April 2011
IMF Country Report No. 11/81

Belgium: 2010 Article IV Consultation—Staff Report; Staff Supplement; and a 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 2010 Article IV consultation with Belgium, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 13, 2010 with the officials of Belgium on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 8, 2011. 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 staff supplement of March 22, 2011 updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its March 23, 2011 discussion of the staff report that concluded the Article IV consultation.

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

Selected Issues Paper

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

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INTERNATIONAL MONETARY FUND

BELGIUM

Staff Report for the 2010 Article IV Consultation

Prepared by the Staff Representatives for the 2010 Consultation with Belgium

Approved by Ajai Chopra and Jan Kees Martijn

March 8, 2011

Executive Summary

The political impasse hampers economic policy making and compounds post-crisis vulnerabilities. Political uncertainty and high public debt have triggered market concerns about Belgium's public finances, and the Belgian sovereign and banks are vulnerable to contagion from possible renewed market turmoil in the euro area. Economic activity expanded more than foreseen in 2010 and progress was made in bank restructuring but real GDP growth is projected to moderate in 2011, in view of the expected slowdown in the euro area.

There was agreement on the need for a comprehensive strategy to address macroeconomic policy priorities but the authorities considered that this would require a new federal government. In the meantime, the caretaker government is preparing a draft 2011 budget while the financial authorities have intensified banking supervision.

There was consensus that significant efforts are needed to bring down the public debt while dealing with rising aging costs. The draft 2011 budget will build on the encouraging 2010 fiscal outcomes but would mostly rely on ad hoc measures. Achieving the appropriate objective of a balanced budget by 2015 will require significant efforts, including a reform of fiscal federalism arrangements, spending constraint at all levels of government and social security, as well as revenue measures. Adopting a rule-based multiyear fiscal framework based on inter-governmental burden-sharing would be important to ensure the credibility of the envisaged consolidation.

In light of the significant risks remaining in the financial sector, continued vigilance is needed. The authorities agreed that banks must ensure sufficient capital and liquidity buffers as the Basel III regulatory framework is implemented. They should also remain flexible to provide liquidity support in the event of renewed stress. The authorities viewed continued strengthening of financial supervision as an important policy priority. More efforts are needed to monitor cross-border exposures, identify risks in the financial sector as a whole, and facilitate the timely resolution of cross-border financial institutions.

Growth-enhancing structural reforms should be pursued vigorously. The focus should be on improving the functioning of the labor market in order to increase employment, and on promoting competition in product and services markets. The limited real wage increase envisaged for 2011–12 would help strengthen competitiveness, and the automatic wage indexation should be reconsidered.

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I. POLITICAL GRIDLOCK AMID FINANCIAL TURBULENCE

1. **Belgium is going through a prolonged political impasse resulting from persistent regional tensions.** The federal government of Prime Minister Leterme fell in April 2010 over long-standing disagreements on how to reform the bilingual electoral district of Brussels-Halle-Vilvoorde. Following early elections in June 2010, negotiations to form a new federal government led by the two largest parties (the New-Flemish Alliance and the francophone Socialist Party) faltered, reflecting *inter alia* divergent views on further fiscal devolution to be imbedded in another reform of the state (Box 1). Subsequent efforts by the mediator appointed by the King in October to work out a framework for negotiations on a new government program fell through in January 2011. Since then, a new round of talks aims at lifting the political deadlock. While these efforts signal continued willingness to form a federal government, new federal elections cannot be excluded.

Box 1. Complex Political Fault Lines

Divergences between the Flemish northern part of Belgium and the francophone south have built up over decades. They range from linguistic and cultural issues; economic policy making, including industrial and labor market policies; to different preferences concerning regional fiscal autonomy and national social safety nets. Five state reforms since 1970 have transformed Belgium from a centralized state to a country made up of federal entities (the federal state and the social security administration, as well as the Flemish, Walloon and Brussels Capital Regions and the Flemish, French, and German linguistic communities).

The current political controversies center in particular on:

- **The extent and modalities of further fiscal devolution** through a revision of the Special Financing Act, which regulates the financial relations between the various federal entities, and the transfer to the regions of part of personal income taxation as well as part of the responsibility for labor market policies, health care, child allowances, and the judiciary.
- **The financing of Brussels** through higher compensation for public services provided to commuters and international civil servants in conjunction with streamlining its governing structures and improving the efficiency of its administration.
- **The reform of the bilingual electoral district of Brussels-Halle-Vilvoorde** that lies partly in Flanders.

2. **The political stalemate hampers economic policy making and compounds post-crisis vulnerabilities.** The Belgian economy is gradually recovering from the downturn but the protracted political negotiations have detracted from addressing important challenges:

- The public debt-to-GDP ratio, which had declined steadily during pre-crisis years, is on the rise again on the heels of the crisis, albeit less than in neighboring countries. Rising aging costs will put pressure on the public finances in the coming years.

- The banking sector is in the midst of a restructuring but remains vulnerable to spillovers from its sizable foreign exposures; asset quality deterioration; and funding shocks.

- The low employment rate and limited competition in product and services markets hold back economic growth, which is also crucial for fiscal consolidation.

3. **Belgium has been affected by the turbulence on European sovereign debt markets and the political impasse has weakened market confidence in the country's resolve to bring its public debt under control.** Despite high household savings and a strong external position, the 10-year sovereign bond spread (vis-à-vis the German Bund) has increased from some 40 bps early in 2010 to around 100 bps in the latter part of the year and early 2011, the highest level among core euro area countries. Preserving market confidence in Belgian sovereign debt is important to avoid adverse debt dynamics as well as to maintain sound bank balance sheets and funding conditions. In view of the large financing needs of Belgium's government and banks in 2011, it is urgent to address the above-mentioned economic policy challenges.[1]

4. **The consultation discussions focused on the need to develop and communicate a clear and comprehensive strategy to address macroeconomic policy priorities without delay.** The mission discussed various options with the authorities to (i) reduce the fiscal deficit in 2011–12 as per Belgium's Stability Program, including through initiating reforms in fiscal federalism arrangements and entitlement programs; (ii) address contagion risks and legacy problems in the financial sector while strengthening banking supervision and preparing for Basel III implementation; and (iii) push ahead with structural reforms in labor and product/services markets. The authorities agreed on the need for such a strategy but considered that this would first require reaching agreement on a new government and a fiscal federalism reform. At the same time, the caretaker government is preparing a draft 2011 budget law to ensure that the 2011 fiscal targets under Belgium's Stability Program will be reached while the financial authorities have intensified banking supervision.

II. Gradual Recovery with Challenging Outlook

A. The Recovery Continued in 2010

5. **After being hit by a severe recession in 2008–09, the Belgian economy is gradually recovering.**

- Supported by the rebound in world trade and by monetary and fiscal easing, real GDP growth in 2010 was stronger than foreseen and is estimated at 2 percent, above the

[1] The Belgian state faces on average euro 3.5 billion monthly T-bill rollover needs in 2011, and large T-bond redemption needs of about euro 28 billion with peaks in March and September. As of late October 2010, the total wholesale funding of banks with maturity less than six months amounted to euro 209 billion (almost 60 percent of GDP).

euro area average (1.7 percent). As in other European countries, the expansion has been driven by strong exports, notably to Germany and Asian emerging economies. Industrial production in November had increased by about 7 percent from the trough a year ago. Both consumer and business confidence indicators have improved.

- With employment expanding again, the unemployment rate increased somewhat further to almost 8½ percent in 2010, but remained below the euro area average of 10 percent. Labor hoarding and use of reduced working time arrangements have mitigated the rise in unemployment.

6. **While core inflation remained subdued in 2010, headline inflation jumped up due to the energy price hike**. Core inflation was weighted down by the sizable output gap and remained low at 1¼ percent in 2010. Headline inflation, however, picked up briskly to 2.3 percent in 2010, well above the euro area average (1.6 percent). The inflation gap with the euro area was largely driven by rising oil prices and amplified by the sensitivity of the Belgian economy to energy price shocks (Box 2). As a result, the automatic wage indexation was triggered in August 2010.

Box 2. Why is Belgian Inflation Sensitive to Energy Prices?

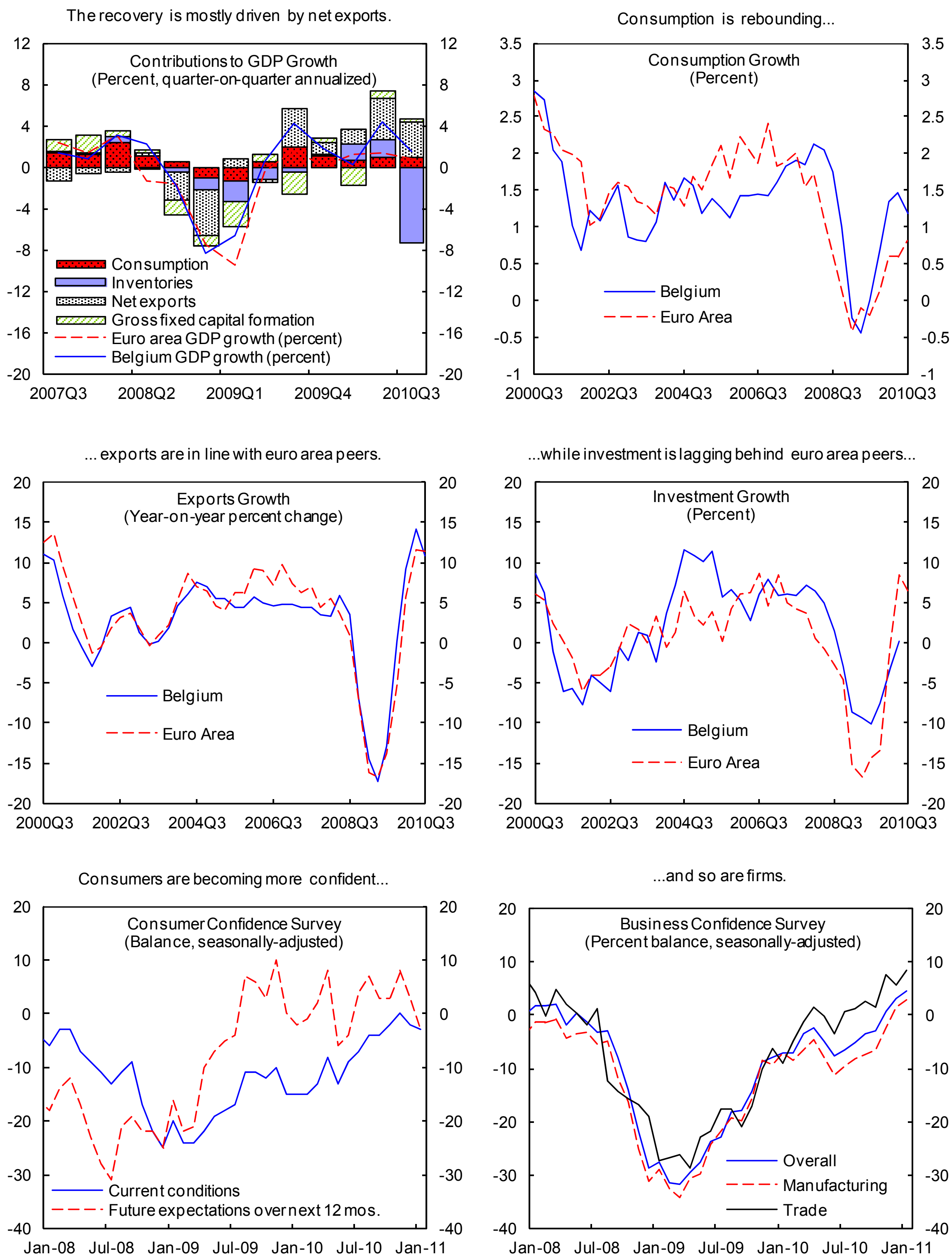
Inflation in Belgium is more sensitive to changes in energy prices than inflation in other euro area countries. National Bank of Belgium studies find that a 10 percent increase in oil prices would lead to a 0.71 percentage point rise in the HICP in Belgium after three years, compared to 0.45 percentage point in the euro area as a whole. Staff analysis has found that the pass-through within one year from oil price increases to domestic fuel prices in Belgium is 0.42, the highest coefficient among advanced countries (average: 0.24).

The sensitivity of Belgian inflation to energy prices reflects not only the relatively high energy dependency of the economy, but also structural rigidities in both energy and labor markets. Belgium's industrial structure and the higher consumption of energy products by Belgian households lead to higher energy dependency than for other euro area countries. The volatility of crude oil prices affects Belgian consumers more because of the relatively low level of excise duties and related taxes, and limited competition in the energy sector. In addition, the pass-through to headline inflation is amplified by second-round effects induced by Belgium's automatic wage indexation mechanism.

B. Outlook and Risks

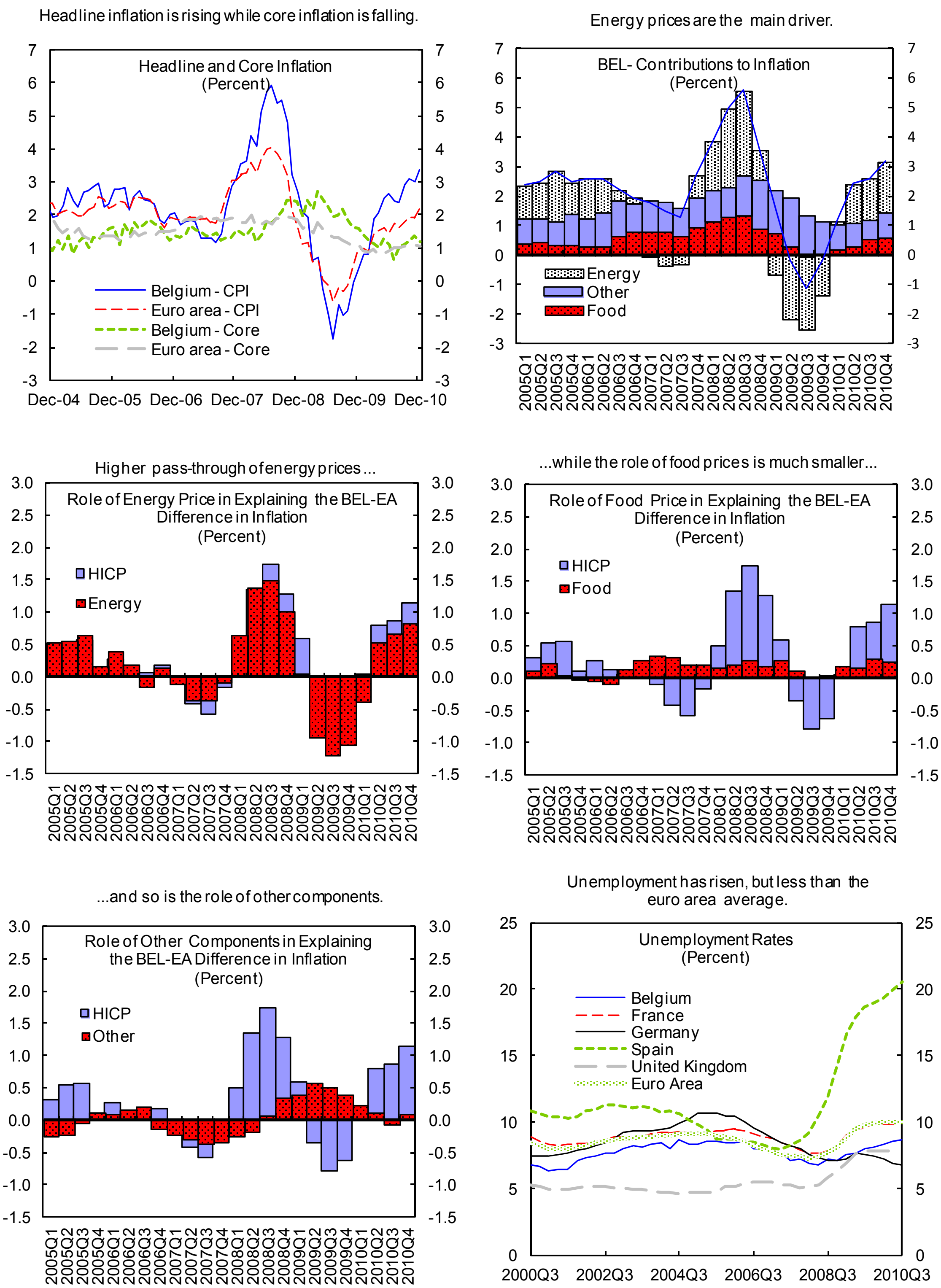
7. **The Belgian economy is expected to continue its gradual recovery.** Staff project real GDP growth to moderate somewhat to about 1.7 percent in 2011, and to pick up gradually to some 2 percent over the medium term. The authorities project growth to remain at 2 percent in 2011. Export growth would weaken in the near term with the expected softening of growth dynamics in Belgium's main trading partners while relatively high labor costs and supply rigidities continue to impede the penetration into fast-growing export markets. Domestic demand would be restrained as the government largely unwinds the

Figure 1. Belgium: Developments in Growth and Demand, 2000–10



Sources: WEO; and Haver.

