February 2006
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Belgium: 2005 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

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 2005 Article IV consultation with Belgium, the following documents have been released and are included in this package:

- the staff report for the 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 21, 2005, 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 January 19, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its February 27, 2006 discussion of the staff report that concluded the Article IV consultation.

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

Financial System Stability Assessment
Selected Issues Paper

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

BELGIUM

Staff Report for the 2005 Article IV Consultation

Prepared by Staff Representatives for the 2005 Consultation with Belgium

Approved by Poul Thomsen and Michael Hadjimichael

January 19, 2006

Belgium's economy has been performing reasonably well, and its economic policies are appropriately guided by the need to deal with population aging. The good economic performance is based on high productivity, supported by credible fiscal policies and a generally stable financial system, as documented in the Financial System Stability Assessment (FSSA) accompanying this report. Recognizing that higher growth is essential to attenuate the consequences of aging, structural reforms are being implemented, and social partners and the authorities have adopted a *Generation Pact* to boost job creation. Fiscal policy aims to support growth through tax cuts while gradually building up fiscal surpluses to fund the rising costs of aging in part through a reduction in the interest bill.

Policies will need to be strengthened to succeed:

- The near-term economic outlook is favorable, but domestic wage developments pose a risk to ***competitiveness*** in the medium term, and ***demographics*** will dampen trend growth. There is consensus on the need for structural reforms to boost productivity and for further wage moderation, though social partners have not yet agreed on how to achieve the latter.

- Balanced budgets during the past five years have contributed to appreciable ***fiscal consolidation***. However, reconciling ongoing growth-enhancing tax cuts with budget surplus goals will require explicit spending restraint as well as structural reforms that rely less on budgetary resources. Reaching the consolidation objectives also requires further strengthening of fiscal institutions and clarification of the responsibilities of the various levels of government.

- To boost employment rates in the ***labor market***, it will be essential to complement the reforms initiated with the *Generation Pact*. Most importantly, the wage-bargaining framework should be focused more on achieving higher employment rates.

- To preserve the stability and resilience of the ***financial system***, it will be important to meet the challenges posed by the move to Basel II, the increasing complexity of financial groups, and European integration; upgrade insurance and pension fund supervision to the same high quality as banking supervision; and continue to ensure adequate oversight and prudential supervision of the globally important payment and securities settlement system.

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I. Economic Background and Outlook[1]

1. ***Growth has been slightly better than in the euro area (Figure 1 and Table 1).*** In 2004, encouraged by low interest rates and permanent tax cuts, households reduced their savings rate and invested in housing. Enterprises stepped up capital formation, reflecting rising profits, the low cost of funding, and a catch-up from earlier depressed levels. While these developments boosted imports, the increase in oil prices choked consumption in late 2004 and, together with a sudden decline in external demand, caused near stagnation of economic activity in early 2005 (Text Table 1). Since then, private consumption and exports have been gaining strength while investment remained resilient, prompting a modest acceleration in growth.

Text Table 1. Belgium: Selected Indicators of Economic Activity, 2004-05

(Percent change from previous period; unless otherwise noted)

	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Projection Q4
	2004				2005			2005
Real GDP growth	0.8	0.5	0.8	0.3	0.1	0.3	0.4	0.5
Domestic demand	1.5	0.5	0.7	-0.5	0.8	1.9	-1.2	0.4
Of which: private consumption	0.6	0.3	0.2	0.0	0.4	0.6	0.2	0.4
Net exports 1/	-0.6	0.0	0.2	0.8	-0.7	-1.6	1.6	0.2
Exports	1.2	1.4	1.9	2.3	-1.6	-0.4	2.1	2.1
Imports	1.9	1.4	1.7	1.4	-0.9	1.4	0.3	2.0

Sources: Belgostat; and IMF staff calculations.

1/ Contribution to GDP growth.

2. ***As elsewhere, oil price hikes have boosted headline inflation.*** Harmonized consumer price inflation peaked at 3 percent in September 2005 but fell back as oil prices decreased somewhat and temporary tax rebates on heating oil took effect. Excess headline inflation over the euro area average can be attributed to transitory factors (Figure 2). Underlying inflation has been hovering at about 1.4 percent, reflecting limited pricing power due to intense international competition and economic slack. Private sector hourly wages are estimated to have risen by about 2.3 percent in 2005, while unit labor costs grew by 2.1 percent.

3. ***Policy conditions have been supportive of activity (Figure 3).*** Low interest rates have been sustaining domestic demand while the return of the euro to a more depreciated

[1] Mission details are included in Appendix I (Fund Relations), and statistical information is in Appendix II.

level helped rekindle exports. The procyclicality implied by the pursuit of balanced budgets has been limited through the use of one-off measures, which allowed masked operation of automatic stabilizers. Even so, with the economy very open and mainly producing for the euro area, fiscal multipliers have been small, and monetary conditions appropriate for the area as a whole have been fine for Belgium as well. Conversely, membership of the monetary union has imparted discipline on domestic policies, with the authorities underscoring that their forward-looking approach had been important to preserve confidence.

4. ***The economic recovery is expected to strengthen.*** The staff projects GDP growth to increase from 1.5 percent in 2005 to about 2.1 percent in 2006, marginally (0.1 percentage point) less than assumed in the 2006 budget. Demand from key trading partners has been edging up, and global growth is projected to remain robust in 2006. Domestically, income tax cuts will compensate for the loss of purchasing power from higher oil prices and, based on approved building permits, residential construction should remain resilient. Nonetheless, household spending will soften somewhat, with the savings rate expected to stop falling. The expansion of fixed investment is expected to moderate, given its exceptional strength in 2005. Harmonized consumer price inflation is projected to average 2.4 percent in 2006.

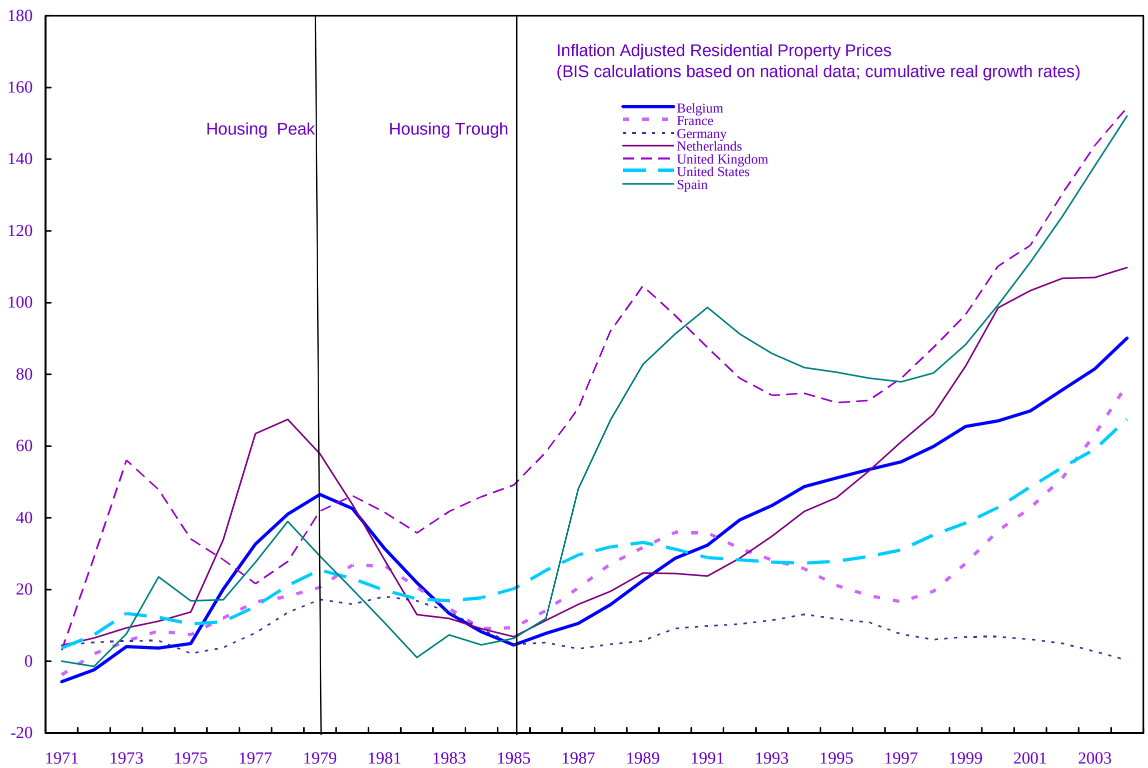
5. ***Foreign demand and global imbalances pose external risks, while wage growth and developments in residential property prices constitute domestic sources of uncertainty.*** A faltering of growth in Europe and a disorderly euro appreciation would dampen growth. If the 2005–06 wage agreement is implemented as envisaged, domestic wage increases will exceed those of key trading partners. While this might support demand in the short run, it would adversely impact competitiveness in the medium run. Risks connected to the buoyant housing market seem confined. The recent rise in residential real estate prices is the combined result of low interest rates, the investment in housing of capital repatriated in the context of the 2004 fiscal amnesty, the introduction of frontloading of the tax deductibility of interest payments, and more aggressive mortgage lending by banks (Box 1 and Selected Issues Chapter I). While further increases in interest rates would dampen house price growth, several factors imply that such an event would impact the economy only gradually and mainly through residential construction. Household mortgage debt and bank exposure to mortgages is relatively low, and there has been no notable evidence of equity withdrawal and thus no direct support from housing wealth for consumption.

6. ***More fundamental are the interrelated challenges of population aging and increasing international competition.*** Aging will adversely impact the budget directly, but also indirectly through its negative affect on potential growth, which is already being hampered by low employment rates. Increased scope for outsourcing should support growth, though only if labor and product markets are sufficiently flexible to respond. In international comparison, Belgium’s relative strengths are its high level of labor productivity, recent per capita GDP growth, and progress in product market deregulation (Figure). Labor market indicators signal an area of comparative weakness, however. Public debt has been declining at a steady pace, strengthening debt sustainability, but the level of public debt remains high and vulnerable to growth shocks (Figure 4 and Table 2).

Box 1. Buoyant Housing Market: How Large a Risk?

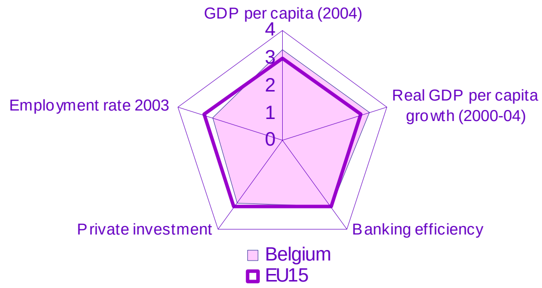
Residential real estate prices have been increasing strongly in Belgium, with some of the pickup prompted by fiscal measures. Year-on-year increases have nonetheless been less than in some of the neighboring countries, such as the Netherlands and the United Kingdom. In contrast to other countries, where there have been recent cycles, Belgian housing prices have been rising continuously during the last 20 years. In real terms, they increased by 44 percent since the previous peak and 86 percent since the previous trough. In 2004, when Belgium introduced a tax amnesty, there was an acceleration as, reportedly, investment in secondary homes was a popular outlet for repatriated capital. Further, the new fiscal regime for mortgage loans permitting frontloading of the fiscal advantage, may have induced households that previously could not afford a home to enter the market. In addition, reductions in transactions costs and the newly-introduced ability to carry over taxes from the purchases of the first home to the next in the Flanders region may have bolstered demand.

If interest rates increased, residential construction could experience a significant slowdown, but risks to the economy are confined since households' and banks' exposure to real estate is not high. The main driver of housing prices in Belgium has been the unusually low interest rate environment. Rising interest rates are likely to slow house price growth or trigger a brief reversal in real terms. However, risks to the economy are limited. Mortgage debt to GDP in Belgium is 47 percent, higher than in France (26 percent), but well below the United Kingdom (75 percent) and the United States (69 percent). Mortgage loans constitute only about 10 percent of banks' assets, lower than in neighboring countries. Further, even though variable rate mortgage contracts increased considerably in recent years, caps on these contracts will limit the impact on disposable income when rates rise. In addition, there is little evidence of equity withdrawal. Consequently, a slowdown in the housing market will have little direct impact on consumption, but residential construction, which is sensitive to house prices and makes up roughly 5 percent of GDP, would slow down, dampening overall growth.

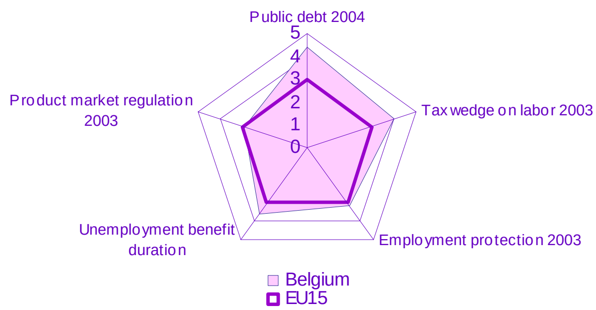


Belgium: Economic Developments in International Perspective

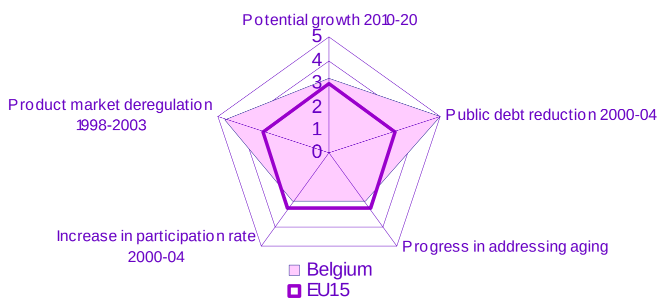
Economic Performance (EU15=3)
Larger is better



Policy Indicators (EU15=3)
Smaller is better



Policy Progress (EU15=3)
Larger is better



Note: The scale used in these charts has been normalized to facilitate comparison. Hence, its absolute value has no meaningful interpretation.

7. ***Even though the regular pension system has been reformed, the remaining incremental cost of aging could push public debt onto an unsustainable path.***[2] Assuming that employment rates can reach Lisbon targets, the authorities project aging to add 3.6 percentage points of GDP to budgetary outlays by 2030. With public debt still at 95 percent of GDP, deficits of such magnitude would become unfinanceable. Options for further reform of the pay-as-you-go component of the regular pension system are limited, as replacement rates are already among the lowest in the EU and further projected to decline since pensions are indexed to prices only. Thus the authorities' strategy to address the budget impact of aging relies on a further reduction in debt and use of the savings from the interest bill to cover most of the cost of aging.

