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IMF Executive Board Concludes 2008 Article IV Consultation with Belgium

On March 4, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Belgium.[1]

Background

The global financial crisis has hit the country particularly hard in recent months, forcing government intervention in major financial institutions. The boom in energy and food prices in early 2008 caused inflation to spike to well above the euro area average, posing risks to competitiveness while uncovering fault lines in domestic price-setting mechanisms and sparking concerns over retail competition. In addition, political uncertainty is high, complicating prospects for decisive action to address the economic difficulties.

Looking ahead, staff expects a deep recession in 2009, with a sluggish recovery in 2010 as the rebound in the world economy will be slowed by the aftermath of the financial crisis. 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 job losses. Spillovers from the global financial turmoil and recessions in partner countries will exert an additional drag on activity. Concerns about the depth and persistence of the ongoing financial market turmoil and its effects on growth constitute downside risks.

[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.

Fuelled by increases in world energy and commodity prices, Belgian headline inflation peaked at 5.9 percent, year-on-year, in July, 2008, almost 2 percentage points above the euro area average. This spike has now begun to reverse, but the aftereffects will continue to be felt in 2009. Inflation should fall to around 2 percent in 2009, but may still remain above the euro area average. Indexation mechanisms will generate higher wage growth than in partner countries over the coming year, which will help sustain demand but also contribute to a continued decline in external competitiveness. The recent inflation dynamics have also highlighted structural concerns about price-setting in food and energy markets.

Belgium's financial sector weathered the early rounds of financial turmoil in 2007, but succumbed in September–October 2008. The system's strong capitalization and moderate exposure to subprime risk appeared to confer relative resilience when the 2007 liquidity shock broke. However, tighter world liquidity conditions in the wake of the Lehman collapse, together with specific concerns about Fortis and Dexia banks, triggered a crisis in September 2008. As world financial conditions turned increasingly desperate, the authorities were forced to intervene in all three major Belgian banks and in an insurance company.

The implementation of the 2008 federal budget was delayed by the lack of a government, and its consolidation effort was less ambitious than originally envisaged. Fiscal policy in 2009 allows for full operation of the automatic stabilizers, plus a moderate discretionary stimulus (around 1 percent of GDP), which will widen the general government deficit to beyond 3 percent of GDP. As an anchor to fiscal policy and to ensure fiscal sustainability, the government should firmly commit now to a structural adjustment of a least 0.7 percent of GDP per year once the crisis has past.

Executive Board Assessment

Executive Directors noted that, as a small open economy, Belgium has been severely affected by the global financial crisis and economic slowdown, as well as the earlier commodity and oil price shocks. They commended the authorities for their prompt and decisive intervention as the Belgian banking sector began to face severe pressure in September 2008. On the fiscal side, Directors concurred that it will be essential to strike the right balance between the need for short-term stimulus and achieving medium-term fiscal sustainability, given the relatively high debt level and the aging population. Directors were of the view that at this stage there is no room for additional fiscal stimulus measures.

Directors noted that the near-term economic outlook is bleak. With a protracted global financial crisis and recessions in partner countries, GDP growth is expected to contract sharply in 2009 and to recover only sluggishly in 2010, with significant downside risks. Acknowledging that the current conjuncture presents significant policy challenges, Directors encouraged the authorities to allow fiscal stabilizers to operate fully, and welcomed the moderate discretionary stimulus. They noted, however, that to be effective, the stimulus measures need to be timely, targeted, and temporary, and should be tied to structural fiscal improvements aimed at ensuring longer-term sustainability. Directors encouraged the authorities to adopt a strong and credible program of medium-term fiscal consolidation.

Directors welcomed the government's initial intervention in the banking sector, and noted that the need for further intervention could not be ruled out. They called for the authorities to establish a comprehensive framework for future interventions, in line with the framework agreed at the EU level.

