4. Financial situation of the Belgian non-financial sectors

In a context of great uncertainty and fragmentation of the euro area financial markets, Belgium's net financial assets are a factor of stability. Keen to exercise caution, and despite the low yields, households increased their savings deposits in 2012 at the expense of riskier assets. Their debt ratio also continued to rise owing to a further expansion of mortgage lending, although the pace of that expansion was slower than in the previous year. Leaving aside the traditionally substantial financial flows between associated companies, non-financial corporations expanded their use of financing via bond issuance. However, bank loans remain a major source of external funding, particularly for SMEs. In that regard, interest rates fell in 2012, but the other credit terms were tightened. The Treasury benefited from the sharp fall in market rates during 2012.

4.1 Overall financial position of the Belgian economy

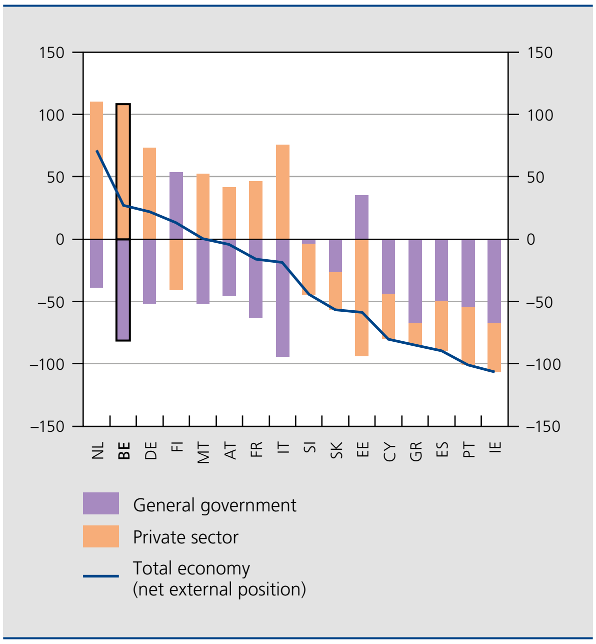
Belgium has net financial assets

Together with the Netherlands, Germany and Finland, Belgium forms a small group of euro area countries with net claims on the rest of the world. In those countries, the domestic sectors taken as a whole have financial assets in excess of their liabilities. In the case of Belgium, this favourable position is due to the size of the net financial wealth of the private sector which, at 108 % of GDP at the end of 2011, exceeded the net liabilities of general government. More specifically, the net financial assets of Belgian households, expressed as a percentage of GDP, is the highest (203 %) among the euro area Member States for which these data are available.

This situation is due to the formation of substantial foreign claims resulting from the accumulation over the years of surpluses on the current account with the rest of the world. It is undeniably a factor of financial stability in a context where the smooth flow of financial transactions within the euro area is hampered by the tendency towards financial market fragmentation. In that regard, as shown

CHART 41 NET FINANCIAL ASSETS IN EURO AREA MEMBER STATES[1]

(end-2011 data, in % of GDP)



Sources : EC, NBB.

[1] Difference between the outstanding amount of financial assets and liabilities. The data are not available for Luxembourg.

TABLE 8 FINANCIAL ASSETS AND LIABILITIES BY SECTOR

(data at the end of September 2012 ; in € billion, unless otherwise stated)

	Outstanding amount				Change in net financial wealth between December 2011 and September 2012		
	Assets	Liabilities	Net financial wealth		Total	Financial transactions	Valuation [2]
			September 2012	*p.m. December 2011*			
Households	1 003	211	792	*749*	43.1	8.0	35.1
Non-financial corporations	1 697	2 148	–452	*–367*	–84.6	5.1	–89.7
General government	131	439	–308	*–301*	–7.3	–13.3	6.0
Financial corporations [1]	1 864	1 836	28	*18*	9.6	3.8	5.9
p.m. Total of domestic sectors	*4 695*	*4 634*	*60*	*100*	*–39.2*	*3.5*	*–42.7*
Idem, in % of GDP	*1 252*	*1 236*	*16.1*	*26.9*	*–10.4*	*0.9*	*–11.4*

Source : NBB.

[1] Financial corporations consist mainly of monetary financial institutions (the NBB, credit institutions and monetary UCIs) and institutional investors (non-monetary UCIs, insurance companies and occupational pension institutions).

[2] Changes due mainly to price and exchange rate fluctuations.

by box 1 on this subject (section 1.1), the countries facing higher interest rates generally have sizeable net debts in relation to the rest of the world.

Although the value of the total net financial assets of the Belgian domestic sectors remained positive, at € 60 billion or 16.1 % of GDP in September 2012, it was € 39.2 billion down against the end of the previous year. This contraction was due solely to negative revaluation effects amounting to € 42.7 billion, concerning existing financial positions, as the stock market rally boosted the value of the share capital on the corporate liabilities side to a greater extent than the value of the portfolios held by Belgian residents. Conversely, new net financial assets were acquired in other countries in the sum of € 3.5 billion.

These new net financial assets were formed in a context of economic gloom which encouraged economic agents to step up their savings and rein in their capital investments. The concern for caution is also evident in the composition of these claims, since it is mainly the assets that households keep in the form of savings deposits that increased. The financial transactions of the domestic sectors therefore helped to boost the net external position by € 3.5 billion, a figure similar to that for the first nine months of 2011 when the financing surplus of the domestic sectors stood at € 3 billion. Although this result was comparable overall, there were changes in its composition. First, for both households and non-financial corporations, the accumulation of net financial assets was lower in the first three quarters of 2012 than in the corresponding period of 2011. For households, the figure was down from € 14.6 to € 8 billion, notably on account of the slower rise in their disposable income, and for non-financial corporations it was down from € 19.6 to € 5.1 billion. However, the financing balance of non-financial corporations remained positive, as the economic uncertainty had inhibited investment in real assets. Also, financial corporations recorded a positive financing balance of € 3.8 billion, whereas that balance had been negative in the previous year. General government contracted new net financial liabilities in the first three quarters of 2012 amounting to € 13.3 billion, which was less than in the corresponding period of 2011 (15.8 billion).

Although the net external position attracts greater attention in the current circumstances, the gross debt ratio of economies has also been the focus of close scrutiny since the eruption of the financial crisis. Thus, the private and public gross debt ratios are among the indicators taken into account in the EU's macroeconomic imbalance procedure (MIP). In addition, recent empirical research suggests the existence of thresholds beyond which debts have an adverse impact on economic growth.

As explained in box 7 of the 2011 Report, debt levels – particularly in the private sector – must nevertheless be interpreted with caution, as they depend on the definition used. In contrast to the non-consolidated concept used in the MIP scoreboard, the Bank takes the consolidated debt ratio for both the private and the public sector; that ratio is obtained by deducting from the non-consolidated debt ratio of each institutional sector the funding received from other entities in that same sector. It concerns more particularly loans between non-financial corporations.

Total debt ratio is down slightly

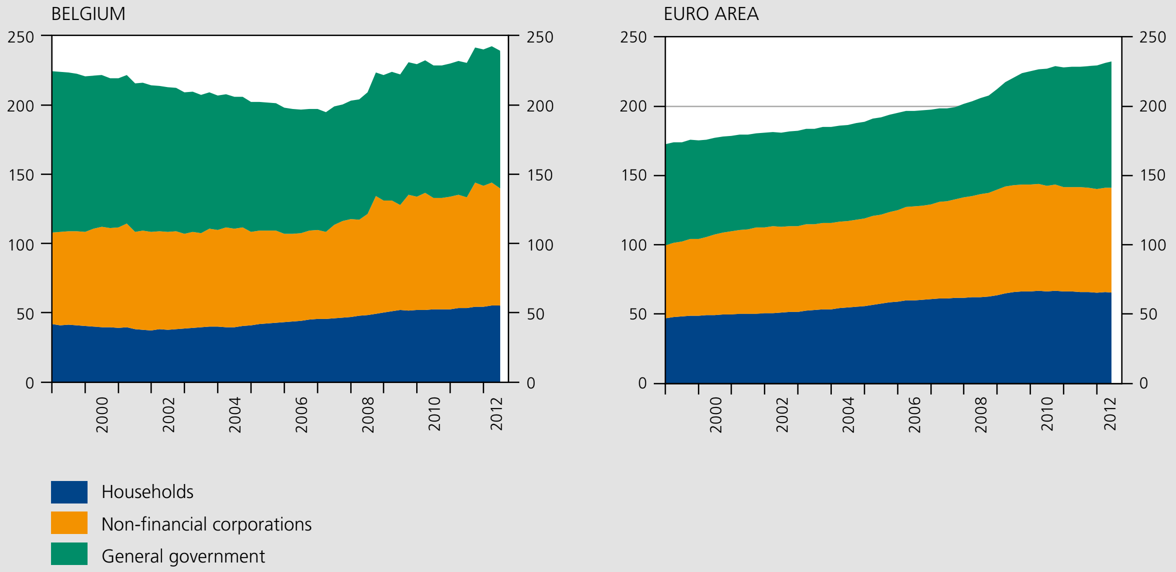
While the figures for Belgium's net external position are good, those relating to the total debt ratio of the non-financial sector are less favourable, the main factor being the high level of the public debt. However, the total debt ratio dipped very slightly during 2012, the decline being attributable to the private sector and, more particularly, to non-financial corporations.

At the end of 2011, the total consolidated debt ratio of the non-financial sector (general government, households and non-financial corporations) stood at 242 % of GDP, putting Belgium above the euro area average (229 %). That situation is due to the relatively high public debt (97.8 % of GDP), which – like that of eleven other EMU countries – exceeds the reference value in the Maastricht Treaty, namely 60 % of GDP. The private sector debt ratio (143.8 % of GDP) was close to the euro area average (141.3 %). That is below the threshold of 160 % of GDP set in the MIP, except that it does not apply to the non-consolidated debt.

During the year under review, Belgium's public debt grew from 97.8 to 99.6 % of GDP. Conversely, the private sector debt ratio was down from 143.8 to 139.9 % of GDP in September 2012. That decline is due entirely to non-financial corporations, whose debt ratio fell by 4.9 percentage points during the first three quarters of 2012 to 84.6 % of GDP at the end of September. In contrast, the household debt ratio was up by 1 percentage point at 55.3 % of GDP.