8. ***Demographics will reduce trend growth.*** The dependency ratio is already rising, but the labor force is projected to increase as well for the next five years, thus supporting growth. Thereafter, under unchanged policies, demographics would lower annual potential growth by almost 1 percentage point. However, the employment rate could rise faster than its progression as the result of the demographic increase in female participation. Indeed, the overall employment rate (15–64 years) in Belgium was about 60 percent in 2003, almost 7 percentage points less than the (unweighted) average of its three key trading partners. High labor costs, a high tax wedge on labor, open-ended unemployment benefits, and ubiquitous early retirement schemes seem to be the underlying causes (Figure 5). Regional differences in unemployment rates point to skill mismatches and lack of mobility.

9. ***Challenged by globalization, the wage bargaining framework faces difficulties in preserving competitiveness.***[3] Designed to maintain competitiveness vis-à-vis a trade-weighted average of France, Germany, and the Netherlands, as enshrined in the 1996 competitiveness law, the framework has nonetheless allowed wages to outpace this average since 2001 (Text Table 2), while productivity growth has broadly kept pace. So far, the resulting erosion of competitiveness has been limited, as evidenced by continuing large trade and current account surpluses and the behavior of export market shares (Figure). For 2005–06, because of partial indexation to higher-than-expected inflation and lower-than-expected wage increases in Germany and the Netherlands, competitiveness is set to erode more substantially.[4] Conversely, globalization could positively affect productivity through

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[2] "Coping with Population Aging in Belgium, An Update," Chapter I in IMF Country Report 05/76.

[3] For a complete description of the wage-bargaining framework see "Employment Effects of Reductions in Labor Taxes in a Wage-Bargaining Model," IMF Country Report 05/76.

[4] Wages are indexed to the "health index," which equals the national consumer price index excluding prices of motor fuels, tobacco, and alcohol, but including heating fuels.

outsourcing, but not much margin appears to be left as Belgium appears to be already among the biggest outsourcers on some measures.[5]

Text Table 2. Belgium: Interprofessional Wage Agreements and Evolution of Labor Costs, 1999-2006

(Hourly labor costs in private sector, percent change)

	1999-2000	2001-02	2003-04	IPA 2005-06 Agreement	IPA 2005-06 Estimated
Wage agreements (Labor cost norm)	**5.9**	**6.4**	**5.4**	**4.5**	...
Underlying inflation assumption (health index)	3.1	3.0	2.9	3.3	...
Evolution of labor cost					
Three neighboring countries 1/	**5.4**	**6.7**	**4.5**	**3.2**	**3.5**
Belgium 2/	**5.3**	**7.4**	**4.6**	**4.5**	**5.2**
Due to:					
Conventional wage increase (wage norm)	4.4	7.2	4.3	3.6	5.1
Indexation	2.6	4.8	2.8	3.3	4.3
Real increase	1.7	2.1	1.3	0.3	0.7
Employers' social security contributions	-1.5	0.9	-0.1	-0.4	-0.1
Wage drift	2.4	-0.7	0.4	1.3	0.2

Sources: Belgian authorities; and IMF staff estimates.

1/ France, Germany, and the Netherlands; based on OECD data, June 2005.

2/ *Conseil central de l'économie: Rapport Technique du Secrétariat sur les Marges Maximales Disponibles pour l'Evolution du Coût Salarial*, November 2005.

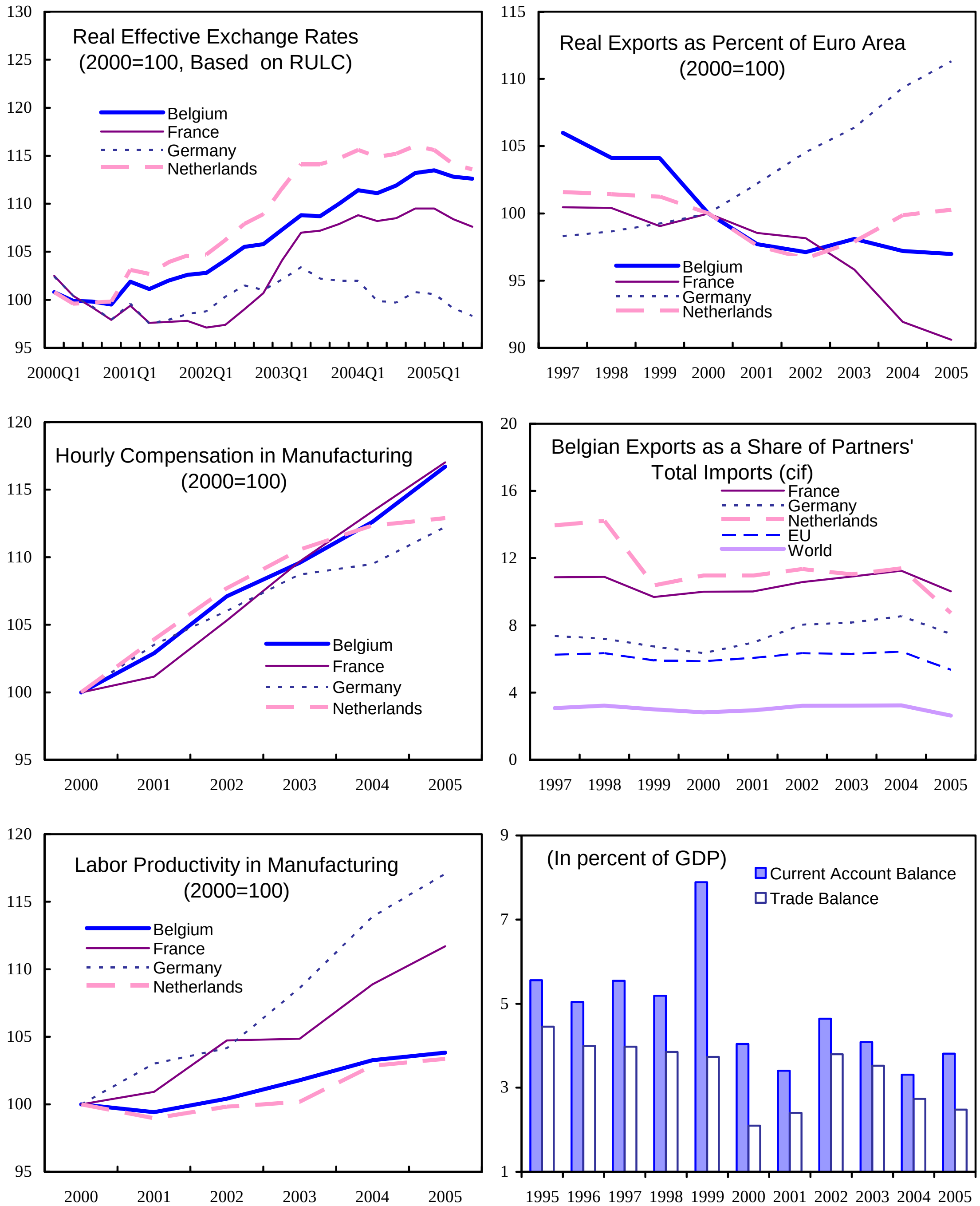
II. Policy Issues

10. ***Policy discussions focused on how to achieve the necessary fiscal consolidation, promote higher potential growth, and uphold the good track record of financial stability.*** There was broad agreement on the authorities' policy objectives and the direction of reforms, but the staff saw a need to broaden reforms, enhance their effectiveness, and ensure that reform measures do not jeopardize the required buildup of fiscal surpluses (Section A). The authorities concurred with the findings of the FSSA—which accompanies this report and is discussed separately in Section B below. They intend to implement most of its recommendations, in line with their receptivity to past Fund advice (Box 2).

11. ***The authorities' strategy is to deal with population aging through further up-front fiscal adjustment, a durable balancing of the social security accounts, and structural reforms to promote higher trend growth.*** This overall approach enjoys broad consensus, including among social partners, though views differ on the specifics required to achieve these goals. Given decentralized policy-making, regions and communities will need to contribute to overall consolidation and structural reforms, while agreements between labor unions and employers are necessary for efficient social security and labor market reforms. To help sustain reform efforts, the authorities favor a strengthening of cooperation on structural policy changes at the EU level.

[5] See Amiti and Wei "Fear of Outsourcing: Is it Justified?" IMF Working Paper 04/186.

Belgium: Competitiveness Indicators



SourceS: IMF; WEO, DOT; and IMF staff estimates.

Box 2. Effectiveness of the Policy Dialogue

The authorities and staff generally agree on economic policy objectives and directions. The authorities see the scope and speed of reform constrained by the long-standing tradition of building consensus among social partners and the country's federal structure and the sensitive interregional relations. They also attach high value to social peace and the preservation of confidence. Consequently, implementation of Fund recommendations has been slow-paced and remains incomplete.

Fiscal policy

Fund recommendations: reduce primary spending growth durably in order to achieve the authorities' twin objectives of further fiscal consolidation and a reduction of the tax burden; adopt a multi-year expenditure-based framework to lock in structural fiscal adjustment and achieve budgetary surpluses to prepare for population aging.

Policy developments: fiscal consolidation has been impressive with the budget in balance since 2000 and public debt steadily falling as a share of GDP. The primary surplus declined recently as interest savings were used for tax cuts and spending increases. The authorities continue to focus on achieving annual nominal balance targets.

Labor and product market reforms

Fund recommendations: reform labor market institutions to boost low labor utilization; specifically, phase out early retirement arrangements, modify the wage-bargaining framework to ensure that cuts in social security contributions lead to lower labor costs, curb the duration of unemployment benefits, and enforce job search requirements; in product markets, continue deregulation and liberalization.

Policy developments: labor market reforms have relied mostly on active labor market programs, including cuts in the labor tax wedge, but recently, employment services have been strengthened and a *Generation Pact* adopted with specific measures to raise employment of the young and old. Product market reforms are complying with timelines set by the EU, while the administrative and regulatory burden on enterprises is being reduced considerably and the competition authority strengthened.

Financial sector

Fund recommendations: Continue to adapt supervisory arrangements to changing market developments, enhance macro-prudential supervision and cooperation between the central bank and supervisors, upgrade insurance supervision, and strengthen pension supervision earnestly.

Policy developments: banking and insurance supervisors have been merged, the central bank has begun publishing financial stability reviews, and a Financial Stability Committee has been set up including representatives from supervisors. An FSAP is being completed with this consultation.

12. ***In the staff's view, the authorities' policies, while guided by a coherent set of medium-term objectives, are not sufficient to jointly achieve the envisaged fiscal consolidation and increase in trend growth.*** Fiscal consolidation necessitates public expenditure restraint and would benefit from higher growth, while higher growth, especially in the context of heightened global competitive pressure, requires more flexible labor markets, including a lower labor tax wedge, and more competitive product markets. The authorities' actions focus foremost on cuts in taxes and social security contributions and other budgetary measures to promote job creation and growth, supported by some structural reforms, though without tackling key labor market rigidities. As an alternative, the staff proposes to reduce these rigidities more directly. Simulations with the Fund's Global Economic Model indicate that comprehensive labor market reforms, which do not rely on up-front tax cuts, could raise GDP by about 6 percent in the long run.[6] Further reforms in product and services markets combined could yield a similar increase. In such a scenario, the tax wedge on labor can fall appreciably without requiring additional expenditure restraint and without jeopardizing fiscal sustainability.

A. Achieving Sustainable Public Finances and Higher Growth

Fiscal consolidation

13. ***The authorities' objective is to shift the budget gradually into surplus.*** For 2006, the budget is targeted to be again in balance (Figure 6 and Tables 3 and 4). The authorities feel very strongly that achieving announced nominal targets has been essential to establish and maintain the credibility of their fiscal strategy, even if recourse to one-off measures has been necessary to cope with cyclical effects. They observe that recourse to such measures has been declining since 2003, implying an improvement in the underlying position. For 2007, a small surplus (0.3 percent of GDP) is envisaged. Thereafter, the surplus would be built up gradually by 0.2 percent of GDP per year until it reaches 1.5 percent of GDP. This surplus is expected to be maintained through around 2020, after which it will be allowed to decline to fund the incremental costs of aging. Technically, this assures fiscal sustainability (i.e., a stable debt-to-GDP ratio in 2030 at about 25 percent), provided the employment rate rises by several percentage points as envisaged under the Lisbon strategy.

14. ***The staff noted that medium-term fiscal surplus objectives had been allowed to slip from earlier ambitions.*** Up to 2003, stability program updates aimed for a surplus of ½ percent of GDP by 2005, and a further buildup of about 0.3 percentage point of GDP per year thereafter. Based on a comprehensive analysis of the aging problem, the High Finance Council (HFC) had set a budget surplus target of 1.5 percent of GDP by 2011, which the staff found appropriate. The current stability program update envisages a slower buildup of the

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[6] See Chapter II of the Selected Issues Paper: "Macroeconomic Impact of Labor and Product Market Reforms."

surplus, while subsequent preliminary estimates of the EU's aging working group show a slight increase in Belgium's cost of aging. The HFC, which experienced a lapse in its functioning last year, was unable to publish its 2005 medium-term assessment of public finances and compliance with the internal stability pact, even though its technical work continued.

15. ***Divergent revenue performance and spending pressures among the different entities of government pose a potential obstacle to overall fiscal consolidation.*** Decentralization was designed to leave the central government in charge of public debt and social security and of executing the strategy of funding the rising costs of aging from the declining interest bill. Subsequent policies have eroded the revenue base and increased spending pressures for the central government and done the opposite for the regions, at least ex ante. Thus, in 2005, to reach overall budget objectives, the central government had to obtain a commitment from the regions to temporarily save some of their revenues. In addition, while budgets of the autonomous regions and communities are jointly expected to be in balance in the medium term, there are underlying divergences between regions. The region with systematic surpluses may not continue to run surpluses as it has no compelling reason to do so.

16. ***The authorities are taking steps to set the social security system on a sound financial footing.*** With pensions and social assistance indexed only to prices, there is a concern that some groups of society will fall into poverty traps. Hence, consistent with the assumptions underlying the long-term aging projections, the budget provides 0.06 percent of GDP per year for real increases in such benefits. The contribution base to fund social security is being broadened beyond labor and will include some indirect taxes and 15 percent of the taxation of savings income.

