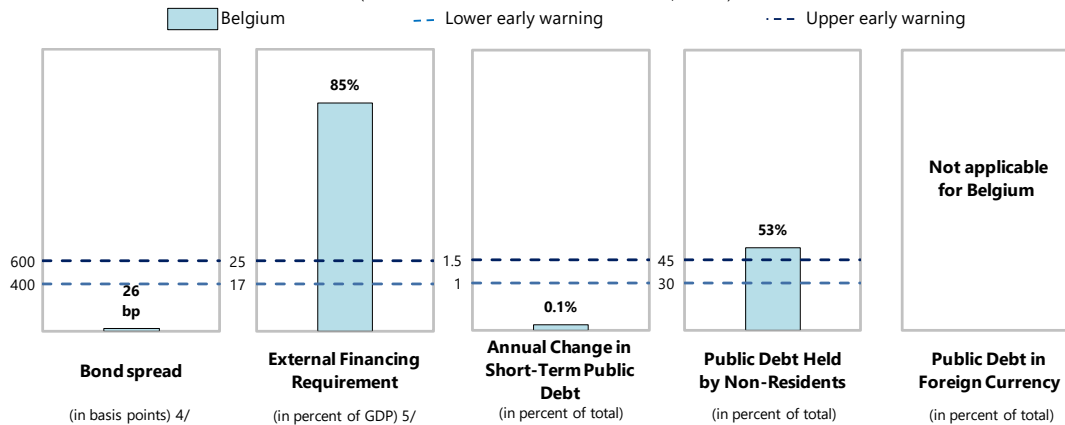


**Restricted (Asymmetric) Distribution**



**Debt Profile Vulnerabilities**

(Indicators vis-à-vis risk assessment benchmarks, in 2019)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white. Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 03-Dec-19 through 02-Mar-20.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.



# BELGIUM

March 13, 2020

## STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department

### CONTENTS

FUND RELATIONS \_\_\_\_\_ 2

STATISTICAL ISSUES \_\_\_\_\_ 5

## FUND RELATIONS

(As of February 29, 2020)

**Membership Status:** Joined December 27, 1945; Article VIII.

### General Resources Account:

	SDR Million	Percent of Quota
Quota	6,410.70	100.00
IMF's Holdings of Currency (Holdings Rate)	5,520.83	86.12
Reserve Tranche Position	889.89	13.88
Lending to the Fund		
New Arrangements to Borrow	330.96	

### SDR Department:

	SDR Million	Percent of Allocation
Net Cumulative Allocation	4,323.34	100.00
Holdings	3,900.06	90.21

**Outstanding Purchases and Loans:** None

### Latest Financial Arrangements:

<u>Type</u>	<u>Date of Arrangement</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
Stand-By	Jun 19, 1952	Jun 18, 1957	50.00	50.00

### Overdue Obligations and Projected Payments to Fund <sup>1/</sup>

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

	Forthcoming				
	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>
Principal					
Charges/Interest	2.38	3.16	3.16	3.16	3.16
Total	2.38	3.16	3.16	3.16	3.16

<sup>1/</sup> When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

**Implementation of HIPC Initiative:** Not applicable

**Safeguards Assessments:** Not applicable

**Exchange Rate Assessments:**

- Belgium's currency is the euro, which floats freely and independently against other currencies.
- Belgium has accepted the obligations under Article VIII, Section 2(a) and 3, and maintains an exchange system free of restrictions on payment and transfers for current international transactions except for restrictions maintained solely for security reasons, which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

**Last Article IV Consultation:**

The last Article IV consultation was concluded on March 6, 2019. The associated Executive Board assessment is available at <https://www.imf.org/en/News/Articles/2019/03/08/pr1973-belgium-imf-executive-board-concludes-2019-article-iv-consultation> and the staff report (IMF Country Report No. 19/74) at <https://www.imf.org/~media/Files/Publications/CR/2019/1BELEA2019001.ashx>. Belgium is on the standard 12-month consultation cycle.

**Financial Sector Assessment Program (FSAP) Participation:**

- **Belgium: Financial System Stability Assessment** IMF Country Report  
No. 18/67

**Summary:** The FSAP conducted in late 2017 concluded that the Belgian financial sector has become more resilient as a result of structural changes experienced since the global financial crisis, but is facing growing vulnerabilities, mostly in the form of risky mortgages. Nonetheless, banks and insurance companies remain capable of absorbing credit, sovereign, and market losses in the event of a severe deterioration in macro financial conditions. To contain rising mortgage-related risks, macroprudential policies recently proposed by the NBB should be enacted promptly. Other risks, including banks' capacity to cope with interest rate shocks, credit risk vulnerabilities in selected portfolios, and growing liquidity risk in insurance companies, should be monitored closely.