The slight fall in the non-financial private sector debt ratio evident from the latest data for Belgium does not yet mean a reversal of the trend. In the euro area, the gradual debt reduction by the non-financial private sector in progress since mid-2010 has continued. That has been accompanied by weak expansion of bank lending and, in a number of countries, a property price correction. However, there is no question as yet of any significant debt reduction by households and non-financial corporations in the euro area, as their debt has fallen by 1.2 and 1.7 percentage points respectively from the peak, declining to 65.6 and 75.6 % of GDP.

CHART 42 CONSOLIDATED GROSS DEBT OF THE NON-FINANCIAL SECTOR[1]
(in % of GDP)

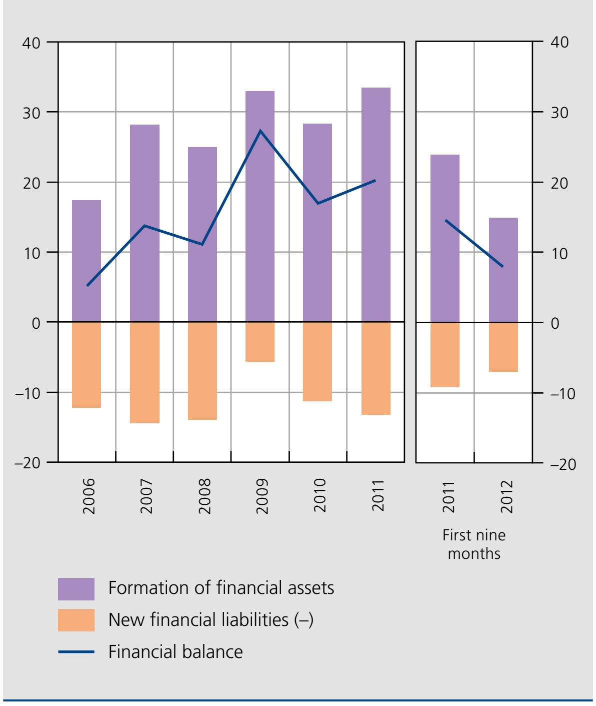


Sources : EC, NBB.
[1] Data up to the third quarter of 2012. Quarterly data for the non-financial private sector debt ratio. Annual data for the public debt (end of period, forecast for 2012), interpolated linearly on a quarterly basis.

In Belgium, movements in the debt burden have been accompanied by stronger expansion of bank lending to the private sector than in the euro area, where growth became negative from June onwards. Nonetheless, despite the persistently low interest rates, Belgium also recorded a slowdown in bank lending, be it to households or to non-financial corporations, owing to the combined effects of slackening demand and tighter credit conditions other than interest rates from the second quarter onwards. The decline in the annual growth of bank lending was primarily apparent for non-financial corporations, as the rate of expansion dropped from an average of 4.2 % in 2011 to 2.1 % in 2012, while lending to households continued to grow at a relatively rapid rate, averaging 5.5 % in 2012, compared to 6.8 % in the previous year.

Moreover, a number of tendencies can be seen regarding the funding sources of the various sectors. For instance, there has been a shift from bank lending towards non-bank credit in the non-financial corporations sector, owing to highly favourable financing conditions on the corporate bond market ; there has also been a shift from foreign banks to resident banks. Box 5 in this chapter analyses these developments in more detail. For the government, too, the domestic sectors are playing an increasing role in funding the public debt. These phenomena may be attributable to the decreasing financial integration in the euro area since the financial crisis.

CHART 43 FINANCIAL TRANSACTIONS OF HOUSEHOLDS
(in € billion)



Source : NBB.

4.2 Households

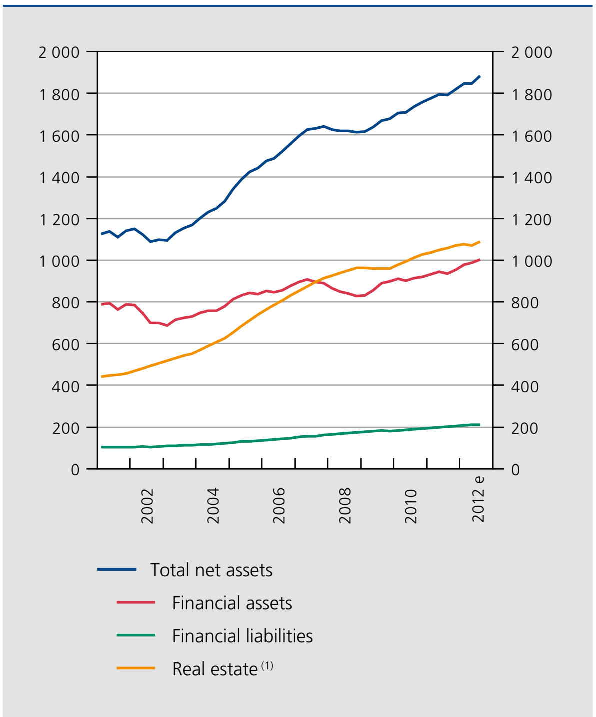
The value of total net assets of households – which includes both their net financial assets and their real estate – increased by € 63.9 billion in the first nine months of the year under review. That growth is due mainly to the gains generated by the rising prices on the financial markets, particularly on the stock markets. Belgian households also continued to invest in new financial assets. As in previous years, the precautionary motive was the main factor determining savers' behaviour, favouring investment in risk-free instruments such as bank deposits and certain life insurance contracts. This was accompanied by an increase in household debt, mainly via mortgage loans.

The balance of financial transactions contributed € 8 billion to the increase in households' net financial wealth during the first nine months of 2012. However, their financial surplus declined considerably compared to the net savings built up in 2011. The formation of financial assets, down to € 14.9 billion, slowed more sharply than the formation of new financial liabilities (€ 7 billion). The low interest rate level, which generally tends to depress the formation of assets and boost the expansion of households' financial liabilities, was a key factor here, as was the uncertain economic environment.

In parallel with the further growth of net financial assets, the increase in the real estate assets owned by households persisted during the year under review. Overall, in 2012, total net assets of households maintained the rise evident since the beginning of 2009, increasing from € 1 818 billion at the end of 2011 to € 1 882 billion on 30 September in the year under review. The amount of households' financial assets stood at € 1 003 billion on 30 September 2012, compared to € 954 billion at the end of the previous year. Households' financial liabilities totalled € 211 billion, against € 205 billion at the end of 2011. Finally, households' real estate was estimated at € 1 090 billion on 30 September 2012, against approximately € 1 069 billion at the end of 2011.

CHART 44 HOUSEHOLD WEALTH

(in € billion, end-of-quarter outstanding amount)



Source : NBB.

(1) From 2005 to 2011, the year-end data are obtained from a new register which combines the volume data from FPS Finance (General Property Records Agency) and the data on the selling prices obtained from FPS Economy. The pre-2005 data are retropolated on the basis of the estimates published in the 2010 Report. The figures as at the end of March, June and September in each year are intrapolations (and forecasts for 2012).

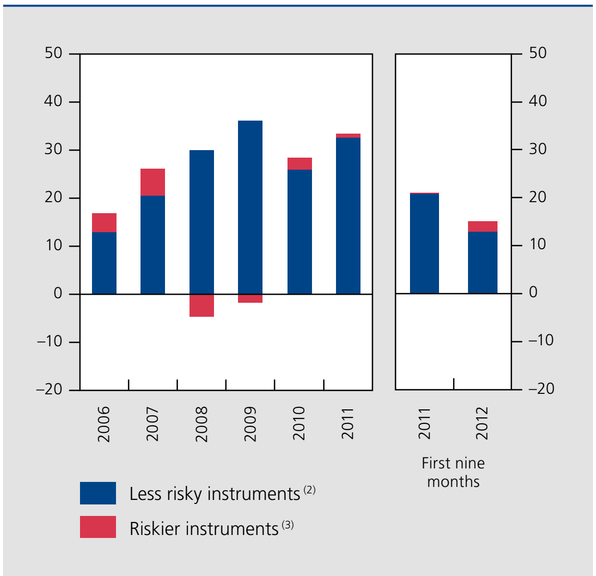
Formation of financial assets still shows signs of high risk aversion

Despite the decline in the already low yields – which were even negative in real terms for some products – households maintained their financial asset formation, driven by a precautionary motive due to the persistent economic uncertainty. In that situation, most of them opted for financial instruments regarded as secure since, during the first nine months of 2012, riskier assets made up only 14.4 % of households' new financial investment. This risk aversion has been evident since the outbreak of the financial crisis. According to the initial findings of the Eurosystem survey on the financial behaviour of households, the financial crisis triggered a twofold flight to greater security : on the one hand, from equities to bank accounts, and on the other hand, from bank accounts to real estate.

Apart from the quest for less risky assets, households' investment behaviour was also influenced by changes in the taxation of income from savings. On 1 January 2012, the tax rate on income from many investment instruments was raised from 15 to 21 %. This applied, in particular, to sight and term deposits, and to savings notes and bonds. The second tax change concerned the introduction of a supplementary 4 % tax on income from movable property in excess of € 20 020 (threshold applicable to income in 2012). For the purpose of implementing this measure, income from movable property – with the notable exception of exempt interest on regulated savings accounts – will have to be reported in 2013 tax returns if the total exceeds € 20 020. Below that figure, a sworn statement will suffice to gain exemption from the additional tax. However, taxpayers who have asked their bank to deduct this tax in full discharge need not mention the income in their tax return, but in this case the additional 4 % will have been charged at source on all the income received. This regime will apply automatically in the future, with effect from income in 2013, since the government has decided to set a uniform 25 % rate for the general withholding tax on income from movable property, while restoring its character as payment in full discharge. However, the 15% withholding tax continues

CHART 45 FORMATION OF FINANCIAL ASSETS BY HOUSEHOLDS ACCORDING TO THE RISK INCURRED (1)

(in € billion)



Source : NBB.

