**FOR AGENDA**

SM/08/65

February 29, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Belgium—Staff Report for the 2007 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2007 Article IV consultation with Belgium, which is tentatively scheduled for discussion on **Friday, March 21, 2008**. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of Belgium indicating that they consent to the Fund's publication of this paper.

Questions may be referred to Mr. Everaert (ext. 38667), Mr. Luzio (ext. 38327), and Ms. Yontcheva (ext. 39912) in EUR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the European Central Bank forthwith; to the WTO Secretariat on Monday, March 10, 2008; and to the European Commission and the Organisation for Economic Cooperation and Development, following its consideration by the Executive Board.

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm) for the issuance date shown above.

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BELGIUM

**Staff Report for the 2007 Article IV Consultation**

Prepared by Staff Representatives for the 2007 Consultation with Belgium

Approved by Alessandro Leipold and Michael Hadjimichael

February 28, 2008


## EXECUTIVE SUMMARY

**Headwinds from a more testing international environment and domestic political tensions are challenging Belgium's enviable economic performance.** Economic growth is expected to decelerate significantly—in the staff's view to 1.6 percent in 2008, though the authorities remain somewhat more sanguine. The recent spike in energy and food prices will likely push average inflation to 2.9 percent in 2008. Partial indexation will temper its impact on real incomes, but poses risks to competitiveness. With political tensions following the June 2007 elections, federal policy making has been at a standstill since April 2007, delaying much needed fiscal consolidation and structural reforms. Meanwhile, the window to tackle the implications of population aging—through fiscal pre-funding and higher growth—is closing rapidly.

**The impact of financial turmoil on the financial system appears contained but, together with heightened cross-border integration, will continue to require the dedicated attention of supervisors.** While not ruling out downside surprises, especially in the event of a severe and prolonged economic downturn, supervisors indicated that financial institutions remained sound. More transparent disclosure of exposures and valuation assumptions and their implications for banks' earnings and capital would dampen market volatility. While already high-quality prudential supervision is being further enhanced, the relentless rise in the cross-border dimension of the financial system requires stronger coordination with host country authorities.

**Though the policy agenda to address aging and fiscal federalism imbalances is well known, timely delivery is not certain.** On the positive side, fiscal consolidation is set to resume in 2008, without recourse to one-off measures. But plans fall short of staff advice and the urgent reform of fiscal federalism arrangements will need to be executed without fiscal costs. Greater accountability, more transparency, and stronger coordination among federal and sub-federal entities are key to achieving the required medium-term buildup of fiscal surpluses. Structural reforms will need to resume without delay to boost employment rates and productivity.

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# I. Introduction

1. **While economic performance has remained good, difficulties in building consensus for institutional reform have caused an ill-affordable hiatus in economic policy making.** Economic growth was robust in 2007, bringing down unemployment to the lowest level in a decade. As elsewhere in the euro area, growth is expected to slow significantly owing to a weakening of the international environment and financial turbulence, though the domestic financial system appears to be resilient. The recent spike in energy and food prices is of concern, as partial indexation may pose risks to competitiveness. More worrisome is the interruption in policy-making at the federal level, broadly since April 2007, reflecting a complex political environment (Box 1). The coordinated early and decisive policy response to tackle long-term challenges that Executive Directors called for in last year's consultation has thus remained absent.

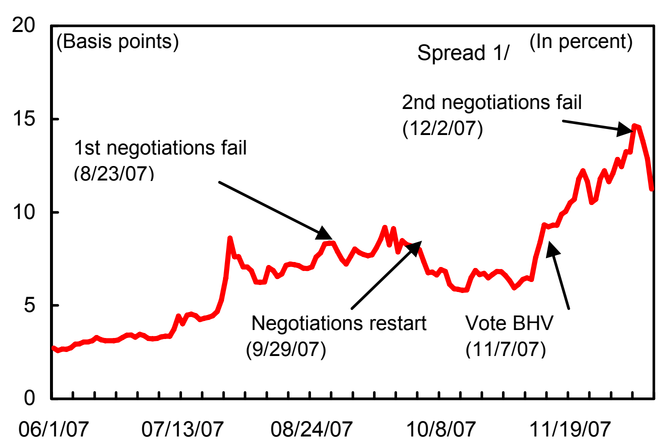
## Box 1. Complex Political Environment

In the June 2007 federal elections, voters rejected the outgoing left-right coalition and put the center Christian Democrats in a commanding position to form a new coalition, but disagreements on reforms of fiscal federalism arrangements led to a 6-month political impasse. In the absence of a federal government, policy making continued only at the regional and community levels but without the usual coordination mechanisms.

To deal with urgent policy matters, especially the 2008 budget, an interim federal government was formed on December 21, 2007, under outgoing Prime Minister Verhofstadt. A regular federal government is expected to be put in place by March 23, 2008, consisting of the same coalition partners but headed by a new Prime Minister. However, serious tensions remain within the coalition, especially surrounding constitutional reforms, and the policy agenda is already being influenced by the perspective of the regional elections of 2009.

The impact of the political uncertainty can be seen in movements in sovereign spreads (Figure 1), with spikes in political tensions[1] leading to their widening. Indeed, fiscal policy has so far been the main victim of the political turmoil: the general government is likely to record a deficit of 0.1 percent of GDP in 2007 instead of the targeted surplus of 0.3 percent of GDP required under the previously agreed strategy to deal with aging.

**Figure 1. Political Tensions and Sovereign Spreads**




Source: Belgium Debt Agency
1/ Compared to average of Germany, France, Spain, and Netherlands.

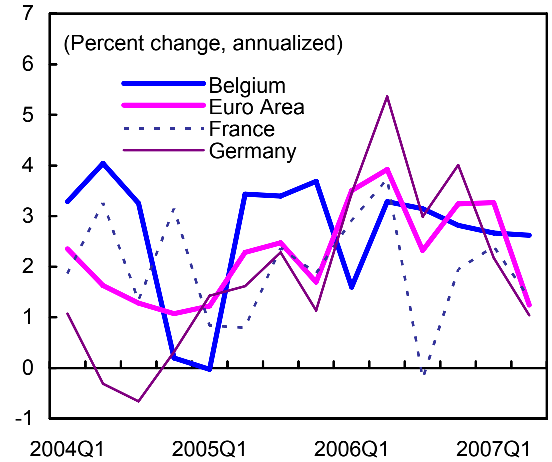
[1] Political tensions peaked when negotiations to form a government failed twice and when a dispute over an electoral district (BHV) evoked the specter of a partition of the country.

## II. Outlook: Supporting Growth, Managing Inflation, and Preserving Competitiveness

### A. How Significant a Slowdown Lies Ahead?

2. **A mostly favorable global environment and strong domestic demand delivered robust economic growth in 2007** (Figure 2). The strong performance of Germany and emerging markets as well as easy financing conditions created a supportive external environment during most of the year. Domestically, household and business confidence indicators rose significantly, inflation was subdued, and job creation increased significantly. All in all, GDP rose by 2.7 percent in 2007.

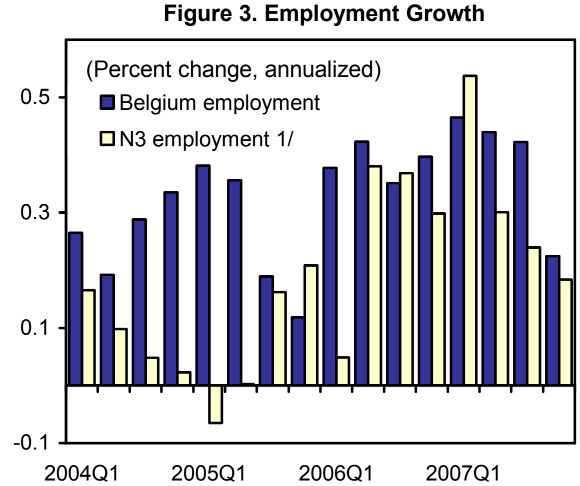
**Figure 2. GDP Growth**




Source: WEO

3. **Robust economic activity absorbed a growing labor force and allowed the unemployment rate to decline continuously** (Figure 3). In addition to cyclical factors, employment growth also benefited from a sharp increase in the self-employed, associated with labor immigration following EU enlargement, and the government-subsidized voucher program for domestic services which led to the creation of low-skill jobs in the services sector. As a result, 55,000 jobs were added during the first 9 months of 2007, raising households' net disposable income which, in turn, spurred strong consumption growth. Meanwhile, labor shortages have started to appear in some regions and sectors.

**Figure 3. Employment Growth**




Sources: Eurostat; and OECD, Economic Outlook.
1/ France, Germany, and the Netherlands.

4. **The authorities and staff agreed that growth would decline significantly, but differed on the degree of the slowdown.** The authorities' macroeconomic framework underlying the budget is based on GDP growth of 1.9 percent in 2008, which they felt was only slightly on the optimistic side. The staff expects economic growth to fall to 1.6 percent (Text Table 1). There was agreement that the slowdown would affect all demand components. Business investment is expected to decelerate due to greater uncertainty and to a lesser extent because of less favorable financing conditions (Figure 4). Residential

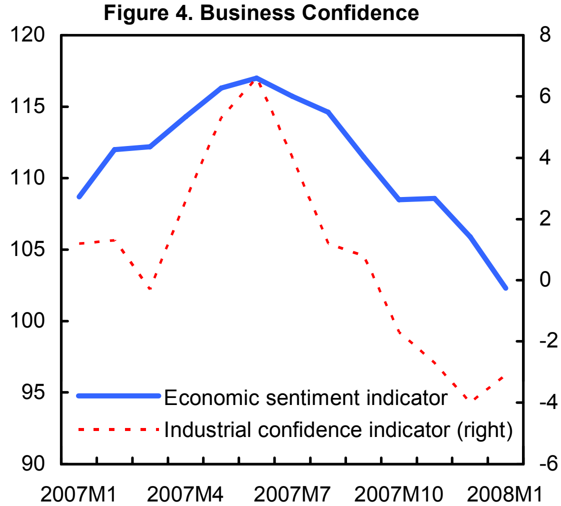
construction will ease from historic highs in line with developments in house prices and mortgage markets (Figure 5).[1] Consumption will grow at a lower pace mostly due to sluggish real disposable income growth as inflation rises and the pace of job creation diminishes. However, with consumer credit less developed than in Anglo-Saxon countries, the drag from less favorable financing conditions will be smaller. Finally, the global slowdown and euro appreciation will dampen export growth.

Text Table 1. Economic Outlook
(Annual growth rates from previous period, unless otherwise indicated)

| | | | Est. | Proj. | | | | Est. | Projectons | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 2007 | | | | 2008 | | | |
| | 2005 | 2006 | 2007 | 2008 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Real GDP (constant prices) | 2.0 | 2.9 | 2.7 | 1.6 | 3.0 | 2.8 | 2.6 | 2.3 | 2.0 | 1.6 | 1.4 | 1.4 |
| Private consumption expenditure | 1.4 | 2.1 | 2.5 | 1.5 | 1.9 | 2.4 | 2.8 | 2.9 | 2.4 | 1.7 | 1.0 | 1.1 |
| Gross fixed capital formation | 6.7 | 4.2 | 4.9 | 1.4 | 4.8 | 4.7 | 4.2 | 6.1 | 2.6 | 1.2 | 1.0 | 0.7 |
| Unemployment rate | 8.4 | 8.2 | 7.4 | 7.4 | ... | ... | ... | ... | ... | ... | ... | ... |
| Consumer price index | 2.5 | 2.3 | 1.8 | 2.9 | 1.8 | 1.5 | 1.3 | 2.6 | 3.3 | 3.1 | 2.8 | 2.6 |
| General government balance (in percent of GDP) | -2.3 | 0.4 | -0.1 | -0.5 | ... | ... | ... | ... | ... | ... | ... | ... |
| Current account balance (in percent of GDP) | 2.6 | 2.7 | 3.3 | 3.0 | ... | ... | ... | ... | ... | ... | ... | ... |
| Memorandum items: | | | | | | | | | | | | |
| Oil prices (US$ per barrel) 1/ | 41.3 | 20.5 | 10.7 | 21.3 | -6.2 | -3.2 | 7.0 | 48.4 | 52.6 | 30.8 | 16.9 | -2.7 |
| Partner country growth 2/ | 1.2 | 2.6 | 2.4 | 1.8 | 2.9 | 2.1 | 2.5 | 2.2 | 1.7 | 1.1 | 0.9 | 1.1 |

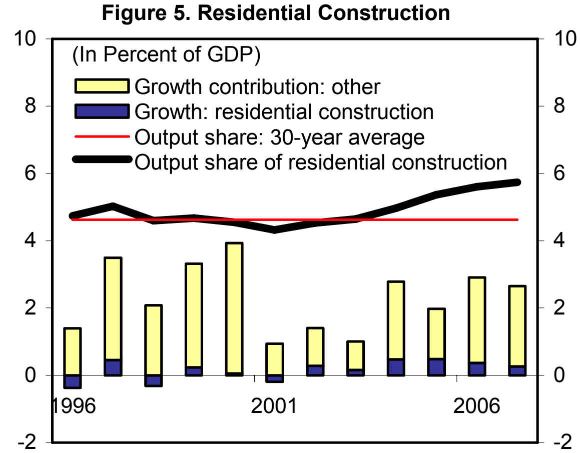
Source: IMF, World Economic Outlook.
1/ Crude Oil (petroleum), simple average of three spot prices; Dated Brent, West Texas Intermediate, and the Dubai Fateh, US$ per barrel.
2/Real GDP growth (France, Germany, Netherlands).

