

BUFF/ED/23/27

February 22, 2023

**Statement by Mr. Dresse and Mr. Verhelst on Belgium
Executive Board Meeting
February 27, 2023**

The authorities thank Mr. Horton and his team for the engagement and candid discussions during the Article IV consultation, which were enhanced by the return to a face-to-face mission. They broadly concur with the thrust of staff's analysis. While economic conditions have been challenging in 2022, the Belgian authorities have taken decisive actions to maintain citizens' purchasing power, the country's energy security, and to protect the vulnerable from the consequences of the energy crisis. Efforts are underway to further implement structural reforms and the authorities are committed to consolidate public finances in the coming years.

Recent data point to somewhat better economic outcomes than previously expected. In its most recent forecast for 2023, the European Commission projects growth at 0.8%, 0.6 percentage points higher than staff, and revised the inflation forecast down to 4.3%. The economy also held up better in 2022 than previously expected, confirmed by staff's 2022 growth forecast of 3%. GDP grew by 0.1% in the final quarter of 2022, hence avoiding a recession. Job creation has been strong in 2022, with employment growth at 1.8 %. Consumer and business confidence has also recovered in recent months, from a low point in mid-2022.

Fiscal policy – towards a consolidation of public finances

Based on the latest estimates, the budget deficit for 2022 is likely to be smaller than previously estimated. According to preliminary estimates by the State Secretary for the Budget, the 2022 budget deficit will amount to around to 4% of GDP. This better-than-expected outcome is driven by both higher income and less spending than previously planned, in line with the somewhat stronger economic data.

Belgium is fully committed to reducing its government deficit in the years to come to a level that puts debt on a sustainable declining path. A budgetary review for 2023-24 will be conducted in March 2023, in order to reassess the budgetary strategy. The authorities will take stock of the recent revenue and expenditure developments and the macroeconomic outlook, both of which are cautiously on the upside. In doing so, they will continue to balance the need to ensure fiscal sustainability without jeopardizing the recovery of economic activity. In the medium term, the

outcomes of the spending reviews will be instrumental in identifying structural efficiency gains alongside further deficit reducing policy changes, including pension and labor market reforms.

In a context of rising interest rates worldwide and with the ECB's net asset purchases having been discontinued, Belgian government securities continue to generate sustained market interest. As staff rightly points out, the debt management strategy has contributed to strengthening market confidence. Also, in response to market demand, the Belgian Debt Agency has lengthened maturities during the period of low interest rates, thereby reducing refinancing risks. The average maturity is now more than 10 years, with an average implicit interest rate at 1.5%.

The objective to lower the deficit is shared among the different government layers in Belgium. The selected issues paper on fiscal federalism points to the specific structure of the Belgian federal state and rightly notes the need to coordinate between the different entities. All levels of government in Belgium share the responsibility to ensure the sustainability of public finances. The COVID-19 crisis, Russia's war in Ukraine, and specific factors such as the floods that hit the Walloon Region in 2021, resulted in a debt increase for all levels of government. They will all make consolidation efforts in line with the European Framework.

The authorities have narrowed the focus of their energy measures and are taking steps to target support further. After broad-scale support measures at the beginning of the energy crisis, Belgium has gradually shifted to more targeted and more limited support measures. Under the so-called “basic energy package”, a bill reduction on electricity and gas during the winter period, the financial support received is subject to income tax, meaning a larger portion is recouped from higher-income households. In February 2023, the Belgian federal government took a further step by keeping the VAT on gas and electricity at 6 percent for residential contracts and offsetting its budgetary impact by introducing excise duties on gas and electricity from April on. The level of these excise duties will depend on international energy prices and will be consumption-driven, with higher consumption being subject to higher duties. Furthermore, stricter eligibility criteria will also reduce the number of people benefiting from a reduced social tariff.

The authorities wish to thank IMF staff for their effective engagement on tax issues throughout 2022. The IMF has assisted Belgian authorities in calculating the VAT collection gap. The results of this analysis will feed into the administration's work, focusing on the areas where gaps are pronounced. In addition, the IMF's input has been actively used in the drafting of a tax reform blueprint prepared by the Minister of Finance. In the coming period, a first package of proposals will be brought to the table. The IMF's support will help guide work on tax reforms in the coming years.