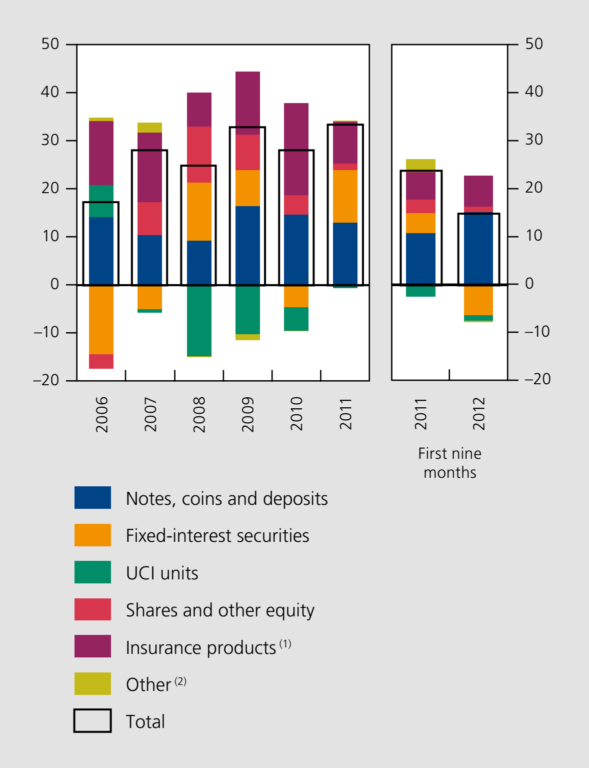
(1) Excluding the assets under the "Other" item in chart 46.

(2) This category covers banknotes, coins and deposits, fixed-interest securities and insurance technical reserves other than class 23. These are therefore all the instruments which, provided they are held to maturity and the debtor honours his commitments, guarantee a positive or zero nominal return in their reference currency. This distinction is therefore arbitrary in that, owing to the absence of information, it disregards the risk inherent in the currency or counterparty of the investment.

(3) This category comprises financial instruments which do not offer the guarantee described above, namely shares and other equity, UCI units and class 23 insurance technical reserves.

CHART 46 FORMATION OF FINANCIAL ASSETS BY HOUSEHOLDS ACCORDING TO THE ASSET CLASS

(in € billion)



Source : NBB.

(1) This item essentially comprises the net claims of households on life insurance technical reserves and pension funds or occupational pension institutions.

(2) This item comprises, so far as they could be recorded, trade credit and miscellaneous assets on general government and financial institutions.

to apply to interest on regulated savings deposits beyond the exemption threshold. That threshold was € 1 830 for income received in 2012.

In this context, households preferred savings deposits to financial market investments. Once again, they put large amounts of savings into bank deposits, ideal instruments for precautionary savings. Viewed overall, banknotes, coins and deposits attracted € 15.1 billion during the first nine months of the year under review, far more than the other financial asset classes which together recorded net disinvestment amounting to € 0.2 billion.

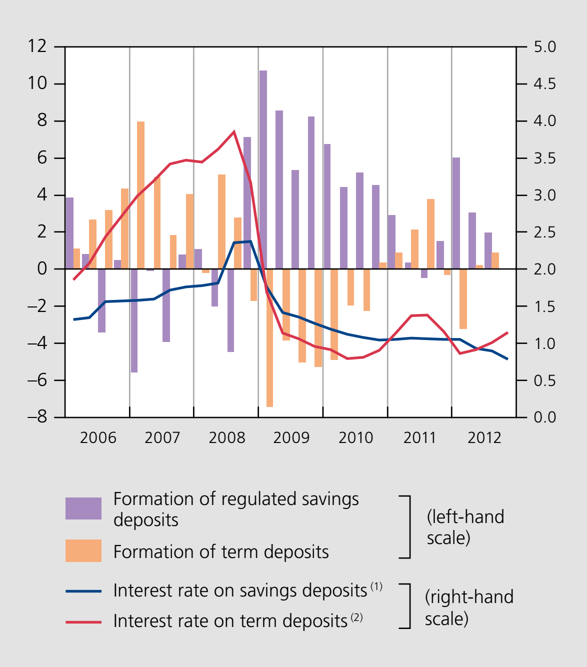
More specifically, in regard to deposits, the formation of savings deposits amounted to € 11.1 billion, while term deposits recorded a net outflow of € 2.1 billion. When basic net returns are similar, at around 1 %, it is hardly surprising that households preferred savings deposits, in view of their greater liquidity and the loyalty bonus that they offer. Moreover, changes to the tax rules applicable to movable property may have worked in favour of savings deposits.

Yields on fixed-interest securities declined overall during the past year. The rise in prices to a record high enabled the most active investors to pocket a capital gain by reselling their securities on the secondary market before maturity, while the trough level of bond yields combined with the increase in withholding tax made new bond investments rather unattractive for savers. Overall, households reduced their positions in fixed-interest securities by € 6.4 billion. For comparison, in the first nine months of 2011, they had made net acquisitions of fixed-interest securities totalling € 4.2 billion. In particular, subscriptions to State notes were minimal at barely € 142 million over the whole year under review, whereas they had raised over € 6 billion in 2011. In that year, when the tension on the sovereign bond markets was at its height, the last issue had enjoyed unprecedented success, owing to very attractive rates and a withholding tax kept, by way of exception, at 15 %.

Despite a fall in the guaranteed yields for beneficiaries of class 21 contracts, following the decline in the return on reserves, households boosted their position with insurers and pension funds for a net total of € 6.5 billion. Admittedly, income from insurance products is exempt

CHART 47 SAVINGS DEPOSITS AND TERM DEPOSITS OF HOUSEHOLDS

(quarterly data ; in € billion, unless otherwise stated)



Source : NBB.

(1) Excluding loyalty bonuses.

(2) Net of 15 % withholding tax (up to 2011) or 21 % (in 2012). Average of the rates applied to the main term deposit categories, weighted by the amounts of the new deposits in each of these categories.

from withholding tax so long as the contracts have an effective duration of more than eight years.

On the other hand, there was hardly any change in holdings of UCI units or shares and other equity in the first nine months of the year under review. While households invested a further € 1.1 billion in shares and other equity, they cut their investment fund exposures by a similar amount.

Despite the absence of significant transactions, the household portfolio of risky assets – be it equities, fund units or class 23 insurance products – benefited greatly from the generally favourable market effects. In other words, during the first nine months of last year, their financial assets appreciated by € 34.9 billion as a result of rising stock markets and exchange rate effects.

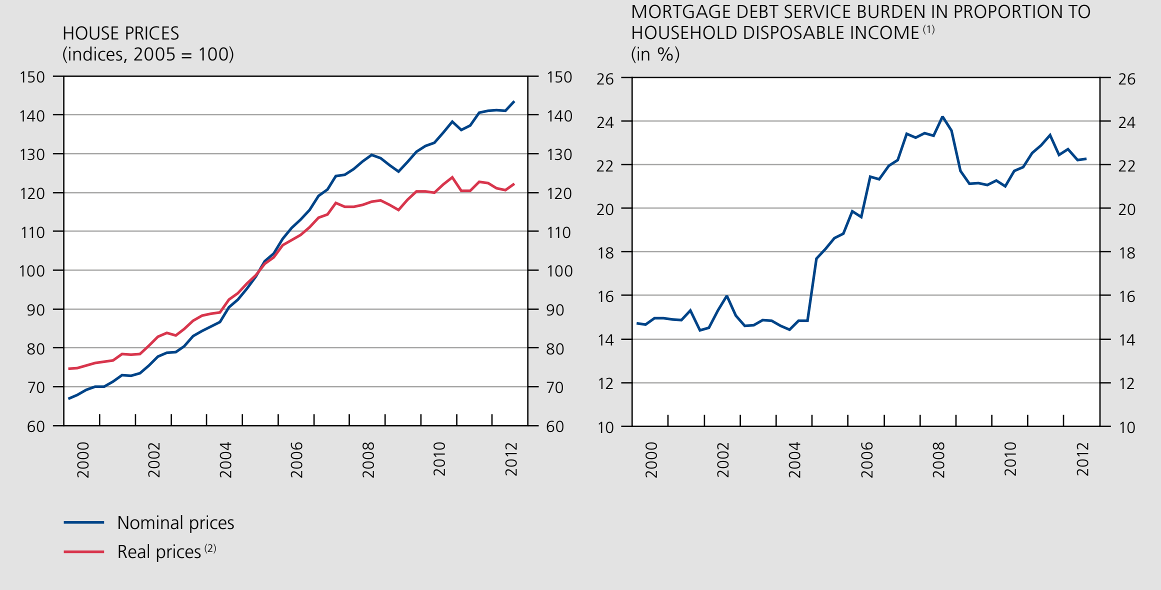
Further increase in the debt ratio

As already mentioned, households in general continued to borrow, so that their debt ratio maintained its upward trend to reach 55.3 % of GDP. Despite the uncertain climate and some house price stabilisation, mortgage loans recorded the largest rise. That is in line with an upward trend evident since 2005. The expansion of consumer loans was more moderate, at least in absolute terms. However, the increase in the debt ratio of households as a whole needs to be qualified. First, the household debt level is still fairly low compared to the euro area average, for example. Moreover, the recent findings of the bank lending survey reveal that demand for housing loans is slowing down. Finally, the statistics on defaults in the case of lending to individuals do not so far record any structural increase.

Box 4 – Affordability of housing in Belgium

In the past decade, house prices in Belgium have practically doubled. Moreover, the price correction during the great recession of 2009 was very modest in comparison with that in many euro area countries. Nonetheless, the slowdown in property price rises that began in the autumn of 2011 persisted in the first half of the year under review. In real terms, prices have tended to fall slightly since the summer of 2011.

RESIDENTIAL PROPERTY PRICES IN BELGIUM



Sources: NAI, NBB.

(1) This measure is based on the technical assumption that a “standard” mortgage loan has an average maturity of 20 years and a loan-to-value ratio equivalent to 80 % of the property value. It concerns the costs of a new purchase.

(2) Deflated by the household final consumption expenditure deflator.