Financial sector supervision and crisis management arrangements have been upgraded markedly. However, the transition to a full banking union must be carefully managed by national and European authorities given the presence in Belgium of large subsidiaries of euro area banks. Sufficient capital and loss absorbing capacity should be kept in these subsidiaries to ensure the viability of group resolution strategies. The NBB and European authorities should continue ongoing efforts to upgrade their supervisory and crisis management frameworks and operational capacity, including by prioritizing the resolution planning for important banks and strengthening the deposit insurance system. It will also be important to address the challenges posed by complex financial conglomerates, ongoing changes in the risk profile of the insurance sector, and potential challenges arising from the low quality of some insurers' capital.

The oversight arrangement for the Belgium-based Society for Worldwide Interbank Financial Telecommunication (SWIFT) has proven effective but is being challenged by new risks. To strengthen the NBB's ability to exercise its role as overseer and protect Belgium's reputation as a key hub for financial market infrastructures, the authorities should consider complementing the NBB's use of

moral suasion with regulatory and supervisory powers and should enhance the NBB's ability to share information with foreign authorities.

**Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT):**

Belgium underwent a mutual evaluation of its AML/CFT regime by the Financial Action Task Force (FATF) in 2015. The FATF 2015 report noted that Belgium has the core elements of a sound AML/CFT regime, although some elements are not yet fully in line with the 2012 FATF Recommendations. Following the adoption of the mutual evaluation report, Belgium was placed in enhanced follow-up process. The latest report (third enhanced follow-up) noted Belgium's progress in strengthening its framework to tackle money laundering and terrorist financing since the mutual evaluation. However, efforts need to continue to fully implement the FATF Standard, including Recommendations 13 and 14 on corresponding banking, and money and value transfer services.

## 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, NBB.Stat. 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 2010 (ESA 2010) in 2014.** Revisions of national accounts were released in September 2014 to comply with EUROSTAT requirements to provide national accounts statistics in ESA 2010. Unlike in other countries, the central bank 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.

**Belgium compiles and publishes a complete set of general government accounts on an accrual basis (ESA 2010).** The NBB publishes annual and quarterly data on general government revenue, expenditure, and net lending/borrowing; transactions in financial assets and liabilities and a financial balance sheet data; and details on the consolidated gross debt.

**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:

NBB.Stat, <http://stat.nbb.be/?lang=en>

National Statistics Institute, [www.statbel.fgov.be](http://www.statbel.fgov.be)

National Bank of Belgium, [www.nbb.be](http://www.nbb.be)

Federal Planning Bureau, [www.plan.be](http://www.plan.be)

High Council of Finance, <https://www.highcounciloffinance.be>

Central Economic Council, [www.ccecrb.fgov.be](http://www.ccecrb.fgov.be)

### Belgium: Common Indicators Required for Surveillance

(As of February 2020)

	Date of latest observation	Date received	Frequency of Data <sup>6</sup>	Frequency of Reporting <sup>6</sup>	Frequency of Publication <sup>6</sup>
Exchange Rates	1/20	2/20	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	1/20	2/20	M	M	M
International Investment Position	2019:Q3	12/19	Q	Q	Q
Reserve/Base Money	1/20	2/20	M	M	M
Broad Money	1/20	2/20	M	M	M
Central Bank Balance Sheet	1/20	2/20	M	M	M
Consolidated Balance Sheet of the Banking System	1/20	2/20	M	M	M
Interest Rates <sup>2</sup>	1/20	2/20	M	M	M
Consumer Price Index	1/20	2/20	M	M	M
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> —General Government <sup>4</sup>	2018	4/19	A	A	A
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> —Central Government <sup>5</sup>	1/20	2/20	M	M	M
Stock of Central Government Debt	2019:Q3	12/19	Q	Q	Q
External Current Account Balance	09/19	12/19	M	M	M
Exports and Imports of Goods and Services	09/19	12/19	M	M	M
GDP/GNP	2019:Q4	2/20	Q	Q	Q
Gross External Debt	2019:Q3	12/19	Q	Q	Q

<sup>1</sup> Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

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

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

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

<sup>5</sup> This information is provided on a budget-accounting basis (not on a national accounts basis).