**Figure 4. Business Confidence**




Source: National Bank of Belgium

**Figure 5. Residential Construction**

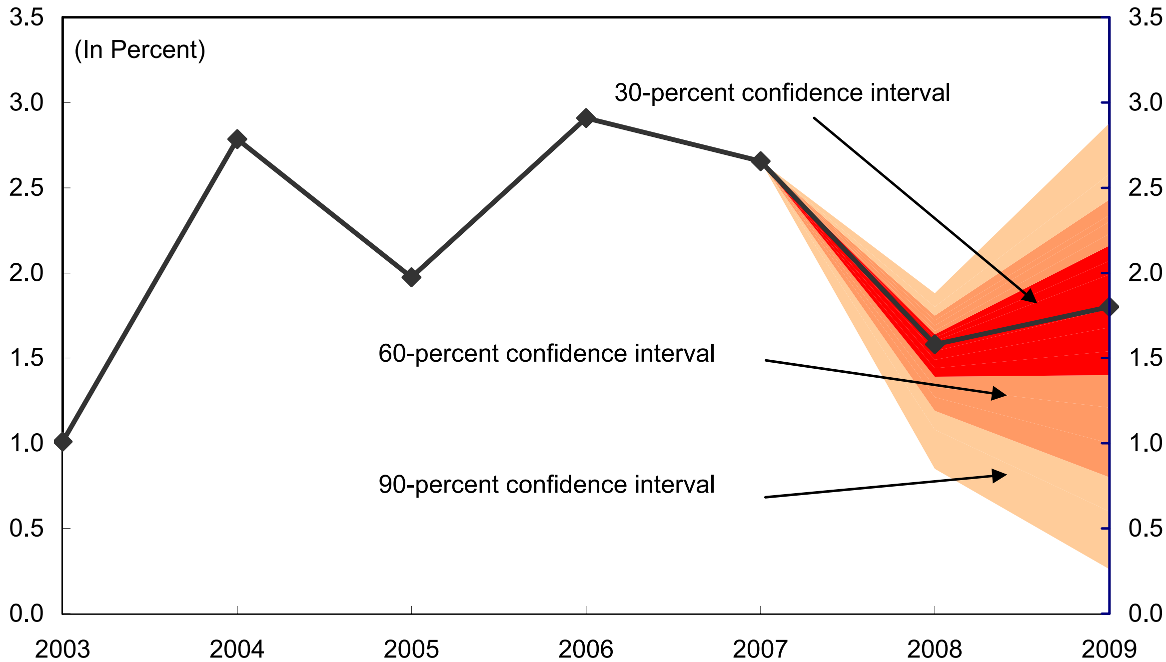



Source: National Bank of Belgium

[1] However, with residential construction only making up 5.7 percent of GDP in 2007, the slowdown in this sector is not a major factor.

5. **There was agreement that risks were tilted to the downside, but that there was no need for a policy response beyond the operation of automatic fiscal stabilizers**. Oil prices, the euro appreciation and the duration of the financial turmoil are all weighing on the downside, while lack of decisive progress with domestic reforms could further sap confidence (Figure 6). The staff supported the authorities' intention to allow automatic stabilizers to operate, thus abandoning the past procyclical practice of targeting nominal balances. However, the staff cautioned that consolidation would need to resume in earnest (see Section IV.A.) and that, with widespread indexation practices (see Sections II.B and II.C), broader fiscal support to the economy could prove counterproductive.

**Figure 6. Belgium: Real GDP Growth: Risks to the Forecast**




The chart includes the following risks to the baseline projections of growth (1.9 percent in 2007 and 1.6 percent in 2008):
- persistent tightening of financing conditions;
- 10 percent euro appreciation;
- 1 percent drop in foreign demand;
- boost in domestic confidence reflecting steady progress in reform agenda;
- a US recession and a disorderly unwinding of global imbalances.

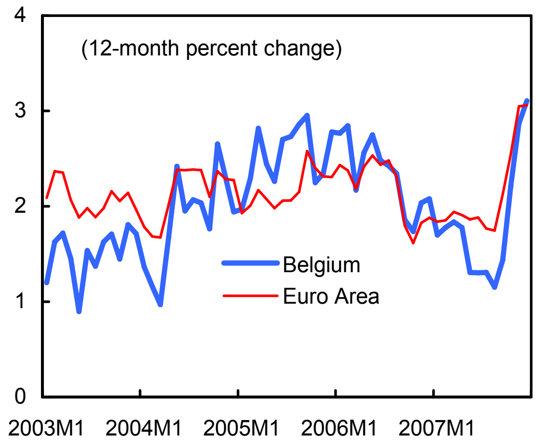
They are weighted by the staff's subjective probability assessment of their occurrence.
Source: IMF staff estimates.

## B. How is Inflation Affecting the Economy?

6. **The factors that moderated inflation in the course of 2007 reversed toward the end of the year.** The liberalization of the gas and electricity markets in Brussels and Wallonia initially reduced the consumer price of energy, exerting a moderating effect on the HICP until the summer of 2007, and allowing inflation to stay well below the average of the euro area. However, subsequently, the sharp increase in energy and food prices pushed inflation up to 3.1 percent in December 2007.

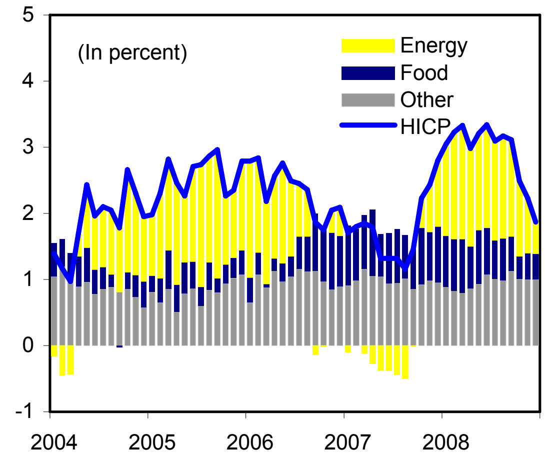
7. **Inflation is expected to peak in early 2008 and recede in the course of the year** (Figures 7 and 8). Even though energy and food markets are likely to stabilize, base effects and increases in the distribution margins in the energy sector in January will keep inflation high during the first quarter of 2008. Thereafter, inflation is projected to decline gradually to around 2 percent by year-end, but the year average will register about 2.9 percent.

Figure 7. Headline Inflation




Source: Eurostat.

Figure 8. Contribution to Inflation




Source: National Bank of Belgium

8. **Low-income groups are being disproportionately affected by the food and energy price increases, triggering a necessary increase in targeted income support.** With consumption patterns varying according to the income level of the household, a study by the central bank (NBB) shows that lower-income households suffer greater loss of purchasing power when these components register above average increases. This was observed between 2004 and 2006 (Text Table 2), and is again applicable since September 2007. Hence, the authorities have increased the subsidies to low-income households for purchases of heating oil, through a mechanism that is generally well targeted and whose budgetary implications are capped.

Text Table 2. Inflation Impact on Lowest Income Group

| | 1997-1998 | 1999-2003 | 2004-2006 | 2007-2008 |
|---|---|---|---|---|
| Inflation | 2.4 | 9.7 | 6.9 | 4.7 |
| Inflation first decile | 2.9 | 8.8 | 7.8 | 5.6 |
| Implicit gain (+)/loss (-) in purchasing power for lower income | -0.5 | 0.8 | -0.9 | -0.9 |

Source: National Bank of Belgium

9. **More general income support measures would not be justified, especially since existing partial indexation practices already hold up purchasing power.** Public sector wages and about two-thirds of private sector wages are indexed to a core inflation index, the so-called "health index." These mechanisms will boost wages by 3 percent in 2008. Even so, against the background of tight labor markets, there are calls for further wage increases. The mission cautioned against broader wage increases, which would evoke past episodes of mishandled supply shocks and subsequent painful adjustment. In line with the tradition of responsible wage bargaining and mindful of the risks to competitiveness, labor union leaders emphasized the need to stick to existing wage agreements, though they recognized that recent price increases had raised social tensions. Meanwhile, the authorities indicated that they had no intention to provide broad income support and would consider the mission's advice to seek ways to contain prices by further promoting competition, especially in the retail sector, and reviewing the distribution margins in the energy sector.

## C. Is Competitiveness an Issue?

10. **The authorities agreed that various indicators suggest that the current level of the real effective exchange rate is broadly appropriate**. Export performance remains relatively robust, with the trend decline in export shares, except for a brief episode in 2006, fully in line with what is to be expected from the mature structure of the economy. Based on the CGER methodology, staff estimates of the REER range between a 2 percent undervaluation (reduced-form estimation) and a 4 percent overvaluation (external sustainability approach). The former approach evaluates the difference between the current REER and an equilibrium REER derived from a panel regression in which fundamental determinants of the REER are evaluated at their trend levels.[2] The latter approach verifies whether on the basis of current trade elasticities, the actual exchange rate is consistent with maintaining a benchmark level of net foreign assets as a share of GDP, here chosen to be the 2006 level.

11. **Current and trade accounts have been recording a steady surplus.** The current account surplus reflects net savings of the private sector, more than offsetting public sector deficits. This is driven by high corporate savings, while Ricardian equivalence considerations have led to a decline in household savings (Text Table 3).[3]

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[2] For Belgium, the relevant fundamental variables are: relative productivity, the net foreign asset position, the terms of trade, and government consumption. For details, see Methodology of CGER Assessments www.imf.org/external/np/pp/eng/2006/110806.pdf.

[3] The government's fiscal consolidation led individuals to lower their saving rate (see e.g. J. C. Cuaresma, and G. Reitschuler, 2007, "Is the Ricardian Equivalence Proposition an 'Aerie Fairy' Theory for Europe?" Economica, 74).

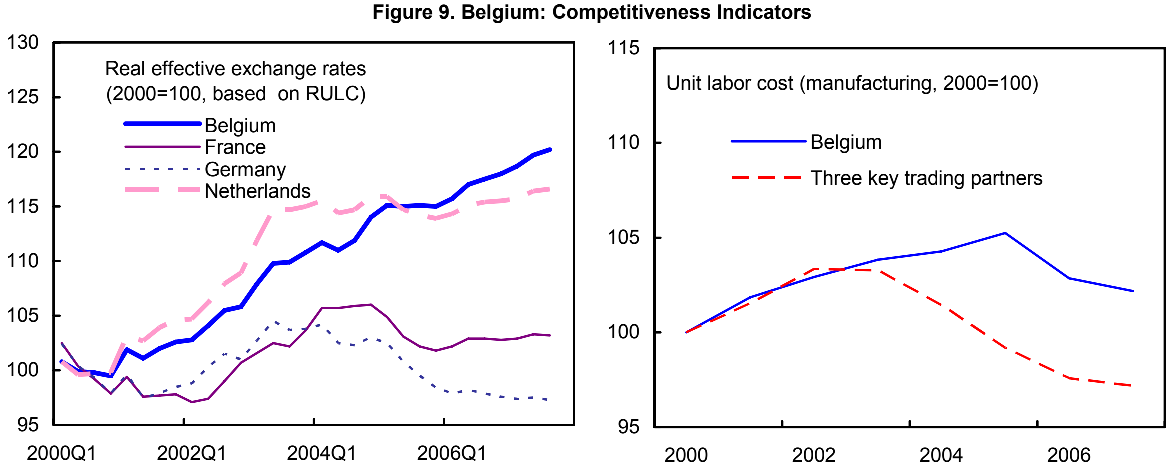
Text Table 3 . Belgium: Saving-Investment Balances
(in percent of GDP)

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 Est. |
|---|---|---|---|---|---|---|
| Private savings | 23.9 | 23.2 | 23.9 | 23.7 | 24.7 | 26.0 |
| Private investment | 17.6 | 17.1 | 17.9 | 18.0 | 18.7 | 19.0 |
| Private saving surplus | 6.3 | 6.1 | 6.1 | 5.7 | 6.1 | 7.0 |
| Government saving surplus | -1.7 | -1.7 | -1.7 | -1.8 | -1.7 | -2.4 |
| National saving surplus | 4.6 | 4.4 | 4.4 | 3.9 | 4.3 | 4.6 |

Source: National Bank of Belgium.