17. ***At the same time, health care spending growth is expected to be curbed.*** Expenditure on health care is being allowed to increase by 4.5 percent per year in real terms through 2007 in order to catch up with modern technology and changing needs. Thereafter, the authorities plan to reduce it to 3.1 percent per year, in line with long-term aging projections. Structural measures are being taken, including benchmarking to best practices, increasing copayments, and promotion of the use of a referring doctor. If approved health spending growth exceeds the increase in revenue from social security contributions, other sources of revenue will be tapped to avoid increases in the labor tax wedge.

18. ***While budget objectives and tax reduction programs have been set in a medium-term context, the staff noted that overall fiscal policy implementation lacked such an orientation:***

- The pursuit of nominal annual budget targets has led to continuing reliance on one-off measures, which is even being slightly stepped up in the 2006 budget. Consequently, while at the current cyclical juncture a balanced budget would imply an appreciable structural surplus, it does not do so once adjusted for one-off measures. More importantly, most of these one-offs (e.g., the takeover of pension fund assets of public enterprises, sale and lease-back arrangements for real estate, tax securitization operations, and compression of public investment) imply future outlays and do not constitute gains in net present value terms.

- Medium-term programs to reduce taxes and social security contributions are not being matched with similar medium-term plans to curb expenditure or raise revenues. The absence of such a framework masks, for example, that achieving surplus targets beyond 2006 without one-off measures would require discretionary spending to fall by ¾ percent per year in real terms (Table 4). In addition, cuts in social security contributions have been used to help reach wage agreements among social partners. Consequently, (i) tax reductions have absorbed a considerable amount of interest savings, thus eroding the primary surplus; and (ii) ad hoc increases in taxes have been increasing uncertainty about the tax system.

19. ***To compensate for ongoing tax reduction, balancing the budget in 2006 requires tight spending restraint and additional new tax measures.*** Broad-based spending restraint and slower public investment are expected to limit spending growth at the federal level (excluding pensions) to 0.3 percent in real terms. However, the final stage of the 2001 income tax reform and ongoing reductions in social security contributions will lower revenues by about 0.8 percentage point of GDP. Hence, tax increases yielding 0.5 percentage point of GDP are being implemented. About half of this will come from taxes levied on certain types of life insurance policies and mutual funds invested in government securities, hitherto exempt. A securitization of VAT tax arrears and an income tax regularization will provide the other half.[7] Concurrently, the tax administration and sanctions for tax evasion are being strengthened. Any windfall revenues from higher-than-projected growth will be saved.

20. ***Achieving a balanced budget in 2006 is not yet in hand.*** While the staff is confident that further measures will be taken as needed to reach budget balance in 2006, its projections indicate that under current policies, a deficit of 0.4 percent of GDP remains to be filled (Text Table 3). Very tight spending guidelines remain to be backed by specific actions. If these measures are not structural, the underlying balance will deteriorate by more than ½ of one percentage point of GDP in 2006.

[7] Outstanding VAT arrears will be sold as a bond, in a similar manner as happened in 2005 with income tax arrears.

Text Table 3. Belgium: Budget Indicators, 1999-2006

(In percent of GDP)

	Actual						Projections	
	1999	2000	2001	2002	2003	2004	2005	2006
Headline balance	-0.5	0.1	0.6	0.0	0.1	0.0	0.0	-0.4
Effect of the cycle (-)	0.5	1.6	1.1	0.4	-0.4	-0.2	-0.6	-0.5
Nonstructural measures (-) 1/	-0.1	-0.2	0.4	0.2	1.2	0.8	0.4	0.5
Of which: Belgacom					*1.8*			
Of which: Tax amnesty						*0.1*		*0.1*
Adjusted structural balance	-0.9	-1.3	-0.8	-0.7	-0.8	-0.5	0.2	-0.4
Interest payments (+)	6.8	6.6	6.5	5.8	5.3	4.8	4.4	4.1
Adjusted structural primary balance	6.0	5.3	5.6	5.1	4.6	4.2	4.6	3.8
Memorandum items:								
Real primary expenditure growth	3.9	2.0	1.3	5.0	4.9	0.1	3.1	2.1
Public debt	113.6	107.7	106.3	103.2	98.5	94.7	94.0	90.4

Sources: National Bank of Belgium; and IMF staff calculations.

1/ Nonstructural measures pertain to the sale of land and property, the receipts from the UMTS auctions (2001), the takeover of the Belgacom pension fund (2003), the tax amnesty (2004), the securitization of tax arrears (2005-06) (see ¶19), timing shifts in the tax collection and the payments to the railways, and various smaller items.

Jobs and economic growth

21. ***Social partners and the authorities have agreed on a "Generation Pact" to boost employment of the young, low-skilled, and older workers.*** The *Pact*, whose implementation starts in 2006, includes: (i) additional cuts in employers' social security contributions targeted at young and older workers and shift and night work for up to about 0.4 percentage point of GDP; (ii) reform of early retirement regimes, inter alia by raising the eligibility age from 58 to 60 years and the minimum career length to 35 years; (iii) tightening job search requirements for older workers; (iv) strengthening training; and (v) a better accompaniment of laid-off workers, including bonuses for a rapid return to work. People working beyond age 60 will see their pensions topped up. The public sector will help lower youth unemployment by allowing more of its vacancies to be filled with first-time jobs.

22. ***Taxes on labor are being reduced, and awareness is being built that wage moderation will be essential to preserve competitiveness.*** During 2002–10, the tax burden on labor is expected to be lowered by the equivalent of nearly 3 percentage points of GDP. With limited budgetary room, revenue is being raised from other sources. To ensure an effective decline in labor costs and import the wage moderation ongoing in trading partners, further tax cuts are to be made contingent on equivalent wage moderation. The staff and authorities agreed that the current level of competitiveness was adequate but should not be allowed to deteriorate. Social partners have been asked to discuss ways to claw back some of the expected competitiveness losses as a result of the implementation of the 2005–06 wage agreement. Labor unions agree with the need for structural reforms to boost competitiveness

but anticipate difficulties in convincing their membership to moderate wage demands so soon after reforms of the early retirement regime, unless additional job creation can be guaranteed.

23. ***The staff emphasized that the ongoing cuts in taxes and social security contributions and the implementation of the Generation Pact will raise employment but not enough to pay for themselves.*** Simulations by the Federal Planning Bureau and the National Bank (NBB) show that cuts in employers' social security contributions (SSC) lower labor costs and generate employment, and that targeted cuts are more effective. Nonetheless, to increase employment rates substantially, e.g., by 5 percentage points, such cuts would need to be large, leading to an annual fiscal cost of about 1.5 percent of GDP in the current wage-bargaining framework, if targeted (Text Table 4). Even if gross wages could be kept unchanged, the steady state budgetary cost would still be at least 1 percent of GDP. SSC cuts implemented so far, mostly on the employer side, and those envisaged in the *Generation Pact* total about 2 percent of GDP and can be expected to raise employment by 1½ percentage points in steady state. Personal income tax cuts will reach 1 percent of GDP with the last stage of the reform in 2006, without significant effects on employment. Alternatives within the budget, such as financing SSC cuts from other revenue sources or through spending restraint have limitations. With targeted cuts to raise the employment rate by 5 percentage points, the latter would imply a real decrease of discretionary spending (outlays excluding social security spending) by 2½ percent per year over 2007–10.

Text Table 4. Belgium: Fiscal Cost of Cutting Social Security Contributions to Raise the Employment Rate by 5 Percent

(Deviation from baseline in the long run; in percent of GDP)

	SSC Cuts	Public Balance
Federal Planning Bureau, unchanged gross wages		
Employers' contributions	4.5	-2.9
Targeted employers' contributions	1.8	-1.4
Employees' contributions 1/	ineffective	
Federal Planning Bureau, wage bargaining		
Employers' contributions	6.8	-3.8
Targeted employers' contributions	3.2	-1.5
Employees' contributions 1/	ineffective	
National Bank of Belgium, unchanged gross wages		
Employers' contributions	2.5	-1.0

Sources: Federal Planning Bureau, National Bank of Belgium; and IMF staff calculations.

1/ Employees' contributions would have to be cut by much more than their current yield.

24. ***The current wage-setting framework impedes the beneficial effects of reform on job creation and the ability of the economy to respond to pressures from outsourcing.*** As the unemployed and persons outside the labor force have little voice in discussions between social partners, cuts in the tax wedge on labor are mostly being used for higher take-home pay.[8] With wage increases in trading partners expected to remain low owing to competitive pressures and structural reforms and indexation placing a floor under domestic wage increases, the wage-bargaining framework does not allow a swift correction of erosion in

[8] This is inherent in the framework, which computes the ex ante room for wage increases after taking into account changes in employers' social security contributions as discussed in "Employment Effects of Reductions in Labor Taxes in a Wage Bargaining Model," IMF Country Report 05/76.

competitiveness. In addition, tying wage increases to those of key trading partners that have lower labor costs and significantly higher employment rates on average is not conducive to catching up with the latter.

25. ***The business environment is being made more attractive.*** To promote investment, a notional interest rate deduction has been introduced for equity capital, equalizing its fiscal treatment with that of debt financing. Administrative simplification has yielded considerable results: the authorities estimate that the associated costs of doing business in Belgium have declined from 3.4 percent of GDP in 2002 to 2.6 percent of GDP in 2004. The backlog of adopting EU directives has been eliminated, and liberalization of network industries, in particular electricity and postal services, is continuing. The competition authority has been strengthened, while public spending is being reallocated to foster a knowledge-based society and encourage research and development. On overall product market regulation, Belgium is ahead of its neighbors (Figure 5) and at the EU average following recent progress (¶6). As noted by the OECD, a further reduction in state control and barriers to entrepreneurship would be desirable.

Discussion

26. ***The authorities and social partners acknowledged the need for further reform while preserving the main features of Belgium's social model.*** They emphasized that the *Generation Pact* constituted a milestone, with its focus on the need to work longer, improve job search assistance, and tighten enforcement of job search requirements to address the consequences of aging. They felt that the existing wage-bargaining model could be refocused on job creation by explicitly taking into account developments in the employment rate in setting the room for wage increases. More widespread use of "all-in" agreements, which set nominal wage growth regardless of subsequent inflation, would be considered, but not before the 2007–08 wage round. On fiscal issues, the authorities emphasized that they would take further measures to balance the 2006 budget. To reach surplus targets in 2007 and beyond, they believed that sufficient spending restraint could be achieved and saw further scope to broaden nonlabor taxation. They agreed that the HFC should continue to play its key role as independent assessor of public finance developments.

B. Financial Sector Issues and Financial System Stability Assessment

27. ***Building on the economic recovery in 2004 and the low-risk environment, the performance of the financial sector has been improving.*** Overall vulnerability declined as financial soundness indicators and bank profitability picked up (Figure 7 and Tables 5 and 6). The increase in bank profits stemmed mainly from rising noninterest income and lower provisioning, while interest income was squeezed by stiffer competition for savings deposits and mortgage loans. With deleveraging by enterprises, mortgage lending and expansion abroad became the key drivers of bank activity, though recently, domestic corporate borrowing has perked up. Banks reported that their preparation for Basel II was on track. Both nonlife and life insurance posted higher profits, the former because of premium growth and the latter largely due to a rise in investment income (Table 7). However, in the current

low interest rate environment, relatively high guaranteed rate of return contracts continue to curb the life sector's profitability.

28. ***With increasing cross-border activity and complexity of bank-insurance conglomerates, the institutional structure governing supervision has been modified.*** In early 2004, the banking and insurance supervisors were merged into a single institution (CBFA). The NBB has stepped up macroprudential supervision and regularly publishes Financial Stability Reviews. A Financial Stability Committee has been established consisting of the combined boards of the CBFA and the NBB to ensure seamless coordination and focus on issues of systemic importance. To further combat money laundering, bearer instruments are being phased out, thus bringing Belgium's AML/CFT framework in line with international guidelines.

29. ***The FSAP found the financial system generally sound but facing pressures to find new sources of income growth.*** There has never been a systemic financial crisis in Belgium, and stress tests conducted in the context of the FSAP confirm the system's resilience. Its stability is anchored in some Belgium-specific features. The system benefits from a steady source of funding in the form of savings deposits, partly supported by tax incentives and to a large extent invested in government securities. Banks hold little equity and continue to be cautious toward risks, while banking supervision is of very high quality. Going forward, rising interest rates may slow mortgage lending activity while the increase in lending to enterprises is likely to continue, leading to a rebound of provisioning from current, historically low levels.

30. ***The authorities were in broad agreement with the FSAP recommendations.*** They have already begun upgrading the supervision of insurance and pension funds and are working on enhancing oversight and supervision of the globally important payment and securities settlement system located in Belgium, while strengthening coordination between the NBB and CBFA in this area. In the life insurance sector, the authorities recognize the risk of guaranteeing returns for the duration of the contract and the need for more adjustable rates of return. The politically sensitive link between the minimum guaranteed interest rate on funded pensions and the maximum rate on life insurance products hampers progress in this area. The authorities are also adjusting the internal structure of the CBFA to enhance its effectiveness in supervising the bank-insurance conglomerates.

III. Staff Appraisal

31. ***The economy has been performing reasonably well, and economic policies are guided by a coherent set of medium-term objectives to deal with population aging, but policies need to be strengthened to achieve these goals.*** Recognizing that higher trend growth will be necessary, measures to boost employment rates have been reinforced, while economic deregulation and administrative simplification are continuing to improve economic efficiency. To jointly achieve the envisaged budget surpluses and higher labor utilization, medium-term spending restraint will be required, and labor market reforms should directly address rigidities, while relying less on budgetary resources to promote job creation. An in-

depth analysis of the financial system found the sector sound and stable, with a need to bring supervision of insurance and pension sectors at par with the high quality achieved for banking supervision.

32. ***Recent economic performance and the near-term outlook are favorable, though they will continue to depend on external demand and domestic wage developments.*** The medium-term orientation of policies has supported household and business confidence. With demand in trading partners recovering, achieving growth of somewhat more than 2 percent in 2006 appears realistic. The prevailing level of competitiveness seems adequate, but domestic wage increases are set to exceed those of key trading partners, posing a downside risk to exports and investment in the medium term. Rising interest rates would dampen housing price growth, but the impact on the economy will be gradual and limited as housing wealth does not directly affect consumption.