▶

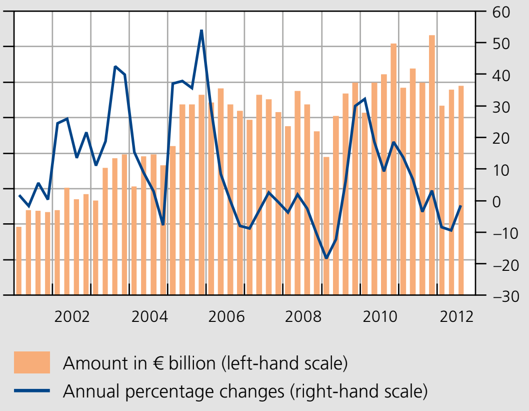
The empirical literature records a number of methods of relating the movement in property prices to that in the fundamental determinants. Those methods can be used to assess the property market valuation. A first approach compares property prices with rents (price-to-rent), the idea being to weigh up the cost of buying a house against the cost of renting it from the point of view of a person wishing to live there. The second approach compares the movement in prices with the movement in disposable income (price-to-income), to measure housing affordability. This may also be adjusted to take account of changes in mortgage interest rates, as the latter have a major impact on households' borrowing capacity (interest-adjusted-affordability).

Since property purchases are generally financed by mortgage loans, the last of the above methods seems the most appropriate for assessing the affordability of housing. For that purpose, the debt service burden – capital repayments and interest – on a "standard" mortgage loan used to finance the purchase of a property valued at the average price of ordinary houses changing hands during the period in question is compared to the average disposable income of households. That measure, based on a number of technical assumptions relating to such factors as the average loan maturity and the loan-to-value ratio, recorded a marked upward trend between 2005 and 2008, mainly because of the surge in property prices during that period. Housing subsequently became more affordable up to the spring of 2010, owing to the substantial decline in interest rates and the slight fall in prices. However, despite the historically low interest rates, the renewed rise in house prices between mid-2010 and the autumn of 2011 plus the moderation of household incomes drove this indicator back up. With more particular reference to the year under review, the improvement in the affordability of housing which began in mid-2011 was due to the slackening pace of property price rises combined with a further – albeit modest – fall in interest rates. This brought the debt service burden for a new purchase to around 22 % of average household disposable income in 2012, a lower figure than before the great recession.

Mortgage lending remained at a high level overall, with new mortgage loans continuing to exceed redemptions by € 6 billion in the first nine months of the year under review. That growth took household mortgage debts to € 171 billion at the end of September 2012, 3.6 % above the outstanding total of housing loans at the end of 2011.

CHART 48 MORTGAGE LENDING

(quarterly data, excluding refinancing)



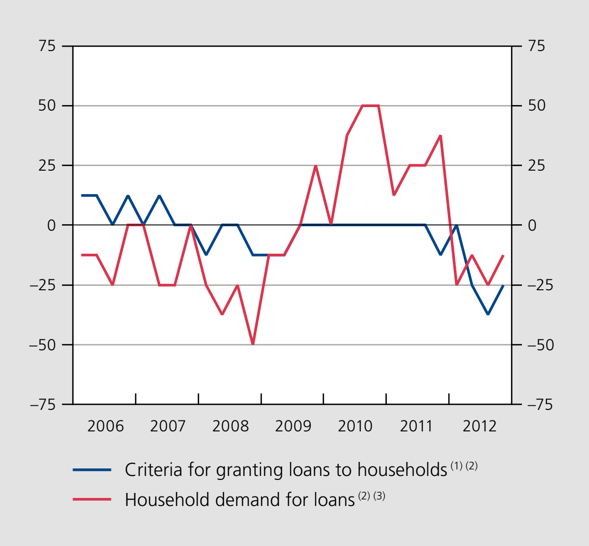
Source : NBB.

However, during the first nine months of last year, the year-on-year change for new mortgage loans (excluding refinancing) was −6.5 %. That fall was evident mainly in the segment comprising loans for renovation work (whether or not combined with the house purchase) and to a lesser extent in that comprising loans to finance a new house. The economic crisis, uncertain outlook and disappearance of certain tax incentives undeniably inhibited households' property projects. These factors also contributed to a stabilisation of property prices during the first half of 2012, which is examined in box 4.

The slight slowdown of growth in mortgage lending is due both to the reduction in supply and to the contraction in demand for loans. According to the results of the bank lending survey, banks thus tightened their mortgage lending criteria during the year. That was evident mainly in lower loan-to-value ratios combined with shorter loan maturities, and in the increase in banks' margins. The banks justify the restriction of supply by their balance sheet constraints and the perception of risks relating to the housing market and to general economic activity.

CHART 49 HOUSING LOAN DEMAND AND SUPPLY CONDITIONS

(quarterly data)



Source: NBB.

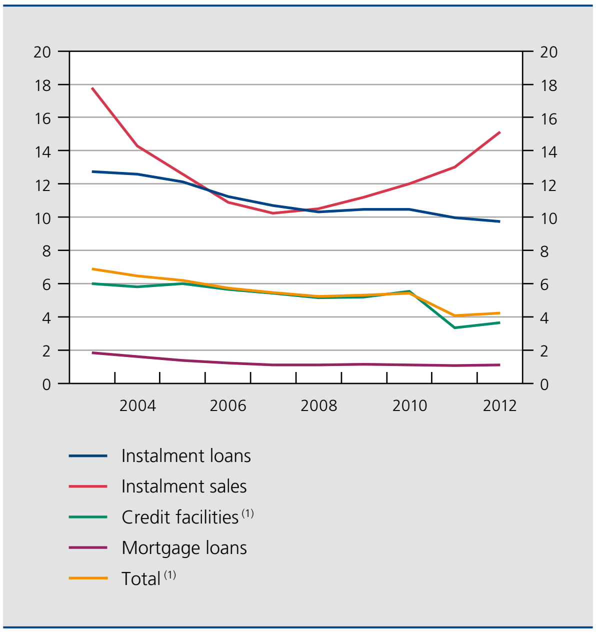
(1) Weighted net percentages of responses by the credit institutions to the Eurosystem's bank lending survey, indicating the degree to which lending criteria were eased or tightened (–).

(2) The responses are weighted according to the distance from a "neutral" response: mention of a "considerable" change in the lending criteria or in the demand for loans is accorded double the weighting of the mention of a "slight" change.

(3) Weighted net percentages of responses by the credit institutions to the Eurosystem's bank lending survey indicating the degree of increase or decrease (–) in loan demand.

CHART 50 NON-REGULARISED DEFAULTS

(in % of the number of current loans, end-of-year data)



Source : NBB.

(1) In the case of credit facilities, there is a statistical break in the series in the fourth quarter of 2011. That break, which also affects the total credit series, is due to an extension of the scope of the Central Individual Credit Register. Since the end of 2011, authorised current account overdrafts have had to be recorded in the Central Register, whereas that was not previously the case if the credit facility amounted to less than € 1 250 and was repayable within three months.

The contraction of supply was accompanied by a simultaneous weakening of demand. At first sight, that decline may seem surprising when interest rates have rarely been so low: the average rate charged on new fixed-rate loans was 3.7 % in 2012. Despite favourable borrowing rates, other factors played a dominant role. Thus, the decline in confidence among consumers aware of the risks of an uncertain economic situation depressed demand for housing loans. The same applies to the expiry of the tax incentives mentioned earlier.

In addition, individuals contracted new consumer loans totalling € 0.4 billion in net terms during the first nine months of 2012, or 2.3 % of the outstanding total recorded at the end of the previous year. That figure reflects the difference between loans granted and loans repaid. According to the data compiled by the Central Individual Credit Register, € 10.8 billion was borrowed in the form of consumer loans over the whole of the year under review, be it credit facilities or instalment loans/sales. The average amount of these new liabilities came to € 9 900. The total outstanding consumer credit stood at € 18 billion on 30 September 2012.

Despite the increase in household debt, the proportion of defaulting loans is stable overall. That is due in particular to the preponderance of mortgage loans in household debts. According to the Central Individual Credit Register statistics, the number of mortgage loans with non-regularised defaults remained unchanged in 2012, at 1.1 % of recorded loans. That low ratio reflects the priority that households accord to repayment of their mortgage loan. As for consumer credit, there are divergent trends between the different variants. The default rate on instalment loans continued to decline, dropping to 9.7 % at the end of the year under review. Credit facilities in default were stable at 3.6 % of the corresponding total. Finally, non-regularised defaults on instalment sales were up again, amounting to 15.1 % of the corresponding loans. It should be noted that, in the case of smaller loans, defaults on instalment sales also record the lowest average amount.

4.3 Non-financial corporations

In a rather unfavourable climate for fixed capital investment, Belgian firms recorded a net financing capacity equal to 1.4% of GDP in the first three quarters of 2012; they thus generated resources which enabled them to proceed with financial investment totalling € 5.1 billion in net terms. These net financial transactions exhibited several major trends during the year under review. First, cross-shareholdings and inter-company loans still form a substantial source of funding for firms in Belgium. Next, a process of substitution between the various external funding sources has been going on for several months: firms – essentially the largest ones – have turned more towards the issuance of fixed-interest securities, whereas they have made less use of bank loans and share issues. Finally, bank financing is still the main source of debt financing for SMEs, which have probably had to contend with restricted access to credit on account of the tightening of lending criteria by the banks.