12. **Investment in Belgium remains attractive, but the high level of labor costs underscores the importance of preserving competitiveness through wage moderation.** The authorities have eased business regulation and cut corporate income taxes, thereby supporting corporate profitability. Moreover, the 2007-08 wage agreements planned to keep wage growth well below key trading partners. However, higher-than-expected inflation will trigger wage indexation in 2008 and lift wages above the envisaged path. Hence, labor costs will evolve in line with partner countries, albeit from a higher starting level. Consequently, additional wage moderation will be necessary, though the extent of the recent REER appreciation would be smaller with more up-to-date weights (Figure 9, Text Table 4). Continuing labor and product market reforms would also help boost productivity (Section V).

**Figure 9. Belgium: Competitiveness Indicators**




Sources: IMF, DOT, IFS, and WEO; and OECD, Economic Outlook.

Text Table 4. Belgium: Unit Labor Costs in the Private Sector, 2003-08
(Percentage change from previous year, adjusted for seasonal and calendar effects)

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|
| **Gross wages per hour worked** | **2.1** | **2.5** | **2.4** | **3.3** | **2.4** | **3.0** |
| Collectively-agreed wages 1/ | 1.9 | 2.4 | 2.3 | 2.3 | 1.9 | 2.7 |
| Agreed real wage increases | 0.4 | 1.0 | 0.3 | 0.5 | 0.2 | 0.6 |
| Indexations | 1.5 | 1.4 | 2.0 | 1.8 | 1.6 | 2.1 |
| Wage drift 2/ | 0.2 | 0.1 | 0.1 | 1.0 | 0.5 | 0.3 |
| Employers' social security contributions 3/ | 0.0 | -0.1 | -0.5 | -0.1 | 0.0 | 0.0 |
| **Labor costs per hour worked** | **2.1** | **2.4** | **1.9** | **3.2** | **2.4** | **3.0** |
| In France, Germany, and the Netherlands | 3.2 | 1.9 | 1.7 | 2.3 | 2.5 | 3.3 |
| Labor productivity 4/ | 2.1 | 2.3 | 1.1 | 1.6 | 1.1 | 1.1 |
| **Unit labor costs** | **0.0** | **0.1** | **0.8** | **1.6** | **1.3** | **1.9** |

Source: Belgian authorities.

1/ Wage increases fixed by Interprofessional Wage Agreements (IPA).

2/ Resulting from increases and bonuses granted by firms, as well as from changes in employment structures.

3/ Contribution to changes in labor costs.

4/ Private sector value added per hour.

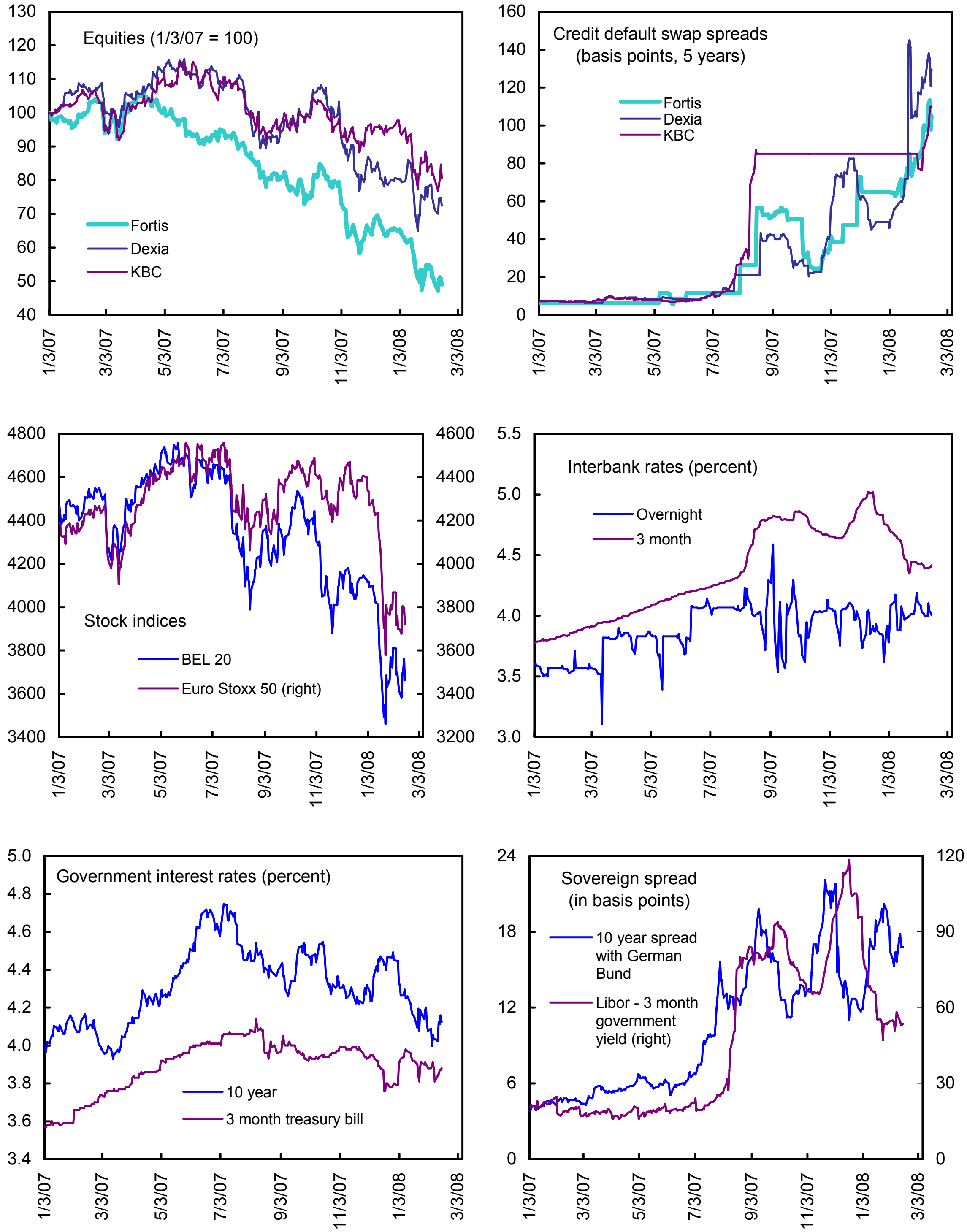
## III. Financial Sector: Addressing Turbulence and Enhancing Stability

### A. How is the Financial System Coping with Financial Turbulence?

13. **The impact on the financial sector of the ongoing financial turbulence appears manageable**. The balance sheets of the major banks have deteriorated since mid-2007 and synthetic credit default insurance spreads have risen significantly in response to the global financial problems (Figure 10). However, strains appear to be smaller than in other major markets, although they vary from bank to bank. Bank exposure to subprime mortgages is limited to less than 1 percent of total assets and credit risk stress tests for subprime-related exposures do not result in a significant impact. Although the size of current financial vulnerabilities is inevitably subject to much uncertainty and differs by bank, estimated exposures to asset-backed securities (ABS) and collateralized debt obligations (CDO) also appear moderate. ABCP conduits sponsored by some of the largest banks have experienced difficulties in rolling over maturing commercial paper and some banks have brought these vehicles back on their books, but their size is small compared to the banks' total on-balance sheet assets.

14. **Despite some write-offs related to the financial turmoil, supervisors judged the financial system to have remained sound.** Banks remain well capitalized, and solvency and coverage ratios of insurance companies and pension funds have been increasing. Participation in ECB liquidity operations does not seem to have been affected by the financial turmoil, and in response to the stress in financial markets, banks have taken liquidity-enhancing measures and reinforced contingency funding plans and liquidity

Figure 10. Belgium: Financial Indicators




Sources: Thomson Financial/DataStream and Bloomberg.

contingency procedures. Moreover, banks' vulnerability to liquidity shocks is mitigated by the traditionally large costumer deposit base relative to the loan book, and the presence of a large securities portfolio, which can be deployed to obtain secured financing in wholesale markets. Exposure to emerging markets is modest at less than 4 percent of total assets.

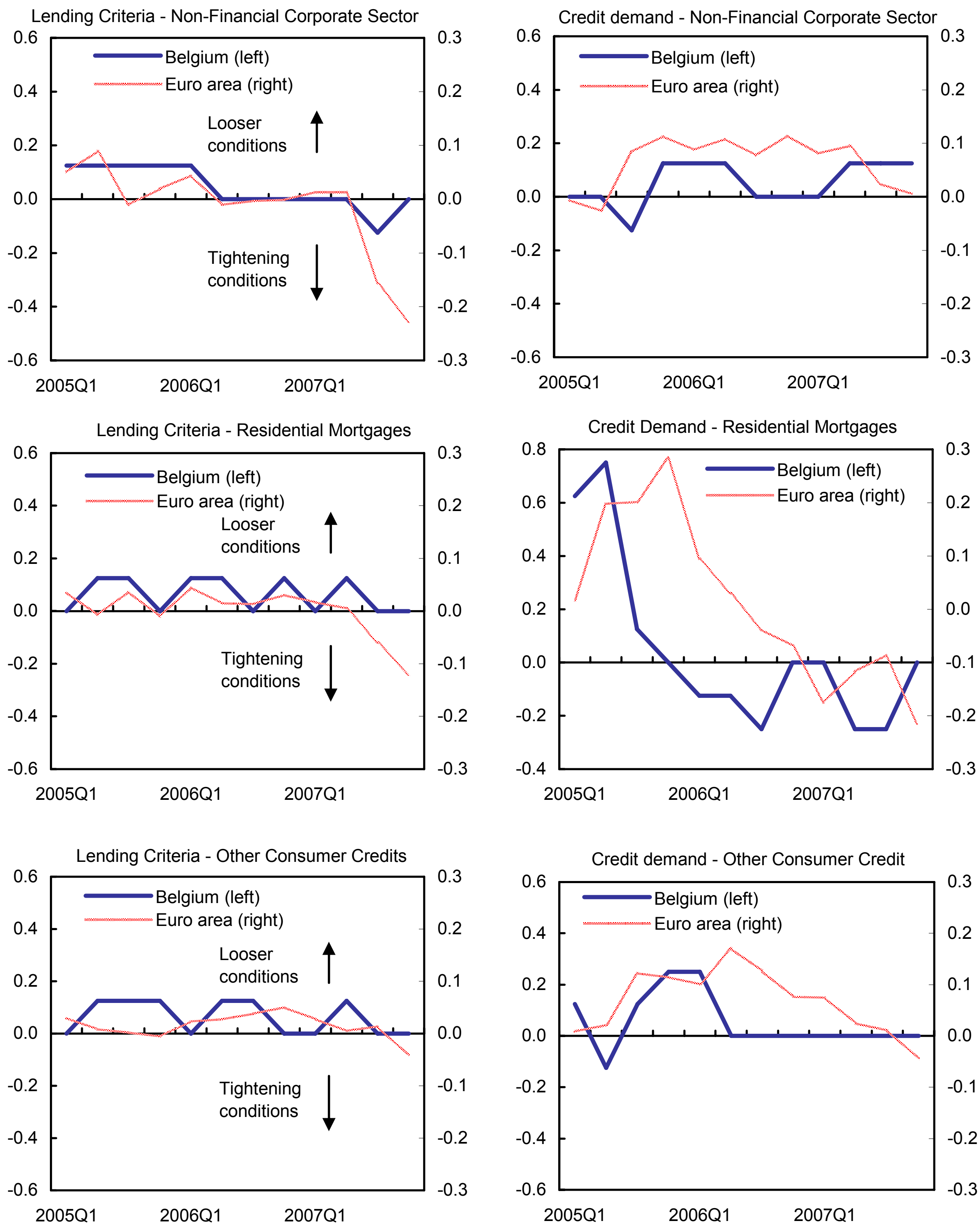
15. **Nonetheless, recent volatility in equity prices of financial institutions indicates the need for more transparent disclosure of exposures and their implications for banks' earnings and capital**. Recent actions taken by some banks to consolidate off-balance sheet exposures, albeit generally not large, generated unease about banks' earnings, even while the adverse impact of the turbulence on profitability and balance sheets of financial institutions appears manageable. Supervisory authorities agreed that early and clear disclosure of exposure by financial institutions and their valuation assumptions and methods would help ease such concerns and were actively encouraging financial institutions to improve transparency. Nevertheless, valuation remained a difficult task and volatile market conditions were likely to persist for some time. The authorities also support an international tier to supervision for regionally and globally systemic institutions and coordinated efforts to address and prevent further financial turbulence.

## B. Will Financial Strains Impact the Real Economy?

16. **Repercussions of the financial turbulence on the real economy have so far been limited.** In contrast to the tightening credit standards in the euro area as a whole, there is no tightening trend in the lending criteria applied by Belgian banks (Figure 11). Bank credit demand by non-financial corporate firms increased in late 2007 and was expected to stabilize in early 2008. Household appetite for credit was robust in late 2007 and anticipated to hold up in early 2008, despite a slowdown in the mortgage market. At the same time, banks remained cautious about lending prospects, noting the adverse impact of the financial turbulence on their balance sheets. The authorities agreed that continued turbulence in financial markets but, more importantly, a severe and protracted slowdown of economic activity, could strain the financial sector's balance sheets, with repercussion for credit conditions.