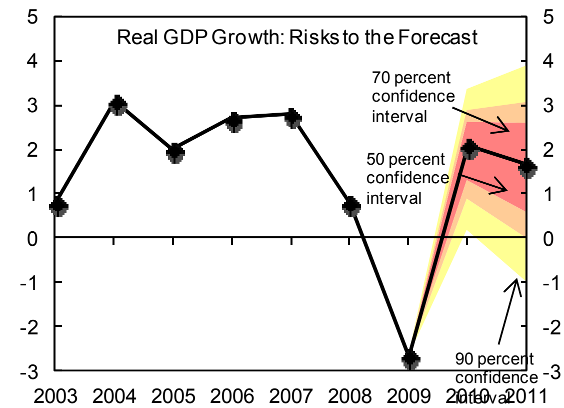
Figure 2. Belgium: Developments in Inflation and Unemployment, 2000–10



Sources: WEO; and Haver.

2009–10 fiscal stimulus while investment picks up somewhat and the inventory cycle runs its course. Private consumption is expected to remain subdued in light of still high unemployment and the real wage moderation envisaged in the negotiations between unions and employer organizations for 2011–12.

8. **The outlook is highly uncertain and risks are tilted to the downside.** In particular, the Belgian sovereign and banking system are vulnerable to contagion from possible renewed market turmoil in the euro area. Increasing concerns about sovereign risks, amplified by the political uncertainty in Belgium, could dampen confidence, increase financing costs, and depress demand. Risks in the financial sector--linked to possible spillovers from foreign markets and deteriorating asset quality, potential delays in executing the banks' restructuring programs, and continued heavy reliance on wholesale funding--could lead to an increase in funding costs, and thus depress credit growth. Also, exports could slow more than foreseen in the event of a synchronized slowdown, possibly related to spillovers from simultaneous fiscal retrenchment in Europe.



Sources: IMF staff estimates and projections.

9. **The growth of potential output is expected to revert to its declining trend over the medium term.** Before the crisis, the potential growth rate of the Belgian economy was already falling owing to demographic factors, particularly population aging. The crisis pushed down potential growth in 2008–09 below its trend rate because of the adverse impact on sectors relying on foreign demand and external finance. From 2010, potential growth is projected to revert to its trend rate of about 1½ percent over the medium term. With significant under-utilization of production capacity and slack in the labor market, the output gap would be gradually closed.

C. External Developments and Competitiveness

10. **The current account balance is expected to continue to be in moderate surplus over the medium term.** Despite the significant widening of the overall fiscal deficit in 2009, the national saving-investment balance returned to a modest surplus, reflecting the surge in private savings as well as the drop in private investment. In view of households' Ricardian behavior, net savings of the private sector would remain large and continue to offset the fiscal deficits.[2] The external current account surpluses projected over the medium term would be smaller than before the crisis.

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[2] During 1993–2008, public savings and household savings in Belgium were negatively correlated (correlation coefficient: -0.8), supporting the hypothesis that Belgian households display Ricardian behavior.

Belgium: Saving-Investment Balances, 2002–15
(In percent of GDP)

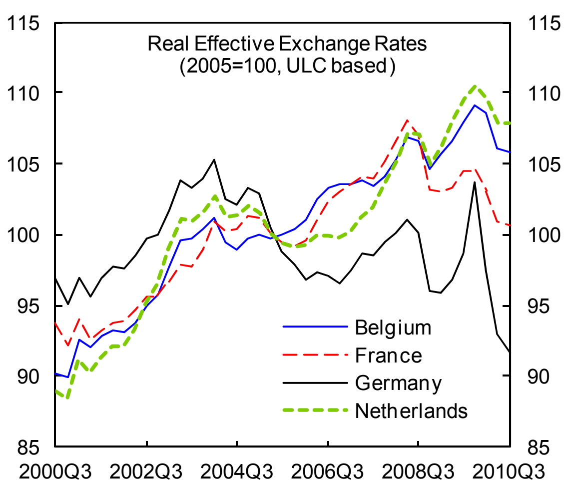
					Projections		
	2002–06	2007	2008	2009	2010	2011	2012–15
Private savings	24.4	24.8	23.4	27.0	24.7	23.8	24.8
Private investment	18.7	21.1	22.2	18.2	17.1	16.9	16.9
Private saving surplus	5.6	3.6	1.2	8.8	7.6	6.9	7.8
Government saving surplus	-2.3	-2.0	-3.1	-7.9	-6.4	-6.0	-6.2
National saving surplus	3.3	1.6	-1.9	0.8	1.1	1.0	1.7

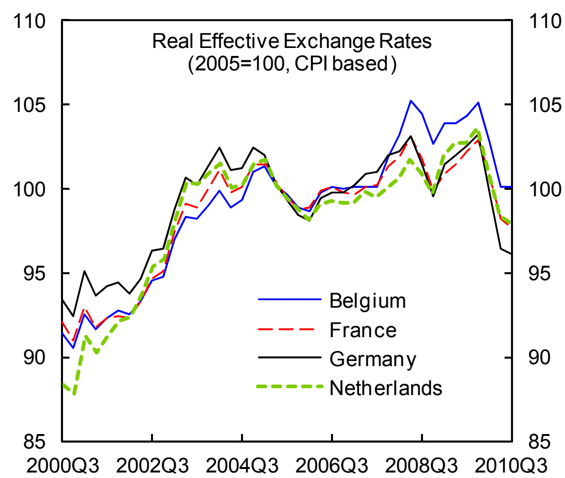
Sources: National Bank of Belgium; and IMF staff projections.

11. **Competitiveness issues relative to key trading partners persist.** Estimates based on the CGER methodologies do not indicate that the real exchange rate is in disequilibrium, but developments in the real effective exchange rates based on unit labor costs (ULC) show a competitiveness gap with respect to some key trading partners, especially Germany. With the wage indexation triggered in 2010, this gap will likely persist and limit export growth, which in turn would hinder the Belgian economy to take full advantage of the rebound in world trade. In view of the loss in world market shares of Belgian exporters over the past decade (see Selected Issues Paper, chapter 4) there is a need to strengthen the competitiveness of the Belgian economy. This requires boosting innovation, investing in human capital, facilitating the movement of production factors, notably labor, to their most productive uses, and containing costs. Hence, the automatic wage indexation mechanism should be reconsidered, including in the public sector.

Belgium: Estimation from Application of CGER Methodologies
(In percent)

Macro balances approach	-3
External sustainability approach	-6
Equilibrium RER approach	0
Simple average	-3





Source: IFS.

III. Policy Challenges

12. **In view of lingering concerns about sovereign risks in the euro area and uncertainty about the pace of the global recovery, the discussions centered on the need**

to build a consensus on macroeconomic policy priorities. The authorities were fully aware of the importance of assuaging sovereign market concerns before policy interest rates are raised from current lows, and underlined the broad support for adhering to the fiscal consolidation objectives set out in Belgium's Stability Program.[3] Staff indicated that significant efforts are needed to deal with rising aging costs while lowering public debt to the SGP limit of 60 percent of GDP over the longer term. The authorities agreed that legacy problems in the financial sector should be resolved while addressing contagion risks, strengthening banking supervision, and preparing for Basel III implementation. Sustained growth and job creation will also be key for fiscal consolidation and staff considered it essential to push ahead with growth-enhancing structural reforms.

A. Fiscal Policy: Achieving Successful Fiscal Consolidation

13. **Fiscal consolidation started in 2010.** The overall fiscal deficit was reduced from 6 percent of GDP in 2009 to 4.6 percent in 2010, below the Stability Program target (4.8 percent of GDP). This outcome reflected the stronger-than-foreseen economic growth, strict budgetary monitoring and spending discipline by the caretaker federal government, and a slowdown in healthcare spending growth. At the same time, the regions and communities underperformed as compared to their efforts foreseen in the Stability Program despite higher-than-expected revenues. Belgium's fiscal consolidation strategy appropriately aims to reduce the overall fiscal deficit to 3 percent of GDP in 2012 before achieving a balanced budget by 2015, in order to start reducing the public debt after 2012.

14. **Building upon the encouraging 2010 fiscal outcome, the caretaker government is preparing a draft federal budget for 2011.** Staff welcomed that the draft budget will aim at reducing the overall deficit to less than 4 percent of GDP in 2011, below the target under Belgium's Stability Program (4.1 percent of GDP). With the sub-national budgets already adopted, the adjustment burden in 2011 will fall on the federal government and social security. In the absence of a new government, however, the draft federal budget would rely mostly on ad hoc measures, including a new tax on nuclear power plants and an increase in the tax on banking activities. Spending will be contained by continuing some of the 2010 savings, including on healthcare.

15. **In order to reduce the overall deficit to 3 percent of GDP by 2012, significant additional tightening measures will be needed.** Under current policies, the overall deficit is projected to remain at about 4 percent of GDP in 2012 and beyond while the public debt is bound to drift up further over the medium term. This reflects in particular the pressure of rising aging costs on the budget which could increase by almost 2 percent of GDP by 2015 and further mount by 3 percent of GDP during 2015–30.

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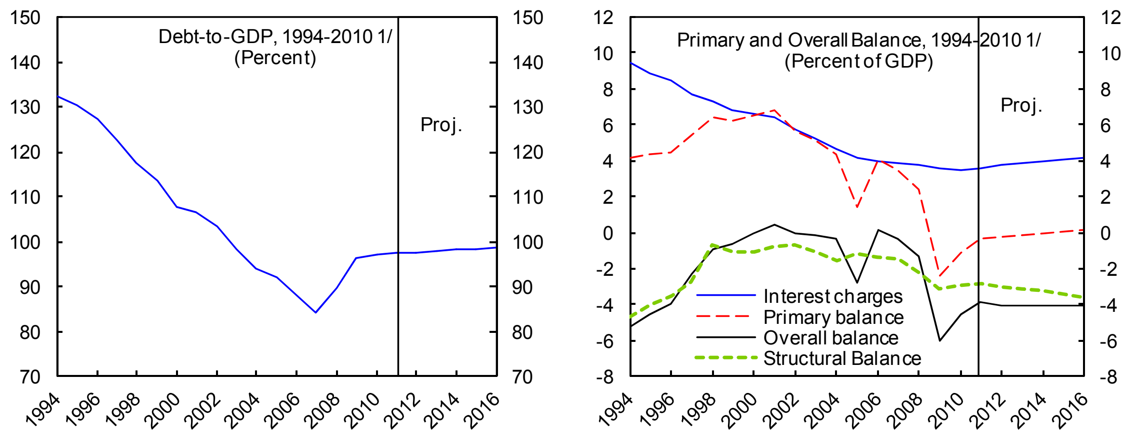
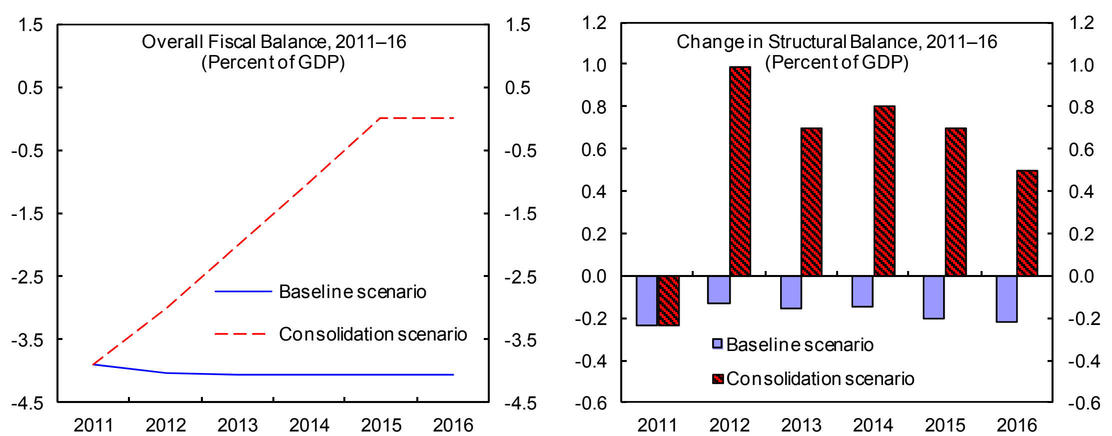
[3] European Commission's repository of the Stability Programs.



Source: NBB; and IMF staff estimates.
1/ Under current policies.

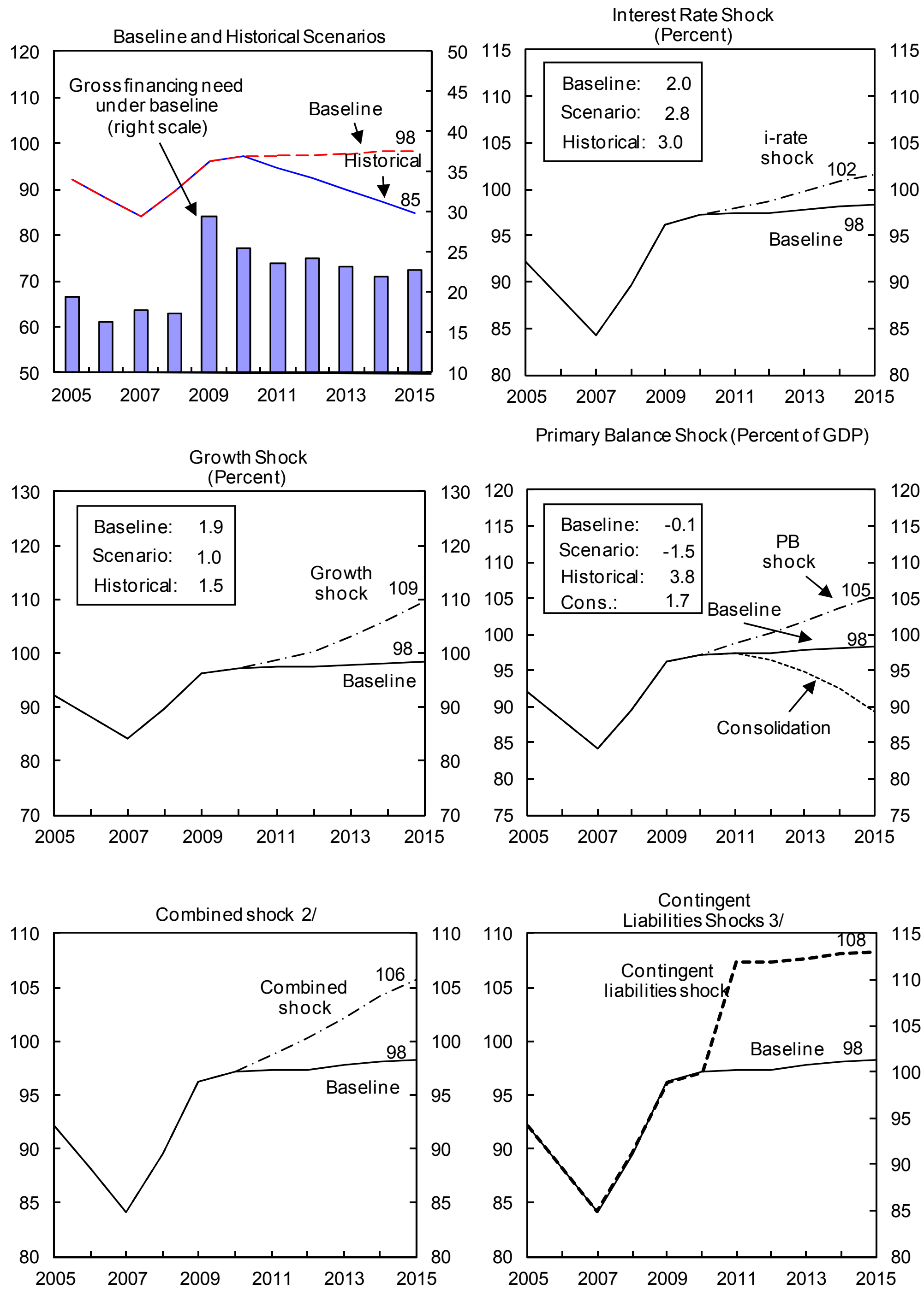
16. **Successful fiscal consolidation will need to be based on a joint effort at all levels of government.** The experience from the past large fiscal adjustment in Belgium shows the importance of reaching agreement on a multiyear budget framework based on intergovernmental burden-sharing with specific deficit targets (Selected Issues Paper, Chapter 1). In order to achieve Belgium's fiscal objectives, a new government will have to undertake a structural fiscal effort of almost 1 percent of GDP in 2012 and about 0.75 percent of GDP thereafter to achieve the balanced budget target by 2015, as illustrated in the Consolidation Scenario in the figure below.