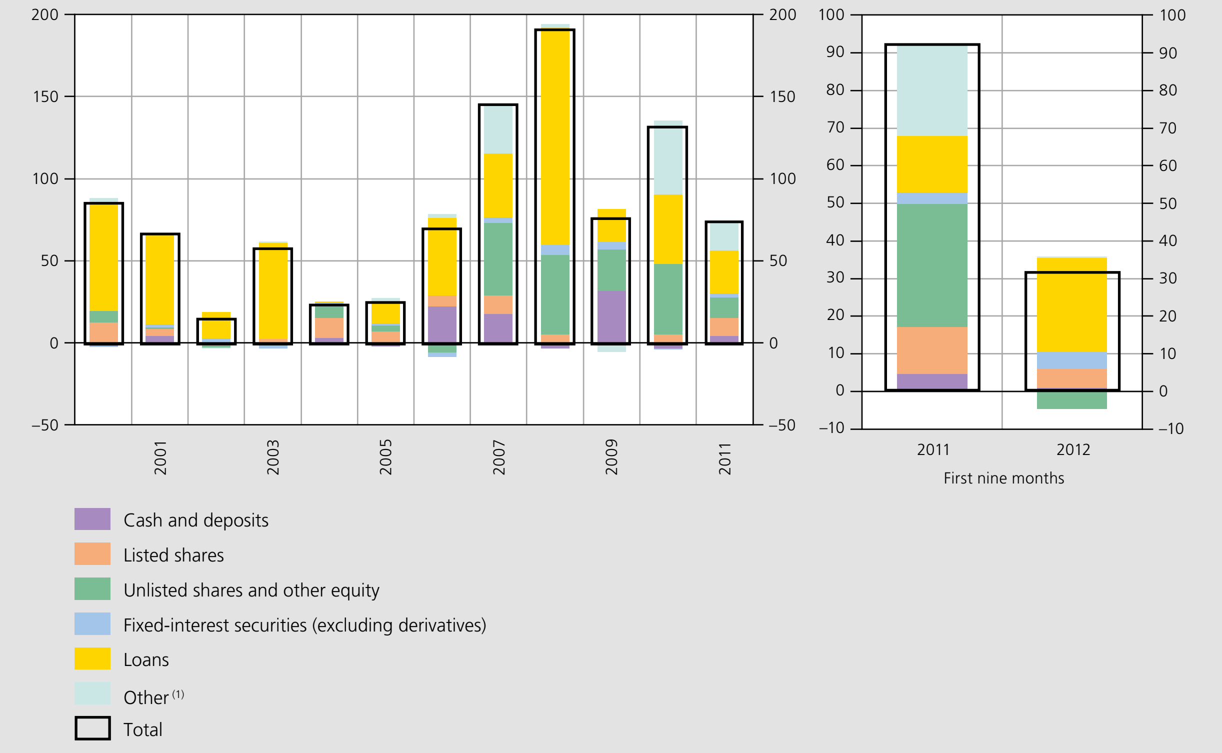
Financial transactions of non-financial corporations are dominated by flows between associated companies

Inter-company financing represents the bulk of the financial transactions of non-financial corporations, on both the assets and the liabilities side. These activities are generally reflected in cross-shareholdings in the form of listed or unlisted shares and other equity, and inter-company loans. The extent of these activities is still considerable, partly because of the presence of numerous financing centres linked to multinationals and the centralisation in Belgium of the treasury management of multinational companies. That situation has a significant influence on the volume of financial transactions by non-financial corporations.

Thus, in the first three quarters of 2012, non-financial corporations formed new financial assets amounting to € 31.3 billion, of which € 25.1 billion took the form of new lending, principally to other firms.

The corollary to these activities consists of the financial liabilities of firms. Owing to the scale of inter-company financing flows, as firms are often affiliated, issues of unlisted shares and other equity are the main external funding channel for non-financial corporations. In the first nine months of last year, those issues totalled € 15.4 billion,

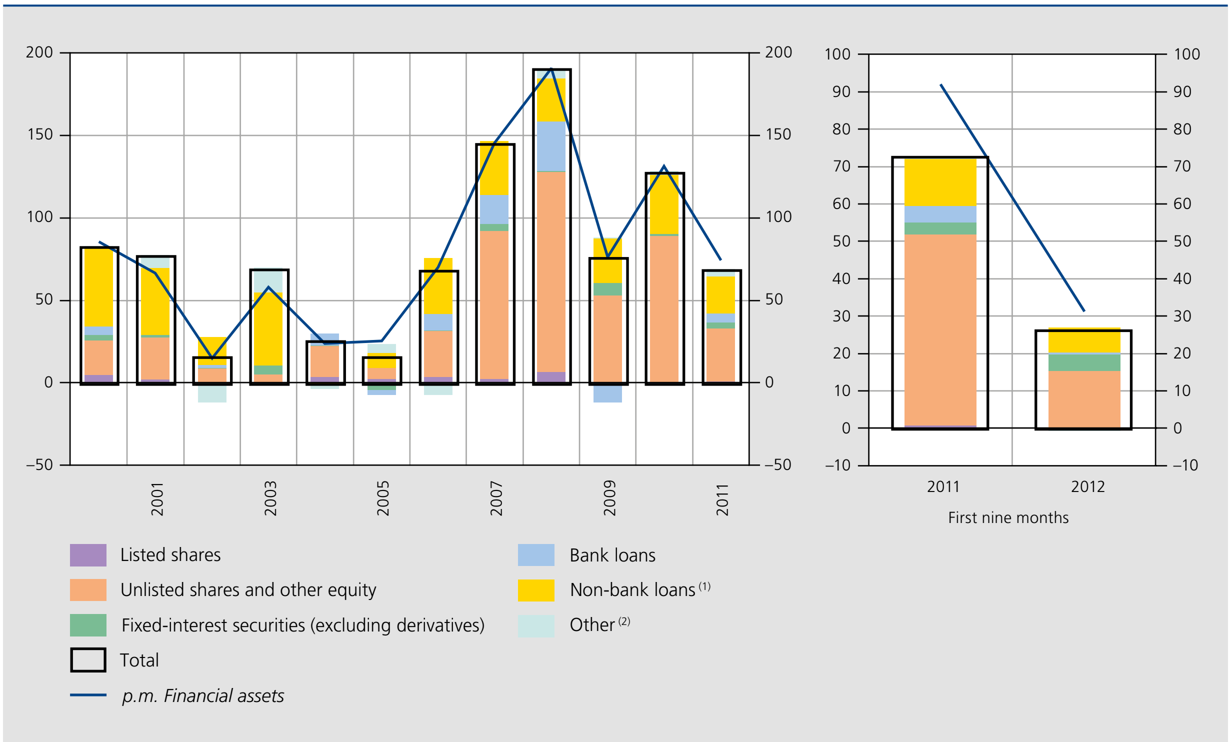
CHART 51 NEW FINANCIAL ASSETS OF NON-FINANCIAL CORPORATIONS
(in € billion)



Source : NBB.
(1) Mainly transitory items and statistical adjustments.

CHART 52 NEW FINANCIAL LIABILITIES OF NON-FINANCIAL CORPORATIONS

(in € billion)



Source : NBB.

(1) Mainly loans granted by Belgian and foreign non-financial corporations, also referred to as inter-company loans.

(2) Includes technical reserves of non-autonomous occupational pension institutions and transitory items.

though that was well below the figure for the corresponding period of the previous year, namely € 51.2 billion. Apart from unlisted share issues, much of the external funding of non-financial corporations comes from inter-company loans. From January to September 2012, firms contracted new non-bank loans totalling € 6.6 billion, down by about half against the corresponding period of 2011 when new loans came to € 12.4 billion.

Leaving aside inter-company activities, non-financial corporations acquired new financial assets totalling € 10.6 billion. The portfolio of fixed-interest securities expanded by € 4.6 billion, compared to € 3.1 billion for the first nine months of 2011. This mainly concerns securities at over one year : acquisitions of long-term fixed-interest securities by firms came to € 3.7 billion. Net investment in listed shares was also positive at € 4.9 billion, though down against the net acquisition of € 12.7 billion recorded in the corresponding period of 2011. Finally, in net terms, cash assets were up by € 1.1 billion.

Signs of a reorientation of non-financial corporations' external funding

Apart from cross-funding and funds generated directly by their business, non-financial corporations resorted to issuance of fixed-interest securities and, to a lesser extent, bank loans to cover their needs. It was mainly the largest firms that opted for bond financing rather than bank loans.

Whereas firms had generally made little use of the bond market previously, this form of funding has clearly gained in importance over the past four years. From 2000 to 2008, non-financial corporations had issued bonds averaging an annual total of € 1.3 billion, whereas in the first three quarters of 2012 they raised € 4.4 billion in funding via this instrument, after having collected € 3 billion in the corresponding period of 2011. That popularity was underpinned by investors' search for better yields than those on sovereign bonds. Moreover, in the post-crisis years, non-financial corporations made an effort to improve their balance sheet, and that may have led to a downward revision of the risks on corporate bonds, making them more attractive.

Issues of long-term securities were more dynamic than those of short-term securities – essentially Treasury bills. From January to September 2012, non-financial corporations raised a total of € 6 billion by issuing long-term securities, whereas they redeemed short-term securities amounting to € 1.7 billion. Most of the new bonds were subscribed by non-financial corporations and resident institutional investors.

Box 5 – Recent trends in the financing of non-financial corporations

Not only did the financial crisis bring profound changes in the financing environment of the banks, it also had a considerable influence on the funding structure of the non-financial private sector, as the two phenomena are linked. This box analyses the sources of external funding for non-financial corporations

Two trends have been emerging since the financial crisis. First, non-financial corporations have stepped up their use of non-bank funding sources, such as corporate bonds. Also, there has been an increase in the share of resident banks in bank lending. These trends are not specific to Belgium; they are in line with a similar international picture regarding lending. These developments need to be monitored, since ease of access to funding plays a crucial role in corporate investment and hence in economic growth.

Shift from bank lending to non-bank sources of funding

Although capital market financing represents only a small share of the total external funding of Belgian firms, since that type of financing is reserved mainly for large enterprises with a solid financial base, there has been an increase in recourse to the bond market since 2009. This concerns more particularly long-term corporate bonds. Over the last four quarters, net issues of corporate bonds grew to a cumulative total of € 5 billion in the third quarter of 2012 (€ 6.5 billion for bonds with a maturity of more than one year). For comparison, over the same period, according to the monthly statistics on resident credit institutions, Belgian banks granted net loans totalling only € 1.5 billion. Consequently, the share of bonds in the outstanding total of debt financing by firms – comprising bank loans and securities other than shares – increased to 18.7 %, against an average of 13.5 % over the past ten years.

The greater attraction of corporate bonds may be linked to the increased appetite for risk on this market. Thus, the average remuneration on capital granted to non-financial corporations in the euro area fell to a historical low point, below the average interest rate on bank loans in Belgium, though that is also hovering around a historical minimum.

The greater recourse to the financial markets is probably also attributable to the tightening of bank lending conditions, apart from the interest rates charged. As the bank lending survey reveals, those conditions were tightened again in the year under review, especially for long-term loans for which the capital market offers an alternative. Since that option is generally less accessible to small firms, the latter are liable to face more difficult access to funding than large firms, a finding borne out by the survey of lending conditions among entrepreneurs. From the perspective of financial institutions, the rise in corporate bond issuance means a significant diversification of their income sources, notably on account of the commission charged.