33. ***The emphasis of fiscal policy on reducing public debt and supporting growth needs to be complemented with medium-term spending restraint.*** The authorities' track record of meeting announced budget targets is commendable, though reliance on one-off measures should be replaced with specific plans to curb expenditure, as is being done in the case of health care. This will be essential in 2006 to avoid a deterioration in the structural fiscal balance. To help achieve surpluses beyond 2006 as intended, budget management should be complemented by a medium-term spending framework, or at a minimum shift to primary balance targets to ensure that the declining interest bill contributes to consolidation. The intention to save revenue windfalls is welcome. The planned decline in the tax wedge on labor and on equity financing will help create jobs and foster investment. However, a more comprehensive approach to tax reform should be instated to provide stability, and recourse to securitization of tax arrears and tax amnesties should be abandoned.

34. ***Fiscal institutions will need strengthening to ensure that medium-term fiscal consolidation objectives are adhered to*. While the balanced budget objective for 2006 is appropriate and within reach with few additional measures, the path toward fiscal surpluses should be brought in line with the recommendations of the HFC, and adjusted as estimates of aging costs are updated. It will be essential for the HFC to resume its traditional role in providing recommendations on the fiscal outlook and assessing developments in public finance and adherence to the internal stability pact, which should be continued to ensure that policies at various levels of government are consistent with overall consolidation objectives.

35. ***Further structural reforms are necessary to improve labor utilization and foster higher trend growth*. With employment rates low by international comparison, the focus should be on reforming labor market institutions. In this context, the *Generation Pact* is a welcome step as its increased emphasis on job search assistance and requirements together with targeted cuts in social security contributions will boost job creation, especially for the young and low-skilled. To support its effectiveness, the duration of unemployment benefits should be limited in time. The *Generation Pact*'s measures regarding early retirement regimes and employability of older workers will need to be taken further to meaningfully boost employment of older workers. The wage-bargaining framework needs to be geared

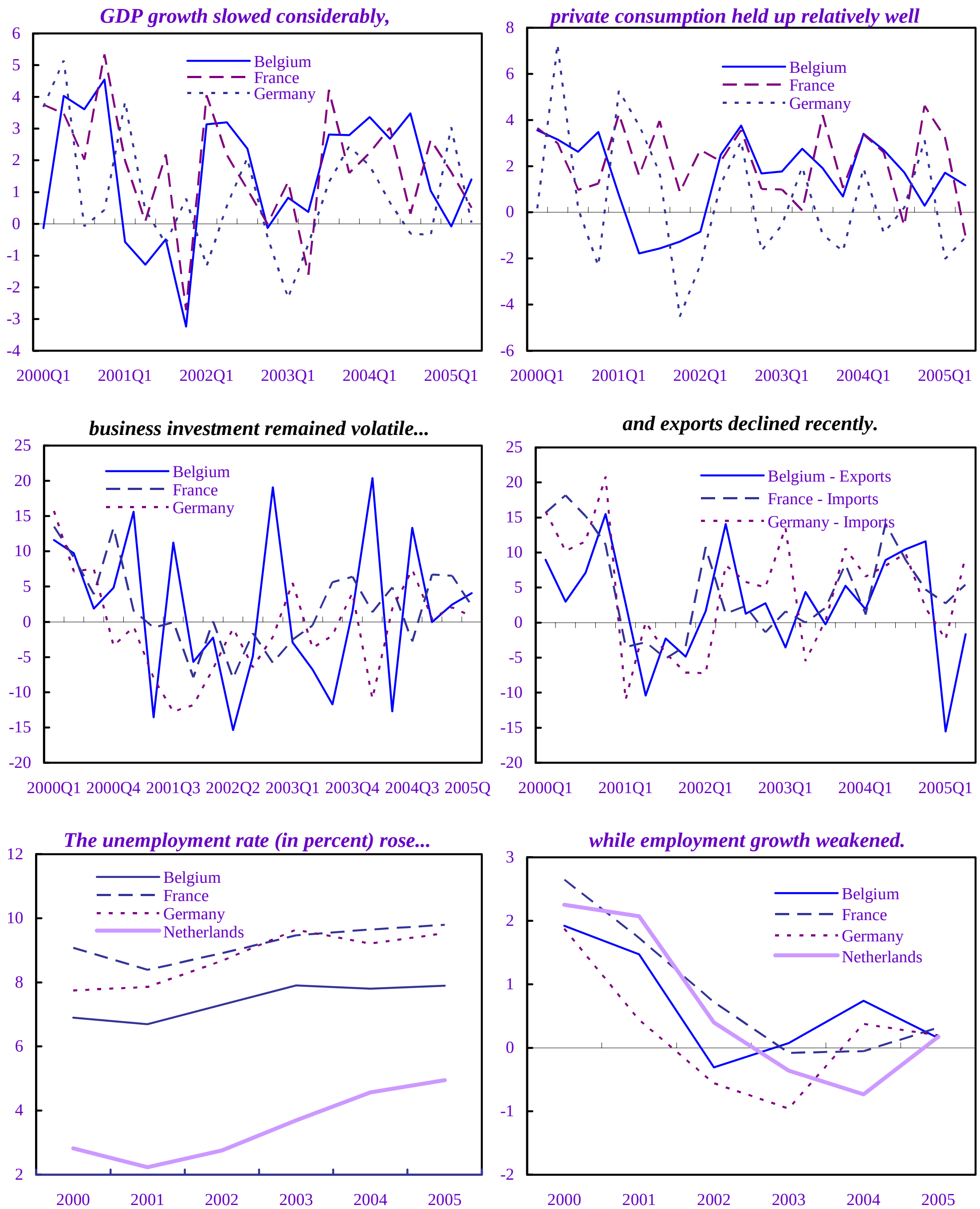
more toward job creation, by explicitly taking into account progress in raising the employment rate in setting wage increases. Social partners should agree on wage moderation to prevent an erosion of competitiveness, reductions in taxes and social security contributions should not be used to boost take home pay, and indexation should be abandoned. Commendable progress in reducing the administrative and regulatory burden needs to continue and be extended to economic deregulation and product market liberalization.

36. ***A thorough assessment of the financial sector under the Fund's FSAP program found the sector to be stable and resilient and recommends further strengthening of supervision:*** (i) the upgrading of banking supervision needs to continue to meet the challenges posed by the move to Basel II and keep pace with the increasing complexity of financial groups and regulations against the backdrop of European integration; (ii) insurance and pension supervision should be strengthened, and developments in the insurance sector need to be monitored closely in the context of a low interest rate environment; (iii) an effective mechanism needs to be established to deal with the consolidated supervision of the bank-insurance conglomerates; (iv) adequate capacity should be devoted to the oversight and prudential supervision of the payments and securities settlement systems while ensuring seamless coordination among the entities involved; and (v) progress in shaping the Banking, Finance, and Insurance Commission supported by the NBB's macroprudential analysis should continue to preserve the record of financial stability.

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

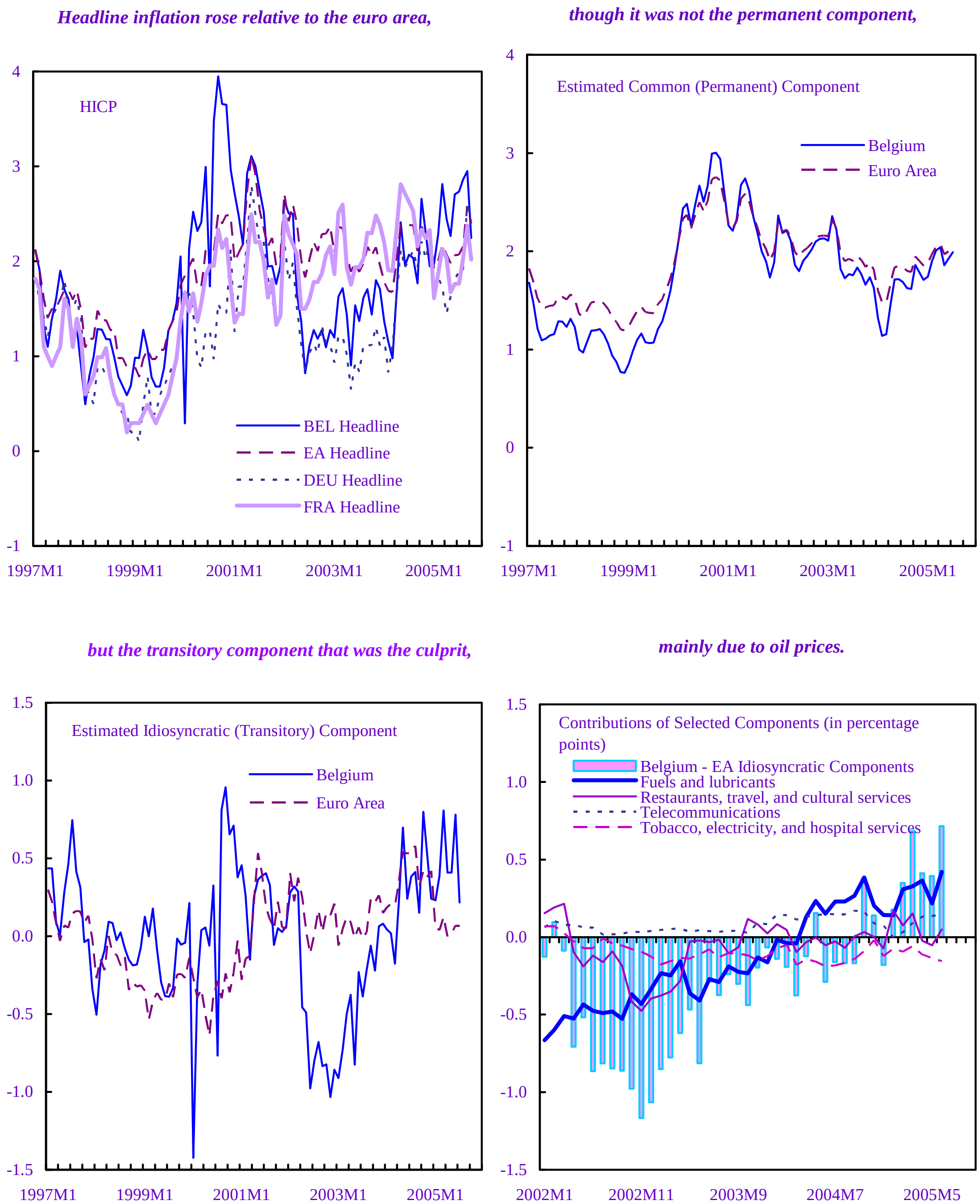
Figure 1. Belgium: Economic Developments

(Annualized quarterly growth rates; unless otherwise indicated)



Sources: AMECO; BelgoStat; Eurostat; OECD Economic Outlook; and IMF, WEO.

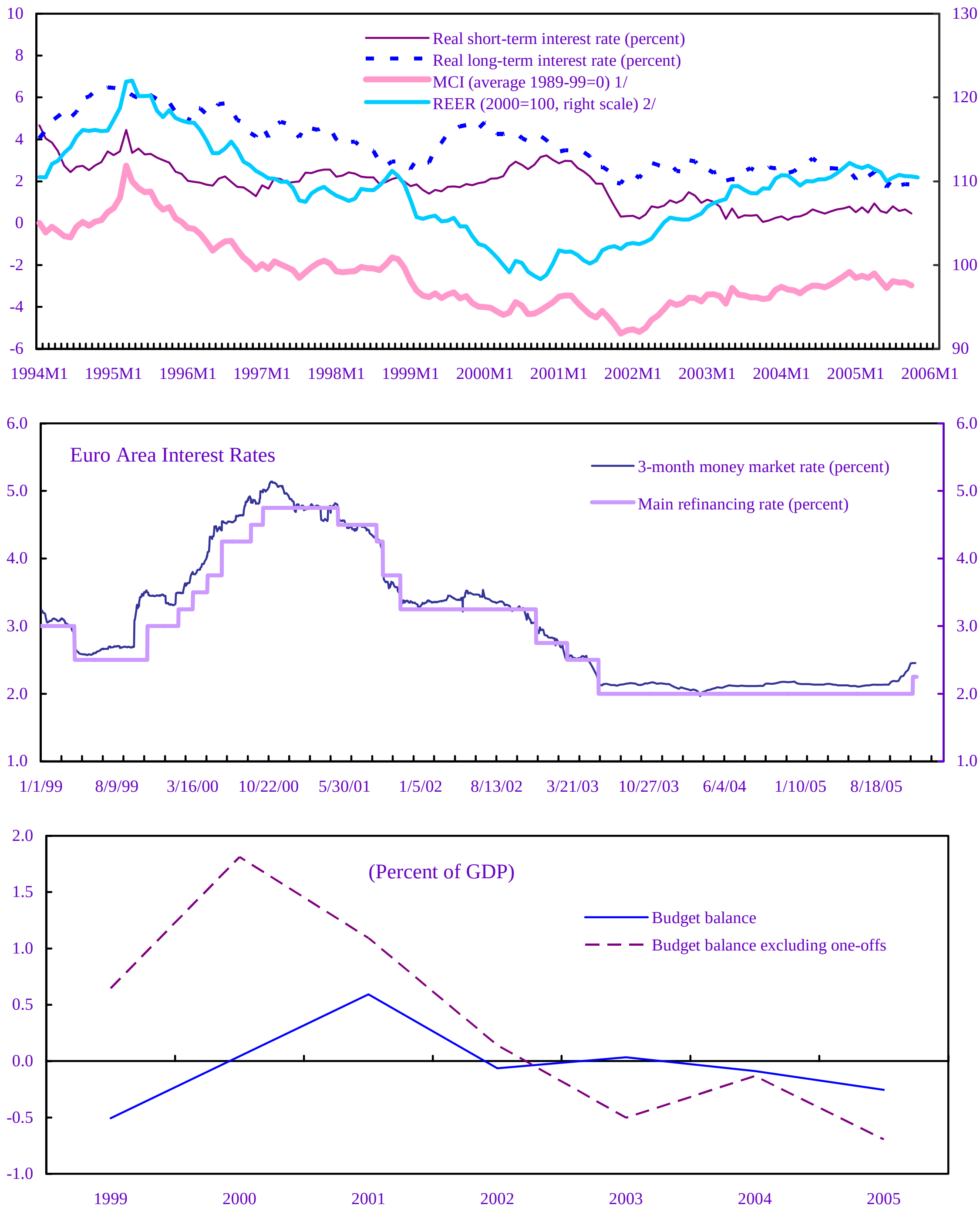
Figure 2. Belgium: Inflation Analysis 1/
(Percent change over same period of previous year)



Sources: Cronos database; and IMF staff calculations.