Source: IMF staff projections.

17. **The debt sustainability analysis shows that public debt reduction calls for strong and persistent fiscal consolidation efforts** (see Selected Issues Paper, Chapter 2). Belgium has the third largest debt-to-GDP ratio in the euro area and its public debt is very sensitive to an economic slowdown, an interest rate hike, or fiscal slippage. Under staff's baseline scenario, public debt would remain close to 100 percent of GDP through 2015. Under the fiscal consolidation scenario envisaged in Belgium's Stability Program, however, the debt-to-GDP ratio would start to decline in 2013 to about 89 percent of GDP by 2015, which would be an important down-payment on reducing the debt to 60 percent of GDP by 2030.

Figure 3. Belgium: Public Debt Sustainability: Bound Tests 1/
(Percent of GDP)



Sources: Belgian Debt Agency, International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks except for interest rate shock (one standard deviation). 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 1/2 standard deviation shocks applied to real interest rate while permanent 1/4 standard deviation shocks applied to growth rate, and primary balance.
3/ One-time 10 percent of GDP shock to contingent liabilities occur in 2011.

18. **To stabilize and start bringing down the public debt, reforming the existing fiscal federalism arrangement is a priority** (Box 3). Key issues to be addressed are the lack of adequate incentives to contain real spending growth in line with trend economic growth and the off-loading on the federal government of revenue shortfalls, higher-than-foreseen social security outlays, and some spending decided by regional and local governments. While the assignment of public services to different levels of government can be based on various considerations (such as economies of scale and voter preferences, including on sub-national fiscal autonomy and national solidarity), it should ultimately be governed by the need to preserve the financial viability of the general government as a whole. With regard to the ongoing political negotiations to revise the fiscal federalism arrangement, the authorities broadly agreed on the importance of the following considerations:

- Adopting a rule-based framework to ensure the credibility of the envisaged consolidation efforts, in line with the ongoing strengthening of fiscal governance in the euro area. This should comprise a multi-year budgetary framework based on realistic macroeconomic assumptions; caps on spending growth for each level of government; and possibly a revenue rule that assigns unforeseen additional revenue to public debt reduction.
- Determining the share in tax revenues of each level of government in a consistent manner, in order to safeguard sufficient revenues for the federal government to honor its debt service and social security obligations;
- Avoiding moral hazard and promoting transparency and accountability at all levels of government, in order to preclude decisions by sub-national governments that create unplanned fiscal liabilities for the federal government and establish a clear link between costs and benefits of public services; and
- Limiting tax competition between sub-national jurisdictions to avoid distortions in the efficient working of the internal common market.

19. **Restoring a credible path towards fiscal sustainability will require a new government to implement a comprehensive strategy, notably including growth-friendly entitlement reforms.** The focus should be on limiting expenditure growth at all levels of government and social security, while also preparing additional revenue measures:

- Both the federal and the sub-national levels of government should take advantage of the projected retirement of about a third of public servants by 2020 by not replacing a sizable number of them. Also at sub-national levels of government the efficiency of public services in Belgium can be significantly improved.[4]

[4] See 2009 OECD Economic Survey of Belgium.

Box 3. Fiscal Federalism in Belgium

Federalization in Belgium derived from historical, linguistic, and cultural divides. The Belgian federation is composed of the federal state, three regions, and three linguistic communities. There is no hierarchy between federal laws and regional and community laws.

Almost three quarters of the regional and community financing come in the form of transfers from the federal government. The main financial transfer to the regions is the federal personal income tax transfer. It is a grant rather than a shared tax as it is not a fixed proportion of the total revenue from the personal income tax. Since 1990 the federal personal income tax transfer is horizontally attributed to the regions according to each region's contribution to federal personal income tax revenues. In parallel, under the National Solidarity Intervention program (*Intervention de solidarité nationale,* ISN), regions receive an equalization grant. Finally, each region obtains a lump-sum grant from the federal budget. Due to their lesser fiscal capacity, the Brussels and Walloon regions are net recipients of ISN transfers.

Belgium: Evolution of Revenue Sources of Regions and Communities

	As a percentage of their total revenue					As a percentage of GDP				
	1990	1995	2000	2005	2009	1990	1995	2000	2005	2009
Revenue	100.0	100.0	100.0	100.0	100.0	11.1	12.6	13.2	14.2	14.5
Own tax revenues	6.7	7.6	8.8	16.2	14.1	0.7	1.0	1.2	2.3	2.0
Transferred taxes	74.7	71.6	69.2	59.6	59.7	8.3	9.0	9.1	8.5	8.7
Revenues from other government transfers	9.1	8.5	8.7	9.5	10.6	1.0	1.1	1.1	1.4	1.5
Other revenues	9.5	12.3	13.3	14.7	15.6	1.1	1.5	1.8	2.1	2.3

Sources: OECD; and National Bank of Belgium.

- Curbing the rise in pension costs by eliminating fiscal incentives for early retirement and introducing actuarial neutral discounts on early pension benefits to compensate for the longer benefit period and the shorter contribution period.[5] It is urgent to organize a national dialogue to prepare a comprehensive pension reform as in other European countries. An increase in the effective retirement age by one year is estimated to yield structural savings of about ½ percent of GDP.

- Reducing federal transfers to the healthcare system (estimated at 1 percent of GDP in 2011) by tightening the excessively loose real healthcare spending growth norm (4.5 percent) and by strengthening cost-saving incentives for healthcare providers and customers. Transferring part of the healthcare responsibilities, e.g.,

[5] At present, the effective retirement age at less than 60 years is much below the statutory retirement age of 65 years.

long-term care, to the regional and local levels would provide better aligned incentives and help trim costs.

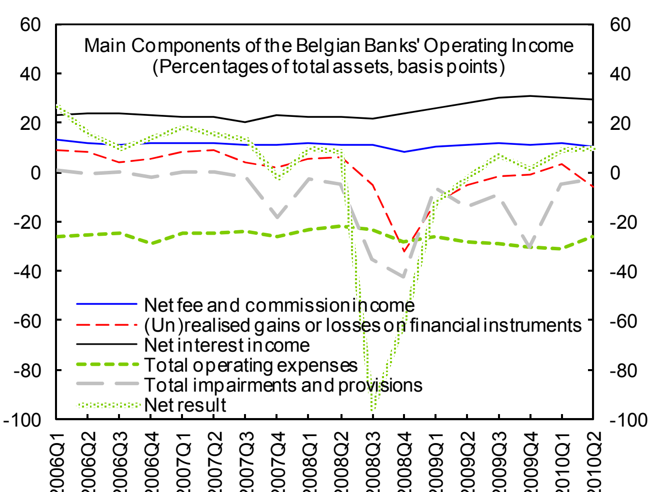
- Strengthening fiscal discipline at the local government level by setting up a forum for regional-local fiscal coordination at all stages of the budget cycle and by applying transparent norms on the size and composition of local investment and borrowing to prevent municipalities from accumulating excessive or overly risky liabilities.

- Broadening the tax base and improving revenue collection. There is also considerable scope to reduce the large federal and regional tax expenditures while using part of the gains to lower statutory tax rates and the labor tax wedge.

The authorities agreed that achieving Belgium's fiscal objectives will necessitate implementing significant adjustment measures, including in the pension and healthcare systems, but indicated that these will have to be decided by a new government.

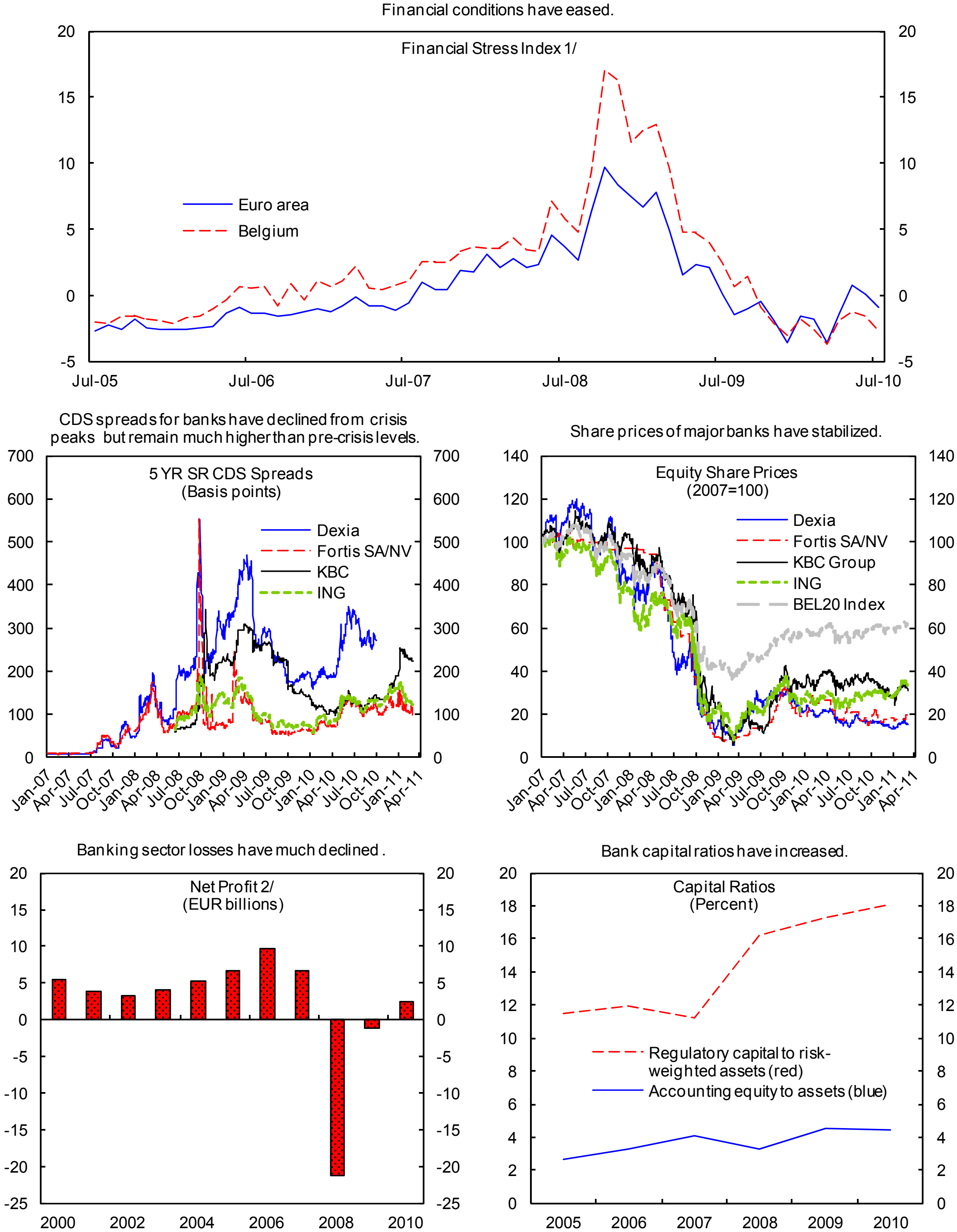
B. The Financial System: Continued Restructuring to Improve Resiliency

20. **Conditions in Belgium's financial system have improved, but the banking sector is still in the midst of significant restructuring with considerable risks remaining.** Deleveraging in the banking sector continued, with total assets falling from some 430 percent of Belgian GDP in mid-2009 to around 360 percent by mid-2010. Share prices and credit default swap (CDS) premiums of Belgium's four main bank-assurance groups (Dexia, KBC, BNP Paribas Fortis, and ING Belgium) have stabilized in 2010, but CDS premiums remain elevated. The banking sector saw a return to net profitability in the second half of 2009 and 2010. Growing net interest income has been an important driver of the increase in banks operating income, reflecting re-pricing of commercial loans and deposits as well as steepening of the euro yield curve.



Sources: CBFA; and NBB.

Figure 4. Belgium: Recent Developments in the Financial Sector

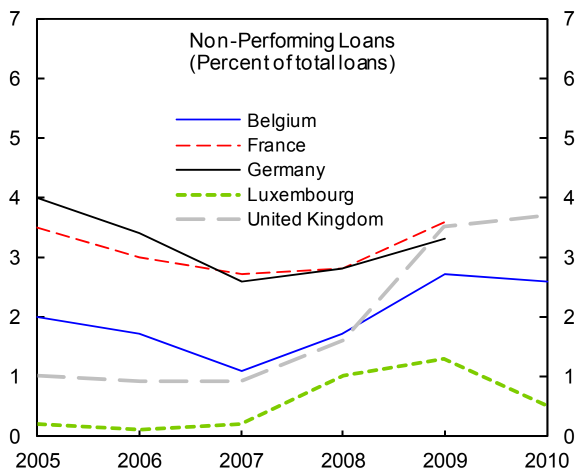


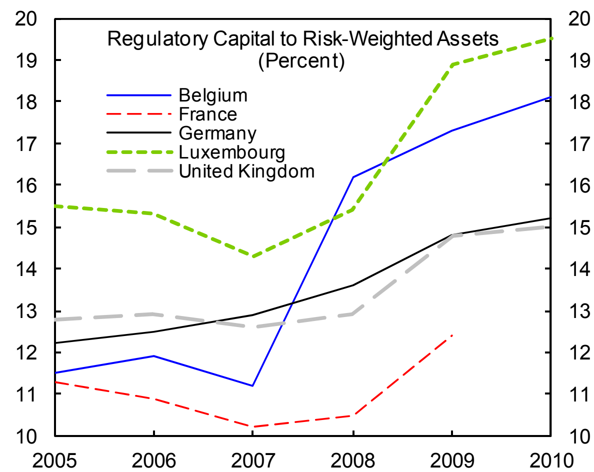
Sources: NBB; IMF GFSR; and IMF Working Paper No. 09/133, "The Transmission of Financial Stress from Advanced to Emerging Economies."

1/ An episode of financial stress is defined as a period when the financial system's ability to intermediate may be impaired. An increase in the index suggests more financial stress.

2/ 2010 non-annualised net profit applies only to first half.

21. **While asset quality has deteriorated somewhat, the banking system remains by and large well capitalized.** The deterioration of the economic situation was mirrored by higher nonperforming loans (NPLs), in particular in Ireland and Central and Eastern European (CEE) countries, but the overall share of NPLs in gross loans remains low. At the same time, the banks have reduced their risk-weighted assets through divestment of non-core business activities. Overall, the capital adequacy of Belgian banks compares favorably to other major European banks, owing in part to the state capital support. The aggregate capital adequacy ratio reached 18 percent by mid-2010 while the Tier 1 capital ratio improved from 13.2 percent at the end of 2009 to 14.1 percent in mid-2010.