Shift from foreign to resident bank lenders

Since the financial crisis, there has also been a shift from foreign to resident bank lenders. The share of foreign banks in lending to Belgian residents – in this case non-financial corporations – has risen steadily since the start of Monetary Union as a result of increasing financial integration in the euro area, boosting the share of foreign banks in bank lending to businesses from around 19 % at the beginning of 1999 to 35 % at the end of 2008. However, that trend was abruptly halted just after the eruption of the financial crisis. While the net flow of lending by Belgian

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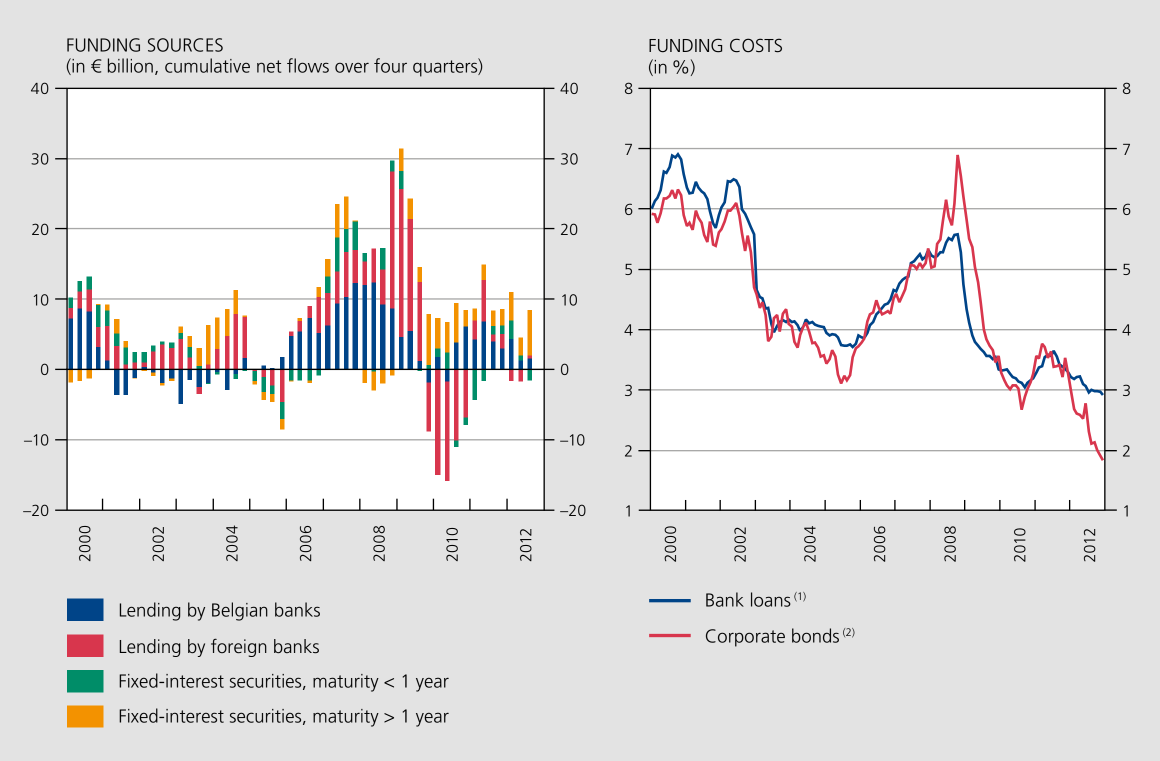
BELGIAN NON-FINANCIAL CORPORATIONS: FUNDING SOURCES AND COSTS


FUNDING SOURCES
(in € billion, cumulative net flows over four quarters)

FUNDING COSTS
(in %)

Sources: Thomson Reuters Datastream, NBB.

(1) Weighted average rate applied by Belgian banks to new business loans.

(2) Yield to maturity of an index of euro-denominated bonds issued by euro area non-financial corporations. These bonds have a minimum rating of BBB-/Baa3, a residual maturity of at least one year, and a minimum outstanding amount of € 250 million.

banks had been only slightly negative at its low point in mid-2010, lending by foreign banks to Belgian residents had fallen much more steeply. After having recovered slightly in the ensuing quarters, returning to positive territory at the end of 2011, lending by foreign banks declined again in 2012.

These developments are connected with structural adjustments within the financial sector, in the wake of the financial crisis, and are evident throughout Europe. The financial environment constraints facing euro area financial institutions, and the tightening of the capital and liquidity requirements imposed by the new Basel III regulations, are encouraging many credit institutions to reinforce their capital buffer and/or revise their business model, which involves terminating certain activities. So far, euro area banks seem to have focused on national markets, first reducing their risky foreign assets and, to some extent, their lending to the foreign non-bank private sector.

These changes are another manifestation of the increasing fragmentation of the funding markets along national borders, mentioned in box 1 of this Report (section 1.1).

Bank lending was down against the previous year. The poor economic prospects and weak business confidence depressed demand for bank loans, which was also restrained by the availability of internal resources and other external funding sources, such as the issuance of debt instruments. In addition, the tightening of lending criteria by banks further accentuated this trend.

Thus, net bank lending to businesses declined from € 4.5 billion in the first nine months of 2011 to € 0.6 billion in the first three quarters of 2012. Resident banks granted loans to businesses totalling € 0.7 billion, while loans by foreign banks were down by € 0.1 billion. Among these foreign lenders, euro area banks proceeded to reduce their loans by € 3 billion, reflecting their renewed focus on their domestic market, while net lending by other foreign banks continued to expand by € 2.9 billion.

Finally, as in previous years, firms made less use of the stock market. In the first nine months of 2012, a net total of € 0.2 billion in listed shares was redeemed, whereas firms had issued shares totalling € 0.7 billion in the corresponding period of 2011. Taking account of secondary market transactions as well, foreign investors disposed of listed shares totalling € 0.7 billion, while Belgian investors acquired shares worth € 0.5 billion. However, including valuation effects, holdings of foreign listed shares increased further during the year to reach 55.2 % at the end of September 2012.

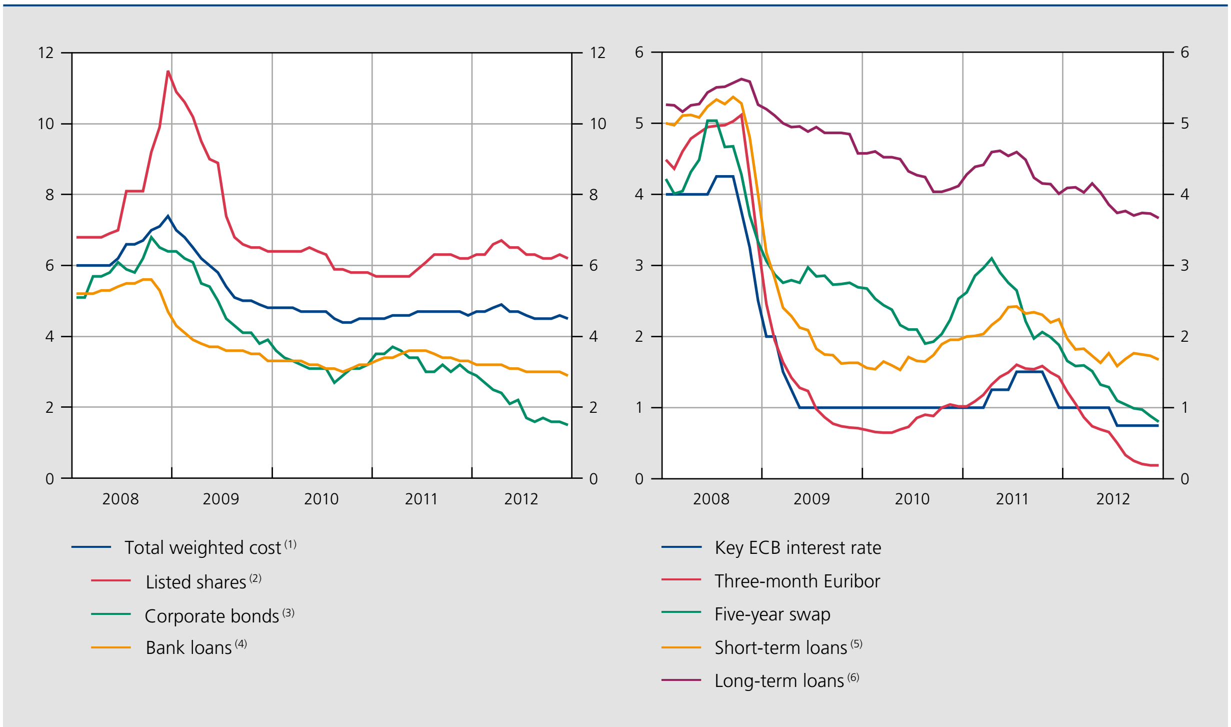
Reduction in financing costs

The movement in business financing costs is part of the reason for the process of substitution between the various funding sources. The total financing cost of non-financial corporations – calculated by weighting the nominal cost of the various funding sources according to their respective shares in the total outstanding amount of their financial liabilities – remained relatively stable in 2012, ranging between 4.5 and 4.9 %.

The fluctuations in this total cost mainly reflected variations in the cost of equity financing, as this instrument represents the major part of the financial liabilities of firms. After having risen to 6.7 % in April of the year

CHART 53 EXTERNAL FINANCING COSTS OF NON-FINANCIAL CORPORATIONS

(monthly data, in %)



Sources: Barclays Capital, Thomson Reuters Datastream, NBB.

(1) Obtained by weighting the cost of financing by listed share issues, bond issues and bank loans according to their respective shares in the total outstanding amount of these financial liabilities. At the end of September 2012, the proportions were 51.9 % for shares, 10.1 % for bonds and 38 % for loans.

(2) Estimated on the basis of a dividend discount model (see box 19 in the 2005 Report). According to that model, the cost of financing by share issues declines (increases) following a rise (fall) in stock market prices and increases (contracts) in response to an increase (reduction) in dividends (not only those actually paid but also those expected).