1/ Permanent (common) and transitory (idiosyncratic) components extracted with a Generalized Dynamic Factor Model applied to 4-digit categories of the HICP.

Figure 3. Belgium: Monetary and Fiscal Policy Conditions

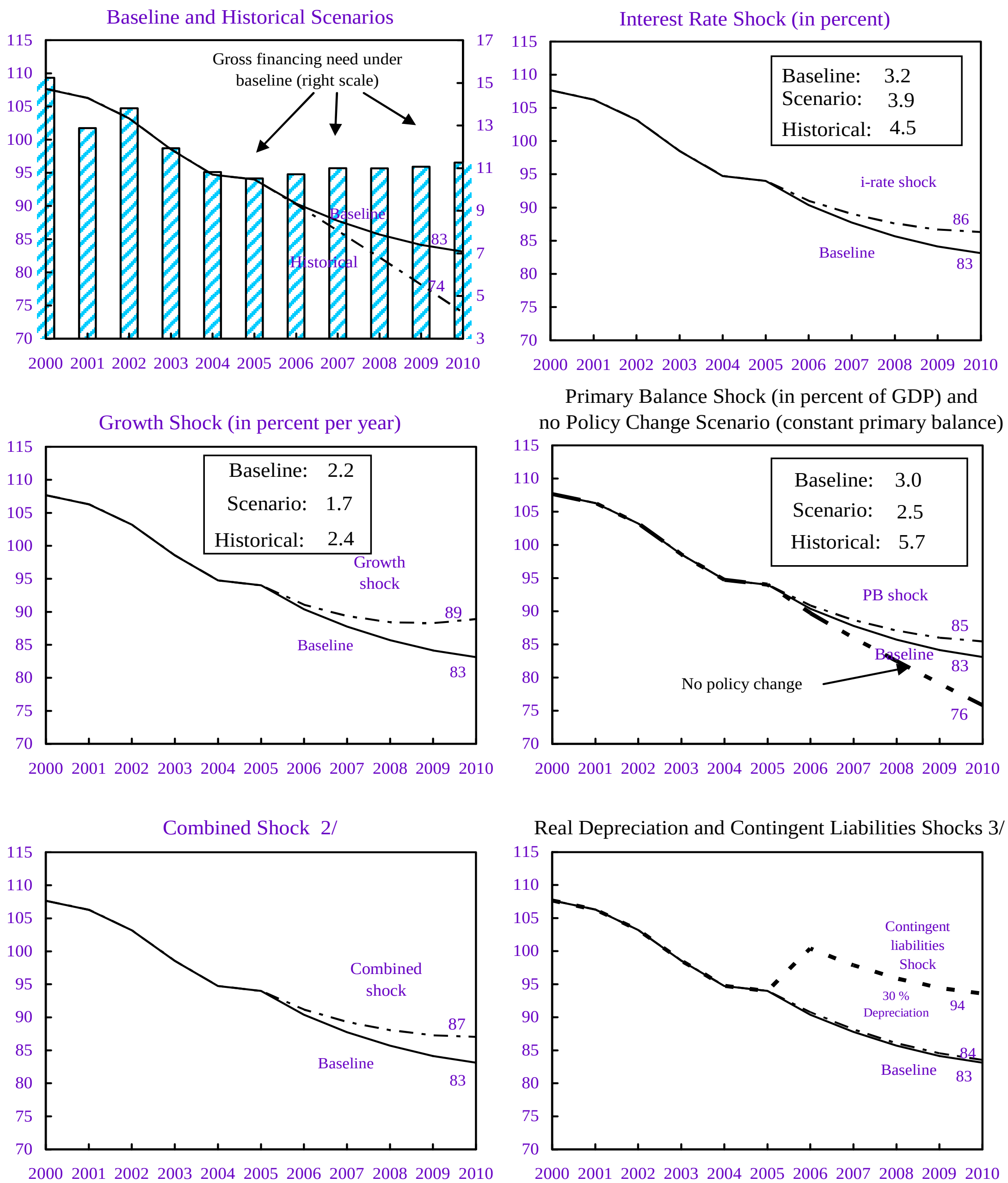


Sources: IMF, IFS; and European Central Bank.

1/ The monetary conditions index (MCI) is a weighted average of the real effective exchange rate (weight=0.3) and the short-term real interest rate (weight=0.7).

2/ Real effective exchange rate index based on normalized unit labor costs.

Figure 4. Belgium: Public Debt Sustainability Bound Tests 1/
(Public debt in percent of GDP)



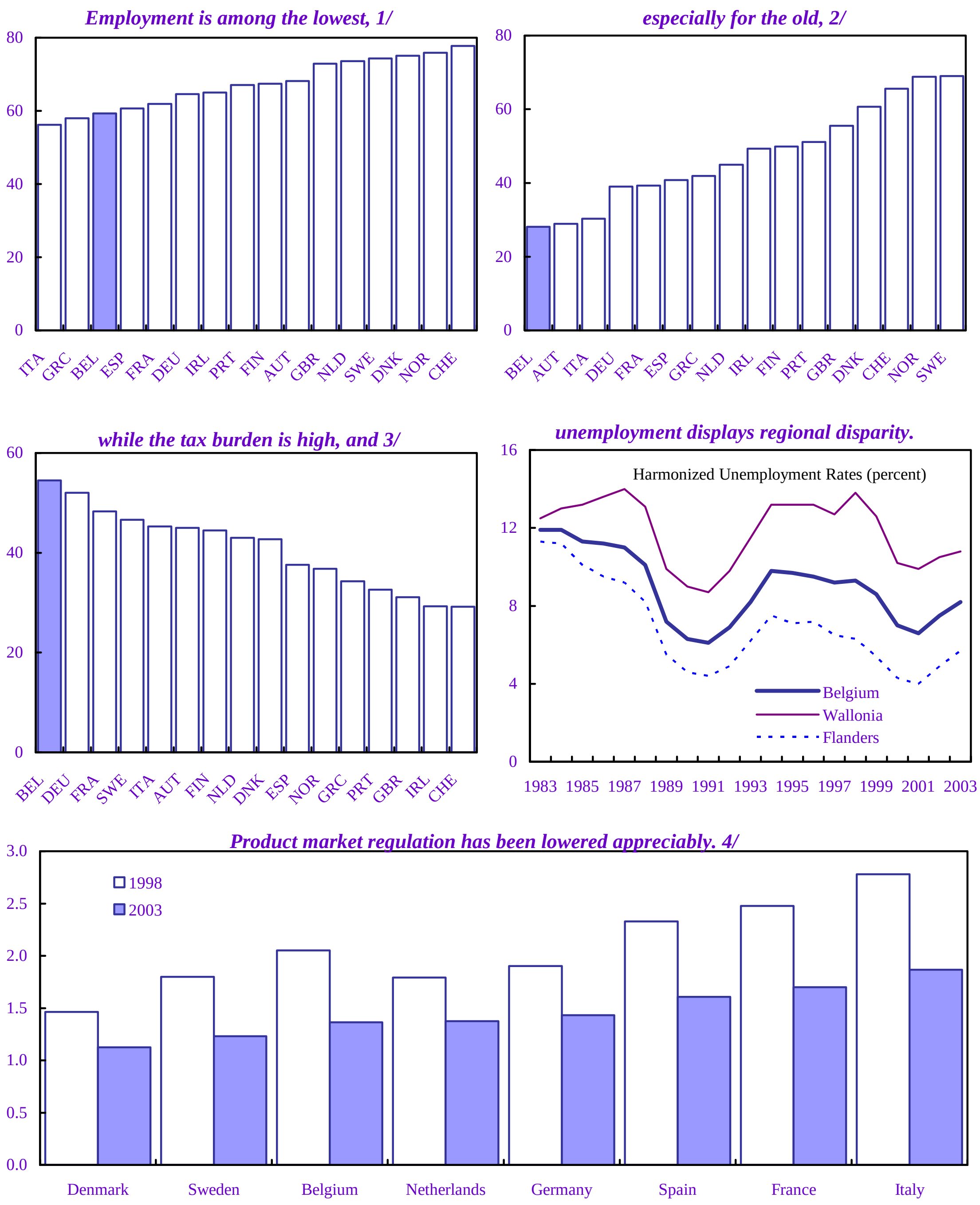
Sources: IMF, country desk data; and IMF staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2006, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

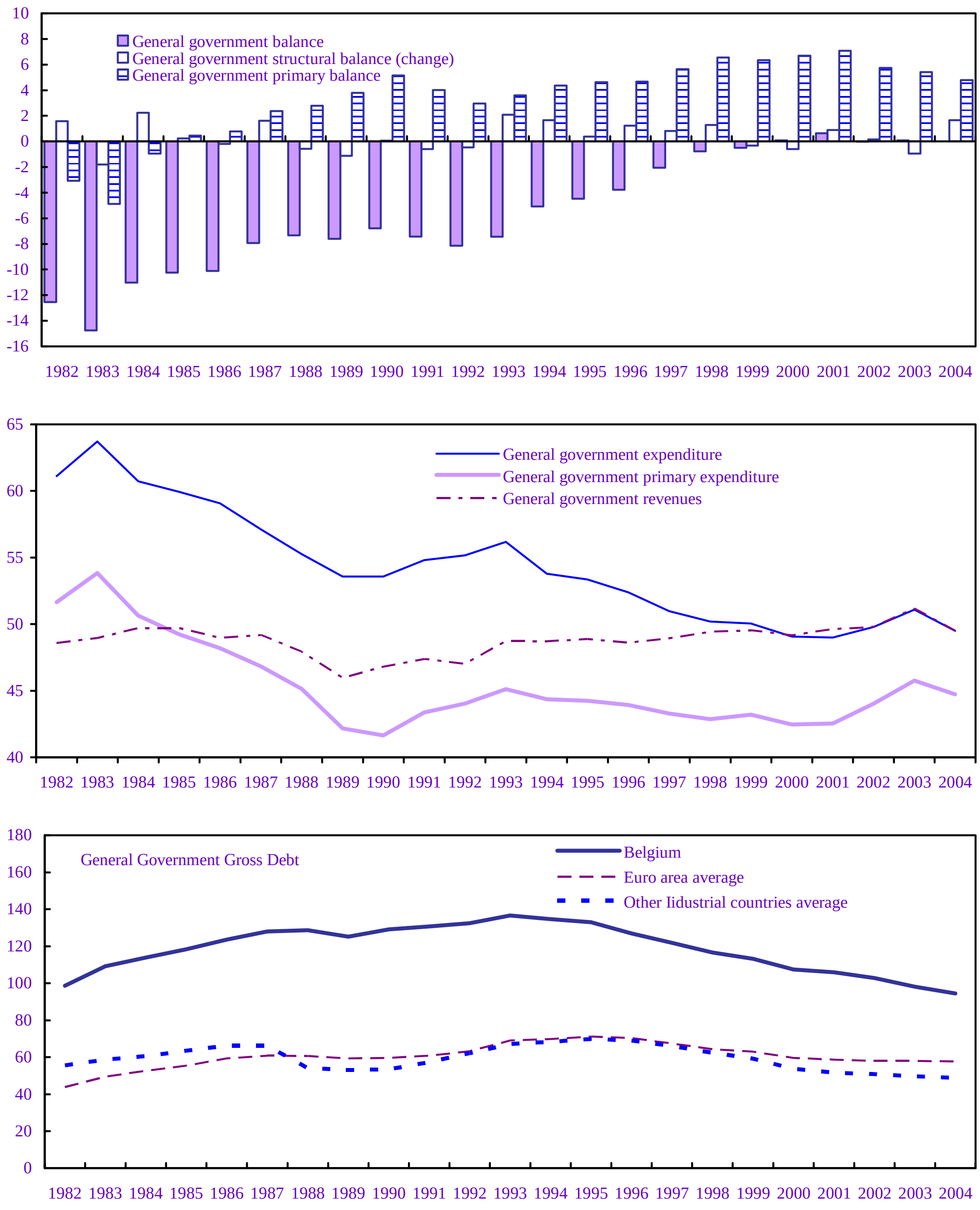
Figure 5. Belgium: Labor and Product Market Indicators



Sources: OECD; Cronos database, and IMF staff estimates.

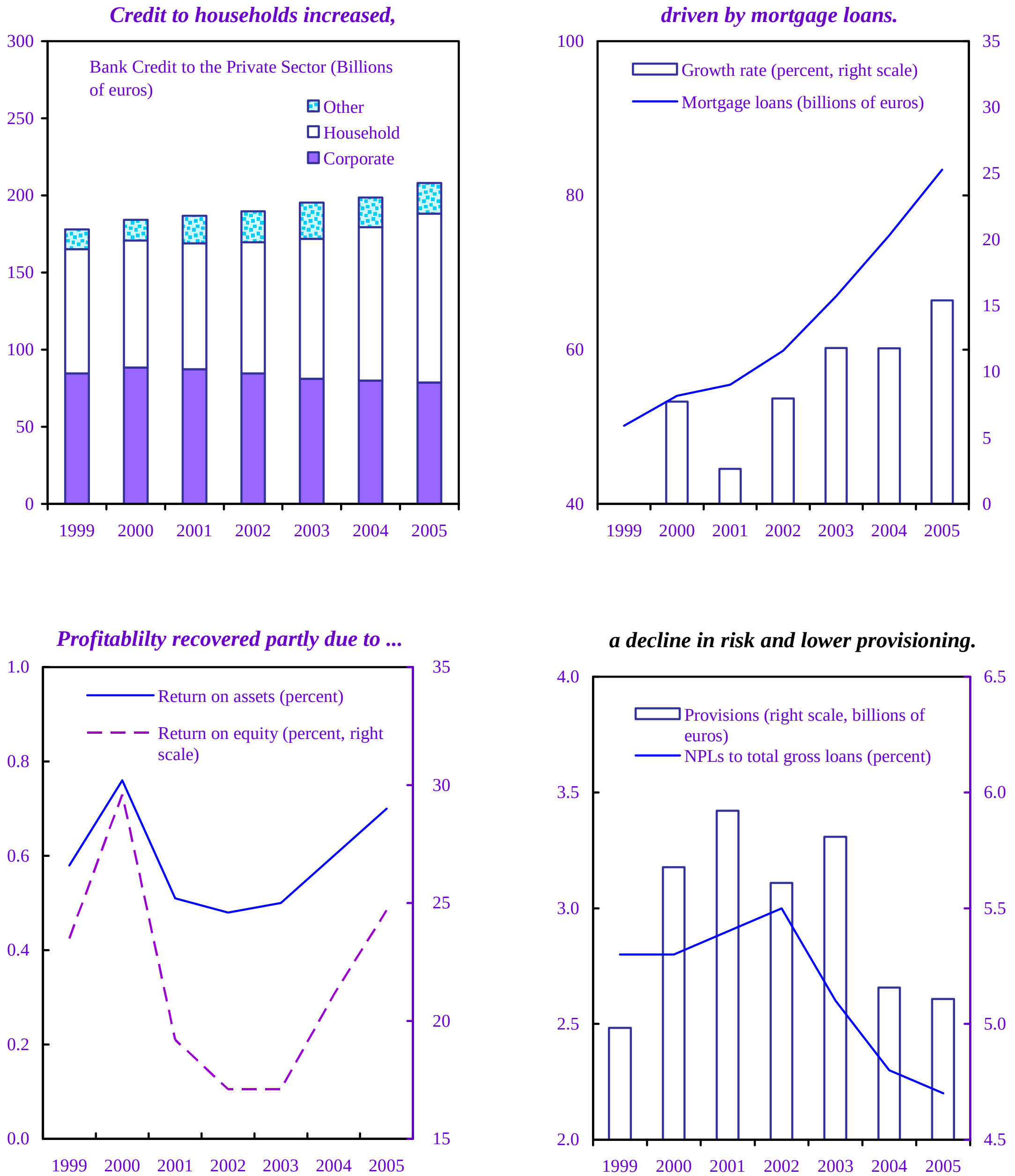
1/ In percent of population aged 15-64 years.
2/ In percent of population aged 55-64 years.
3/ Income tax plus employee and employer contributions as percent of labor costs (single persons without children).
4/ OECD index of overall product market regulation.