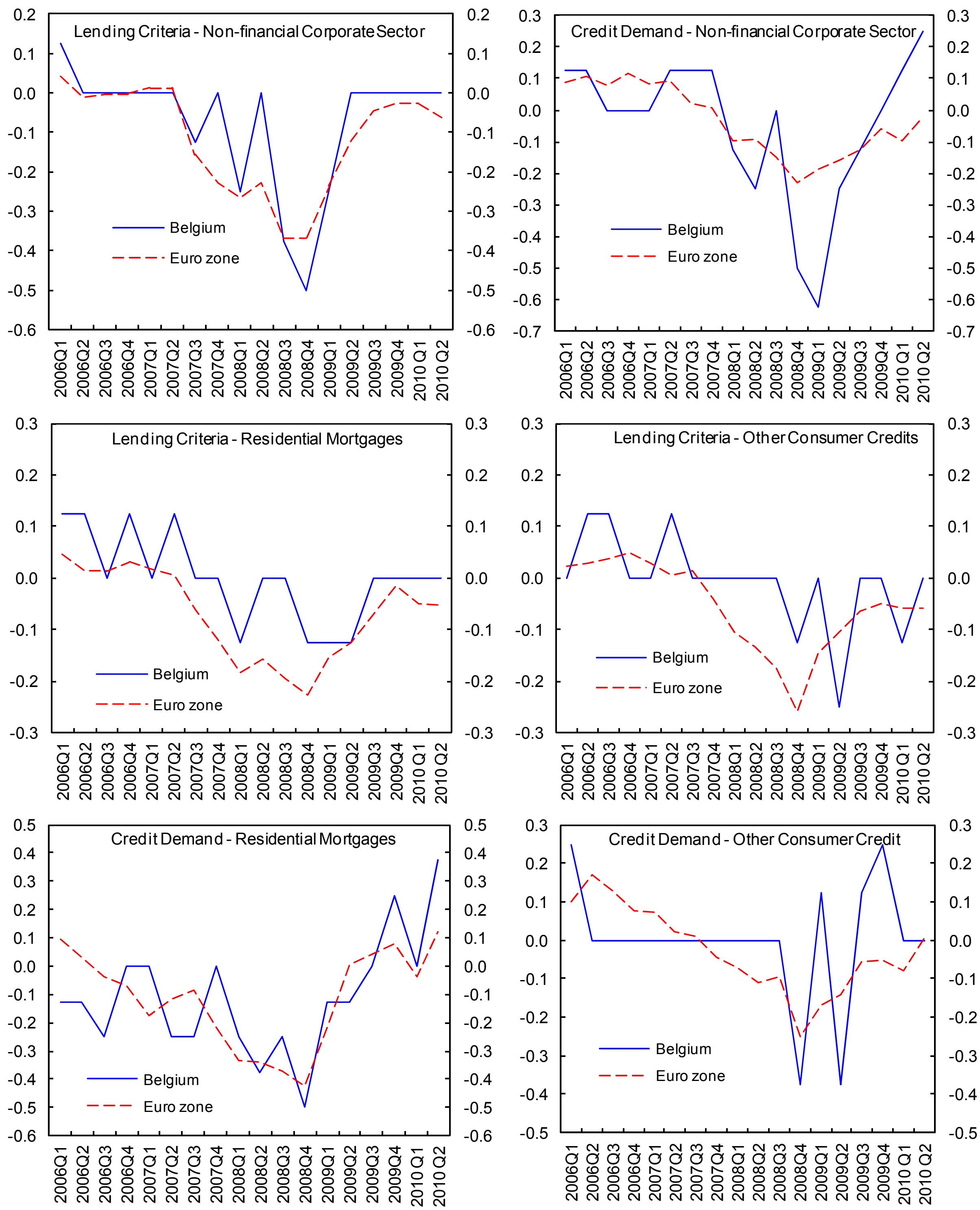


Source: IMF GFSR.

22. **Staff and the authorities agreed on the importance of ensuring that banks continue to have sufficient capital buffers as the Basel III regulatory framework is implemented.** Although the forthcoming changes in the definition of regulatory capital implied by Basel III will impact the largest banks, the authorities' simulations showed that the large Belgian banking groups would be able to comply with the new regulations without raising additional equity. This finding assumed the envisaged grandfathering and transitional arrangements for phasing-in the new regulations, as well as continued progress in bank restructuring. As market pressures may require early compliance with Basel III requirements, the authorities need to ensure that banks maintain sufficient capital buffers. This will enhance the banks' ability to raise longer-term funds at reasonable costs and supply adequate credit to the private sector.

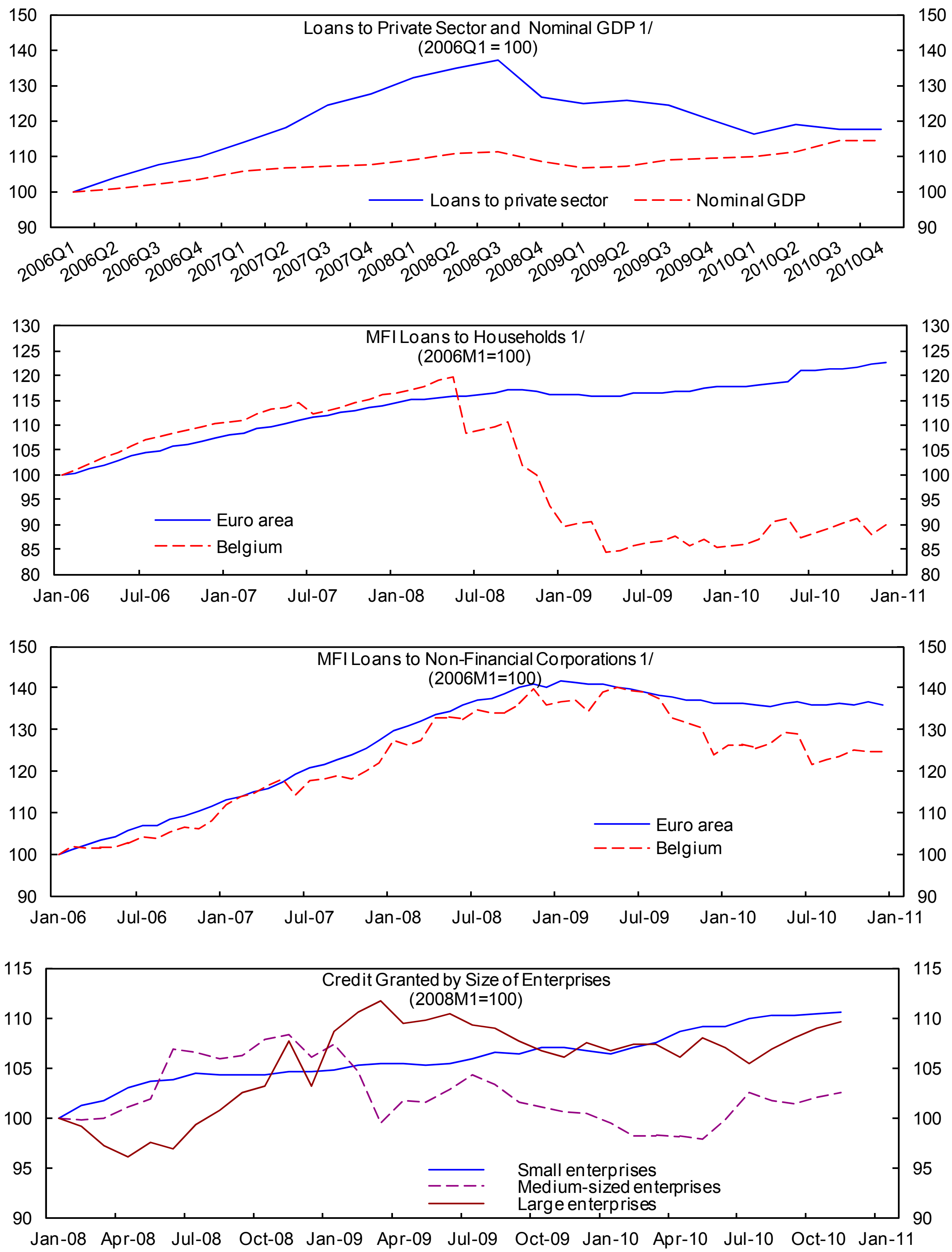
23. **Banks' lending criteria have eased relative to the depth of the crisis and demand for credit and credit to the private sector have picked up.** Loan demand for mortgages has shown a strong increase in 2010, as has demand for loans by companies. At the same time, the criteria for granting credit in Belgium have moved sideways since the end of 2009, amid a tighter lending environment elsewhere in the euro area. Overall credit to the private sector recovered in 2010 at a rate that is in line with nominal GDP.

Figure 5. Belgium: Bank Lending Survey 1/



Source: National Bank of Belgium.
1/ Data above the zero line are looser conditions and below the zero line are tighter conditions.

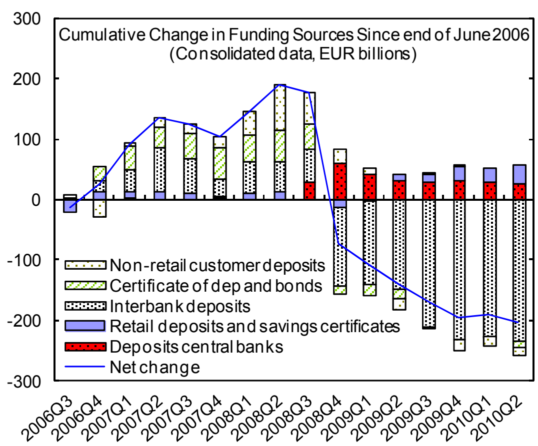
Figure 6. Belgium: Credit Developments

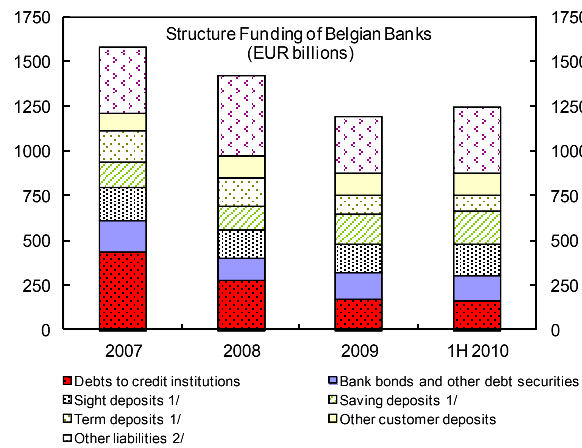


Sources: Haver; IMF, IFS; ECB; and Eurostat.
1/ Credit growth in 2008 and 2009 was largely affected by securitization operations. Excluding these operations, the underlying credit growth decelerated but remained positive in 2008 and 2009.

24. **Bank restructuring is progressing but execution risks are considerable**. The authorities are closely monitoring the significant restructuring of three of the four major banks that is aimed at deleveraging and refocusing on core markets and activities (Annex I). Wholesale funding has fallen but about 60 percent of bank assets continue to be funded by wholesale sources. Banks' funding costs have increased because of more reliance on liabilities with longer maturities and the stiff competition for retail deposits. This—coupled with lower fees and commissions as well as the refocusing on retail banking—implies that the profitability of Belgian banks is unlikely to return to its pre-crisis level over the medium term. The sizable deleveraging in many parts of the European banking system could hamper envisaged asset disposals. Renewed turbulence in European financial markets could further increase funding costs and involve losses on foreign exposures.

25. **Liquidity conditions have improved, but the authorities should remain flexible to provide liquidity support in the event of renewed stress.** The funding structure of the Belgian banking system has been rebalanced with a major retreat from more volatile interbank deposits and an increased focus on deposits by retail customers. ECB financing of Belgian banks has come down to pre-crisis levels by end-2010. However, the still high degree of dependency on wholesale funding of some Belgian banks implies that crisis-related public support to the banking system must be managed flexibly and contingency plans should be prepared to address a possibility of renewed market tensions (including through swap lines with other central banks). The authorities need to keep up the pressure on banks to develop new funding models based upon a sound mix of simpler and more transparent instruments, and a larger deposit base. Quantitative impact analyses undertaken by the authorities imply that Belgian banks—similarly to other large European banks—will have to take substantial measures to comply with the new Basel III liquidity framework. Staff welcomes the introduction of the stress test liquidity ratio developed by the Banking, Finance

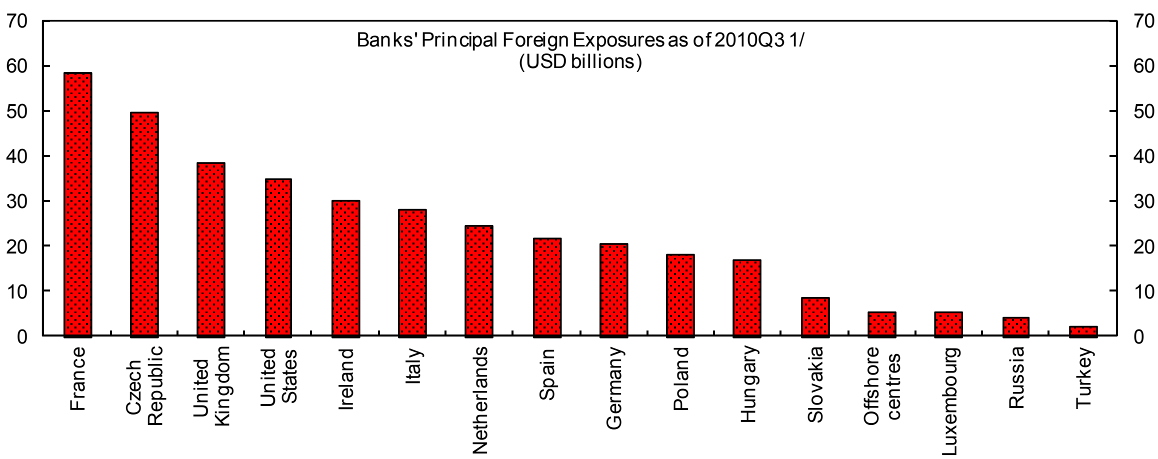




Sources: CBFA; and NBB.
1/ Deposits booked at amortised cost only.
2/ Includes subordinated liabilities, derivatives, short positions and own funds and minority interest.

and Insurance Commission (CBFA) as a binding requirement as of January 2011.[6]

26. **Belgian banks remain vulnerable to potential spillovers from both mature and CEE markets.** Exposures to CEE countries (mainly the Czech Republic, Poland, and Hungary) and to Ireland (in particular to the real estate sector) reflect the activities of subsidiaries of Belgian banks in these countries that are to be scaled down with the implementation of the restructuring plans. The legacy structured products portfolios—protected by government guarantees—remain sensitive to developments in the U.S. financial sector. The combined exposures to Greece, Ireland, Italy, Portugal, and Spain amounted to almost 10 percent of bank liabilities (30 percent of GDP) in 2010:Q3, with about a third of this exposure to sovereign debt (mainly Italy and Spain) and some 40 percent to the non-bank private sector (mostly Ireland and Spain). With sizable holdings of Belgian sovereign debt (about 17 percent of GDP), the banks are also exposed to valuation losses on Belgian public debt instruments.



Source: BIS Consolidated Banking Statistics.
1/ Amounts outstanding based on consolidated foreign claims of reporting banks on an ultimate-risk basis.
Note: The Belgian banking sector data exclude ING Belgium and BNPP Fortis, classified respectively under the exposures of Dutch and French banks, and only include data from Dexia Bank Belgium and not other subsidiaries of Dexia Group.

27. **Continued emphasis on proactive supervision against the backdrop of institutional change is an important policy priority.** The integration of prudential supervision of licensed financial institutions into the National Bank of Belgium (NBB), now foreseen to become effective as of April 1, 2011, should facilitate a better understanding of macro-financial linkages in the Belgian economy, in order to prevent banks from undertaking excessively risky activities with large externalities. During the transition period, the new

[6] Similarly to the Basel Liquidity Coverage ratio (LCR), the CBFA stress ratio targets 30-day liquidity under a stressed scenario of liquidity outflows, but with a wider definition of liquid assets and more severe stress scenarios. See *Gestion du risque de liquidité*, CBFA Circulaire 2010/21 from September 30, 2010 at www.cbfa.be/fr/ki/circ/pdf/cbfa_2010_21.pdf . The implementation of the new Basel III liquidity framework envisaged in 2015 for the LCR will require changes in the calibration of the CBFA stress ratio.

Systemic Risks and Systemic Institutions Committee—a joint CBFA and NBB body—has been responsible for supervision of systemic financial institutions. The remaining challenges of better integration of micro- and macro-prudential supervision should be addressed while putting emphasis on intensive and intrusive supervision, close monitoring of cross-border exposures, and keeping up the pressure on banks to develop transparent organizational structures. The authorities should also closely coordinate their regular stress testing efforts with the next round of EU-wide stress tests, based on credible and stringent scenarios, subject to intensive supervisory scrutiny, and benchmarked against sufficiently high capital levels.