(3) Yield on an index of euro-denominated bonds issued by Belgian non-financial corporations taking all maturities of more than one year together, and with a rating of more than Baa; the index is weighted according to the outstanding amounts. In December 2012, the average maturity was 5 years.

(4) Weighted average rate applied by Belgian banks to business loans. The weighting is based on the outstanding amounts of the various types of credit.

(5) Interest rate on loans of more than € 1 million at variable rates, initially fixed for up to one year.

(6) Interest rate on loans of € 1 million or less, with a rate initially fixed for more than five years.

under review, that cost subsided gradually, owing to the rising stock market, falling to 6.2 % in December, a level close to that at the start of the year. This figure was 0.7 percentage point below the average of 6.9 % recorded between 1996 and 2011.

Conversely, the cost of other financing channels, mainly bonds and bank loans, declined throughout the year. However, it should be noted that this fall was largely reflected in the average cost of new funding, since the funding raised in the first three quarters of 2012 mainly concerned these instruments. On average, the cost of the new liabilities was therefore well below the total cost calculated on the basis of the outstanding amount, which tends to reflect the firm's opportunity cost.

The sharpest fall concerned financing via the bond markets, reinforcing its attraction compared to other funding sources during the year under review. The yield measured on the basis of an index of euro-denominated bonds issued by Belgian non-financial corporations, taking all maturities of more than one year together, declined from 3 % at the end of December 2011 to less than 2 % at the end of December 2012. In addition, the spread in relation to interest rates on five-year swaps, which reflects the risk premiums required for holding these securities, diminished overall between January and December. While the spread stood at 116 basis points at the end of December 2011, it was down to 75 points at the end of 2012. This fall marks a general improvement in financial market confidence during this period, in the light of a search for yield.

Finally, the interest rate applicable to new bank loans – weighted average rate based on the outstanding amount of the various types of loan that Belgian banks granted to businesses – declined between the beginning of January and the end of December 2012, falling from 3.3 to 2.9 %, a historically low figure. Taking account of a certain time lag in the transmission of monetary policy decisions, that interest rate fall partly reflects the movement in the ECB's key interest rate. However, it was tempered by an increase in the margin on bank loans.

Tightening of access to bank loans

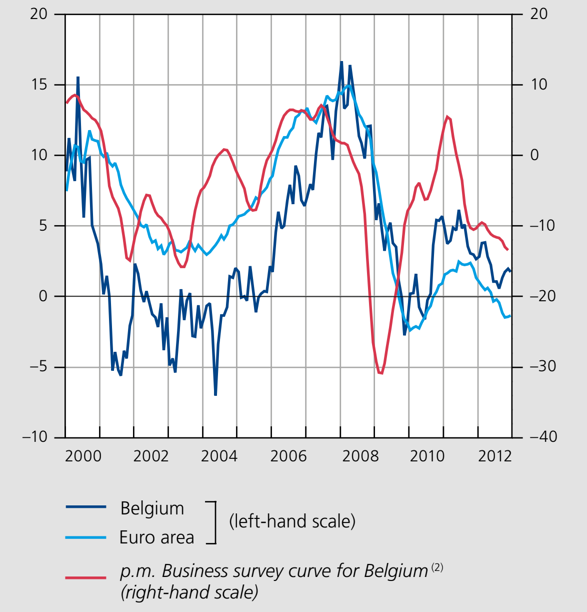
Despite the growing success of financing via bond issues, bank loans remain vital for many firms, especially for SMEs. The latter – defined as firms with fewer than 250 workers – accounted for 68 % of employment in 2010, testifying to their importance in the economy.

According to the monthly statistics of the Belgian banks, the growth of their lending remained positive in 2012, although a marked slowdown was seen between April and August, followed by a slight rebound. On an annual basis, the growth rate stood at 1.8 % in December, well below the average of 4.2 % recorded in 2011. The euro area presented a similar profile but at a lower level, since the growth of lending by resident banks became negative there from June 2012 ; in December it came to –1.3 %. However, that average masked wide variations between euro area Member States, with Spain and Italy recording negative growth rates for lending, while growth remained positive in the Netherlands, Germany and France, as it did in Belgium.

The results of the qualitative surveys polling banks and business leaders provide information that supplements the quantitative data and may explain the factors determining the movement in bank lending to businesses, both large firms and SMEs. To some extent, they also permit identification of the supply and demand effects. The deterioration of the economic climate in 2012 prompted banks to exercise caution and tighten their lending criteria. At the same time, this rather unfavourable environment also inhibited demand for bank loans, at least among large firms, which turned to other funding sources

CHART 54 LENDING BY RESIDENT BANKS TO RESIDENT NON-FINANCIAL CORPORATIONS [1]

(end-of-month data ; annual percentage change, unless otherwise stated)



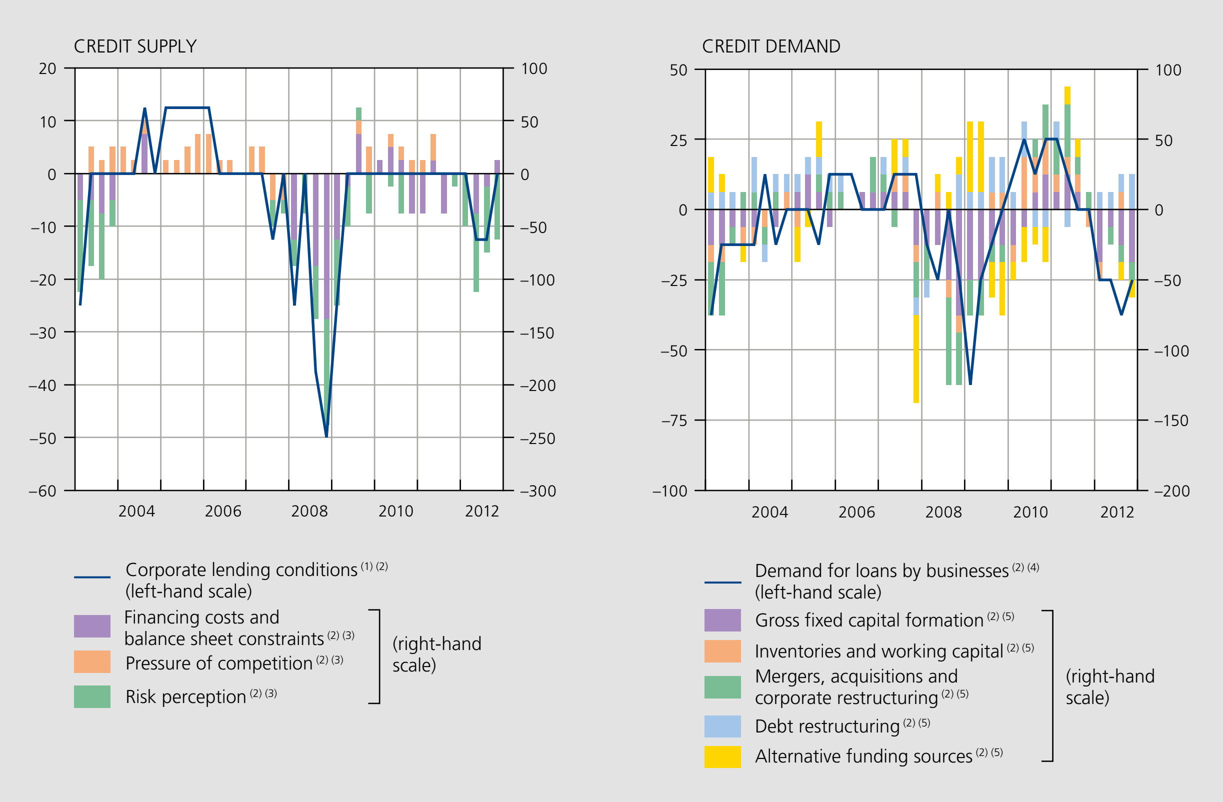
Sources : ECB, NBB.
[1] Including securitised loans (only from January 2010 for the euro area).
[2] Balance of responses.

as described above. Conversely, SMEs – which have fewer alternatives in terms of external funding – continued to resort to bank loans during the first three quarters. The combination of these two developments – tightening of the lending criteria and an increase in demand – may have exacerbated the constraints affecting SMEs by restricting their access to their main source of funding.

The first of those surveys, the bank lending survey, conducted by the Eurosystem among banks, supplies qualitative information on movements in lending criteria and demand for bank loans from firms. During 2012, the four large Belgian banks polled by that survey stated that they had tightened their lending criteria twice, in the second and third quarters, whereas they had previously kept them unchanged for twelve consecutive quarters, between the second quarter of 2009 and the beginning of 2012. Lending criteria were tightened on both loans to large firms and loans to SMEs.

Generally speaking, risk perception was reported throughout 2012 as a dominant factor affecting business lending conditions. More particularly, the banks surveyed cited the prospects specific to firms or branches of activity, and the deterioration in expectations concerning general economic activity, as the main risk factors. In addition, in the case of SMEs, they stressed that the increased risks relating to the collateral required did to some extent influence their decision to tighten the criteria for lending to those firms. Their own funding costs and their balance sheet constraints also played a role in the banks' behaviour, mainly following the renewed tension on the euro area's financial markets during the second quarter of the year.

CHART 55 LENDING CONDITIONS AND DETERMINANTS AND DEMAND FOR LOANS ACCORDING TO CREDIT INSTITUTIONS



Source: NBB (Eurosystem bank lending survey).

[1] Weighted net percentages of responses by credit institutions to the Eurosystem's bank lending survey indicating the degree to which lending criteria were eased or tightened (–).