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





# BELGIUM

## STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION— SUPPLEMENTARY INFORMATION

March 25, 2020

Prepared by

European Department  
(In consultation with other departments)

*This supplement provides information that became available since the issuance of the Staff Report (SM/20/69) on March 16. The thrust of the staff appraisal remains unchanged.*

### A. Developments Related to COVID-19

- 1. The coronavirus outbreak has continued, taking a toll on human life and activity in Belgium.** The number of confirmed cases has increased to 4,937, with 178 fatalities registered until March 25. The authorities have taken a range of containment measures to reduce the spread of the virus, including school and retail shop closures, a ban on all gatherings, limiting movement to essential needs, and ban of non-essential travel abroad.
- 2. A temporary government was formed on March 17 to deal with the coronavirus emergency.** The new minority government, led by Prime Minister Wilmès, is composed of the three parties represented in the former caretaker government, and is benefiting from the support of six opposition parties. The new administration has been granted enhanced executive powers for a period of three months (renewable once for another period up to three months) to take exceptional measures by decree to deal with the impact of the coronavirus crisis.
- 3. The previous and new government have developed measures to mitigate the economic impact of the outbreak.** A fiscal envelope of €8–10 billion (about 2 percent of GDP) was recently announced to cover previously announced measures (e.g. enhancing support for those temporarily unemployed and the self-employed, and postponements of social security and tax payments for companies and self-employed) and new spending on health to combat the Coronavirus crisis. A further €50 billion (about 10 percent of GDP) will cover federal guarantees for new bank loans to companies and self-employed. Regional governments have also announced additional measures, including guarantees for affected firms, compensation schemes for affected businesses, and suspensions of energy bill payments for the unemployed.

The monetary and financial support announced by the ECB, together with the NBB's proactive decision to release the CCyB also aim to support the flow of credit to the economy

**4. While the macroeconomic outlook is subject to very high uncertainty, the thrust of staff's appraisal remains unchanged.** As the crisis continues and containment measures take hold, activity is expected to be further affected. The broader economic impact is highly uncertain and will depend on the duration and depth of the outbreak in Belgium and globally, as well as on the policy response. Staff strongly supports the authorities' policy response, which is fully in line with staff's recommendations included in the report, in particular use the available fiscal space to provide targeted support to affected individuals and firms and to support financial sector intermediation

## **Statement by Mr. De Lannoy and Mr. Cools on Belgium—Staff Report for the 2020 Article IV Consultation**

We thank staff for the insightful report, its annexes and the Selected Issues Paper *'The Appropriate Fiscal Stance: A Model Assessment'*. We also thank staff for the productive interactions with the Belgian authorities, and for their flexibility to adapt the draft report in light of the unfolding COVID-19 crisis.

### **Recent Developments**

On March 17, a new Federal Government led by Ms. Sophie Wilmès was sworn into office. On March 19, a vote of confidence garnered a large majority in the Lower House of the Federal Parliament<sup>1</sup>. The new government obtained a specific mandate to address the fall-out from the COVID-19 crisis. On Thursday March 26, the Lower House delegated exceptional legislative powers to the Federal Government to enable a swift implementation of its mandate. This delegation of powers encompasses public health, social policy, labor law, public order, and economic policy. The acts adopted by the Government on the basis of this delegation can enter into effect immediately upon enactment and shall be submitted to the Lower House for ex post validation within three months upon enactment. A similar extraordinary delegation of powers was most notably used in 1996 when far reaching measures were needed to meet the Maastricht convergence criteria for joining the Economic and Monetary Union.

Both the outgoing and the new Federal Government have adopted a string of targeted fiscal and financial measures in response to the COVID-19 outbreak. On the fiscal side, this includes enhanced access to temporary unemployment, deferred payment of personal income and corporate taxes, withholding tax, VAT, and social security contributions, exemptions of social security contributions, replacement incomes for the self-employed, and suspension of penalties for public contractors, as well as several sector-specific support measures. On March 19, the Lower House approved a 1 billion EUR additional expenditures package to combat the COVID-19 crisis.

With the support of the National Bank of Belgium (NBB), the Federal Government has agreed with the financial sector on a 50 billion EUR (about 10% of GDP) guarantee scheme for all new credit with a maximum duration of 12 months, extended up till end September 2020 to viable businesses. The financial sector has also agreed to accept deferred payments to September 30 on all loans to viable businesses. Finally, on March 11, the NBB entirely released the countercyclical capital buffer of 0.5% of banks' risk weighted assets. This release will remain in force for at least a year.