Figure 6. Belgium: Fiscal Developments
(In percent of GDP)



Source: IMF, WEO.

Figure 7. Belgium: Financial Sector Indicators 1/



Source: Data provided by the authorities.

1/ 2005 based on September data; 2005 growth rates based on September 2004 over September 2005 growth.

Table 1. Belgium: Basic Data, 2000-06

Demographic and other data:

Population (2004)	10.4 million
GDP per capita (2003)	$33,866
Social indicators (2003)	
Life expectancy at birth	
Male	75.1
Female	81.1
Infant mortality rate	5 per 1,000 live births
Population per physician (1995)	437
Population per sq. km. (1995)	335

	1990		2004	
	Billions of Euros	Percent of GDP	Billions of Euros	Percent of GDP
Private consumption	90.5	55.4	152.7	53.1
Public consumption	33.2	20.3	65.9	22.9
Gross capital formation	36.5	22.3	54.3	18.9
Exports of goods and services	116.1	71.1	240.1	83.5
Imports of goods and services	112.8	69.1	229.5	79.8
GDP	163.4	100.0	287.5	100.0

						Proj.	
	2000	2001	2002	2003	2004	2005	2006
			(Changes in percent)				
National Accounts							
Demand and output (volume)							
Private consumption	3.6	1.2	0.8	1.0	1.3	1.2	1.6
Public consumption	2.3	2.6	2.9	2.6	1.9	1.8	1.6
Gross fixed investment	3.4	0.4	-2.1	-0.6	4.4	8.3	1.0
Of which: enterprise investment	4.3	3.6	-2.8	-2.0	3.3	9.5	0.8
Stockbuilding 1/	0.3	-0.8	0.1	-0.1	0.7	-0.8	0.1
Total domestic demand	3.6	0.5	0.8	0.9	2.8	1.9	1.6
Exports of goods and nonfactor services	8.6	1.0	1.0	2.8	5.6	2.5	5.1
Imports of goods and nonfactor services	8.6	0.2	0.2	2.9	6.3	3.0	4.6
Foreign balance 1/	0.2	0.7	0.7	0.0	-0.3	-0.3	0.6
GDP	3.7	1.2	1.5	0.9	2.4	1.5	2.1
Output gap (in percent of potential GDP)	2.3	1.2	0.5	-0.6	-0.4	-0.9	-0.8
Labor market							
Labor force (national definition)	1.0	1.2	0.2	0.6	2.0	0.6	0.8
Employment (national definition)	1.9	1.5	-0.3	0.1	0.7	0.0	0.7
EU harmonized unemployment rate 2/	6.9	6.7	7.3	8.0	7.9	8.3	8.2
NAIRU 2/	8.5	8.3	7.9	7.9	7.8	7.7	7.7
Prices, wages, and incomes							
GDP deflator	1.7	1.8	1.8	1.7	2.3	2.4	2.4
Terms of trade (goods)	-1.3	-1.0	1.5	-0.2	-0.5	0.7	0.1
Consumer price index 3/	2.7	2.4	1.6	1.5	1.9	2.5	2.4
Compensation per employee 4/	2.6	4.0	4.1	1.7	2.1	3.6	2.2
Labor productivity 4/	1.8	-0.3	1.8	0.8	1.7	1.5	1.5
Unit labor costs 4/	0.9	4.3	2.4	0.9	0.5	2.2	0.8

Table 1. Belgium: Basic Data, 2000-06 (concluded)

	2000	2001	2002	2003	2004	Proj. 2005	2006
	(In percent)						
Interest rates (percent)							
Money market rate (3 month) 5/	4.4	4.3	3.3	2.3	2.1	2.2	...
Government bond yield	5.6	5.1	5.0	4.2	4.1	3.4	...
	(In percent of GDP)						
Saving and investment							
Private saving	25.9	24.0	24.2	23.5	23.8	24.2	24.7
Of which: household saving as percent of disposable household income	15.4	16.4	15.8	14.3	12.8	12.3	12.5
Growth of real disposable income (in percent)	2.5	2.1	-0.1	-0.9	0.4	1.3	1.9
Private investment	18.8	18.7	17.5	17.2	17.3	18.1	17.9
Private saving surplus	7.1	5.3	6.7	6.3	6.4	6.1	6.8
Government saving surplus	-1.9	-1.1	-1.7	-1.6	-1.7	-1.8	-2.1
National saving surplus	5.2	4.2	5.0	4.7	4.8	4.2	4.7
Public finances, general government							
Revenue	49.2	49.6	49.8	51.2	49.5	49.8	49.1
Expenditure	49.1	49.0	49.8	51.1	49.5	49.9	49.5
Of which: interest on public debt	6.6	6.5	5.8	5.3	4.8	4.4	4.1
Fiscal balance 6/	0.1	0.6	0.0	0.1	0.0	0.0	-0.4
Primary balance 6/	6.7	7.1	5.7	5.4	4.8	4.4	3.7
Structural balance 7/	-1.5	-0.6	-0.5	-1.3	0.2	0.6	0.1
Structural primary balance 7/	5.2	5.9	5.3	3.9	5.0	5.0	4.2
Gross public debt	107.8	106.2	103.2	98.5	94.9	94.0	90.4
	(In billions of euros; unless otherwise indicated)						
Balance of payments							
Current account balance	10.2	8.8	12.4	11.2	9.5	13.1	14.5
(In percent of GDP)	4.0	3.4	4.6	4.1	3.3	4.4	4.7
Trade balance	5.3	6.2	10.2	9.7	7.9	8.9	10.5
(In percent of GDP)	2.1	2.4	3.8	3.5	2.7	3.0	3.4
Exchange rates							
Euro per U.S. dollar (January 18, 2006) 8/					0.827		
Nominal effective rate (2000=100)	100.0	100.5	101.6	105.7	106.8	...	
Real effective rate (2000=100) 9/	100.0	101.5	104.5	108.6	110.6	...	

Sources: Data provided by the authorities; and IMF staff estimates and projections.

1/ Contribution to growth.
2/ Percent of the labor force.
3/ Harmonized consumer price index.
4/ Economy-wide.
5/ Since 1999, euro rate.
6/ Includes UMTS license revenue of 0.2 percent of GDP in 2001 and proceeds from the transfer of Belgacom's pension fund of 1.9 percent of GDP in 2003.
7/ Excludes UMTS license revenue of 0.2 percent of GDP in 2001 and proceeds from the transfer of Belgacom's pension fund of 1.9 percent of GDP in 2003.
8/ Belgium entered the final stage of EMU on January 1, 1999 at a rate of 40.3399 Belgian francs to the euro.
9/ Based on relative unit labor costs in manufacturing.

Table 2. Belgium: Public Sector Debt Sustainability Framework, 2000-10

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

		Actual					Projections						
		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	**Debt-stabilizing primary balance 9/**
1	**Baseline: Public sector debt 1/**	107.7	106.3	103.2	98.5	94.7	**94.0**	**90.4**	**87.8**	**85.7**	**84.1**	**83.1**	**1.2**
	Of which: foreign-currency denominated	3.2	2.6	2.0	1.4	0.8	0.8	0.8	0.8	0.8	0.8	0.7	
2	Change in public sector debt	-5.9	-1.4	-3.1	-4.7	-3.8	-0.7	-3.6	-2.6	-2.1	-1.6	-1.0	
3	Identified debt-creating flows (4+7+12)	-5.5	-3.5	-3.6	-3.1	-4.7	-3.3	-3.7	-2.6	-2.1	-1.6	-1.0	
4	Primary deficit	-6.7	-7.1	-5.7	-5.4	-4.8	-4.4	-3.7	-3.3	-3.0	-2.6	-2.2	
5	Revenue and grants	49.1	49.7	49.8	51.2	49.4	49.8	49.1	49.0	49.0	49.0	49.0	
6	Primary (noninterest) expenditure	42.4	42.6	44.0	45.8	44.6	45.4	45.4	45.7	46.0	46.4	46.8	
7	Automatic debt dynamics 2/	1.1	3.6	2.2	2.3	0.0	1.1	0.0	0.7	0.9	1.0	1.2	
8	Contribution from interest rate/growth differential 3/	0.5	3.5	2.3	2.7	0.2	1.1	0.0	0.7	0.9	1.0	1.2	
9	*Of which:* contribution from real interest rate	4.7	4.6	3.8	3.6	2.6	2.2	1.9	2.8	2.8	2.9	2.9	
10	*Of which:* contribution from real GDP growth	-4.2	-1.1	-1.5	-0.9	-2.4	-1.2	-1.9	-2.1	-1.9	-1.8	-1.7	
11	Contribution from exchange rate depreciation 4/	0.6	0.1	-0.1	-0.3	-0.1	...	...	...	...	...	...	
12	Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
13	Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
14	Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15	Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16	Residual, including asset changes (2-3) 5/	-0.3	2.1	0.5	-1.6	0.9	2.6	0.1	0.0	0.0	0.0	0.0	
	Public sector debt-to-revenue ratio 1/	219.2	214.1	207.4	192.6	191.8	188.7	184.0	179.2	175.0	171.8	169.7	
	Gross financing need 6/	15.2	12.9	13.8	11.9	10.8	10.5	10.7	11.0	11.0	11.1	11.3	
	In billions of U.S. dollars	35.5	29.9	34.9	37.1	38.7	39.2	40.6	43.5	45.3	47.5	50.2	
	Scenario with key variables at their historical averages 7/						**94.0**	**90.2**	**86.3**	**82.2**	**78.1**	**73.9**	**1.5**
	Scenario with no policy change (constant primary balance) in 2005-10						**94.0**	**89.7**	**86.0**	**82.5**	**79.1**	**75.8**	**1.1**
	Key macroeconomic and fiscal assumptions underlying baseline												
	Real GDP growth (in percent)	3.9	1.1	1.5	0.9	2.6	1.3	2.1	2.4	2.2	2.2	2.1	
	Average nominal interest rate on public debt (in percent) 8/	6.1	6.2	5.6	5.3	5.1	4.8	4.6	5.0	5.1	5.1	5.1	
	Average real interest rate (nominal rate minus change in GDP deflator, in percent)	4.4	4.4	3.8	3.6	2.8	2.4	2.2	3.2	3.3	3.5	3.6	
	Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	-13.4	-3.1	5.4	19.7	9.9	...	...	...	...	...	...	
	Inflation rate (GDP deflator, in percent)	1.7	1.8	1.8	1.7	2.3	2.4	2.4	1.8	1.7	1.6	1.5	
	Growth of real primary spending (deflated by GDP deflator, in percent)	2.0	1.3	5.0	4.9	0.1	3.1	2.1	3.0	3.0	3.0	3.0	
	Primary deficit	-6.7	-7.1	-5.7	-5.4	-4.8	-4.4	-3.7	-3.3	-3.0	-2.6	-2.2	

1/ Covers general government. Gross debt is used.

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

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

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

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

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

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

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

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

Table 3. Belgium: Operations of the General Government, 1998-2004

(In percent of GDP, unadjusted for working days)

	1998	1999	2000	2001	2002	2003	2004
Revenue	49.5	49.6	49.1	49.7	49.8	51.2	49.4
Tax revenue	44.6	44.7	44.4	44.5	44.7	44.3	44.6
Direct taxes	17.3	16.9	17.1	17.3	17.1	16.7	16.8
Personal income tax	13.7	13.5	13.6	14.0	13.9	13.5	13.3
Company income tax	3.5	3.4	3.3	3.2	3.2	3.0	3.3
Other direct taxes	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Indirect taxes	12.7	13.1	12.9	12.5	12.7	12.7	13.0
Social contributions	14.2	14.3	13.9	14.2	14.4	14.4	14.1
Other taxes	0.4	0.4	0.5	0.5	0.5	0.5	0.8
Nontax revenue	4.8	4.8	4.7	5.2	5.1	6.9	4.8
Expenditure	50.2	50.1	49.0	49.0	49.8	51.1	49.4
Primary expenditure	42.9	43.2	42.4	42.6	44.0	45.8	44.6
Current expenditure	40.0	40.1	39.3	40.2	41.5	42.6	42.4
Wages	11.7	11.8	11.5	11.7	12.2	12.3	12.0
Operations and maintenance	3.2	3.2	3.2	3.3	3.7	3.7	3.6
Social transfers	21.8	21.7	21.3	21.8	22.3	23.0	23.2
Old age	8.6	8.5	8.3	8.4	8.6	8.7	8.6
Health	5.5	5.5	5.6	5.8	5.7	6.1	6.3
Unemployment	2.0	1.9	1.7	1.8	2.0	2.1	2.1
Other social transfer	5.8	5.8	5.7	5.8	6.0	6.2	6.1
Subsidies to enterprises	1.2	1.3	1.3	1.3	1.2	1.4	1.2
Other transfers	2.0	2.1	2.0	2.0	2.1	2.3	2.3
Capital expenditure	2.9	3.2	3.1	2.4	2.5	3.1	2.3
Interest	7.3	6.8	6.6	6.5	5.8	5.3	4.8
Overall balance	-0.8	-0.5	0.1	0.6	0.0	0.1	0.0
Primary balance	6.6	6.4	6.7	7.1	5.7	5.4	4.8
Memorandum items:							
Structural balance	-0.6	-1.0	-1.5	-0.6	-0.5	-1.3	0.2
Central government balance	-1.5	-1.6	-0.4	-0.8	-0.2	0.3	-0.1
Gross public debt (Maastricht definition)	117.0	113.6	107.7	106.3	103.2	98.5	94.7

Source: Data provided by the Belgian authorities.