17. **The high personal savings ratio and low household leverage provide a buffer to financial turbulence, but not complete insulation**. Gross financial assets of the household sector amount to over 400 percent of gross disposable income compared to financial liabilities of less than 80 percent, contributing to one of the highest levels of accumulated net worth in industrialized countries. At the same time, the household sector has sharply increased its borrowing in recent years, lifted by a buoyant mortgage market. With housing and equity prices moderating, net wealth creation is expected to slow down. In addition, households have been increasing their claims on institutional investors, raising the risk profile of household assets. Hence, while households do not appear overly sensitive to credit

Figure 11. Belgium: Bank Lending Survey Data




Source: National Bank of Belgium.

conditions, financial turbulence has raised uncertainty about household real incomes. With the sensitivity of private consumption to changes in real income comparatively high in Belgium, a slowdown in private demand is likely.

18. **The deleveraging of the corporate sector has reduced debt-financing risks in the short term.** Profit margins of nonfinancial corporations continued to rise through mid-2007, allowing internal funds to finance investment. Similarly, with the implementation of the notional interest rate deduction for corporate equity in 2006, equity financing exploded. The corporate sector's healthy balance sheets suggest resilience to a credit squeeze. However, the financial turbulence-induced slowdown in domestic and global demand is likely to pressure profit margins and delay investment plans.

## C. How Can Financial Stability be Further Enhanced?

19. Commendable progress has been made in enhancing the effectiveness of the prudential supervision, helping to safeguard financial stability. In line with the 2005 FSAP recommendations, the supervisory framework is being continuously upgraded. The management committee of the Banking, Insurance and Finance Commission (CBFA) has been streamlined and synergies between the CBFA and the central bank (NBB) have been further developed. Regular stress tests have helped promote a systematic dialogue between supervisory authorities and market participants, while a thorough test of detailed procedures for financial crisis management yielded a satisfactory outcome. Prudential supervision of the insurance sector has been upgraded and regulation of the pension funds sector reinforced.

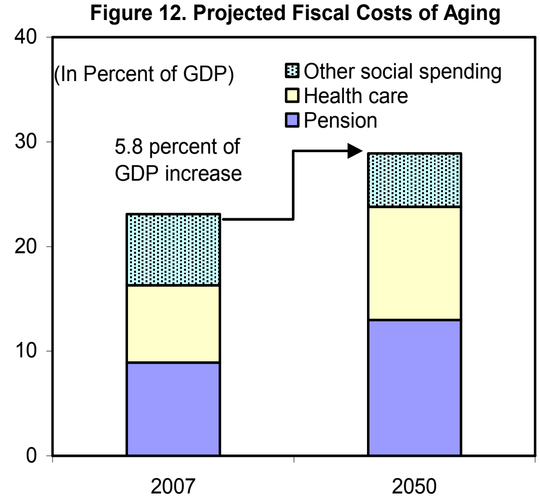
20. **At the same time, financial innovations and cross-border consolidation are modifying the financial landscape considerably.** Given the increasing sophistication of financial instruments and the complexity of bancassurance conglomerates, the authorities are well aware of the need to remain vigilant and ensure that their capacity to identify risks keep pace with market developments. To help limit the adverse effects of the ongoing financial turbulence, they favor more disclosure of exposures, risks, and valuation assumptions and methodologies. The staff noted that with the cross-border dimension of the financial system continuing to gain importance, especially following the recent Fortis-ABN AMRO transaction, deeper coordination with host country authorities will be needed.

# IV. Fiscal Policy: Resuming Consolidation and Improving Institutions

## A. Why has Fiscal Consolidation Become an Urgent Priority?

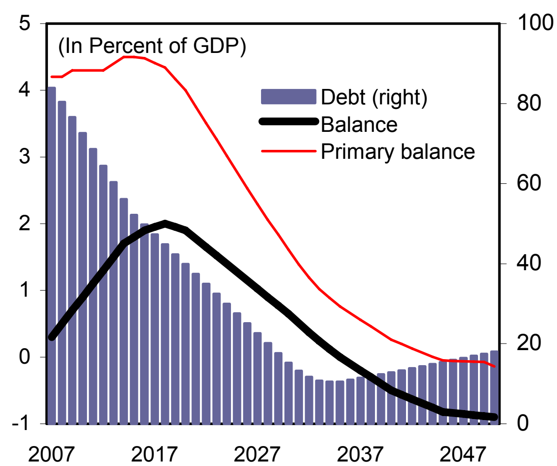
21. **Fiscal adjustment is at the core of a comprehensive strategy to address the projected rise in aging-related costs**. Population aging will raise public expenditures by close to 6 percentage points of GDP by 2050 (Figure 12). In the absence of fiscal adjustment, the public debt-to-GDP ratio is set to move onto an unsustainable path. There is broad public support for a significant pre-funding of the rise in aging-related spending, reflecting concerns about intergenerational fairness and the need to avoid activity-discouraging tax increases or drastic spending cuts in the future. This strategy, as carefully articulated by the High Finance Council (HFC), consists of building surpluses gradually and using the savings from declining public debt to finance part of the costs of aging (Figure 13). Durable primary expenditure restraint will be needed to deliver the required primary surpluses as Belgium's revenue-to-GDP ratio—close to 50 percent of GDP—is already very high. Ideally, spending should be lowered even further to allow a reduction in the tax burden on labor, which would help job creation, as would growth-enhancing policies and entitlement reforms.

**Figure 12. Projected Fiscal Costs of Aging**




Source: Hight Finance Council.

**Figure 13. HFC Recommended Adjustment**




Source: High Finance Council

22. **Initially planned to begin in 2007, fiscal consolidation has slipped below the HFC's recommended path**. The 2007 budget is now estimated to post a small deficit instead of the planned surplus of 0.3 percent of GDP (Text Table 5). The authorities stressed that fiscal slippage was mostly due to the hiatus in policy making since April 2007, albeit partly offset by higher revenue reflecting higher-than-anticipated economic growth. In addition, with the elimination of one-off measures, fiscal policy was broadly neutral, with the structural balance remaining close to balance. However, on current policies, the fiscal position is set to deteriorate, raising concerns about medium and long-term sustainability (Figure 14). In this context, the authorities recognized that fiscal consolidation is a priority to address the projected rise in aging-related costs.

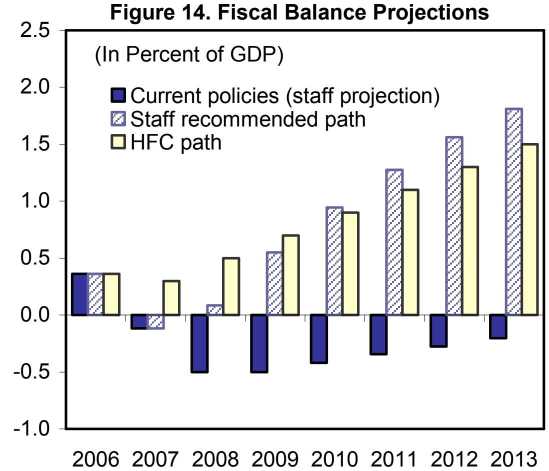
Text Table 5. Belgium: General Government Fiscal Indicators, 2003-2009
(In percent of GDP, unless otherwise indicated)

| | | | | | Est. | Proj. 1/ | |
|---|---|---|---|---|---|---|---|
| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
| General government balance 2/ | 0.0 | 0.0 | -2.3 | 0.4 | -0.1 | -0.5 | -0.5 |
| Nonstructural measures | 1.2 | 0.8 | -2.0 | 0.7 | -0.1 | -0.1 | 0.0 |
| Structural balance | -1.0 | -0.6 | 0.4 | -0.1 | -0.1 | -0.2 | -0.2 |
| Interest charges | 5.3 | 4.7 | 4.2 | 4.0 | 3.8 | 3.7 | 3.5 |
| Structural primary balance | 4.3 | 4.2 | 4.5 | 3.8 | 3.8 | 3.5 | 3.3 |
| Change in structural balance | -0.8 | 0.5 | 0.9 | -0.5 | 0.1 | -0.1 | 0.0 |
| Public debt 2/ | 98.7 | 94.4 | 92.2 | 88.1 | 84.5 | 81.7 | 79.2 |
| Memorandum items: | | | | | | | |
| Real primary spending growth (in percent) 2/ | 4.9 | -0.2 | 8.9 | -3.7 | 3.7 | 2.0 | 2.0 |
| Real GDP growth | 1.0 | 2.8 | 2.0 | 2.9 | 2.7 | 1.6 | 1.8 |

Sources: National Bank of Belgium; and IMF staff.
1/ Based on unchanged policy assumption.
2/ Assumes Eurostat's treatment of the national railway company debt transfer in 2005.

23. **The authorities are committed to resuming structural fiscal adjustment in 2008**. Staff stressed the need for a significant effort so as to restore the credibility of their commitment to fiscal consolidation. However, given that only a provisional budget has been in place in the first quarter of 2008, reaching a surplus of ½ percent of GDP already this year, as envisaged under the HFC-recommended scenario, appears to be unrealistic. Targeting a structural improvement of ½ percent of GDP in 2008 would seem to strike the right balance with feasibility. It is consistent with the prescription of the Stability and Growth Pact for countries that have not yet reached their medium-term objectives, and would bolster confidence in economic policies, especially important now that other sources of uncertainty cloud the outlook. On the basis of the authorities' macroeconomic assumptions, this approach would imply a nominal budget surplus of nearly 0.2 percent of GDP. The authorities responded they would try to achieve a small surplus, though this would be difficult, and emphasized that balancing the budget in nominal terms in 2008 was their minimum objective. At the same time, they conceded that uncertainty regarding constitutional reform and the political economy of the 2009 regional elections posed significant risks for fiscal consolidation.

**Figure 14. Fiscal Balance Projections**




Source: High Finance Council; and Staff

24. **The authorities are focused on using structural measures to deliver the required consolidation, while avoiding recourse to one-off measures**. They agreed that such

measures only postponed the needed adjustment and often constitute non-transparent claims on future resources. For the same reason, staff emphasized that public-private partnerships should not be used to circumvent fiscal adjustment needs. Risks and future spending obligations related to such arrangements should be reported in a transparent way.

25. **Delivering the envisaged structural adjustment requires a concerted effort at all levels of government**. The authorities agreed that there is little room for new spending initiatives or tax cuts, absent compensation elsewhere within the tighter budget envelope, though various coalitions partners remained to be convinced. At the same time, the high tax pressure, especially on labor, also rules out further increases in the overall tax burden. Hence, the adjustment will need to focus on expenditure restraint, for which the following will be essential:

- Any savings from a declining interest bill will have to be set aside.

- Regions and communities will need to contribute more than envisaged in the budgets adopted for 2008. Sustaining a surplus of at least 0.3 percent of GDP, as was achieved in 2007, seems feasible (Text Table 6). In the staff's view, such an objective is justified because commitments to future spending have increased under public-private partnerships, and the resolution of vertical imbalances in the fiscal federalism arrangements will require a devolution of competencies and associated spending to the regions without a proportional transfer of revenues. However, some regions disagree with this approach and seek further transfers from the federal level.

- The social security surplus should be maintained at its current level (about 0.5 percent of GDP). The authorities agreed that the rise in health care spending could be kept in line with trend-GDP growth without compromising the high quality of the health care system.

- Similarly, there is scope to slow the pace of spending growth on priority items in the federal budget compared to existing plans, and curb other discretionary spending, e.g., by streamlining functions across levels of government, deriving efficiency gains from upcoming retirements from the civil service, outsourcing of activities, and cutting subsidies.

- In addition, subsidies (including tax expenditure) for key items rose by ½ percentage point of GDP over the past five years. Partly reversing this process (e.g., by lowering the subsidies for service vouchers) will help fiscal adjustment and raise efficiency and fairness. Moreover, tax exemptions (e.g., on some savings instruments) can usefully be tightened.

Text Table 6. Belgium: Fiscal Accounts by Level of Government, 2002-2007 1/
(In percent of GDP)

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 Est. |
|---|---|---|---|---|---|---|
| Revenue | | | | | | |
| Federal | 13.1 | 13.9 | 11.5 | 11.7 | 11.2 | 10.7 |
| Social security | 18.8 | 18.7 | 19.3 | 19.2 | 19.2 | 19.5 |
| Local government | 6.5 | 6.9 | 6.6 | 6.7 | 6.6 | 6.6 |
| Regions and communities | 11.4 | 11.7 | 11.7 | 11.7 | 11.7 | 11.8 |
| Primary expenditure | | | | | | |
| Federal | 8.0 | 8.7 | 7.3 | 10.3 | 7.5 | 8.1 |
| Social security | 18.3 | 18.9 | 19.3 | 19.2 | 18.9 | 18.9 |
| Local government | 6.5 | 6.7 | 6.5 | 6.6 | 6.7 | 6.5 |
| Regions and communities | 11.3 | 11.5 | 11.3 | 11.3 | 11.3 | 11.4 |
| Balance | | | | | | |
| Federal | -0.2 | 0.3 | -0.1 | -2.4 | 0.1 | -0.9 |
| Social security | 0.5 | -0.3 | 0.1 | 0.0 | 0.3 | 0.5 |
| Local government | -0.2 | -0.1 | -0.2 | -0.1 | -0.2 | 0.0 |
| Regions and communities | -0.1 | 0.0 | 0.2 | 0.3 | 0.2 | 0.3 |

Sources: National Bank of Belgium; and IMF staff.
1/ Follows Eurostat's definition of the national railway company debt transfer in 2005.