The three Regional Governments of Flanders, Wallonia and Brussels have also adopted a series of targeted measures, as they manage extensive levers of economic policy. They, among others, extended crisis guarantees to affected firms, created compensation schemes for affected businesses, and suspended energy bill payments for vulnerable groups.

The authorities welcome the Eurogroup statement of March 16, including the wording on flexibility under the Stability and Growth Pact, and the guidance of the European Commission on state aid to affected firms. They also welcome the bold actions by the European Central Bank ('ECB') to support all sectors of the economy and its commitment to do everything, as much as necessary and for as long as needed. Finally,

---

<sup>1</sup> The Lower House gathered in a severely restricted format due to the COVID-19 crisis.

they welcome the ECB Banking Supervision's announcement on temporary capital and operational relief measures to stimulate bank lending.

### **Outlook and risks**

While staff rightly noted that GDP growth was resilient prior to the COVID-19 outbreak, reaching 1.4% in 2019, significant downward revisions are now expected for 2020. Risks to growth, now firmly to the downside, were already tilted downwards prior to COVID-19. A hard outcome from the negotiations between the EU and the UK on their future trading relationship in particular and continued trade uncertainty globally remain significant risks to Belgium's open economy.

### **Return to a Structural Equilibrium**

Once the COVID-19 crisis will have abated and the related temporary targeted fiscal measures will have run their course, a return to the medium-term objective of a structural equilibrium will be the top priority for Belgium. The authorities agree with staff that a credible, sustained, and growth-friendly medium-term consolidation strategy is needed to put the deficit and debt on a firm downward path, and have taken good note of the case made in the Selected Issues Paper on the high marginal benefit of building buffers. They agree with staff that a medium-term strategy should be pursued by containing aging costs, reorienting the budget toward growth-enhancing areas, and improving spending efficiency. In that light, they very much welcome the annex on Benchmarking and Prioritizing Spending Reforms.

While committed to the European Union's fiscal rules, the authorities also recognize that flexibility with regards to investment will be necessary, given Belgium's important need for infrastructure and green investments. Finally, guaranteeing the sustainability of public finances is a task for both the federal state as well as the Regions and Communities, especially as the latter now oversee a much greater portfolio since the 2011 devolution of powers under the sixth State Reform.

### **Structural Reforms**

The authorities largely agree with staff's advice to remove structural growth constraints, and thus to improve Belgium's competitiveness and external position.

Prior to the COVID-19 outbreak, the Belgian labor market was operating at an all-time high, with the unemployment rate at 5.4%, and the employment rate at 70.5% in 2019, compared to 67.2% in 2015. The authorities agree with staff that further efforts will be needed to increase labor force participation, especially among vulnerable groups. The regional active labor market policies implemented by the three regional governments last year are key tools here. They are all the more important as the working age population is set to shrink in the future, as a result of population ageing. Belgium's labor shortage<sup>2</sup> can prevent firms from investing, muting productivity growth. Yet productivity gains are essential to generate sustainable growth, once the labor potential has been fully exploited. It is therefore vital to render the economic fabric more dynamic and to step up investments in growth-enhancing infrastructure, in line with the National Pact on Strategic Investments.

Boosting the growth potential by increasing productivity and the number of people at work is the only sustainable source of purchasing power and income creation. If more people are integrated into the labor

---

<sup>2</sup> Belgium has the highest vacancy rate in the euro area: Staff Report, figure 5, p. 35.

market, growth will also become more inclusive, as employment is a powerful driver of social inclusion, and the best protection against poverty. Generating more growth and employment also makes it easier to consolidate public finances. That is the only way to continue mobilizing sufficient resources to provide an effective social security safety net in the face of population ageing.

### **Financial Sector**

The Belgian financial sector is well positioned to weather adverse shocks given its high levels of capitalization and solid liquidity buffers. To address the rise in private leverage, the NBB has adopted consecutive macroprudential measures in the residential real estate sector, including last year, as well as the above mentioned CCYB, now released due to the COVID-19 crisis.

The authorities agree with staff that supervision of systemic financial conglomerates should be further operationalized, especially given their weight in the Belgian financial sector. The authorities therefore welcome the development of technical standards on the reporting of intragroup transactions, risk concentration, and capital adequacy for systemic financial conglomerates. The authorities also agree with staff that the feasibility and effectiveness of bank-resolution strategies shall be ensured, including by maintaining a sufficient and consistent allocation of MREL across banking groups. Finally, a compliant implementation of Basel 3.5 in European law will be crucial to ensure financial stability.

### **Climate**

The authorities would like to thank staff for their intention to dedicate a specific section in next year's Article IV staff report on the climate transition.