28. **The tightening of banking sector regulation might cause risks to migrate into other parts of the financial system and the supervisory framework must gear itself to be able to identify these developments.** The new Financial Services and Markets Authority, separate from the NBB, will remain in charge of the supervision of financial markets (and related conduct of business rules) and will be given additional functions in consumer protection of financial products and supervision of certain financial intermediaries (e.g., insurance brokers). It is important to set up an effective cooperation and information exchange between the two new supervisory authorities, including through formalized cooperation agreements.

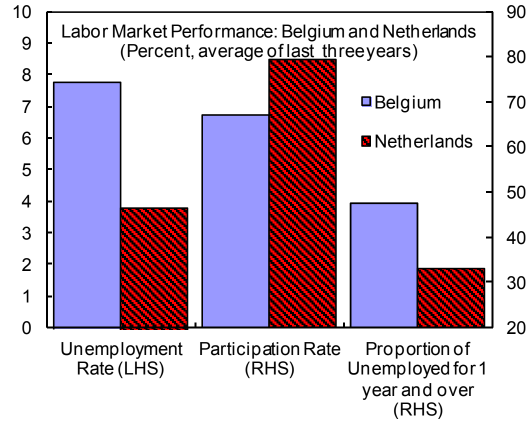
29. **Staff welcomes the enactment of a new law that extends the authorities' intervention powers in the event of a systemic crisis, but more needs to be done to strengthen resolution mechanisms.** The Financial Crisis Law passed in June 2010 gives the authorities strong powers to act decisively in times of crisis and provides supervisors with strong political backing for resolving systemic institutions (Annex II). Additional work, including at the international level, is required to facilitate the timely resolution of complex, cross-border financial institutions, if needed. In view of the high interconnectedness of the Belgian financial sector with those in neighboring countries (see Selected Issues Paper, Chapter 3), continued close cooperation with foreign regulators and central banks, notably within the EU, is critical to develop a shared understanding of the risk profile and activities of Belgian financial institutions as well as robust contingency plans.

C. Structural Reforms: Promoting Growth

30. **Increasing Belgium's potential growth requires steadfast reforms in the labor market.** There is considerable scope to improve labor market outcomes in Belgium in comparison with some of its euro area peers (Box 4). By increasing the Belgian employment rate to the euro area average, trend output growth could be increased by about ½ percent per year over the medium term. In order to expand employment, and thereby lift trend growth and improve fiscal soundness, the authorities agreed that it is important to step up labor market reform. To this end, staff encouraged the authorities to:

Box 4. Why is Labor Market Performance Better in the Netherlands?

Belgium and the Netherlands are neighboring small open economies, but labor market outcomes are strikingly different. Specifically, Belgium has a higher unemployment rate, lower labor participation rate, and longer unemployment duration—although there is a high degree of regional disparity, reflecting differences in economic structures, linguistic skills, and activation policies.



Source: OECD; and IMF staff calculations.

The gap in labor market performance between the two countries likely reflects a confluence of factors:

- *Generosity of unemployment benefits system.* The replacement rate—the amount of benefits received by the unemployed as a percent of previously earned wage income—in the Netherlands is higher but the duration of unemployment benefits is capped at around 20 months, providing incentives for job search, whereas in Belgium it is unlimited.

	Employment Strictness Index, 2008 1/	Tax Wedge, 2008 2/
Belgium	2.18	56
Netherlands	1.95	45

Source: OECD.
1/ The higher the index, the stricter is employment protection.
2/ Calculated as income tax plus employee and employment contributions less cash benefits as a percent of labor costs for a single person without children with average earnings.

- *Intensity of activation policies*—In the Netherlands, as in Germany, unemployment compensation is more closely linked to job search activities. In Belgium, activation policies vary across regions and are typically more proactive in Flanders than elsewhere, which might partly explain the better labor market outcomes in the region. Overall, however, the incentives for an unemployed person to search for a job are weaker in Belgium.

- *Strictness employment protection legislation.* Belgium has stricter employment protection legislation than the Netherlands, thereby making it more difficult to fire a worker. This, in turn, increases the risks of hiring in Belgium and makes employers less willing to do so.

- *Tax wedge*—Belgium has a much higher tax burden on wage incomes than the Netherlands. This effectively lowers the differential between earnings and unemployment benefits (unemployment trap), thereby reducing incentives to stay on a job for the employed and to look for a job for the unemployed.

- Phase out temporary unemployment programs to improve job search incentives and labor re-allocation during the recovery;

- Enhance incentives for individuals to find a job by stepping up the monitoring of search activities and increasing sanctions on inadequate efforts, including in case of refusal of suitable employment; expanding job counseling and training opportunities; gradually limiting the duration of unemployment benefits; and increasing performance incentives for employment agencies;

- Reduce the tax wedge on labor income, in order to increase the differential between wages and unemployment benefits with a view to enhancing job search incentives;

- Put in place mechanisms that discourage workers to leave the labor force temporarily or permanently before having reached the legal retirement age; and

- Increase labor market participation for younger workers and immigrants by stepping up targeted language and other training, and reconsidering the employment protection legislation.

31. **Moderating wage increases and reconsidering automatic wage indexation are important to strengthen competitiveness.** Belgium's labor costs are high compared to its peers (Box 5). Staff agrees with the authorities that labor costs need to be kept in line with those of Belgium's main euro area trading partners. In this connection it is welcome that negotiations between unions and employer associations envisage limiting real wage increases in 2011–12. Staff encourages the authorities to reform the automatic wage indexation mechanism, including in the public sector, in order to increase the flexibility in wage negotiations to take account of varying circumstances in different sectors and avoid second-round effects of energy price volatility.

32. **Continued progress in product market reform is necessary for enhancing competition.** Staff welcomes the new law on market practices, which has eased regulation in the retail sector, and the transposition of the EU Services Directive into Belgian legislation. Further steps should ensure that the liberalization in the services sector is effectively implemented. In light of the sensitivity of the Belgian economy to energy price shocks, it is important to enhance transparency, regulation, and competition in energy markets. The Competition Council should be provided with sufficient resources and its independence should be strengthened further. It should be able to conduct independent sectoral analyses, issue specific competition policy recommendations, and cooperate effectively with sectoral regulators.

Box 5. Why are Labor Costs High in Belgium?

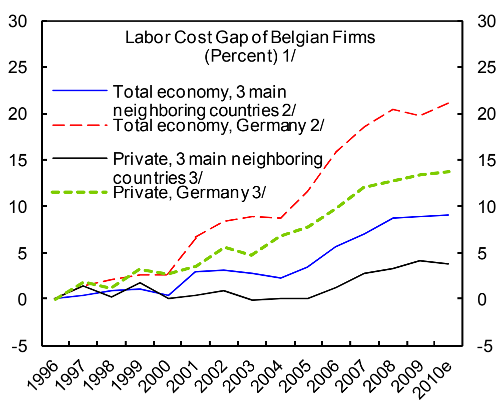
The relatively high labor costs in Belgium have weakened the country's competitiveness. Compared to its European peers, notably Germany, Belgium's unit labor cost has grown faster in both the private and the public sectors. This partly reflects the inflexible wage negotiation process, which has resulted in real wage increases that exceeded labor productivity growth.

Belgium's wage negotiation system is based on two pillars:

- **Wage norm—**This puts an (indicative) upper bound on wage increases, in order to keep them in line with those in France, Germany, and the Netherlands. The norm is set by the social partners (or by the government in case of non-agreement) on the basis of biannual calculations by the *Conseil Central de l'Économie* (CCE) based on labor cost developments in the three neighboring countries.

- **Automatic wage indexation—**This effectively puts a lower bound on wage increases and Belgium is one of the last OECD countries that still use such automatic wage indexation. The wage indexation is anchored on an adjusted inflation measure known as the health index, which excludes the prices of tobacco, alcohol, and fuel energy (but not heating energy).

The inflexibilities inherent to the wage bargaining process have led to several unintended consequences. The combination of wage indexation and the wage norm fixes a substantial part of the annual wage growth at the national level, leaving little room for wage negotiations to take account of varying circumstances in different sectors. Furthermore, the automatic wage indexation results in considerable second-round effects of energy price hikes. In fact, the ex-ante expected increases of its neighbors have usually been over-estimated and the ex-post Belgian wage increases have usually been higher than those in its neighbors This has raised Belgium's unit labor costs and weakened external competitiveness.



Sources: Belgian authorities; and OECD.
1/ Percent differences in unit labor costs in Belgium and the average of Germany, France, and the Netherlands.
2/ Total economy unit labor costs.
3/ Private sector hourly labor costs.

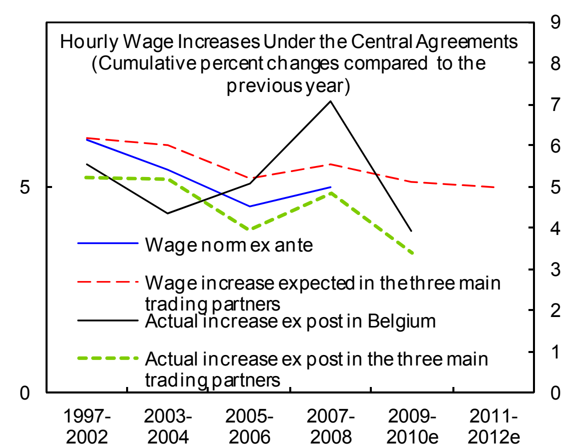
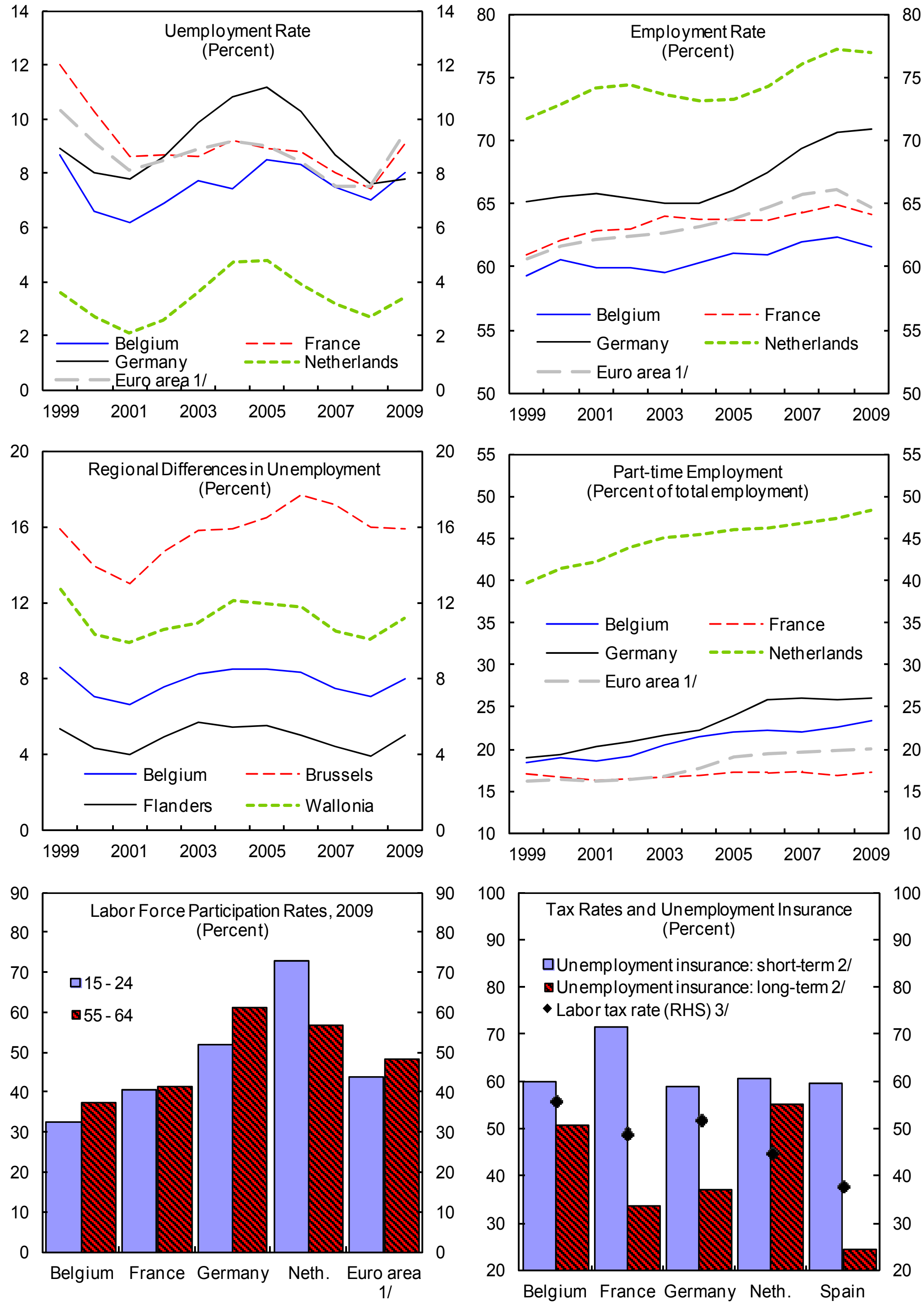


Figure 7. Belgium: Labor Market Indicators, 1999–09



Sources: Belgian authorities; Global Insight; OECD; Eurostat; and IMF WEO.
1/ EA11-2000, EA12-2006, EA13-2007, EA15-2008, EA16-2010.
2/ Unemployment insurance: net replacement rates for single worker without children, in percent of the "average worker" wage (AW). Expressed as the average of 67% and 150% of AW levels. Data are for 2007.
3/ Labor taxes are for a single person without children, at 100% of the average wage, measured in percent of labor costs.

IV. Staff Appraisal

33. **The Belgian economy is recovering from the financial crisis and global recession but the protracted political impasse hampers policy making and compounds post-crisis vulnerabilities.** Economic activity expanded more than foreseen in 2010, the unemployment rate is stabilizing, and progress was made in bank restructuring. At the same time, the absence of a new federal government is tying the hands of the authorities in addressing the important challenges facing the country. With high and rising public debt, the political stalemate has triggered market concerns. Preserving market confidence in Belgian sovereign debt is important to avoid adverse debt dynamics and to bolster the banking system.

34. **The near-term outlook is challenging.** The Belgian economy is expected to continue its gradual recovery but real GDP growth is projected to moderate somewhat in 2011, in view of the expected slowdown in the euro area. While the still sizable output gap is keeping core inflation subdued, headline inflation would remain above target in 2011, reflecting strong pass-through of rising world prices. Risks, however, are tilted to the downside. In particular, the Belgian sovereign and banks are vulnerable to contagion from possible renewed market turmoil in the euro area, which could shake confidence, increase financing costs, and depress demand. Risks in the banking sector are linked to possible spillovers from its sizable foreign exposures, asset quality deterioration, and funding shocks. Possible strains would be amplified by negative feedback loops between sovereign and banking sector risks.

35. **There is a strong need to adopt a clear and comprehensive strategy to address macroeconomic policy priorities without delay.** It is important to assuage financial market concerns before policy interest rates are raised from current lows. To this end, early action should be taken to restore fiscal sustainability, including by initiating reforms in fiscal federalism arrangements and entitlement programs; strengthen financial sector stability; and push ahead with structural reforms to create jobs, improve competitiveness, and promote growth.

36. **Significant efforts are needed to bring down the public debt while dealing with rising aging costs.** Staff supports the authorities' objective to achieve a balanced budget by 2015. Building on the encouraging 2010 fiscal outcome, the draft 2011 federal budget under preparation by the caretaker government will appropriately aim at reducing the deficit below the target under Belgium's Stability Program. Without a new government, however, the draft budget would mostly rely on ad hoc measures. Given rising aging-related government spending, achieving the fiscal objectives for 2012 and beyond will require a structural fiscal effort of 1 percent of GDP in 2012 and about 0.75 percent of GDP over the medium term at all levels of government.

37. **Bringing down the public debt requires reforming the fiscal federalism arrangement and implementing a comprehensive consolidation strategy.** It is important

that a new state reform strengthens incentives to keep spending in line with trend growth and ensures the financial viability of the government as a whole. The experience of Belgium's past successful fiscal consolidation shows the importance of agreeing on a multiyear budget framework based on inter-governmental burden-sharing. Adopting a rule-based fiscal framework would help ensure the credibility of the envisaged consolidation efforts. A new government should focus on limiting expenditure growth at all levels of government; curbing the rise in pension costs by increasing the low effective retirement age; and tightening the healthcare spending norm while strengthening cost-saving incentives. There is also room to broaden the tax base, improve revenue collection, and reduce tax expenditures.