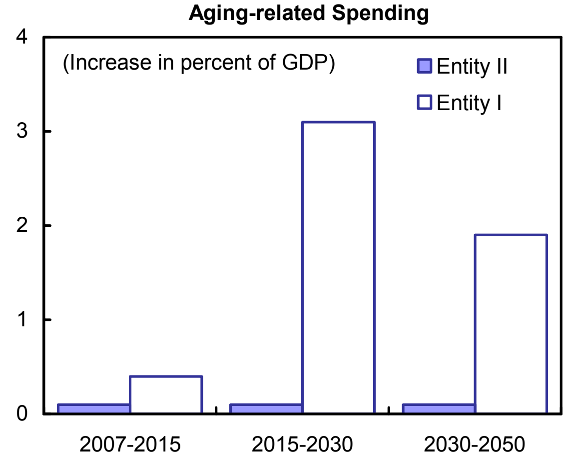
26. **Fiscal adjustment over the medium term will need to make up for the recent slippage**. The authorities argued that the measures adopted in the 2008 budget together with upcoming reforms to fiscal federalism arrangements should set in motion sufficient adjustment to deliver the HFC-recommended surplus of 1.1 percent of GDP by 2011, consistent with a primary structural surplus of close to 4½ percent of GDP. Staff noted, however, that future surpluses will need to exceed this path to make up for the recent slippage and catch up with the required reduction in public debt. Interest savings from favorable debt dynamics will then bring about further increases in nominal surpluses.

27. **More generally, refocusing the fiscal framework on a medium-term path for the primary surplus will allow to anchor sustainable fiscal consolidation**. The authorities noted that moving away from a nominal budget target could complicate public communication and accountability, but agreed that a multi-year expenditure framework would help guide the annual budget process, including through the careful costing of initiatives within a multi-year budgetary envelope. In addition, a performance-oriented approach to budgeting should help increase efficiency and the effectiveness of public services.

## B. Why is There a Need to Revise Fiscal Federalism Arrangements?

28. **The current fiscal federalism arrangements have led to unsustainable fiscal imbalances among different levels of government**. Current expenditure and revenue assignments will result in widening imbalances between the federal institutions (federal government and social security, the so-called "Entity I") and regional and local governments (the so-called "Entity II," Figure 15). With most of the increase in aging-related spending projected to fall on Entity I, the federal entities will have to bear the brunt of the adjustment, likely leading to an unsustainable squeeze in expenditure growth at the federal level. Entity II will need to share more of the adjustment burden in the context of changes in the fiscal federalism arrangements, possibly through a shift of some aging-related expenditure responsibilities from Entity I to Entity II. The authorities agreed that such a shift would be necessary and that regional entities would need to become fully accountable for any decisions that impact the social security system. In addition, strengthening the municipalities' accountability for their budgetary decisions was also necessary. The authorities hoped to be able to build a consensus to solve these vertical imbalances in the next few months.

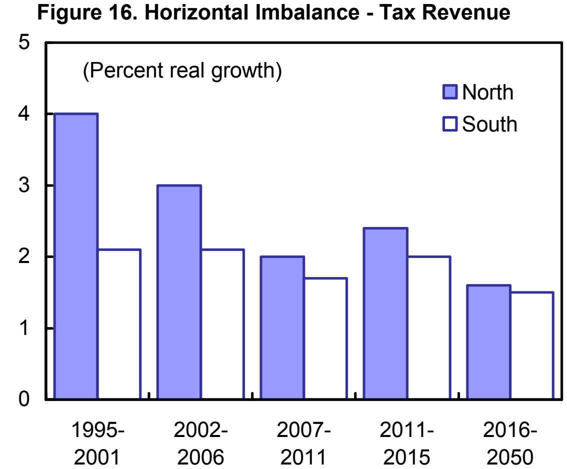
**Figure 15. Vertical Imbalance - Aging-related Spending**




Source: High Finance Council

29. **Current fiscal federalism arrangements also feature horizontal imbalances within Entity II**. These imbalances reflect regional income and growth differentials due to the linking of the distribution of part of intergovernmental revenue sharing to the growth of personal income tax revenues (Figure 16). While tempered by an equalization scheme and expected to evolve as regional growth patterns change, horizontal imbalances raise equity, incentive, and solidarity concerns, adding another layer of complexity to reaching agreement on population-aging burden sharing. A broad consensus will have to guide their resolution. It will be essential that any new agreements be neutral from a consolidated budget perspective, provide incentives for regions to work toward narrowing income differences, and are fully transparent about the intergovernmental solidarity mechanisms.

**Figure 16. Horizontal Imbalance - Tax Revenue**



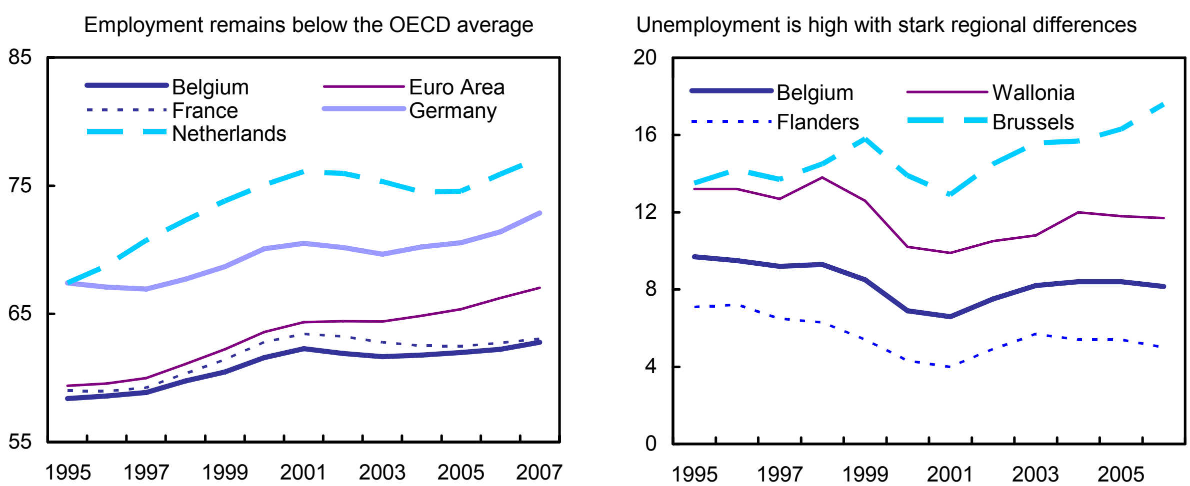

Source: High Finance Council

30. **Successful medium-term adjustment will also require greater accountability, more transparency, and stronger coordination among government entities**. The arrangements to coordinate fiscal policy between levels of government centered on the High Finance Council overall have been effective, but could be further strengthened. To avoid a hiatus in these arrangements in periods of political uncertainty, targets for the different levels of government could be fixed for a rolling multi-year horizon, which would facilitate medium-term expenditure planning, and be embedded in published internal stability pacts. The role of the High Finance Council could be reinforced and expanded through a mandate that includes an assessment of compliance with the internal stability pact at the stage of budget submission to parliament, and through a strengthening of the analytic capacity of the HFC. The authorities agreed that further devolution of competencies would necessitate strengthening of coordination and accountability for budgetary and other economic policies, but there was no agreement yet on what mechanism to put in place.

## V. Structural Reforms: Raising Employment and Productivity

31. **Pressing ahead with structural reforms, especially in the labor market, is key to preserving high living standards.** Without further reforms, demographic trends will dampen long-term growth, as population aging curbs labor supply and sharply raises dependency ratios. Despite recent increases, employment rates remain among the lowest in the industrialized world, especially among older and low-skilled workers (Figure 17). While some areas of the country are close to full employment, others are mired in high unemployment, contributing to geographical differences in growth and income. In addition, labor market participation is low throughout the country, underscoring fundamental skill mismatches and limited labor mobility.

**Figure 17. Employment and Unemployment**
(In percent of the labor force)




Sources: National Bank of Belgium; OECD; and IMF.

32. **To sustain good rates of job creation, further labor market reforms will be essential.** The spotlight on activation policies (i.e., enforcing job search requirements and providing job search assistance) has been appropriate, and has taken advantage of the until recently buoyant economy. Nonetheless, better tailoring of labor market policies to regional needs and coordination across regions and sub-regions is necessary to raise their effectiveness. Consensus is lacking for a new round of comprehensive labor market reforms, though most stakeholders agree on the need to further improve labor market performance. Specifically, labor market reforms should involve:

- ***Raising investment in human capital.*** There is broad agreement that the pursuit of ongoing initiatives with respect to R&D, the further strengthening of programs for on-the-job and life-long training, and an increase in the efficiency of secondary and higher education are likely to pay off handsomely in terms of the economy's ability to adopt new technologies, attract foreign investment, and maintain comparatively high living standards.

- ***Removing inactivity traps and keeping older workers in the labor force.*** To achieve the first, a comprehensive review of the tax-benefit system would be useful, but parts of the political spectrum and labor unions are adverse to lowering or taxing benefits. In line with OECD recommendations, a balanced reform could consist of the phasing out of unemployment benefits—virtually all other industrialized countries have strict time limits and phased benefits—in exchange for an increase in payouts during the first few months of unemployment. It could be accompanied by the inclusion of all out-of-work benefits and allowances in taxable income, in exchange for a gradual, rather than immediate removal of these benefits when jobs are taken up. Alternatively, a higher earned income tax credit could be considered. Such an approach would reap the synergies between fiscal adjustment and labor market polices. To help raise employment rates of older workers, the planned extension of activation policies to these workers is welcome, but it will need to be complemented by a complete phasing out of early retirement regimes.

- ***Sustaining wage moderation and increasing wage flexibility***. While the central wage-bargaining framework is likely to continue to maintain wage moderation, shifting its focus from job preservation to job creation would improve labor market outcomes. To take better account of productivity differentials between regions, sectors, and enterprises, and foster a dynamic reallocation of workers to new activities, the practice of "all-in" wage agreements should be extended and larger margins for wage differentiation allowed. Social partners, however, do not see a need for any significant changes to the current wage-bargaining framework.

33. **More competition in product markets will boost productivity.** The authorities agreed that continuing the reduction in the administrative burden on businesses and households, and the swift implementation of EU directives regarding market liberalization

and the removal of obstacles to competition would raise efficiency. They indicated that progress in this area had fallen victim to the hiatus in federal policy making following the June 2007 elections and suffered from lack of coordination between regional and federal levels of government. With the preoccupation about fiscal federalism reforms, they conceded that reviving attention for structural reform could take a while.

## VI. Staff Appraisal

34. **With growth slowing and the window to address population aging closing rapidly, returning to an ambitious reform agenda has become urgent.** Expectations a year ago that, following the June 2007 elections, a new federal government would take immediate decisive action to meet long-term challenges have not been validated. The difficulty in creating consensus around much needed fiscal federalism reforms has so far prevented the emergence of a full-fledged government and diverted attention from these priorities. However, further delays in building up fiscal surpluses and boosting employment rates and productivity cannot be afforded. Meanwhile, clarifying the direction of policies early on has become especially important now that other sources of uncertainty cloud the outlook.

35. **Addressing the cyclical downturn through automatic fiscal stabilizers is appropriate, while the impact of partial indexation on competitiveness will require continued wage moderation.** After several years of robust economic performance, growth is expected to slow significantly, mostly owing to external factors. In addition, risks are tilted to the downside. Provided fiscal consolidation is resumed, the authorities' intention to allow fiscal stabilizers to operate fully and abandon the procyclical use of one-off measures to meet nominal budget targets is welcome. Similarly, limiting the response to energy price spikes to an increase in well-targeted and capped income support for the lowest-income households is apposite. Indeed, with widespread partial indexation, broader measures would be counterproductive. Furthermore, maintaining competitiveness, which is broadly fine at its current level, will require wage moderation going forward.

36. **Maintaining a sound financial system and high-quality supervision are paramount.** Financial institutions have remained resilient in the face of the ongoing financial turbulence, but market conditions have yet to return to normal and a stronger-than-expected economic slowdown could prove taxing. Financial institutions therefore need to uphold capital buffers. Actions by supervisors to promote early disclosure of exposures and losses and enhanced transparency practices would be welcome as they would help dampen market volatility and underpin confidence. While already high-quality prudential supervision is being further enhanced, the relentless rise in the cross-border dimension of the financial system requires stronger coordination with host country authorities.