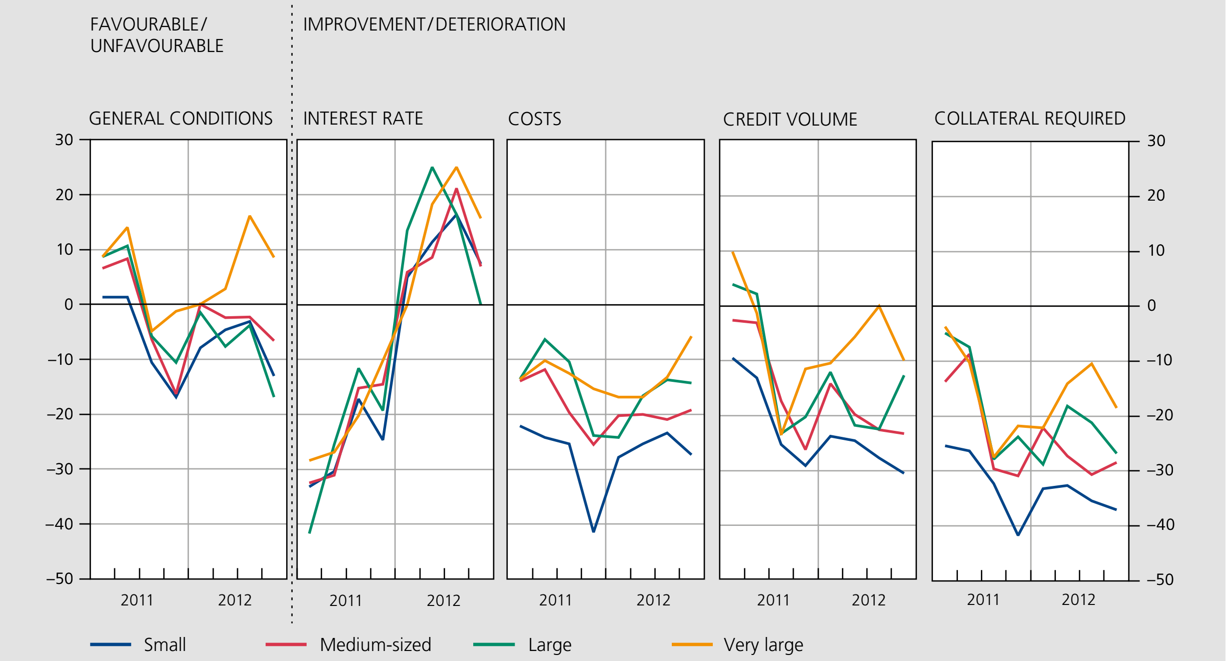
[2] The responses are weighted according to the distance from a "neutral" response: mention of a "considerable" change in the lending criteria or in demand for loans is accorded double the weighting of the mention of a "slight" change.

[3] Weighted net percentages of responses by the credit institutions questioned about lending criteria. A negative (positive) percentage corresponds to a criterion reflecting tightening (easing). The responses to the various sub-questions were cumulated.

[4] Weighted net percentages of responses by credit institutions to the Eurosystem's bank lending survey indicating the increase or decrease (–) in demand for loans.

[5] Weighted net percentages of responses by the credit institutions questioned about the factors determining demand for loans. A positive (negative) percentage corresponds to a factor which contributed to the increase (decrease) in demand. The responses to the various sub-questions were cumulated.

CHART 56 BUSINESS MANAGERS' PERCEPTION OF LENDING CONDITIONS[1]: BREAKDOWN BY FIRM SIZE



Source: NBB (survey of credit access conditions among business managers).

[1] Balance, in %, of the responses by the business managers polled, indicating their favourable or unfavourable (–) assessment of general bank credit access conditions, and their assessment (improvement or deterioration (–)) concerning the various criteria.

According to the banks questioned, demand for loans from businesses showed a marked decline throughout the year. However, that trend was due mainly to large firms, whereas credit institutions reported increased demand from SMEs in the second and third quarters of the year. The decline in corporate financing needs for gross fixed capital formation was the main factor contributing to the overall reduction in demand for bank loans by non-financial corporations. The contraction in funding needs for mergers, acquisitions and restructuring, and firms' recourse to other funding sources also contributed, to a lesser extent, to the decline in demand for loans. Conversely, debt restructuring had the opposite effect throughout the year, generating moderate support for demand.

The second qualitative survey is conducted by the Bank among business managers. Their assessment of general credit conditions worsened during the year, with the exception of very large firms. Despite the improvement in interest rate conditions throughout the year, business managers cited the high level of collateral demanded by banks and the restrictions on the amounts loaned as the reasons for their negative overall assessment. Broken down by firm size, the survey results reveal that the deterioration in these conditions mainly affected small firms (those with fewer than 50 workers) and medium-sized firms (employing between 50 and 249 workers).

Finally, the SAFE survey (Survey on the Access to Finance of SMEs in the euro area), the third qualitative survey conducted on the initiative of the ECB and the EC, specifically questions SMEs about the borrowing conditions which they are offered. It corroborated the results of the Bank's survey, reporting similar developments. Faced with an uncertain economic environment featuring a rise in the number of corporate bankruptcies, credit institutions probably applied a stricter lending policy, and were doubtless more selective in regard to certain investment projects which had become riskier. SMEs, which are more dependent on bank loans, were the main ones to suffer the consequences of this situation.

4.4 Financing of the public debt

Reduction in gross financing requirements and improvement in market conditions in 2012

In 2012, the gross balance to be financed by the Treasury came to € 40.5 billion, well below the 2011 figure of € 50 billion. That reduction was due to the large fall in the federal State's net balance to be financed, while conversely, the amount of medium- and long-term loans maturing was slightly higher than in the previous year.

Taking advantage of the marked improvement in financing conditions during the year, the Treasury conducted issues in excess of the original target figures. That enabled it in particular to pre-finance its 2013 needs to a greater extent than expected, and to reduce its short-term debt. In 2012, the Treasury raised finance mainly via medium- and long-term issues in euro, especially OLOs.

TABLE 9 FINANCING REQUIREMENTS AND RESOURCES OF THE FEDERAL STATE

(in € billion)

	2010	2011	2012 e
Gross financing requirements . . .	43.5	50.4	40.5
Gross balance to be financed	37.0	42.9	33.5
Budget deficit [1]	11.2	18.9	8.0
Medium- and long-term debt maturing during the year	25.9	24.1	25.6
In euro	25.3	24.1	25.6
In foreign currencies	0.6	0.0	0.0
Buy-backs (securities maturing the next year or later)	6.5	7.1	7.0
Other financing requirements	0.0	0.4	0.0
Medium- and long-term funding	45.3	49.5	48.0
Linear bonds (OLOs)	40.9	40.9	43.0
State notes and others [2] . . .	4.5	8.6	5.1
Net change in the short-term debt in foreign currencies	0.0	–0.1	0.0
Change in the outstanding amount of Treasury Certificates	0.3	–5.3	–3.4
Net change in other short-term debts in € and in financial assets	–2.1	6.4	–4.1

Source: FPS Finance.

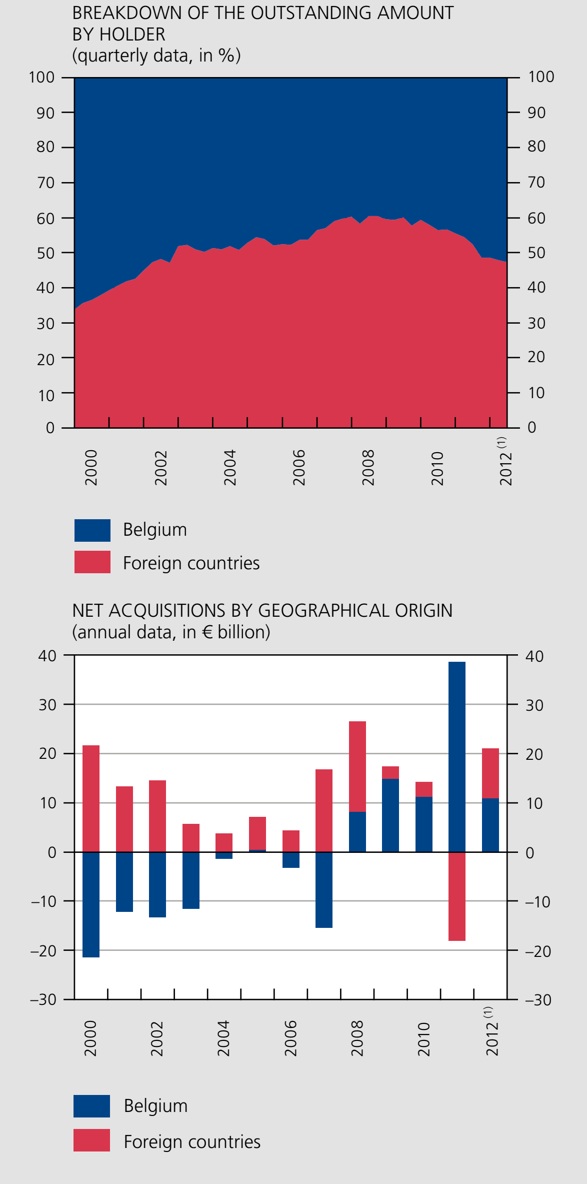
[1] The budget balance is calculated on a cash basis and, among other things, takes account of financial transactions which are not included in the overall balance of general government which, in accordance with the ESA 95, is calculated on a transaction basis.

[2] Including, in particular, Euro Medium-Term Notes and *Schuldscheine*.

Since the introduction of the euro, there has been a trend towards increasing internationalisation of the holding of the Belgian public debt, so that the share of the consolidated gross debt held by foreign investors rose to 60 % at the end of 2008. However, the financial crisis prompted a reversal in that trend. At the end of the third quarter of 2012, the share of the public debt held abroad dropped to 47 %.

The reason is that, in the context of the sovereign debt crisis, foreign investors – notably European financial

CHART 57 HOLDERS OF THE BELGIAN PUBLIC DEBT



Sources: NAI, NBB.

(1) First three quarters.

institutions – have tended to refocus their asset portfolio on their domestic market. In Belgium more specifically, the failure of the June 2010 federal elections to produce a government with a full mandate generated additional uncertainty over the country's ability to meet its medium- and long-term liabilities. Despite the attractive rates offered, foreign investors abandoned Belgian government securities. Thus, while net foreign investment flows were decidedly positive before the financial crisis erupted, they subsequently declined sharply to become negative in 2011.

During the year under review, foreign investors again displayed interest in the Belgian debt. That trend illustrates the markets' renewed confidence in Belgium. It is due in particular to the improvement in the outlook for the country's institutional and fiscal situation, following the formation of the government at the end of 2011, and to the restructuring of the financial sector. The stronger demand for Belgian government paper among foreign investors was certainly a factor reinforcing the decline in interest rates evident from the start of the year.