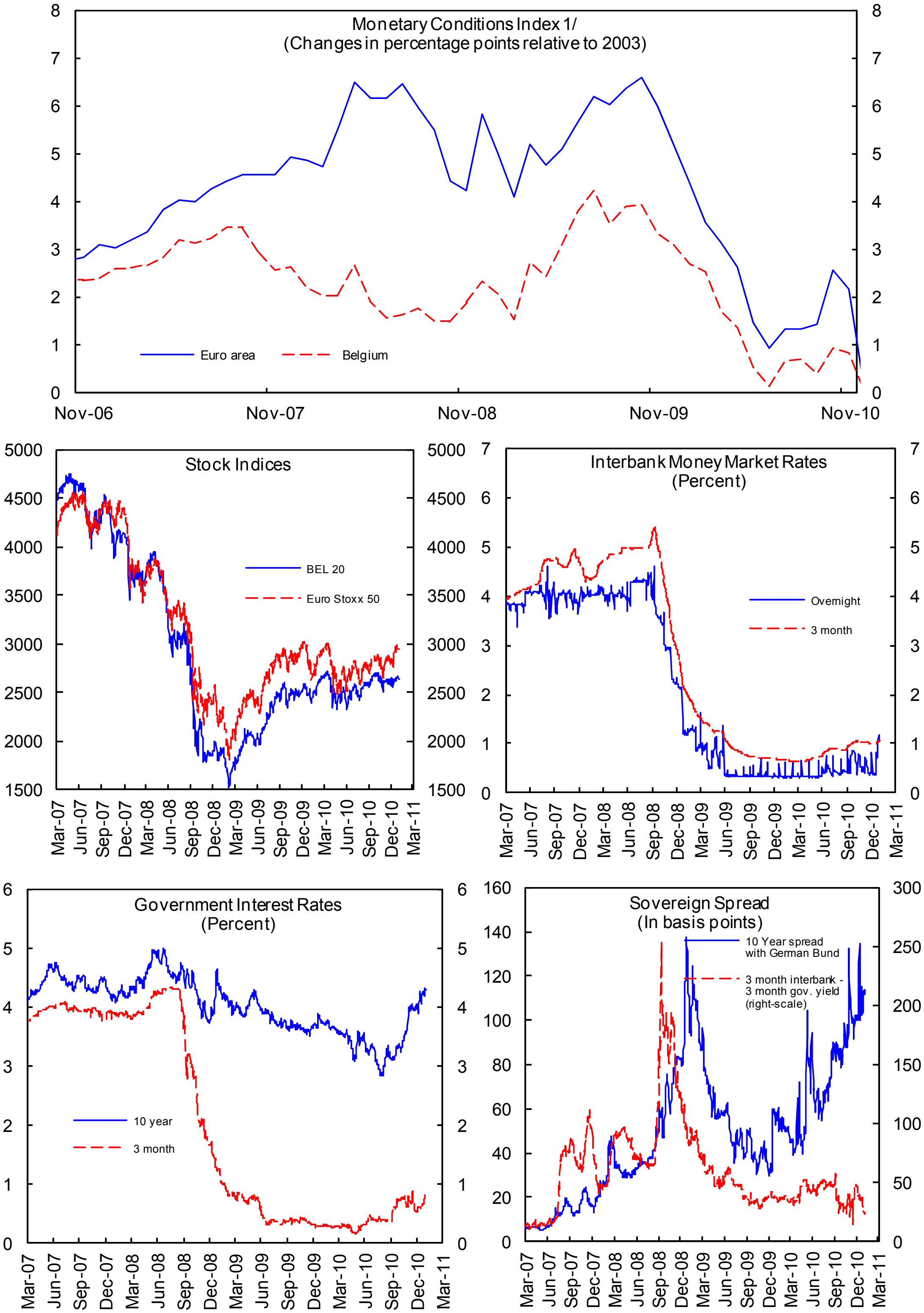
38. **Bank restructuring is progressing but considerable risks remain.** Renewed financial market turmoil could hamper the envisaged assets disposals, increase funding costs, and involve losses on foreign exposures. While at present the banking system is well-capitalized, the authorities need to ensure that banks maintain sufficient capital buffers as the Basel III regulatory framework is implemented, in order to safeguard adequate credit supply to the economy. Liquidity conditions in the banks have improved but the authorities should remain flexible to provide liquidity support in the event of renewed stress. At the same time, they should encourage banks to develop robust new funding models and take the measures needed to comply with the new Basel III liquidity framework.

39. **Continued strengthening of financial supervision is an important policy priority.** The integration of micro-and macro-prudential supervision at the central bank is welcome. This should be accompanied by intensifying supervision, closely monitoring cross-border exposures, and inducing the banks to develop transparent organizational structures. The authorities should also coordinate their regular stress testing efforts with the next EU-wide round. Formalized cooperation agreements between the central bank and the new Financial Services and Markets Authority should help to identify risks in the financial system as a whole. The new Financial Crisis Law is an important tool to deal with a systemic crisis but more needs to be done, including at the international level, to facilitate the timely resolution of cross-border financial institutions.

40. **Growth-enhancing structural reforms are crucial.** In order to expand employment, and thereby boost growth and improve the public finances, labor market reforms need to be stepped up. The priorities are to strengthen job search incentives, reduce the tax wedge on wages, and raise labor market participation. In view of subdued productivity growth, the real wage moderation envisaged for 2011–12 would help to strengthen competitiveness. To increase flexibility in wage negotiations and avoid second-round effects of energy price hikes, the automatic wage indexation should be reconsidered. Further measures are also needed to strengthen competition in product and services markets. In the energy sector, there is a need to enhance transparency, regulation, and competition.

41. **It is proposed that the next Article IV consultation with Belgium be held on the regular 12-month cycle.**

Figure 8. Belgium: Financial Indicators Overview



Sources: Thomson Financial/DataStream; and Bloomberg.
1/ Weighted average of changes in interest and exchange rates relative to their average values in a base period. An increase (decrease) indicates a monetary tightening (loosening).

Table 1. Belgium: Selected Economic Indicators, 2006–15

					Prel.	Projections				
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	(Percentage change from the previous period; unless otherwise indicated)									
Real economy										
Real GDP	2.7	2.8	0.8	-2.7	2.0	1.7	1.9	1.9	1.9	2.1
Private consumption	1.8	1.7	1.4	-0.2	1.4	1.2	1.3	1.4	1.4	1.7
Public consumption	0.6	2.1	2.5	0.4	1.1	0.9	1.5	1.1	1.0	1.0
Gross fixed investment	2.0	6.3	2.4	-4.9	-1.8	2.3	2.6	1.8	1.8	2.1
Business investment	2.0	7.9	3.4	-7.5	-1.2	2.4	2.7	2.6	2.6	2.7
Dwellings	6.4	3.4	-0.6	-3.0	-3.5	-0.1	0.7	0.7	0.7	0.8
Public investment	-11.8	4.2	5.5	10.3	-0.5	9.2	8.1	-0.1	-0.1	1.5
Stockbuilding 1/	0.8	0.1	0.0	-1.0	-0.5	-0.9	0.0	0.0	0.0	0.0
Foreign balance 1/	0.4	0.0	-1.1	-0.5	2.2	0.9	0.3	0.5	0.6	0.5
Exports, goods and services	5.0	4.3	1.4	-11.4	10.5	4.7	4.7	4.7	5.0	5.2
Imports, goods and services	4.6	4.4	2.8	-10.9	7.7	3.7	4.6	4.4	4.6	4.8
Household saving ratio (in percent)	15.9	16.4	17.0	18.3	17.2	16.9	16.9	16.8	16.8	16.7
Potential output growth	1.8	1.9	1.3	0.9	1.4	1.4	1.5	1.5	1.6	1.6
Output gap (in percent)	1.1	2.0	1.5	-2.1	-1.5	-1.2	-0.8	-0.5	-0.2	0.3
Employment										
Unemployment rate	8.3	7.5	7.0	8.0	8.4	8.4	8.2	8.2	7.9	7.9
Employment	1.2	1.6	1.7	-0.3	0.6	0.7	0.9	0.9	1.0	1.2
Prices										
Consumer prices	2.3	1.8	4.5	0.0	2.3	2.9	2.3	2.1	2.0	2.0
GDP deflator	2.3	2.3	1.9	1.1	1.5	2.3	2.3	2.1	1.9	2.0
ULC (in whole economy)	1.9	2.1	4.5	4.4	-0.2	2.7	1.8	1.6	1.5	1.5
	(In percent of GDP; unless otherwise indicated)									
Public finance										
Revenue	48.8	48.1	48.8	48.1	48.9	49.2	49.0	49.0	49.0	49.0
Expenditure	48.6	48.4	50.1	54.1	53.4	53.1	53.1	53.1	53.1	53.1
General government balance	0.2	-0.3	-1.3	-6.0	-4.6	-3.9	-4.0	-4.1	-4.0	-4.0
Structural balance	-1.4	-1.5	-2.2	-3.0	-2.9	-2.8	-3.0	-3.1	-3.2	-3.4
Primary balance	4.1	3.5	2.4	-2.4	-1.1	-0.3	-0.2	-0.2	0.0	0.1
General government debt	88.1	84.2	89.6	96.2	97.2	97.4	97.4	97.7	98.2	98.3
Balance of payments										
Trade balance	0.7	0.2	-3.3	-0.6	0.0	0.3	0.7	1.1	1.5	1.9
Current account	1.9	1.6	-1.9	0.8	1.1	1.0	1.2	1.5	1.9	2.3
Terms of Trade (percent change)	-0.7	0.2	-2.4	3.4	-1.1	-0.6	0.0	0.2	0.2	0.3
Exports, goods and services (volume, percent change)	5.0	4.3	1.4	-11.4	10.5	4.7	4.7	4.7	5.0	5.2
Imports, goods and services (volume, percent change)	4.6	4.4	2.8	-10.9	7.7	3.7	4.6	4.4	4.6	4.8

Sources: Data provided by the Belgian authorities, and IMF staff projections.
1/ Contribution to GDP growth.

Table 2. Belgium: Balance of Payments, 2006–15
(Percent of GDP)

					Prel.	Projections				
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Balance on current account	1.9	1.6	-1.9	0.8	1.1	1.0	1.2	1.5	1.9	2.3
Balance on goods and services	2.3	1.5	-2.3	1.2	1.5	1.4	1.6	1.9	2.3	2.7
Balance of trade (f.o.b., c.i.f.)	0.7	0.2	-3.3	-0.6	0.0	0.3	0.7	1.1	1.5	1.9
Exports of goods and services	80.0	81.4	82.6	70.7	80.2	82.7	84.2	86.0	88.1	90.3
Exports of goods	65.1	65.2	65.2	53.3	62.6	65.5	66.5	67.9	69.6	71.3
Exports of services	14.9	16.2	17.4	17.3	17.5	17.2	17.7	18.1	18.5	19.0
Imports of goods and services	77.7	80.0	85.0	69.5	78.7	81.3	82.6	84.0	85.8	87.6
Imports of goods (f.o.b.)	64.4	65.0	68.5	54.0	62.6	65.2	65.9	66.9	68.1	69.4
Imports of services	13.3	15.0	16.4	15.5	16.1	16.1	16.8	17.2	17.7	18.2
Income, net	1.2	1.5	2.3	1.6	1.5	1.5	1.4	1.2	1.2	1.1
Current transfers, net	-1.6	-1.4	-1.9	-1.9	-1.8	-1.9	-1.8	-1.7	-1.7	-1.6
Balance on capital account	-0.1	-0.4	-0.6	-0.4	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3
Balance on financial account	-1.9	-1.7	2.8	-1.1	-0.9	-0.6	-0.8	-1.2	-1.5	-2.0
Direct investment, net	2.1	2.9	-4.4	8.0	-16.8	-17.0	-16.6	-16.4	-16.3	-15.7
Portfolio investment, net	-1.5	-8.6	11.1	9.5	9.5	9.0	8.7	8.4	8.1	7.8
Other investment, net	-2.4	4.2	-4.2	-18.4	6.5	7.6	7.3	6.9	6.7	6.4
Reserve assets	0.0	-0.3	0.2	-0.2	-0.2	-0.2	-0.2	0.0	0.0	0.0
Errors and omissions, net	-1.3	-1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Belgian authorities; and IMF staff projections.

Table 3. Belgium: Fiscal Scenarios, 2006–15

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

					Prel.	Projections				
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Staff projections (A)										
Revenue	48.8	48.1	48.8	48.1	48.9	49.2	49.0	49.0	49.0	49.0
Expenditure	48.6	48.4	50.1	54.1	53.4	53.1	53.1	53.1	53.1	53.1
Primary expenditure	44.6	44.6	46.4	50.5	50.0	49.5	49.3	49.2	49.1	49.0
Interest payments	3.9	3.8	3.8	3.6	3.5	3.6	3.8	3.9	4.0	4.1
Balance	0.2	-0.3	-1.3	-6.0	-4.6	-3.9	-4.0	-4.1	-4.0	-4.0
Structural balance	-1.4	-1.5	-2.2	-3.0	-2.9	-2.8	-3.0	-3.1	-3.2	-3.4
Primary balance	4.1	3.5	2.4	-2.4	-1.1	-0.3	-0.2	-0.1	0.0	0.1
Structural primary balance	2.5	2.3	1.5	0.6	0.6	0.8	0.8	0.8	0.8	0.7
Debt	88.1	84.2	89.6	96.2	97.2	97.4	97.4	97.7	98.2	98.3
Memorandum items (in percent):										
Real primary expenditure growth	-4.4	2.8	5.0	5.9	0.8	0.7	1.5	1.7	1.7	1.9
Real discretionary spending growth	-8.0	3.7	4.3	5.5	-0.8	0.6	0.1	0.4	0.5	0.4
Output gap	1.1	2.0	1.5	-2.1	-1.5	-1.2	-0.8	-0.5	-0.2	0.3
GDP growth	2.7	2.8	0.8	-2.7	2.1	1.7	1.8	1.8	1.9	2.0
Consolidation scenario (B)										
Revenue	48.8	48.1	48.8	48.1	48.9	49.2	49.3	49.3	49.3	49.3
Expenditure	48.6	48.4	50.1	54.1	53.4	53.1	52.3	51.3	50.3	49.3
Primary expenditure	44.6	44.6	46.4	50.5	50.0	49.5	48.6	47.6	46.6	45.7
Interest payments	3.9	3.8	3.8	3.6	3.5	3.6	3.7	3.7	3.7	3.6
Balance	0.2	-0.3	-1.3	-6.0	-4.6	-3.9	-3.0	-2.0	-1.0	0.0
Structural balance	-1.4	-1.5	-2.2	-3.0	-2.9	-2.8	-2.1	-1.4	-0.6	0.1
Primary balance	4.1	3.5	2.4	-2.4	-1.1	-0.3	0.7	1.7	2.7	3.6
Structural primary balance	2.5	2.3	1.5	0.6	0.6	0.8	1.6	2.3	3.1	3.7
Debt	88.1	84.2	89.6	96.2	97.2	97.4	97.7	96.1	93.2	89.5

Sources: Belgian authorities; Belgian Stability Programme 2009–12; and IMF staff projections.