37. **Resuming ambitious fiscal consolidation and improving fiscal frameworks and federalism arrangements are urgent priorities.** While there has so far been broad support for a strategy of pre-funding of the expected rise in aging costs, actual fiscal consolidation

has slipped below the path recommended by the High Finance Council as the result of the hiatus in policy making at the federal level since April 2007. It will be important to get back on track as soon as possible:

- From this perspective, the intention to resume fiscal consolidation in 2008 is welcome, but a more ambitious effort, amounting to an improvement in the structural balance by ½ percent of GDP, would better underpin credibility and bolster confidence in economic policies.

- Delivering the necessary structural adjustment will require a concerted effort at all levels of government. There is no room for new spending initiatives or tax cuts, while the high tax pressure, especially on labor, also rules out further increases in the overall tax burden. Expenditure restraint will thus need to be the primary source of adjustment.

- Refocusing the fiscal framework on a medium-term path for the primary surplus will be key to achieving consolidation objectives. The authorities' intent to avoid recourse to one off measures is welcome, as such measures often imply nontransparent claims on future resources. In the same vein, recourse to public-private partnerships, which has risen substantially recently, should be restrained.

- Finally, while a broad consensus will need to guide the revision of fiscal federalism arrangements, it will be important that new arrangements be neutral from a consolidated budgetary perspective, provide incentives for regions to narrow income differences, and be accompanied by strengthened accountability and stronger coordination of economic policies across all levels of government.

38. **Implementing a new round of structural reforms will be essential to reap synergies with fiscal adjustment and achieve the much needed increase in employment rates and productivity growth.** Progress in raising employment rates is evident, owing to better activation policies, while initiatives with respect to training, education and R&D investments are likely to pay off in terms of productivity. Meanwhile, the wage bargaining framework continues to deliver wage moderation. Nonetheless, labor market performance is still lagging well behind the OECD average, and large geographical differences in unemployment rates reflect deep-rooted structural problems. Priority areas for reform are removing inactivity traps, raising low employment rates of older workers, and fostering labor mobility. Addressing these issues would generate synergies between fiscal adjustment and labor market reforms. Further goods and services markets reforms would boost productivity growth and consumer welfare.

39. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Belgium: Main Economic Indicators, 2003-09

(Percentage change from previous year; unless otherwise indicated)

| | | | | | Est. | Proj. | |
|---|---|---|---|---|---|---|---|
| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
| **Demand and output** (in real terms) | | | | | | | |
| GDP | 1.0 | 2.8 | 2.0 | 2.9 | 2.7 | 1.6 | 1.8 |
| Private consumption | 0.7 | 1.4 | 1.4 | 2.1 | 2.5 | 1.5 | 1.9 |
| Public consumption | 2.1 | 1.8 | -0.2 | 0.0 | 1.8 | 2.4 | 2.2 |
| Gross fixed investment | -0.3 | 7.5 | 6.7 | 4.2 | 4.9 | 1.4 | 2.7 |
| *Of which:* enterprise investment | -1.8 | 7.4 | 4.6 | 3.9 | 5.1 | 1.9 | 3.0 |
| Stockbuilding 1/ | 0.0 | 0.2 | 0.2 | 0.8 | 0.1 | 0.0 | 0.0 |
| Exports of goods and nonfactor services | 2.9 | 6.3 | 4.1 | 2.6 | 4.6 | 4.6 | 5.4 |
| Imports of goods and nonfactor services | 2.8 | 6.5 | 4.9 | 2.5 | 5.0 | 5.2 | 5.4 |
| Foreign balance 1/ | 0.2 | 0.1 | -0.5 | 0.2 | -0.1 | -0.4 | 0.1 |
| Output gap (in percent of potential GDP) | -0.9 | 0.0 | -0.2 | 0.2 | 0.4 | -0.2 | -0.4 |
| **Labor market** | | | | | | | |
| Labor force (national definition) | -2.7 | 1.3 | 1.3 | 0.8 | 0.5 | 0.5 | 0.5 |
| Employment (national definition) | -1.7 | 0.6 | 0.9 | 1.1 | 1.6 | 0.6 | 0.4 |
| EU harmonized unemployment rate 2/ | 8.2 | 8.4 | 8.4 | 8.2 | 7.4 | 7.4 | 7.5 |
| NAIRU 2/ | 7.9 | 7.9 | 7.8 | 7.7 | 7.6 | 7.5 | 7.5 |
| **Prices, wages, and incomes** | | | | | | | |
| GDP deflator | 1.6 | 2.4 | 2.4 | 2.0 | 1.7 | 2.4 | 2.1 |
| Terms of trade (goods) | -0.4 | -0.2 | -0.5 | -0.7 | 0.8 | 0.3 | 0.0 |
| Consumer price index (harmonized) | 1.5 | 1.9 | 2.5 | 2.3 | 1.8 | 2.9 | 1.9 |
| Labor productivity 3/ | 2.7 | 2.2 | 1.0 | 1.8 | 1.1 | 1.0 | 1.4 |
| **Interest rates** (percent) | | | | | | | |
| Money market rate (3 month) | 2.3 | 2.1 | 2.2 | 3.1 | 4.3 | ... | ... |
| Government bond yield | 4.2 | 4.2 | 3.4 | 3.8 | 4.3 | ... | ... |
| **Saving and investment** (in percent of GDP) | | | | | | | |
| Private saving | 23.2 | 23.5 | 23.1 | 24.4 | 25.7 | 25.4 | 25.4 |
| Private investment | 17.1 | 17.9 | 17.9 | 18.5 | 18.8 | 18.6 | 18.6 |
| Private saving surplus | 6.1 | 5.6 | 5.2 | 5.9 | 6.9 | 6.8 | 6.8 |
| Government saving surplus | -1.7 | -1.7 | -1.8 | -1.7 | -2.2 | -2.4 | -2.4 |
| National saving surplus | 4.4 | 3.9 | 3.4 | 4.2 | 4.7 | 4.4 | 4.4 |
| **Public finances, general government** (in percent of GDP) 4/ | | | | | | | |
| Revenue | 51.1 | 49.2 | 49.4 | 48.7 | 48.5 | 48.2 | 48.1 |
| Expenditure | 51.1 | 49.2 | 51.6 | 48.4 | 48.7 | 48.7 | 48.6 |
| *Of which:* interest on public debt | 5.3 | 4.7 | 4.2 | 4.0 | 3.8 | 3.7 | 3.5 |
| Fiscal balance | 0.0 | 0.0 | -2.3 | 0.4 | -0.1 | -0.5 | -0.5 |
| Primary balance | 5.3 | 4.7 | 1.9 | 4.3 | 3.7 | 3.2 | 3.0 |
| Structural balance 5/ | -1.0 | -0.6 | 0.4 | -0.1 | -0.1 | -0.2 | -0.2 |
| Gross public debt | 98.7 | 94.4 | 92.2 | 88.1 | 84.5 | 81.7 | 79.1 |
| **Balance of payments** | | | | | | | |
| Current account balance (in billions of euros) | 11.4 | 10.2 | 7.9 | 8.6 | 10.8 | 10.4 | 10.7 |
| (In percent of GDP) | 4.1 | 3.5 | 2.6 | 2.7 | 3.3 | 3.0 | 3.0 |
| Trade balance (in billions of euros) | 9.7 | 7.8 | 4.7 | 2.6 | 3.9 | 4.4 | 4.6 |
| (In percent of GDP) | 3.5 | 2.7 | 1.6 | 0.8 | 1.2 | 1.3 | 1.3 |
| **Exchange rates** | | | | | | | |
| Nominal effective rate (2000=100) | 105.7 | 106.8 | 106.9 | 107.3 | 109.1 | ... | ... |
| Real effective rate (2000=100) 6/ | 110.3 | 111.9 | 113.3 | 115.0 | 117.6 | ... | ... |

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

1/ Contribution to growth.
2/ Percent of the labor force.
3/ Based on national accounts data, for economy-wide.
4/ Includes the effect of the restructuring of the national railway company in 2005 as presented by Eurostat.
5/ Excludes effect of one-off measures, including the restructuring of the national railway company in 2005.
6/ Based on relative unit labor costs in manufacturing.

Table 2. Belgium: Operations of the General Government, 2000-2006 1/

(In percent of GDP, unadjusted for working days)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|---|
| Revenue | 49.1 | 49.6 | 49.8 | 51.1 | 49.2 | 49.4 | 48.7 |
| Tax revenue | 44.4 | 44.4 | 44.7 | 44.2 | 44.5 | 44.3 | 43.9 |
| Direct taxes | 17.1 | 17.3 | 17.1 | 16.7 | 16.7 | 16.9 | 16.5 |
| Personal income tax | 13.6 | 14.0 | 13.9 | 13.6 | 13.3 | 13.3 | 12.6 |
| Company income tax | 3.3 | 3.2 | 3.2 | 3.0 | 3.3 | 3.6 | 3.9 |
| Other direct taxes | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Indirect taxes | 12.9 | 12.5 | 12.7 | 12.7 | 13.0 | 13.0 | 13.2 |
| Social contributions | 13.9 | 14.2 | 14.4 | 14.3 | 14.0 | 13.7 | 13.6 |
| Other taxes | 0.5 | 0.5 | 0.5 | 0.5 | 0.8 | 0.6 | 0.7 |
| Nontax revenue | 4.7 | 5.2 | 5.1 | 6.9 | 4.7 | 5.1 | 4.8 |
| Expenditure | 49.0 | 49.1 | 49.8 | 51.1 | 49.2 | 51.6 | 48.4 |
| Primary expenditure | 42.4 | 42.6 | 44.1 | 45.8 | 44.5 | 47.5 | 44.4 |
| Current expenditure | 39.3 | 40.2 | 41.6 | 42.7 | 42.2 | 42.4 | 41.9 |
| Wages | 11.5 | 11.7 | 12.2 | 12.3 | 12.0 | 12.0 | 11.8 |
| Operations and maintenance | 3.2 | 3.3 | 3.8 | 3.7 | 3.7 | 3.6 | 3.6 |
| Social transfers | 21.3 | 21.8 | 22.3 | 23.0 | 23.0 | 22.8 | 22.4 |
| Old age | 8.3 | 8.4 | 8.6 | 8.7 | 8.6 | 8.5 | 8.4 |
| Health | 5.6 | 5.8 | 5.7 | 6.1 | 6.2 | 6.3 | 6.1 |
| Unemployment | 1.7 | 1.8 | 2.0 | 2.1 | 2.1 | 2.0 | 1.9 |
| Other social transfer | 5.7 | 5.8 | 6.0 | 6.1 | 6.1 | 6.0 | 6.0 |
| Subsidies to enterprises | 1.3 | 1.3 | 1.3 | 1.4 | 1.2 | 1.6 | 1.7 |
| Other transfers | 2.0 | 2.0 | 2.1 | 2.3 | 2.4 | 2.4 | 2.4 |
| Capital expenditure | 3.1 | 2.4 | 2.5 | 3.1 | 2.2 | 5.1 | 2.5 |
| Interest | 6.6 | 6.5 | 5.7 | 5.3 | 4.7 | 4.2 | 4.0 |
| Overall balance | 0.1 | 0.6 | 0.0 | 0.0 | 0.0 | -2.3 | 0.4 |
| Primary balance | 6.7 | 7.0 | 5.7 | 5.3 | 4.7 | 1.9 | 4.3 |
| **Memorandum items:** | | | | | | | |
| Structural balance 2/ | -0.5 | -0.4 | -0.4 | -1.0 | -0.6 | 0.4 | -0.1 |
| Central government balance 2/ | 0.1 | -0.1 | 0.2 | 0.0 | -0.2 | -0.3 | -0.6 |
| Gross public debt (Maastricht definition) | 107.7 | 106.5 | 103.5 | 98.7 | 94.4 | 92.2 | 88.1 |

Source: Data provided by the Belgian authorities.

1/ Includes the effect of the restructuring of the national railway company in 2005 as per Eurostat. According to the authorities, the government balance should be 0.1 percent of GDP in 2005 and the public debt 91.5 percent of GDP.

2/ Excludes effect of one-off measures, including the restructuring of the national railway company in 2005.