Table 4. Belgium: Fiscal Scenarios, 2002-10

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

				Est.	Proj.				
	2002	2003	2004	2005	2006	2007	2008	2009	2010
Current policies (A)									
Revenue	49.8	51.2	49.4	49.8	49.1	49.0	49.0	49.0	49.0
Expenditure	49.8	51.1	49.4	49.8	49.5	50.0	50.3	50.6	50.9
Primary expenditure	44.0	45.8	44.6	45.4	45.4	45.7	46.0	46.4	46.8
Interest payments	5.8	5.3	4.8	4.4	4.1	4.4	4.3	4.2	4.1
Balance	0.0	0.1	0.0	0.0	-0.4	-1.1	-1.3	-1.6	-1.9
Structural balance 1/	-0.5	-1.3	0.2	0.6	0.1	-0.7	-1.2	-1.6	-2.0
Primary balance	5.7	5.4	4.8	4.4	3.7	3.3	3.0	2.6	2.2
Structural primary balance 1/	5.3	3.9	5.0	5.0	4.2	3.6	3.2	2.8	2.4
Debt	103.2	98.5	94.7	94.0	90.4	87.8	85.7	84.1	83.1
Memorandum items (in percent):									
Real primary expenditure growth	5.0	4.9	0.1	3.1	2.1	3.0	3.0	3.0	3.0
Real discretionary spending growth	6.5	5.2	-3.5	4.5	1.6	2.5	2.5	2.5	2.5
Output gap	0.5	-0.6	-0.4	-0.9	-0.8	-0.4	-0.2	0.0	0.1
GDP growth	1.5	0.9	2.4	1.5	2.1	2.4	2.2	2.2	2.1
Government scenario; stability program (B)									
Revenue	49.8	51.2	49.4	49.7	49.4	49.2	48.8	48.7	n.a.
Expenditure	49.8	51.1	49.4	49.7	49.4	48.9	48.3	48.0	n.a.
Primary expenditure	44.0	45.8	44.6	45.4	45.3	45.0	44.7	44.6	n.a.
Interest payments	5.8	5.3	4.8	4.3	4.1	3.9	3.6	3.4	n.a.
Balance	0.0	0.1	0.0	0.0	0.0	0.3	0.5	0.7	n.a.
Structural balance 2/	-0.5	-1.3	0.2	0.5	0.5	0.8	0.8	0.8	n.a.
Primary balance	5.7	5.4	4.8	4.3	4.1	4.2	4.1	4.1	n.a.
Structural primary balance 1/	5.3	3.9	5.0	4.9	4.6	4.7	4.4	4.3	n.a.
Debt	103.2	98.5	94.7	94.3	90.7	87.0	83.0	79.1	n.a.
Memorandum items (in percent):									
Real primary expenditure growth	5.0	4.9	0.1	3.1	2.0	1.4	1.6	2.0	n.a.
GDP growth	1.5	0.9	2.6	1.4	2.2	2.1	2.3	2.2	n.a.
High Council for Finances and staff-recommended scenario (C)									
Revenue	49.8	51.2	49.4	49.8	49.1	49.0	49.0	49.0	49.0
Expenditure	49.8	51.1	49.4	49.8	49.6	49.1	48.7	48.2	47.8
Primary expenditure	44.0	45.8	44.6	45.4	45.1	44.8	44.4	44.1	43.9
Interest payments	5.8	5.3	4.8	4.4	4.5	4.4	4.2	4.1	3.9
Balance	0.0	0.1	0.0	0.0	-0.5	-0.1	0.3	0.8	1.2
Structural balance 1/	-0.5	-1.3	0.2	0.6	0.0	0.2	0.4	0.7	1.1
Primary balance	5.7	5.4	4.8	4.4	4.0	4.2	4.5	4.8	5.1
Debt	103.2	98.5	94.7	94.0	90.4	86.9	83.2	79.4	75.4
Memorandum items (in percent):									
Real primary expenditure growth	5.0	4.9	0.1	3.1	1.5	1.5	1.5	1.5	1.5
Real primary expenditure growth 3/	5.0	4.9	0.1	3.1	1.5	1.2	1.2	1.2	1.2
Real discretionary spending growth 3/	6.5	5.2	-3.5	4.5	0.6	-0.6	-0.7	-0.8	-0.9
Output gap	0.5	-0.6	-0.4	-0.9	-0.8	-0.4	-0.2	0.0	0.1
GDP growth	1.5	0.9	2.4	1.5	2.1	2.4	2.2	2.2	2.1

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

1/ Excluding the effects of the UMTS auctions and the capital transfer resulting from the takeover. Other nonstructural items and one-off factors have not been excluded, in line with the WEO convention.

2/ Excluding the effects of the UMTS auctions only.

3/ Assuming in addition that 2006 one-off measures are eliminated gradually over 2007-10.

Table 5. Belgium: Indicators of External and Financial Vulnerability, 2000-05

	2000	2001	2002	2003	2004	2005 1/
External Indicators						
Exports (annual percentage change, in U.S. dollars)	-0.8	-0.4	6.3	20.5	19.3	...
Imports (annual percentage change, in U.S. dollars)	5.3	-0.6	4.2	21.2	20.1	...
Terms of trade (annual percentage change)	-1.3	-1.0	1.5	0.7	0.6	...
Current account balance (percent of GDP)	4.0	3.4	4.6	4.1	3.3	...
Inward portfolio investment (debt securities, etc.) 2/	56.5	63.5	…	…	…	...
Inward foreign direct investment (percent of GDP)	106.9	23.7	23.7	23.7	23.7	...
Official reserves (in billions of U.S. dollars, end-of-period)	10.0	11.3	11.9	11.0	10.4	9.2
Official reserves in months of imports	0.6	0.7	0.7	0.6	0.4	...
Exchange rate per U.S. dollar (period average)	1.082	1.117	1.059	0.884	0.804	0.801
Market indicators						
Financial markets indicators						
Public sector debt (Maastricht definition)	107.8	106.2	103.2	98.5	94.9	...
3-month T-bill yield (percent)	4.0	4.2	3.2	2.2	2.0	2.0
3-month T-bill yield (real, percent)	1.5	1.7	1.5	0.6	-0.3	-0.5
Spread of 3-month T-bill over EURIBOR (percentage points)	-0.3	0.0	-0.1	-0.1	-0.1	-0.2
10-year government bond yield (percent)	5.6	5.1	5.0	4.2	4.3	3.2
10-year government bond yield (real, percent)	2.9	2.7	3.4	2.7	2.5	0.7
Spread of 10-year government bond rate with Germany (percentage points)	0.3	0.3	0.2	0.1	0.1	0.2
Stock market index (period average)	2,967	2,807	2,410	1,975	2,557	3,074
Credit markets indicators (end-of-period 12-month growth rates)						
Credit to the private sector	3.5	1.4	1.5	3.0	1.7	4.7
Bank credit to households	2.4	-1.1	4.1	6.8	9.6	14.7
Mortgages	7.7	2.7	8.0	11.8	11.8	15.4
Bank credit to nonfinancial enterprises	4.4	-1.2	-3.0	-4.1	-1.5	-3.4
Number of credit institutions	119	113	111	109	104	102
Sensitivity to market risk						
Off-balance sheet operations of banks as percent of assets	269	304	419	448	535	425
Of which: foreign exchange operations	37	35	42	45	44	39
Of which: interest rate operations	213	248	354	379	474	363
Other	19	22	23	24	17	23
Net long position in foreign exchange as a percentage of Tier I capital	7.5	6.8	8.5	7.0	5.3	5.8

Sources: Data provided by the authorities; IMF, IFS; and IMF Research Department.

1/ September 2005 data.
2/ Capital account data cover the definition of the Belgium-Luxembourg Economic Union (BLEU).

Table 6. Belgium: Financial Soundness Indicators of the Banking Sector, 2000-05 1/

	2000	2001	2002	2003	2003	2005 2/
Banking sector						
Capital adequacy						
Regulatory capital as percent of risk-weighted assets *	12.0	12.9	13.2	12.9	12.9	11.8
Regulatory Tier I capital as percent of risk-weighted assets *	7.5	8.2	8.6	8.8	9.4	8.5
Capital as percent of assets 3/ *	2.8	2.7	3.0	3.1	3.1	2.8
Asset composition and quality						
*Sectoral distribution of bank credit to the private sector (as percent of total credit to private sector) 4/ **						
Nonfinancial enterprises	48.0	46.7	44.6	41.5	40.2	37.8
Households	44.8	43.7	44.8	46.4	50.1	52.6
*Sectoral distribution of bank credit to corporations (as percent of total loan exposure) 5/ **						
Construction	5.1	4.9	5.1	4.9	4.4	4.3
Real estate	5.8	6.2	6.6	7.5	7.1	6.9
Industry	37.7	38.5	37.2	34.0	35.5	34.6
Transport and tourism	14.1	13.9	13.3	12.1	12.4	12.8
Energy and utilities	5.4	5.3	5.7	4.8	5.1	6.0
TMT	3.3	3.1	3.0	2.4	2.4	2.6
Financial	15.7	16.0	15.9	22.3	23.4	24.1
Other	12.9	12.1	13.2	12.0	9.7	8.7
*Geographical distribution of bank credit (as percent of total bank credit) **						
Belgium	42.0	38.3	37.1	37.5	35.7	30.6
Other EMU countries	30.4	33.5	33.7	33.8	33.7	35.4
Other developed countries	20.4	20.9	22.4	21.5	23.7	25.5
Asset quality						
Nonperforming loans (NPL) as percent of gross loans 6/ 7/ *	2.8	2.9	3.0	2.6	2.3	2.2
Provisions and write-offs as percent of NPL 7/	57.0	57.0	51.8	52.8	54.2	51.5
NPL net of provisions as percent of Tier I capital 7/ *	15.0	14.4	15.2	15.7	12.8	13.9
Foreign exchange loans as percent of total loans	22.3	24.9	22.3	22.6	26.4	32.0
Large exposures as percent of Tier I capital 7/ *	51.0	67.0	61.0	46.0	40.0	38.6
Earnings and profitability						
Gross profits as percent of average assets (ROAA) *	0.8	0.5	0.5	0.5	0.6	0.7
Gross profits as percent of average equity capital (ROAE) *	29.6	19.2	17.1	17.1	21.1	24.7
Net interest margin (net interest income as percent of interest bearing assets) *	1.3	1.4	1.5	1.4	1.4	1.2
Gross income as percent of average assets	2.6	2.5	2.5	2.3	2.2	2.0
Net interest income as percent of gross income	46.0	47.5	51.4	53.1	52.9	50.0
Noninterest income as percent of gross income	54.0	52.5	48.6	46.9	47.1	50.0
Trading income as a percent of gross income *	7.8	7.0	4.4	4.5	4.8	6.6
Noninterest expenses as percent of gross income *	72.2	74.1	74.7	73.9	72.0	69.8
Personnel expenses as percent of noninterest expenses *	41.8	42.8	44.3	45.5	44.7	43.4
Spread between reference loan and deposit rates 8/ *	1.6	1.6	1.5	1.5	...	...
Spread between reference loan and deposit rates 9/ *	...	...	...	1.9	1.9	1.8
Liquidity						
Liquid assets as percent of total assets 10/ *	35.3	35.3	33.3	33.2	32.7	31.0
Liquid assets as percent of short-term liabilities 11/ *	100.3	103.2	91.1	86.0	86.3	81.6
Foreign currency liabilities as percent of total liabilities *	29.8	30.0	26.9	25.1	27.1	30.8
Deposits as percent of assets	51.9	51.2	52.3	51.5	49.9	45.5
Loans as percent of deposits *	77.8	76.4	79.7	80.6	84.7	92.6

Sources: BFIC; and NBB.

1/ Data on a consolidated basis, unless otherwise stated.
2/ September 2005 data.
3/ Simple ratio of capital-to-total assets, without risk weighting.
4/ Territorial data; excluding government, interbank, and nonresident loans.
5/ Unconsolidated (solo/company) data from the Corporate Credit Register.
6/ Nonperforming loans refer to loans classified as substandard, doubtful, or loss.
7/ Unconsolidated (solo/company) data.
8/ RIR-survey. Difference between lending rate on loans <= 1 year and deposit rate on term deposits >= 1 month and <= 1 year.
9/ MIR-Survey. Difference between lending rate on loans <= 1 year and deposit rate <= 1 year.
10/ Liquid assets consist of cash, short-term interbank claims (maturity < 1 month) and the total securities portfolio.
11/ Short-term liabilities consist of short-term interbank debt (< 1 month) and sight, savings, and short-term deposits (< 1 month) of nonbank clients.
* Core and encouraged set of indicators.

Table 7. Belgium: Financial Soundness Indicators of the Nonbanking Sectors, 2000-05

	2000	2001	2002	2003	2004	2005 1/
Insurance sector						
Coverage ratio 2/	265.0	276.0	254.1	248.4	252.1	...
Profitability (return on average equity, in percent)	21.5	12.1	-10.4	7.3	18.0	...
Life	12.4	9.4	-3.0	5.6	8.4	...
Nonlife	7.6	0.0	-3.7	9.1	13.0	...
Corporate sector 3/						
Total debt in percent of equity *	88.6	83.0	79.5	78.2	62.7	...
Profitability (return on equity, in percent) *	11.6	9.8	11.7	12.9	10.3	...
Debt service coverage 4/ *	179.7	113.6	176.7	195.6	185.9	...
Household sector						
Debt (percent of GDP)*	40.3	38.7	39.4	40.3	40.6	41.9
Debt service burden (percent of disposable income)*	3.8	3.6	3.5	3.4	3.2	...
Financial savings ratio (percent of GDP)	7.2	7.7	6.7	6.0	5.4	4.1
Savings rate (percent of disposable income)	15.4	16.4	15.8	14.3	12.8	12.3
Real estate sector						
House price inflation 5/ *						
Small- and medium-sized houses	4.1	5.3	7.8	7.6	6.8	...
Apartments	7.2	4.4	8.4	8.5	14.5	...
Mortgage loans as percent of total loans 6/	20.3	20.5	22.3	27.6	27.4	26.2
Of which: domestic	14.2	14.1	14.9	16.1	15.9	15.0
Of which: domestic households *	13.8	13.3	14.2	15.6	15.5	14.8
Variable rate mortgages as percent of total new mortgages	12.8	6.2	12.3	25.9	53.3	40.7

Sources : BFIC; NBB; UPC; and Stadim.