Directors agreed that the rapid expansion of some Belgian banks in emerging market economies had been beneficial for both Belgium and the host countries. At the same time, these increased interlinkages call for strong and effective cross-border cooperation between supervisors. Directors recommended strengthening existing venues such as supervisory colleges and bilateral memoranda of understanding, with some Directors suggesting consideration for expanding pan-European supervisory mechanisms.

Looking beyond the current crisis, Directors encouraged the authorities to tackle longstanding structural weaknesses, particularly in light of Belgium's inflation differentials with its European partner countries and relatively high labor costs. To ease structural rigidities, boost growth, facilitate job creation, and help reverse the deterioration of Belgium's competitive position in the world, they recommended reinforcing the competition authority, liberalizing product and service markets, and reviewing the price-setting mechanism in energy supply and distribution. Directors encouraged the authorities to press ahead with labor market reforms so as to boost participation rates and reduce unemployment. They also advised considering a revision of the wage indexation mechanisms within the centralized bargaining framework. Consideration should also be given to reforming the current fiscal federalism framework to improve its efficiency and effectiveness, with a view to providing a better match between spending authority and revenue-raising responsibilities.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2008 Article IV Consultation with Belgium is also available.

Belgium: Selected Economic Indicators 2005-10						
				Projections		
	2005	2006	2007	2008	2009	2010
	(Percentage change from the previous period; unless otherwise indicated)					
Real economy						
Real GDP	2.2	3.0	2.6	1.2	-2.5	0.3
Private consumption	1.5	2.1	2.0	0.8	-1.1	0.7
Public consumption	0.4	0.1	2.3	2.0	1.7	1.7
Gross fixed investment	7.3	4.8	6.1	4.3	-5.3	-0.5
Business investment	5.2	5.6	8.5	6.4	-6.2	-0.6
Dwellings	10.0	7.9	1.3	1.0	-4.1	-0.6
Public investment	15.5	-10.6	3.4	-2.8	-0.3	0.7
Stockbuilding 1/	0.3	0.8	0.1	0.4	-0.3	0.3
Foreign balance 1/	-0.6	0.0	-0.3	-1.1	-0.9	-0.5
Exports, goods and services	3.9	2.7	3.9	2.7	-1.9	0.7
Imports, goods and services	4.9	2.7	4.4	4.0	-0.9	1.3
Household saving ratio (in percent)	12.6	13.2	13.2	15.7	16.6	16.5
Potential output growth	1.9	1.9	1.8	1.7	1.6	1.5
Output gap (in percent)	-0.2	0.9	1.7	1.2	-3.0	-4.2
Employment						
Unemployment rate	8.5	8.3	7.5	7.1	8.8	9.7
NAIRU	7.8	7.7	7.6	7.5	7.5	7.5
Employment	1.3	1.4	1.5	1.2	-1.7	-0.7
Prices						
Consumer prices	2.5	2.3	1.8	4.5	0.9	1.5
GDP deflator	2.5	2.3	2.4	2.1	1.9	2.0
ULC (in whole economy)	1.3	1.6	3.2	3.7	1.8	2.3
	(In percent of GDP; unless otherwise indicated)					
Public finance						
Revenue	49.3	48.6	48.1	48.8	48.7	48.6
Expenditure	52.0	48.3	48.4	49.7	52.1	53.1
General government balance	-2.7	0.3	-0.3	-0.9	-3.4	-4.5
Structural balance	-0.1	-0.2	-0.3	-0.5	-1.3	-1.7
Primary balance	1.5	4.2	3.5	2.8	0.5	-0.4
General government debt	92.0	87.7	83.9	86.3	91.8	94.1
Balance of payments						
Trade balance	1.6	0.8	0.4	-1.2	-0.7	-0.9
Current account	2.6	2.6	2.1	-2.4	-1.8	-2.3
Terms of Trade (percent change)	-0.9	-1.0	0.0	-0.4	0.7	-0.2
Exports, goods and services (volume, percent change)	3.9	2.7	3.9	2.7	-1.9	0.7
Imports, goods and services (volume, percent change)	4.9	2.7	4.4	4.0	-0.9	1.3

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