Table 3. Belgium: Fiscal Scenarios, 2004-13

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

| | | | | Est. | Projection | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| **Current policies (A)** | | | | | | | | | | |
| Revenue | 49.2 | 49.4 | 48.7 | 48.5 | 48.2 | 48.1 | 48.1 | 48.0 | 48.0 | 47.9 |
| Expenditure | 49.2 | 51.6 | 48.4 | 48.7 | 48.7 | 48.6 | 48.5 | 48.4 | 48.3 | 48.2 |
| Primary expenditure | 44.5 | 47.5 | 44.4 | 44.8 | 45.0 | 45.1 | 45.1 | 45.1 | 45.0 | 45.0 |
| Interest payments | 4.7 | 4.2 | 4.0 | 3.8 | 3.7 | 3.5 | 3.4 | 3.3 | 3.2 | 3.1 |
| Balance 1/ | 0.0 | -2.3 | 0.4 | -0.1 | -0.5 | -0.5 | -0.4 | -0.4 | -0.3 | -0.2 |
| Structural balance 2/ | -0.6 | 0.4 | -0.1 | -0.1 | -0.2 | -0.2 | -0.2 | -0.1 | -0.1 | -0.1 |
| Change in structural balance | 0.5 | 0.9 | -0.5 | 0.1 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Primary balance | 4.7 | 1.9 | 4.3 | 3.7 | 3.2 | 3.0 | 3.0 | 3.0 | 2.9 | 2.9 |
| Structural primary balance 2/ | 4.2 | 4.6 | 3.8 | 3.8 | 3.5 | 3.3 | 3.3 | 3.2 | 3.1 | 3.0 |
| Debt 1/ | 94.4 | 92.2 | 88.1 | 84.5 | 81.7 | 79.2 | 76.7 | 74.3 | 72.0 | 69.8 |
| Memorandum items (in percent): | | | | | | | | | | |
| Real primary expenditure growth 2/ | -0.2 | 8.9 | -3.7 | 3.7 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Output gap | 0.0 | -0.2 | 0.2 | 0.4 | -0.2 | -0.4 | -0.3 | -0.2 | -0.1 | 0.0 |
| GDP growth | 2.8 | 2.0 | 2.9 | 2.7 | 1.6 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 |
| **Staff-recommended scenario (B)** | | | | | | | | | | |
| Revenue | 49.2 | 49.4 | 48.7 | 48.5 | 48.2 | 48.1 | 48.1 | 48.0 | 48.0 | 47.9 |
| Expenditure | 49.2 | 51.6 | 48.4 | 48.7 | 48.1 | 47.6 | 47.1 | 46.7 | 46.4 | 46.0 |
| Primary expenditure | 44.5 | 47.5 | 44.4 | 44.8 | 44.4 | 44.1 | 43.8 | 43.5 | 43.3 | 43.2 |
| Interest payments | 4.7 | 4.2 | 4.0 | 3.8 | 3.7 | 3.5 | 3.4 | 3.2 | 3.0 | 2.9 |
| Balance 1/ | 0.0 | -2.3 | 0.4 | -0.1 | 0.1 | 0.6 | 1.0 | 1.3 | 1.6 | 1.9 |
| Structural balance 2/ | -0.6 | 0.4 | -0.1 | -0.1 | 0.4 | 0.9 | 1.2 | 1.5 | 1.8 | 2.0 |
| Change in structural balance | 0.5 | 0.9 | -0.5 | 0.1 | 0.5 | 0.4 | 0.4 | 0.3 | 0.3 | 0.2 |
| Primary balance | 4.7 | 1.9 | 4.3 | 3.7 | 3.8 | 4.1 | 4.3 | 4.5 | 4.6 | 4.7 |
| Structural primary balance 2/ | 4.2 | 4.6 | 3.8 | 3.8 | 4.1 | 4.4 | 4.6 | 4.7 | 4.8 | 4.9 |
| Debt 1/ | 94.4 | 92.2 | 88.1 | 84.5 | 81.1 | 77.6 | 73.7 | 69.8 | 65.8 | 61.7 |
| Memorandum items (in percent): | | | | | | | | | | |
| Real primary expenditure growth 2/ | -0.2 | 8.9 | -3.7 | 3.7 | 0.6 | 0.9 | 1.2 | 1.5 | 1.5 | 1.6 |
| Output gap | 0.0 | -0.2 | 0.2 | 0.4 | -0.2 | -0.5 | -0.4 | -0.3 | -0.2 | -0.1 |
| GDP growth | 2.8 | 2.0 | 2.9 | 2.7 | 1.6 | 1.7 | 1.9 | 1.9 | 2.0 | 2.0 |

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

1/ Includes the effect of the restructuring of the national railway company in 2005 as presented by Eurostat. According to the authorities, the government balance should be 0.1 percent of GDP in 2005 and the public debt 91.5 percent of GDP.

2/ Excludes one-off measures including the restructuring of the national railway company in 2005.

Table 4. Belgium: Financial Soundness Indicators of the Non-Banking Sectors, 2001-07
(In percent)

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|---|
| **Insurance sector** 1/ | | | | | | | |
| Coverage ratio 2/ | 276.0 | 254.1 | 248.4 | 250.7 | 258.8 | 252.6 | 256.7 |
| Profitability (return on equity) 3/ | 12.1 | -10.4 | 7.3 | 18.0 | 23.3 | 20.8 | 30.1 |
| Life Premiums 4/ | 13.1 | 14.4 | 17.6 | 20.0 | 25.2 | 20.4 | 23.1 |
| Technical result/premiums 3/ | 6.1 | -1.7 | 2.7 | 4.0 | 4.7 | 4.9 | 6.8 |
| Non-life Premiums 4/ | 7.8 | 8.5 | 9.0 | 9.6 | 8.9 | 9.3 | 9.8 |
| Combined ratio 3/ | 117.5 | 111.6 | 102.1 | 99.6 | 104.3 | 101.7 | 100.4 |
| Technical result/premiums 3/ | 0.0 | -3.4 | 8.8 | 12.8 | 12.0 | 12.7 | 16.7 |
| **Corporate sector** 5/ | | | | | | | |
| Total debt (percent of equity) | 83.0 | 79.5 | 78.2 | 70.6 | 65.6 | 60.5 | ... |
| Profitability (return on equity) | 9.8 | 11.7 | 12.9 | 10.4 | 15.8 | 14.8 | ... |
| Debt service coverage ratio | 113.6 | 176.7 | 195.6 | 182.8 | 285.0 | 236.4 | ... |
| **Household sector** | | | | | | | |
| Debt (in percent of GDP) 6/ | 41.3 | 41.4 | 42.3 | 43.1 | 41.1 | 46.2 | 48.8 |
| Interest burden (in percent of disposable income) 7/ | 2.5 | 1.8 | 1.5 | 1.2 | 1.6 | 2.0 | 2.0 |
| Financial savings ratio (in percent of GDP) 6/ | 7.5 | 5.0 | 4.0 | 4.8 | 1.5 | 2.4 | 6.2 |
| Savings rate 7/ | 16.6 | 15.9 | 14.8 | 13.5 | 12.3 | 12.6 | 12.8 |
| **Real estate sector** 8/ | | | | | | | |
| House price inflation | | | | | | | |
| Houses | 6.4 | 8.2 | 6.6 | 10.3 | 18.1 | 11.2 | 7.1 |
| Apartments | 4.4 | 8.3 | 8.9 | 14.6 | 9.4 | 10.1 | 6.3 |
| Mortgage loans as percent of total loans | 20.5 | 22.3 | 27.6 | 27.4 | 26.2 | 34.0 | 30.5 |
| o/w Domestic households | 13.3 | 14.2 | 15.6 | 15.5 | 14.5 | 17.5 | 16.7 |
| Variable rate mortgages (in percent of new loans) | 6.2 | 12.3 | 25.9 | 53.3 | 36.3 | 7.4 | 1.2 |

Sources: CBFA, NBB, Stadim, UPC.

1/ Unconsolidated data.
2/ Provisional figure for end-September 2007.
3/ Provisional 2007 figure for first 9 months annualised.
4/ Provisional figure for full year 2007, based on projection by Assuralia.
5/ Data for 2006 based on a sample of available annual accounts in the Central Balance Sheet Register.
6/ 2007 figure for end-June 2007.
7/ Projection for full year 2007.
8/ 2007 data for first half of 2007.

Table 5. Belgium: Financial Soundness Indicators of the Banking Sector, 2002-07 1/
(In percent)

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 2/ |
|---|---|---|---|---|---|---|
| | Belgian GAAP | | | | IFRS | |
| **Earnings and profitability** | | | | | | |
| Return on assets | 0.4 | 0.4 | 0.5 | 0.5 | 0.7 | 0.7 |
| Return on equity | 11.8 | 13.6 | 15.8 | 18.5 | 22.4 | 23.4 |
| Net interest income to total income | 55.1 | 56.4 | 56.3 | 53.5 | 47.9 | 48.4 |
| Interest margin | 1.5 | 1.4 | 1.3 | 1.2 | 1.0 | 1.0 |
| Average yield on assets | 4.9 | 4.0 | 3.9 | 4.1 | 4.6 | 5.3 |
| Average cost of funding | 3.4 | 2.6 | 2.6 | 2.9 | 3.6 | 4.3 |
| Noninterest expenses to gross income | 44.9 | 43.6 | 43.7 | 46.5 | 52.1 | 51.6 |
| o/w Net fee and commission income | 24.6 | 24.4 | 25.5 | 25.9 | 25.1 | 27.9 |
| (Un)realised capital gains booked in P&L | 9.9 | 10.1 | 8.9 | 8.2 | 14.6 | 18.1 |
| Cost/income ratio | 74.7 | 73.9 | 72.0 | 72.6 | 55.7 | 58.8 |
| Personnel expenses to noninterest expenses | 44.3 | 45.5 | 44.7 | 42.8 | 54.7 | 53.4 |
| **Structure assets** | | | | | | |
| Total assets (in percent of GDP) | 383.1 | 376.2 | 395.4 | 453.5 | 448.5 | 473.9 |
| o/w (in percent of total assets) | | | | | | |
| Loans to credit institutions 3/ | 21.0 | 20.0 | 18.6 | 20.3 | 20.1 | 19.6 |
| Debt securities 3/ | 27.1 | 27.4 | 25.5 | 23.4 | 22.5 | 19.5 |
| Equity instruments 3/ | 1.3 | 1.7 | 2.7 | 3.5 | 3.6 | 4.0 |
| Derivatives 3/ | 0.0 | 0.0 | 0.0 | 0.0 | 4.5 | 5.4 |
| Loans to customers 3/ | 41.1 | 41.5 | 42.2 | 43.2 | 41.6 | 42.5 |
| o/w Belgian residents (in percent of loans) | 52.1 | 52.3 | 48.5 | 41.6 | 43.0 | 43.0 |
| Other EMU residents (in percent of loans) | 21.7 | 22.5 | 22.7 | 25.5 | 29.0 | 30.0 |
| Rest of the World (in percent of loans) | 26.2 | 25.2 | 28.8 | 32.9 | 28.0 | 27.0 |
| o/w Mortgage loans (in percent of loans) | 93.6 | 117.4 | 132.0 | 154.7 | 189.7 | 193.0 |
| Consumer loans (in percent of loans) | 14.3 | 13.5 | 12.7 | 13.7 | 15.4 | 16.0 |
| o/w Term loans (in percent of loans) | 57.5 | 53.7 | 53.5 | 54.8 | 46.1 | 37.7 |
| o/w Reverse repo operations (in percent of loans) | ... | ... | ... | ... | 41.0 | 32.6 |
| **Funding and Liquidity 3/** (in percent of total assets) | | | | | | |
| Debts to credit institutions | 24.9 | 24.9 | 24.6 | 30.1 | 29.2 | 26.7 |
| Bank bonds and other debt securities | 12.6 | 11.2 | 10.0 | 8.7 | 11.2 | 11.5 |
| Customer deposits | 39.7 | 40.3 | 39.9 | 36.7 | 39.1 | 38.5 |
| o/w Sight deposits 3/ | 13.3 | 13.7 | 13.4 | 13.5 | 11.1 | 12.1 |
| Saving deposits 3/ | 11.1 | 12.9 | 13.2 | 11.6 | 10.2 | 8.6 |
| Term deposits 3/ | 14.3 | 12.5 | 12.1 | 10.6 | 10.6 | 11.3 |
| o/w Retail deposits | ... | ... | ... | ... | 20.4 | 18.0 |
| o/w Repo's | ... | ... | ... | ... | 13.5 | 11.2 |
| Liquid assets 4/ | 33.3 | 33.2 | 32.7 | 31.1 | 18.6 | 16.0 |
| **Asset quality** | | | | | | |
| Sectoral distribution of loans | | | | | | |
| Credit institutions | ... | ... | ... | ... | 20.1 | 19.6 |
| Corporate | ... | ... | ... | ... | 18.3 | 19.7 |
| Retail | ... | ... | ... | ... | 18.3 | 16.7 |
| Central governments | ... | ... | ... | ... | 0.8 | 1.0 |
| Non-credit institutions | ... | ... | ... | ... | 4.1 | 5.2 |
| Non-performing loans (in percent of gross loans) 5/ | 3.0 | 2.6 | 2.3 | 2.0 | 1.7 | 1.6 |
| Provisions + writeoffs (in percent of NPL) 5/ | 51.8 | 52.8 | 54.2 | 51.6 | 50.8 | 45.0 |
| **Capital adequacy** | | | | | | |
| Regulatory capital to risk-weighted assets | 13.1 | 12.8 | 13.0 | 11.5 | 11.9 | 11.9 |
| Regulatory Tier I capital to risk-weighted assets | 8.6 | 8.8 | 9.4 | 8.5 | 8.7 | 8.5 |
| Capital to assets | 3.0 | 3.1 | 3.1 | 2.7 | 3.3 | 3.2 |
| NPL net of provisions as percent of Tier I capital 5/ | 15.2 | 15.7 | 12.8 | 13.8 | 10.9 | 11.6 |
| Large exposures as percent of Tier I capital 5/ | 61.0 | 46.0 | 40.0 | 42.5 | 36.2 | 16.8 |
| Net open position in foreign exchange to capital | 8.5 | 7.0 | 5.3 | 5.8 | 6.4 | 4.1 |

Sources: CBFA and NBB.
1/ Consolidated data. Since 2006, the data are based on the IAS/IFRS reporting Scheme.
2/ Data for end-September 2007 or the first 9 months of 2007. The flow data are annualised.
3/ Deposits booked at amortised cost only.
4/ As of 2006, liquid assets include cash and debt instruments issued by central government and financial institutions.
5/ Unconsolidated data.