1/ September 2005 data.
2/ Available solvency margin over required solvency margin.
3/ Data for 2004 based on a sample of already available annual accounts in the Central Balance Sheet Register.
4/ Earnings before interest and tax as a percentage of interest and principal expenses.
5/ Percent change in house price index (1953=100).
6/ Mortgage loans after deduction of deposits related to mortgage loans; consolidated basis.

* Encouraged set of indicators.

BELGIUM: FUND RELATIONS

(As of December 31, 2005)

***Mission*:** Brussels, November 10–21, 2005. The concluding statement of the mission is publicly available at http://www.imf.org/external/np/ms/2005/112105.htm.

***Staff team*:** Mr. Everaert (Head) and Mmes. Allard, Yelten, and Zhou (all EUR) and Mr. Ouanes (MFD).

***Country interlocutors*:** The minister of finance, the minister of labor, the governor of the central bank, the director of the treasury and their staffs; staff of the cabinet of the prime minister; the Financial Stability Committee; the Finance, Banking, and Insurance Commission; the Central Economic Council; the Planning Bureau; staff of the ministries of the budget, social affairs and health, and the economy; representatives of labor unions, employer organizations, academia, and the financial sector. Mr. Kiekens (Executive Director) or Mr. Rottier (Advisor to the Executive Director) attended the meetings.

***Fund relations*:** The previous Article IV Consultation took place on February 18, 2005. The associated Executive Board's assessment is available at http://www.imf.org/external/np/sec/pn/2005/pn0526.htm and the staff report at http://www.imf.org/external/pubs/ft/scr/2005/cr0575.pdf. Belgium accepted the obligations under Article VIII and, apart from certain security restrictions, maintains an exchange system free of restrictions.

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

I. **Membership Status**: Joined 12/27/45; Article VIII

		SDR Million	% Quota
II.	**General Resources Account**:	**SDR Million**	**% Quota**
	Quota	4,605.20	100.00
	Fund holdings of currency	3,827.33	83.11
	Reserve position in Fund	777.89	16.89

		SDR Million	% Allocation
III.	**SDR Department**:	**SDR Million**	**% Allocation**
	Net cumulative allocation	485.25	100.00
	Holdings	219.90	45.32
	[Designation plan]		

IV. **Outstanding Purchases and Loans**: None

V. **Latest Financial Arrangements**: None

VI. **Projected Payments to Fund** (SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal					
Charges/interest	8.10	8.07	8.10	8.07	8.07
Total	8.10	8.07	8.10	8.07	8.07

VII. **Exchange Rate Arrangement**:

Until December 31, 1998, Belgium formed a monetary union with Luxembourg in which the Belgian and Luxembourg francs were at par, while also participating in the exchange rate mechanism of the European Monetary System. Belgium entered the final stage of European Economic and Monetary Union on January 1, 1999 at a rate of 40.3399 Belgian francs to the euro.

VIII. **Article IV Consultations**:

Belgium is on the 12-month cycle; the last consultation was completed on February 18, 2005.

IX. Belgium retains restrictions vis-à-vis Iraq, the Socialist Peoples' Libyan Arab Jamahiriya, and the Federal Republic of Yugoslavia (Serbia and Montenegro) pursuant to UN Security Council resolutions 661, 883, and 757, respectively. These restrictions have been notified to the Fund pursuant to Decision No. 144-(52/51). The residual restrictions vis-à-vis the Federal Republic of Yugoslavia (Serbia and Montenegro) relate solely to balances of the former National Bank of Yugoslavia that remain frozen, since they are subject to unresolved legal claims.

BELGIUM: STATISTICAL ISSUES

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

Belgium adopted the European System of Integrated Economic Accounts 1995 (ESA95) in 1999. Revisions of national accounts started in November 2005 to comply with EUROSTAT requirements and prepare for the adoption of chain-linked national accounts statistics. Unlike in other countries, the NBB is responsible for compiling national accounts statistics. Quarterly accounts are published within a lag of three months. Both annual and quarterly accounts data are of good quality, with shortcomings mainly related to export and import deflators, which are based on unit values rather than prices collected directly from exporters and importers.

General government revenue, expenditure, and balance on an accrual basis (ESA95) are published annually. The NBB publishes monthly data on central government operations. It would be helpful to present these data quarterly on a national accounts basis to facilitate monitoring of public finances.

The recent FSAP found that overall quality and availability of financial indicators were good and suggested that additional indicators for the insurance sector be developed. The authorities are providing quarterly updates of financial sector indicators (FSIs) in a timely manner.

Key publicly accessible websites for macroeconomic data and analysis are:

National Statistical Portal .... www.belgostat.be
National Statistics Institute .... www.statbel.fgov.be
Institute for National Accounts .... www.inr-icn.fgov.be
National Bank of Belgium .... www.nbb.be
Federal Planning Bureau .... www.plan.be
Banking, Finance, and Insurance Commission .... www.cbfa.be
High Finance Council .... www.docufin.be
Central Economic Council .... www.ccecrb.fgov.be

BELGIUM: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of January 12, 2006)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	1/12/06	1/12/06	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/05	12/14/05	M	M	M
Reserve/Base Money	12/05	1/11/06	M	M	M
Broad Money	12/05	1/11/06	M	M	M
Central Bank Balance Sheet	11/05	12/29/2005	M	M	M
Consolidated Balance Sheet of the Banking System	11/05	12/29/2005	M	M	M
Interest Rates[2]	1/05/06	1/05/06	D	D	D
Consumer Price Index	12/05	1/05/06	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2004	5/30/05	A	A	A
Revenue, Expenditure, Balance, and Composition of Financing[3]—Central Government	2004	5/30/05	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	10/05	11/17/05	M	M	M
External Current Account Balance	Q3 2005	01/04/06	Q	Q	M
Exports and Imports of Goods and Services	Q3 2005	01/04/06	Q	Q	M
GDP/GNP	Q3 2005	12/08/05	Q	Q	Q
Gross External Debt	Q3 2005	10/18/2005	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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

IMF Executive Board Concludes 2005 Article IV Consultation with Belgium

On February 27, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Belgium.[1]

Background

Following weakness in early 2005, mainly reflecting a negative contribution from the external sector and weak household consumption due to high energy prices, growth has picked up. Exports revived as external demand strengthened. Household confidence improved, rekindling consumption. Enterprises stepped up capital formation in response to rising profits and the low cost of funding. Boosted by oil price increases, inflation peaked in September 2005 while wages rose faster than in key trading partners, supported by widespread, if partial indexation. Low interest rates and the depreciation of the euro from earlier peaks supported demand. In spite of a balanced budget rule, the procyclicality of fiscal policy has been limited by the use of one-off measures.

The authorities and the staff project GDP growth to strengthen into 2006 to somewhat more than 2 percent, as demand from trading partners increases further. Private consumption is projected to pick up in response to tax cuts, and residential construction is likely to remain

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

resilient, even though house price growth is likely to slow. Bank exposure to mortgages, use of variable interest rate mortgage loans, and household debt are low by international comparison, and there is no evidence of equity withdrawals. Business fixed investment is expected to moderate, after exceptional buoyancy in 2005. Domestic wage increases will continue to outpace those of key trading partners if the 2005–06 wage agreement is implemented as envisaged. While this would support consumption in the short run, it could adversely affect competitiveness and thus dampen exports and investment in the medium run.

As elsewhere, the economy is facing pressures from population aging on the budget and growth. Potential growth and future costs of aging are in line with the EU15 average, while labor productivity is slightly above it. However, the employment rate is very low in comparison and the tax wedge on labor very high. The government's strategy to deal with aging consists of fiscal consolidation and measures to raise labor utilization. With the budget in balance since 2000, public debt has fallen sharply as a share of GDP, creating room to fund the rising costs of aging through interest savings. However, these savings have recently been applied to cuts in social security contributions and spending increases. Most of the tax cuts have ended up in higher take-home-pay rather than in lower labor costs. A *Generation Pact* is set to be implemented to raise employment of the young, low-skilled, and older workers. Key measures include more targeted cuts in employers' social security contributions, a gradual reform of early retirement regimes, and a strengthening of training.

The financial sector, which has never experienced a systemic crisis, has seen its performance improve over the past two years. Profitability rose, mainly in the banking sector and, to a lesser extent, in the insurance sector. In the life sector, products with guaranteed returns above market rates continue to weigh on profits. Since early 2004, the banking and insurance supervisors have been operating as a single institution (CBFA) to better deal with the dominant bank-insurance conglomerates and increasing cross-border activity. The National Bank has developed macroprudential supervision and regularly publishes Financial Stability Reviews. A Financial Stability Committee has been established to ensure seamless coordination between the CBFA and the NBB and focus on issues of systemic importance. To further combat money laundering, a law was adopted to phase out all bearer instruments.

Executive Board Assessment

Executive Directors commended the authorities for the continued good performance of the economy and for adopting economic policies guided by a coherent set of medium-term objectives. Directors observed that measures taken to boost employment rates, deepen economic deregulation, and further administrative simplification are improving growth prospects. The maintenance of balanced budgets for six consecutive years has contributed to improved market confidence and to reduced risk premiums. They underscored that, while policy goals are appropriate, reforms should be strengthened and rebalanced to achieve both the budget surpluses envisaged and the higher labor utilization needed to address population aging. In particular, labor market rigidities should be dealt with more directly, with diminished recourse to budgetary resources to promote job creation.

Directors viewed that the near-term outlook, while dependent on external developments, is favorable and that the authorities' growth projections are realistic. They observed that domestic wage increases, which are set to exceed those of key trading partners, pose a downside risk to exports and investment in the medium term. Directors concurred that risks related to housing price developments are limited.

Directors urged the authorities to complement the present emphasis of fiscal policy on reducing public debt and supporting growth with medium-term spending restraint and a comprehensive approach to tax reform. They commended the authorities' track record of meeting announced budget targets, and welcomed their intention to save revenue windfalls from higher growth and to take further measures, as needed, to balance the 2006 budget. Directors underscored the need to adopt specific plans to curb spending. Emphasizing the benefits of a stable tax system, Directors discouraged the recourse to tax amnesties and ad hoc tax measures to meet revenue objectives. They supported the shift in the tax burden away from labor, in the context of comprehensive reforms.

Directors urged the authorities to adhere to the path toward fiscal surpluses, as recommended by the High Finance Council (HFC). To help achieve such surpluses, they saw merit in adopting a formal medium-term spending framework, or at a minimum shifting the focus of budget management to primary balance targets to ensure that the declining interest bill contributes to consolidation. Directors noted that it will be essential for the HFC to resume its traditional role in assessing developments in public finance, providing recommendations on the fiscal outlook, and underpinning the internal stability pact to ensure that policies at various levels of government are consistent with overall consolidation objectives.

Directors welcomed the Generation Pact as an important step toward higher employment rates, especially for the young and low-skilled. They noted, however, that, in order to boost employment of older workers meaningfully, the Pact's measures should be extended to phase out early retirement regimes and to improve the employability of such workers. Directors agreed that addressing labor market rigidities more directly would ensure that the wage-bargaining framework delivers more job creation, and noted that, to prevent an erosion of competitiveness, social partners will need to moderate wage increases. The use of reductions in taxes and social security contributions to boost take-home pay should be avoided, and indexation discontinued. In this connection, the use of "all-in" nominal wage agreements as an intermediate step was welcomed. Directors commended reductions in the administrative and regulatory burden on businesses, and encouraged the authorities to progress with economic deregulation and product market liberalization.

Directors welcomed the findings of the Financial System Stability Assessment that the financial sector was stable and resilient, and the authorities' intention to adopt its recommendations to further strengthen supervision. They underscored the need to maintain the high quality of banking supervision in a rapidly changing environment, and to raise insurance and pension supervision to the same quality. Adequate capacity should be devoted to the oversight and prudential supervision of the payments and securities settlement systems, while ensuring seamless coordination among the entities involved. Progress in shaping the Banking, Finance, and Insurance Commission supported by the National Bank of Belgium's macro prudential analysis should continue to preserve the record of financial stability.

Directors commended Belgium's continued commitment to a liberal international trading system and the recent increase in the level of its official development assistance.

Belgium: Selected Economic Indicators, 2002–06

	2002	2003	2004	2005 1/	2006 1/
Real economy (change in percent)					
Real GDP	1.5	0.9	2.4	1.5	2.1
Domestic demand	0.8	0.9	2.8	1.9	1.6
CPI	1.6	1.5	1.9	2.5	2.4
Unemployment rate (in percent)	7.3	8.0	7.9	8.3	8.2
Public finance (percent of GDP)					
General government balance	0.0	0.1	0.0	0.0	-0.4
Structural balance	-0.5	-1.3	0.2	0.6	0.1
Primary balance	5.7	5.4	4.8	4.4	3.7
General government debt	103.2	98.5	94.9	94.0	90.4
Interest rates (percent)					
Money market rate (3 months)	3.3	2.3	2.1	2.2	...
Government bond yield	5.0	4.2	4.1	3.4	...
Balance of payments (percent of GDP)					
Trade balance	3.8	3.5	2.7	3.0	3.4
Current account	4.6	4.1	3.3	4.4	4.7
Official reserves (US$ billion)	11.0	11.0	10.4	9.3	
Exchange rate					
Exchange rate regime			Member of EMU		
Euro per U.S. dollar (January 18, 2006)			0.827		
Nominal effective rate (2000=100, ULC based)	100.5	101.6	105.7	106.8	
Real effective rate (2000=100, ULC based)	101.5	104.5	108.6	110.6	

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

1/ IMF staff estimates and projections.