Table 4. Belgium: Public Sector Debt Sustainability Framework, 2006-15
(In percent of GDP, unless otherwise indicated)

	Actual				Projections					
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Baseline: Public sector debt 1/	88.1	84.2	89.6	96.2	97.2	97.4	97.4	97.7	98.2	98.3
o/w foreign-currency denominated	0.1	0.1	0.6	1.3	1.9	1.8	1.3	0.9	0.6	0.2
Change in public sector debt	-4.0	-3.9	5.4	6.6	1.0	0.2	0.0	0.3	0.4	0.2
Identified debt-creating flows (4+7+12)	-4.0	-3.8	5.6	6.4	1.3	0.2	0.0	0.3	0.4	0.2
Primary deficit	-4.1	-3.5	-2.4	2.4	1.1	0.3	0.2	0.1	0.0	-0.1
Revenue and grants	48.8	48.1	48.8	48.1	48.9	49.2	49.0	49.0	49.0	49.0
Primary (noninterest) expenditure	44.6	44.6	46.4	50.5	50.0	49.5	49.3	49.2	49.1	49.0
Automatic debt dynamics 2/	-0.5	-0.5	1.5	5.0	0.2	-0.1	-0.2	0.2	0.4	0.2
Contribution from interest rate/growth differential 3/	-0.5	-0.5	1.5	5.0	0.2	-0.1	-0.2	0.2	0.4	0.2
Of which contribution from real interest rate	1.9	1.8	2.2	2.6	2.1	1.5	1.6	1.9	2.2	2.2
Of which contribution from real GDP growth	-2.4	-2.3	-0.7	2.4	-1.8	-1.6	-1.8	-1.7	-1.8	-2.0
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	...	...	...	...	...	...
Other identified debt-creating flows	0.6	0.2	6.5	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
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
Other (specify, e.g. bank recapitalization)	0.6	0.2	6.5	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes (2-3) 5/	0.0	-0.1	-0.2	0.2	-0.3	0.0	0.0	0.0	0.0	0.0
Public sector debt-to-revenue ratio 1/	180.8	175.1	183.6	199.8	198.9	198.0	198.7	199.4	200.3	200.6
Gross financing need 6/	16.4	17.7	17.4	29.4	25.4	23.7	24.3	23.2	21.9	22.8
in billions of U.S. dollars	65.4	81.4	88.1	138.9	118.4	114.4	121.2	119.5	116.4	125.2
Scenario with key variables at their historical averages 7/					97.2	94.8	92.3	89.8	87.3	84.8
Scenario with no policy change (constant primary balance) in 2010-2015					97.2	98.2	99.0	100.3	101.8	103.1
Key Macroeconomic and Fiscal Assumptions Underlying Baseline										
Real GDP growth (in percent)	2.7	2.8	0.8	-2.7	2.0	1.7	1.9	1.9	1.9	2.1
Average nominal interest rate on public debt (in percent) 8/	4.5	4.6	4.6	4.0	3.7	3.9	4.1	4.2	4.3	4.3
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.2	2.2	2.7	2.8	2.3	1.6	1.8	2.1	2.4	2.3
Nominal appreciation (increase in US dollar value of local currency, in percent)	11.4	10.3	-6.6	7.2	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.3	2.3	1.9	1.1	1.5	2.3	2.3	2.1	1.9	2.0
Growth of real primary spending (deflated by GDP deflator, in percent)	-4.4	2.8	5.0	5.9	0.8	0.7	1.5	1.7	1.7	1.9
Primary deficit	-4.1	-3.5	-2.4	2.4	1.1	0.3	0.2	0.1	0.0	-0.1

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

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ 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.

Table 5. Belgium: Key Financial Market Indicators, Quarterly Averages

	2010Q4	2010Q3	2010Q2	2010Q1	2009Q4	2009Q3	2009Q2	2009Q1	2008Q4	2008Q3
Financial institution equity indices 1/										
Dexia	3.0	3.4	3.6	4.2	5.2	5.6	4.2	2.3	5.3	8.6
Fortis	27.6	28.5	31.3	37.7	37.0	29.2	17.4	12.8	41.7	89.7
KBC	29.9	33.9	33.2	33.7	32.3	22.3	15.1	12.8	38.5	66.0
ING	7.6	7.3	6.8	7.1	7.5	7.3	5.5	4.2	8.7	15.9
Credit default swap spreads 2/										
Dexia	---	284.9	268.1	186.8	183.8	234.7	342.0	355.1	281.8	199.4
Fortis	115.4	114.4	109.7	70.5	60.6	62.7	103.5	123.6	118.7	104.3
KBC	140.5	123.7	118.5	82.3	73.5	79.2	114.6	144.4	131.6	93.9
ING	152.6	128.4	123.7	114.6	150.6	234.6	275.7	251.0	187.5	70.9
Stock indices 1/										
BEL 20	2,632.8	2,515.4	2,526.0	2,552.5	2,494.6	2,265.8	1,977.7	1,795.0	2,025.0	3,013.8
Euro stoxx 50	2,817.8	2,715.9	2,743.1	2,850.8	2,874.0	2,660.6	2,376.6	2,166.4	2,497.7	3,278.8
Interbank interest rates 3/										
Overnight	0.6	0.5	0.3	0.3	0.4	0.4	0.8	1.4	3.1	4.3
three-month	1.0	0.9	0.7	0.7	0.7	0.9	1.3	2.0	4.2	5.0
Government interest rates 3/										
three-month	0.7	0.4	0.3	0.3	0.4	0.4	0.7	1.1	2.5	4.3
10-year	3.6	3.1	3.4	3.7	3.6	3.8	4.0	4.1	4.2	4.7
Money market risk spread 4/	35.0	47.6	42.2	36.5	34.1	49.8	56.3	90.3	168.4	72.4

Sources: Bloomberg; Datastream.

1/ Equity index, period average.

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

3/ Percent.

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

Table 6. Belgium: Financial Soundness Indicators of the Banking Sector, 2003–10 1/
(In percent)

	2003	2004	2005	2006	2007	2008	2009	2010 2/
	Belgian GAAP			IFRS				
Earnings and profitability								
Return on assets	0.4	0.5	0.5	0.7	0.4	-1.3	-0.1	0.4
Return on equity	13.6	15.8	18.5	22.4	13.2	-36.5	-2.7	10.1
Net interest income to total income	56.4	56.3	53.5	47.9	50.3	75.0	79.1	67.1
Interest margin	1.4	1.3	1.2	1.0	1.1	1.0	0.8	1.2
Average yield on assets	4.0	3.9	4.1	4.6	5.3	5.0	2.8	2.7
Average cost of funding	2.60	2.60	2.90	3.60	4.20	4.00	2.00	1.50
Noninterest income to gross income	43.6	43.7	46.5	52.1	49.5	24.9	20.9	32.9
Of which: Net fee and commission income	24.4	25.5	25.9	25.1	27.9	35.1	30.1	26.3
(Un)realised capital gains booked in P&L	10.1	8.9	8.2	14.6	14.3	-19.9	-14.5	-4.0
Cost/income ratio	73.9	72.0	72.6	55.7	61.1	86.1	77.7	64.8
Structure assets								
Total assets (in percent of GDP)	3.7	3.9	4.5	4.5	4.7	4.1	3.5	3.5
Of which (in percent of total assets)								
Loans to credit institutions	20.0	18.6	20.3	20.1	20.3	15.0	13.1	14.6
Debt securities	27.4	25.5	23.4	22.5	18.8	21.0	22.3	20.1
Equity instruments	1.7	2.7	3.5	3.6	3.3	1.1	0.8	0.6
Derivatives	0.0	0.0	0.0	4.5	7.6	15.7	11.3	14.5
Loans to customers	41.5	42.2	43.2	41.6	42.2	39.1	45.0	43.3
Of which: Belgian residents (in percent of loans)	52	49	42	43	43	53	59	60
Other EMU residents (in percent of loans)	23	23	26	29	30	20	19	18
Rest of the world (in percent of loans)	25	29	33	28	27	28	22	22
Mortgage loans (in billion euro)	117	132	155	190	208	132	158	158
Consumer loans (in billion euro)	14	13	14	15	17	17	17	17
Term loans (in percent of loans)	53.7	53.5	54.8	46.1	40.1	47.8	44.0	41.6
Reverse repo operations (in percent of loans)	...	...	...	41.0	37.8	21.9	16.4	16.7
Funding and liquidity (in percent of total assets)								
Debts to credit institutions	24.9	24.6	30.1	29.2	27.4	19.4	14.1	13.3
Bank bonds and other debt securities	11.2	10.0	8.7	11.2	11.3	8.7	12.6	11.1
Customer deposits	40.3	39.9	36.7	39.1	37.9	40.2	46.8	45.6
Of which: Sight deposits 3/	13.7	13.4	13.5	11.1	11.8	10.9	13.2	14.0
Saving deposits 3/	12.9	13.2	11.6	10.2	8.5	9.2	14.1	14.6
Term deposits 3/	12.5	12.1	10.6	10.6	11.5	11.7	8.9	7.2
Retail deposits	...	...	...	20.4	17.8	18.2	23.8	23.3
Repo's	...	...	...	13.5	11.7	14.8	13.4	11.3
Liquid assets 4/	…	…	…	27.0	24.0	23.0	32.0	31.0
Asset quality								
Sectoral distribution of loans (in percent of total assets)								
Credit institutions	...	...	...	20.1	20.3	15.0	13.1	14.6
Corporate	...	...	...	18.3	19.9	20.5	20.5	19.5
Retail	...	...	...	18.3	17.5	14.6	19.9	19.4
Central governments	...	...	...	0.8	1.0	0.9	1.2	0.8
Non-credit institutions	...	...	...	4.1	3.8	3.1	3.4	3.5
Non-performing loans (NPL) as percent of gross loans 4/	2.6	2.3	2.0	1.7	1.1	1.7	2.7	2.6
Provisions + writeoffs as percent of NPL 4/	53	54	52	51	48	67	51	52
Capital adequacy								
Regulatory capital to risk-weighted assets	12.8	13.0	11.5	11.9	11.2	16.2	17.3	18.1
Regulatory Tier I capital to risk-weighted assets	8.8	9.4	8.5	8.7	12.1	11.3	13.2	14.1
Capital to assets	3.1	3.1	2.7	3.3	4.1	3.3	4.5	4.4
NPL net of provisions as percent of Tier I capital 4/	15.7	12.8	13.8	10.9	9.2	6.5	13.8	13.5
Net open position in foreign exchange to capital	…	…	…	5.0	3.0	7.0	5.0	4.0

Sources: CBFA; and NBB.

1/ Consolidated data. Since 2006, the data are based on the IAS/IFRS reporting Scheme.

2/ Data for the first six months of 2010. The flow data are annualised.

3/ Deposits booked at amortised cost only.

4/ Unconsolidated data.

Table 7. Belgium: Financial Soundness Indicators of the Non-Banking Sectors, 2003–10
(In percent)

		2003	2004	2005	2006	2007	2008	2009	2010 2/
Insurance sector 1/ 2/									
Solvency ratio		248.4	250.7	258.8	252.6	222.6	223.3	230.0	227.0
Profitability									
	Return on equity (percent, annualised)	7.3	18.0	23.2	20.8	31.7	-27.5	6.3	6.8
Life	Premiums (billions of euros)	17.6	20.0	25.2	20.4	21.9	19.5	18.6	10.0
	Technical result/premiums (percent)	2.7	4.0	4.7	4.9	4.4	-18.8	4.0	4.4
Non-life	Premiums (billions of euros)	9.1	9.6	8.9	9.3	9.3	9.7	9.2	4.7
	Combined ratio (percent)	102.1	99.6	104.3	101.7	102.1	100.2	103.8	105.8
	Technical result/premiums (percent)	8.8	12.8	12.0	12.7	13.8	1.8	7.1	8.7
Corporate sector 3/									
Total debt as a percentage of equity		78.2	62.7	65.6	60.5	59.9	59.9	50.4	…
Profitability (return on equity)		12.9	10.3	10.8	9.6	9.8	11.4	7.8	…
Debt service coverage ratio		195.6	185.9	194.5	152.5	162.8	278.2	196.2	…
Household sector									
Debt (percent of GDP)		40.7	41.3	43.8	46.0	47.8	50.3	54.5	54.4
Interest burden (percent disp. income) 4/		1.5	1.1	1.6	2.1	2.9	3.0	1.9	1.8
Financial savings ratio (percent of GDP) 4/		4.3	2.8	4.3	3.1	2.1	3.5	6.8	7.2
Savings rate 4/		16.7	15.4	15.2	15.9	16.4	17.0	18.3	16.8
Real estate sector									
House price inflation									
Houses		7.9	3.9	16.1	12.3	9.9	4.5	-0.3	3.3
Apartments		8.9	14.6	14.6	11.3	7.4	3.5	1.9	3.8
Mortgage loans as percent of total loans		27.6	27.4	26.2	34.0	32.7	24.3	30.3	31.5
Of which: domestic households		15.6	15.5	14.5	17.6	16.5	14.7	14.1	14.9
Variable rate mortgages (percent of total new loans)		25.9	53.3	36.3	7.4	1.2	2.9	34.0	39.4

Source: NBB, Stadim, Mineco, UPC.
1/ Unconsolidated data.
2/ Provisional data for first 6 months of 2010, unless mentioned otherwise.
3/ Data for 2009 based on a sample of already available annual accounts in the Central Balance Sheet Register.
4/ Projections for 2010.

Annex I. Recent Developments on the Restructuring of Main Belgian Banks

In the aftermath of the financial crisis, the Belgian banking system has initiated a restructuring process, which has led to a shift in the business model for the three main banks. The Belgian public authorities acquired ordinary shares of Dexia and Fortis bank Belgium and subscribed to KBC perpetual Core-Tier 1 securities. The Belgian authorities have guaranteed illiquid and risky assets of KBC, and illiquid and risky assets of FSA (a monoline subsidiary of Dexia) were severally guaranteed by France and Belgium. The authorities financed a defeasance structure that acquired some assets of Fortis before its takeover. The restructuring at these banks aims at deleveraging, refocusing on core banking operations, de-risking, and strengthening domestic retail franchises. As beneficiaries of state aid, the restructuring plans of KBC and Dexia were approved by the European Commission which imposed a number of restructuring requirements. Specifically,

- **Dexia** accelerated its deleveraging program in 2010. A total of euro 26 billion of bonds and loans has already been sold in the first 10 months of 2010, after a total sale of euro 18 billion in 2009 (with only a small discount to nominal value). The divestment program is also under way, with the sale of the U.S. subsidiary FSA insurance closed in July 2009—benefitting from the guarantee by the Belgian and French states on commitments by Dexia under the put option for the buyer—and stakes in Dexia Crediop and Dexia Sabadell to be disposed by end-2012 and end-2013, respectively. Its reliance on short term wholesale funding and central bank borrowing fell to about ⅕ of its balance sheet total. The group only collects retail deposits in Belgium and Luxembourg. Against this background, Dexia has fully exited state guarantees on funding (provided severally by Belgium, France, and Luxembourg) as of end-June 2010 with some euro 45 billion of guaranteed bonds outstanding as of 2010:Q3. The bank returned to profitability in 2009 and 2010. Its Tier 1 capital ratio stood at 13.1 percent and its core Tier 1 ratio at 12.1 percent at end-2010.

- **KBC** has an option to buy back the securities subscribed by the federal government and the Flemish region (euro 7 billion) at 150 percent of issue price by 2013, which is to be financed through asset disposals/IPOs (including, among others, a disposal of its private banking subsidiary KBL, divestments of its banking and insurance subsidiaries in Belgium (Centea and Fidea), and its consumer finance bank Zagiel in Poland, and a partial IPO of the bank's Czech subsidiary CSOB). A total of euro 39 billion of risk-weighted assets (25 percent of the balance sheet total) have been earmarked for sale in 2009–13 with more than half of this amount achieved by mid-2010 (euro 21 billion), taking into account the 2010 sale of KBL, which has not yet been finalized, however. In addition, the restructuring plan also included putting KBC's financial structured products in run-off status. After exceptional losses in 2009 related to its derivative positions—that are covered by an asset insurance scheme from the Belgian state—losses on financial instruments booked at fair value decreased substantially in 2010 and the bank has shown net profits starting from mid-2009. At end-2010, KBC's Tier 1 capital ratio stood at 12.6 percent and the core Tier 1 ratio at 10.9 percent.

- **Fortis bank** has been acquired by BNP Paribas in May 2009. The restructuring entailed the transfer of toxic assets to a special purpose vehicle (SPV) and reorganization of trading activities within the BNP Paribas structure. Restructuring is concentrated on deleveraging of the loan book; runoff and divestment of the investment, private equity and hedge fund portfolios; and re-focusing on the core banking business in Belgium. By 2010:Q3 BNPP-Fortis' loan book exposure had fallen by 38 percent, and its capital markets bond portfolio by 65 percent. The corporate loan book has been transferred to BNP Paribas with Fortis refocusing on SME and retail business. The bank has more than doubled its operating income in the first nine months of 2010 compared to 2009, and its Tier 1 capital ratio reached 14.8 percent by mid-2010.