Table 6. Belgium: Indicators of External and Financial Vulnerability, 2001-07

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|---|
| **External Indicators** | | | | | | | |
| Exports (annual percentage change, in U.S. dollars) 1/ | -0.4 | 6.3 | 20.6 | 19.4 | 7.2 | 6.6 | 19.5 |
| Imports (annual percentage change, in U.S. dollars) 1/ | -0.6 | 4.2 | 21.2 | 20.2 | 8.4 | 7.2 | 19.0 |
| Terms of trade (annual percentage change) 1/ | -1.0 | 1.8 | -0.4 | -1.3 | -1.0 | -1.2 | 0.9 |
| Current account balance (percent of GDP) 1/ | 3.4 | 4.6 | 4.1 | 3.5 | 2.6 | 2.7 | 3.3 |
| Inward portfolio investment (percent of GDP) 2/ | 63.5 | 8.1 | 2.5 | 1.5 | -0.5 | 4.4 | … |
| Inward foreign direct investment (percent of GDP) 2/ | 23.7 | 6.5 | 10.8 | 12.1 | 9.2 | 15.7 | … |
| Official reserves (in billions of U.S. dollars, end-of-period) 3 | 11.3 | 11.9 | 11.0 | 10.4 | 8.2 | 8.8 | 10.4 |
| Official reserves in months of imports | 0.7 | 0.7 | 0.6 | 0.4 | 0.3 | 0.3 | 0.3 |
| Exchange rate per U.S. dollar (period average) 4/ 4/ | 1.117 | 1.059 | 0.884 | 0.804 | 0.803 | 0.796 | 0.730 |
| **Market indicators** | | | | | | | |
| **Financial markets indicators 4/** | | | | | | | |
| Public sector debt (Maastricht definition) 1/ | 106.5 | 103.5 | 98.7 | 94.4 | 92.2 | 88.1 | 84.5 |
| 3-month T-bill yield (percent) | 4.2 | 3.2 | 2.2 | 2.0 | 2.1 | 3.4 | 3.8 |
| 3-month T-bill yield (real, percent) | 1.7 | 1.5 | 0.6 | -0.3 | -0.4 | 1.0 | 2.0 |
| Spread of 3-month T-bill over EURIBOR (percentage poi | 0.0 | -0.1 | -0.1 | -0.1 | -0.2 | -0.1 | 0.0 |
| 10-year government bond yield (percent) | 5.1 | 5.0 | 4.2 | 4.3 | 3.4 | 3.8 | 4.4 |
| 10-year government bond yield (real, percent) | 2.7 | 3.4 | 2.7 | 2.5 | 0.9 | 1.5 | 2.6 |
| Spread of 10-year government bond rate with Germany (percentage points) | 0.3 | 0.2 | 0.1 | 0.1 | 0.2 | -0.1 | 0.0 |
| Stock market index (period average) | 2,807 | 2,410 | 1,975 | 2,557 | 3,192 | 3,961 | 4,501 |
| **Credit markets indicators (end-of-period; percentage increase) 5/** | | | | | | | |
| Bank Credit to the private sector | 6.0 | 1.2 | 1.8 | 12.6 | 22.4 | ... | 12.7 |
| Belgian residents | 2.0 | -0.3 | 2.2 | 4.4 | 5.0 | ... | 12.7 |
| Other EMU residents | 7.9 | -2.0 | 5.5 | 13.6 | 37.6 | ... | 16.6 |
| Rest of the World | 13.8 | 7.3 | -2.1 | 28.7 | 39.9 | ... | 8.7 |
| Mortgage loans | 13.3 | 11.4 | 27.7 | 26.6 | 43.5 | ... | 14.7 |
| Consumer loans | 7.6 | 4.1 | -3.9 | 5.9 | 32.1 | ... | 17.1 |
| **Banking sector capital adequacy** (in percent) | | | | | | | |
| Regulatory capital to risk-weighted assets | 12.9 | 13.1 | 12.8 | 13 | 11.5 | 11.9 | 11.9 |
| Regulatory Tier I capital to risk-weighted assets | 8.2 | 8.6 | 8.8 | 9.4 | 8.5 | 8.7 | 8.5 |
| Capital to assets | 2.7 | 3 | 3.1 | 3.1 | 2.7 | 3.3 | 3.2 |
| NPL net of provisions as percent of Tier I capital 6/ | 14.4 | 15.2 | 15.7 | 12.8 | 13.8 | 10.9 | 11.6 |
| Large exposures as percent of Tier I capital 7/ | 67 | 61 | 46 | 40 | 42.5 | 36.2 | 16.8 |
| Net open position in foreign exchange to capital 7/ | 6.8 | 8.5 | 7 | 5.3 | 5.8 | 6.4 | 4.1 |

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

1/ IMF staff projection.
2/ Data before 2002 cover the definition of the Belgium-Luxembourg Economic Union (BLEU).
3/ October 2007; reserves and foreign liabilities refer to the Belgian central bank, both before and after EMU.
4/ Latest data.
5/ Beginning 2006 data under IFRS while before data was under Belgium GAAP, hence data break in 2006.
6/ Unconsolidated data.
7/ The 2007 figure refers to banks still applying Basel I.

**APPENDIX I. DRAFT PUBLIC INFORMATION NOTICE**

Public Information Notice (PIN) No. 08/xx
FOR IMMEDIATE RELEASE
[March xx, 2008]

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

# IMF Executive Board Concludes 2007 Article IV Consultation with Belgium

On [March xx, 2008], the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Belgium.[1]

**Background**

With a supportive external environment and buoyant domestic demand, GDP is estimated to have grown by 2.7 percent in 2007 and unemployment declined to its lowest level in a decade. Rapid job creation contributed to rising households' net disposable income and private consumption. Meanwhile, business investment firmed up, boosted by strong net revenue growth in the first half of 2007. However, headwinds from a worsening international environment, combined with domestic political tensions, contributed to a slowdown of activity toward the end of the year.

Looking ahead, the spike in oil prices, euro appreciation, the spillovers from the global financial turmoil, and dimmer economic prospects in partner countries will exert a drag on activity. Hence, the staff projects output growth to weaken to 1.6 percent in 2008. Greater economic uncertainty and less favorable financing conditions will lower business investment and consumption will decelerate in response to more sluggish real disposable income growth and a slower pace of job creation. Moreover, concerns about the depth and persistence of the ongoing financial market turmoil and its effects on growth constitute downside risks.

Headline inflation has risen to 3.1 percent in December 2007 with the surge in food and energy prices. Partial wage indexation will boost wages and shield purchasing power,

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[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.

but it will drive up unit labor costs in excess of what was envisaged in earlier wage agreements. These agreements contained moderate wage increases to help preserve competitiveness. The authorities have responded to the energy price spike by raising targeted income support for the energy needs of low-income households.

The ongoing financial turbulence has so far had only a limited impact on the financial system and the economy. Banks' exposure to the U.S. subprime market is small, bank capitalization is strong, and liquidity shocks have been absorbed. Nonetheless, market concerns about banks' off-balance sheet exposures and their implications for earnings and capital remain. Meanwhile, the cross-border dimension of the financial system has gained further importance with a partial merger between a Belgian and Dutch bank.

With political tensions following the June 2007 elections, federal policy making has been at a standstill, delaying fiscal consolidation and structural reforms. The 2007 general government outcome is estimated to show a small deficit, short of the planned surplus of 0.3 percent of GDP. The stance of fiscal policy was broadly neutral, with the structural balance remaining close to balance. The authorities are in the process of finalizing a 2008 budget which is expected to resume fiscal consolidation. Current fiscal federalism arrangements have led to unsustainable fiscal imbalances, both between the federal and regional entities and between the regions, but lack of consensus about a new allocation of competencies between federal and regional governments has delayed their reform.

Demographic trends are projected to dampen long-term growth, as population aging curbs labor supply and sharply raises dependency ratios. Despite recent increases, employment rates remain among the lowest in the industrialized world. At the same time, skill mismatches and geographical differences in growth and income persist, amid limited labor mobility.

**Executive Board Assessment**

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***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.

## Belgium: Selected Economic and Social Indicators
(Annual percentage change; unless otherwise indicated)

| | 2003 | 2004 | 2005 | 2006 | 2007 1/ | 2008 1/ |
|---|---|---|---|---|---|---|
| **Real economy** | | | | | | |
| Real GDP | 1.0 | 2.8 | 2.0 | 2.9 | 2.7 | 1.6 |
| Domestic demand | 0.9 | 2.9 | 2.4 | 2.8 | 2.9 | 1.6 |
| CPI Inflation | 1.5 | 1.9 | 2.5 | 2.3 | 1.8 | 2.9 |
| Unemployment rate (in percent) | 8.2 | 8.4 | 8.4 | 8.2 | 7.4 | 7.4 |
| Gross national saving (percent of GDP) | 23.2 | 23.4 | 23.0 | 24.4 | 25.2 | 24.6 |
| Gross domestic investment (percent of GDP) | 19.1 | 19.9 | 20.4 | 21.7 | 21.9 | 21.6 |
| **Public finance** (percent of GDP) 2/ | | | | | | |
| General government balance | 0.0 | 0.0 | -2.3 | 0.4 | -0.1 | -0.5 |
| Structural balance | -1.0 | -0.6 | 0.4 | -0.1 | -0.1 | -0.2 |
| Primary balance | 5.3 | 4.7 | 1.9 | 4.3 | 3.7 | 3.2 |
| General government debt | 98.7 | 94.4 | 92.2 | 88.1 | 84.5 | 81.7 |
| **Interest rates** (percent) | | | | | | |
| Money market rate (3 months) | 2.3 | 2.1 | 2.2 | 3.1 | 4.2 | … |
| Government bond yield | 4.2 | 4.1 | 3.4 | 3.9 | 4.3 | … |
| **Balance of payments 3/** | | | | | | |
| Exports of goods (percent of GDP) | 66.0 | 68.3 | 70.0 | 70.6 | 74.6 | 76.6 |
| Volume growth | 2.9 | 6.3 | 4.1 | 2.6 | 5.6 | 5.7 |
| Imports of goods (percent of GDP) | -62.5 | -65.6 | -68.4 | -69.8 | -73.5 | -75.3 |
| Volume growth | 2.8 | 6.5 | 4.9 | 2.5 | 6.0 | 5.9 |
| Trade balance (percent of GD*P), of which:* | 3.5 | 2.7 | 1.6 | 0.8 | 1.2 | 1.3 |
| Oil (US$ billion) | -6.8 | -10.0 | -16.1 | -16.4 | -18.1 | -19.9 |
| Current account (percent of GDP) | 4.1 | 3.5 | 2.6 | 2.7 | 3.3 | 3.0 |
| FDI (percent of GDP) | 10.8 | 12.1 | 9.2 | 15.7 | ... | ... |
| Official reserves (US$ billion) 4/ | 11.0 | 10.4 | 8.2 | 8.8 | 8.7 | ... |
| **Fund position (February 12, 2008)** | | | | | | |
| Holdings of currency (percent of quota) | ... | ... | ... | ... | ... | 91.9 |
| Holdings of SDRs (percent of allocation) | ... | ... | ... | ... | ... | 74.3 |
| Quota (SDR millions) | ... | ... | ... | ... | ... | 4605.2 |
| **Exchange rate** | | | | | | |
| Nominal effective rate (2000=100, ULC based) 4/ | 105.7 | 106.8 | 106.2 | 108.2 | 108.1 | ... |
| Real effective rate (2000=100, ULC based) 4/ | 110.3 | 111.9 | 113.2 | 115.4 | 116.2 | ... |

**Social Indicators** (reference year):
**Per capita GDP** (2006): $37,301; **Income distribution** (ratio of income received by top and bottom quintiles, 2005): 4.1; **Life expectancy at birth** (2005): male: 76.7, female: 82.4; **Gender pay gap** (as percent of male pay, 2005): 7; **Passenger car ownership** (2000): 467 per thousand inhabitants; **Greenhouse gas emissions** (2003): kg CO2 per capita: 11.2; **Population density** (2006): 343.6 inhabitants per sq. km.; **At-risk-of-poverty rate** (2005): 15 percent.

1/ Staff estimates and projections.
2/ Staff projections for 2008, assuming no policy adjustment. According to Eurostat, the debt transfer of the national railway company to the Railway Infrastructure Fund should be accounted as expenditure in 2005.
3/ Staff projections for 2007-08.
4/ Data for 2007 refers to end-December 2007.