Financial sector – strong buffers, but close vigilance is warranted

The Belgian financial sector remains in a strong financial position and is well positioned to support the real economy. Financial institutions have so far adapted well to the new environment of geopolitical fragmentation, asset price corrections, high inflation, rising interest rates and less favorable growth prospects. Non-bank financial intermediation was resilient in 2022, supported by prudent risk management. Financial sector firms maintained strong buffers, with Tier 1 capital in the banking sector at 17.1% and a solvency rate in the insurance sector at 227%. This enables them to absorb possible unexpected losses, without impairing their functions vis-à-vis the real economy.

The authorities agree with staff on the need to preserve resilience and ensure adequate provision of credit. Given the signs of a downward turning point in the financial and credit cycles, the reactivation of the countercyclical capital buffer has been postponed, to ensure that banks can use their ample capital reserves. In view of potential vulnerabilities, macroprudential measures for mortgages were maintained. Macroprudential expectations continue to discipline the mortgage lending conditions at origination. Price growth in the housing market has slowed in 2022, yet prices continued to grow in nominal terms. The housing market in Belgium has historically been stable compared to peers, *inter alia* avoiding a pronounced drop in prices during the global financial crisis. Risks linked to higher interest rates are in addition mitigated, as more than 70% of mortgages carry a fixed interest rate for the whole maturity of the loan. If vulnerabilities nonetheless were to materialize, a sectoral systemic risk buffer has been put in place, corresponding to €2 billion, to finance losses or solutions for borrowers facing repayment problems. The National Bank of Belgium has also increased its focus on the prevention of money laundering and terrorist financing, with a comprehensive action plan in which higher risk in certain sectors is accompanied by heightened vigilance and inspection.

Authorities are looking forward to the IMF's Financial Sector Assessment Program for Belgium, which will be carried out mainly in 2023. A first scoping mission took place at the end of 2022, with two additional missions later this year. Belgium attaches great importance to financial surveillance by the IMF, including in its own jurisdiction. The authorities are working closely with staff. As during previous occasions, they will carefully consider the findings and act on the recommendations of the assessment.

Structural policies – continued commitment to long-term reforms

The federal government and the subnational levels of government are committed to increase the employment rate. The federal government has set an employment rate target of 80% by 2030. To meet this target, Belgium is working to both reduce the number of unemployed, and to increase overall labor market participation. In 2022, Belgium intensified its back-to-work policy, with more coaching and financial enticements to bring currently inactive people to the labor market. The authorities expect to reap the benefits of this policy in the coming years. Employment efforts are furthermore tailored to the needs of the different regions, with a focus on increasing overall employment rates in Brussels and Wallonia and addressing labor market bottlenecks in Flanders.

Policy reforms are being further implemented to support growth and improve the sustainability of public finances in the longer term. The federal government is currently discussing the pension policy. Reforms to the pension system will enable the unlocking of resources from the EU's Recovery and Resilience Facility, which in turn allows for investments underpinning Belgium's long-term growth potential

The authorities note that automatic wage indexation has been helpful in protecting purchasing power in Belgium and buttressing consumer confidence. Indexation is furthermore not expected to lead to inflation higher than the EU average in the period 2022-23. The indexation mechanism is coupled with a wage law, which ensures that wages do not deviate on a structural basis from neighboring countries, as indicated in the staff's analysis. The authorities aim to preserve the benefits of wage indexation while being mindful of drawbacks for the economy. Together with trade unions and employers, the authorities will continue to monitor the functioning of the automatic indexation.

Belgium is working towards meeting the net-zero by 2050 objective, including by moving away from fossil fuels towards electrification of energy consumption. Efforts are ongoing to electrify heating and transport, as well as reducing overall energy consumption. The selected issues paper on accelerating emissions reductions provides useful input into meeting Belgium's objectives. Besides examining price-based policies, the authorities are increasing investments to address climate change. An agreement has furthermore been reached in January 2023 to extend the operations of certain nuclear reactors by ten years. This will help bolster energy security and affordability in the uncertain times ahead.

The Belgian authorities look forward to a continuation of the productive interaction with Fund staff.