Annex II. Belgium Bank Resolution Framework and Changes Introduced by the Financial Crisis Law of June 2, 2010

The CBFA has a broad range of remedial powers enshrined in the Banking Act. A special inspector can be appointed by the CBFA and a purchase and assumption transaction (P&A) is enabled by the Credit Institutions Law. The Credit Institutions Law also offers powers to split banks, while it ensures that institutions whose license has been revoked remain subject to the Credit Institutions Law and supervision until all funds collected from the public have been reimbursed.

The Financial Crisis Law of June 2, 2010, introduced a special resolution regime for banks, insurance companies, and settlement institutions designed for systemic crises.[7] A systemic crisis is defined as a situation where failure of a financial institution could affect the stability of the Belgian or international financial system because of (i) the volume of deposits of a credit institution, its importance for the functioning of the credit market or its role in the financial system; (ii) the volume of the liabilities of an insurance company or its role in the financial system; or (iii) when a settlement institution is concerned. When these conditions are fulfilled, the King may by decree (discussed in the Council of Ministers) either at the CBFA's request or on His own initiative, and having received an opinion from the supervisor, adopt any act of disposal, in favour of the State or any other person or entity, whether Belgian or foreign, public or private, and in particular any act of transfer, sale or contribution relating to the following:

- Assets, liabilities or one or more areas of activity and, more generally, all or part of the rights and obligations of the institution concerned; and

- Securities or shares issued by the financial institution.

Upon notification of the Royal decree, the financial institution looses the power to dispose freely of the assets covered by the acts of disposal laid down in the Royal decree.

In line with the strong shareholder and creditor preference inherent in the EU Convention of Human Rights, the Royal decree has to define the compensation to be paid to the owners of the assets or the holders of the rights covered by the act of disposal. The application of this procedure is subject to a judicial review guided by a second law passed on June 2, 2010. The court rules on the lawfulness of the act and the adequacy of

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[7] *Loi visant à compléter les mesures de redressement applicables aux entreprises relevant du secteur bancaire et financier* and *Loi complétant, en ce qui concerne les voies de recours, la loi du 2 juin 2010 visant à compléter les mesures de redressement applicables aux entreprises relevant du secteur bancaire et financier*, both published in Belgisch Staatsblad/Moniteur Belge of June 14, 2010.

the compensation. This Law obliges the court to take into account the situation of the financial institution at the moment of the act of disposition and in particular considers what its financial situation would have been if it had not, directly or indirectly, received public aid, emergency liquidity assistance or public guarantees. The Law excludes any appeal against this judgment.

The potential delays (up to 27 days) for obtaining the Court judgment, publication of which perfects the resolution transaction vis-à-vis third parties, can adversely affect financial stability. Prompt action is paramount when dealing with a systemic situation. Staff advised the authorities to analyze why such long delays were deemed necessary and investigate ways to shorten the process while striking a balance between speed and legal certainty.

INTERNATIONAL MONETARY FUND

BELGIUM

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by the European Department

March 8, 2011

Contents Page

ANNEX I. BELGIUM: FUND RELATIONS
(As of January 31, 2011)

Mission: Brussels, November 30–December 13, 2010.

Staff team: Mr. De Vrijer (Head), Ms. Xiao, Mr. Cheng, Ms. Yakadina (all EUR), and Ms. Erbenova (MCM).

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

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

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

II.	**General Resources Account:**	**SDR Million**	**Percent of Quota**
	Quota	4,605.20	100.00
	Fund holdings of currency	3,611.72	78.43
	Reserve position in Fund	993.51	21.57

III.	**SDR Department:**	**SDR Million**	**Percent of Allocation**
	Net cumulative allocation	4,323.34	100.00
	Holdings	4,408.38	101.97

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				
	2011	**2012**	**2013**	**2014**	**2015**
Principal					
Charges/interest	0.04	0.04	0.04	0.04	0.04
Total	0.04	0.04	0.04	0.04	0.04

VII. **Article IV Consultations:**

Belgium is on the 12-month cycle. The previous Article IV consultation was concluded on March 8, 2010. The associated Executive Board's assessment is available at http://www.imf.org/external/np/sec/pn/2010/pn1037.htm and the staff report (IMF Country Report No. 10/63) at http://www.imf.org/external/pubs/cat/longres.aspx?sk=23701.0.

VIII. **Exchange Rate Arrangements**

- Belgium's currency is the euro, which floats freely and independently against other currencies.

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

IX. **FSAP Participation:**

FSAP Assessment IMF Country Report No. 06/75

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

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

Notwithstanding the strengths of the Belgian financial sector, a number of issues emerged from the FSAP. The heavy exposure abroad, the open nature of the economy, and the importance of the Euroclear Group globally, made the domestic financial system potentially vulnerable to global economic developments and financial contagion. Risks remained and may increase with a downturn in the business cycle, increased cross-border operations, and deeper links with the global money centers. In line with the 2005 FSAP recommendations, the supervisory framework has been strengthened. The Banking, Finance, and Insurance Commission's (CBFA) management committee has been streamlined and synergies between the CBFA and the National Bank of Belgium (NBB) have been further developed. Regular stress tests have helped promote a systematic dialogue between supervisory authorities and market participants, while detailed procedures for financial crisis management have been tested. Prudential supervision of the insurance sector has been upgraded and regulation of the pension funds sector reinforced.

ANNEX II. 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 and quarterly data on general government operations since April 2007.

The overall quality and availability of financial indicators are good. The authorities are providing quarterly updates of financial sector indicators (FSIs) in a timely manner.

Key publicly accessible websites for macroeconomic data and analysis are:

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

Belgium: Table of Common Indicators Required for Surveillance
(As of February 16, 2010)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	2/12/11	2/12/11	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/10	1/14/11	M	M	M
International Investment Position	2010	2/10	A	A	A
Reserve/Base Money	12/10	1/11	M	M	M
Broad Money	12/10	1/11	M	M	M
Central Bank Balance Sheet	12/10	1/11	M	M	M
Consolidated Balance Sheet of the Banking System	12/10	1/11	M	M	M
Interest Rates[2]	2/12/11	2/12/11	D	D	D
Consumer Price Index	12/10	1/11	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2009	6/30/10	A	A	A
Revenue, Expenditure, Balance, and Composition of Financing[3]—Central Government	2009	6/30/10	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/10	1/11	M	M	M
External Current Account Balance	Q3 2010	12/10	Q	Q	Q
Exports and Imports of Goods and Services	Q3 2010	12/10	Q	Q	Q
GDP/GNP	Q3 2010	12/10	Q	Q	Q
Gross External Debt	Q3 2010	12/10	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

BELGIUM

Staff Report for the 2010 Article IV Consultation

Supplementary Information

Prepared by the Staff Representatives for the 2010 Consultation with Belgium

Approved by Ajai Chopra and Jan Kees Martijn

March 22, 2011

1. **This supplement provides an update of economic and policy developments since the release of the staff report** (SM/11/48, March 9, 2011). The thrust of the staff appraisal remains unchanged.

2. **Recent data confirm a continuing gradual recovery.** Industrial production in December 2010 had increased by about 8 percent from the trough a year ago and the unemployment rate in the fourth quarter fell to 8.2 percent. The National Bank's February 2011 business barometer for the manufacturing sector, construction industry, and trade-related services marked its eighth consecutive monthly increase. While business confidence further improved in early 2011, consumer confidence deteriorated in March probably due to the persistent rise in oil prices. Annual headline inflation remained elevated at above 3 percent in January–February, reflecting higher energy prices.

3. **The caretaker government has prepared a draft federal budget for 2011 that aims to reduce the overall fiscal deficit to 3.6 percent of GDP.** The draft budget is based on projected real GDP growth of 2 percent in 2011, and would bring the deficit considerably below the target under Belgium's Stability Program (4.1 percent of GDP). The additional effort undertaken by the federal government and social security consists of spending restraint, including in healthcare, and a variety of revenue measures, including an increase of excise taxes on tobacco products. Based on preliminary information, staff estimates the structural adjustment effort at all levels of government in 2011 at about 0.5 percent of GDP.

4. **The caretaker government has also adopted a package of labor market measures for 2011–12 that is based on the inter-professional negotiations between unions and employer organizations.** The key measures consist of a real wage freeze in 2011 and a moderate wage increase of 0.3 percent in 2012, as well as measures to mitigate the unemployment trap for low-wage workers and lower firing costs for white-collar workers. The real wage moderation decided for 2011–12 will help to strengthen competitiveness of the Belgian economy.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/43
FOR IMMEDIATE RELEASE
April 4, 2011

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

IMF Executive Board Concludes 2010 Article IV Consultation with Belgium

On March 23, 2011 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Belgium.[1]

Background

The Belgian economy is recovering from the financial crisis and global recession. Economic activity expanded more than foreseen in 2010, the unemployment rate is stabilizing, and progress was made in bank restructuring. But the absence of a new federal government delays addressing important long-term challenges facing the country.

The Belgian economy is expected to continue its gradual recovery but real GDP growth is projected to moderate somewhat in 2011, in view of the expected slowdown in the euro area. While the still sizable output gap is keeping core inflation subdued, headline inflation would remain above target in 2011, reflecting strong pass-through of rising world oil prices.

Fiscal consolidation started in 2010, and the overall fiscal deficit was reduced from 6 percent of GDP in 2009 to 4.6 percent in 2010. Building on this encouraging outcome, the caretaker government has prepared a draft federal budget for 2011 that aims at reducing the overall deficit to 3.6 percent of GDP in 2011, below the target under Belgium's Stability Program (4.1 percent of GDP). With the sub-national budgets already adopted, the adjustment burden in

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

2011 will fall on the federal government and social security. The additional effort undertaken consists of spending restraint, including in healthcare, and a variety of revenue measures, including an increase of excise taxes on tobacco products. In order to restore fiscal sustainability, the authorities appropriately aim to reduce the overall deficit to 3 percent of GDP by 2012 and achieve a balanced budget by 2015. Given rising aging-related government spending, realizing their fiscal objectives will require a structural fiscal effort of about ¾ percent of GDP over the medium term at all levels of government.

Conditions in Belgium's financial system have improved. The banking sector is still in the midst of significant restructuring. Deleveraging in the banking sector continued, and the banks saw a return to net profitability in the second half of 2009 and 2010. The integration of prudential supervision of licensed financial institutions into the National Bank of Belgium (NBB) is now foreseen to become effective as of April 1, 2011. The Financial Crisis Law passed in June 2010 gives the authorities strong powers to act decisively in times of crisis and provides supervisors with strong political backing for resolving systemic institutions.

Executive Board Assessment

Executive Directors commended the authorities for advancing fiscal consolidation and restoring confidence in the financial sector. To build on this progress, Directors underscored the need for a better articulated strategy to address macroeconomic policy priorities. Further efforts are necessary to bring down public debt relative to GDP, safeguard financial sector stability, and intensify structural reforms to boost potential growth, create jobs, and enhance competitiveness.

Directors welcomed the 2011 draft budget, which targets a more ambitious reduction of the overall deficit than that envisaged under the Stability Program, and supported the authorities' objective of a balanced budget by 2015. Achieving these objectives will require, however, a strong fiscal adjustment, including limits on spending growth at all government levels, further reform of the pension system, and a slower expansion of health care expenditure. There is also some room to broaden the tax base, improve revenue collection, and reduce tax expenditures. Directors also recommended a review of the current arrangement for fiscal devolution so that spending is kept in line with trend growth, as well as the adoption of a multi-year fiscal framework based on clear rules and inter-governmental burden-sharing.

Directors noted that bank restructuring is progressing well, the banking system is well capitalized, and liquidity conditions are improving. Nevertheless, considerable risks remain, calling for continued vigilance and contingency planning. In particular, measures to ensure that banks are in compliance with the new regulatory framework should remain on top of the policy agenda, while maintaining flexibility in providing liquidity support in the event of renewed stress. Directors welcomed the integration of micro- and macro-prudential supervision at the central bank and the enactment of the new Financial Crisis Law. Further efforts should focus on identifying risks in the financial sector as a whole, strengthening coordination with supervisory agencies within the European Union, and facilitating the timely resolution of cross-border financial institutions.

Directors saw a need to reinvigorate labor market reforms, in particular strengthening job search incentives, reducing the tax wedge on wages, and raising labor market participation. They regarded the recent adoption of a labor market package as a welcome step toward wage moderation. Further flexibility in wage-setting would help enhance competitiveness, as would a review of the wage indexation mechanism to take account of productivity developments. Directors recommended enhancing the independence of the Competition Authority and improving transparency and regulation in energy markets.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2010 Article IV Consultation with Belgium is also available.

Belgium: Selected Economic Indicators, 2006–15

					Prel.	Projections				
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	(Percentage change from the previous period; unless otherwise indicated)									
Real economy										
Real GDP	2.7	2.8	0.8	-2.7	2.0	1.7	1.9	1.9	1.9	2.1
Private consumption	1.8	1.7	1.4	-0.2	1.4	1.2	1.3	1.4	1.4	1.7
Public consumption	0.6	2.1	2.5	0.4	1.1	0.9	1.5	1.1	1.0	1.0
Gross fixed investment	2.0	6.3	2.4	-4.9	-1.8	2.3	2.6	1.8	1.8	2.1
Business investment	2.0	7.9	3.4	-7.5	-1.2	2.4	2.7	2.6	2.6	2.7
Dwellings	6.4	3.4	-0.6	-3.0	-3.5	-0.1	0.7	0.7	0.7	0.8
Public investment	-11.8	4.2	5.5	10.3	-0.5	9.2	8.1	-0.1	-0.1	1.5
Stockbuilding 1/	0.8	0.1	0.0	-1.0	-0.5	-0.9	0.0	0.0	0.0	0.0
Foreign balance 1/	0.4	0.0	-1.1	-0.5	2.2	0.9	0.3	0.5	0.6	0.5
Exports, goods and services	5.0	4.3	1.4	-11.4	10.5	4.7	4.7	4.7	5.0	5.2
Imports, goods and services	4.6	4.4	2.8	-10.9	7.7	3.7	4.6	4.4	4.6	4.8
Household saving ratio (in percent)	15.9	16.4	17.0	18.3	17.2	16.9	16.9	16.8	16.8	16.7
Potential output growth	1.8	1.9	1.3	0.9	1.4	1.4	1.5	1.5	1.6	1.6
Output gap (in percent)	1.1	2.0	1.5	-2.1	-1.5	-1.2	-0.8	-0.5	-0.2	0.3
Employment										
Unemployment rate	8.3	7.5	7.0	8.0	8.4	8.4	8.2	8.2	7.9	7.9
Employment	1.2	1.6	1.7	-0.3	0.6	0.7	0.9	0.9	1.0	1.2
Prices										
Consumer prices	2.3	1.8	4.5	0.0	2.3	2.9	2.3	2.1	2.0	2.0
GDP deflator	2.3	2.3	1.9	1.1	1.5	2.3	2.3	2.1	1.9	2.0
ULC (in whole economy)	1.9	2.1	4.5	4.4	-0.2	2.7	1.8	1.6	1.5	1.5
Public finance										
Revenue	48.8	48.1	48.8	48.1	48.9	49.2	49.0	49.0	49.0	49.0
Expenditure	48.6	48.4	50.1	54.1	53.4	53.1	53.1	53.1	53.1	53.1
General government balance	0.2	-0.3	-1.3	-6.0	-4.6	-3.9	-4.0	-4.1	-4.0	-4.0
Structural balance	-1.4	-1.5	-2.2	-3.0	-2.9	-2.8	-3.0	-3.1	-3.2	-3.4
Primary balance	4.1	3.5	2.4	-2.4	-1.1	-0.3	-0.2	-0.2	0.0	0.1
General government debt	88.1	84.2	89.6	96.2	97.2	97.4	97.4	97.7	98.2	98.3
Balance of payments										
Trade balance	0.7	0.2	-3.3	-0.6	0.0	0.3	0.7	1.1	1.5	1.9
Current account	1.9	1.6	-1.9	0.8	1.1	1.0	1.2	1.5	1.9	2.3
Terms of Trade (percent change)	-0.7	0.2	-2.4	3.4	-1.1	-0.6	0.0	0.2	0.2	0.3
Exports, goods and services (volume, percent change)	5.0	4.3	1.4	-11.4	10.5	4.7	4.7	4.7	5.0	5.2
Imports, goods and services (volume, percent change)	4.6	4.4	2.8	-10.9	7.7	3.7	4.6	4.4	4.6	4.8

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

1/ Contribution to GDP growth.