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Statement by Mrs. Zajdel-Kurowska and Mr. Gasiorowski on Belgium
(Preliminary)
Executive Board Meeting 09/22
March 4, 2009

1. Given the high degree of openness of the Belgian economy, its integration with the world economy and the further deterioration of the international outlook, Belgium is likely to face more financial turmoil and a significant recession. In particular, two important pillars of its economy, the bancassurance groups and the automobile industry, may experience increased stress. Against this background, we agree that the quick and decisive measures the authorities took so far to to deal with the crisis were appropriate.

2. The staff makes a point for the need to improve the financial intermediation in Belgium, by mentioning tightening of the lending criteria, and – the most serious evidence – a high mistrust between market participants. Therefore, if the economic crisis were to deepen further, additional actions to safeguard financial stability may be needed. We would like to stress that such actions should be based on clear intervention rules and should go along the lines pointed out by the staff.

3. The balance sheets of the Belgian banks are impaired with troubled assets and the capital buffers may be depleted by rising loan defaults. Therefore, financial institutions should seek to improve their capital basis. However, given a tight fiscal space we consider that any support from the government should only be seen as a last resort and if private sources cannot be mobilized. *However, we would like to hear from the staff if the recapitalization of the banks would be a sufficient measure to eliminate the mistrust and to revitalize the interbank lending. The evidence from some advanced economies suggests that recapitalization alone is not unlocking the interbank market and easing credit conditions. Given the high integration of the insurance and banking industry in Belgium, we would also like to hear the staff's assessment of the vulnerabilities of the insurance sector.*

4. The legal complications in the context of the Fortis operation should be resolved as quickly as possible. Also, closer cooperation between the Banking, Finance and Insurance Commission and the Belgian National Bank as well as between banking supervisors at home

and in host countries would be needed. In this light we agree that the authorities should – while ensuring effective supervision on the national level – press for an improvement in cross-border supervision. *In light of the issues with the resolution of the Fortis bank we would like to hear the staff's comment on the adequacy of the banking resolution framework for these times of crisis.*

5. High indebtedness and population ageing-related costs limit the scope for further fiscal stimulus to support the real sector. The authorities should remain committed to attaining fiscal balance in the medium term as the stimulus package and the quickly worsening economic outlook may lead to a budget deficit higher than 3 percent of GDP in 2009. The Belgian authorities should be more explicit in stipulating the target of reaching balanced budgets and, later on, surpluses. Introducing a clear fiscal rule would be a very helpful tool, making use of periods of positive output gaps to strengthen the fiscal balance.

6. The deterioration of the fiscal outlook is also mirrored in the sharp increase in the spread on Belgian debt and the downgrading of the sovereign outlook by rating agencies. We wonder whether the increase in the spread has resulted in an increase in the government's effective funding costs. *Could the staff comment?*

7. As to the composition of the proposed fiscal stimulus, we are not as worried as the staff about the timing of public investment targets. Our reading of the crisis points to a longer lasting and more profound downturn. Consequently, the proposed measures will be positive even if they have a delayed impact. However, we are more worried about the reductions in social contributions and increases in unemployment and other social benefits, as they will be politically very costly to reverse once the crisis recedes. It is important that the authorities put a coherent exit strategy in place. In that context, we wonder whether the households will not increase their precautionary savings as long as this exit strategy is not credible. This impact might actually be bigger than the wealth effect impact reported in §19.

8. The staff argues that the fiscal burden for population ageing should be shifted from federal/social security to community/regional entities (§6). *We would like to ask the staff if it considers it to be a generally applicable advice in federal countries?* We understand that population dynamics are usually very similar across communities and regions, which would rather warrant a national scheme. *In the case of Belgium, would a reinforcement of the federal states' revenue base not be the first best solution? Could the staff comment?*

9. Further, we would welcome the staff's judgment on the potential costs of over-expansion on the fiscal side. What would be the needed structural adjustment if the authorities do not engage in a fiscal stimulus?

10. Finally, we agree with the staff that structural reforms should be implemented to raise the potential growth rate. Reforms should aim to lower inflationary pressure and improve competitiveness and a special focus should be placed on making the labor market more

flexible. Most helpful would be the strengthening of price- and wage-setting mechanisms through increased competition and wage moderation, or modifying wage indexation, respectively.

11. Finally, on the format of the staff report; as on previous occasions, we would like to put on record that we prefer the staff appraisal and the executive summary to be presented separately, given that they serve different functions. Particularly, the staff appraisal is what the Board is asked to support.